Flash Economics

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The risk of "suffocating" the French economy

The French economy risks being 'suffocated', i.e. losing all dynamism, by:

- The very high level of taxation, with taxes essentially financing transfer spending, which reduces the incentive to innovate and undertake;
- Strong employment protection, which stiffens the labour market;
- The rise in long-term interest rates, due to the widening of the interest rate gap with other eurozone countries, and the partial transmission to the eurozone of long-term interest rate rises in the United States;
- The failure to correct the weakness in output (which stems from the weakness in the employment rate and in productivity).

To avoid suffocating the French economy, we would need to be able to improve public sector productivity, shift public spending towards expenditure that promotes future growth, increase the number of hours worked over a lifetime, and move from strong job protection to employee protection.

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The risk of suffocating the French economy

The French economy risks being "suffocated" (losing all economic dynamism) by a number of factors:

1. **The very high tax burden (Chart 1)**, with taxes essentially financing transfer spending, which reduces the incentive for companies to innovate (**Chart 2**), and for households to work (**Chart 3**).

Chart 1
Tax burden (as % of nominal GDP)

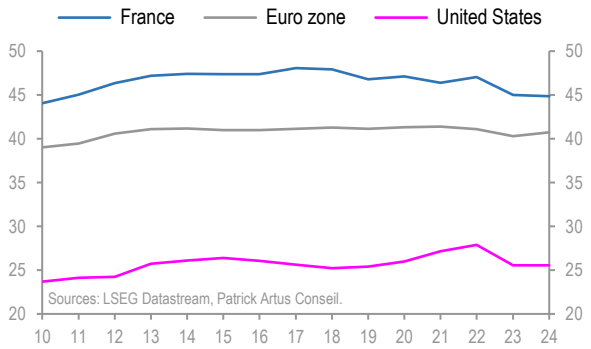


Chart 2
Corporate R&D spending (as % of nominal GDP)

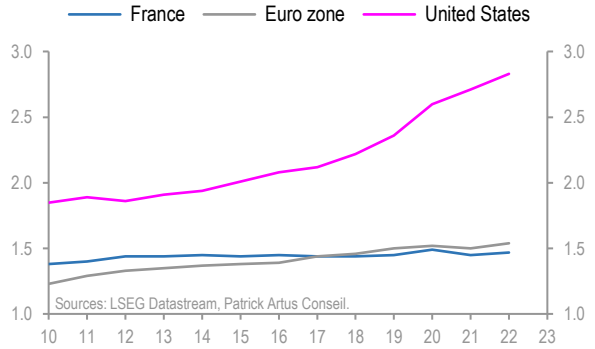
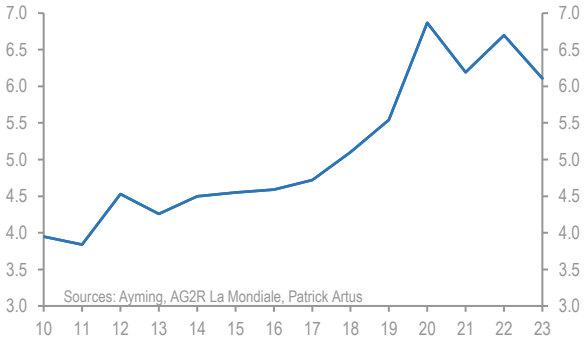


Chart 3
France: Absenteeism rate (as %)



2. **The very high level of employment protection (Table 1),** which freezes the labor market, reduces job mobility from one sector to another or from one company to another, and thus contributes to weak productivity gains **(Chart 4).**

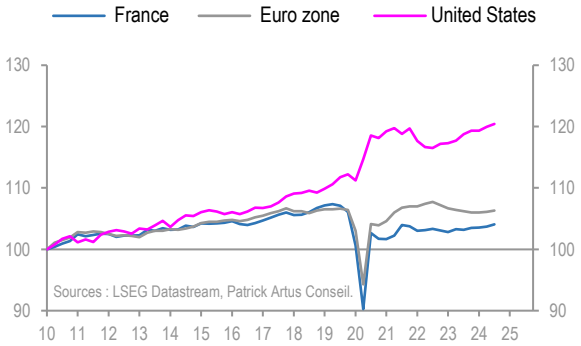
Table 1: Strictness of employment protection (2019)

Strictness of employment protection	France	Germany	Spain	Italy	United States
Individual and collective dismissals (regular contracts)	2.68	2.33	2.43	2.86	1.31
Collective dismissals	3.25	2.61	2.43	3.19	1.33
Individual dismissals (regular contracts)	2.45	2.22	2.43	2.72	1.30
Temporary contracts	2.58	1.67	2.47	2.82	0.27

Source: OECD

(*) Scale from 0 to 6, with values increasing with the degree of stringency of regulation

Chart 4
Productivity per head (2010.Q1 = 100)



3. Rising long-term interest rates

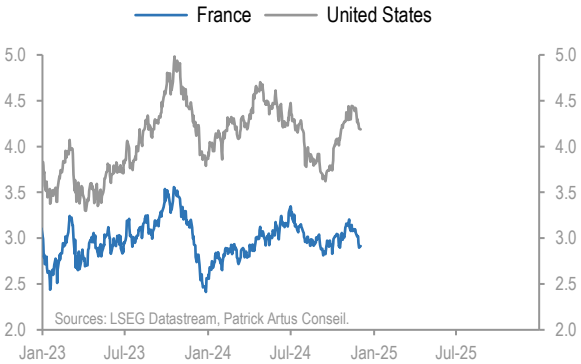
France's difficulties in reducing its public deficit and reaching a minimum consensus on economic policy issues (retirement age, tax burden, public spending, etc.) **will lead to a continued rise in the long-term interest rate differential with Germany (Chart 5)**.

Chart 5
France: Yield spread on country's 10-year government bonds against Germany (as % point)



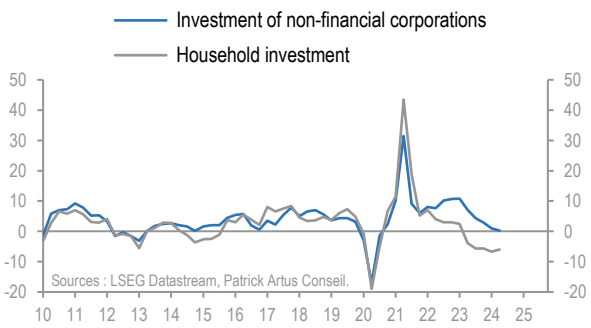
In addition, **the rise in long-term interest rates in the United States** will lead to a rise, albeit smaller, in long-term interest rates in the eurozone, and hence in France (**Chart 6**).

Chart 6
Interest rate on 10-year government bonds (as %)



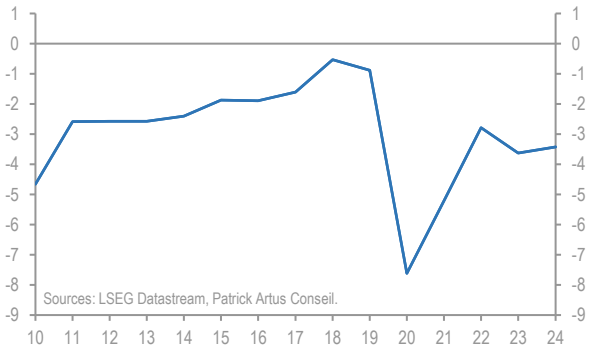
For both those reasons, France's long-term interest rates are set to rise, which will have several negative consequences: a decline in investment by businesses and in housing (**Chart 7**);

Chart 7
France: Investment of non-financial corporations and household investment (in value terms, Y/Y as %)



and increasing the reduction in the primary public deficit (**Chart 8**) needed to stabilise the public debt ratio (this increase is all the greater the higher the real long-term interest rate is relative to potential real growth in volume).

Chart 8
France: Primary fiscal deficit (as % of nominal GDP)

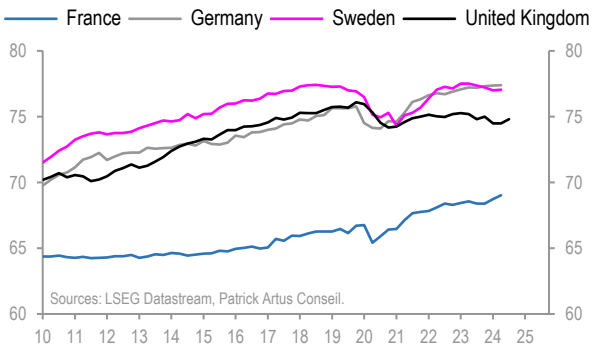


4. Failure to correct low output

The level of output (GDP) in France is low mainly because of:

- **The decline in labour productivity (Chart 4);**
- **The low employment rate (Chart 9).**

Chart 9
Employment rate of population aged 15 to 64 (as %)



Labour productivity has fallen sharply since 2019 when compared with other European countries (**Chart 4**), and even more so when compared with the United States.

France's employment rate gap with Germany, the UK and the Nordic countries is not closing.

If France had the employment rate of Germany and if labour productivity had not fallen since 2019, gross domestic product would be 14% higher and tax revenues 7 points of GDP higher.

Summary: how can we avoid suffocating the French economy?

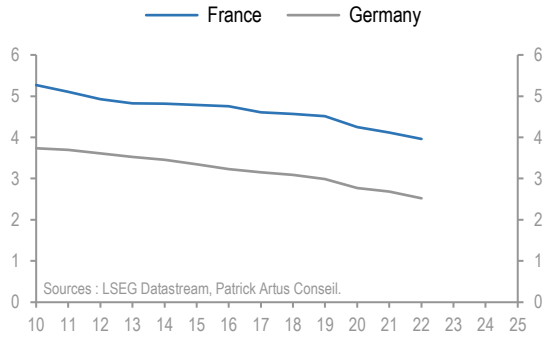
The French economy therefore runs the risk of being suffocated by:

- A very high tax burden;
- Very high employment protection;
- Rising long-term interest rates;
- Falling productivity and a low employment rate, which will lead to low tax revenues and therefore a high tax burden.

One would need to be able to:

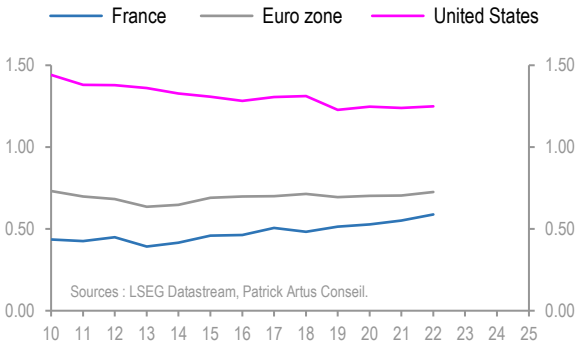
- **Improve the productivity of the public sector**; **Chart 10** shows that the ratio of public sector employment to public expenditure is very high in France;

Chart 10
Ratio between public employment and public expenditure (in millions of euros)



- Once public sector productivity has been improved, **shift public spending towards expenditure that promotes future growth** (in particular support for investment in new technologies, **Chart 11**);

Chart 11
ICT investment (in value terms, as % of nominal GDP)



- **Increase the number of hours worked over a lifetime** (by raising the employment rate, mainly among young people and the over 60s (**Charts 12 a/b**);

Chart 12A
Employment rate of population aged 20 to 24 (as %)

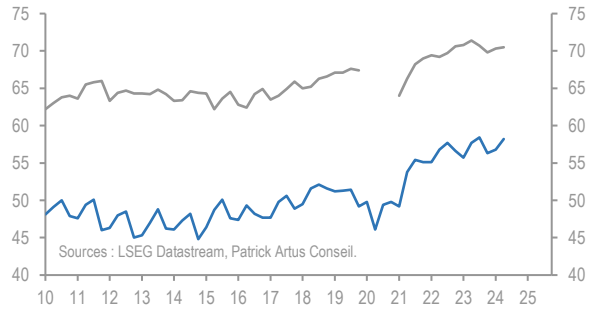
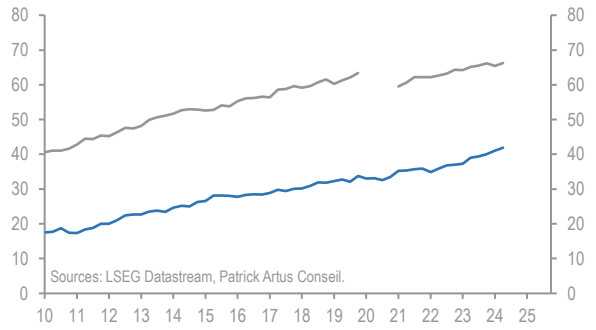


Chart 12B
Employment rate of population aged 60 to 64 (as %)



- **Move from employment protection to employee protection**, by promoting training, retraining and back-to-work assistance rather than preserving existing jobs.

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