CEPR
CENTER FOR ECONOMIC AND POLICY RESEARCH

The French Economy, European Authorities, and the IMF: "Structural Reform" or Increasing Employment?

By Mark Weisbrot, Lara Merling, Alexander Main, and David Rosnick*

April 2017

Center for Economic and Policy Research
1611 Connecticut Ave. NW
Suite 400
Washington, DC 20009

tel: 202-293-5380
fax: 202-588-1356
http://cepr.net

* Mark Weisbrot is the Co-Director and an Economist at the Center for Economic and Policy Research (CEPR) in Washington, DC. Lara Merling is a Research Assistant, Alexander Main is Senior Associate for International Policy, and David Rosnick is an Economist at CEPR.

Contents

Executive Summary....2
Introduction....5
Fiscal Policy, the Public Debt, and the European Authorities....9
The Eurozone....10
Structural Adjustment and Reforms....13
Conclusion....17
References....19
Appendix....22

Acknowledgements

The authors thank Dean Baker for helpful comments, Jake Johnston for research assistance, and Rebecca Watts and Dan Beeton for editorial assistance.

Executive Summary

This paper looks at two competing views among economists and other observers, of how the French economy can overcome mass unemployment and have a more robust recovery. One view sees the unemployment and economic stagnation of the past decade as overwhelmingly structural. This appears to be the view of the current French government as well as the predominant view of the European authorities, which include the European Central Bank, the European Commission, and the International Monetary Fund (IMF).

In this view, the most important reforms are those that would encourage employers to increase hiring, mostly by lowering unit labor costs. These include moving unions from industry-wide collective bargaining to negotiating at the company level, thereby lowering their bargaining power; reducing unemployment insurance benefits and tightening eligibility; reducing payroll and other taxes; means-testing social benefits; and making it easier for employers to dismiss employees. This view also sees the public debt as a serious problem that must be reduced by cutting spending, and sees the state sector overall as too big.

An alternative narrative, mostly from the Left but with some elements adopted by the far Right, sees the most immediate problem as one of inadequate demand in the economy. In this view, unions are already too weak (e.g., as compared with Germany), and in any case it is not labor costs that are responsible for the slow pace of job growth. Employment and growth can be jump-started with the proper macroeconomic policies, especially with inflation running at just 0.35 percent, and real public borrowing costs near zero. In this narrative, the euro and the European authorities have been a huge part of the problem, due to European agreements restricting fiscal policy, the lack of sovereign control over monetary and exchange rate policy, and a number of policy errors committed or pushed by European authorities. Advocates of this narrative do not necessarily support leaving the euro, with many arguing that France could, under the proper government, fight to change eurozone and European policy to accommodate a more robust recovery.

Among the highlights of points relevant to these competing views:

- At the end of 2016, Gross Domestic Product (GDP) per capita in France was almost unchanged from a decade earlier, representing an entire lost decade in terms of the potential for increasing average living standards. Unemployment averaged 9.1 percent over the decade, and remains at 9.9 percent as of the fourth quarter of 2016.

- This substantial decline in employment since 2008 is not easily explainable by the "structural" problems singled out by advocates of neoliberal reforms. For example, it is difficult to point to any major changes in the structure of labor market institutions over the past decade, such as disincentives to work, that would explain this fall-off in employment. If anything, reforms have moved in the opposite direction.

- Interest payments on the French public debt are estimated at 1.7 percent of GDP for 2017. This is a very modest debt burden by historical or international comparisons. During the 1990s in the US, for example, the interest burden on the debt exceeded 3 percent. The government can currently borrow, for 10-year bonds, at approximately zero real (inflation adjusted) interest rates.

- In the face of mass unemployment and sluggish growth, and below-target inflation, it seems reasonable for a government to take advantage of zero real interest rates to finance investment — including public investment — that can yield substantial positive returns. This includes investment in renewable energy infrastructure, as part of France's commitment to reducing greenhouse gas emissions.

- IMF projections show the French budget deficit hitting the target of 3 percent of GDP this year, as required by the Maastricht Treaty. However, the Fund projects, and recommends, continued fiscal tightening through 2021.

- The spending cuts that the government of France has agreed to for the next few years would preclude a role for the government in reducing mass unemployment. The government appears to have committed to having no real (inflation-adjusted) increase in overall spending for at least the next three years. This could pose problems for a number of reasons, including population growth or aging, or even the investments in education or training that the IMF says it favors in order to enhance global competitiveness.

- A close examination of the process that led to Europe's unnecessary second recession shows the European authorities repeatedly going to the brink of financial meltdown, apparently in order to force the more vulnerable countries (including Greece, Italy, Spain, and Portugal) to accept various unpopular economic reforms that are part of the above program. These confrontations and resultant financial crises were a major contributor to the eurozone's interrupted recovery, double-dip recession, and lost decade.

These unpopular reforms generally represent an elite consensus between finance ministries (or governments) and the predominant forces among the European authorities. Many have been implemented in the eurozone countries, including France, since the 2008 crisis. In the last two years, the French government has advanced three major labor reforms with the stated goal of revitalizing the French labor market and reducing unemployment.

The Macron Law, despite its prominence in the reform agenda, is projected to have only a miniscule impact on the growth of the French economy. The OECD evaluated five sets of measures in the law, and estimated that these would increase GDP by 0.4 percent over 10 years (not annually, but over the whole decade). This means that in 2025 (10 years after the law passed), France would have a real GDP in August that they would otherwise have to wait until approximately December to achieve.

In addition to fiscal consolidation and labor market reforms, the French pension system has recently undergone two reforms, in 2010 and 2014, that raised the retirement age, and the amount as well as the number of years of required contributions. The 2010 reform raised the retirement age by two years; for full pension benefits this was an increase from age 65 to 67.

This reform hit workers who were close to retirement. A worker born in 1955 who was expecting to retire in 2020 would have to wait two additional years; if retiring earlier, they would have to take a substantial cut in retirement income. Normally, such changes are given a much longer phase-in time. In the US, for example, the retirement age for full benefits was also raised from 65 to 67 in 1983; but the first workers who would have to wait until 67 would not be retiring for 44 years. To cut the retirement benefits of someone who is so close to retirement is tantamount to a breach of contract, since they paid taxes into the system for almost all of their working life, expecting a certain benefit. Furthermore, it is a regressive cut, because the public pension comprises a larger share of the retirement income of poor and blue-collar workers than of upper income groups.

It is difficult to argue that any of these cuts to the pension system were necessary. In 2009, projections for the next 60 years showed that at the end of the period, pension spending would be higher by just 1 percent of GDP. Compared to the expected more than doubling of GDP over the next 60 years, it is difficult to see this as a burden on future generations.

Introduction

At the end of 2016, Gross Domestic Product (GDP) per capita in France was almost unchanged from 10 years earlier, representing an entire lost decade in terms of the potential for increasing average living standards.[1] Perhaps even more importantly, unemployment averaged 9.1 percent over the decade, and remained at 9.9 percent as of the fourth quarter of 2016.[2] IMF projections for the future show only weak growth and that "[t]he unemployment rate is projected to decline only very slowly" in the medium term.[3]

There are competing economic narratives as to what is wrong with the French economy, and how to fix it. There is an elite consensus that the present sluggish growth and high unemployment are overwhelmingly "structural." In this view, the most important reforms are those that would encourage employers to increase hiring, mostly by lowering unit labor costs. These include moving unions from industry-wide (or "branch") collective bargaining to negotiating at the company level, thereby lowering their bargaining power; reducing unemployment insurance benefits as well as tightening eligibility; and reducing payroll and other taxes. This view also sees the public debt as a serious problem that must be reduced by cutting government spending; and sees the state sector overall as too big.

An alternative narrative, mostly from the Left, but with some elements adopted by the far Right, sees the most immediate problem as one of inadequate demand in the economy. In this view, unions are already too weak (e.g., as compared with Germany), and in any case it is not labor costs that are responsible for the slow pace of job growth. Employment and growth can be jump-started with the proper macroeconomic policies, especially with inflation running at just 0.35 percent.[4] In this narrative, the euro and the European authorities have been a huge part of the problem, due to European agreements restricting fiscal policy, the lack of sovereign control over monetary and exchange rate policy, and a number of policy errors committed or pushed by European authorities. Advocates of this narrative do not necessarily support leaving the euro, with many arguing that France could, under the proper government, fight to change eurozone and European policy to accommodate a more robust recovery.

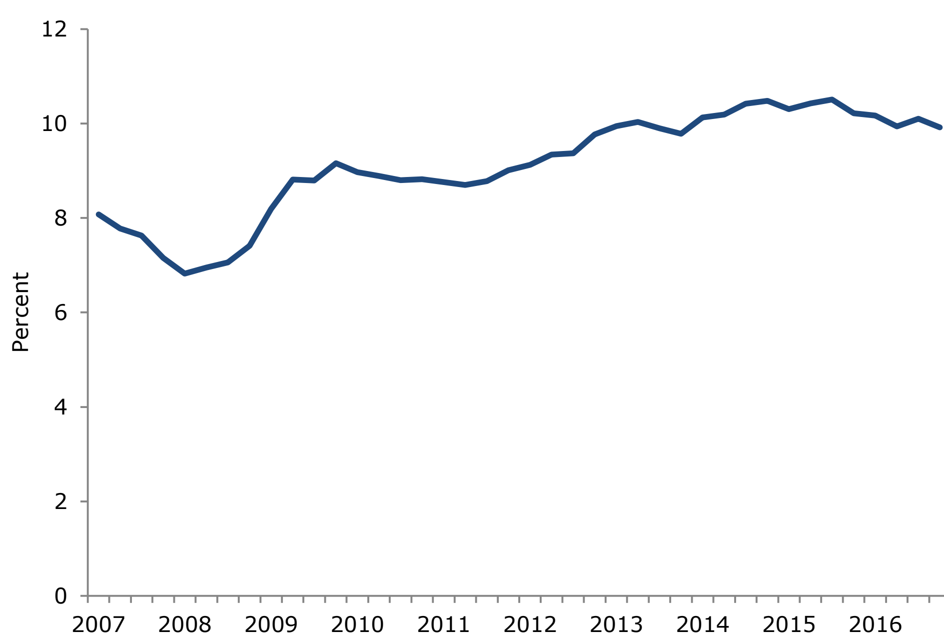
1 This is based on OECD quarterly data from the fourth quarter of 2006 to the fourth quarter of 2016, which shows 1.6 percent total real GDP growth over the period. See http://stats.oecd.org/.
2 OECD (2017).
3 IMF (2016a).
4 IMF (2016c).

This paper looks at some of the arguments and evidence for these competing views, as well as some of the reforms that have been implemented in recent years, and some that are currently on the table.

Unemployment and Stagnation

Figure 1 shows the unemployment rate in France since 2007. It hit a low of 7.1 percent in 2008 and last peaked in 2015 at 10.4 percent, averaging 9.1 percent over the decade. For the last quarter of 2016, it averaged 9.9 percent.

FIGURE 1
Unemployment Rate



Source: OECD (2017).

This substantial decline in employment since 2008 is not easily explainable by the "structural" problems singled out by advocates of neoliberal reforms. For example, it is difficult to point to any major changes in the structure of labor market institutions over the past decade, such as disincentives to work, that would explain this fall off in employment. If anything, reforms have moved in the opposite direction (see below).

The percentage of the unemployed that suffer from long-term unemployment, or more than 12 months of unemployment, has also shot up, from 34.9 percent in 2009 to 44.3 percent in 2015.[5]

5 OECD (2017).

This is another indication that the labor market is weaker than indicated by the official unemployment rate.

The International Monetary Fund (IMF) states that "[t]he unemployment rate is projected to decline only very slowly, converging with the NAIRU (to around 8½ percent) over the medium term."[6] The NAIRU, or Non-Accelerating-Inflation Rate of Unemployment, is a controversial measure of full employment that is not accepted by many economists, and it does not seem to apply to France since the 1980s. However, even by this measure, there would be much room to reduce unemployment in the short to medium term without exceeding the 2 percent target for inflation. The details of this are shown in the **Appendix**.

The IMF's measure of potential output also shows some room to expand employment and output. The Fund's projections for potential GDP in France can be seen in **Table 1**. Currently, the economy is estimated to be at 1.8 percent of GDP below potential. If GDP growth were to reach the IMF's estimate of potential GDP, it would be expected to lower unemployment by an estimated 0.9 percent, adding about 270,000 jobs.[7]

But the IMF's estimates of potential GDP are almost certainly too low. The Fund itself recently noted[8] that as compared to the trend line from its estimates of potential GDP up to the crisis (2008), projections for the next four years show a drop in potential GDP of 8 percentage points. It must be emphasized that this is not a forecast of *actual* GDP, but rather the economy's *capacity* to produce. It is difficult to imagine what has happened to the French economy that would take such a large chunk out of its future capacity.

It must be emphasized that this potential GDP and employment gain is just a small part of what is possible for increasing growth and employment in France. With inflation at 0.35 percent, and real borrowing costs basically zero,[9] the government has the potential through spending and public investment to dramatically lower unemployment. The constraints on increasing employment and growth appear to be political, not economic.

6 IMF (2016a).
7 See: IMF (2016b).
8 IMF (2016a).
9 Bloomberg Markets (2017).

TABLE 1

France: Select Economic Indicators											*Projections*				
	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	***2017***	***2018***	***2019***	***2020***	***2021***
GDP (Constant Prices, Percent Change)	2.4	2.4	0.2	-2.9	2.0	2.1	0.2	0.6	0.6	1.3	1.3	*1.3*	*1.6*	*1.7*	*1.8*	*1.8*
GDP Per Capita (Constant Prices, National Currency)	32,067	32,614	32,499	31,376	31,841	32,345	32,248	32,270	32,331	32,594	32,876	*33,168*	*33,538*	*33,948*	*34,406*	*34,879*
Output Gap (Percent of Potential GDP)	0.8	1.8	1.0	-2.8	-1.9	-0.9	-1.7	-2.2	-2.5	-2.2	-1.8	*-1.5*	*-1.1*	*-0.7*	*-0.2*	*0.2*
Inflation (Average Consumer Prices, Percent Change)	1.9	1.6	3.2	0.1	1.7	2.3	2.2	1.0	0.6	0.1	0.3	*1.0*	*1.1*	*1.3*	*1.5*	*1.7*
General Government Net Lending/ Borrowing (Percent of GDP)	-2.3	-2.5	-3.2	-7.2	-6.8	-5.1	-4.8	-4.0	-4.0	-3.5	-3.3	*-3.0*	*-2.7*	*-2.1*	*-1.5*	*-1.0*
General Government Net Debt (Percent of GDP)	57.8	57.7	60.3	70.1	73.7	76.4	81.6	84.4	87.4	88.2	89.2	*89.8*	*90.0*	*89.4*	*88.0*	*85.8*
General Government Gross Debt (Percent of GDP)	64.4	64.4	68.1	79.0	81.7	85.2	89.6	92.4	95.3	96.1	97.2	*97.8*	*97.9*	*97.4*	*95.9*	*93.8*
General Government Structural Balance (Percent of Potential GDP)	-2.9	-3.6	-3.9	-5.5	-5.6	-4.5	-3.6	-2.6	-2.4	-2.0	-2.0	*-1.9*	*-2.0*	*-1.7*	*-1.4*	*-1.1*
Current Account Balance (Percent of GDP)	0.5	0.1	-0.9	-0.8	-0.8	-1.0	-1.2	-0.9	-1.1	-0.2	-0.5	*-0.4*	*-0.3*	*-0.1*	*0.1*	*0.3*

Source: IMF (2016c).

Fiscal Policy, the Public Debt, and the European Authorities

Among the political objections to any program that would help reduce mass unemployment in France is that the French public debt is too high, and therefore reducing the public sector budget deficit must come first. Table 1 contains the projections for France's gross and net debt, as a percentage of GDP. Gross debt for 2016 is 98 percent of GDP, while net debt is 89 percent of GDP. Although the net debt is the more relevant figure for purposes of considering the sustainability of the debt, it is the gross figure that is most commonly used.

While 98 percent of GDP seems high, a more important measure of the burden of the debt is how much interest the government has to pay each year. Japan, for example, has a gross debt of 250 percent of GDP but its net interest payments on the debt are currently less than 1 percent of GDP. In France's case, interest payments on the debt are estimated at 1.7 percent of GDP for 2017.[10] This is a very modest debt burden, by historical or international comparisons. For example, in the US in the 1990s, the interest burden of the public debt exceeded 3 percent of GDP.

The French government can currently borrow, for 10-year bonds, at 0.9 percent.[11] The average maturity of outstanding government bonds is about 7.3 years.[12]

The average effective interest rate on the public debt is about 1.8 percent, hence the low interest burden as a percentage of the economy.[13] The argument could be made that as interest rates rise, so will the interest burden on the debt. But any scenario of interest rates rising would likely be associated with stronger nominal GDP growth, which would reduce the interest rate burden as a percentage of GDP. Therefore, in the face of mass unemployment and sluggish growth, it seems reasonable for a government to take advantage of zero interest rates to finance investment — including public investment — that can yield substantial positive returns. This includes investments in renewable energy infrastructure, as part of France's commitment to reducing greenhouse gas emissions.

But this runs up against another political constraint, which comes from the European authorities. As part of the Maastricht Treaty, France is committed to reducing its budget deficit to 3 percent of GDP. (There is another requirement that public debt be limited to 60 percent of GDP, but that

10 See: IMF (2016a).
11 Bloomberg Markets (2017).
12 See: IMF (2016a).
13 Ibid.

seems to be honored much more in the breach than in practice). IMF projections show the French budget deficit hitting the target of 3 percent this year. However, they project continued fiscal tightening through 2021. This is perhaps best measured by the structural balance, as seen in Table 1.[14] It is projected to fall by about 0.8 percent of GDP by 2021. The government budget deficit is projected to fall more than twice as much, by about 2 percent of GDP.

This continued fiscal tightening precludes any serious government efforts to reduce mass unemployment. Pressure to implement this tightening from the European authorities comes from the 2011 reforms of the EU Stability and Growth Pact, which tightened monitoring and potential enforcement against governments found to be exceeding fiscal deficit targets. France, with a fiscal deficit of more than 3 percent of GDP since 2009, has been subject to the Pact's new Excessive Deficit Procedure. In 2016, the government agreed to a Stability Program for the years 2016–2019, which commits it to further spending cuts.

The Eurozone

One of the constraints on France's recovery is obviously the euro. To point this out does not imply that France should necessarily leave the euro; this is a political decision that involves considerations other than economic policy, as well as public opinion. Nonetheless, any analysis of France's mass unemployment and economic stagnation that ignores the common currency would be incomplete without mentioning the constraints of the eurozone, and to a lesser extent, the European Union.

At the most basic level, by adopting the euro, France gave up control over two of its most important macroeconomic policies: monetary and exchange rate policy. This turned out to be a major handicap for the eurozone countries, including France: while the US Federal Reserve lowered policy interest rates to near zero in December of 2008 and kept them there for seven years, the European Central Bank (ECB) was much slower to respond and even raised interest rates twice in 2011. The Fed began its quantitative easing in 2008, whereas the ECB did not begin this until seven years later.

But this is only part, and not the largest part, of the explanation for why the eurozone still has more than twice the unemployment rate of the United States. Nor does it fully explain why America's Great Recession lasted only 18 months (from December 2007 to June 2009), while the eurozone,

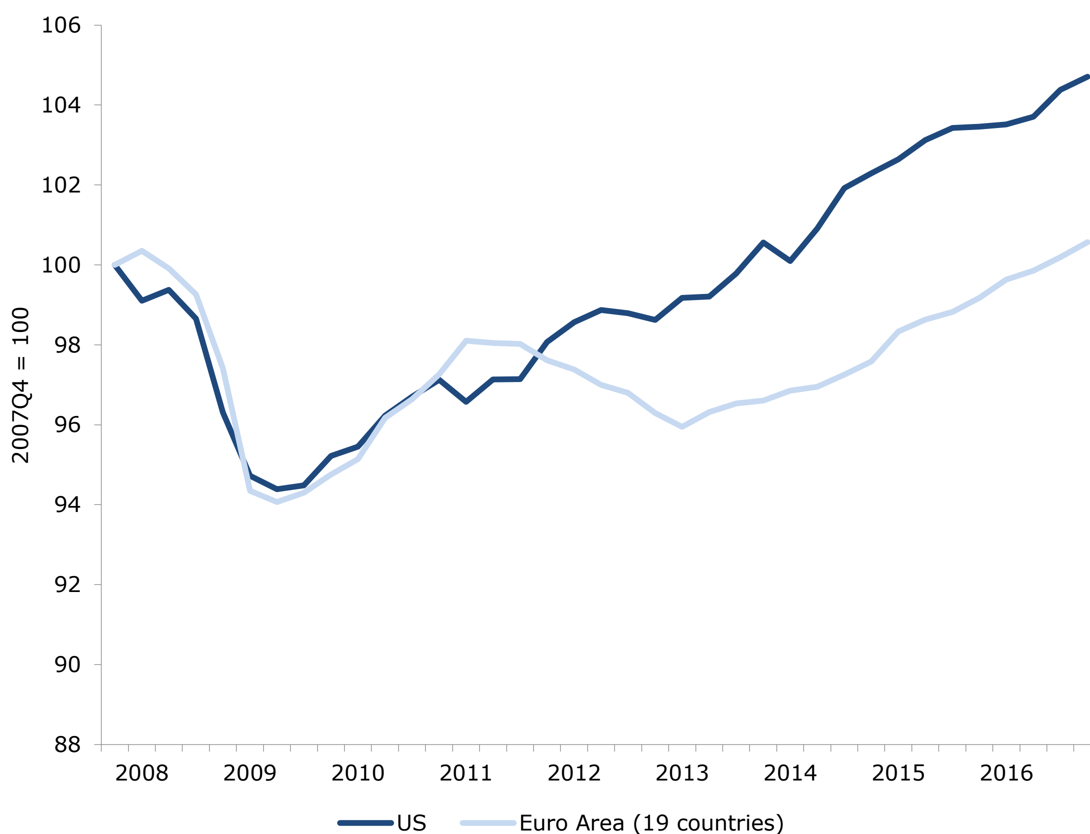
14 The structural balance is an estimate of what the budget balance would be if the economy were at potential output. Thus, the estimates in Table 1 show that fiscal tightening is taking place over the next five years, as the structural deficit is declining.

after suffering a similar downturn for six quarters beginning in the first quarter of 2008, went back into recession for another two years in 2011.

This can be seen in **Figure 2**, which shows real (inflation-adjusted) GDP adjusted for population growth, indexed to start at 100, from the fourth quarter of 2007, for the US and the eurozone economies. As of the end of 2016, the US is 4.6 percent above its initial level of per capita GDP, whereas the eurozone economies are up just 0.6 percent. At the rate of per capita GDP growth since the eurozone recovery began, this difference (4 percentage points) is more than 3 years of growth.

FIGURE 2

Real Quarterly GDP Per Capita, US and Euro Area 19 (seasonally adjusted)



Source and notes: BEA (2017), Eurostat (2017), and authors' calculations. See also: Piketty (2016).

French economist Thomas Piketty has described some of the policy failures that led to the extra two years of recession:

> the countries in the Euro zone endeavoured to reduce their deficits too rapidly in 2011–2013 with, in particular, excessively heavy increases in tax in France which led to stifling the upturn…[15]

But there is another dynamic of the eurozone that is also crucially important, not only in explaining the current mass unemployment and sluggish recovery of the past decade, but also what to expect for a baseline projection of the future policies of the European authorities. There is compelling evidence that the balance of forces in the European authorities favor a somewhat coherent program of economic and social reforms, and that their efforts to impose these reforms have contributed to this lost decade of the eurozone. This program can be seen most clearly in the papers produced by the regular Article IV consultations of European governments with the IMF.

The Article IV papers, so named because the consultations are required of member countries under Article IV of the IMF's charter, generally represent an agreement between the finance ministries of the governments and the IMF. In the case of Europe, the IMF's decisions are made by the European directors, so on both sides of the consultations that produce these policy papers, there is generally an elite consensus of the most powerful influences in Europe on what the major economic policy decisions should look like. Since finance ministries are not necessarily the part of the government most representative of the voting public, and the German government and its allies have disproportionate influence within the European authorities, there can be quite a gap between this elite consensus and the voting public of most, if not all, eurozone countries.

A look at 67 Article IV papers for the (then 27) EU countries for the four years 2008–2011 shows a consistent pattern of reforms that were oriented toward a substantially reduced welfare state, including cuts to public pensions and health care spending, labor market reforms that diminish the bargaining power of organized labor, reforms that increase labor supply, and overall reduction of spending and taxation.[16]

A close examination[17] of the process that led to Europe's unnecessary second recession shows the European authorities repeatedly going to the brink of financial meltdown, apparently in order to force the more vulnerable countries (including Greece, Italy, Spain, and Portugal) to accept various unpopular economic reforms that are part of the above program. These confrontations and resultant financial crises were a major contributor to the eurozone's interrupted recovery, double-dip recession, and lost decade. Only in late July of 2012, when ECB President Mario Draghi announced

15 Piketty (2016).
16 Weisbrot and Jorgensen (2013), Weisbrot (2015), Chapter 2.
17 Weisbrot (2015), Chapter 2.

that he would "do whatever it takes" to insure the stability of the euro, and subsequently followed through on his promise, was the stage set for economic recovery in Europe. Interest rates on 10-year Italian and Spanish bonds, which had reached unsustainable levels as high as 7 percent in 2013, today are just 2.3 percent and 1.7 percent respectively.[18] Of course the ECB's quick resolution of Europe's financial crisis, by essentially guaranteeing Italian and Spanish bonds, was nothing more than what a Central Bank is supposed to do in such a situation.[19] The fact that this could have been done years earlier, thereby avoiding years of financial crisis and recession, clearly shows that the failed policies of the eurozone in the prior years were political in nature, more than economic. The European authorities were taking advantage of the continuing crises in order to reconfigure Europe in ways that the electorate would not vote for. This is something to consider when looking at the pressures on France to make unpopular structural reforms that are supposedly designed to reduce unemployment and increase potential GDP.

Structural Adjustment and Reforms

As noted above, the IMF Article IV agreements generally reflect an elite consensus that includes the view of the country's finance ministry and the IMF, which for France would mean the prevailing view of the European authorities. France's 2009 Article IV consultation contains language indicating that the world financial crisis and recession was seen as an opportunity to push through the policy changes that these people had always wanted: "historical experience indicates that successful fiscal consolidations were often launched in the midst of economic downturns or the early stages of recovery."[20] Clearly, the double-dip recession that Europe has experienced since that Article IV paper was written shows that such a strategy entails serious risks, aside from its undesirability for other reasons.

The most recent Article IV paper for France, from July of 2016, has much to say about fiscal consolidation. The IMF recommends "limiting growth of government spending to the rate of inflation, as targeted in the government's Stability Program."[21] This is a pretty restrictive mandate, which does not take into account spending increases that might be necessary because of demographic changes (e.g., the aging of the population), or even population growth, much less any of the investments in education or training that the IMF says it favors in order to enhance global competitiveness.

18 Bloomberg Markets (2017).
19 Unfortunately, the ECB continued to take the opposite approach, to new extremes, with Greece, forcing a shutdown of the Greek banking system in June 2015 in order to coerce the government into accepting further austerity after nine years of depression. But this did not affect the rest of the eurozone's recovery at this time because Grexit was no longer much of a threat to the euro.
20 IMF (2009).
21 IMF (2016a).

All this is despite the fact that the Fund projects that France will meet the Maastricht Treaty target of a 3 percent of GDP fiscal deficit this year; "it will be important to bring down the deficit further." The IMF appears to be worried about "spillover effects" to the rest of Europe: "Failure to deliver on fiscal consolidation and structural reform commitments could be seen as weakening the credibility of EU economic governance."

The Fund is further concerned that "structural adjustment is coming to a halt," but as noted above, the IMF WEO data from October 2016, published just a few months later, already showed a falling structural budget deficit. Still it is not enough, since the goal is to have a structural budget balance of zero in four years. Again, this is quite restrictive for a country with mass unemployment.

The IMF also recommends means-testing public benefits as a way to reduce spending. There are a number of downsides to such changes; universal benefits (like public pensions or national health care) tend to be less vulnerable to cuts or other attacks than means-tested programs that are seen as welfare. Also, means-tested programs often have high administrative costs. In addition, they can have substantial disincentive effects on work, with marginal effective tax rates close to one hundred percent or even more for workers who face a phase-out of benefits with additional wage income.

The paper also contains a number of recommendations and arguments for structural reform of the labor market: "[A] key obstacle to growth remains the labor market, where structural unemployment is projected to remain high in the absence of additional reforms." [22]

Such reforms include "strengthening job search incentives through the unemployment and welfare benefit systems."

> The poor labor market performance reflects deep-rooted structural rigidities, not just a weak recovery**.** Several factors seem to have made France's labor market less adaptable to an evolving global economy — centralized labor agreements for over 700 branches; long and uncertain judicial procedures around dismissals; relatively easy access to unemployment and welfare benefits; a relatively high minimum wage; and a sizeable labor tax wedge. Moreover, real wages and unit labor costs have grown steadily since 2000, including during the crisis years, contributing to a labor cost competitiveness gap.

22 Ibid.

The paper also notes that as "important barriers to job creation," certain "aspects of the unemployment and welfare benefits systems may contribute to inactivity traps, with relatively easy qualification for benefits and weak job search incentives."

If France were running a significant current account deficit, there would be a certain logic — albeit one that reflects badly on the eurozone system — to the idea that it has a "cost competitiveness gap," and therefore would need an "internal devaluation." The argument would be that since France does not have its own currency that can be allowed to depreciate in nominal terms, it can increase its international competitiveness by lowering its unit labor costs. The difficulty of adjusting to different rates of productivity growth and changes in unit labor costs reflects a serious structural problem of the eurozone system that many have written about, since the implications for a race to the bottom and bias toward unnecessary recessions are obvious. Clearly it would make much more sense for a country like Germany, running a current account surplus of 8 percent of GDP, to have more inflation and wage growth, and thereby appreciate its currency in real terms relative to its eurozone trading partners. But France, in particular, has only a small current account deficit, at 0.5 percent of GDP (2016).[23] France also has a high level of productivity, just above Germany and with the same rate of (slow) productivity growth from 2008–2015.[24]

So the justification for all these efforts to push down labor costs in France cannot be based on international competitiveness — although government officials who support such measures may say that this is the rationale.

This leaves only the argument that "high" labor costs and overly generous welfare and unemployment benefits, rather than weak demand, are the main reasons for France's mass unemployment. But as has been shown, this appears very unlikely.

Nonetheless, the ideas expressed in the IMF Article IV consultation have continued to drive important policy changes in recent years. In the last two years, the French government has advanced three major labor reforms[25] with the stated goal of revitalizing the French labor market and reducing unemployment. However, in practice the laws seem to have had a much smaller impact on job creation than predicted. For example, a much-touted provision to allow more commercial coach

23 If France were to embark upon a much faster growth path in a slow-growing eurozone, its current account deficit would rise. But as noted above, that is a structural problem with a eurozone committed to slow growth, not a structural problem in the French labor market.

24 OECD

25 The Macron Law was adopted in August 2015, the Rebsamen Law was adopted in August 2015, and the El Khomri Law was adopted in August 2016.

routes to operate in France was estimated to create 22,000 new jobs.[26] A year later, it was reported that only 1,300 new transportation jobs were created.[27]

The three major labor reforms centered on offering more flexibility to employers, and included measures that targeted the bargaining power of unions, simplified layoff procedures, and expanded options for temporary work contracts. The Macron Law included a reform of employment tribunals, and broadened layoff criteria for companies.[28] The Rebsamen Law then reduced the number of consultations necessary between employers and labor unions, and decentralized negotiations from industry to company-wide unions. (This is a commonly advocated reform in Article IV agreements, including France's; it weakens the bargaining power of unions.) This law also allowed companies to renew temporary work contracts (as opposed to them having to offer permanent positions after a certain amount of time).[29] The El Khomri Law built on the Rebsamen Law and further simplified dismissal procedures, reduced severance payments for laid off workers, as well as rates on overtime pay.[30]

The Macron Law, despite its prominence in the reform agenda, is projected to have only a miniscule impact on the growth of the French economy. The OECD evaluated[31] five sets of measures in the law, and estimated that these would increase GDP by 0.4 percent over 10 years (not annually, but over the whole decade). This means that in 2025 (10 years after the law passed), France would have a real GDP in August that they would otherwise have to wait until approximately December to achieve.

In addition to fiscal consolidation and labor market reforms, the French pension system has recently undergone two reforms, in 2010 and 2014, that raised the retirement age, and the amount as well as the number of years of required contributions.

The 2010 reform was the bigger of the two reforms, raising the minimum retirement age by two years; for full pension benefits this was an increase from age 65 to 67. It was scheduled to be implemented in increments of four, then five months for people born between 1951 and 1955. This by itself is difficult to defend since it hits workers who were so close to retirement. A worker born in 1955 who was expecting to retire in 2020 would have to wait two more years; if retiring earlier, they would have to take a substantial cut in retirement income. Normally, such changes are given a much

26 France Stratégie (2015).
27 Chateau (2016).
28 Government of France (2017).
29 Ministère du Travail, de l'Emploi, de la Formation professionnelle et du Dialogue social (2016a).
30 Ministère du Travail, de l'Emploi, de la Formation professionnelle et du Dialogue social (2016b).
31 OECD (2015).

longer phase-in time. In the US, for example, the retirement age for full benefits was also raised from 65 to 67 in 1983; but the first workers who would have to wait until 67 would not be retiring for 44 years. To cut the retirement benefits of someone who is so close to retirement is tantamount to a breach of contract, since they paid taxes into the system for almost all of their working life, expecting a certain benefit. Furthermore, it is a regressive cut, because the public pension comprises a larger share of the retirement income of poor and blue-collar workers than of upper income groups. Lower income workers also have a lower life expectancy[32] and tend to retire earlier than higher-income workers, and are thus likely to suffer more reduction in benefits when the retirement age is raised.

In 2010, the minimum pay-in time into the pension fund was increased from 40 to 41.5 working years, then increased again in 2014 to 43 years (to be phased in by 2035).

It is difficult to argue that any of these cuts to the pension system were necessary. In 2009, projections for the next 60 years showed an increase of 1 percent of GDP for retirement payouts over the whole period, from 13 to 14 percent of GDP. While the starting point is one of the largest public pension systems in the EU, in terms of percent of GDP, there is nothing unsustainable in adding another percentage point as the population ages over the coming decades. Compared to the expected more than doubling of GDP over the next 60 years, it is difficult to see this as a burden on future generations.

Conclusion

In sum, there is a great deal of evidence to support the idea that France's mass unemployment and stagnation is a result of inadequate demand, rather than structural problems in the labor or other markets, or an overly high public debt burden. To the extent that there are structural impediments to a robust recovery that would alleviate mass unemployment in France, these come from the structure and policies of the eurozone and the European Union.

The European authorities are committed to a slow path of GDP and employment growth, since they are prioritizing debt reduction — despite France's low interest burden — and a whole set of domestic reforms that appear, on the basis of the past decade or more of policy, to be core political goals. There is little reason to believe that these reforms, including laws limiting collective bargaining, restricting or tightening eligibility for social benefits, cuts in public pensions and other

32 See: Blanpain (2016). Also see: Baker and Rosnick (2010).

social spending, will have a significant positive impact on increasing GDP or employment growth. At the same time, commitments to reduce debt in a time of weak recovery will create a further drag on that recovery, while likely increasing income inequality. With inflation well below target, real borrowing costs at about zero, and a low current interest burden on the debt, it would make much more economic sense for the government — and the eurozone as well — to pursue an expansionary fiscal policy that increases employment.

References

Baker, Dean and David Rosnick. 2010. "The Impact of Income Distribution on the Length of Retirement." Washington, DC: Center for Economic and Policy Research. October. http://cepr.net/publications/reports/impact-of-income-distribution-on-retirement-length

Baker, Dean and Jared Bernstein. 2013. *Getting Back to Full Employment: A Better Bargain for Working People*. Washington, DC: Center for Economic and Policy Research. http://cepr.net/documents/Getting-Back-to-Full-Employment_20131118.pdf

Blanpain, Nathalie. 2016. "Les hommes cadres vivent toujours 6 ans de plus que les hommes ouvriers." Institut national de la statistique et des études économiques. February. https://www.insee.fr/fr/statistiques/1908110

Bloomberg Markets. 2017 "Markets: Rates & Bonds." April 2017. https://www.bloomberg.com/markets/rates-bonds

Bureau of Economic Analysis (BEA). 2017. "Current-dollar and 'real' GDP." National Economic Accounts, Gross Domestic Product (GDP). March. https://www.bea.gov/national/xls/gdplev.xls

Chateau, Pauline. 2016. "Un an après, les «autocars Macron» affichent un bilan en demi-teinte." *Le Figaro*, October 6, http://www.lefigaro.fr/societes/2016/10/06/20005-20161006ARTFIG00146-un-an-apres-les-autocars-macron-affichent-un-bilan-en-demi-teinte.php.

Eurostat. 2017. Online Database. http://ec.europa.eu/eurostat/data/database

France Stratégie. 2015. "Ouverture de l'offre de transport par autocar." January. http://www.strategie.gouv.fr/sites/strategie.gouv.fr/files/atoms/files/fiche-offretransport.pdf

Government of France. 2017. "La loi pour la croissance, l'activité et l'égalité des chances économiques." April. http://www.gouvernement.fr/action/le-projet-de-loi-pour-la-croissance-l-activite-et-l-egalite-des-chances-economiques

International Monetary Fund (IMF). 2009. "France: 2009 Article IV Consultation: Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for France." IMF Country Report 09/232. July.

https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2009/_cr09232.ashx

———. 2016a. "France: 2016 Article IV Consultation —Press Release; Staff Report; and Statement by the Executive Director for France." IMF Country Report 16/227. July. https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2016/_cr16227.ashx

———. 2016b. "France: Selected Issues." IMF Country Report 16/228. July. https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2016/_cr16227.ashx

———. 2016c. "World Economic Outlook: October 2016 Edition." https://www.imf.org/external/pubs/ft/weo/2016/02/weodata/index.aspx

Ministère du Travail, de l'Emploi, de la Formation professionnelle et du Dialogue social. 2016a. "La loi relative au dialogue social et à l'emploi." August. http://travail-emploi.gouv.fr/dialogue-social/reforme-du-dialogue-social/article/la-loi-relative-au-dialogue-social-et-a-l-emploi

———. 2016b. "Loi Travail." August. http://travail-emploi.gouv.fr/grands-dossiers/LoiTravail/

Organisation for Economic Co-operation and Development (OECD). 2015. "France: Évaluation de certaines mesures de la *Loi pour la croissance, l'activité et l'égalité des chances économiques* et perspectives de futures réformes." September. https://www.oecd.org/fr/france/france-evaluation-de-certaines-mesures-de-la-Loi-Macron.pdf

———. 2017. "Main Economic Indicators — complete database." April. https://data.oecd.org/

Piketty, Thomas. 2016. "2007–2015: Such a Long Recession." Le blog de Thomas Piketty, *Le Monde*, February 27. http://piketty.blog.lemonde.fr/2016/02/27/2007-2015-such-a-long-recession/

Weisbrot, Mark. 2015. *Failed: What the "Experts" Got Wrong About the Global Economy*. New York: Oxford University Press.

Weisbrot, Mark and Helene Jorgensen. 2013. "Macroeconomic Policy Advice and the Article IV Consultations: A European Union Case Study." Washington, DC: Center for Economic and

Policy Research. January. http://cepr.net/publications/reports/macroeconomic-policy-advice-and-the-article-iv-consultations

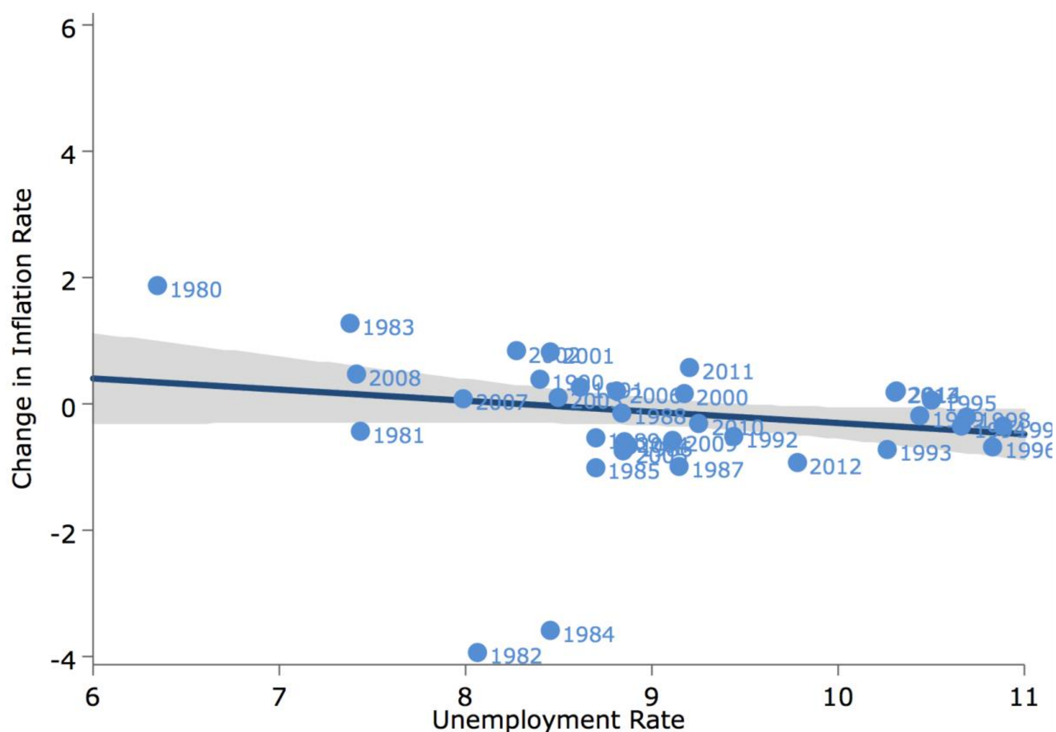
Appendix

The IMF estimates that the NAIRU, or Non-accelerating Inflation Rate of Unemployment, for France is 8.5 percent, and that the economy will gradually converge to this overall unemployment rate by 2020.[33] This is basically a measure of full employment, based on the idea that if unemployment falls below this rate, inflation will begin to accelerate. The concept has become controversial within the economics profession, with many maintaining that a stable relationship between unemployment and inflation cannot be found empirically.[34] This seems to be the case for France at least since the 1980s.

Figure A1 shows changes in core inflation, which excludes food and energy, relative to unemployment.[35] There was a rapid disinflation in the early 1980's with unemployment at unemployment at 8–9 percent, so in 1985 the regression starts to increase the likelihood of finding a negative relationship between changes in inflation and unemployment.

FIGURE A1

Unemployment and Changes in Core Inflation Rate



Source: IMF (2016) [WEO], OECD (2017), and authors' calculations.

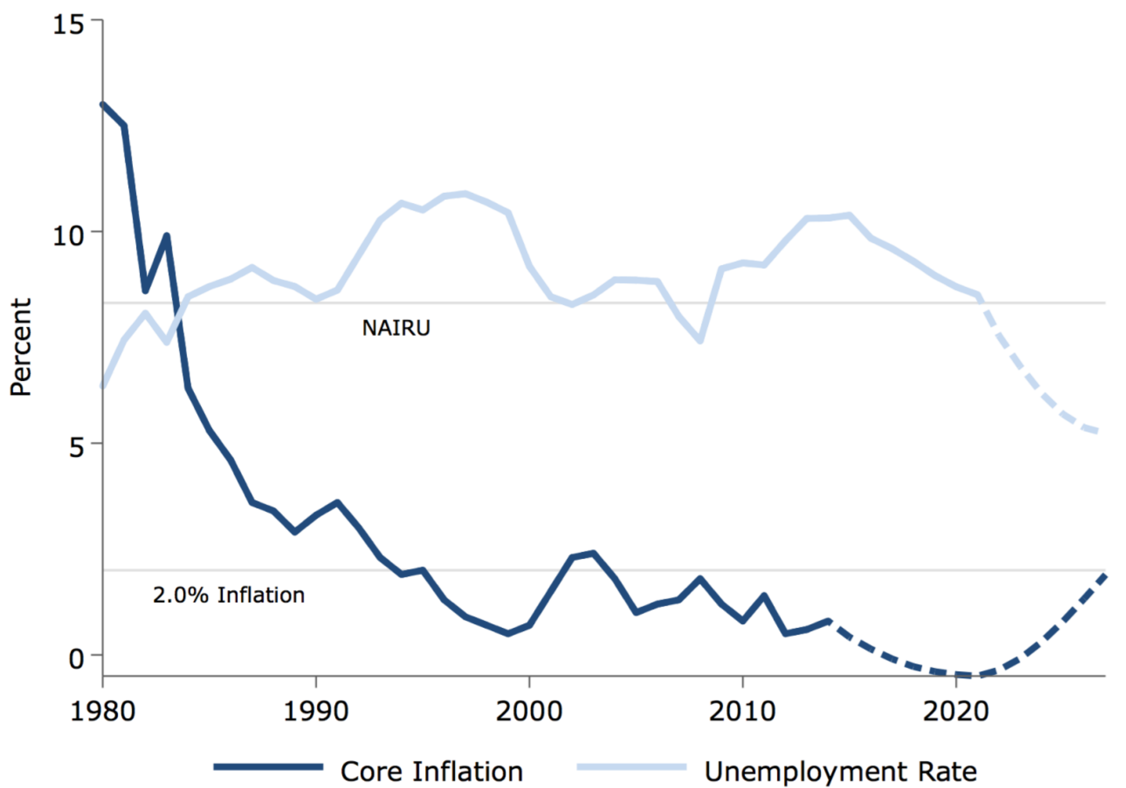
33 IMF (2016c).
34 See Baker and Bernstein (2013).
35 Inflation is measured from December to December. Unemployment is measured as an average over the entire year.

This analysis estimates the NAIRU to be somewhere between 6.7 and 9.8 with a central estimate of 8.3. (If we were to include all available data, the NAIRU is even less certain: between 2.2 and 12 with a central estimate of 7.1. For all practical purposes, there is no NAIRU for France from 1980 to the present).

As we see in **Figure A2**, even if this relationship were to hold and unemployment continued to fall well below the NAIRU, then core inflation — only slowly accelerating — would not reach even 2 percent until 2027. At this point, unemployment would be down to 5.1 percent.

FIGURE A2

Projected Core Inflation Given Hypothetical Path for Unemployment Based on NAIRU Estimate



Source: IMF (2016) [WEO], OECD (2017), and authors' calculations.

Of course, it is not likely that France will see such a sustained decrease in unemployment for the next decade, regardless. It is more probable that the economy will suffer a downturn before 2017, increasing unemployment and — if accepting this model — slowing or reversing the rise in core inflation.

But most importantly, this data shows that even if we were to accept the dubious concept of the IMF'S NAIRU for France, there would be plenty of room to reduce unemployment quite drastically without running into high or even above-target levels of inflation.