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EDITORIAL

Productivity and Employment in the Tertiary Sector

Reports by Pierre Cahuc and Michèle Debonneuil

This report makes a significant contribution to the services sector economy and the economic policies that arise from it.

In France, the employment rate in the services sector is especially low, particularly in the retail trade, hotels and restaurants. Pierre Cahuc emphasises that this reflects a combination of inefficiencies both in the labour and services markets.

Michèle Debonneuil starts by closely analysing an increasingly important category of services, namely services to individuals. These cater to an area of consumer demand with high growth potential and represent a prime source of employment. Promoting services to individuals is also a way of encouraging employment that cannot, by and large, be relocated and of lessening some of the effects of demographic ageing.

The recommendations include a set of concrete proposals relating to the functioning of the labour market and the organisation of the services sector. These recommendations follow on logically from the analysis contained in the reports.

Christian de Boissieu
Executive Chairman of the CAE

The authors remind us that France has a low overall employment rate compared with other OECD countries, including a substantial deficit in services. The ability to create new jobs in services is therefore crucial.

Michèle Debonneuil points out that services to individuals cater to new needs and are currently underdeveloped in France. She shows how IT and communications technologies may encourage expansion in this area by creating productive employment.

After outlining the characteristics of the service sector, Pierre Cahuc highlights the regulations that are currently stifling growth. This leads to a number of recommendations relating to the functioning of the labour market and the service market.

Both reports were presented at the plenary meeting held on 29th January 2004 and in the presence of the Prime Minister on 27th February 2004. This letter, published under the direction of the permanent unit of the CAE, summarises the authors' main conclusions.

France has an employment deficit, particularly in services...

Both authors proceed from a recognised fact: in international terms, France has a low employment rate⁽¹⁾ and this is mainly due to trends in the service sector, which currently represents around three-quarters of total employment in OECD countries. Whereas France's employment rate was only

1 percentage point below that of the United States at the beginning of the 1970s, the gap widened to more than 17 percentage points in 2001 (64% versus 81%)⁽²⁾. This drop in performance is partly due to a sharper decrease in manufacturing employment in France. However, the bulk of the decline has occurred in the services sector. In fact, this sector accounted for nearly all of the difference in 2001. A broader comparison confirms this finding. France has not suffered greater de-industrialisation than countries with a good track record in terms of employment, but it has created much less employment in the services sector.

A finer analysis reveals that our employment deficit is particularly pronounced in the retail trade, hotel and restaurant sectors. If France had the same employment rate as the United States in all three sectors, it would have 3.4 million extra jobs, which would be enough to absorb unemployment. The same comparison with Germany produces a figure of 1.2 million jobs.

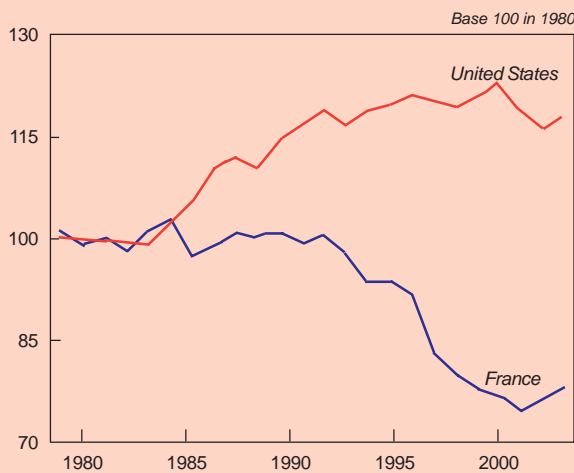
... and is losing ground on per-capita GDP

A second important finding relates to developments in productivity and the standard of living. Until the mid 1990s, productivity – defined in this case as the ratio of GDP to total employment – grew more rapidly in France than in the United States. From that period onwards, productivity has been slowing in France, mainly because of the government's policy of reducing payroll taxes,

(1) The employment rate is the ratio of people in employment to the working age population (between 15 and 64). The employment rate of a sector is the ratio of total employment in the sector to the working age population.

(2) Source: OECD.

1. Productivity in the leisure and domestic service industries



Comment: The leisure and domestic service industries cover only a portion of services to individuals.

Sources: INSEE, BEA, OECD and Commissariat général du Plan.

which is stimulating unskilled employment. At the same time, productivity is picking up significantly in the United States, primarily in response to a strong build-up of capital stock related to information technologies, including and especially in some service industries such as the retail trade.

Both before and after the mid 1990s—since 1980 in fact—France has been losing ground to the United States in terms of per-capita GDP. France's best productivity performance before then is actually misleading, because it mostly arose from a capital-labour substitution that seems to reflect an excessively high cost of labour. Meanwhile, the United States were creating massive employment in the services sector. France's relative productivity gains were more than offset by lower job creation.

This goes to the heart of the employment problem. If our country is to achieve full employment and a better standing of living, we must turn to the services sector, which is clearly an important source of potential employment. Moreover, in recent years, the United States has proved that it is possible to develop productive services.

Michèle Debonneuil points out that there is strong potential for job creation within services to individuals and spells out what needs to be done in order to expand

this area. Pierre Cahuc analyses the state of play in the hotel, restaurant retail trade and suggests measures aimed at encouraging job creation within these sectors.

Services to individuals: an underdeveloped sector...

The rise of the tertiary sector within developed economies is a well-known long-term phenomenon. As productivity increases in industry and goods can be produced with less and less input from labour, labour is reallocated to services, where productivity is in principle lower and where demand increases as the standard of living rises.

In France, services to individuals have not been firmly established in the economy. By services to individuals we mean all those services that enable households to outsource certain day-to-day tasks that they usually perform themselves. These include services that are downstream of the purchase of goods, i.e. the selection, delivery, use, maintenance and repair of those goods; and those that relate to quality of life, such as housekeeping, administrative tasks, house and garden maintenance, childcare, tuition, youth and adult education and leisure.

For several decades, these services have accounted for no more than 3% of GDP. There are a number of objective reasons for this, chiefly material problems

(premises) and problems of confidence (e.g. individuals' reluctance to hand over the keys of their home or the care of their children). However, there are also psychological obstacles to contend with. Households are not prepared to pay for a service that they can deliver themselves and which they view as expensive in relation to the benefits provided. Furthermore it is difficult to structure the offer of these services, as they draw on a variety of skills and require the capacity to reconcile supply and demand

Yet, these services cater to real needs associated with the ageing of the population, the expansion of female employment and the need to free up time in order to achieve a better balance between professional and private life, etc. Furthermore, this area represents a large number of potential jobs. Michèle Debonneuil shows that if households consumed three hours of these services per week, corresponding to EUR 20 to 30, two million jobs would be created.

... with the potential to create productive employment

In recent years, the United States has shown that the use of IT not only improves productivity within existing sectors, but also makes it possible to provide services to individuals on a vast scale.

The large-scale development of services to individuals is impeded by the difficulties potential customers face in accessing a diverse range of these services. However, new technology is creating platforms providing a variety of offerings matching supply and demand. Under these circumstances, the success of the service offering depends on how well it suits demand, the capacity to develop attractive packages, the existence of payment facilities, and so on. This suggests that the industry should be organised along the following lines:

- large corporations (major retailers for example) will set up the service offering, because they alone are capable of financing the high fixed costs associated with the platforms;
- these enterprises will establish a network of service providers (small businesses, craftsmen, associations, etc), will guarantee the

quality of these service providers and will, on a fee basis, handle everything that falls outside the service providers' core businesses, such as employee management, accountancy, contact with official bodies, etc.

The platform represents a substantial cost in this fixed-cost economy, and its amortization depends on the number of customers. This set-up can be seen emerging in various parts of the United States and in Europe.

State involvement needed

The state has an important role to play in launching services to individuals. Possible avenues of support include providing funding assistance for the setting-up of platforms and the licensing of service providers as well as prolonging and increasing the VAT cuts on some services to individuals within the European Union. Steps should also be taken to reduce competition from subsidised associations that move out of their core business while continuing to receive state subsidies.

It is also vitally important to improve the quality of services. Because of rising living standards and crises such as BSE, consumers are turning to better quality products. It is therefore fair to assume that the outsourcing of day-to-day tasks will only increase if consumers can obtain a high quality service, even if it means paying a higher price. It is crucial to work with firms and teachers to establish training systems for these new businesses, not only to dispense technical training, but also to teach service providers to meet customers' expectations and inspire confidence. This may also draw more people into the industry by making the corresponding jobs more appealing.

Under this framework, the quality of services to individuals is ensured via two avenues. First is the platform, which enables customers to find the products they need at a lower cost and relatively quickly. The other aspect is the quality of the service provided. As service providers gain experience, quality will

increase, which will warrant an increase in prices. In this context, quality is a form of productivity.

The retail, hotel and restaurant sectors: specificities...

Services present a number of characteristics that distinguish them from manufacturing. In the retail, hotel and restaurant sectors, in which as we noted at the beginning of this report there is an employment deficit, these specificities are pronounced. Pierre Cahuc recalls some of these:

- higher concentration of wage income towards the lower end of the wage scale. This reflects a higher proportion of unskilled employees;
- greater reliance on part-time labour and less standardised working conditions because of the need to fit in with the hours kept by customers;
- finally, a higher turnover⁽³⁾ of labour⁽⁴⁾. This seems to be mostly due to workers moving jobs within the sector, which has a strong influence on productivity gains.

In fact, these characteristics are not suited to French employment regulations. This is one explanation for the low level of activity in the commercial, hotel and restaurant sectors in our country.

... requiring a more efficient labour market

Pierre Cahuc therefore recommends that regulation governing the labour market be modified. He identifies a number of priorities.

The author's first point is that, generally speaking, the underdevelopment of the services sector illustrates the negative influence of the high cost of unskilled labour on employment. In this regard, the minimum wage is a poor instrument of income redistribution unless it is

accompanied by a reduction in labour costs. He outlines the beneficial effects of cuts in payroll taxes since the mid 1990s as highlighted in several empirical studies, but suggests that these reductions should be more narrowly targeted at the low-paid than at present. This is vital if employers are to take on people who face more difficulty entering the labour market such as young people, women, immigrants and the unskilled.

In a situation where labour mobility is a key element of productivity and employment, the rigidities associated with French job protection practices have a heavy impact. Job protection regulations must therefore be adapted. The recommendations of the CAE's Blanchard and Tirole report (2003) include simplifying collective layoff procedures and abolishing the need for the courts to decide whether firms have an economic need to lay off employees. These recommendations warrant serious consideration.

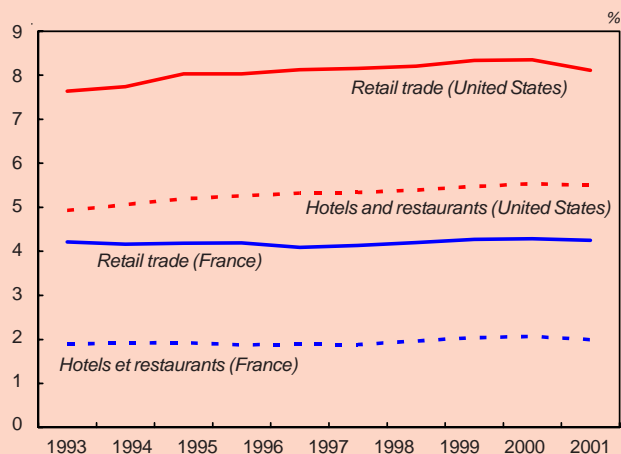
Finally, barriers to the expansion of part-time work must be lifted in order to encourage activity in the services sector, where the use of part-time work is a crucial aspect of flexibility. Reform of the employment premium (Prime pour l'emploi) would be necessary in this regard.

... and better regulation of competition

The entry barriers in some service sectors are generally aimed at protecting existing businesses and preserving jobs by restricting competition. However, Pierre Cahuc points out that several studies suggest that these regulations encourage cartel-like behaviour and therefore impede innovation, productivity and growth and, in the end, have a negative impact on employment. The retail trade, hotels and restaurants, healthcare, passenger transport and the legal sector are all particularly affected by this problem.

Increasing competition in all these sectors is therefore necessary. Even if such reform does not lead to much direct job creation, it may have a major impact at the

2. Employment rates in France and the United States



Source: OECD.

macroeconomic level through the reduction of prices.

Comments

Daniel Cohen welcomes the high quality of the two reports, both of which place services at the centre of economic policy issues relating to employment. He notes that in a general equilibrium model, de-industrialisation can be interpreted as an excess supply in the manufacturing sector (linked to a rapid increase in output) and excess demand in the services sector. According to this model, it should not be difficult to create employment in the service sector. However, this is not what we are witnessing in France. Daniel Cohen reaches the same conclusion as Pierre Cahuc: the key issue is unskilled labour, reflecting the question of reducing payroll taxes for the low paid. However, he also underlines the fundamental role played by competition restrictions, which may account for much of the job shortage in our country. The underdevelopment of the services to individuals sector highlighted by Michèle Debonneuil may well be due to the same factors. The use of IT and vocational training are certainly important factors in encouraging the expansion of high quality services to individuals, but businesses will have to be driven by competitive pressure if they are to innovate in this area.

Michel Godet thanks Pierre Cahuc and Michèle Debonneuil for putting services at the centre of the employment issue. France seems incapable of using productivity gains in industry to create more jobs in services. Services to individuals are most often ignored. Nevertheless, he warns against theoretical solutions to unemployment and emphasises the need to match the supply of labour with the skill requirements of employers. In this respect, the urge to obtain a university degree is counterproductive because the biggest labour shortages are currently in trades. There is a shortage of gardeners, cooks, hotel staff and drivers of heavy vehicles, etc. These jobs do not require a high level of formal qualification, but they do demand a high level of professionalism. The notion that productivity can be raised by putting more effort into higher education and R&D is mistaken. In fact we can raise our standard of living by increasing jobs that do not necessarily require high qualifications. In order to adjust skills to meet demand, we need to raise the status of these discarded occupations. To do this, we must continue to reduce the cost of labour by cutting payroll taxes and increasing job incentives through premiums for specific jobs in unattractive occupations and regions as well as part time work. Selective immigration is also necessary.

(3) The turnover rate is the half sum of incoming and outgoing employees divided by the average payroll for the year.

(4) Particularly in hotels and restaurants, where the turnover rate approaches 100%.