Why Is French Unemployment So High?

Despite three years of unprecedented job creation, France's unemployment rate remains nearly twice the U.S. rate. Almost 9 percent of the French labor force is currently looking for a job. France's unemployment rate began to diverge from the United States' roughly 20 years ago and has remained stubbornly high since then (*Chart 1*). Most commentators attribute the situation to characteristics of the European labor market.

Night and Day

French and U.S. labor markets could hardly differ more. U.S. employers and employees can unilaterally terminate their relationship at any time, for almost any reason, in accordance with the common law doctrine of employment at will.[1] In sharp contrast, French law imposes strict limits on the use of fixed-term contracts and stipulates that layoffs must be for a "serious and real cause." Furthermore, workers must receive advance notice of at least one month and a minimum severance payment.[2] In practice, collective bargaining agreements between firms and trade unions typically stipulate severance in excess of the legal minimum.

Union contracts determine the wages and benefits of nine of every 10 French workers, while fewer than 20 percent of U.S. employees are covered by similar agreements (International Monetary Fund 1999). Although fewer than 10 percent of French employees belong to trade unions, most receive union-negotiated wages.

France is also characterized by high payroll, income and sales tax rates. Nickell and Layard (1999) estimate that in 1992, French firms faced a ratio of labor costs to wages of almost 40 percent, twice the ratio U.S. firms faced. After income and sales taxes, the average French worker was left with only a third of his or her gross wage.

Unemployed French workers are entitled to comparatively generous benefits. The Organization for Economic Cooperation and Development (OECD) estimates that in 1994, initial benefits represented an average of 70 percent of previously earned income in France, compared with 60 percent in the United States (OECD 1997). While benefits usually expire after six months in the United States, they are available for up to four and a half years in France.

Furthermore, when unemployment benefits expire, unemployed French workers are entitled to a minimum income of about a third of the minimum wage. These minimum-income recipients also qualify for various subsidies, most notably a housing subsidy that may cover much of a person's rent.

Causes and Cures

The solution seems clear: reform French labor market institutions. This is essentially the message of an OECD study designed to find cures for Europe's chronic unemployment (OECD 1994). The study recommends, among other things, that France reduce the generosity of unemployment benefits, tighten eligibility for the benefits and liberalize its job protection legislation. The International Monetary Fund has reached similar conclusions (IMF 1999).

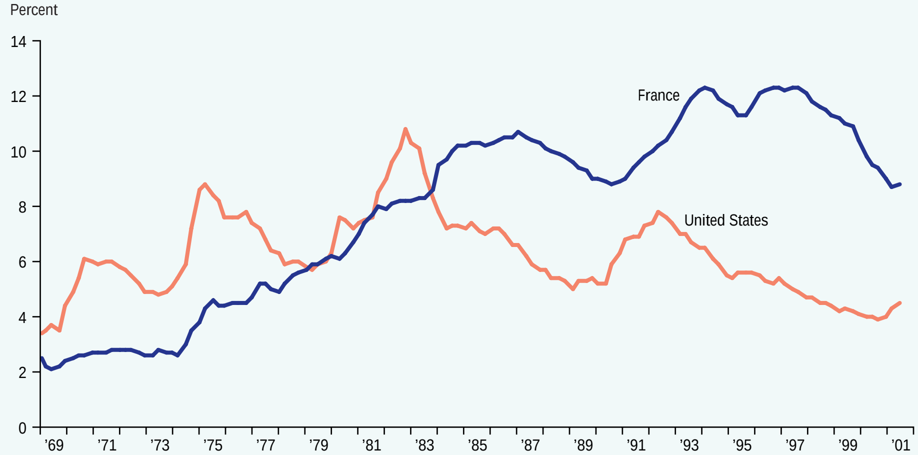
Although such advice is common, there is surprisingly little empirical evidence that labor market rigidities account for much of the cross-country variation in unemployment. France's unemployment rate was below the U.S. rate for most of the 1970s, even though most institutional features of its labor market were already in place. Portugal has strict employee protection laws but boasts unemployment of only 4 percent.[3]

Economies with very different institutions may, in fact, have similar long-run unemployment levels. Firing costs make firms more reluctant to hire, but they also tend to increase the duration of employment contracts.[4] Individuals remain unemployed longer, but they don't face unemployment as often.

Economists argue, nevertheless, that labor market rigidities can have a lasting impact on unemployment by magnifying the effect of adverse shocks. While economies with flexible labor markets are able to adjust quickly, those with rigid

Chart 1

U.S. and French Unemployment Rates



NOTE: All data are quarterly.

SOURCES: Institut national de la statistique et des études économiques; Bureau of Labor Statistics.

labor markets require a long time to revert to their long-run unemployment level (Ljungqvist and Sargent 1998; Blanchard and Landier 2000). The leading explanation for France's high unemployment holds that like many of its neighbors, the country is still recovering from a series of adverse shocks that included two oil shocks and a sharp productivity slowdown in the 1980s.

The impact of those shocks was compounded by the fact that the wage bargaining process is highly centralized. Nonunion workers and the unemployed are not directly involved in the wage formation process, which limits the influence of rising unemployment on wages.

Meanwhile, many individuals are caught in "inactivity traps." In 1998, a third of those who decided to forgo France's minimum income by taking a job saw little or no increase in their overall income (Lhommeau and Rioux 2000). It is, in fact, remarkable that most unemployed workers continue looking for jobs despite many financial disincentives.

What the French Want

The French government has adopted various measures to encourage the unemployed to seek work. Minimum-income recipients who accept a job now keep part of their benefits for one year. The government also cut payroll taxes on low salaries to increase the net pay of workers at or near the minimum wage.

In a recent report commissioned by Prime Minister Lionel Jospin, Jean Pisani-Ferry (2000) calculates that those measures won't significantly impact long-term unemployment. The French economist goes on to suggest the adoption of a tax credit that would eliminate most financial disincentives to work. He also recommends that requirements making job search efforts a condition of unemployment benefits be reinforced.

Pisani-Ferry points out, however, that "the French, much like most Europeans, do not wish to adopt the rules that govern the U.S. labor market, which probably means that they are willing to accept a higher equilibrium unemployment level than what it could be." Only two of the OECD's 1994 recommendations to the French government were implemented at what was categorized as a "sufficient" level because many of them are politically infeasible (OECD 1998). A limited attempt at reform by France's last conservative government in 1995 triggered massive demonstrations and strikes.

Recent reforms, if anything, should make labor markets yet more rigid. In response to a wave of mass layoffs, in June the government passed a "social modernization" law that toughens layoff standards. Employers must now demonstrate that they have considered all other options before resorting to layoffs. When the finance minister expressed concern that this might hinder French firms' ability to compete, the communist party accused him of being "sensitive to liberal ideas" (Pisani-Ferry 2000).

These developments underscore the importance of assessing the political viability of reforms. As a first step in this direction, Boeri, Börsch-Supan and Tabellini (2000) asked a sample of 4,000 European households what proportion of their income they'd be willing to pay for various levels of unemployment benefits. Their study found that a majority of the French sample were willing to pay for the current level of benefits. They also found that a majority of the French respondents would approve a reform package extending benefits to more people but reducing the duration of benefits. Such a reform would have a direct, beneficial impact on long-term unemployment.

While these findings should be interpreted with caution, they suggest there is room in France for reforms that would alleviate inactivity traps. In the words of Pisani-Ferry, the fact that the French like many aspects of their welfare system "does not imply that a 9 or 10 percent unemployment rate is socially optimal."

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Notes

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1 Miles (2000) discusses common law exceptions to the employment at will doctrine. Layoffs of 50 or more employees in a given establishment (mass layoffs) are governed by the Worker Adjustment and Retraining Notification Act, which requires employers to give workers 60 days' notice.

2 French workers are entitled to financial damages if the labor affairs authority decides the separation is without serious cause. Two months' notice of a layoff is required if the worker's tenure exceeds two years.

3 While Di Tella and MacCulloch (1999) find, based on surveys of businesspeople, that labor market flexibility leads to lower unemployment rates, a study of OECD countries by Nickell and Layard (1999) finds "no evidence that stricter labor standards or employment protection lead to higher rates of unemployment." They conclude that "time spent worrying about strict labor market regulation, employment protection and minimum wages is probably time largely wasted."

4 See, for example, Cohen, Lefranc and Saint-Paul (1997).

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