

COUNTRY SCAN

France

Alliance Francaise!

France, one of the world's most developed countries (with a per capita income of about \$22,000) has also emerged as one of the most eccentric. In the age of liberalization, privatization and globalization, the French still believe in strong governmental controls.

Due to excessive state intervention, the French economy has not quite performed to its full potential. During the 1990s, the Government did make some progress in privatization and reduction of budget deficits. Taxes, however, still remain the highest among the G-7 industrial countries. Regulation of goods and labor markets is quite high for a developed country. Moreover, rigidities still plague the labor market. Experts wonder whether the estimated structural rate of unemployment of 8.5 percent can be reduced. Efforts to privatize continue, but the Government still controls major firms in several sectors. In addition, the French concept of a "golden share" enables the Government to block strategic moves made by firms in which it holds a minority interest.

Money matters

Like many other industrialized countries, the French economy is dominated by services. The services sector accounts for 72 percent of the GDP. Agriculture and agro-food industries account for six percent of the total value added in the French economy. Manufacturing accounts for 16 percent of GDP, construction for four percent and energy generation for three percent. Many of the services such as health care, education, telecommunications and transport are in public sector.

During the last few years, France has witnessed a distinct improvement in many macroeconomic indicators. The budget deficit had increased sharply in the early 1990s, but the situation has been improving since 1994. This improvement is the result of curbs on spending by Central Government, local authorities and the social security system. For a long

time, inflation was high in France but it has now been reined in. From 14 percent per year in the early 1980s, it was brought below three percent in 1991. The downward trend has continued in recent times with 1.5 percent for 1996, 1.3 percent for 1997 and 1.3 percent in 1999. As a result, France, after meeting the criteria set by the Treaty of Maastricht, has entered the Eurozone.

Most Frenchmen are happy with the strong state. It played a major role in the 30 years of spectacular economic growth after the Second World War, which rapidly industrialized a mostly rural economy. It also made France the world's fourth-largest industrial power after America, Japan and Germany.

The French have all along felt that their model is superior to the US, due to its emphasis on equality and community. The French dislike for the American style of management intensified in the 1950s under the twin influences of the French Communist Party and General Charles de Gaulle. De Gaulle once said that France would show the world how to "build an industrial civilization which is not derived from the American model and in which man will serve as an end, not a means."

But despite the rhetoric, the French businessmen have been quietly and slowly changing with the times. Various sectors of the economy have been liberalized. Electricity, telecommunications and gas markets have been opened to competition. One-time icons of the French State such as Air France, Aérospatiale and France Telecom have been partially privatized. Foreign investors hold nearly half the shares in many formerly state-owned firms such as

Societe Generale (a bank) and Elf (an oil giant).

Labor wealth

One of France's major strengths is high labor productivity. Measured by output per hour worked, labor productivity in France is higher than America. However, the main reason for this phenomenon is that the companies in France employ fewer people and prefer to grow by investing in machines. High social-security charges, redundancy pay and rigid rules about hiring and firing make employers think twice before recruiting more workers.

The enforced introduction of a 35-hour week in 2000 is a good example of state interventionism to regulate work practices. The law, however, has had unintended consequences. Employers are using the prospect of a shorter week to extract various concessions from the unions: Wage moderation, weekend work and late-night shifts. Many jobs in the private sector are now in the form of short-term contracts.

A major headache for France is its pension system. The young generation effectively supports the older generation's pensions. The dependency ratio, people over 60 as a proportion of those aged 20-60, is roughly one to three currently.

Health care is another area of concern. The French spend about 10 percent of their GDP on health care, more than any other country in the EU. Per capita consumption of tranquilizers, sleeping pills and anti-depressants is probably the highest in the developed world. The Government has tried to curb costs in various ways, but much more has to be done.

Tax rates in France are well above the EU average. The standard rate of corporate tax is 33.3 percent, while that of value added tax is 19.6 percent. The peak income tax rate is 52.75 percent.

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Trade across borders

By becoming more open to the rest of the world since 1945 and casting aside its traditional protectionist attitudes, France has emerged as one of the most important players in the global economy. In 2000, France exported goods worth \$295.5 bn and imported goods valued at \$294.4 bn. It now accounts for six percent of world trade, second only to the USA in services and agricultural exports and fourth in industrial products. The country's exports account for 21 percent of its GDP.

France's five largest customers are its closest European neighbors: Germany, United Kingdom, Italy, Belgium-Luxembourg and Spain. These countries are also France's largest suppliers with the exception of Spain. Germany has long been France's leading trading partner, currently accounting for 16.3 percent of total French foreign trade, ahead of Italy (9.6 percent) and the UK (9.2 percent). In 1996 and 1997, France's chronic trade deficit with Germany was reversed. Outside the EU, France has three main trading partners: The USA and Japan, with both of which it has a trade deficit and Switzerland, with which it has a large trade surplus.

Foreign investments

French government officials see foreign investment as a way to create jobs and stimulate growth. Investment regulations are simple. A range of financial incentives is provided to foreign investors. The investment promotion agency, DATAR, provides assistance to potential investors. The formal French investment regime is among the world's least restrictive. There is no generalized screening of foreign investments. But acquisitions are subject to official reviews. Also, in some sectors, policies tend to favor investors from other EU countries only.

France has attracted many coveted IT, communications and automotive investments in recent times. The country's main attractions are its skilled labor force, central location in Europe and good infrastructure. IT overtook automobiles as the top FDI sector in France in 1998. In May 1999, the French Government announced an annual fund to encourage R&D in five priority areas—life sciences, IT, human and social sciences, energy and transport and earth and environmental sciences.

In November 1999, Sun Microsystems announced it would expand its European R&D center in Grenoble. Sun preferred Grenoble to other sites in Europe because

| Important Macroeconomic Indicators | | | | |
|-------------------------------------|--------|--------|--------|--------|
| | 1997 | 1998 | 1999 | 2000 |
| GDP per head (USD) | 24,033 | 24,640 | 24,306 | 21,700 |
| GDP (% real change p.a.) | 1.89 | 3.33 | 3.18 | 3.19 |
| Government consumption (% of GDP) | 24.21 | 23.54 | 23.64 | 23.47 |
| Budget balance (% of GDP) | -3.10 | -2.80 | -1.70 | -1.30 |
| Consumer prices (% change p.a.; av) | 1.22 | 0.59 | 0.57 | 1.69 |
| Public debt (% of GDP) | 64.70 | 65.19 | 64.94 | 63.30 |
| Labor costs per hour (USD) | 17.99 | 18.28 | 17.98 | 16.23 |
| Recorded unemployment (%) | 12.48 | 11.86 | 11.22 | 9.72 |
| Current-account balance/GDP | 2.69 | 2.61 | 2.55 | 1.80 |
| Foreign-exchange reserves (bn\$) | 30 | 44 | 39 | 37 |

Source: Economist Intelligence Unit

of its excellent R&D infrastructure including local universities and engineering schools. In the same year, another American company, Lucent Technologies announced that it would locate a new European R&D center in France for development of third generation mobile phones.

But the French are still somewhat paranoid about giving up control of their businesses to foreigners. There has been stiff labor opposition to acquisitions of French businesses by the US firms. In other cases, French firms have shown a distinct preference for working with French and European firms, rather than American firms. Lack of transparency in the privatization process has aggravated suspicions about the equal treatment of foreign investors in public companies.

Many foreign investors cite excessive labor regulation and high income and payroll taxes as the greatest disincentive to investing in France. A specific tax burden faced by US investors is the treatment by French authorities of two social security taxes, as income taxes rather than as social security contributions. Therefore, companies and employees effectively contribute to the financing of two social security systems. The need to compensate foreign workers for the extra tax burdens of people working abroad has considerably increased the cost of employing highly skilled expatriate workers.

Infrastructure

France has one of the densest and most efficient transportation networks in the world. Roads carry 60 percent of domestic freight, compared to 40 percent in 1970. Nearly 90 percent of travel is made by road, mainly by cars, although use of public transport is rising sharply, especially for tourism. With over 965,000 km of roads, the French network is the

biggest in Europe. International links have increased with the construction of the Paris-Lille-Brussels, Macon-Geneva and Perpignan-Barcelona motorways and the Mont-Blanc (1965), Fréjus (1980) and Puymorens (1994) road tunnels. The three main entry points for airfreight are the Orly and Charles de Gaulle airports in Paris and Saint-Exupéry airport in Lyon. France has 12 major seaports, many of which are equipped for container ships. There is also an extensive river-transport system. The communications infrastructure is also advanced and telephone lines cover the whole country. There is easy access to the Internet. The French "Minitel", a telephone-based computer network is widespread and provides many consumer services. High-speed Internet access though limited is expanding rapidly. The Government is also trying to promote widespread use of information technology.

Outlook

France stands at the crossroads today. It is still a world leader in many industries. With its sophisticated infrastructure and highly skilled labor, France is a player to reckon with in the global economy. Many French companies have been aggressive globalizers. Carrefour, the retail chain and Renault, the automobile company are good examples. Renault, which took a stake in Nissan, has done a remarkable job of reviving the ailing Japanese company's fortunes. But many of France's policies that revolve around active state intervention are proving to be increasingly burdensome and expensive. ■

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