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The Challenge of Reforming France

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France is an economic success story. It is the sixth largest economy in the world, the fourth biggest exporter of services and the third largest investor abroad. All the main macroeconomic indicators have improved in the past 12 months. 2005 was a year of record profits for the forty leading French corporations. Beyond well known consumer and luxury goods companies like L'Oréal and LVMH, French companies are international leaders in sectors such as nuclear technology (Areva) and communications (Alcatel). Not bad for a country of fewer than 63 million people who do not always enjoy a reputation for hard work.

Nevertheless, there are some worrying economic and social issues. The French welfare system no longer seems sustainable in the face of demographic pressure, mounting debt, and persistent unemployment. The riots in the poorer suburbs of Paris in November 2005 gave some hint of how disenfranchised one growing segment of the population has become. At the same time, even fairly modest reforms, such as the proposed CPE (*Contrat Première Embauche* or First Employment Contract) intended to reduce youth unemployment, provoked massive demonstrations and nationwide strikes. Such measures are often withdrawn or scaled back under pressure. What former Prime Minister Edouard Balladur said about his would-be youth labor law in 1994 could have been said by Prime Minister Dominique de Villepin in April 2006 about his own attempt: "I would like to see an end to the sort of hypocrisy that consists in lamenting youth unemployment while criticizing every single measure we are trying to take." Finding a way to move past this societal blockage will be one of the key issues in the 2007 presidential elections in France.

Two Frances

There are, in fact, "two Frances". Globalization *per se* is not the problem. Many French companies, not just the large ones, have proven adept at making the most of globalization, relying on France's own assets as well as international ones (more than a third of the stock of the largest French companies is held by foreign funds). But there is another France made up of a substantial civil service, a large public enterprise sector—the third largest in the OECD, behind Poland and Turkey—which includes partially privatized utility companies, and numerous service sector professions (including large chunks of the retail sector) that are largely shielded from competition.

This duality is also visible in the labor market. A privileged group enjoys all but permanent positions, but, with the development of short term contracts and part-time work, these jobs are increasingly difficult to get, which leads to a split between insiders and outsiders. Not surprisingly, a very different mindset has developed within the two Frances, generating misunderstanding and resentment. And the result has been poorly employed French resources. According to the IMF, the long term effects of comprehensive reforms in labor and product markets could amount to as much as a 14% increase in GDP.

But it is unemployment that is France's enduring nightmare. In the last 20 years, the country's unemployment rate has consistently been above 8%, hovering around the 10% threshold for nearly half that time. The youth unemployment rate is 22%, which is 3.5% above the EU average. The country's social problems are often linked to these dreadful statistics.

Why is there such a high level of unemployment? Growth has been slow for a long time now and even the dynamic years of the late 1990s could not significantly dent the structural unemployment level. Stringent labor laws have made the labor market very inflexible: companies are reluctant to take on board new employees who could prove difficult to lay-off during a market downturn. The national minimum wage (€8.03 an hour as of July 2005) is too high relative to the productivity level of that segment of workers and a large "tax wedge" (the difference between the net wage received by employees and the gross labor cost to employers) distorts the labor market.

There are also disincentives stemming from the high degree of support for the unemployed in France. Many job openings remain vacant despite the high number of job seekers, a consequence of the lack of mobility (both geographic and occupational) and the mismatch between the skills sought by companies and the ones developed within the university system. Out of fear of losing their benefits and not being able to find another position, many employees stay in a job they do not like, increasing the overall level of frustration and reducing the labor market's ability to adjust to changes in economic opportunities.

The labor participation rate, 2% below the OECD average, is too low to support the benefits and entitlements accumulated over the past few decades. People join the workforce later and retire earlier than is the case in most of France's competitors. And, in addition to the high unemployment level, the number of hours worked (an average of 37 hours per week with 5 weeks paid vacation) is low. Even though, according to the OECD, "productivity levels in terms of output per hour are probably higher in France than in the United States," it is not enough to make up for the small number of hours worked.

A Lack of Consensus

The confidence level of households, despite improving economic indicators, has seldom been so low. The main barriers to moving forward are of a psychological and sociological nature. Indeed, the problem is much less *what* to do—very few of the challenges facing France are new and they are well understood—than *how* to do it.

In the past few months, France has gone through two significant social crises. In November 2005, following the accidental death of 2 young men of African and Arab descent, violent

protests erupted in the suburbs of numerous French cities. In Soviet-style housing estates where youth unemployment hovers around 40%, second and third generation immigrants burned cars and clashed with police for weeks. These riots, sometimes energized by criminal elements, illustrated the widespread sense of disenfranchisement and discrimination in this part of the population.

A few months later, students and workers demonstrated in large number against the new labor law. The CPE would have allowed employers to lay off workers under 26 years old without cause. This amounts to a strong departure from French labor law, which historically has been very protective of employees. French youth, who find it difficult to settle into a “real job”, rejected the principle of being singled out and channeled into jobs that would have, in their view, increased their level of job insecurity. In April, after weeks of protest, the law was eventually withdrawn.

Why this strong French inclination to say *Non*? One reason is that the French rarely shun confrontation. The fact that France is not a consensus-seeking society does have far reaching consequences in the social and labor arenas. French governments are rarely noted for their negotiation skills. (One of the problems with the CPE may have been that it was designed at the top, without the “social actors” being consulted from the outset). Setting unrealistic pre-conditions for negotiation or quitting the negotiating table in the middle of the process are not uncommon with trade unions.

Paradoxically, trade unions assertiveness is inversely proportional to their size. The trade union landscape is highly fragmented between many organizations that compete for what is in reality a small pool of participants: only 8% of French workers belong to a union (5% in the private sector, 15% in the public sector). This figure is less than in most other industrialized countries, including the United States. This situation leads to an exacerbation of tensions and to phenomena such as strikes by proxy and free-riding attitudes by other workers. Also, unions tend to be strong in public utilities where, as the ultimate insiders, they have larger than average entitlements to protect and the available tools to bring the country to a standstill. The so-called *droits acquis* (acquired social rights) have become totems to some of these trade unions.

There are other factors as well. The Malthusian mindset is quite pervasive in France. Rather than seek to enlarge the pie, it is common for people to take its size as a given and spend a huge amount of energy in seeking an equitable way to divide it. In addition, many people distrust the motives of the private sector. Thus, during the CPE crisis many students spontaneously adopted the idea that, if given the right to fire workers without cause during a two-year probation period, companies would systematically exercise it. Overall, an anxiety of downward mobility seems to have gripped the nation: children of immigrants feel they cannot join mainstream France, the youth worry about not being able to reach their parents’ standard of living, and the middle-class resent the possibility of getting stuck there.

The concept of reform has become a French political nightmare. “A feeling of distrust toward any reform”, as the author Jacques Julliard notes, has developed “within lower social groups.”

The Need for a New Deal à la française

The journey toward the currently fashionable Scandinavian *flexsecurity* model, in which workers can be fired at will but benefit from a strong support system during their transition back into the job market, could prove an arduous one. The fundamentals that underpin the social system of these (much smaller) economies—high unionization levels, consensus-seeking societies, absence of extreme social and political actors—do not exist in France.

In addition, the French political system is currently in a weak position to deal with the reform conundrum for two main reasons. The first is the level of activism at the extremes of the political spectrum. In the first round of the 2002 presidential elections, in which no less than 16 candidates competed, nearly a third of the electorate voted for an extremist party (not even counting the Communist Party.) Jean-Marie Le Pen, leader of the far-right *Front National* came in second while Arlette Laguiller of the far-left *Lutte Ouvrière* (the Workers' Struggle) came in fifth. Such a broad spectrum of political opinion is not a good basis for reaching consensus. And because these extremist parties are not represented in parliament (the electoral system favors larger parties), they have turned the street into their favored terrain of expression.

Moreover, representation in parliament would probably not suffice to satisfy their demands. The Fifth Republic is a hybrid between a parliamentary system (the Prime Minister needs the support of a majority in parliament) and a presidential one (the French president is directly elected by the people.) In practice however, parliament has little power. The executive finds itself confronting non-representative trade unions, extremist parties, and all sorts of civil society groups without a parliament that can act as an intermediary or be a genuine source of political ideas. The result is that even when the government enjoys a significant majority in parliament, as is currently the case, it does not hold all the reins of power.

Although the process might include imported elements, France must ultimately design its own way forward. Incremental reforms, such as the healthcare and pensions reforms implemented between 2002 and 2005, are helpful but not sufficient. In some countries, voting in political elections is compulsory: France could introduce the obligation for all workers to vote for a trade union, turning them into more legitimate and constructive partners for the government and probably rationalizing the trade union landscape. France would also benefit from embracing the principles of simplicity and fairness: one job contract instead of many, a simple fiscal system rather than high taxes with too many complicated exemptions, the disappearance of anachronistic entitlements for specific groups – all changes that would take France in the right direction. In other words, merge the two Frances into one. This can only be achieved by putting everything on the table and by broadening the issues rather than keeping them separate in small parts that are difficult to deal with. France needs coherence and a sense of destination, and a fully involved parliament.

Tapping into the energy and goodwill that exists throughout France but is currently wasted is possible. France's high fertility rate, the second highest in Europe, is only one expression of the French people's faith and optimism in the future. Now is the time to demonstrate it in other ways and to reconnect French society with the impressive potential of the French economy.