



## Economic Survey of France, 2000

### Summary

From 1997, France entered a phase of rapid growth. Domestic demand is particularly buoyant, thanks to a virtuous circle of job creation, renewed household confidence and increased disposable income. Business investment has also revived. This recovery is not only due to the improved economic situation but also reflects the beneficial effects of the structural reforms that have been implemented since the start of the 1990s. However, strains are starting to emerge, with some sectors finding it difficult to increase production and to recruit skilled workers. A vigilant economic policy is therefore required now that the economy seems to have caught up. In this connection, the authorities have decided to lower taxes in order to reduce the obstacles to more rapid growth of production potential. However, in the short term these tax cuts will stimulate demand. During this rising phase of the cycle, in order to continue to reduce taxes it will be necessary to step up efforts to bring public expenditure under tighter control so as to prevent inflationary pressures and to return rapidly to a balanced general government budget. Prudence and pragmatism are also called for in reducing working time and setting the minimum wage so as not to push up production costs and not to hamper job creation. The return of growth also opens up an opportunity to speed up the pace of structural reforms. In this connection, it is important that the reform of the pension system and health sector move forward rapidly, given the imminent demographic shock. This should go hand in hand with continuing reforms to create a better entrepreneurial climate and to promote business creation. The deepening of structural reforms will enable France to continue to grow on a sustainable basis, to create jobs and to combat social exclusion more effectively. ■

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*This Policy Brief presents the assessment and recommendations of the 2000 OECD Economic Survey of France. The Economic and Development Review Committee, which is made up of the 29 Member countries and the European Commission, reviewed this Survey. The starting point for the Survey is a draft prepared by the Economics Department which is then modified following the Committee's discussions, and issued under the responsibility of the Committee.*

## How solid is the recovery?

France has not enjoyed such a favourable economic situation for ten years. After performing poorly during 1990-96, the French economy benefited from rapidly growing activity, low inflation and growth that was richer in jobs, and entered the new millennium with an effervescent stock market and favourable prospects. After a temporary pause in the wake of the Asian and Russian crises, activity picked up again, and the outturn for 1999 as a whole exceeded most forecasts, with real GDP growing by 2.9 per cent. Job creation in the private sector revived from 1997, putting an end to years of deterioration in the labour market. This recovery did not trigger off a resurgence of inflation, which remained below 1½ per cent, not only because spare production capacity was available but also because the greater degree of competition curbed price increases. As in most other OECD countries, companies specialised in the new information and communication technologies have started to expand. Admittedly, it is a sector that is still small, but it is growing at an exceptionally rapid rate.

The buoyancy of the French economy was aided by a favourable international environment. Like other euro area countries, France benefited from the strong recovery of world trade. Exports grew at an annual rate of over 10 per cent in the second half of the year, especially those to North America and Asia. In addition, like the rest of the euro area, the French economy profited from the accommodating policy conducted by the European Central Bank during 1999. The rise in long-term interest rates in line with the revival of activity does not seem to

have reduced the demand for credit significantly. Also, the depreciation of the euro against the US dollar and the yen has reinforced the competitiveness of French firms on world markets and facilitated exports outside the euro area.

In this context, the combination of job creation, a revival of households' confidence and rising disposable income boosted domestic demand, which became the main engine of growth. Consumption thus remained on a strong growth path even during the difficult winter period of 1998-99. The emergence of new services in information and communications technologies, the opportunities offered by the opening up of the telephone market, and the fall in consumer electronics prices were an additional stimulus. Historically low interest rates and tax breaks for investing in new housing and in the renovation of existing buildings encouraged households to invest in property. The construction sector thus had one of its best years in recent history. Business investment accelerated strongly as firms started to approach their maximum production capacity in some sectors, including the automobile sector.

The recovery under way is not explainable solely by the improved economic climate but also by a gradual return to more balanced growth. The pick-up in demand reveals the scale of the progress made on structural reform in the 1990s. Starting from a situation of high unemployment, the French economy has especially benefited from growth, which has been much richer in jobs. This stems from continuing wage moderation, the policies of cutting social contributions for unskilled workers, and the development of more flexible contracts of employment. At the same time, the French economy has also reaped the microeconomic benefits

of the reforms of labour and capital markets, in particular at the European level. Complementing the creation of the single market, the introduction of the euro has helped to make the financial system more efficient and to enhance the ability of the French economy to withstand turbulence arising from its external environment. Increasing competition, especially in network industries, and the withdrawal of the State from purely commercial activities have also helped to improve the economy's productive efficiency. These favourable developments have not yet translated into an acceleration of total factor productivity. The deepening and strengthening of structural reforms therefore remain important objectives. ■

## What is the outlook?

The conditions seem to be in place for robust output growth in 2000 of about 3½ per cent. Growth is set to continue to be pulled strongly by household demand but also by business investment. Exports should also grow briskly on account of the buoyancy of foreign trade and continuing competitiveness of French products abroad. This phase of rapid growth of activity should be accompanied by the creation of about 450 000 jobs in the private sector, and by additional "emplois jeunes" in the public sector, which could approach the 50 000 mark. Consequently, unemployment should decline below 10 per cent and then continue to fall. These trends are set to continue in 2001, though at a slightly slower rate, as world trade loses momentum, especially imports from North America, and as the ECB tightens monetary policy. Real GDP growth could nevertheless approach 3 per cent and the unemployment rate could fall below 9 per cent by

the end of the year. This phase of rapid growth is likely to be accompanied by a rise in inflation, with the increase in consumer prices projected to slightly exceed 1½ per cent on a year-on-year basis by the end of 2001, mainly due to a rise in unit labour costs.

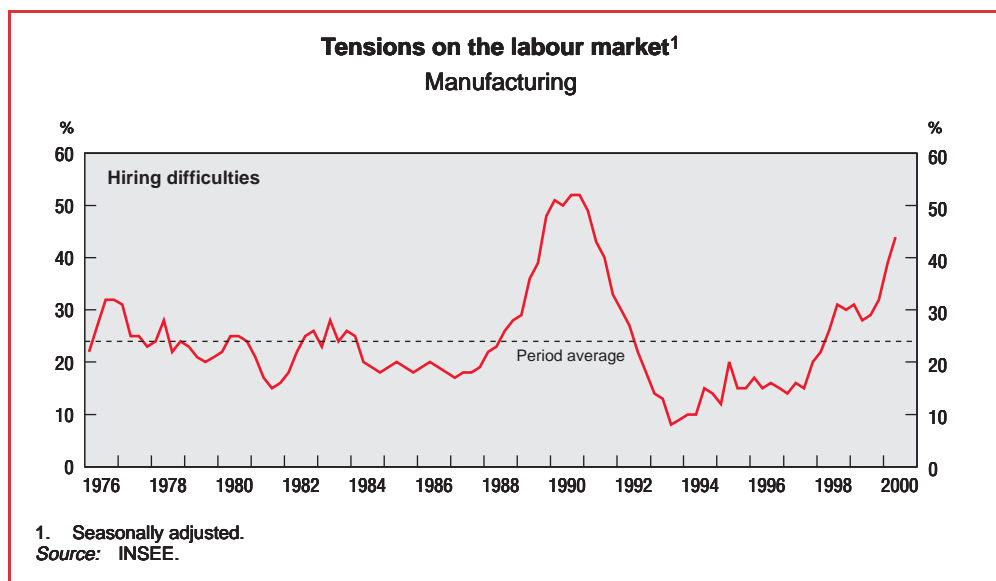
If this projection is confirmed, France will enter its fifth year of growth in 2001, with average annual real GDP growth of 3 per cent since 1997. Experience shows that, at this stage of the cycle, the French economy could be affected by over-heating. The period 1987-90, which had seen strong growth of 3½ per cent per year, ended with production capacity over-stretched, hiring difficulties, wage drift and a property market bubble. Admittedly, as noted below, favourable structural changes have taken place in the past ten years. Nonetheless, the two periods show certain similarities. In particular, it cannot be ruled out that the output gaps and deviations from the NAIRU (non-accelerating inflation rate of unemployment) are comparable. For the first time since the 1980s, company managers are starting to report difficulties in increasing production, a sharp increase in capacity utilisation ratios and problems finding workers. However, these indicators have not reached their historic highs and for the moment the strains are limited to a few sectors and to a few categories of wage-earners, but they could become more accentuated and spread in the near future. In this context, the key question for the authorities is how to avoid the pitfalls encountered in the previous cycle. The answer lies, on the one hand, in further fiscal consolidation and, on the other, in a supply side policy to expand production capacity. ■

## What about fiscal policy?

With monetary policy now being set for the euro area as a whole, the only instrument, which the French authorities have at their disposal to influence domestic demand, is the budget. The authorities have been pursuing a prudent fiscal policy for several years, reducing the general government deficit gradually without bearing down on domestic demand. After the sharp reduction in the deficit in 1999, they decided to concentrate on cutting taxes while continuing to reduce the deficit but at a less rapid rate. The government has thus announced tax cuts of FF 170 billion by 2002 (about 1 per cent of GDP) with a view to boosting the supply potential of the economy. As the structural deficit is still not quite within the safety zone that would ensure that public finances were safe from a sharp economic downturn, fiscal consolidation should be continued in parallel with the tax cuts. A policy to restore budget balance rapidly would also help to avoid the emergence of possible inflationary pressures. Accordingly, fiscal consolidation and tax cuts require that efforts to bring public spending under tighter control be continued and stepped up. Similarly, if general government revenue is more buoyant than expected, the additional revenue should be used to cut the budget deficit, rather than increase expenditure, as the authorities have already announced for 2000. Finally, tax cuts would be more effective if they were announced as part of a multi-year programme of tax reform. ■

## And the implementation of the reduction in working time?

The reduction in working hours could also increase the risks of cyclical strains. The new law provides for a reduction in the statutory working week from 39 to 35 hours. Under the new framework, hours worked beyond 35 hours have to be considered as overtime. It comprises state assistance to limit the rise in production costs automatically produced by the reduction in working time. The results of the first agreements covering a third of the employees concerned suggest that state assistance combined with productivity gains and wage restraint seem to have prevented wage costs from rising. They also suggest that the transition to the 35-hour week is often accompanied by work reorganisation, in particular by greater recourse to annualised working time and an increase in the length of plant utilisation time. In addition, in those firms that have switched to the 35-hour week, wage moderation should prevail since the indexation mechanism guaranteeing the monthly remuneration of workers on the SMIC rises less rapidly than the hourly wage. This being so, the government projects that the net number of jobs created as a result of the reduction in working time should amount to 150 000 over the period 2000-01. This estimate is largely based on the first Aubry law. It cannot be easily extrapolated because the second Aubry law has no specific requirements regarding job creation. If this official projection materialised, net job creation could have a slightly expansionary effect on income and prices despite wage moderation and the elements of flexibility in the agreements that have already been signed.



Eventually, however, the reduction in working time could push up production costs and damage the competitiveness of firms if it is not implemented with sufficient flexibility. Several risks can be identified. Productivity gains may be difficult to achieve in small firms since they are often too small to adopt a new work organisation. Also, during a cyclical upswing, firms could be hampered by the new restrictions on the quota of overtime. Lastly, the acceleration of the hourly wage produced automatically by the introduction of the 35-hour week is likely to have a negative impact on firms that have not reduced the working time. These firms will have to increase the hourly minimum wage, which is indexed to the average hourly wage rate. However, they will not benefit from the wage moderation, productivity gains, or lower social security contribution linked to the 35 hours. It is thus important that the hikes in the hourly minimum wage be as moderate as possible in order not to push up labour costs, especially for low-skilled workers. In addition, the new overtime arrangements should be applied flexibly. Lastly, the applica-

tion of the 35-hour week to SMEs in 2002 should be very flexible.

The authorities hope that the government subsidies for the 35 hours will be self-financed, thanks to the expected favourable impact of the reduced working time on employment, and therefore on social security contributions and unemployment benefits. Similarly, in the long term, a lower unemployment rate benefits the public finances. As mentioned above, however, such a favourable impact is uncertain. It is particularly important that the reduction in working time does not exacerbate the financing difficulties of the pension system, especially if it leads to a reduced labour supply and social security contributions. ■

### Which structural reforms are necessary?

The aforementioned risks could also be averted by continuing a policy to raise the economy's growth potential. Irrespective of the method of calculation used, the potential growth rate seems unlikely to exceed 2¼-2½ per cent per year on a sustainable basis in

the near future, and probably even less in the long term, given the projected decline in the labour force. As the experience of some countries shows, not only in North America but also in Europe, structural reforms can help raise potential growth, notably by promoting the supply of skilled labour, the expansion of the capital stock and total factor productivity. Priority areas for such reforms in France are: improving the working of the labour market, combating inactivity traps, taxation, and the entrepreneurial climate.

With the disappearance of cyclical unemployment in the near future, the main priority is still to reduce structural unemployment. The experience of some European countries (like the Netherlands) shows that structural unemployment can be reduced drastically on a lasting basis. In France, progress has been made since the early 1990s towards this goal, with the policy of reducing employers' social security contributions on low wages, a more flexible labour market and moderate wage increases. Measures to reduce the labour costs implemented by the central and local governments are,

however, costly from the budgetary point of view and, consequently, they have probably gone as far as they can. Labour market flexibility has increased as a result of the growth of new types of contractual relationships (temporary work, fixed-term contracts, part-time work). Impediments to a better functioning labour market still exist however, in particular an ill-adapted vocational system and financial and tax disincentives to work (see below). For this reason, the progress made towards a more flexible labour market and work organisation in firms should be continued.

Strong, sustainable growth also calls for an increased labour supply. The unemployment rate among the working-age population is high, especially among the young, over-fifty year-olds and those on the fringes of society. The situation regarding young people is starting to improve thanks to the recovery of employment. The average length of studies is starting to fall, with some young people deciding to get a job instead of accumulating qualifications. Nevertheless, those who quit the schooling system very early without any qualification are likely to miss out on the recovery. For them, the existing vocational training system seems ill-adapted since it is primarily tailored to those who already have a job rather than to those who need to learn a job. For adults on the fringes of the labour market, the supply of labour may be discouraged, especially for part-time jobs, by the fact that basic income support and tax exemptions are badly co-ordinated. This creates “inactivity” and “poverty” traps. The authorities have recently taken measures to remedy this and others are under consideration. Several other possibilities also deserve to be explored. Income support benefits

could continue to be paid for some time after the resumption of a professional activity in order to ease the transition. They could also be made more conditional on accepting a job or training. In any case, a reform of income support benefits seems required to make them easier to use and more transparent. Lastly, reform of certain taxes would help to encourage the excluded to return to the labour market. ■

### Should the tax burden be lightened?

The tax system may also penalise people on middle or high incomes. Income tax is paid by only half of the total number of families, and thus at high rates. The average rate of income tax and social contributions (including tax/social contributions and employers' social security contributions) for a childless single person earning the average wage is 48 per cent. For an executive earning three times the average wage, the average rate is 58 per cent. Mobile taxpayers have to pay other taxes such as wealth tax and taxes on capital gains and stock options. These high average rates of taxes and contributions may encourage very productive and innovative people, who are often also very mobile, to move to other countries. A fresh approach to tax may thus be needed, one which, while recognising the need to maintain progressive taxation, neither encourages inactivity nor the departure of productive and innovative people. It could consist, as in several OECD countries, in a medium-term fiscal strategy offering lower average and marginal income tax rates, in exchange for a widening of the tax base, i.e. the elimination of income deductions and tax reliefs. ■

### How can the business climate be improved?

For the moment, growth is rich in jobs but still fairly poor in business creation. The number of start-ups has fallen steadily since 1994 and, despite a slight recovery in 1999, the current level is still below that in the mid-1990s. To a large extent, this reflects the regulatory environment. The authorities have recently decided to simplify the administrative procedures of business registration, but other impediments still prevail, especially the fact that several markets are closed to competition. As shown by the successful examples of the telephone and Internet access markets, increased competition can encourage business creation and have beneficial effects on employment. However, the transposition into French law of the European directive on the opening of the electricity market has been done belatedly, and then the opening-up has been a minima. The same is likely to happen for natural gas and probably rail transport and postal services – three sectors covered by European directives – the opening-up of which also seems likely to proceed gradually. The approach adopted in the telecommunications sector could be extended to public enterprises in these sectors so as to give them the margin of manoeuvre they need to remain competitive in a more competitive market.

A new approach to relations between government and business is also important for improving the entrepreneurial climate. Thus, SMEs still have to deal with several departments when paying taxes and social insurance contributions. In this connection, the authorities aim to modernise tax collection, and in particular eventually to create a one-stop shop for tax formalities. It is important that

the discussions with the personnel concerned be continued with a view to achieving this modernisation. The authorities recognise that the administration needs to be modernised so that it supports rather than impedes economic growth. For example, the “performance contracts” which were experimented by the Budget Directorate of the Ministry of Economy, Finance and Industry could be a useful model for defining the objectives of government departments and the budgetary resources required, while introducing monitoring indicators. This new approach could be extended to other departments. Greater transparency of public finance is also needed to facilitate dialogue between the administration and the public. Progress has been made but efforts should continue to make data even more transparent. The complete presentation of public finance statistics on an accruals basis would be an important step in this direction. ■

## Should pensions be reformed?

More generally, it is by bringing public expenditure under tighter control that the tax burden on the economy can be lightened. The efforts to rein in public spending should be continued and stepped up. In the short term, the 2000 budget provides for a freeze on real public spending which will require resources to be reallocated to offset the increases in public spending decided for education and hospitals. In the medium term, the authorities have shown a certain degree of moderation in their multi-year public finance programme, as they have done for several years. These positive orientations would be more effective if the manner in which expenditure will actually be controlled were spelt out in detail.

As civil servants represent 25 per cent of the total number of jobs (more than in most other OECD countries) human resource management is a particularly important dimension of fiscal policy. With nearly half of all civil servants retiring in the next ten years the evolution of the number of public employees could mirror more closely the reduction in the labour force. Accordingly, it seems timely to continue the policy of freezing public sector jobs. Furthermore, pensions and health care reform are prerequisites for controlling public expenditure in the medium and long term.

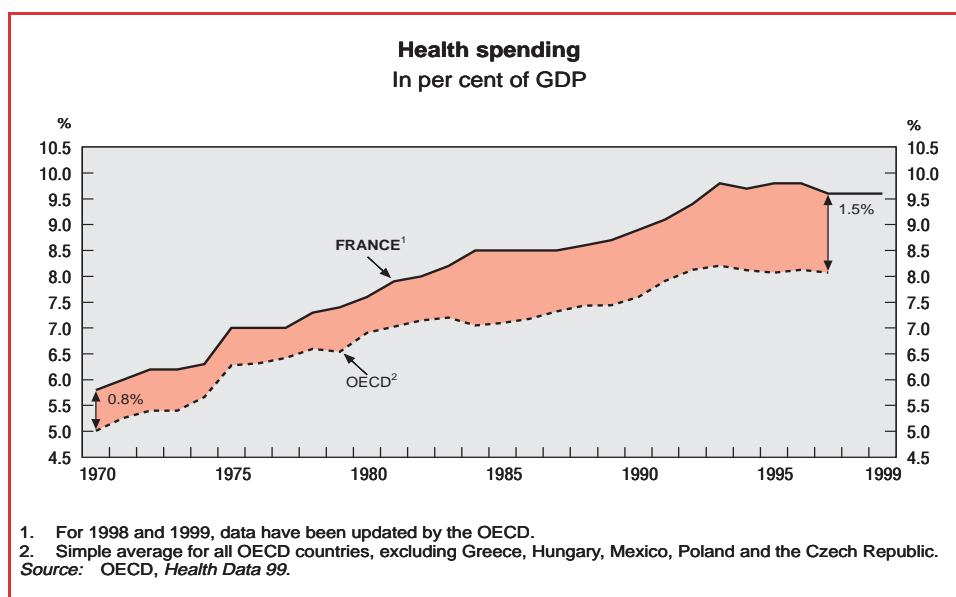
As in other OECD countries, a demographic shock is looming, as large groups of workers born during the baby boom retire. According to a report by a commission of experts (the Charpin Report), pension schemes will be in balance during the period 2000-05, slightly in deficit until 2020, and heavily in deficit between 2020 and 2040, when the additional financing required could reach 5 per cent of GDP per year. As pension reforms operate with long lags, action needs to be taken rapidly. A first reform package introduced in 1993 has improved the prospects of the private sector pension system. The authorities recently proposed opening further discussions on the reform of all pensions. Greater equity between the various pension schemes, in particular between public and private sector pensions, should be the first aim of this reform. The latter should also aim to restore the long-term sustainability of pension schemes and to permit the introduction of funded pension arrangements or employee saving schemes. It would also be desirable that they encompass actuarially neutral methods of calculation which would make it possible to choose the retirement age and at the same time encourage those who wish

to go on working to do so. Lastly, the forthcoming negotiations should consider ways of curbing the number of early retirements, which are costly and deprive the economy of experienced workers. International experience shows that pension reform can take many forms, that solutions are often found by combining various approaches, and that none should be ruled out in advance. ■

## And healthcare?

The ageing of populations that have been accustomed to large amounts of health care spending is also likely to cause health expenditure to soar. The French health system delivers good-quality medical care, it offers wide freedom of choice and generally there are no waiting lists for treatment. However, it is expensive compared with the health systems in most other OECD countries. As the special chapter in the new *Survey* points out, France spends nearly 10 per cent of its GDP on health, which makes it one of the countries that spends the most on health, preceded only by the United States, Germany and Switzerland who spend more. On average, each dependent worker devotes 20 per cent of his or her gross income to financing the health system, mainly via social security contributions and premiums paid to *mutuelles* (mutual insurance companies) and private insurers. After Japan, France is the biggest consumer of drugs per capita in the OECD countries. Hence, the rapidly rising growth of health care consumption has led to recurrent deficits on the health insurance funds.

The authorities have implemented a series of reforms of the health care system in the past twenty years. These reforms have generated savings but have not produced lasting



changes in the microeconomic behaviour. In particular, spending on ambulatory care (doctors and drugs) has not been curbed. Public hospital staff have been unhappy about the budget squeeze and the authorities have decided to increase funding to hospitals. Reform of the health sector should thus be continued.

A new approach to consumption and prescription behaviour is desirable. Experience shows that too extensive health cover can lead to over-consumption by patients and over-prescription by health professionals. The French system, which, via supplementary insurance schemes and universal health insurance, refunds treatment generously, encourages such behaviour. Basic and supplementary insurers could usefully engage in discussions with a view to drawing up timely solutions for financing health care, to redefining cover appropriately, and to striking a better balance between prevention and curative care. These discussions could also encompass the definition of a basket of reimbursable medical goods and care such as exists in

other OECD countries. Pending the outcome of such discussions, a strengthening of the existing “gatekeeper” system could lead to a better control over ambulatory expenditure. For instance, access to certain categories of specialists, for which excessive expenditures have been noticed, could be made subject to the filtering by a general practitioner.

Reform of the hospital sector is more complex than that of the ambulatory sector since it is not only necessary to reintroduce the notion of “price” but also to reform institutions which operate largely on the basis of budget allocations, which are essentially renewed automatically every year. Eventually, these could be replaced by a system in which the best possible hospital care would be bought by regional hospitalisation agencies (ARH) at the lowest cost. The ARH would represent the insured, buying medical care on their behalf as cheaply as possible, while ensuring that it is of the best possible quality and delivered in optimal conditions of safety. Hospital care could be paid

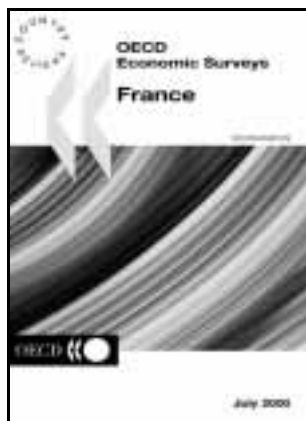
for on the basis of diagnostic-related groups, after appropriate adjustments. A new type of governance is also needed in the decision-making structures of hospitals to ensure that budgets are used efficiently. Hospital boards should thus be made more accountable for their decisions. The legal status of hospitals could be modified to give them more freedom in the management of their human and financial resources. Lastly, more weight should be given to public health policy and to prevention and screening in particular. These measures would help to make the various actors in the system more accountable and to bring about a lasting change in the trend of health care expenditure while preserving the main strengths of the French system – quality of care, freedom of choice and equity of access. ■

## For further information

More information about the Study can be obtained from Patrick Lenain (e-mail: [patrick.lenain@oecd.org](mailto:patrick.lenain@oecd.org), telephone: (33-1) 45.24.88.07). ■

## For further reading

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- **Economic Outlook No. 67,** June 2000.  
A preliminary edition is published on the OECD Web site approximately one month prior to the publication of the book: [www.oecd.org/eco/out/Eo.htm](http://www.oecd.org/eco/out/Eo.htm).

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Public Affairs and Communications Directorate.  
They are published under the responsibility of the Secretary-General.

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