authorities, a continuation of policies to lower labor costs could be crucial to ensure reduced unemployment rates.

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II. The Fiscal Effects of Job-Rich Growth in France[13]

A. Introduction

21. This chapter addresses the question of the fiscal benefits of job-rich growth in France during 1997-2000. Higher economic growth tends to improve the fiscal accounts, since revenues automatically increase with income while most spending does not. But are the favorable effects of growth particularly large if growth is rich in employment? While a number of *a priori* considerations would suggest so, the experience of France indicates that the "fiscal dividend" from strong employment creation was negligible.

22. When growth is job-rich fiscal revenues may be higher and expenditures lower. On the revenue side, large employment creation may boost the labor share and revenues, since labor is usually taxed more heavily than capital.[14] On the spending side, transfer expenditures on unemployment insurance or poverty programs are likely to decline appreciably as employment expands. Indeed, the large size of transfer programs in France often results in a small financial gain in shifting from inactivity to employment because generous benefits are withdrawn and employment income is taxed.[15] The counterpart of this phenomenon should be that the government reaps a large financial gain from reducing the benefit rolls. Spending on labor market policies (including cuts in social security contributions) may also fall as the target population for these policies shrinks. Here, though, the relationship is more ambiguous, because growth might be rich in employment because of stepped up spending on in labor market policies.

23. The chapter is organized as follows. The next section contains an overview of the behavior of revenues, spending on unemployment insurance and other unemployment-related transfers, poverty programs, and active labor market policies in France in the 1990s. Section C analyzes why labor-related expenditure declined only marginally. Section D concludes.

B. Fiscal Revenues, Labor Market, and Poverty Spending in 1990-2000

24. By boosting economic growth, and therefore fiscal revenues, wage moderation certainly contributed to ease the financial position of the government and create room for tax cuts in 1997-2000. In addition, during this period fiscal revenues grew much faster than income.[16] Can the job-rich nature of growth explain these high elasticities? A disaggregated

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[13] Prepared by Enrica Detragiache and Marcello Estevão.

[14] For an overview of the relative taxation of capital and labor and their evolution in OECD countries, see Duval (2002).

[15] Laroque and Salanié (1999 and 2000) and Hagneré and Trannoy (2001), among others, study different aspects of the poverty and inactivity traps in France.

[16] According to the *Rapport Economique, Social et Financier du Gouvernement 2001*, the elasticity of government revenues with respect to GDP was 2.2 in 1999 and 1.9 in 2000.

analysis of the relationship between tax revenues and employment is beyond the scope of this paper. However, at a more general level job-richness leads to revenue elasticities higher than one if it increases the share of labor in GDP, since labor is taxed more heavily than capital. In particular, between 1991-1997 the average effective tax rate on labor was 40.2 percent in France, while the tax rate on capital was 23.6 percent (Duval, 2002). Accordingly, an increase in the labor share of, for instance, 5 percentage points could increase the ratio of tax revenues to GDP by 0.8 percentage points. However, using INSEE annual national accounts data, the share of labor income in total value added barely increased in 1997-2000, moving from 56.5 percent to 56.6 percent of GDP as employment creation was almost completely offset by slow wage growth.[17] Thus, when wage moderation is the main factor causing job-rich growth, revenues need not be especially buoyant.[18]

25. On the spending side, unemployment and poverty transfers should be directly affected by job-rich growth. Table II.1 below shows the behavior of these spending categories in France at the beginning of the decade, the year in which job-rich growth began (1997), and the year of the cyclical peak (2000). Unemployment spending includes unemployment insurance, early retirement programs, and other transfers to the unemployed. The largest poverty programs are housing subsidies, means-tested transfers related to maternity and family, and an income support mechanism (RMI). Some benefits related to illness and disability are also provided on a means-tested basis. Means-tested old-age pensions have been excluded, because they are not affected by current labor market conditions but rather by past earnings.

Table II.1 Government Transfer Programs Related to Poverty and Unemployment
(In percent of GDP)

	1990	1997	2000
Labor market	2.0	2.0	1.8
Of which: Unemployment insurance	1.2	1.3	1.2
Early retirement	0.6	0.4	0.3
Other	0.3	0.3	0.3
Means-tested transfers	1.9	2.4	2.3
Of which: Health	0.4	0.5	0.5
Maternity and family	0.8	1.0	0.9
Housing	0.8	0.9	0.9
Poverty (RMI)	0.2	0.4	0.4
Total: Unemployment and poverty transfers	4.0	4.3	4.1
Memorandum item:			
Unemployment rate (Eurostat)	8.4	11.6	9.0
Government spending (Percent of GDP)	50.7	55.0	52.7

Source: DREES, Comptes de la Protection Sociale.

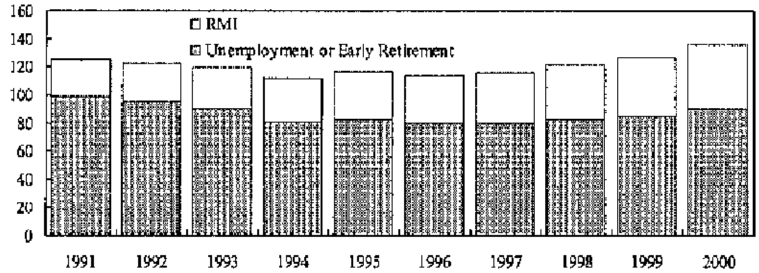
26. Spending on unemployment and poverty represented 4 percent of GDP in 1990, rose to 4.3 percent as unemployment climbed in 1997, and then fell back to 4.1 percent at the end

[17] The labor share had declined sharply in the 1980s, from 61.4 percent in 1982 to 55.9 percent in 1994.

[18] High revenues from corporate taxes and capital income were important contributing factors.

of the decade. At constant prices, this class of expenditures rose by a cumulative 4.7 percent, while real government spending grew by 6.7 percent in 1997–2000.

Figure II.1. Coverage Ratios of Unemployment Programs
(Benefit Recipients as a Percent of Unemployment)



Source: DREES, Comptes de la Protection Sociale; and Eurostat.

27. The sensitivity of unemployment spending to changes in the unemployment rate was curbed by movements in the coverage ratio (the fraction of the unemployed entitled to compensation) and the average benefit.[19] The average benefit fell about 4 percent in real terms in 1990–97, helping to contain the growth in unemployment spending, while it rose by 9.6 percent in 1997–2000, a bit below real GDP growth of 11.3 percent. The coverage ratio fell from over 90 percent in the early 1990s to below 80 percent in 1997, and reached over 90 percent in 2000 again (see Figure II.1 below).[20] Thus, during the job-rich growth years of 1997–2000 the increase in the coverage ratio limited cost savings in unemployment spending, even as early retirement programs were being phased out.

28. Spending on poverty programs grew sharply between 1990 and 1997, but declined only modestly in the following three years. Some savings were achieved in family and maternity transfers and, to a lesser extent, housing subsidies. On the other hand, means-tested transfers related to health and spending on the RMI grew slightly relative to GDP. Thus, somewhat surprisingly, high economic growth and the sharp reduction in unemployment did not generate substantial savings in social spending.

29. Expenditures on active labor market policies declined only modestly during the period of job-rich growth. France has a large array of instruments, ranging from training programs to incentives for private enterprises to hire particular categories of workers, to special public sector jobs programs. The cost of these measures almost doubled as a percent of GDP from 1990 to 1997, but declined only modestly in the following three years. More

[19] A large negative correlation between the coverage ratio and the rate of unemployment is found also in longer times series including the 1980s.

[20] These ratios are computed using Eurostat's harmonized unemployment.

specifically, training and employment subsidies in the private sector were scaled back during this period, but spending on youth measures increased markedly starting in 1999 as a result of a new program of temporary, public sector jobs for young workers (*emploi jeunes*).

Table II.2 Spending on Active Labor Market Policies
and Reductions in Social Security Contributions
(In percent of GDP)

	1990	1997	2000
Public employment services and administration	0.1	0.2	0.2
Training	0.3	0.3	0.3
Youth measures	0.2	0.3	0.4
Subsidized employment	0.1	0.5	0.4
Total active labor market policies	0.7	1.3	1.2
Reductions unrelated to 35 hours	0	0.6	0.4
Reductions 35 hours	0	0.0	0.4
Total reductions in SSCs	0	0.6	0.8
Total active policies and reductions in SSCs	0.7	1.8	2.0

Sources: OECD, DARES.

30. Increased use of cuts in social security contributions to boost labor demand has also weighed on the public finances, although it probably also contributed to job-rich growth (see Chapter I). Employers' social security contributions were reduced for low-skilled workers first in 1993. As part of the policy to reduce the standard workweek to increase labor demand, broader cuts were offered to firms switching to a 35-hour workweek and committing to hire new workers beginning in June 1996 with the law Robien and reinforced by the laws Aubry I of mid-1998 and Aubry II of January 2000. As more firms adopted the reduced workweek, the revenue loss associated with these policies grew from 0.6 percent of GDP in 1997 to 0.8 percent in 2000. These additional costs all but erased the savings in labor market spending obtained elsewhere.

31. Adding together all the spending categories considered, labor market-related spending rose from 4.7 percent of GDP in 1990 to 6.2 percent in 1997, and declined only marginally during the subsequent upswing, reaching 6.1 percent in 2000. Thus, the job-rich nature of growth during 1997–2000 seems to have contributed only marginally to expenditure reduction during the period.

C. Explaining the Rigidity of Labor-Market and Poverty Expenditures

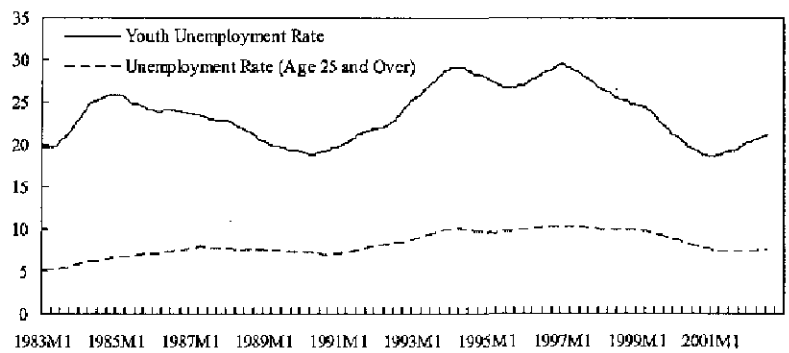
32. Active management of the unemployment fund (UNEDIC) likely played a role in limiting the response of unemployment spending to changes in the unemployment rate.[21] Faced with a rapid increase in spending in the early 1990s, the social partners, who run the fund, put in place corrective measures involving not only higher contributions but also lower

[21] See Freyssinet (2002) for a brief overview of unemployment reform in France in an international perspective.

benefits.[22] Conversely, the new UNEDIC accord reached at the end of 1996, when the financial situation of the fund was improving, expanded benefits and introduced a new program for older unemployed—the *allocation chômeurs âgés*. In 2001, faced with a Unedic surplus a new accord further reduced contributions and increased benefits by abolishing tapered benefits (*dégressivité*), although it tightened job search requirements. With the recent cyclical downturn, the accounts of the unemployment fund deteriorated once again, and the cuts in contributions were recently rescinded.

33. The hiring and firing decisions of employers may also lead to procyclical changes in the coverage ratio. During adverse economic conditions firms prefer to reduce employment by not replacing retiring employees to avoid firing costs. As a result, the unemployment rate increases mostly among new entrants in the labor market, who are not entitled to unemployment benefits. On the other hand, in times of strong employment growth it may be easier for employers to hire individuals who are not receiving benefits and thus do not face high implicit marginal tax rates when returning to work. This interpretation is consistent with high firing costs and inactivity traps in France, as well as data on unemployment by age group, showing that youth unemployment has the greatest sensitivity to the cycle (see Figure II.2).

Figure II.2. Youth Unemployment Rate
(Percent)



In addition, there may be a negative stigma associated with being a benefit recipient, which leads employers to prefer new entrants.

34. Fluctuations in the coverage ratio of unemployment insurance are not just due to the movement of people from unemployment insurance to the minimum income program (RMI). This program provides a minimum benefit to the unemployed not entitled to compensation, either because they did not work long enough before becoming unemployed or because they exhausted their benefits. The coverage ratio including RMI recipients increased even more

[22] The *dégressivité*, whereby benefits decline with unemployment duration, was introduced in 1992.

sharply in 1997-2000, as the number of minimum income recipients continued to rise until 1999. All in all, if the coverage ratio had remained as in 1997, spending on unemployment transfers and the RMI would have been lower by almost 0.3 percentage points of GDP in 2000.

35. Concerning poverty programs, there may be an underlying trend towards broadening social insurance in France, which led to the introduction of new programs and expansion of others even as income and employment grew rapidly.[23] The RMI program has shown an especially strong upward trend, which improved economic conditions may have just slowed down rather than reversed.[24] In addition, as in the case of unemployment insurance the level of some transfers tended to behave somewhat pro-cyclically. For example, the housing subsidy per beneficiary fell in real terms in 1993–97—when the parameters were not revalued to keep up with inflation—and then caught up in 1998-2000. Also, the policy of the "*intéressement,*" by which benefits (mainly the RMI and the housing subsidy) are withdrawn only gradually when an individual returns to work, may have resulted in a sluggish response of poverty expenditures to employment growth. This policy, expanded at the end of 1999 and 2000, is intended to remove disincentives to return to work.

36. New labor market policies, especially reductions in social security contributions for low wage workers to promote a reduction in the workweek, offset savings in other programs. Unfortunately, accurate ex-post evaluations of the effects of these policies on employment are not available yet, so it is not possible to assess to what extent they contributed to the job-rich nature of growth. The analysis of Chapter I, however, suggests that autonomous shifts in labor supply not directly related to government policy are large enough to explain most of the employment creation observed during 1997–2000.

D. Conclusions

37. Structural changes in the labor market led to rapid economic growth during 1997–2000 in France, which boosted revenues and taxes contributed to the notable improvement in the public finances during this period and created room for tax reduction. However, while labor market and poverty spending had grown sharply in the early 1990s, the subsequent improvement in labor market conditions and decline in unemployment did not result in a significant reduction of the share of these expenditures in GDP: while there were fewer unemployed, more of them received unemployment insurance, and the benefits became more generous. Among poverty programs, savings remained small or absent as a trend towards

[23] For instance, eligibility to obtain subsidies on private rentals was expanded substantially in 1992–95; access to disability benefits was expanded in 1998, and to certain family benefits in 1999.

[24] For a recent evaluation of the RMI, including the difficulties in exiting the program, see the collection of articles in *Économie et Statistique*, No. 346–347, 2001.

expanding social programs and a pro-cyclical behavior of the level of benefits offset the consequences of higher incomes and lower unemployment. In addition, spending on active labor market policies grew relative to GDP, mainly because of the expansion of public sector jobs for young people and the growing cost of reductions in social security contributions tied to the 35-hour workweek.

38. Looking forward, with labor market and poverty expenditures in France at 6 percent of GDP, the potential savings from further progress towards lowering structural unemployment are non-negligible. However, past experience shows that to reap this "employment dividend" the tendency to expand benefits when resources become available needs to be curbed. Also, the present level and any further expansion of active labor market policies needs to be carefully considered in the light of their cost-effectiveness.

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