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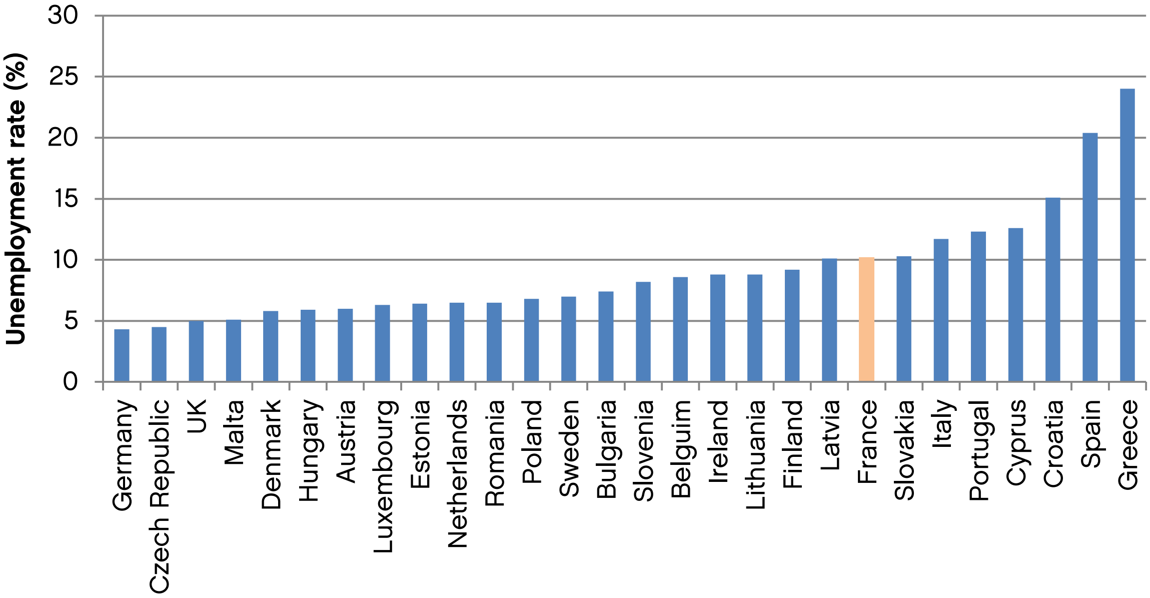
THE LINGERING TRAVAILS OF THE LOI DU TRAVAIL

- While junior doctors strike in the UK, a French general strike is planned on Thursday over proposed labour market reforms.
- IMF, OECD, Moody's and HSBC all find that France's current labour laws are partly responsible for economic underperformance. Yet 70% of the French population still oppose the reforms.
- Labour laws are also leading to increasing number of temporary contracts. Since 2000, the proportion of new short-term contracts has increased by 11 percentage points.
- Without reforms, the competitiveness gap between Germany and France will grow. Germany is the 4th most competitive country while France is 22nd.
- The Government has already watered down the reforms. Proposals to cap compensation payments for unfair dismissal have been dropped.
- Further reforms are unlikely after the 2017 Presidential election. Reforms are deeply unpopular and other priorities have risen up the political agenda.

1. BACKGROUND: IMPACT OF FRANCE'S LABOUR LAWS

Figure 1: Unemployment in EU member states (2016)



Source: Eurostat link

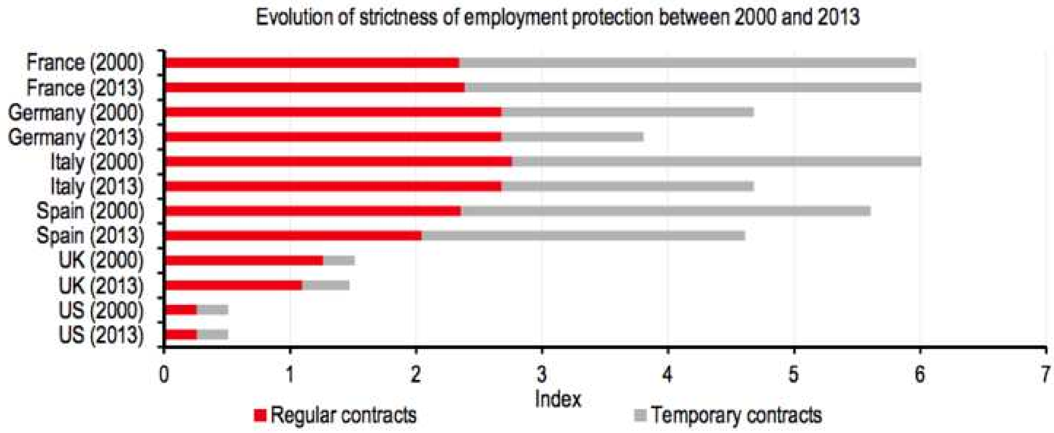
As shown in Figure 1, France's labour market continues to underperform compared to European competitors. Despite France reporting a 1.1% year-over-year economic growth rate in 2015, its unemployment rate is forecast to rise to 10.5%, which is over double the level observed in the United Kingdom. Nearly one in four French youths are unemployed and more than 20% of 20 to 29 year olds are neither in employment nor education.

It is difficult to attribute one particular variable to the underperformance of France's employment rate. However, the lack of reform in France's labour market goes some way to explaining the underperformance, according to analysis from HSBC. The International Monetary Fund also suggests that restrictions on firm-level bargaining along with costly and uncertain dismissal procedures act as a major disincentive for employers to offer full-time contracts. The OECD suggests that strong protection accorded by open-ended contracts in France hinders labour mobility.

Employment protection is higher in France than in other major western countries, according to calculations by the OECD and HSBC (see Figure 2). Furthermore, the labour code is complex and imposes a range of bizarre regulations. For example, all companies that employ more than 100 workers are required to provide a nursing room with a height of at least three metres and walls covered with paint that "make it easy to clean".

France's excessive employment protections are also having a downward impact on France's projected economic growth rate. The ratings agency Moody's decision to cap growth projections at 1.5% over the medium term has, in part, been driven by the inflexibility of France's labour market.

Figure 2: France's employment protection compared to other developed nations



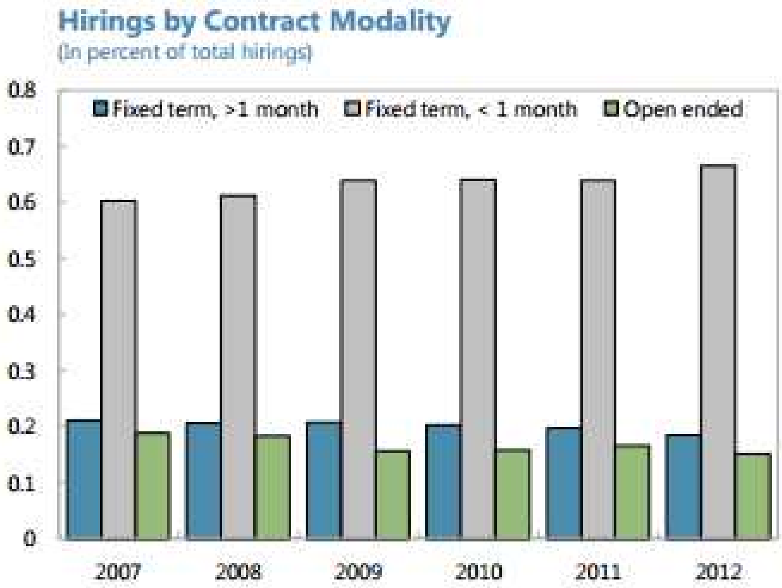
Source: HSBC link

2. IMPLICATIONS FOR JOB PROSPECTS

France's complex labour code, inefficient labour courts and a broader lack of flexibility in the labour market has not only contributed to high unemployment rates, it also appears to be promoting the widespread use of fixed-term contracts (known as CDDs in France), leading to increased insecurity for French workers. The International Monetary Fund reports that over half of French workers below 25 are on fixed-term contracts. Furthermore, evidence suggests that the use of fixed-term contracts is growing in France. Since 2000, the proportion of new short-term contracts in the French economy has risen by 11 percentage points, according to data from Acoss.

Fixed term contracts also appear to be a less effective stepping stone to more permanent jobs in France than their equivalents in other countries. Only 20% of French temporary workers in 2008 had moved into full-time permanent contract by 2011. According to OECD figures that is a worse record than in Spain, Italy or Portugal, and compares to about 50% in Britain.

Figure 3: France's growing proportion of fixed term contracts



Source: International Monetary Fund link

3. REFORMS IN OTHER EURO AREA COUNTRIES

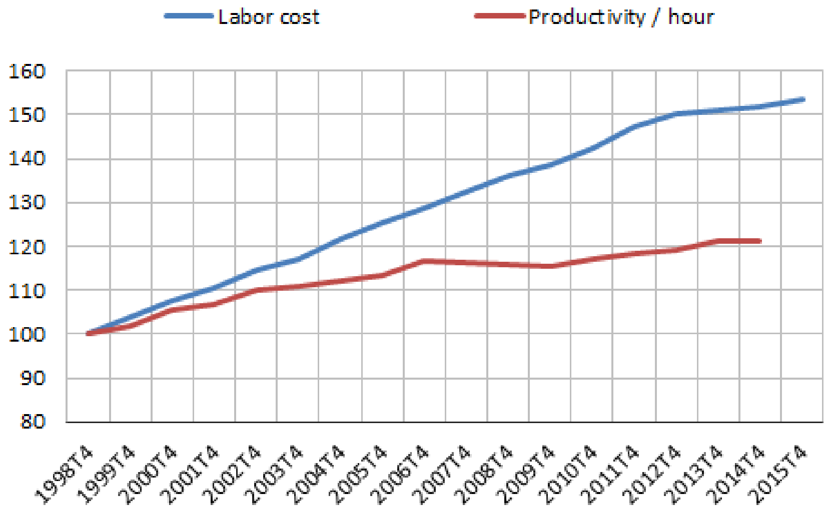
In the early 2000s, Germany embarked on series of reforms undertaken by the centre-left Schröder Government. As shown in the Centre for Policy Studies report *The Hartz Reforms…and their lessons for the UK* these reforms to Germany's welfare system had a huge benefit for the German population. In 2002, 13.4% of the German population were unemployed, but the Hartz Reforms helped dramatically lower joblessness by creating 2.5 million jobs for the German economy.

In more recent times, many other Euro area countries have embarked on significant reforms to promote flexibility in labour markets. Spain's labour market reforms, for example, have been relatively successful in promoting the internal flexibility of firms and reducing dismissal costs for permanent workers. Since the reforms were introduced in 2012 an additional 25,000 new permanent contracts have been created each month, according to analysis from the OECD.

There also appears to be some modest progress made in Italy. The Italian Government has recently eased labour market restrictions, and the first year following these reforms has seen a fall of nearly 1 percentage point in the share of temporary contracts. In France the reverse trend is being observed.

4. GROWING COMPETITIVENESS GAP BETWEEN FRANCE AND GERMANY

Figure 4: French Labour costs and productivity since 1998



Source: INSEE

As can be observed in Figure 4, the growth in France's labour costs has consistently outpaced productivity gains. This has led to a widening competitiveness gap between France and Germany. According to the World Economic Forum's Global Competitiveness Index, Germany now ranks as the 4th most competitive country in the world. France now ranks 22nd.

Over the past decade, Germany's growth rate has been roughly 50% higher than the level observed France, according to data from the World Bank. This has been partly accounted for by France's manufacturing unit-labour costs rising by 28% since 2000 compared to just 8% in Germany. France's businesses also suffer under the weight of punitive company taxation. For every Euro paid to an employee, a French employer pays an average of 48 cents in payroll tax, according to France's business association Medef. The equivalent in Germany is just 35%.

The growing competitiveness gap between Germany and France is putting strain at the Eurozone's core. Part of the competitiveness gap is accounted for by France's labour laws, which the French Government is seeking to tackle in its reform proposals. It is widely commented that the proposed reforms would bring France's labour laws in line with those in Germany.

5. PROPOSED REFORMS

The current French labour regulation framework is mainly based on uniform laws enacted by the parliament, where collective bargaining takes place an industry level. Negotiations between trade unions and employers' representatives can only result in deals more favourable to employees.

The proposed reforms would change this. Industries would be given the opportunity to use collective bargaining as a way to tailor labour legislation to their own needs and the proposals would allow for collective bargaining at the firm level. This would bring France's labour laws in line with European competitors such as Germany and Switzerland.

There would also be more flexibility for negotiations over the "35 hour working week." The reforms would allow firms to overrule the overtime premium set at an industry level. Current regulations state that overtime premiums have to be set between 25-50%. The French Government is also seeking to broaden the list of different situations that can justify economic redundancies. This includes specific criteria such as a turnover decline lasting more than four trimesters in a row.

There have, however, been a series of concessions made by the Government. There were initially proposals to impose an upper amount on claims for unfair dismissal, but this suggestion has subsequently been dropped from the reform package. This is a major concession given that unpredictable and high payouts are currently a major source of legal uncertainty for smaller businesses in France.

N.B: Information comes from the France Assemblee Nationale and the Ministere des Affaires sociales et de la Sante.

6. RESISTANCE TO REFORMS

Despite the evidence that France's stringent labour laws are leading to comparatively high levels of unemployment, some domestic economists take opposing views. The prominent left-wing group of economists "Les Economists Attérrs" along with Thomas Piketty have opposed the reforms – although it is notable that the Nobel Prize winning economist Jean Tirole has come out in support of the proposals.

French public opinion is also very resistant towards the modest labour reform proposals, with the majority of the population supporting anti-Government protests. Around 70% of the French population are opposed to the reforms, according to an Odoxa poll. This highlights the challenge that the French political class faces in driving through supply-side labour market reforms. Reforms to France's labour laws were previously attempted in 2006, but months of strike action meant the legislation was eventually scrapped altogether.

7. CONCLUSION

Reforms to France's labour market are necessary. France has continued to face high levels of unemployment after the financial crisis, while many of its equivalent competitors have seen unemployment fall over this period. Stringent labour laws also appear to be leading to the widespread use of fixed-term contracts, trapping many young French people into job insecurity. Evidence from other countries suggests that labour market reforms would lower unemployment and boost the numbers of permanent jobs in France.

It is also notable that there has been a widening competitiveness gap between France and Germany, which are the Eurozone's two most important economies. Much of this is attributable to the holding down of wages in Germany and an overall lower tax burden on businesses.

Major trade imbalances among the Eurozone have emerged as a result, with Germany managing to accumulate a 1.2 trillion Euro trade surplus with other Eurozone countries. If these imbalances within the Eurozone are to be corrected, France's competitiveness needs to converge with that of Germany. This is another important reason why reform to France's labour market is so imperative.

However, even if reforms are passed, their effectiveness might be fairly modest due to a number of recent concessions. It is disappointing that the proposal to cap compensation payments for unfair dismissal has been dropped. This is a huge blow to smaller businesses, which face major legal uncertainty from unlimited compensation packages.

Further reforms to France's labour market are unlikely to materialise in the near future. In the run-up to the French Presidential election in 2017, there has been a notable lack of detail from centre-right candidates about further reforms to the labour market. Such proposals are electorally unappealing and economic reform has fallen down the French political agenda in the wake of the Paris terror attacks.

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