THE BROOKINGS INSTITUTION

1775 Massachusetts Avenue, NW Washington, DC 20036-2188
Tel: 202-797-6000 Fax: 202-797-6004
WWW.BROOKINGS.EDU

U.S.-FRANCE ANALYSIS SERIES
July 2002

THE ECONOMIC CHALLENGES FACING PRESIDENT JACQUES CHIRAC

PETER A. HALL
DIRECTOR, MINDA DE GUNZBURG CENTER FOR EUROPEAN STUDIES, HARVARD UNIVERSITY

What are the principal social and economic challenges facing President Jacques Chirac? In legislative terms, he has substantial room for maneuver. Under the banner of the *Union pour la Majorité Présidentielle*, his newly appointed Prime Minister, Jean-Pierre Raffarin, leads a solid majority in the National Assembly, given a strong mandate by an electorate weary of five years of *cohabitation*. The French economy is picking up, after a year of relatively slow growth, and even the Euro is strengthening against the American dollar. There would seem to be room for optimism in the *Elysée* palace.

Despite his victory, however, the elections of 2002 present the French President with a cautionary tale. In the first round of the Presidential elections on April 21st, Chirac received only 20 percent of the vote. Together, the two mainstream candidates, Chirac and Jospin, received only 36 percent of the vote, as almost 20 percent went to Jean-Marie Le Pen and Bruno Mégret, the candidates of the radical right, and another 20 percent to a host of other candidates on the far left. In the legislative elections, a record 40 percent of the electorate abstained. These figures reflect a deep discontent among French voters that is unlikely to be banished by the reelection of the President.

On the face of it, such discontent is paradoxical. Macroeconomic performance, which is crucial to electoral outcomes, was good during the *cohabitation* of Chirac and Jospin. The French economy grew by almost 3 percent a year, compared with 1.9 percent from 1981 to 1997. Gross fixed capital investment, which had increased by only 1.4 percent a year in 1981-97, rose by 5.5 percent a year under the Jospin government, and high levels of unemployment were finally coming down. Employment grew by almost 2 percent a year between 1997 and 2002.

Moreover, this performance was based on a structural transformation of the economy. In barely fifteen years, an economy that had been dependent on the initiatives of a *dirigiste* state and unable to redeploy resources rapidly became highly responsive to the changing shape of global competition. Although ultimately the accomplishment of French firms, this achievement was inspired by the efforts of successive governments to open French markets to international competition, to remove regulatory impediments to foreign investment, and to expose firms to the competitive pressure engendered by a *franc fort*.[1] Today, over 40 percent of the equity in the top CAC 40 firms is now owned by foreign investors, a figure barely imaginable in the days of de Gaulle.[2] Many French firms have become nimble players on global markets.

Why should such accomplishments engender discontent, rather than satisfaction, among the electorate? In large measure, the answer rests on the character of France's economic adjustment and how its costs have been distributed. Since it entered the single European market in 1985, the emphasis of French policy has been on enhancing the role of markets relative to the state in the allocation of resources. A high exchange rate in the run-up to monetary union forced many firms to shed labor and reorganize production. Inevitably, the cost was a high level of unemployment that peaked at 12.5 percent in 1997. Although disguised by generous early-retirement schemes, this figure reflects a dramatic deterioration in many lives. By 1999, almost 40 percent of the unemployed had been out of work for over a year.

Many who held onto jobs over this period also paid substantial costs, since the French model of adjustment depended on intensifying work effort and restraining wages so as to secure greater productivity. Between 1985 and 1997, unit labor costs in France fell by 15 percent, while profits rose by 15 percent. By 2002, French firms were substantially stronger, but real disposable income had increased only slowly, and levels of income inequality rose more substantially in France than they did in the United States between 1981 and 1995. A *dirigiste* economy became a full-blown market economy but not without pain for those experiencing the transition. It is their voices that spoke to Chirac in the presidential elections, when over a third of the unemployed voted for Mégret or Le Pen, and talk of *la France du haut* and *la France du bas* began to surface.

The first challenge the President confronts is to address this reservoir of discontent. The dilemma is more intense for Chirac than it would be for an American or British leader because the republican tradition still influential in French political discourse assigns responsibility to the state for the well-being of the people in the name of a 'social solidarity' of which the Republic is meant to be the guardian.

Between 1997 and 2002, the Jospin government responded to this problem with a series of policies, which, if adroit, also leave Chirac a difficult legacy. Economists often argue that, faced with a more open global economy, nations have to choose between measures that improve economic flexibility and those that meet rising demands for social protection.[3] However, the Socialist coalition under Lionel Jospin deliberately rejected this choice. On the one hand, it took

---

[1] See Peter A. Hall, "The Evolution of Economic Policy" in Alain Guyomarch, Howard Machin, Peter A. Hall and Jack Hayward, eds., *Developments in French Politics 2*. Basingstoke: Palgrave, 2001: 172-90.

[2] Michel Goyer, "Anglo-American Institutional Investors and the Transformation of Corporate Governance in France and Germany." Paper presented to a Conference on Transforming the Democratic Balance, Harvard University, May 2002.

[3] For an especially trenchant example, see: Dani Rodrik, *Has Globalization Gone Too Far?* Washington, D.C.: Brookings, 1997.

a series of steps to enhance the operation of market mechanisms by means-testing more social benefits, allowing those who take jobs to receive some benefits, and allowing many firms to lay-off workers or merge with foreign enterprises to survive international competition. On the other hand, the government continued or embarked on a variety of schemes to create jobs, adding several hundred thousand workers in the public sector, subsidizing almost two million low-wage jobs in the private sector, and legislating a thirty-five hour week designed to encourage firms to hire more employees. The latter was not the economic disaster many predicted but produced an unexpected political backlash, not only among small businessmen who found the policy unwieldy to operate, but also among many low-paid workers who wanted the overtime that the new policy prohibited. In the end, the Jospin government did manage to enhance economic flexibility *and* to provide higher levels of social protection. About ten percent of the French populace currently receives some form of minimum income from the state.

As a result, levels of public spending have soared and, at about 53 percent of GDP, public spending is now higher in France than in all other nations in the European Union except Sweden and Denmark. While potentially sustainable, this level of public spending poses a series of problems for the President. Spending of this sort is sensitive to fluctuations in economic activity. Thus, if France experiences an economic downturn, budgetary deficits may rise quickly. Moreover, Chirac was elected on a promise to reduce income taxes by 5 percent this year and 30 percent over the next five years, as well as to cut the 19.5 percent value-added tax on restaurant meals and hotels. To do this without dramatic cuts in public spending, he has already had to persuade his counterparts in the EU to let France out of its commitment to balance its budget by 2004, and there is no doubt that future tax cuts will depend on reductions in public spending. How painful these will be will depend on the course of the economy over the next few years. There are bound to be reductions in the level of public employment, but it remains to be seen what can be accomplished beyond that. Finding room for cuts in public expenditure is the second major challenge the President faces, and it will not be easy.

The third challenge facing President Chirac is familiar and much like the one on which the government of Alain Juppé foundered in 1997. He has to cope with the rising cost of public pensions. Because France has an aging population, the proportion that will retire in the coming decades is rising and the number of young employees to support them is declining. As a result, if pension benefits and the retirement age do not change, the social charges used to pay for retirement benefits will have to rise by at least 15 percent—and more likely 20 percent—by 2040 to accommodate a growing cohort of pensioners. As an economic problem, this one is not insuperable. With modest increases in the retirement age, some reductions in benefits, and gradual increases in contributions, it can be managed. But, as a political problem, this is a time bomb. No one likes to see his pension reduced, and the French welfare state provides especially generous benefits for selected groups of workers, such as those in public transport, who have won substantial public sympathy in the past when they went on strike about this issue.

Here, we can expect the President to move cautiously, mindful of the debilitating strikes of December 1995 that efforts to reform public sector pension schemes inspired. Chirac will expand the scheme subsidizing private savings initiated by Jospin, in the hope that it will take some pressure off public pensions. After the September *prud'homales* elections, a test of union strength in which workers choose delegates to industrial tribunals charged with resolving individual workplace disputes, officials will begin negotiations with the trade unions and employers about the pension issue, since the pension system is again moving into deficit. Chirac's principal problem will be to prevent the political left from rallying support around this cause.

In many respects, the auspices are favorable. No one familiar with Jacques Chirac's political skills would underestimate his ability to cope with such dilemmas. He faces a socialist party demoralized by electoral loss and unsure in which direction to move. And the economic fundamentals are good. In the coming years, economic and social policy is likely to follow the pragmatic patterns of the past decade. The question is whether this will be enough to speak to the profound political discontent that bubbled to the surface in these elections. Here, Chirac's task lies as much in the symbolic as the economic realm. He has to persuade the French electorate to embrace a Republic that is now deeply embedded in European institutions and committed to intense market competition. In both political and economic terms, that is a new edifice and, until all its rooms are comfortable for those who have to live in them, many in France will continue to feel uneasy about their Republic and those who lead it.