ECO FLASH

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France: employment and job support measures

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- **The ending of the SMEs hiring premium, the sharp cutback announced in the number of government-subsidised job contracts and the less favourable CICE tax credit contribute to slow employment growth in the near term.**
- **An extended slowdown in 2018 is not the most likely scenario in our view.**
- **Growth is gaining momentum, which should bolster employment. New support factors are also expected to come into play, including tax cuts and greater flexicurity measures in the job market.**
- **In 2019, even though growth is expected to slow, we foresee another slight acceleration in employment, which should get a boost from the transformation of the CICE tax credit into a cut in employers' social contributions and from a further reduction in the cost of labour around the minimum wage level.**

The French employment recovery was the big surprise of the past two years. Indeed, since 2015, the job market has been surprisingly robust given the sluggish pace of growth over the period. Until late 2016 and early 2017, growth was running at about 1%, which is far short of the 1.5-2% growth rates normally associated with job creations capable of bringing down unemployment. Since year-end 2016, growth has accelerated to an annualised quarterly rate of 2% – and there is a good chance that it will hold close to this pace in the quarters ahead – leading to a more consistent picture with strong job growth. Yet we cannot be certain that job growth will hold to this trajectory: although the horizon is brighter in terms of economic growth, the same cannot be said for job prospects. The big question is whether the Q3 slowdown in private payroll employment is only temporary or marks the beginning of an extended slowdown. In this article, we will look at the reasons behind this uncertainty.

France: employment and GDP growth

Year-on-year, %

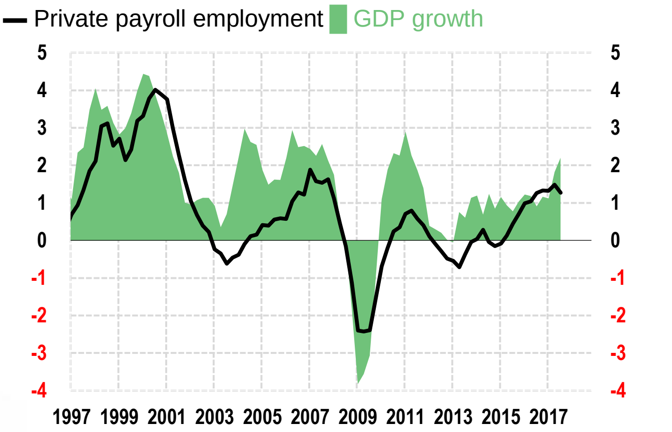

Chart 1 Source: INSEE

Job-richer growth

Private payroll employment swung back into growth in Q2 2015 (see chart 1). Nearly 550,000 private payroll jobs were created between Q2 2015 and Q3 2017 (the most recent quarter for which data are available), at an average quarterly rate of 55,000, a cumulative increase of 2.9%, or 0.3% per quarter (annualised rate of 1.2%). Over the same period, real GDP increased a cumulative 3.5%, or an average quarterly rate of 0.3% (annualised rate of 1.4%).

This similar pace of growth in private payroll employment and GDP is striking: such sluggish GDP growth (at least through year-end 2016) was not expected to generate such a robust pace of job creations. This situation is even better illustrated by another series of statistics: in 2016, private payroll employment increased at an average annual rate of 1.2%, the fastest pace since 2007, and in line with the job growth of

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1997, even though GDP growth was significantly lower (averaging only 1.2% in 2016, compared to 2.4% in 2007 and 2.3% in 1997[1]). This performance has a price, however: squeezed labour productivity gains.

The change in total employment is also instructive. The recovery in private payroll employment, which is the focus point of this article, began in 2015, but the upturn in total employment dates back to 2010. Total employment has increased constantly since the end of the Great Recession, whereas private payroll employment dropped off again in 2012-2013, following the European sovereign debt crisis and the ensuing stagnation in growth. Total employment managed to hold in positive territory[2] thanks to the increase in public-sector employment and non-payroll employment (see chart 2).

Sluggish but positive economic growth most certainly contributed to job growth, but another driving force (and probably the main one) was economic policy and the wide array of job support measures that enriched the job content of growth over the period. Among these measures were the usual variety of government-subsidised job contracts. Using a countercyclical logic, they address the social handling of unemployment and result in few or no permanent jobs, although they contributed to the total number of jobs created. Other job support measures were designed to reduce labour costs (CICE competitiveness and employment tax credit, cut in employers' social contributions via the responsibility and solidarity pact, and the SME hiring premium[3]). They are less direct but they tend to have a more lasting impact on employment.

The correlation between growth and employment works in both directions: growth stimulates employment, and in return, employment bolsters growth, which as unemployment declines, creates a positive gearing effect that lays the ground for a virtuous circle of self-sustaining growth. If we add the rebound in corporate investment that accompanied the first signs of an upturn in the job market, then the ingredients for a self-sustaining recovery have been in place in France since 2015. As a result, French economic growth can be characterised as being both slow and robust: slow in terms of the economic growth rate, which until recently was very modest for several reasons[4]; but also robust thanks to the solidity derived from job growth. This highlights the importance of employment, which will be even more important when several major budget and fiscal reforms are introduced next year, which could strain household consumption. Its strength will depend primarily on the strength of employment.

What kind of slowdown in the short-term?

Some of the job support measures mentioned above have already expired (the SME hiring premium ended on 30 June) or their budgets have been scaled back sharply (the number of government-subsidized job contracts). Consequently, it is worth asking whether and by how much the job market will slow down by the end of the year.

[1] Unadjusted for the number of working days
[2] Total employment can be broken down into private payroll employment (70%), public-sector employment (20%) and non-payroll employment (10%).
[3] The CICE tax credit was launched in 2013; the responsibility and solidarity pact first reduced charges in 2015 and then expanded the cuts in 2016; and the hiring bonus was offered between January 2016 and June 2017.
[4] *France: on the road to recovery*, Conjoncture n°7, July-August 2017

France: Total employment and its components (1)

Average annual change (%) and contribution (percentage points)

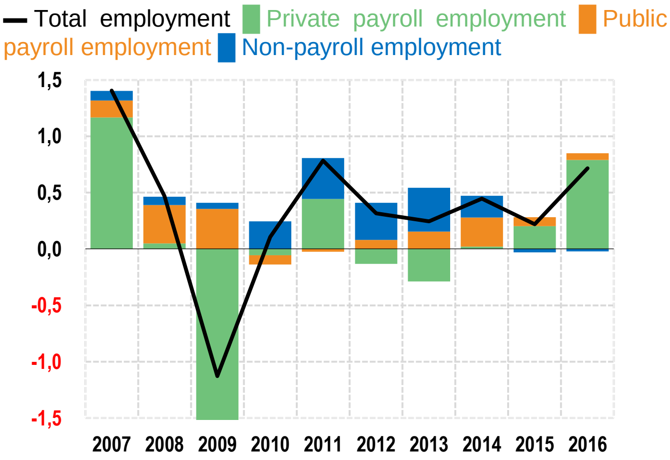


Chart 2 Source: INSEE

France: Employment and the job market climate

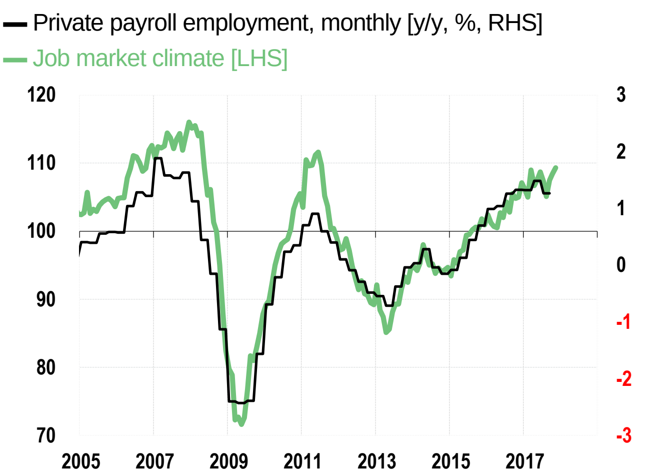


Chart 3 Source: INSEE

In the market sector, the slowdown should be rather mild since the payback due to the ending of the hiring premium should be offset by the positive impact of growth and the other measures to reduce labour costs that are still at work. Moreover, this slowdown can barely be seen, if at all, in the various surveys available on expected employment trends: the INSEE monthly economic survey for services; the INSEE quarterly economic survey for industry; the INSEE monthly index on the job market climate (see chart 3); and the jobs component of the Markit PMI indexes. The signal from temporary employment trends is also rather positive (see chart 4). And although the payback can be seen in terms of Q3 hiring reports (-0.7% q/q, all types of job contracts combined), monthly data shows that it is mainly concentrated in July. All this information suggests that the Q3 dip in private payroll employment should prove short-lived (0.2% q/q according to preliminary INSEE estimates, compared to average quarterly growth of 0.4% q/q in the previous four quarters).

In contrast, according to INSEE estimates, the reduction in the number of government-subsidised job contracts will have a more negative impact on non-market employment, triggering a sharp slowdown in total employment in H2 2017 (see chart 5).

Framing the debate in 2018 and 2019

Yet the question of a job market slowdown cannot be limited solely to the second part of 2017: the trend could well extend into 2018, due not only to the elimination of the job support measures mentioned above, but also to the less favourable CICE tax credit, whose rate will drop from 7% to 6%.

However, nothing is certain yet, at least not as far as the slowdown in market employment is concerned. Like in H2 2017, it will continue to be supported by economic growth, and it could even benefit from greater support given the expected acceleration in 2018 growth (to an annual average of 2%, from 1.8% in 2017 according to our forecasts). Employment is also expected to get indirect support from new fiscal incentives to boost investment and attractiveness. We might also see the first positive effects of the new Labour Code reform, as well as other reforms pertaining to apprenticeships, vocational training and unemployment benefits[5].

Granted, the impact of structural reforms such as these is usually not felt until the medium to long term. Yet a positive short-term effect is also conceivable if business confidence is improved. When companies are more confident and optimistic, it is growth-supportive and with growth comes employment (the same argument applies to household confidence). And the good news is that companies are bound to see these reforms in a positive light, particularly the labour code reform, which introduces greater flexibility, simplicity and visibility (see the infographic on the following page for more information on the content of the ordinances[6]). The unemployment insurance reform might not be received as warmly due to the proposed introduction of a bonus-malus system for CDD fixed-term job contracts (to regulate their use and promote CDI open-ended job contracts, by internalising costs that are currently borne by the unemployment insurance system)[7]. Although the reform will have a negative impact on some companies, it must be seen in terms of the overall benefits that are expected to be derived from a better functioning job market.

In the eyes of French households, it is too early to say what impact these reforms will have on their confidence, between, on the one hand, the favourable perception of measures to promote job security and improve the functioning of the labour market, and on the other hand, the more negative perception of flexibility measures. At this stage, it is impossible to say which way the scales will tip.

France: Employment and temporary services

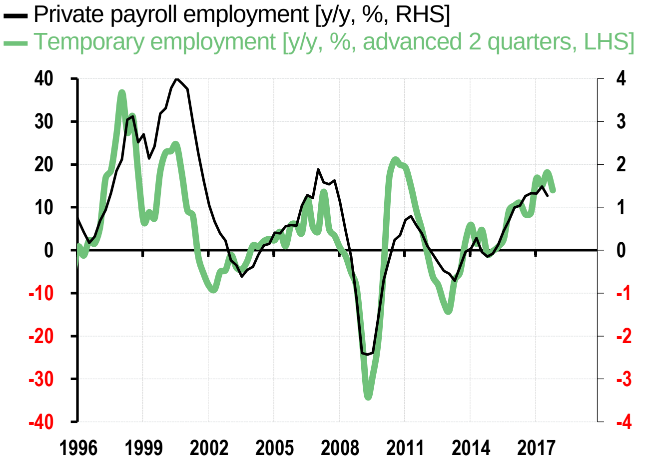


Chart 4 Source: INSEE

France: Total employment and its components (2)

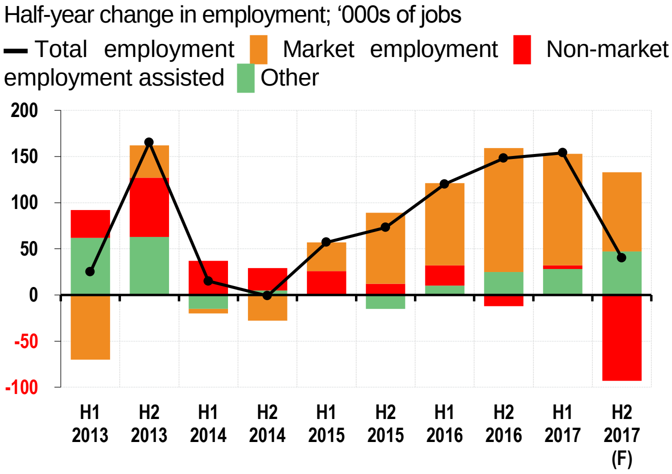


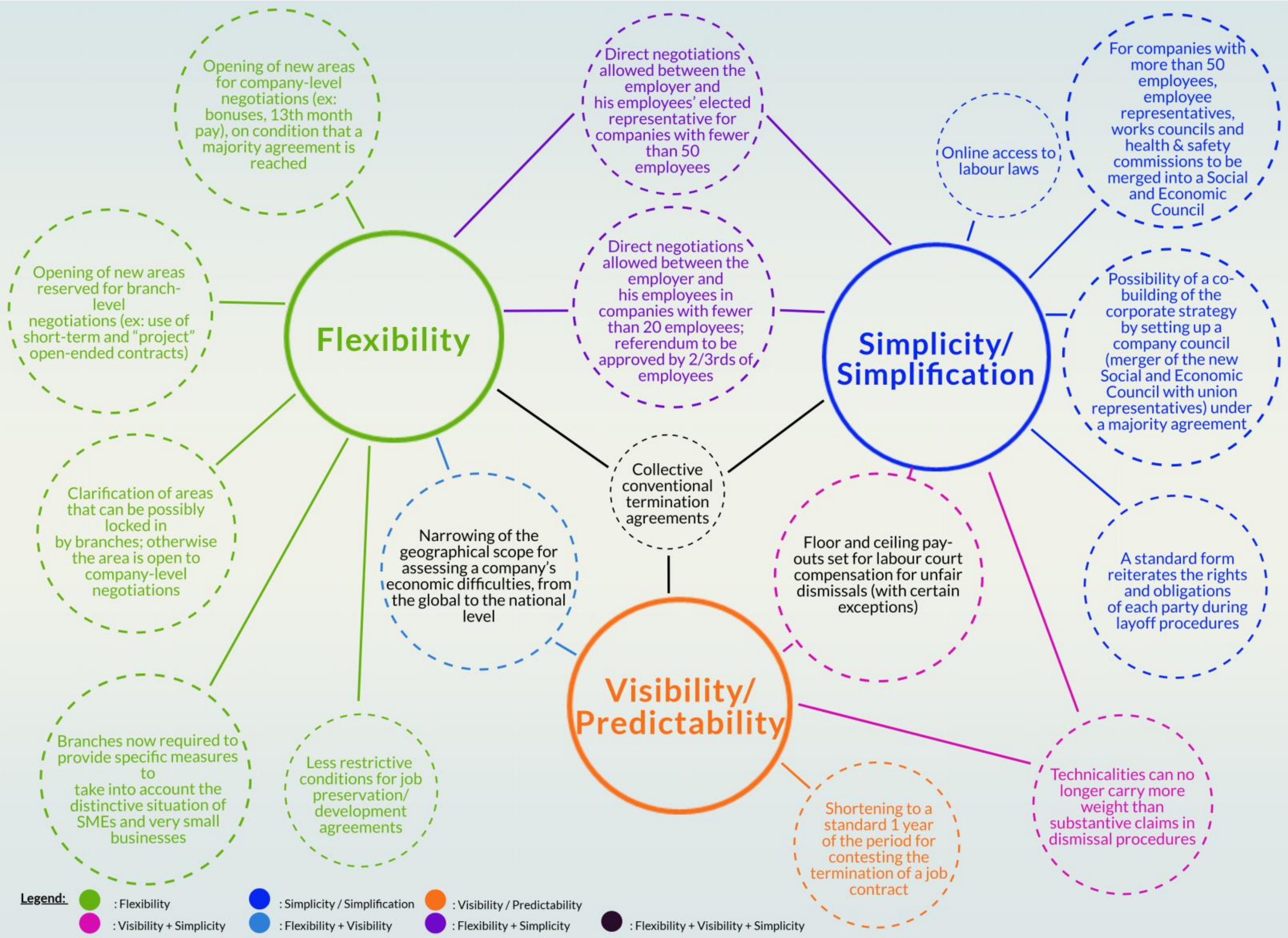
Chart 5 Sources: INSEE, INSEE forecast (Point de Conjoncture, October 2017), BNP Paribas

In the near-term, the labour code reform may already have a positive impact on employment via business confidence but it could also have a negative effect. This latter depends on the size of overstaffing and workforce hoarding due to difficulties to fire workers. If the reform were to eliminate these difficulties, the number of layoffs could rise rather quickly in the short term, cancelling out the increase in hiring. This would be a real and significant risk during a cyclical downturn, but with the current economic upturn and the first signs of difficulties in hiring, we think this risk can be minimised or even neutralised.

In 2019, other changes are being examined to reduce the cost of labour, which are bound to have an impact on employment. This is the year that the CICE tax credit is scheduled to be transformed into a 6-point reduction in employers' social contributions, for workers earning up to 2.5 times the minimum wage. This transformation will be accompanied by another 4-point cut in employer charges for workers earning between 1 and 1.6 times the minimum wage.

[5] These three reforms are currently in the preparatory phase and will take effect during 2018.
[6] For further details, Thibault Mercier, *France: What to expect from labour code reform?* Conjoncture n° 8, September 2017.
[7] In addition to this feature, the unemployment insurance reform contains three other major changes: it would extend coverage to those who quit and the self-employed; it would strengthen the principle of "rights and obligations" and introduce tighter controls on job hunting; and it would switch from the current bi-party system of governance to a tri-party system associating the State and social partners, the terms of which have yet to be defined.

Content of labour code reforms



By targeting low wage earners, this reduction in labour costs should have a positive impact on low-skilled employment. There is a consensus over the effectiveness of this type of measure. In contrast, the debate is still open on the impact of transforming the CICE tax credit. For workers earning more than 1.6 times the minimum wage and up to the 2.5x threshold, the new reduction in charges would not be as favourable for companies as the previous system due to the induced increase in corporate taxes. What companies win in terms of lower charges is offset in part by higher taxes indeed[8]. A less favourable measure means a less positive impact on employment. However, the government intends to accompany the transformation of the CICE tax credit into lower charges with a step-by-step reduction in the corporate tax rate. Consequently, it does not expect companies to lose out in the process. In the end, employment should get the same support in financial terms.

Yet the nature of the job support mechanism changes, which raises the question about possible differences in the sensitivity of employment to the manner in which labour costs are reduced. This is a legitimate question since the CICE tax credit has so far produced rather meagre results in terms of jobs created or saved (roughly 100,000 between 2013 and 2015 according to the CICE monitoring committee's latest estimates[9]). But it also raises another question: are these poor results due to the measure's lack of effectiveness or is it just a matter of time? The answer is not clear at this point. In the meantime, this argues in favour of the transformation of the CICE tax credit into a reduction in charges, a simpler and better known method of lowering the cost of labour, which could prove to be a more effective way to support job than the CICE tax credit.

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[8] All other factors being the same, fewer charges means higher profits, which in turn means higher taxes.

[9] http://www.strategie.gouv.fr/publications/rapport-2017-comite-de-suivi-credit-dimpot-competitivite-lemploi

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