FOR FORUM OBYWATELSKIEGO ROZWOJU
ANALIZA

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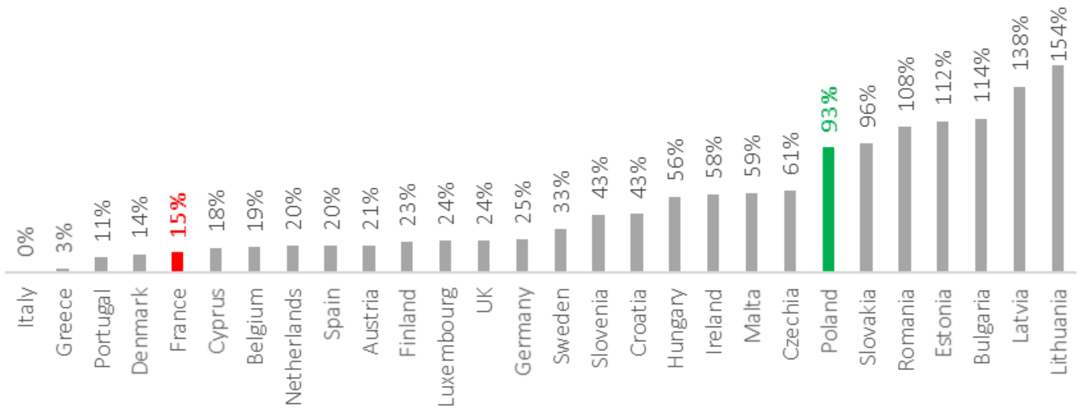
Analysis 1/2019: The Mass Demonstrations in France is a Reaction to the Effects of Interventionism, Not Liberalism

- Mass protests of the "yellow vests" have been taking place in France since 17 November 2018. The demonstrations are accompanied by numerous acts of vandalism: burning cars, knocking out shop windows or devastating the Arc de Triomphe. The catalyst of the demonstration was a fuel tax increase, supposed to place a disproportionate burden on the middle class from the province. However, the list of demands quickly grew to include various social and protectionist slogans. The protestors are demanding a simultaneous growth of the state and a reduction of taxes.
- For some commentators, the riots in France have become an excuse to put the traditional blame on liberalism. They speak of "the process of disintegration and transformation of the structures of power created in Europe by post-war liberalism" (Cichocki 2018) – despite the omnipotence of bureaucracy in France. They say, that "the current neoliberal paradigm has been discredited" (Zielonka 2018) - despite the overregulation of the French economy. Or they argue that it is "the policy of liberal elites that strengthens the extreme right" (Tok FM 2018) – despite the stable several percent of support for nationalists in French elections for the past 30 years, at a time when a developed social state lasted at its best, without the market reforms that have been implemented in other European countries. These are therefore utterly false diagnoses.
- If liberalism is to be interpreted as economic freedom, France is very far from this ideal. While the majority of Western European welfare states, such as Sweden and Germany, have carried out profound reforms in the last three decades, the country on the Seine is still one of the most bureaucratized and state controlled economies in the European Union:
  - In the latest edition of the Index of Economic Freedom (Heritage Foundation) France is only 34th out of the 45 included European countries, and 29th out of 44 countries of the Old Continent in the Economic Freedom of the World (Fraser Institute).
  - It has the highest public spending and the second highest social welfare spending in the European Union. The lack of reforms means that both remain significantly higher than in Sweden or Greece, countries known for the bloated government.
  - The state-owned enterprise sector is the fourth largest in the EU. It is more extensive only in Poland, Croatia and Romania, where privatization after the socialist era has not been finished.
  - The average effective retirement age of men in 2016 was 60 and was the lowest among OECD countries. The cost of pensions in France is the third highest in the EU and is rising rapidly.
  - Public debt is 98% of GDP, the fifth highest in the EU. Only Belgium, Greece, Italy and Portugal score worse than France.
  - The country's labour market is over-regulated. France also ranks fourth in the EU in terms of salary taxation. This results in a low employment rate, including migrant employment, and a high youth unemployment rate.
  - Over-regulation and high taxes on labour, blocking young people's access to the most productive jobs, limit social mobility in the conditions of economic stagnation and provoke protests.

Economic stagnation

French economic growth is one of the slowest in the European Union. Since the creation of the Eurozone in 1999, French per capita income has only increased by 15%, which is the fifth worst result in the 28 EU countries. For comparison, in Poland the income per capita increased by 93%, and in Germany – by 25% (Chart 1).

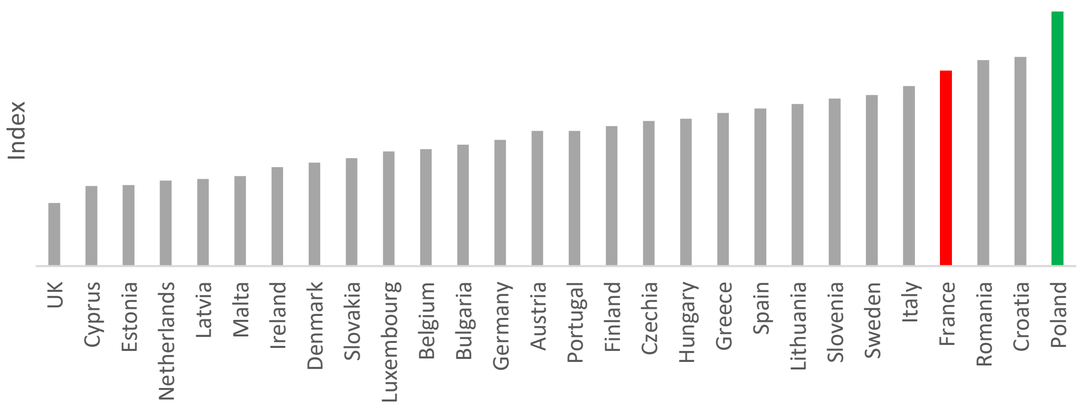
Chart 1: GDP per capita growth in constant prices and PPP in EU countries, 1999-2017



Source: FOR own study based on Total Economic Database data (Nov. 2018)

Low growth is caused by economic interventionism, manifested in the bloated state-owned enterprise sector, regulations discouraging people from working, high government spending and high public debt. Based on the number of economic sectors in which the state controls at least one company, the OECD has created an index which shows that in 2013, France was fourth in terms of the size of the state-owned enterprise sector among the 28 EU Member States. The more extensive sector of state-owned enterprises is only in Poland, Croatia and Romania, i.e. the countries of the former Eastern Bloc which have still not finished the privatization process (Chart 2). So far, Poland has been able to develop rapidly despite the high share of state-owned enterprises – mainly due to the increase in labour productivity as a result of the movement of labour and capital to more productive sectors and emerging market services, and later private industry, as well as the inflow of technological and organizational knowledge from abroad. Unfortunately, these growth factors are becoming depleted today, and maintaining a large part of labour and capital resources in the politicized part of the economy will be an increasing barrier to growth, among others caused by the underinvestment in the state's energy and mining industries and the danger posed by state ownership in the banking sector (FOR, 2015).

Chart 2: Scope of the state-owned enterprises sector in EU countries, 2013

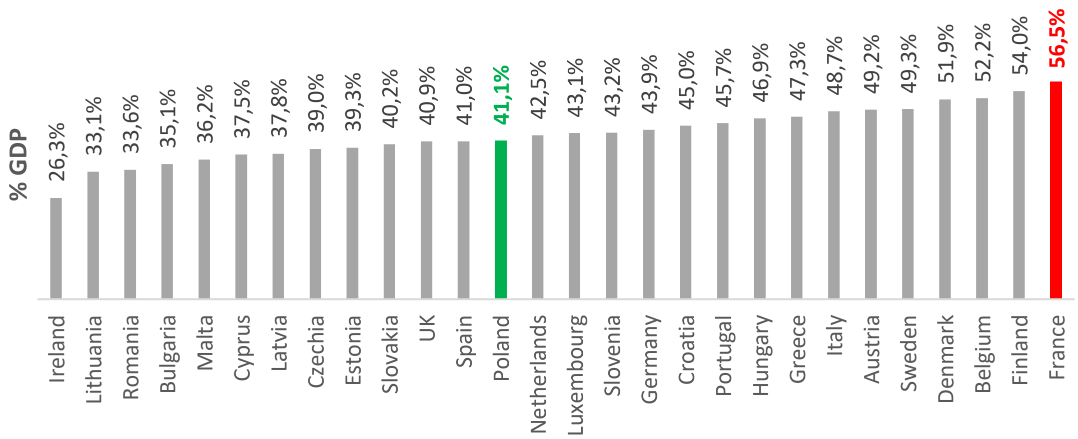


Source: FOR own study based on OECD data.

Highest government spending in the EU

France currently has the highest government spending in the EU. In 2017, government spending in France amounted to 56% of GDP, which is significantly more than in such well-developed welfare states as Sweden (49% of GDP) and Greece (47% of GDP). Poland's spending amounted to 41% of GDP and was in the middle, slightly above much richer Spain and the United Kingdom. Ireland has the lowest government spending in the EU of 26% of GDP (Chart 3).

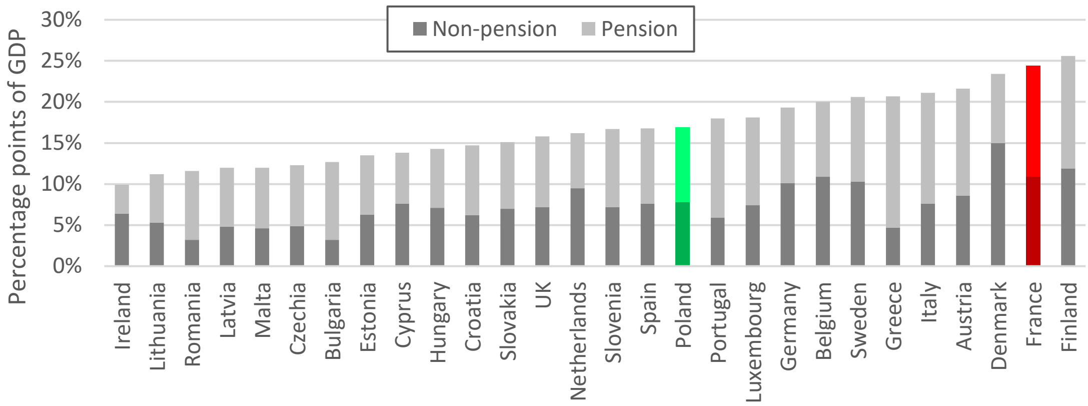
Chart 3: State expenditure in EU countries, 2017



Source: FOR own study based on data from the European Commission.

The dominant part of the public spending is social welfare spending, of which France ranks second in the EU, with a high proportion of both pension and non-pension expenditures. In 2016, France's social welfare spending amounted to more than 24% of GDP, slightly less than in Finland, which spent 26% of GDP on social protection. Poland, as in the case of total public spending, is in the middle with social welfare spending at 17% of GDP, slightly higher than in richer countries such as: Spain, the Netherlands and the United Kingdom. Social welfare spending was the lowest in Ireland, where it amounted to 10% of GDP (Chart 4).

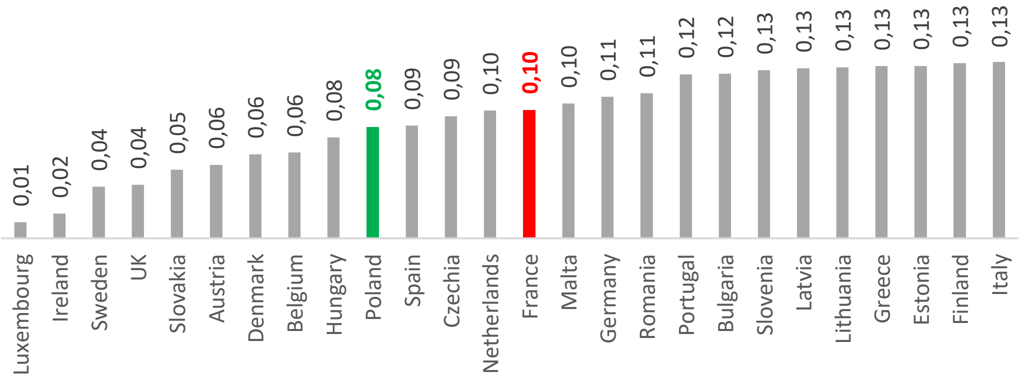
Chart 4: Social expenditure of the state divided by pension and non-pension in the EU countries, 2016



Classification of general government expenditure by function (COFOG).
Source: FOR own study based on data from the European Commission

High government spending is becoming more and more difficult to fund as European societies age. The increase in public debt and pension expenditure is mainly financed by people of productive age. However, in all EU Member States their number is decreasing in relation to the number of people of post-productive age (Chart 5). France has so far performed relatively well against this background due to high immigration and one of the highest fertility rates in the EU. In Poland, the baby boom of the 1980s improved the situation only to a limited extent, due to the large emigration of these generations at a time when people born in the post-war baby boom started to retire. Currently, the above statistics do not include numerous foreigners working in Poland, because they are mostly not classic immigrants, i.e. they do not have the right of permanent residence and do not stay in Poland for a full year.

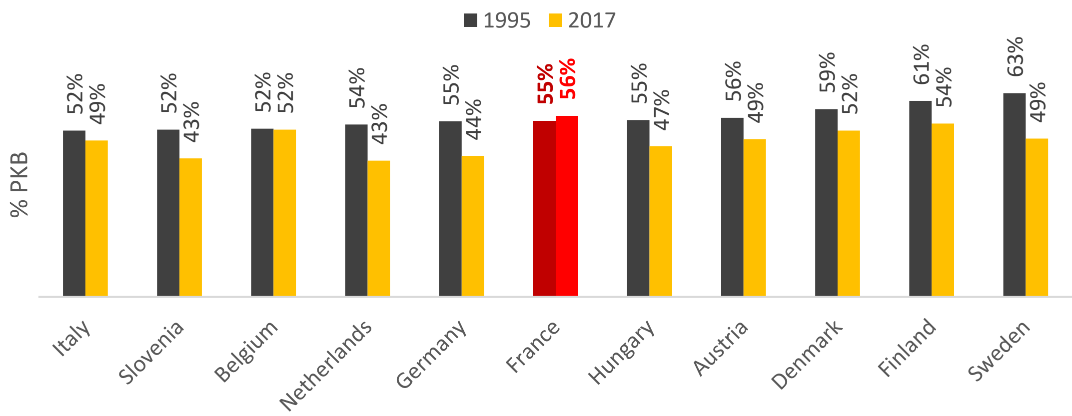
Chart 5: Change in the old-age dependency ratio in the EU Member States, 1989-2016



Source: FOR own study based on data from the European Commission.

An ageing population and the over-regulation of 20th century welfare states have led many Western European countries to undertake radical fiscal consolidation and social reforms over the last three decades. In 1995, as many as 11 of today's EU Member States had government spending exceeding 50% of GDP. To this day, all but France have reduced their spending. Between 1995 and 2017, government spending in Sweden fell from 63% of GDP to 49% of GDP, in the Netherlands from 54% of GDP to 43% of GDP and in Germany from 55% of GDP to 44% of GDP. At the same time, in France, public spending increased from 55% of GDP to 56% of GDP (Chart 6).

Chart 6: Current public expenditure in today's EU Member States, where it exceeded 50% of GDP in 1995



Source: FOR own study based on data from the European Commission.

When other Western European welfare states were cutting spending, in France social welfare spending was increasing, mainly due to an increase in pension costs. From 1995 to 2017, the fastest growing category of the French government spending was social protection, which increased by more than 3 percentage points of GDP, and, moreover, health expenditure also increased significantly – by 1 percentage point of GDP (Chart 7). The increase in social protection spending is almost entirely due to pension spending, which increased by 3 percentage points of GDP (Chart 8).

Chart 7: Change in state expenditure in France by category, 1995-2017

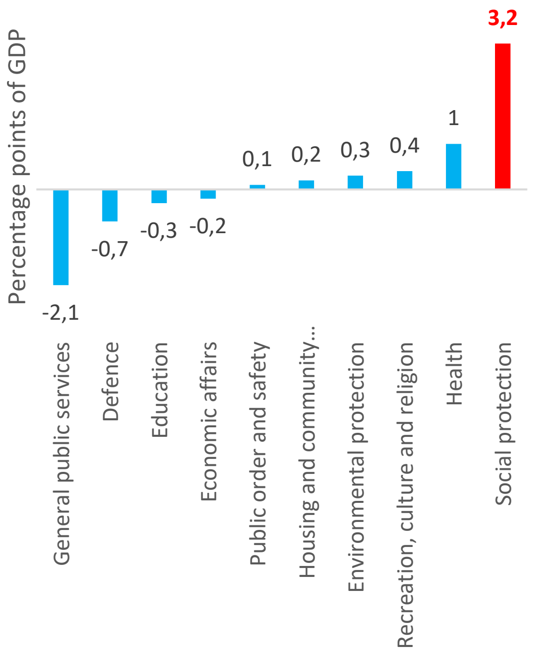
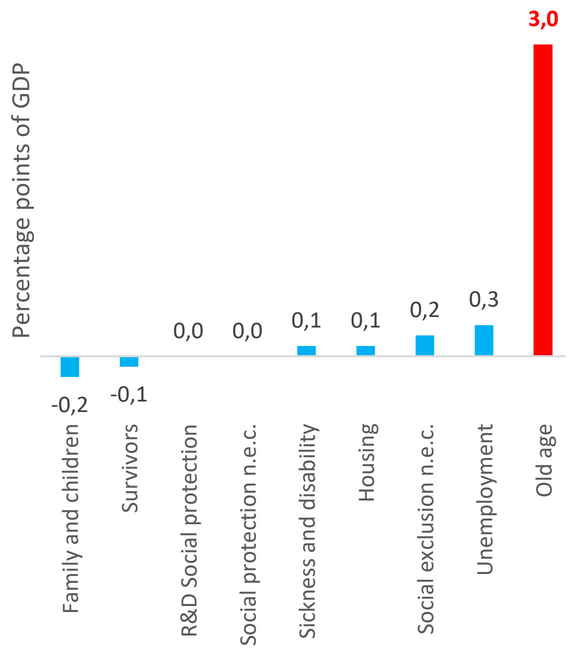


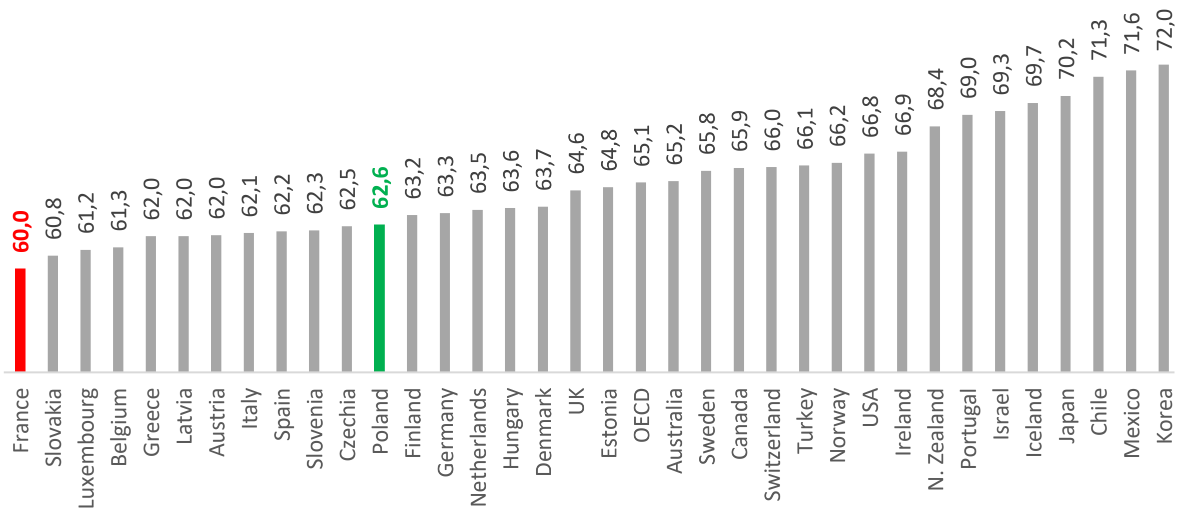
Chart 8: Change in social expenditure in France by category, 1995-2017



Classification of general government expenditure by function (COFOG). "Social protection" is the COFOG category, which includes pension expenditure and all social transfers. The subcategory "geriatrics" refers to pension expenditure alone..
Source: FOR own study based on Eurostat data

The increase in pension spending is due to the fact that France still has an outdated defined-benefit pension scheme and a low retirement age. The increase in pension spending is beneficial for pensioners, but costly for young people who work and pay taxes. The defined-benefit pension system – unlike the new pension system in Poland created by the 1999 reform – does not directly link the amount of benefits to the value of the contributions paid. Therefore, it does not adjust the level of pensions to demographic changes and thus also to the financial capacity of the society. In 2016, the average effective retirement age for men in France was 60 and was the lowest among EU and OECD countries. For comparison, in Poland and Germany, countries that are also struggling with the problem of early retirement, men retired at the average age of about 63 years (Chart 9).

Chart 9: Average effective retirement age of men in OECD countries, 2016

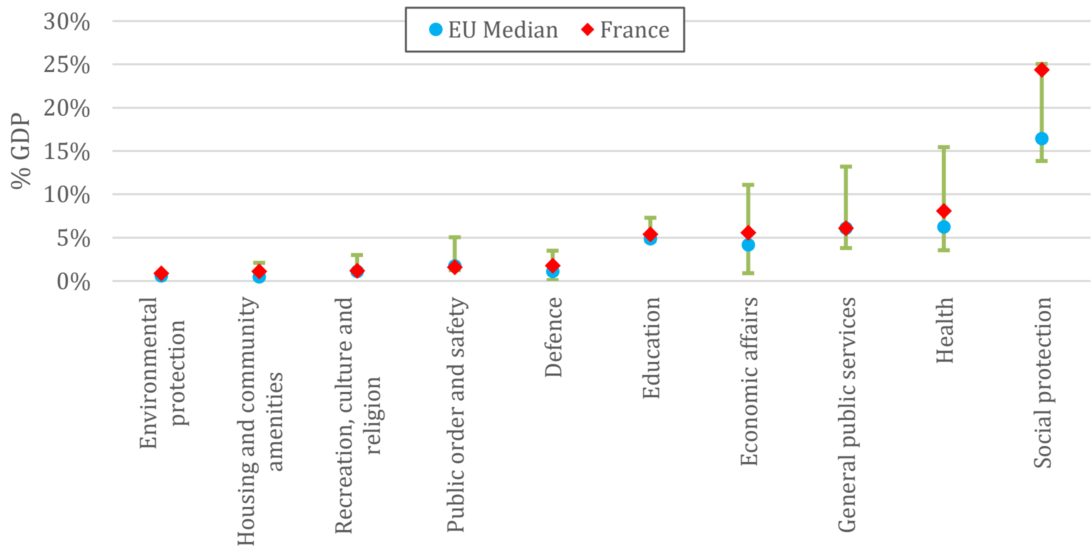


Source: FOR own study based on OECD data

High social spending and high taxes on labour

France has very high social spending as compared to other EU countries. In 2017, France's expenditure on social protection was 8 percentage points higher than the median for the EU countries, and its expenditure on health – by 2 percentage points of GDP. The only category of government spending, which for France is slightly lower than the median, is spending on security and public order (Chart 10).

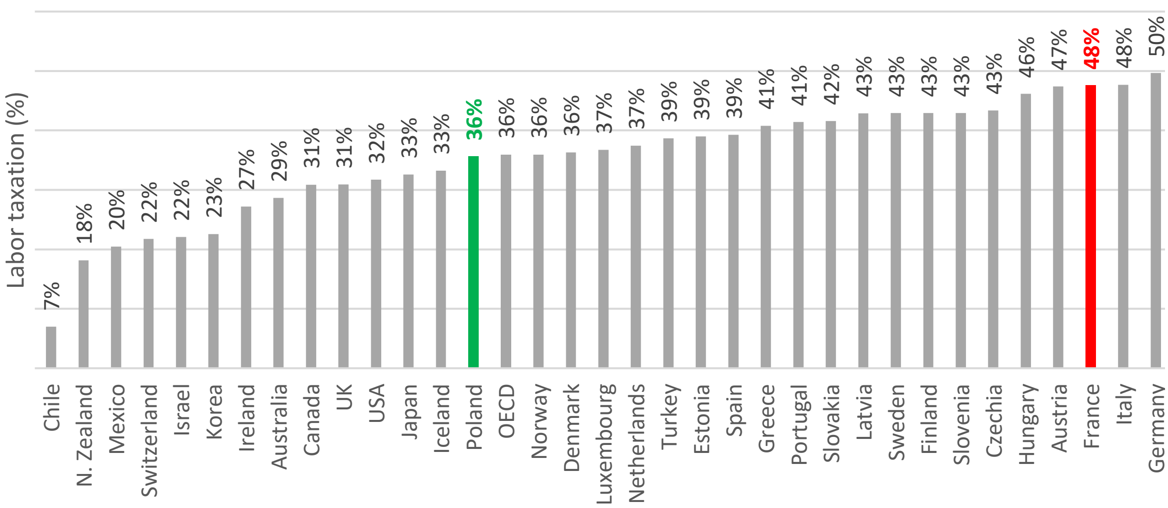
Chart 10: State expenditure by category in France as compared to the lowest, media and highest in the EU, 2016



Classification of general government expenditure by function (COFOG). Social protection is a COFOG category covering pension expenditure and all social transfers.
Source: FOR own study based on data from the European Commission

The need to fund high social spending is reflected in high labour taxation and rising debt. Labour taxation in France is one of the highest in the OECD (Chart 11). High taxes on labour are more harmful to economic growth than taxes on consumption or wealth, as they are usually characterized by high rates forced by a relatively small payer base (Gemmell et al., 2014; European Commission, 2006). Behavioural studies indicate that taxation on labour discourages labour more than other taxes (Kessler and Norton, 2016; Florack, Sheffrin, 2013; Blumkin et al., 2012).

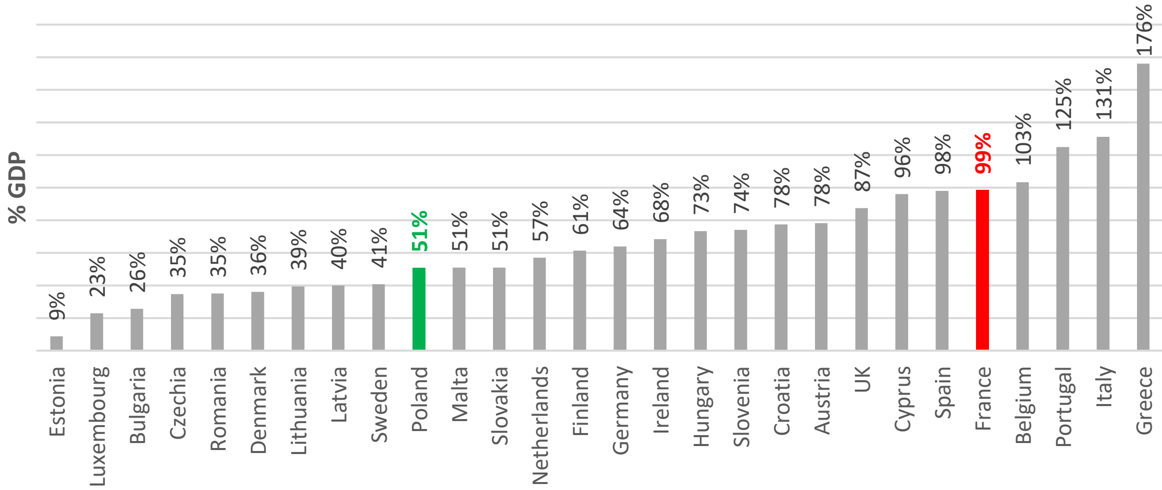
Chart 11: Average tax wedge in OECD countries, 2017



Source: FOR own study based on OECD data

Even very high taxes do not allow for funding high social spending – as a result, France's public debt is one of the highest in the EU. In 2017, French public debt was as much as 99% of GDP, the fifth highest of all 28 Member States (Chart 12). Empirical studies show that high public debt, particularly when it exceeds a certain level, has a negative impact on economic growth. This relationship is of a particularly long-term nature. High public debt leads to an increase in long-term interest rates and restrains the accumulation of capital and the rate of labour productivity growth, hindering economic growth. In turn, the slowdown in economic growth is reflected in a further increase in the volume of public debt in relation to GDP (Kumar, Woo 2010; Baum, Checherita-Westphal, Rother 2010; Masuch, Moshammer, Pierluigi 2016; Mika, Zumer 2017).

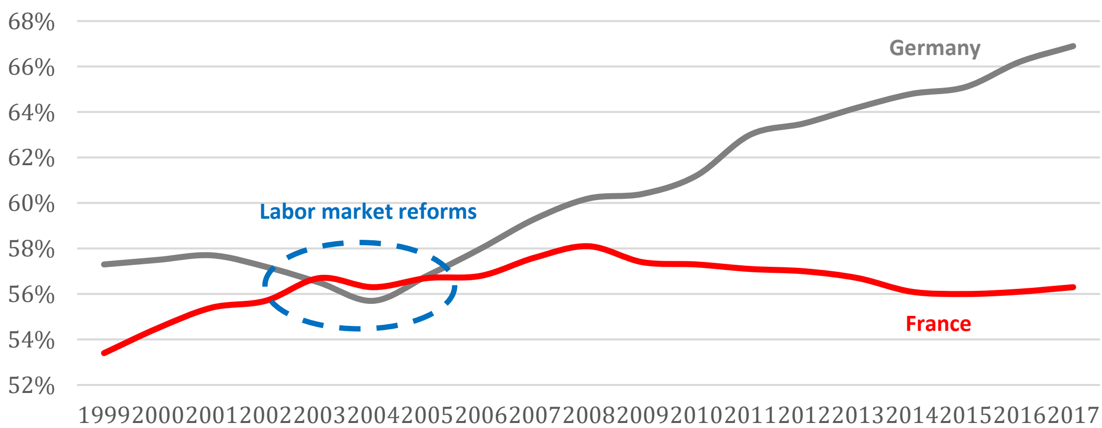
Chart 12: Level of public debt in EU countries, 2017



Source: FOR own study based on EC data

High social spending does not solve the problem of low employment in France, and possibly even contributes to it - that is why labour market reforms are becoming necessary. Only two decades ago Germany suffered from a low employment rate (at 57%), similar to France. However, after labour market reforms, the employment rate started to rise in Germany, while in France, where similar reforms were not carried out, it remained at its current level. As a result of 2017, 56% of 15–74 year olds were still employed in France compared to 67% in Germany (Chart 13).

Chart 13: Employment rate of people aged 15-74



Source: FOR own study based on Eurostat data

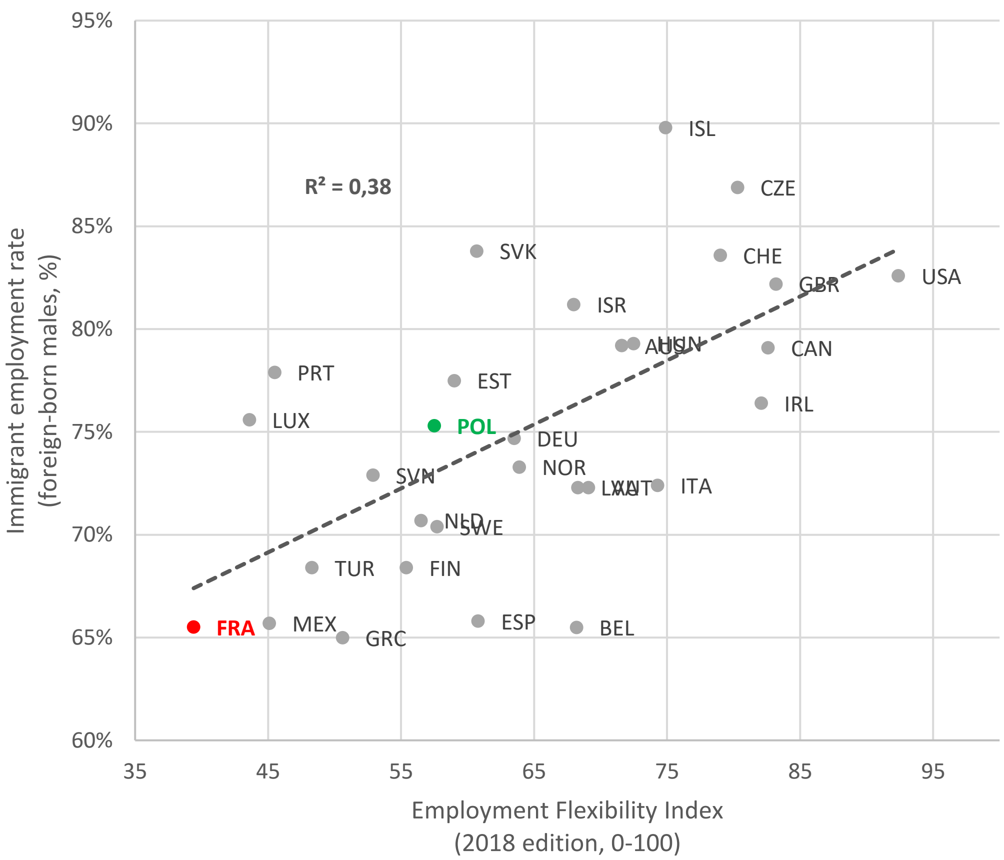
Inflexible labour law results in high youth unemployment. In the case of France, the regulations on employment (including minimum wage) and working time remain a particular problem, but in addition, it is also complicated and costly to lay off employees. As a result, employers are reluctant to create new jobs, and young people are pushed into forms of employment other than employment contracts and into short-term forms of employment. The IMF's annual report (IMF, 2016) describing the economic challenges facing France points to restrictive labour market regulations as a factor limiting youth employment. That is why the IMF is calling for the introduction of reforms that increase flexibility and limit the duality of the French labour market. It also draws attention to the high minimum wage in France, from which there are fewer exceptions for young workers than in the neighbouring EU's countries. Undoubtedly, the high minimum wage is reflected in the low employment of young people (Chart 14).

Chart 14: Youth employment rate (20-29 years) and minimum wage in EU countries, 2017

The World Bank divides the minimum wage by value added per employee, which is defined as the ratio of GNP per capita to the working age population expressed as a percentage of the total population. Denmark and Sweden are excluded as these countries do not have a national minimum wage according to the methodology of the World Bank's Doing Business report, but use similar tools at sectoral level. Greece was also excluded due to its exceptionally severe economic internal devaluation after the euro crisis.
Source: FOR own study based on Eurostat and World Bank data

The inflexibility of French labour market regulations results not only in youth unemployment, but also in the low employment of immigrants. Labour market regulations are usually created with domestic workers in mind, who in developed countries are characterized by very high human capital. However, these regulations often exclude immigrants, especially those from non-European countries. Relatively lower human capital – poorer language skills, less work experience and education, less useful skills – make such immigrants less productive and they earn less on average than domestic workers. It is therefore more difficult for them to find job in the case of high minimum wages or restrictive labour market regulations. As a result, where labour regulations are inflexible and the minimum wage is high, employment rates of immigrants are low. This is what happens in France (Chart 15). The figure shows the employment rate for foreign-born men only, in order to limit the effect of the low employment rate for first-generation women from non-EU countries. The Employment Flexibility Index 2018 takes the inflexibility of labour law and the level of the minimum wage into account (Trzeciakowski, 2017). However, a number of other regulations also contribute to the exclusion of immigrants in France. Firstly, approx. 30% of occupations require French citizenship to take up employment – the highest rate in the EU (Alexynska and Tritah, 2013). Secondly, refugees gain access to the market only after a one-year asylum procedure, which lasts much longer than in most EU countries (Dustmann et al., 2017).

Chart 15: Employment of immigrants and flexibility of labour regulations in OECD countries, 2017



Denmark has been excluded as an outlier observation - it is likely that the Employment Flexibility Index overstates the flexibility of its labour market regulation because it does not include regulation at sectoral level.
Source: FOR own study based on OECD and LFMI data (2017)

Social mobility remains relatively low

The social mobility in France remains relatively low: children's income and occupation are more determined by their parents' income and occupation than in most OECD countries. These are the conclusions of a recent OECD report (2018), which indicates that the intergenerational occupational and economic mobility is low in France (although educational and health mobility remain at a medium level). The often postulated correlation that intergenerational labour mobility is high where income inequalities are low does not exist for France. France, like Germany, Austria and Hungary, is characterized by both low mobility and low inequalities. The OECD also shows that France has a problem of low income mobility of low-income earners (Table 1).

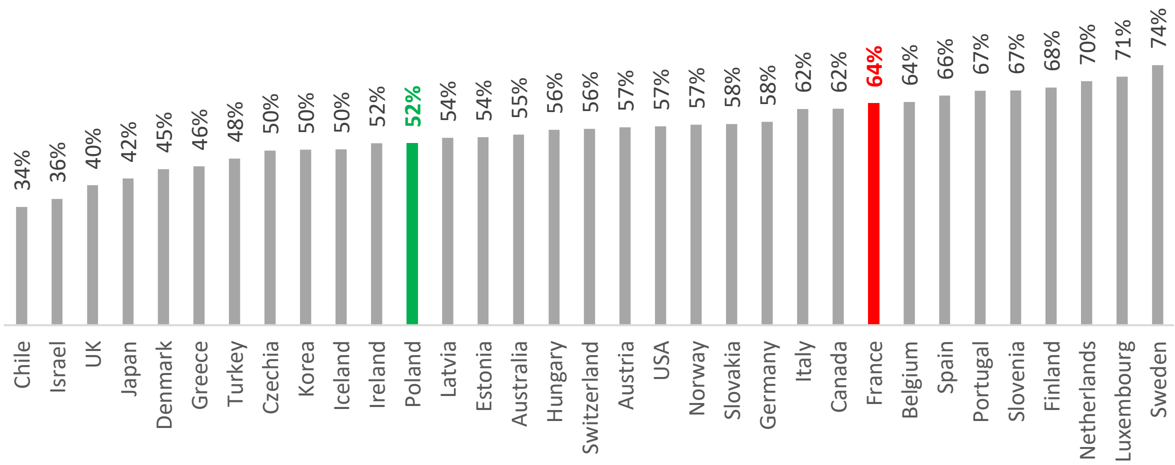
Table 1: Social mobility in OECD countries

Intergenerational occupational mobility		Income mobility among low-income earners	
Low	Australia, Finland, France, Hungary, Italy, Korea, Poland, Portugal, Spain, Italy	Low	Belgium, Finland, France, Italy, Netherlands, Canada, Luxembourg, Portugal, Slovenia, Spain, Sweden
Medium	Belgium, Czech Republic, Ireland, Germany, Slovakia, Slovenia, Switzerland, Sweden	Medium	Australia, Austria, Estonia, Latvia, Mexico, Germany, Norway, Poland, Slovakia, Switzerland, USA, Hungary
High	Denmark, Estonia, Netherlands, Iceland, Israel, Norway, USA, United Kingdom	High	Chile, Czech Republic, Denmark, Greece, Ireland, Iceland, Japan, Korea, Turkey, United Kingdom

OECD evaluation on the basis of available indicators and parameter estimates.
Source: FOR's own elaboration based on OECD (2018)

The mobility of low-income earners can be measured in different ways. OECD (2018) shows the most complete data for the group of 20% of people with the lowest income after 4 years. In France, after that time as many as 64% of low-income earners remained in this group. For comparison, in Poland such persons constituted 52% of low-income earners (Figure 16). The OECD also shows results for seven countries after 6 and 9 years: after this period, France's performance is much better compared to them. However, the OECD assesses the mobility of low-income earners in France as low.

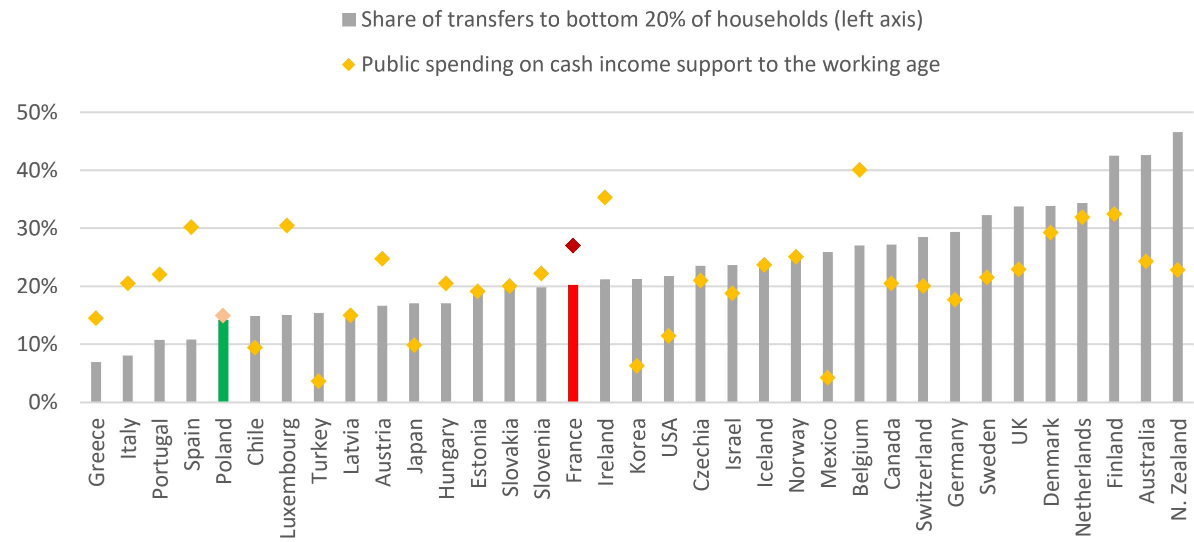
Chart 16: Percentage of people in the lowest income quintile (lower 20%) who remain in this group after 4 years, OECD countries



Source: FOR own study based on OECD data (2018)

In the light of the low mobility of low paid persons in France, the question arises on the extent to which large social spending is well directed. It may happen that a large part of them will go to the richest households instead of the poorest ones. The OECD (2016) reports that in 2013 France spent less than 6% of GDP on money transfers to the working-age population (one of the highest results in the EU). However, only 20% of them were directed to 20% of households with the lowest income (Chart 17).

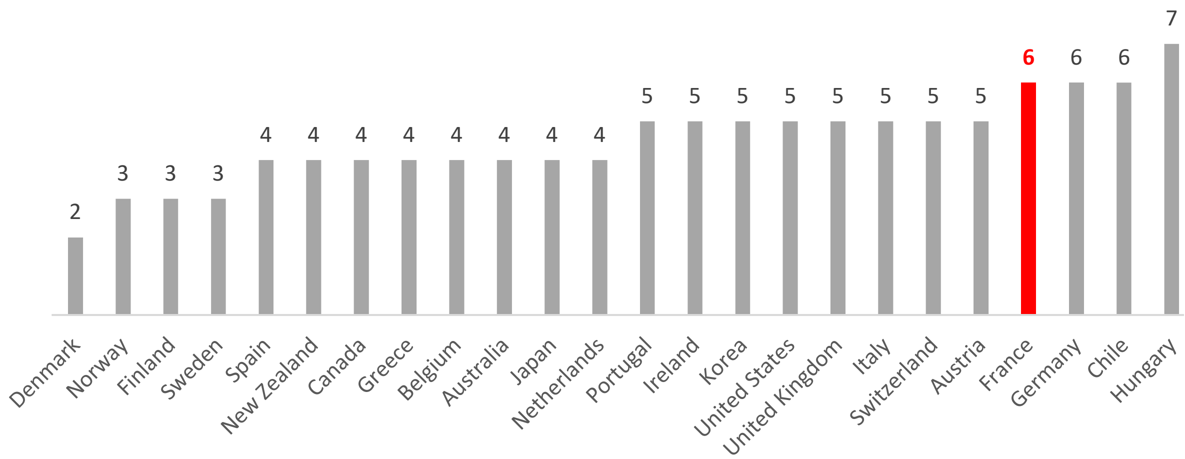
Chart 17: Money transfers to households of working age in OECD countries, 2013



Source: FOR own study based on OECD data (2016) Social Expenditure Update

The French social mobility is also negatively illustrated by the expected number of as many as six generations that the children of parents with the lowest income decile (lower 10%) take to reach the average income level (Chart 18).

Chart 18: Expected number of generations that the children of parents with the lowest income decile (lower 10%) take to reach the average income level, refers to OECD countries



Source: FOR own study based on the OECD simulation (2018)

Conclusion

The current ills France is facing are the result of decades of statism - the state over control (moreover, the term 'etatism' itself has French origins: l'état – state). Contrary to the statements of some commentators, it was interventionism and not liberalism that led to a situation in which people took to the streets. Unfortunately, the protesters put forward proposals to reduce taxes and increase spending, i.e. at the same time reduce and increase the role of the state. This is a simple way to deepen the stagnation of the French economy. This, in turn, will potentially lead to further protests and further populist demands. The only way to deal with this fatal spiral of interventionism is through radical reforms – especially in the areas of public spending, including social spending in particular, and labour market regulation. Otherwise, France – like the "yellow vests" that usually gather on roundabouts – will go round and round.

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Forum Obywatelskiego Rozwoju - Civic Development Forum

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