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EXPORT PERFORMANCE IN EUROPE: A SINK OR SWIM GAME

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- 07 Competitiveness (price and quality) explains around three-quarters of China's export growth since 2001
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EXECUTIVE SUMMARY



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- **European exporters, and France in particular, have lost significant market share over the past two decades as China emerged as a global exporter for manufactured goods.** China's remarkable export expansion has coincided with the dramatic decline of France's export shares since 2001: -1.7pp, compared to -1.3pp in Germany and -1.1pp in Italy. With the Covid-19 crisis, the situation has only worsened: France has continued to lose export market shares (-0.2pp y/y), even as Germany and Italy have managed to preserve theirs.
- **What's the culprit? Not sectoral specialization but rather weak competitiveness in flagship export industries, including aircraft, pharmaceuticals, vehicles, electrical machinery and equipment.** Our decomposition analysis reveals that French and, to a greater extent, German exporters have specialized in sectors with dynamic growth worldwide. However, they underperformed their global peers in terms of export value growth due to weak competitiveness, in particular vis-à-vis exporters from China. For instance, between 2001 and 2019, German exporters seem to have suffered from poor (price) competitiveness in highly dynamic sectors such as machinery and electrical machinery and equipment in particular. However, Germany's underperformance gap was smaller compared to France, thanks to its specialization towards fast-growing markets (notably China) and positioning in "high-end" industrial products. While Italy's export performance has also suffered from the rise of China, its overall competitiveness has significantly improved since 2011, reflecting the cost-cutting reforms implemented after the Eurozone sovereign debt crisis. Italy's export performance happens to be highly cyclical, strongly correlated with global demand dynamics. In 2020, its exports grew faster than the world average in the vehicles sector, a sign of the greater resilience of Italian exports during the Covid-19 crisis compared to French exports.
- **Competitiveness in terms of price and quality explains around three-quarters of China's export growth since 2001.** Interestingly, taking all sectors together, we do not find that Chinese exports significantly benefit from a specialization in fast-growing sectors. China's strong competitiveness in the machinery and electrical machinery and equipment sectors displays the opposite trend to competitiveness developments in Germany, Italy and France. European export market share losses in these sectors are certainly not only the outcome of China's unbeatable cost competitiveness, but also the country's astonishing success in climbing up the quality ladder.
- **What does this mean for policymakers in Europe?** Competitiveness is a complex issue that involves multiple dimensions (e.g. price, quality, regional specialization) so there is no silver bullet to quickly tackle structural issues. Nevertheless, bold and targeted policy action could boost export competitiveness. This would include measures to improve price competitiveness (e.g. tax relief, continuation of production tax cuts), as well as efforts to speed up the reallocation of the labor force via structural reforms that improve the flexibility of labor contracts. In addition, active and effective labor-training policies are essential to address skill shortages in fast-growing sectors. Finally, supporting industries with high growth potential, but also accompanying traditional industries during the low-carbon transition phase will be key to preserving the market share of European exporters going forward.



Photo by Rinson Chory on Unsplash

-1.7pp

Decline in France's export market share since 2001

EUROPEAN EXPORTERS LOSING OUT TO CHINA

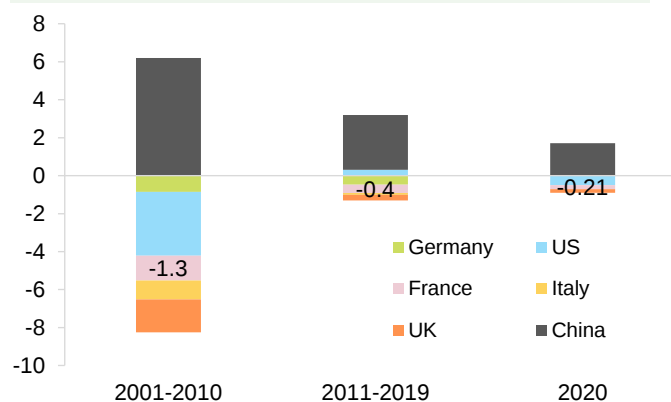
European exporters, notably France but also Germany, have lost significant market shares over the past two decades after the emergence of China as a global exporter for manufactured goods. The dramatic increase in Chinese exports since the 2000s has fundamentally changed the global trade landscape. China has quickly gained export market shares in manufactured goods at the expense of major advanced economies, particularly in the electrical equipment, machinery and vehicles sectors. Its remarkable export expansion coincided with the dramatic decline of France's export shares over the past two decades (see Figure 1), which at -1.7pp was more

significant than that seen in Germany (-1.3pp) and Italy (-1.1pp). Moreover, France has continued to lose export market shares (-0.2pp y/y) in the context of the Covid-19 crisis, even as Germany and Italy have managed to preserve theirs.

In Germany and France, sectoral specialization is not the culprit for export market share losses but weak competitiveness is! In France, there is a common belief that unfavorable sectoral specialization has significantly hindered the country's export performance over time. However, our decomposition analysis (see Appendix for methodology) reveals that French

and, to a greater extent, German exporters have specialized in sectors with dynamic growth worldwide. Unfortunately, in these sectors, they underperformed their global peers in terms of export value growth. These weak export performances in highly dynamic sectors reflect the countries' weak competitiveness compared to peers, in particular to exporters from China.

Figure 1: Cumulative change in world export shares in values (pp)



Sources: Euler Hermes, Allianz Research, ITC Trade Map

Figure 2: Export performance decomposition: A tale of four countries-Goods export growth decomposition (pp)-annual, all sectors

Sources: Euler Hermes, Allianz Research, ITC Trade Map

Notes: We obtained the overall decomposition above by adding up HS-2 digit level sectoral decompositions based on the shift share methodology described in Appendix.

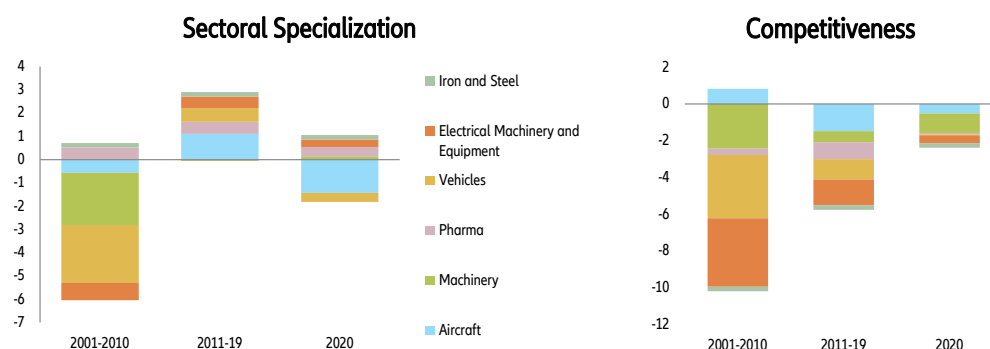
Looking at the sectoral level, we find that France has recorded strong export share losses since 2011 in flagship sectors, such as aircraft, pharmaceuticals, vehicles, electrical machinery and equipment (see Appendix Figure 7). Interestingly, exports in these sectors remained dynamic in the rest of the world, outpacing overall world export growth. Our decomposition analysis reveals that at the aggregate level, sectoral specialization made a neutral contribution to France's export performance between 2011 and 2019 while weak competitiveness was by far the main drag on exports (Figure 2). Looking at the largest export sectors, we find that export specialization in the aircraft, pharmaceuticals, electrical machinery and equipment and vehicles sectors positively contributed to France's export performance between 2011 and 2019, thanks to strong demand dynamics. Yet, 2020 is likely to mark a turnaround in this respect as mobility restrictions due to the pandemic hit the exports of the aircraft and vehicles sectors hard. This economic fallout translated into a large negative contribution of sectoral specialization to export performance for the first time in 20 years. Importantly, the Covid-19 crisis is likely to result in some perma-

nent changes to some sectors; the aircraft and fossil fuel vehicle sectors may not even recover to their pre-crisis dynamics in the next few years. In this context, "intelligent" industrial policies will be key to reallocate the existing idle technology and other resources to fast-growing and more environmentally sustainable sectors.

When it comes to Germany, we find that overall sectoral specialization boosted export performance between 2001 and 2019, while in 2020 this contribution became neutral (see Figure 2). The sectoral breakdown shows that the vehicles and electrical machinery and equipment sectors have especially benefitted from strong growth dynamics worldwide. Only these two sectors combined already accounted for over 25% of total German exports of goods between 2011 and 2019 (see Appendix Figure 8). On the other hand, the growing export shares of China in these sectors was bad news for Germany, as we observe from the negative contribution of competitiveness to Germany's export performance over time. In fact, between 2001 and 2019, Germany has underperformed global peers in highly dynamic sectors: in machinery and electrical machinery and equipment in

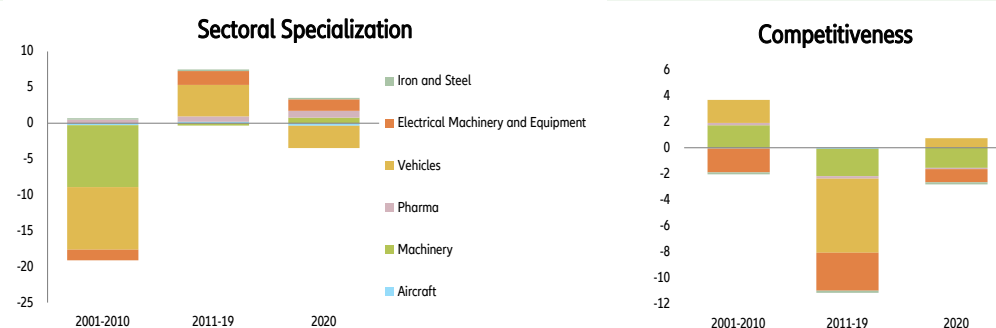
particular, German exporters seem to have suffered from poor (price) competitiveness vis-à-vis China.

The picture gets brighter when we compare Germany's competitiveness with France. True, German exports grew slower than global peers in the flagship export sectors but their under-performance gap was smaller compared to France's (see Appendix Figure 9). In fact, German manufacturing exporters are benefiting from the buoyant demand from fast-growing Emerging Market consumers and also their positioning in "high-end" industrial products. To illustrate this, in the first half of 2021, the share of German car brands in total Chinese car sales was around 23%, against only 0.4% for French car brands. Looking ahead, transition challenges towards a low CO2 economy represent a key risk for Germany's export performance in traditional flagship industries such as vehicles and machinery. The possible emergence of China as a global exporter in electrical vehicles could translate into significant market share losses for Germany as we observed in the past for photovoltaic modules and other Chinese renewable-energy technology exports.

Figure 3: France: Contribution of sectoral specialization and competitiveness to export growth (USDbn)

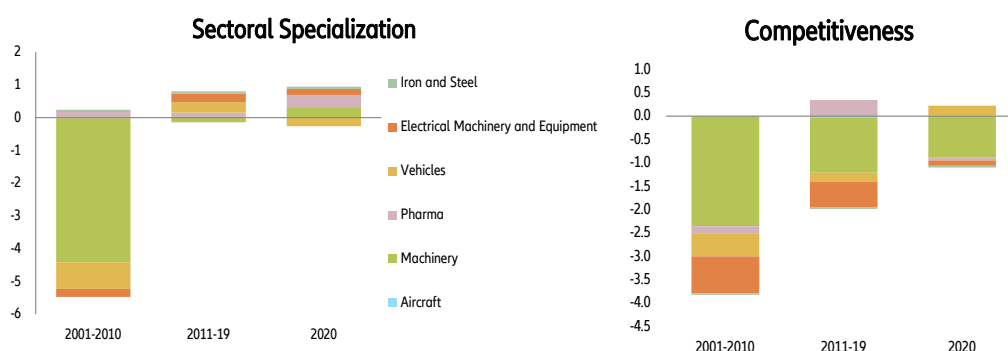
Sources: ITC Trade Map Notes:

See Appendix for decomposition methodology, average cumulative share of these 6 sectors in total exports is 49%.

Figure 4: Germany: Contribution of sectoral specialization and competitiveness to export growth (USDbn)

Sources: ITC Trade Map Notes:

See Appendix for decomposition methodology, average cumulative share of these 6 sectors in total exports is 55%.

Figure 5: Italy: Contribution of sectoral specialization and competitiveness to export growth (USDbn)

Sources: ITC Trade Map Notes:

See Appendix for decomposition methodology, average cumulative share of these 6 sectors in total exports is 41%.

Turning to Italy, we find that its overall competitiveness has significantly improved since 2011, certainly reflecting the cost-cutting impact of internal devaluation and the structural reforms implemented after the Eurozone sovereign debt crisis. Italy's export performance happens to be highly cyclical, strongly correlated with global demand dynamics. The sectoral break-

down shows that Italy's export performance has been boosted by high competitiveness in the pharmaceuticals sector between 2011 and 2019 (see Figure 5) but also in other sectors such as metal and metal products and other chemicals. However, our sectoral decomposition analysis also shows that Italy's export performance has suffered from weak competitiveness in machine-

ry, electrical machinery and equipment, suggesting a similar "China effect" as seen in Germany. Interestingly, in 2020, Italy's exports grew faster than the world average in the vehicles sector, highlighting the resilience of Italian exports during the Covid-19 crisis, especially compared to France whose vehicle exporters lost market shares.

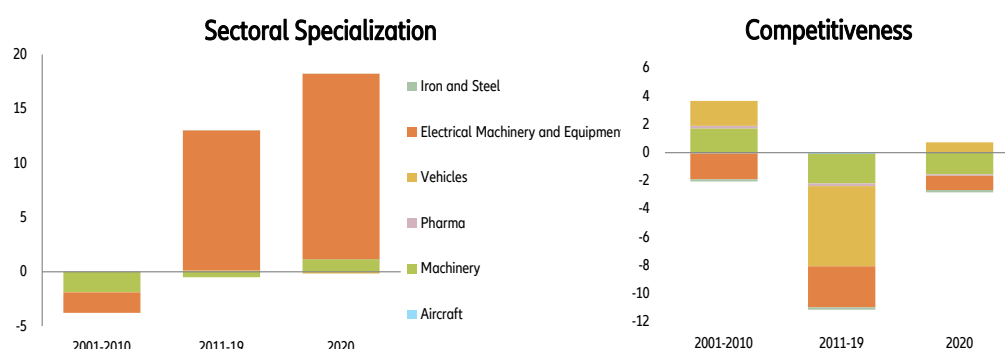
COMPETITIVENESS (PRICE AND QUALITY) EXPLAINS AROUND THREE-QUARTERS OF CHINA'S EXPORT GROWTH SINCE 2001

China's remarkable export performance and market share gains since 2001 were mainly driven by high competitiveness. We find that competitiveness explained around $\frac{3}{4}$ of China's export growth over the past two decades (see Figure 6). In contrast to the general belief, taking all sectors together, we do not find that Chinese exports significantly benefit from a specialization in fast-growing sectors. The sectoral analysis (see Figure 6)

shows that sectoral specialization in the electrical machinery and equipment sector was a good exception, bringing a significant boost to China's exports over the past decade. On the other hand, the contribution of sectoral specialization in the aircraft, pharmaceuticals and iron and steel sectors to export growth is meager, nearing only USD0.2bn per year all together. Turning to competitiveness, China's strong competitiveness in the

machinery and electrical machinery and equipment sectors displays the opposite trend to what we see for these sectors in Germany, Italy and France. Importantly, European export market share losses in these sectors are not only the outcome of China's unbeatable cost competitiveness, but also the country's astonishing success in climbing up the quality ladder over time.

Figure 6: China: Contribution of sectoral specialization and competitiveness to export growth (USDbn)



Sources: ITC Trade Map Notes:

See Appendix for decomposition methodology, average cumulative share of these 6 sectors in total exports was 35% between 2001-2010 and 49% thereafter.

WHAT DOES THIS MEAN FOR POLICYMAKERS IN EUROPE?

There is no silver bullet to tackle structural issues but policymakers can implement bold and targeted action. Competitiveness is a complex issue that encompasses various dimensions such as productivity and cost (price), quality (non-price) and regional specialization (towards fast/slow growth markets). Improving export competitiveness is a lengthy process that first requires a deep understanding of the major opportunities and threats for exporters in different industries. Nevertheless, after having played a key role in absorbing the economic shock of the Covid-19 crisis, European policymakers can act at both the national and the European Union levels to boost export competitiveness. Bold and targeted policy action may help to ignite profound transformations of our economic, educational and regulatory frameworks and improve competitiveness down the road. Supporting industries with high growth potential, but also accompanying traditional industries during the low-carbon transition phase, will be key to preserving the market share of European exporters going forward.

First of all, policymakers can implement measures to improve price competitiveness (e.g. tax relief, continuation of production tax cuts). They could also speed up the reallocation of the labor force via structural reforms that improve the flexibility of labor contracts. In addition, active and effective labor-training policies will become crucial to address skill shortages in fast-growing

sectors in the post-Covid-19 era. Policymakers can also actively support the transition towards a low-carbon economy by incentivizing green investments and also offering temporary compensation for the losses in traditional industries due to stranded assets. Finally, a wide range of policy instruments could promote the development of exports towards fast-growing geographies and sectors (e.g. assistance and information, pre-financing of export projects and export credit insurance).

The Covid-19 crisis has triggered profound transformations in certain sectors, but reshoring traditional industries back home is certainly not the “ideal” solution. Over the past decades, the globalization of world trade has brought great benefits (in terms of variety of goods and low prices) that consumers might not be ready to give up. However, the supply-chain disruptions during the pandemic that created shortages of essential medical goods (surgical masks, ventilators etc.) revealed the vulnerability of our extremely concentrated production processes. Moreover, the interdependence of our production systems failed to ensure a coordinated distribution of these essential products. We certainly need to overcome this vulnerability, not by reshoring production back home but by diversifying the risks associated with possible disruptions (whether sanitary, cyber or environmental) to improve resilience. Reducing our dependence on foreign production in sectors

deemed “strategic”, such as pharmaceuticals, agrifood and IT and communications, could incur significant opportunity costs. Such strategies may lead to inefficient allocation of public investment at the expense of other sectors with greater growth potential (advanced technologies or green industries).

Insufficient European demand is another obstacle to local production of certain large-scale industrial goods. Take the example of semiconductors, a strategic sector for European industry. The global shortage emerging from the sanitary crisis put the vulnerability of European producers in the spotlight due to their over-reliance on East Asian suppliers. As a consequence, Europe has set itself the objective of increasing its global market shares in semiconductor production to 20% (against 6% currently) by 2030¹. This ambitious goal means that in addition to meeting the demand of local producers, Europe would become a globally competitive exporter for these goods. However, producing semiconductors on a large scale is unlikely to boost the competitiveness of European exporters vis-à-vis global exporters such as South Korea or Taiwan. Thus, instead of setting quantitative targets, it might be strategic for

¹ See our recent report [Semiconductors realpolitik - A reality check for Europe](#)

Europe to encourage specialization in segments where competition is less intense and where local firms would have a technological advantage.

The necessity of speeding up the ecological transition will profoundly change international trade and policymakers also have an important role to play there. Globalization has intensively relied on purely economic motives, with the goal of minimizing production costs while ignoring the environmental costs of production and transport. The need to act against climate change and the associated transition policies (carbon taxes, border taxes, environmental regulations etc.) are set to profoundly modify the process of production fragmentation and the prices of intermediate goods, hence triggering a

profound restructuring of our value chains. Indeed, any increase in the pricing of carbon-intensive inputs would increase production costs. This would modify the competitiveness of exporters, but also create incentives for the substitution of inputs towards less carbon-intensive ones. In addition, public commitments to respect the Paris Agreement would have two other important implications over the coming decades: the fall in imports of fossil fuels (coal and oil) and a greater regionalization of international trade. First, certain technological changes, such as robotics, computerized manufacturing or artificial intelligence, are expected to make less use of the international fragmentation of production in countries that are far apart geographically, dramatically changing trade patterns in

the future. No matter which technologies are adopted, this transition will incur some costs that would erode the purchasing power for the consumer and/or the profit margins of companies. In this context, active public policies would become essential to speed up the ecological transition but also to support polluting industries throughout the transition period. Second, the challenges of the energy transition will certainly reshuffle the cards between regions, modify trade routes and intensify trade within regional blocs. For instance, we expect the African continent to gain key importance in the next decade, thanks to its abundant rare earth resources (to produce electric batteries and for the hydrogen sector), but also to its geographical proximity to Europe compared to East Asia.

APPENDIX

Methodology: We use a shift share analysis at a sectoral level to decompose export growth in a given time period into three components following the methodology of Cheptea and al. 2005 (insert link http://www.cepii.fr/pdf_pub/wp/2005/wp2005-23.pdf).

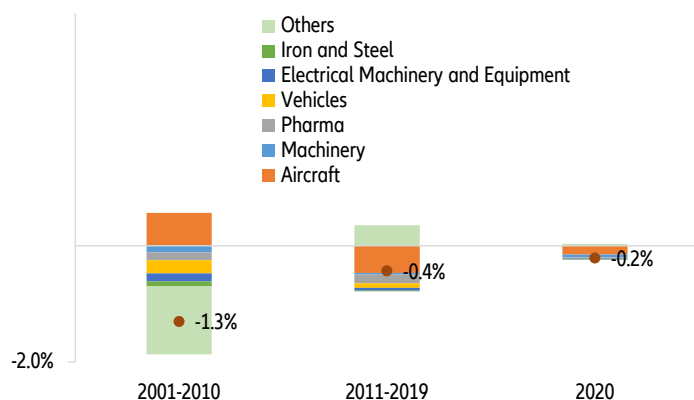
$$\text{Actual Export Growth} = \text{Global trade growth} + \text{Sectoral specialization} + \text{Competitiveness}$$

Global trade growth: The share of export growth in the sector/country that is driven by the global export growth rate.

Sectoral specialization (industry mix): The component of export growth that is driven by the export growth rate of the specific sector and the growth rate differential between global export growth. From a country perspective, being specialized dynamic sectors (that grow faster than the global exports) would bring a boost to export performance and vice-versa.

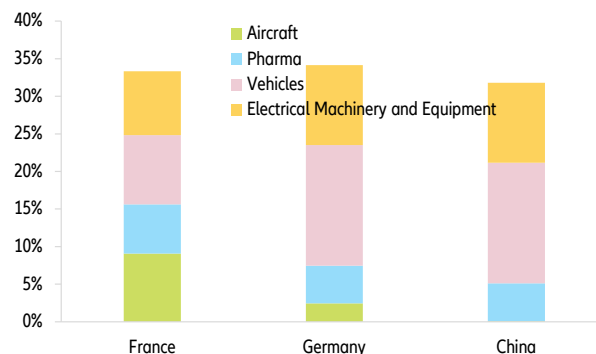
Competitiveness: Corresponds to the component of export growth that is explained by the difference between the observed growth rate in a specific country and sector and the worldwide growth rate of the sector. If in a given country the sector's exports grow faster than globally, we consider that the country has a competitive edge in this sector and vice versa. Competitiveness is a broad concept that encompasses multiple dimensions such as price, quality as well as specialization towards fast-growing markets

Figure 7: France: Sectoral contributions to cumulative market share change (pp, %)



Sources: Euler Hermes, Allianz Research, ITC Trade Map

Figure 8: Sector shares in countries' total exports 2011-2019 (%)



Sources: Euler Hermes, Allianz Research, ITC Trade Map

Figure 9: Sectoral exports growth rates: World, France and Germany

	2001-2010	2011-19	2020	2001-2010	2011-19	2020	2001-2010	2011-19	2020
Global export growth	144%	24%	-8%	France			Germany		
Aircraft	89%	50%	-36%	169%	15%	-46%	80%	40%	-35%
Machinery	100%	24%	-8%	53%	15%	-19%	109%	18%	-10%
Pharma	247%	48%	10%	179%	6%	7%	282%	42%	8%
Vehicles	94%	38%	-15%	24%	12%	-17%	104%	20%	-14%
Electrical Machinery and Equipment	125%	38%	2%	29%	0%	-11%	102%	17%	-4%
Iron and Steel	242%	-5%	-12%	119%	-16%	-23%	168%	-14%	-13%

Sources: Euler Hermes, Allianz Research, ITC Trade Map

Notes: Sectors with export growth higher (lower) than global export growth are in green (red) cells. Sectors in orange cells follow the global export growth rates. At the country level, sector exports growing higher (lower) than worldwide growth rate of the sectors are in green (red). Sectors in orange follow the export growth the pace of the sector at the global level.

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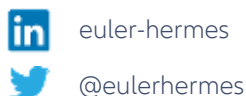
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