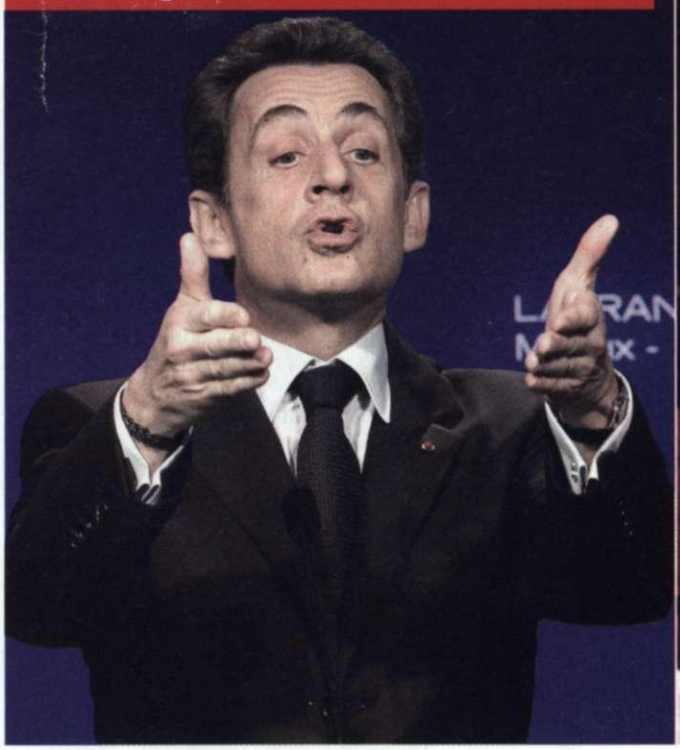


An inconvenient truth

Interactive: See our guide to the leading candidates for the French presidency at Economist.com/frenchelec12

PARIS

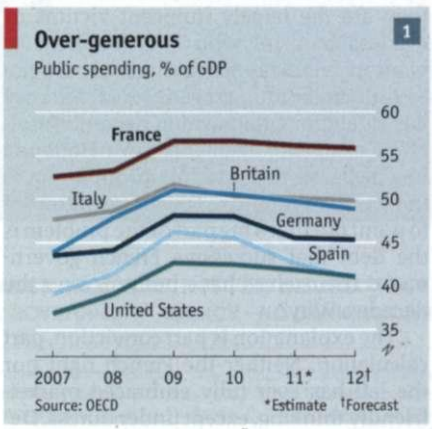
The French have had a security wake-up call. But when it comes to the dangers facing their economy, they are still dozing

A WEEK after France was shaken by terrorist shootings in and around Toulouse, candidates for the country's presidential election have gone back to the stump. The tone is a little less shrill, the contenders respectful of the sombre mood. Yet the return to electioneering has a surreal quality nonetheless, unlinked to the new concerns about security. For the country faces an imminent economic shock, which the presidential candidates are utterly failing to acknowledge.

The awkward truth is that France, the second-biggest economy in the euro zone after Germany, faces a public-finance squeeze. French public spending now accounts for 56% of **G D P** (see chart 1), compared with an OECD average of 43.3%: higher even than in Sweden. For years France has offered its people a Swedish-style social model of services, benefits and protection, but has failed to create enough wealth to pay for it.

Today France continues to behave as if it enjoyed Sweden's or Germany's public finances, when in truth they are closer to those of Spain. Although France and Germany have comparable public-debt levels, at over 80% of **G D P**, Germany's is now inching downwards whereas France's is at 90% and rising. One rating agency has already stripped France of its **A A A** credit rating over worries about high debt and low growth. The country's auditor, the Cour des Comptes, chaired by Didier Migaud, a former Socialist deputy, has warned that unless "difficult decisions" are taken this year and next on spending, public debt could reach 100% by 2015 or 2016.

The underlying problem is that, over the past ten years, France has lost competitiveness. In 2000 hourly labour costs in France were 8% lower than those in Germany, its main trading partner; today, they are 10% higher (see chart 2 on next page).



French exports have stagnated while Germany's have boomed. An employer today pays twice as much in social charges in France as he does in Germany. France's unemployment rate is 10% next to 5.8% in Germany-and has not dipped below 7% for nearly 30 years.

This erosion of French competitiveness raises hard questions about the underlying social compact. Frenchmen cherish the notion that everyone has an equal right to decent services in good times and a generous safety net in bad. But what sort of level of support, in sickness, joblessness, infancy or old age, can France really afford to offer its citizens? How can the country justify its massive public administration—a mille-*feuille* of communes, departments, regions and the central state-which employs 90 civil servants per 1,000 population, compared with 50 in Germany? How can France lighten the tax burden, including payroll social charges, so as to encourage entrepreneurship and job creation?

Put simply, France is about to face the tough choices that Gerhard Schroder, Germany's former chancellor, confronted in the early 2000s or that Sweden did in the mid-1990s, when its own unsustainable social system collapsed. The euro-zone crisis, which has made bond markets unsparing of slack economic management, means that these decisions have become both more urgent and more difficult. Whoever is elected at France's two-round presidential election on April 22nd and May 6th ••

will face a choice. If he fails to be tough enough on the deficit, markets will react badly, and France could find itself at the centre of a new euro-zone financing crisis. If he tackles the deficit with tax increases across the board and even spending cuts, voters will not be remotely prepared for it.

"The real risk for the euro zone now is not Greece, but France," says a top French finance boss. Nicolas Baverez, a commentator who foresaw the country's looming debt problems in a bestselling book of 2003, agrees: "I'm convinced that France will be the centre of the next shock in the euro zone."

The candidates, however, are masterfully managing to duck all this. Before the Toulouse shootings intervened, the campaign turned around such pressing matters as halal slaughterhouses, immigration and tax exiles. Although both Nicolas Sarkozy, the Gaullist incumbent, and Francois Hollande, his Socialist rival, have embraced deficit reduction, each vowing to bring France's budget deficit down to 3% of **G D P** next year, neither is promising to do so by making radical spending cuts.

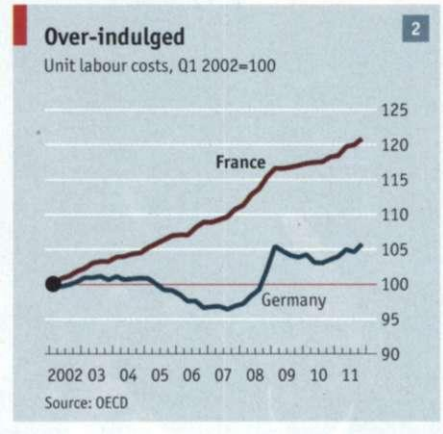
Both presidential front-runners instead rely heavily on balancing the books through tax increases. Mr Sarkozy has already raised corporate and income tax. He now says he wants to tax even those who leave France for tax reasons. Mr Hollande promises a 75% top income-tax rate on those earning over €1m ($1.3m) a year, which means they would pay over 90% after social charges. He also wants to increase the annual wealth tax, levied annually on assets worth over €1.3m, and tax dividends more. He vows to raise the minimum wage, create 60,000 teaching jobs, lower the minimum retirement age to 60 for those who began work young, and "renegotiate" the European fiscal compact, a hard-won deal that seeks to guarantee budgetary discipline.

How can France be holding an election that so signally fails to confront the right questions? What are the chances that any of the candidates, if elected, is ready to face up to the shock that is to come?

A **parallel universe**

Last summer Jean-Pascal Tricoire, the chief executive of Schneider Electric, a French energy-services company founded in Burgundy in 1836, packed up and moved to Hong Kong to run the company from Asia. He took two top executives with him; others followed. They join a new French exodus to Hong Kong, particularly among entrepreneurs. Schneider Electric's official headquarters, and tax domicile, remains in France. But with only 8% of annual turnover in France these days, the firm's eyes are on the rest of the world.

Spend time with the chiefs of France's foremost companies and, like Schneider Electric, their concerns are global. They



talk about Brazil and China, and are constantly watching their international competitiveness. With more Fortune 500 companies than any other European country, France has a global leader in almost every sector from insurance (**AXA**) to cosmetics (L'Oreal). These firms know full well how damaging a 75% tax rate, for instance, would be. "A catastrophe," says one boss. "Completely mad," says another.

Yet ordinary French folk seem almost uniquely hostile to these very companies, and to the globalised markets that have helped to make their economy the fifth-largest in the world. Only 3% of the French agree that the free-market economy is the best system available, according to a poll by Globescan, a polling firm (see chart 3); across ten years of polling, the French have consistently been among the most distrustful of capitalism. This is the France that voted "no" in 2005 to the draft European Union constitution, amid fears about Polish plumbers flooding into France under single-market rules. And this is the France that made a book calling for "deglobalisation" a bestseller last year.

The French live with this national contradiction—enjoying the wealth and jobs that global companies have brought, while denouncing the system that created them-because the governing elite and the media convince them that they are victims of global markets. Trade unionists get far more air-time than businessmen. The French have consistently been told that they are the largely innocent victims of reckless bankers who lent foolishly, or wanton financial speculators, or "Anglo-Saxon" credit-ratings agencies. Mr Sarkozy has called for capitalism to become "moral" so as to curb such abuse. Mr Hollande has declared that his "main opponent is the world of finance". Few politicians care to point out that a big part of the problem is the debt that successive French governments themselves have built up over the decades. Why?

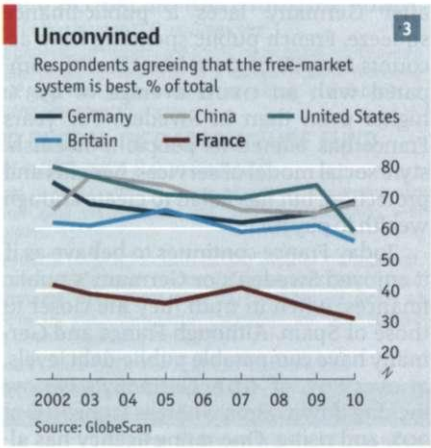
The explanation is part conviction, part calculation. Neither the French right nor the left has ever fully embraced market-friendly thinking, except under duress. Despite the occasional liberal impulse, Mr Sarkozy is part of the Gaullist family, which largely rejects such a doctrine. Most of today's Socialist leaders cut their political teeth working for Francois Mitterrand (Mr Hollande was on his presidential staff); the party still worries far more about redistribution than wealth creation. "The soul of France", declared Mr Hollande when launching his campaign, "is equality." Liberal candidates in France tend to get nowhere. Ten years ago the most recent such presidential hopeful, Alain Madelin, got just 3.9% of the vote.

Dangerous talk

So it is with today's election. Rather than confronting these attitudes, and shaking the French out of their comfort zone, the two front-runners are pandering to popular reflexes. At a giant rally in Villepinte, north of Paris, Mr Sarkozy laid into **EU** trade rules, which he said had unleashed "savage" competition; called for a "Buy European Act" for public procurement if non-European trading partners did not open up their markets; and threatened to pull the country out of the Schengen passport-free zone, unless fellow members did more to control immigration from outside the area. Apparently without irony, the son of a Hungarian immigrant started to tread on nasty ground, with talk of "too many foreigners" in France. All this is meant to reassure fretful French voters, who think Europe is failing to protect them from global competition.

Certainly Mr Sarkozy can point to some useful liberalising reforms on his watch, such as a rise in the minimum retirement age from 60 to 62, or the granting of autonomy to universities. He also pointed to the crushing weight of French social charges on employers, which deter job creation and which he has trimmed a bit. But the politician who once wrote disapprovingly that France "has never stopped discouraging initiative and punishing success" has now raised taxes on the rich, and bashes big bosses and bankers at every turn.

All this is also tactical. In the first round



• of voting in France (as in America's primaries), candidates try to shore up their base; in the runoff, they compete for the centre. On the far right Mr Sarkozy has to confront Marine Le Pen, the telegenic National Front candidate. Present polls put her in distant third or even fourth place, with 16%-18% of the first-round vote, compared with 28% or so each for Mr Sarkozy and Mr Hollande. But nobody has forgotten that her father, Jean-Marie, snatched a place in the second round in 2002 at the Socialists' expense. The feisty Ms Le Pen, who has rid the party of its jack-booted image, is unlikely to repeat that feat. Her strong campaign nevertheless frames much of the election debate, with calls to leave the euro, reindustrialise the country and curb Islamification.

Mr Hollande faces a similar squeeze on the left. With a reputation as a moderate, who promises to introduce his own balanced-budget law, he has been struggling to keep the hard left at bay in the person of Jean-Luc Mélenchon, a one-time Trotskyite and former Socialist senator now backed by the Communist party. At a recent rally held, with theatrical symbolism, at the Bastille, Mr Mélenchon called for a "civic insurrection" against the "ancien régime". He wants full pensions for all at 60, a 20% hike in the minimum wage and a cap on all salaries at €360,000 a year. With his tub-thumping style and gruff manner, Mr Mélenchon's campaign has been a sensation. More than one in ten French people say they will vote for him.

Although most of this electorate would then swing behind Mr Hollande in the second round, Mr Mélenchon's recent poll surge has been nibbling away at Mr Hollander numbers, depriving him of the momentum that might carry him to victory. Hence his plans for a new tax on financial transactions, the abolition of stock options and the 75% tax rate. Hence too his stinging attacks on finance and wealth, and denunciation of the new super-rich as "grasping and arrogant".

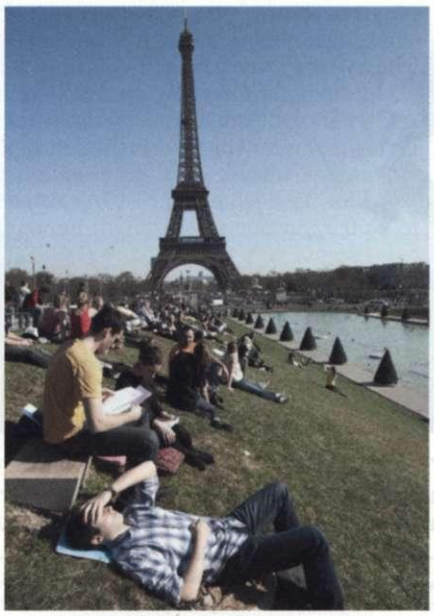
Opération décryptage

Many French commentators dismiss all this as mere political posturing. Aides to both front-runners argue that, in reality, each understands what is at stake. The 75% tax rate, says Olivier Ferrand, head of Terra Nova, a Socialist-linked think-tank, is "just a symbolic measure": even Mr Hollande has conceded that it will bring in little revenue, if any. Behind all the rhetoric, Mr Ferrand insists, "the Socialist Party has modernised, and does understand the need to improve competitiveness and control the deficit."

Mr Hollande, a jovial character in private, rejects the idea that he is dangerous, stating as much-in English—as he arrived in London in February. He has put in charge of his campaign two men, Pierre Moscovici and Manuel Valls, who were once close to the moderate Dominique Strauss-Kahn, ex-boss of the **IMP**, who has been ruled out of the race by a sex scandal. Once in power, French Socialists can end up doing sound things. With Mr Strauss-Khan as his finance minister, Lionel Jospin, the Socialist prime minister in 1997-2002, privatised more French companies than all his predecessors put together. "We liberalised the economy, and opened up the markets to finance and privatisation," recalled Mr Hollande before heading to London.

Yet it requires much forbearance on the part of the electorate to accept that the candidate will not do half the things he has said he will. There is a serious risk of disappointment if, for example, President Hollande were to say upon taking office: "We have examined the public accounts and, *quel dommage,* there is no money for anything I promised after all." And in order to defuse this risk the new president would have to put into place at least some of his dafter ideas, if only as a political gesture. The last such measure the Socialists introduced was the 35-hour working week.

Decoding Mr Sarkozy is no easier. He has now eased off on some of his more unpleasant rhetoric, but plenty more is merely disingenuous. There is already, for instance, a Schengen review under way that would allow members to suspend free movement in certain circumstances. His idea of an American-style tax on the French abroad, but only on those who have left to avoid such taxes, would be all but impossible to apply. Perhaps he knows as much, and would do none of it. Indeed, Mr Sarkozy's friends claim that he would turn out to be a reformist president if re-elected. "Sarkozy started to campaign by calling for German-style reforms," says one adviser "But he realised he had no chance of winning with that, because it's unpopular, so he has gone for rightist, populist measures instead." In office, claims the same adviser, he would turn out to be a "very active, reformist president".



The obliviousness of spring

Amid all this doublespeak, the one candidate who has consistently talked about the need for debt reduction and spending cuts is Francois Bayrou, a centrist. He is a perennial presidential contender, without much of a party behind him, who gets off his tractor on his Beam farm every five years to run for office in Paris. Mr Bayrou is no liberal: he wants a "fair price" for farm produce, and proposes voting rights for unions on company boards. But he at least promises €50 billion in spending cuts (alongside €50 billion in tax increases, including a new top income-tax rate of 50%, up from 44% now). Dismissing Mr Hollande's 75% tax rate as "crazy", he deplores the level of political debate. "We are not asking any of the questions on which France's future survival depends," says Mr Bayrou. "When a country doesn't tackle any of these questions, it runs the risk of catastrophe." For now, though, the voters do not seem to care for this message: Mr Bayrou's numbers are no better than Mr Melenchon's, which have surged to 12-13%.

Promises to break

All of which leaves voters with the unenviable task of deciphering which part of each candidate's message is credible, and which part pure fantasy. The best guess is that both front-runners, for their own political security, would need to put in place a couple of the barmier ideas. This could be damaging enough. In 2007, after equally tough talk about immigration, Mr Sarkozy went ahead and set up a ministry of national identity—only to abolish it later on, having caused much offence along the way. Were a President Hollande to implement his 75% tax rate-just when Britain has cut its top rate from 50% to 45%-it would send an untimely message abroad about the way France treats financial success, much as the 35-hour week tarnished the country's image for years. His overall tax policy would tell aspiring French entrepreneurs that they might be better off launching a good idea elsewhere.

The inconvenient truth is that whoever emerges the victor on May 6th will need to show a tough approach to the deficit, in the face of wary bond markets and possible recession. A President Sarkozy would need to find new budget savings, despite his promise to "protect" the French from austerity. A President Hollande would be forced to postpone or scrap some of his spending pledges, and would get a taste of German steeliness if he insisted on pushing Chancellor Angela Merkel on the subject of reviewing the fiscal compact. Either way, the result would be a shock for the French, and one that neither candidate has remotely prepared them for.

Fonte: The Economist, London, v. 402, n. 8778, p. 31-34, 31 Mar. a 6 Apr. 2012.