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The Income Balance in France and in the Euro Area

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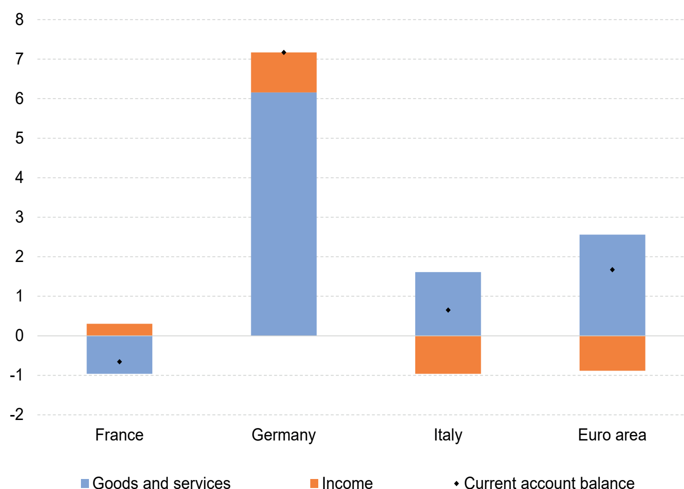
- The income balance and the goods and services trade balance are the two components of the current account. France, along with Germany, is one of the few euro area countries with an income balance surplus. The surplus was relatively stable averaging about €7bn, or 0.3% of GDP, between 2009 and 2019. This surplus partially offsets France's trade deficit.

- The income balance encompasses a wide variety of flows, including income from French investments in foreign companies. This income comes from direct investments abroad (equity stakes exceeding 10%) and portfolio investments. Compensation of cross-border workers, government transfers, such as international development aid, and remittances of foreign workers in France to their home countries are also part of the balance of income.

- Between 2009 and 2019, the surplus on France's income balance stemmed from French businesses' foreign direct investment income and from the compensation of cross-border workers. France's income balance surplus is much larger than those of its European counterparts. On the other hand, France and the euro area as a whole register structural deficits on portfolio investment income, government transfers and foreign workers' remittances.

- The income balance has worsened in France and other euro area countries since the pandemic. The deterioration is primarily due to the fall in French foreign subsidiaries earnings, which had a major impact on investment income. The impact of the pandemic on compensation of employees was less severe since the switch to remote and short-time working made it possible for cross-border workers to keep their jobs.

Current account and its components (% of GDP, average 2009-2019)

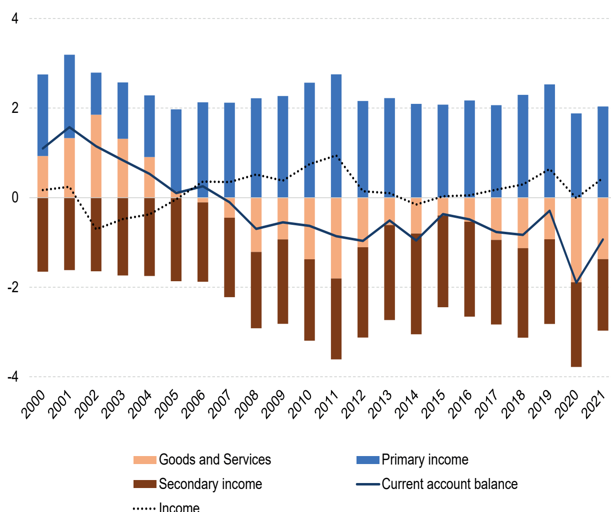


Source: Eurostat.

1. France's income balance presents a structural surplus

The primary and secondary income balance, alongside with the trade in goods and services balance, constitute the current account balance. The goods and services trade balance is traditionally more closely monitored than the income balance because (i) the trade volume is four times greater that of income,[1] (ii) the balance of income is complex owing to the wide diversity of flows that it includes (see below) and (iii) trade statistics are produced and analysed by more French institutions.[2] Nevertheless, the income balance plays an important economic role because of its direct impact on the current account by taking into account a large array of services.[3] The surplus on France's income balance remained at around 0.3% of GDP between 2009 and 2019 (see Chart 1). This surplus partially offsets the trade deficit and has driven the current account deficit closer to equilibrium (-0.7% of GDP between 2009 and 2019).

Chart 1: France's current account balance and its components (as a % of GDP)



Source: Eurostat.

A current account surplus means that the country sent more resources (capital and labour) abroad than it received and that its foreign trade has resulted in an accumulation of foreign assets.

The balance of income components are:

- Primary income, that include financial flows generated by factors of production. Income from French citizens as portfolio and foreign direct investments (FDI) abroad, are counted as primary income receipts. Similarly, compensation of persons residing in France and working in another country, for instance a person living in the north of France and working in Belgium, is also recorded as primary income. In the national accounts, the balance of primary income corresponds to the difference between gross national income (or all of the income received by the residents of an economy) and the gross domestic product (the income distributed by its residents).
- Secondary income, also referred to as current transfers, is made up of other income transfers that are not related to factors of production. Some of these transfers are made by governments for the purposes of international cooperation, such as France's contribution to the European Union budget, various taxes and social security contributions received from non-residents and social security benefits paid to non-residents. Personal transfers without compensation, such as foreign workers remittances to their home countries, are another important source of transfers recorded as secondary income. The main countries receiving the most remittances from France are Morocco (17% of transfers in 2016, according to the Banque de France), Algeria (13%) and Portugal (11%).

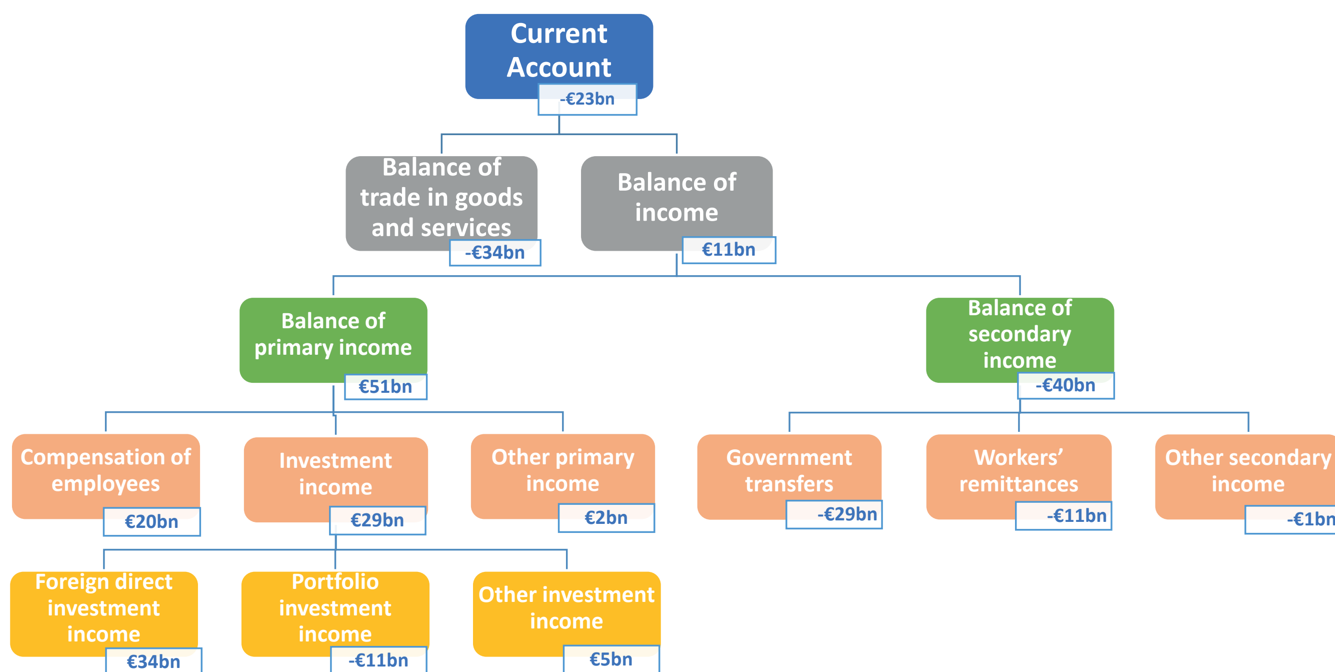
(1) France's trade in goods and services amounted to some €1,600bn in 2021 and flows on its balance of income amounted to approximately €400bn.

(2) France's monthly balance of income data is published by the Banque de France with a two-month lag. The foreign trade figures are published (i) monthly by the customs administration, (II) monthly by the Banque de France for their contribution to the balance of payments and (iii) quarterly by the national statistics institute, INSEE, for their contribution to value added.

(3) For example, services provided by subsidiaries of foreign companies (Mode 3 called "commercial presence" in the WTO methodology) are not counted as exports of services in the balance of payments, but some of the flows related to the presence of such subsidiaries (expatriate workers' compensation or remittances to their home countries) are counted in the balance of payments.

The primary income balance exhibits a significant surplus while the secondary income balance registers a significant deficit. The primary income surplus, averaging 2.3 % of GDP between 2009 and 2019, is larger than the deficit on secondary income at 2.0% of GDP and their sum offsets approximately one third of the goods and services trade deficit, standing at 1.0% of GDP.

Chart 2: Main components of the current account in the balance of payments (France's 2021 balances are shown in the boxes)



Source: Eurostat,[4] Banque de France,[5] DG Trésor calculations.

2. In contrast, the income balance for the euro area as a whole presents a structural deficit

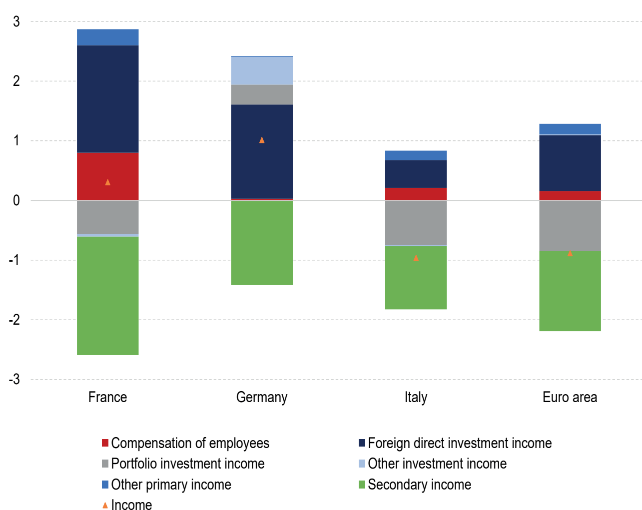
2.1 The French exception is explained by foreign direct investment income and compensation of employees

The structure of the income balance for the euro area as a whole is relatively similar to that of France's income balance : net foreign direct investment income and compensation of employees show surpluses and net portfolio investment and net secondary income flows exhibit significant deficits (see Chart 3). The difference is that the euro area balance of income shows of deficit averaging 0.9% of GDP between 2009 and 2019, as a result of the deficits in Italy, Spain and the Netherlands, whereas France's balance of income shows a surplus of 0.3% of GDP (see above).

France's surplus on foreign direct investment income is nearly twice as large as the euro area's surplus.

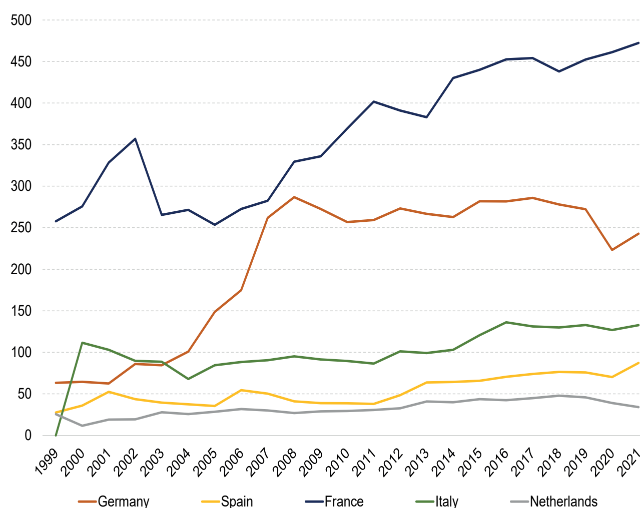
(4) The data published by Eurostat is very similar to the balance of payments data produced by the Banque de France. The €70bn deficit on trade in goods shown by the Banque de France in 2021 is smaller than the €85bn deficit calculated by the customs administration in the same year because of methodological differences between the two institutions' estimates.
(5) The Banque de France data was used to break down secondary income, which is not available from Eurostat.

Chart 3: Balance of income components (as a % of GDP, average 2009-2019)



Source: Eurostat and ECB.

Chart 4: Number of residents working in another country (thousands of jobs)



Source: Eurostat.

Furthermore, France's surplus on compensation of employees is also much larger than that of the euro area as a whole. Germany is one of few neighbouring countries that shows a surplus on its balance of income. However, Germany's surplus derives from portfolio investment income. In contrast, France shows a deficit on portfolio investment income, which could be explained by the scale of inward portfolio investment, since France has the largest market capitalisation[6] of any country in continental Europe.

2.2 France's surplus on compensation of employees comes from the large number of cross-border workers

The surplus on compensation of employees, a component of primary income, is particularly high in France. This surplus stems primarily from employees living in France and working in a neighbouring country.[7] France is home to more cross-border workers than any other European country, with nearly 472,000 people residing in France who worked across the border in another country in 2021, according to Eurostat. This represents slightly less than 2% of the labour force, putting France far ahead of Germany, Italy and Spain (less than 1% of the labour force).

The largest share of French cross-border workers is concentrated in Switzerland (nearly half in 2015), followed by Luxembourg, with 21%. French cross-border workers are well paid in both countries[8] and occupy more highly skilled jobs than in other countries.[9]

2.3 Foreign direct investment income is a product of French companies' international strategy

France like Germany, Italy and to a lesser degree the euro area registers a net foreign direct investment income surplus. France's FDI income surplus is largely the result of the rapid growth of French companies' FDI[10] from the beginning of the century into the middle of the last decade, aiming at reducing

(6) According to the World Bank, the market capitalisation of domestic companies listed on the French stock exchange in 2018 stood at \$2,366bn, or 85% of GDP, versus \$1,755bn in Germany, or 44% of GDP.
(7) Compensation of employees generated inflows of €22bn in France in 2020, which were much greater than the outflows of less than €2bn.
(8) The average gross hourly wage in Switzerland stood at €36 in 2018, according to the Swiss Federal Statistical Office, and at €25 in Luxembourg, compared to €20 in Germany, €18 in France, €12 in Spain and an average of €17 for the euro area countries, according to Eurostat.
(9) Mironova E., S. Villaume (2019), "Forte croissance du nombre de travailleurs frontaliers vers la Suisse et le Luxembourg", *Insee Première* No. 1755. According to INSEE, in 2015, the proportion of management positions and higher intellectual professions among cross-border workers was greater in Switzerland (21%) and in Luxembourg (16%) than in Germany (12%). Similarly, the proportion of manual workers among French cross-border workers is much higher in Germany (53%) than in Switzerland (29%) and Luxembourg (29%).
(10) De Warren G. (2020), "The international strategies of France's business sector", *Tresor-Economics* No. 267.

production costs and improving sales in local markets. But the surplus also stems from the differential between return on companies' foreign assets and foreign liabilities. The apparent return[11] on France's outward FDI stood at 4% in 2021, whereas that of inward FDI in France stood at only 2.6%.[12] However, this differential could also be due, to some extent, to tax avoidance practices of multinational companies that are incentivised to declare part of their profits in jurisdictions with lower taxes than France.[13]

2.4 Secondary income makes a negative contribution to France's current account balance

France's balance of secondary income and those of its European partners follow the same pattern. All of them show deficits.[14] These deficits are relatively stable and of comparable size, even if France's secondary income deficit is the largest, which may be explained by its contribution to the European Union budget.[15]

3 The pandemic caused a temporary deterioration of the balance of income

3.1 The general deterioration of balances of income in 2020 was partially offset in 2021

The balance of income deteriorated from 2019 to 2020 due to the disruption of international trade caused by the pandemic. This trend was similar in France, Germany and the euro area (see Chart 5).[16] The deterioration stemmed primarily from a sharp contraction of the surplus on foreign direct investment income, whereas the deficits on portfolio investment income were partially offset in 2020, as outward investment slowed. The balances of income recovered in 2021, even though (i) they have not returned to their pre-pandemic levels and (ii) the balance of foreign direct investment income showed no signs of improvement between 2020 and 2021. The balance of income was boosted in 2021 by smaller deficits on portfolio investment income and secondary income.

3.2 The balance of FDI income deteriorated sharply in France, as it did in all European countries

The balance of FDI income saw a sharp deterioration in 2020 in all euro area countries, except Italy. Part of the sharp deterioration of France's balance of investment income[17] could be explained by the weight of the financial and energy sectors in the

(11) See the methodology presented by S. Avouyi, P. Bui-Quang and P. Sicsic (2019), "Le solde des revenus : un renfort pour le compte courant de la France", Billet No. 134 de la Banque de France. Apparent returns on assets are derived by comparing investment income inflows to outstanding investments.

(12) Several factors may explain the differences in rates of return between countries: investment risk perceptions, economic growth or taxes on investment income.

(13) According to a CEPII paper (V. Vicard (2019), "L'évitement fiscal des multinationales en France : combien et où ?"), €25bn in income from French outward FDI resulted from tax avoidance by French multinational companies in 2015. This would be equivalent to 38% of the income on inward FDI. Two thirds of the income from outward FDI comes from French parent companies' transferring profits to their foreign subsidiaries and the other third comes from under-reporting of the profits of French subsidiaries of foreign companies. After adding in taxes, the missing profits in France would stand at €36bn in 2015, or 1.6% of GDP and 29% of corporation tax revenue in 2015.

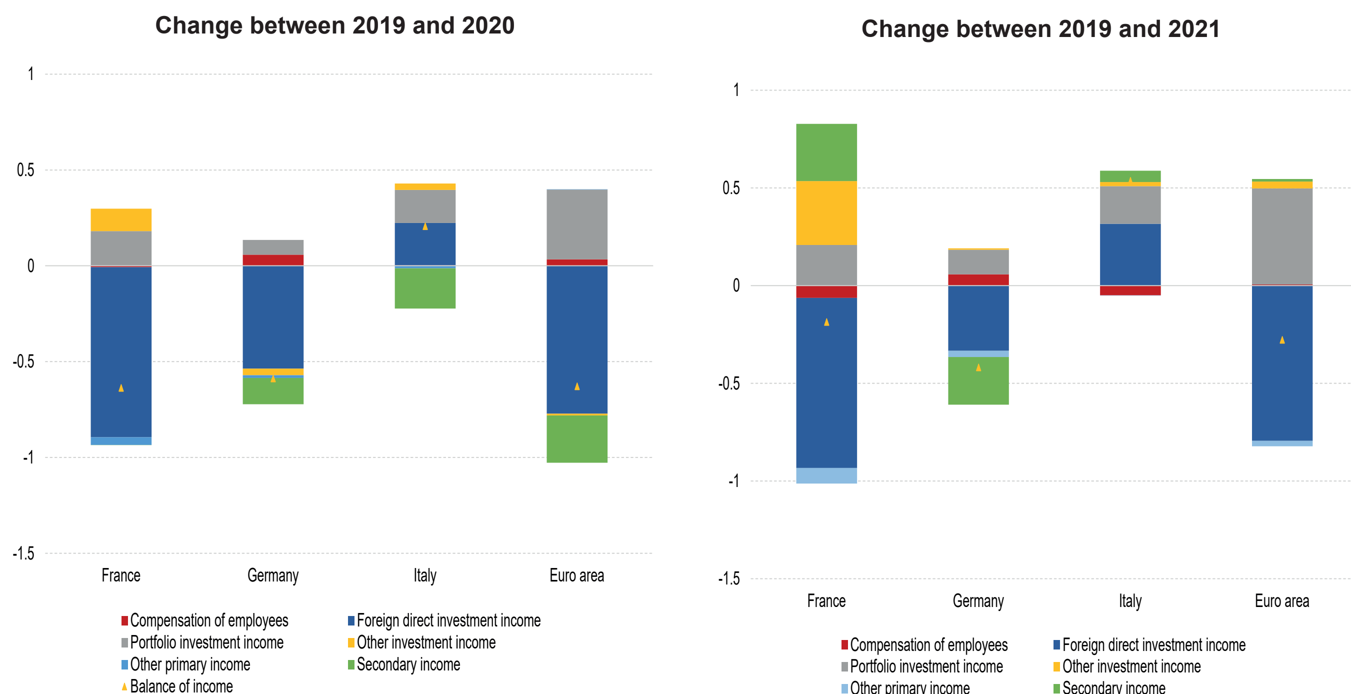
(14) The reimbursement of VAT on exports, for example, is a drain for France, and for all of the EU member countries that apply the tax.

(15) Only a minority of Member States make a positive net contribution to the European Union budget. France, along with Germany and the United Kingdom, was one of the leading contributing countries (in net terms) over the period.

(16) Italy was the exception, seeing an improvement in its balance of income in 2020.

(17) Income from France's foreign assets also dropped markedly, losing 1.8 percentage points between 2019 and 2020, which was greater than the drop in income paid on its foreign liabilities, which fell by 1.2 percentage points.

Chart 5: Changes in the balance of income and its components between 2019 and 2020 and between 2019 and 2021 (in percentage points of GDP)



Source: Eurostat.

investment income[18] of France's large business groups, which account for the vast majority of France's outward investment.[19] Finance and energy were some of the hardest hit sectors in 2020. Financial corporations saw their business risks increase and had to make substantial provisions, while oil companies were hit by falling demand. On the other hand, France's balance of portfolio income improved substantially in 2020 and 2021, in contrast to the euro area as a whole, where the balance showed little change since the pandemic. The drop in flows on the balance of portfolio investment income led to a smaller deficit in France and the euro area.

3.3 French cross-border workers maintained their activity, despite the pandemic

While the surplus on FDI income contracted in France, the surplus on compensation of employees remained steady in 2020. It was also stable in Italy, but Germany's balance of compensation of employees improved as outflows dropped sharply.

France's cross-border workers maintained their activity thanks to the switch to working from home. However, this change made it urgent to reach amicable agreements with Switzerland, Luxembourg, Germany and Belgium back in March 2020 in order to solve

(18) See D. Nivat (2015) "Revenus d'investissements directs à l'étranger et profits des groupes du CAC 40 de 2005 à 2013", *Bulletin de la Banque de France* No. 200. The two sectors receiving the most foreign direct investment income are finance, which accounted for a quarter of the income in 2013 and oil, gas and commodities, which accounted for a fifth of the income. In comparison, their shares of the market capitalisation of CAC 40 companies in March 2022 stood at 6% for companies in the oil, gas and commodities sector and at 10% for companies in the financial sector.

(19) According to Nivat (2015), CAC 40 companies account for more than three quarters of France's outstanding outward FDI and four fifths of France's FDI income.

some of the problems resulting from remote working with regard to the tax rules applying to cross-border workers.[20] Measures were taken to ensure the cross-border mobility of workers who could not work from home. Switzerland and Luxembourg[21] also loosened the eligibility requirements for unemployment benefits for cross-border workers from France affected by short-time working schemes, so that they could receive the benefits from the countries where they were employed.

(20) Under these agreements, days worked at home because of the pandemic may be considered as worked in the country where the workers usually work, meaning that the related compensation remains taxable in that country.

(21) Luxembourg introduced special procedures for temporary access to unemployment benefits for employees affected by short-time working schemes during the pandemic. The Swiss Federal Council simplified the processing of applications for unemployment benefits for such employees, expedited the payment of benefits and expanded the right to short-time working for apprentices and employees on temporary contracts.

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