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France: the hottest economy you've never heard of

Wednesday Briefing No. 6

The Wednesday Briefing is a weekly free-market commentary on topical economic issues by our Head of Research, Diego Zuluaga. You can subscribe to the Wednesday Briefing by e-mailing Greta Gietz at greta.gietz@epicenternetwork.eu.

France tends to get a bad rap from the international economic press. The ongoing labour unrest in response to what is, by any objective measure, a fairly innocuous reform of the country's employment regulations was received with characteristic despondency from commentators. A question I received in advance of a TV debate captured the mood: "Are the French always on strike?" The stereotype was only compounded by the 50th industrial action in seven years by the country's air-traffic controllers at the end of the week, which drew the ire of airlines and passengers.

This French-bashing is, admittedly, justified to a rather large extent. The country's byzantine labour laws are a relic of a previous age, their long-term marginalisation of substantial numbers of able-bodied men and women of working age – often from the most disadvantaged groups – notorious and unjustifiable. The unemployment rate has been hovering around 10 per cent for the better part of the last thirty years, a level of structural joblessness that is double that of comparable economies.

Indeed, someone of a more Marxist inclination might say that France's Code du Travail, which protects relatively veteran and well-off workers at the direct expense of the more unskilled and inexperienced, is crumbling under the weight of its own contradictions. These onerous rules result – again in Marxist parlance – in the creation of a vast reserve army of idle labour which is vulnerable, frustrated, hopeless – and, as a consequence, ripe for radicalisation.

Similarly, the French public sector gobbles up 57 per cent of the country's national income, among the highest in the OECD and only surpassed by Finland, Slovenia and Greece – all economies which have been stuttering – full-on depressed, in the Greek case – in recent years. This somewhat conceals the true weight of the French state. To put it in cruder terms, it means that the public, mostly wealth-consuming part of France's economy is around 30 per cent larger than the private, wealth-creating bit!

France badly needs economic reform. But we shouldn't let negative news headlines blind us to the fact that the French economy has tremendous potential and that, provided a small number of important but feasible policy changes, it can do very well. Even more auspiciously, an ongoing political realignment arguably makes reform more likely than at any time since Charles de Gaulle founded the Fifth Republic. In other words, there is both an economic and a political case for what one might call 'Francoptimism.'

The economic case

The most important reason to be optimistic about France's economic prospects lies in what economist Julian Simon termed "the ultimate resource": people. France boasts the highest fertility rate in the EU, expected to remain at similar levels until 2060. This means that, propelled further by modest amounts of inward migration, the French population will grow noticeably over the next 50 years, from the current 65 million to 75 million by 2060. France will thus experience a less dramatic ageing of its population than its EU peers, most poignantly Germany, Belgium and Portugal, which will see their numbers fall by between 15 and 25 per cent.

Contrary to Malthusian accounts, people in a market economy are not net resource consumers, but net resource creators. Human ingenuity and initiative is what drives the process of innovation, which enables all of us to raise our living standards while using production inputs more efficiently. The world is today 8-9 times more populated than it was in 1800, and yet whereas 9 out of 10 people lived in extreme poverty back then, 1 of 10 does in 2016, and the proportion is quickly plunging further.

People's independent and spontaneous contribution to productive activity is the main reason to welcome population growth, yet rising ranks of working-age individuals also help to sustain welfare programmes and public expenditure. A rising population will help to pay down France's public debt, which right now is worryingly close to breaking the 100 per cent of GDP barrier.

French economic fundamentals are sound. The country obtains 75 per cent of its electricity from nuclear energy, which is reliable, cheap to produce, and environmentally friendly. In 2015, 4 of the top 100 global firms by market capitalisation were French. This is down from 7 in 2009, but still notable given that the French economy accounts for just 2.39 per cent of world

GDP. But France is not just home to industrial behemoths. Paris has a thriving startup scene, behind London – which itself has seen its French expat count swell in recent years – but ahead of Berlin. Blablacar is just one of the better-known examples among many new and exciting French ventures.

Add to that a robust and dependable infrastructure network, and – despite the brouhaha over strikes and Marine Le Pen – high levels of political stability and national cohesion, and you get most of the key ingredients for a growing and successful economy. So, what should policymakers do to unleash this potential? Just three things would go a long way:

1. **Cut taxes and public spending in line with the EU norm.** France's government sector (57 per cent) and taxation (45 per cent) as a share of GDP are outliers among OECD and EU countries. Bringing spending down to the EU average would provide some room to reduce the tax burden.

   In particular, the statutory rate of corporation tax could fall towards 20-25 per cent from the current very high 33.3 per cent. Top personal income tax rates could be lowered from 41 and 45 per cent, respectively, to a single rate of 40 per cent above €75,000 of income. Crucially, social security charges must be lightened. Right now, it costs French employers €237 to give €100 of purchasing power to employees, according to EPICENTER partner Institut Economique Molinari.

   Spending cuts should focus on progressive attrition of public sector staff, which would come with the boon of releasing a trained workforce to the private sector, and a reduction in France's social transfer spending, which is the highest in Europe. The challenge may seem insurmountable, but Sweden undertook reforms on just such a scale in the 1990s, lowering government spending as a share of GDP from 64 to 52 per cent. And it has since thrived.

2. **Overhaul labour market regulation.** The Hollande government's proposed changes to the Code du Travail – more bargaining flexibility, eased conditions for hiring and firing – will help, but in the medium term French labour market policy must be brought into the 21st century. Specifically, the 35-hour week and the strict boundary between fixed and temporary contracts must go. More and more, firms and workers seek flexibility and choice in their working arrangements, but a highly regimented labour market militates against them. The unions' prerogative to establish working conditions for everyone, not just their members, is also unsuited to an age where the trend is self- and multiple employment.

   The link between labour market regulation and unemployment has been amply documented in many countries and settings. Freeing up its workforce will allow France to bring its jobless and hopeless into mainstream economic life.

3. **Change the tone on trade and innovation.** The French government has been among the more reluctant partners in the TTIP negotiations, even though half of the French population actively support a deal. Similarly, France has of late tended to make headlines more for its harsh treatment of tech firms than for its burgeoning startups. And the country remains extremely inhospitable to GM foods and any other innovation found to be non-compliant with the precautionary principle.

   The common thread linking all of these together is an opposition to change, which in turn is responsible for France's bad image among international investors. If the country can manage to create an environment that is more welcoming to foreign firms and innovative industries, its international reputation will improve, and so will its growth prospects.

The political case

All of the above may be feasible and desirable, but France will still need a political climate conducive to reform in order to successfully carry it out. French politics might not seem to offer grounds for optimism, given the rise of the authoritarian and illiberal Front National, and increasing rifts within the ruling Socialist party. But a more encouraging picture emerges when one digs below the surface.

Like other Western countries, France is witnessing a political realignment which is shaking up the old political coalitions on Left and Right. The divide is no longer between (broadly speaking) capital and labour, or conservatives and socialists. It is increasingly between nationalists and globalists – between those who confront change by pulling up the drawbridge and retreating into protectionism, and those who wish to adapt to change and to thrive with it. The FN, as well as certain parts of the Old Left and the Old Right, belong to the former camp. Reformist figures such as Economy Minister Emmanuel Macron and former centre-right Prime Minister François Fillon would fall into the latter one.

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Importantly, such a realignment creates a window of opportunity for reform. Under the old Gaullist consensus, there was an implicit agreement between Left and Right not to shake things up too much. Preserving the *dirigiste* economic model of the Fifth Republic was to the advantage of the political establishment, big business and the trade unions. But globalisation and the decline of French two-party politics have simultaneously increased the urgency for fundamental change, and lowered its political cost. Regardless of who becomes the new French President in 2017, it is not unreasonable to suggest that such a reformist agenda will make it to the Elysée Palace before 2030, quite likely in the form of an alliance between centre-right and centre-left.

A business metaphor best captures the case for France. It is not a rotten firm waiting to be liquidated and picked apart. On the contrary, it has excellent fundamentals and is just in need of new management guided by a starkly different philosophy. Right now, it looks like its shareholders (the French people) might choose a charismatic fraudster promising change at no cost. But sooner or later economic reality will set in, bringing into power precisely the kind of reform programme that is needed.

So, count me a Francoptimist.

Further reading:

Giménez-Roche, Gabriel A. "Taxation and its negative impact on business investment activities." IEM Economic Note. Paris: Institut Economique Molinari, 2015.

Philippe, Cécile, Nicolas Marques, and James Rogers. "Fardeau social et fiscal de l'employé moyen au sein de l'UE." Sixth edition. Paris: Institut Economique Molinari, 2015.