Comment
Long-term productivity in the French Pacific territories

Comment on the articles "*Economic growth and productivity in French Polynesia: a long-term analysis*" by Vincent Dropsy and Christian Montet and "*Sectoral labour productivity and economic competitiveness in New Caledonia*" by Serge Rey and Catherine Ris

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Abstract – Limited access and small size of the domestic market hamper long-term productivity gains of New Caledonia and French Polynesia, like independent small island economies. Institutional agreements setting up their relationship within France also impact their productivity. The two articles presented here analyse long-term productivity gains, for the first one through total factor productivity and for the second one through labor productivity. They both conclude that the two entities have barely experienced productivity gains since the early nineties and that their growth dynamics were mostly extensive. Local governments economic policies – specifically revenue policy and competition policy – will play a crucial role to promote productivity gains needed to ensure long-term growth of the two economies.

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This issue offers two articles on long-term productivity dynamics on the French Pacific islands and provides welcome insight into the economies of these remote territories of the Republic, which have been experiencing significant developments these past years. The first article, by Vincent Dropsy and Christian Montet, focuses on French Polynesia while the second, by Serge Rey and Catherine Ris, deals with New Caledonia.

General background

Before presenting and commenting on the main lessons which these two articles offer, we propose to recapitulate certain characteristics of the two economies, essential to understanding the issues at stake in their changing productivity trends. New Caledonia and French Polynesia are reined in by two primary issues: land-lock and a small domestic market. Like small independent island economies, they experience these as detrimental to their productivity, all the while boasting specific characteristics as part of the French Republic, which also influence the level and dynamics of their productivity.

The high degree of isolation experienced by New Caledonia is even more strongly felt by Polynesia, due to its widely-scattered archipelago: these are emerged spaces which, combined, amount to barely 3,500 km^2, yet are spread across a maritime surface as large as the European Union. This remoteness puts these islands at a disadvantage, both in terms of cost and access to the global markets. Moreover, these barriers are due at least as much to low traffic as to distance: a detour via Nouméa or Papeete generates a marginal cost per good transported that is all the higher as the average volume transported is limited. Due to historical, cultural, entrepreneurial and institutional ties, mainland France remains a preferred commercial partner to both islands, notwithstanding all the costs arising from trade between partners 15,000 km apart.

The small size of their internal market also limits the economies of scale and agglomeration which local companies can achieve and makes certain capital-intensive activities, not focused on export, structurally unprofitable. Although the population has grown significantly over the past 50 years, shaped by the natural balance and migratory phenomena, New Caledonia and French Polynesia remain sparsely populated, each being home to around 275,000 inhabitants. As a result, the size of their economy remains modest and significantly smaller than that of the smallest of metropolitan French regions, Centre-Val de Loire: New Caledonia's GDP (€8 billion) amounts to only 11% of the latter's.

The economic dynamics of the two island territories have widely diverged over the last two decades. The New Caledonian economy benefited from a threefold positive shock over the period from 1998 to 2012: a shock in the terms of trade, thanks to the high prices of its main export, nickel; an investment shock resulting from the construction of two new metallurgical factories, built to increase mining of nickel resources; and a confidence shock following the signing of the Nouméa agreement in 1998, which offered a stabilised institutional investment framework for twenty years, and thereby facilitated the investment decisions of companies and households (CEROM, 2008 and CEROM, 2017). While these favourable factors have since fallen away, driving the economy into a phase of weak growth, New Caledonia's GDP has more than doubled in the last 20 years. In contrast, as shown in the article by Vincent Dropsy and Christian Montet as well as in the CEROM's study (2007), since the end of the Pacific Testing Centre (CEP)'s construction and operation and the public investment shock it generated, the Polynesian economy has, conversely, seen its GDP per capita go into stagnation, even entering depression between 2008 and 2012, according to the authors. All in all, while the two economies were similar in size 20 years ago, New Caledonia's GDP now exceeds that of French Polynesia by 75%.

Economic literature has shown that the geographic isolation and market size issues characterising small island economies make growth far more dependent on an increase in production factors, whether capital or labour, than on an increase in total factor productivity. The goods or services in which these economies have comparative advantages at the international level (like tourism) are those that offer low productivity gains over the long-term. That both these territories are part of the French Republic, with specific constitutional and institutional rules governing their relations, adds further characteristics that impact their productivity trends.

From an institutional point of view, French Polynesia is the largest territorial authority governed by Article 74 of the French Constitution, alongside Wallis and Futuna, Saint Pierre and Miquelon, Saint Martin and Saint Barthélemy.

New Caledonia, meanwhile, benefits from a special status defined in Section XIII of the Constitution ("transitional provisions relating to New Caledonia"), according to which a referendum is to be held in November 2018, determining its accession to full sovereignty and independence. In application of these constitutional articles, the two authorities have a status that "takes into account the interests of each within the Republic" (art. 74) and enjoy considerable autonomy, particularly from an economic point of view. Apart from currency and credit, all the economic powers are held locally. The Polynesian and New Caledonian governments thus hold powers over direct taxation (both corporate tax and income tax, which moreover does not exist in French Polynesia) and indirect taxation, commercial policy, support for enterprises, labour law (including minimum wage), vocational training, competition, etc. All these policies influence the productivity of the two economies. The choices made by the two territories' successive governments, which favoured policies protecting local production, combined with the transaction costs caused by being land-locked, have resulted in the highest cost of living in all of the national area.

Thus, while the two territories hold most of the economic powers of independent countries, two key characteristics distinguish them:

(i) they receive substantial financial support from the State. This support is the result of a constitutional obligation under internal law that ensures stability through high levels of State transfers, whereas an independent country benefiting from financial flows under official development aid (ODA) policies enjoys less predictability in the said aid and, moreover, often less significant financial support. Financial support remains significant: net public transfers from mainland France account for 12% and 24% respectively of the wealth created in New Caledonia and French Polynesia. These transfers mainly come in the form of remuneration for civil servants and financing for investment programmes. The current principle of over-remuneration for civil servants has both diffusion and knock-on effects on private sector wages and apparent labour productivity;

(ii) the monetary arrangements in effect exempt them from external constraints. Both islands are part of the Pacific franc area, which also includes Wallis and Futuna, with the Pacific franc managed by the Central Bank for Overseas France (IEOM). Created in 1945, the Pacific franc is pegged to the euro (previously to the French franc) under a set exchange rate – defined by decree – and has not seen any change in parity since 1949. The State ensures the unlimited convertibility of the Pacific franc via an IEOM transaction account mechanism to the Public Treasury. This system guarantees the currency's credibility and allows the Pacific authorities not to be subject to the external constraint that so hampers small independent island economies, pushing them to develop multiple strategies (specialisation in tourism, tax havens, etc.) to finance the gap between their goods imports and exports. This lack of constraint reduces the need for international competitiveness and therefore the need to achieve productivity gains.

Key learnings from both articles

The general framework having been set, what do the two articles in this issue teach us? The article by Vincent Dropsy and Christian Montet offers a long-term analysis of economic growth and changing patterns in productivity, based on a series of data relating to the period 1959-2006. Statistical availability constraints prevent the authors from extending the analysis any further, and thus analysing shifts in productivity during the protracted economic crisis in Polynesia since 2008. However, one of its main points of interest lies in its showing that the Polynesian economy veered off course well before 2008 and, even before going into negative growth, saw its GDP per capita stagnate for 20 years.

To understand the reasons behind this, the authors use a classic approach inspired by Solow and Mankiw to break down French Polynesia's economic growth in order to dissociate the elements attributable to the increase in production factors (capital, labour and human capital) from those linked to total factor productivity, in other words, technological change, market organisation or public governance. The most powerful conclusion from their analysis is that it is possible to separate the long-term economic trajectory of French Polynesia into two distinct periods. Between 1959 and 1987, the accumulation of capital and the improvement of total factor productivity played a decisive role in the island's economic performance; this was a period of massive public investment for construction, followed by the development of the CEP. Since that time, capital stock has decreased slowly and, above all, total factor productivity has stagnated, reflecting, according to the authors, the existence of structural

obstacles to growth (high costs, and poor allocation of resources due to protectionist policies). As to labour productivity alone, it has also stagnated over the last three decades. This reflects the fact that the post-CEP development strategy has not been able to stem the economic consequences of the exit from the nuclear test era. Over the whole period considered in this study, however, the labour factor saw continuous growth, which was also the case of human capital mostly, reflecting the significant efforts dedicated to education.

The article by Rey and Ris on New Caledonia covers a shorter period (1992-2014) and focuses on a single component of total factor productivity: labour. The authors calculate the labour productivity of the eight main sectors in the New Caledonian economy, linking an activity indicator to paid employment. The results show that only four sectors (agriculture, construction, manufacturing industry and trade) have seen their apparent labour productivity improve over the period in question, while the two main export sectors, nickel and tourism, saw a decrease. The authors then calculate average total and non-nickel productivity to conclude that the former tightened over the period (given developments specific to the nickel sector), while the latter improved slightly. The authors then propose to extend the analyses by looking at unit labour cost, comparing the wage rate to labour productivity. Using the guaranteed minimum wage (SMG) as their foundation, they show the increase in unit costs. The SMG was used due to a lack of available data on wages by sector; this can be considered a shortcoming in the analysis insofar as the New Caledonian government has for 15 years conducted a deliberate policy to increase the SMG which has not had an equal-proportional impact on all wages in the economy. However, the analysis is corroborated by the use of a unit cost for the economy as a whole. The article ends with a section based on real exchange rates, which shows New Caledonia's loss of competitiveness compared with the majority of its trading partners, the said loss being more prominent in the market sector.

Implications for public policy

The two articles thus show the virtual lack of productivity gains since the early nineties for the French territories in the Pacific. They also highlight the fact that periods of strong growth were fuelled above all by the increase in production factors, i.e. via extensive growth. What can be deduced from this in terms of economic policy recommendations? While this is not the main entry point for the two articles, the authors nevertheless put forward a number of suggestions.

Dropsy and Montet focus on French Polynesia in the period 1997-2000, the only time since 1987 when the island experienced an improvement in total factor productivity, to derive insights from this. They point out that this period is marked by three structural changes – a reduction in protectionism, growth in public investment, particularly in transport, and an increase in density in the Tahiti urban area – all favourable to scale and agglomeration effects. Rey and Ris mention, meanwhile, that although the education level of the New Caledonian population has increased, it remains significantly below the OECD average, and suggest increasing investment in education. The two articles lastly highlight the role of the market protection measures decided by local governments which, by extending the size of the sector protected from international competition, reduce incentives for companies to achieve productivity gains, when the economies are already not forced to deal with the competitiveness imperative, in contrast to independent countries.

The long-term economic growth of the New Caledonian and Polynesian economies cannot be sustained solely by accumulating production factors, whether capital or labour. The investment rate in New Caledonia has therefore been very high for more than a decade, leading to marginal efficiency in decreasing physical capital. The economic policy implemented by local governments has a fundamental part to play in boosting productivity gains through appropriate incentives for companies. The adoption of a genuine competition policy that takes into account the features specific to small economies, which favour monopoly and oligopoly situations, is particularly crucial. Initial steps have been taken in this direction with the very recent creation of competition authorities (in 2015 in Polynesia; in 2014 in New Caledonia with operations beginning in February 2018), which must now prove themselves by sanctioning anti-competitive behaviour. Fiscal policy, by gradually replacing customs duties with indirect taxation, also has a key part to play (Ris *et al.*, 2017). □

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