SPECIAL REPORT

Into gear

Getting business moving again

France is well placed to benefit from the knowledge economy

Print edition | Special report

Sep 30th 2017

THE WORD “FACTORY” does not do justice to Bugatti’s state-of-the-art production site in the shadow of the forest-clad Vosges mountains in eastern France. There is no grease or grime around the assembly line. The floor is a shimmering white gloss. The airy space feels more like a museum of modern art, gleaming eight-litre engines displayed like so many design exhibits. Workers wear white gloves, as if handling treasures. In fact, they are building the world’s fastest supercar.

A Milanese engineer, Ettore Bugatti, founded a car factory in this corner of France in 1909. Germany's Volkswagen, which later bought the brand, chose Bugatti's historic French site to develop the Veyron, a car designed to combine elegance and speed. The French factory turned out every one of these luxury record-breaking cars after their launch in 2005. This year Bugatti unveiled a successor, the Chiron, which pushes the limits of physics and sleek design further still. The car reaches 100km (62 miles) an hour in two-and-a-half seconds and has a starting price of €2.4m. Christophe Piochon, head of the French plant, compares the exquisite craftsmanship that goes into the construction of a Bugatti car to haute couture.

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Although France has a reputation for making life difficult for business and struggles to hold on to low-end industries and jobs, it is in some ways well placed to carve out a competitive niche in the knowledge economy—if it can get its mix of taxes and business regulation right. As the Bugatti factory suggests, the country has strong traditions in both luxury and creative industries, as well as in engineering. It boasts excellent research in maths and has a number of outstanding business and engineering schools.

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Moreover, something has begun to stir in corporate France, as the car industry illustrates more broadly. In the past, French car designers had a reputation for a certain cool. When Citroën launched the futuristic DS “Goddess” in 1955, Roland Barthes, a French structuralist, described it as “spiritual”. Now, after years of turning out dull vehicles and focusing on cost-cutting by shifting production to cheaper countries, French carmakers are back on form. PSA has just bought General Motors’ European operations. Renault has launched the Alpine sports car, a retro nod to its 1960s classic, which is being built in the French port of Dieppe. The Renault-Nissan alliance took an early bet on electric vehicles. By this year it had become the biggest carmaker in the world. “A few years ago the motor industry was said to be the steel of the 21st century, but today there’s an incredible effervescence in the sector,” comments Jacques Aschenbroich, head of Valeo, which makes high-tech automotive parts, such as sensors for driverless cars. Half of Valeo’s current orders are for products that did not exist three years ago.

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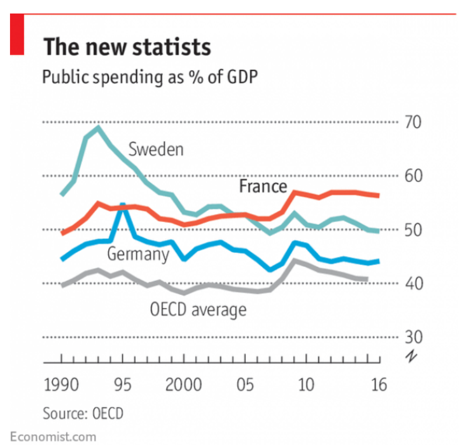
Like Valeo, other giants of the CAC 40, which provide the world with tyres (Michelin), shampoo (L’Oréal), lipstick (Chanel), yogurt (Danone), intelligence systems (Thales) and handbags (Louis Vuitton), have long been globalised. France has more firms than Germany in the *Fortune* 500. But a tangle of rules for mid-sized firms deters small ones from expanding. France has less than half as many mid-sized companies as Germany, and half as many firms that export. Too few invest in digitisation. Last year’s World Economic Forum competitiveness index ranked France 21st overall, out of 138 countries, but only 33rd for firms’ adoption of technology.

Enterprise à la française

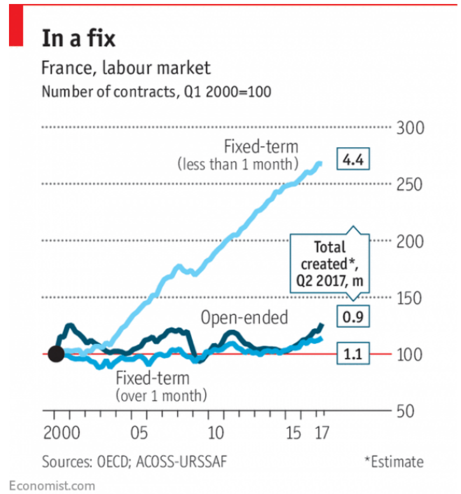
Startups provide a good example of how better incentives, and fewer burdens, could release French growth. High taxes on stock options and bureaucratic rules used to make France a difficult place for them. But the boost Mr Macron gave the sector when he was minister helped bring about a cultural shift. Venture-capital investment in France has increased sharply since 2014, and last year was higher than in Germany. France "used not to celebrate success", says Frédéric Court, a London-based venture capitalist, but he is now bullish about the country. Xavier Niel, a billionaire entrepreneur and godfather to tech startups, describes a "new alchemy" in France.

The country has particular potential in sectors set for rapid growth, notably machine learning, artificial intelligence (AI) and big data. Two years ago Facebook set up its only European research lab into AI in Paris because of the research going on in France, says Antoine Bordes, who runs it. Young French graduates are increasingly trying their luck with startups. Hugo Mercier, a 25-year-old engineering graduate, shunned corporate life to launch Dreem, a headband that uses promising neurotechnology to improve deep sleep. Another, Frédéric Mazzella, founded BlaBlaCar, a ride-sharing startup now valued at about €1.4bn. This summer Mr Niel opened Station F, the world's biggest incubator in eastern Paris, designed to attract international talent. "Within five years", claims Mr Niel with his customary flourish, "France will be the top country in Europe for startups."



"There is every reason in the medium run for economic growth in France to match or exceed the average in the euro zone," says François Villeroy de Galhau, the governor of the central bank. If growth in the French economy were to reach this average, combined with labour-market reforms, the effect on unemployment could be "spectacular", he says. France also benefits from strong demographics, dynamic regional cities, excellent infrastructure, a first-class health system and good public services.

The two main brakes on growth are well documented: an overly large public sector and a rigid labour market. Public spending accounts for 56% of GDP, the highest level in the OECD (see chart), requiring higher taxation than in any other OECD country bar Denmark, without generating more growth in return. The rigid labour market discourages firms from creating permanent jobs, and hiring young (and older) people. French unemployment, at 9.8%, is at twice the German level; for the under-25s it reaches 23%. The 3,500-page labour code offers little flexibility, so firms use temporary contracts, often for less than a month, which now account for over four-fifths of new contracts (see chart).



Mr Macron spent a lot of time hanging out with tech types when he was economy minister and has a good grasp of what is needed. He plans to reduce the corporate tax rate from 33% to 25% over five years, and ease the payroll burden by transferring some social charges to a more broad-based tax. He wants to encourage investment in the productive economy by transforming the annual personal-wealth tax into a property tax, and to put a flat tax on financial income. By 2022 he plans to have curbed the share of GDP consumed by public spending to 52% and to have sold off a chunk of state holdings. “Our guiding principle is to create an environment in which companies can succeed,” says Mr Le Maire, his centre-right finance minister. In this respect, the labour reform, agreed on earlier this month, is crucial. It will give companies more freedom to negotiate at enterprise level and reduce the financial risk of wrongful dismissals, a deterrent to hiring permanent staff.

Further reforms draw on the insight that France needs to adapt its system of rules and safeguards, designed in the post-war years to protect jobs, to focus on protecting individuals instead. “We need a state that says: I’m not going to lead your life for you, I’m not there to replace what you do. Some will do well, others less so. But I will protect you from the great accidents of life and I will help give you the capacity to succeed,” says Mr Macron. The government intends, for example, to replace the spaghetti soup of 35 different pension regimes with a universal system, based on individual points-based accounts, so as to encourage job mobility. It wants to put more of the €32bn state-mandated budget for training in the hands of individuals, using personal credits; currently, 62% of the budget is spent on those who already have jobs and only 14% on the unemployed.

These are ambitious projects. Unifying France's pension system could take ten years, and public-spending cuts will be contested. If the government achieves its aim of curbing the budget deficit to 2.9% this year, that will be the first time in ten years that it has dipped below 3%. What makes Mr Macron's proposed reforms more promising than past efforts is their transparency. Plans to change pensions in 1995 and to introduce a flexible work contract for the young in 2006 had not been flagged up in the preceding election campaigns, and were roundly defeated by the street. Mr Macron, by contrast, spelled out his reforms and secured a mandate for them. He has put a mix of specialists and career politicians in government to implement them. He has also been careful to maintain a dialogue with interested parties. Muriel Pénicaud, his labour minister, held about 50 meetings with unions and bosses this summer. They seem to have found a constructive partner in the Confédération Française Démocratique du Travail (CFDT), a moderate union, which has overtaken the hardline Confédération Générale du Travail (CGT) in the private sector for the first time since it was founded in 1895. "The French elected the president because they wanted something new," says Laurent Berger, the head of the CFDT. "I'm convinced they want that novelty elsewhere too, including from unions."

It would be remarkable if the country were able to shift to a less theatrical form of conflict resolution. Confrontation and street drama still retain a romantic hold on the collective imagination. Mr Macron's plans could yet go wrong. Some of his opponents, who portray him as unforgivably pro-business, will seek conflict for political ends. A web of public-sector industrial interests will resist disruption, too. Mr Macron is not looking for a show of force, but he seems ready to engage in one if need be. If he can break with his predecessors' habits, manage reform wisely and put in place the basis for a more sustainable upturn, the French economy may at last realise its promise.

This article appeared in the Special report section of the print edition under the headline "Into gear"