

# Business & Economics

## A French Action Figure:

*Nicolas Sarkozy's First Months as President*

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On 6 May 2007, Nicolas Sarkozy was elected the sixth president of France's Fifth Republic with just over 53 percent of the vote. In campaigning for the post, he proposed a series of economic and social reforms, and upon taking office he moved with surprising speed to implement them. In the scant months since his election, President Sarkozy has surprised the French by the decisiveness and vigor of his actions and impressed more minds than would be pleased to admit it—including many who opposed his election—with the zeal with which he has applied himself to the job.<sup>1</sup>

Sarkozy's reform program contains three central elements: tax reform, overhaul of labor market institutions, and reorganization of French universities. After reviewing the main proposals in each of these three areas, I will discuss the broader strategy that underlies them and the likelihood of their success.

**The Reforms.** *Fiscal Reform:* The tax package that was enacted on 1 August has several distinct elements.<sup>2</sup> The first component is the elimination of payroll and income taxes on hours worked above the legally mandated thirty-five per week. This measure is intended to reduce labor costs for overtime work and allow greater flexibility in workforce management, while encouraging workers to put in extra hours. The second component of the tax package is a measure to provide a tax credit for interest paid on home mortgages in order to encourage a higher rate of home

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ownership in France.<sup>3</sup> The tax bill also sharply reduces the inheritance tax—eliminating it altogether for bequests to a surviving spouse—and adjusts the maximum percentage of income that can be taken by the state—the tax shield, or *bouclier fiscal*—from 60 to 50 percent.

second major reform would involve a further overhaul of the French retirement system, extending the changes introduced by the Fillon Law of 2003.<sup>5</sup> As with contract reform, this move would simplify the existing system, which includes a number of “special retirement

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Two related reforms are worth mentioning here. The first, an increase in the co-payment for medical treatment and prescription drugs, is effectively a small tax increase to finance medical research on cancer and Alzheimer’s disease. The second, discussed though not yet enacted, is a proposed increase in the value-added tax (VAT) to compensate for the decrease in payroll tax revenues specifically earmarked to support the social security system. “Social security” in France includes universal health care, day care, and other benefits, and hence is much broader than social security in the United States. The revenues from this “social VAT” would reduce the social security deficit, which would otherwise increase due to the elimination of the payroll tax on overtime. The burden would be borne by the final purchaser of goods rather than by producers.

*Labor Market Reform:* President Sarkozy is also sponsoring three labor-market reforms. The most significant of these, a proposal to replace the several different existing labor contracts—covering long-term, short-term, and newly hired employees—with a single, more flexible contract, has yet to be given a precise formulation, but it would ease existing restrictions on layoffs and dismissals.<sup>4</sup> A

regimes” applicable to specific categories of workers in addition to the “general regime” restructured in earlier reforms.

The third institutional reform of the labor market is the “minimum service law,” which was enacted on 3 August. Its intent is to ensure a minimum level of service in public transportation in the case of a strike.<sup>6</sup> More narrowly focused than the other two labor-market reforms, this could be regarded as a tactical measure to provide the government with the legal instruments to contain anticipated opposition to its more ambitious proposals. The transport sector is particularly sensitive. In 1995, a strike of transport workers paralyzed the country and forced Prime Minister Alain Juppé to withdraw key elements of his retirement reform.

*University Reform:* The third panel of Sarkozy’s triptych features the universities. The keyword here is *autonomy*. Power would be devolved from the ministry of education to the presidents of France’s eighty-four universities. The presidents will gain control of their own budgets, greater influence over hiring, and a mandate to compete for teaching and research talent. Ultimately, the goal is to revise university curricula to equip more students with marketable skills. Research

is to be integrated with teaching rather than segregated in a series of parallel institutions. Maladapted university curricula and a lack of facilities for applied research are seen as impediments to economic growth in an era when economies with high labor costs must shift away from manufacturing toward high technology and information-intensive services in order to compete effectively.

**The Underlying Strategy.** Sarkozy's approach to economic reform is based on three principles. First, the French are attached to their social model: universal health care, generous retirement benefits and employment protections, broad access to state-subsidized higher education, and numerous other state-managed services. Since the proposed European constitution was perceived, rightly or wrongly, as a threat to that model, the French voted against it. Second, in light of demographic change and increased international competition, the French will need to work additional hours, if they want to continue living under the current social model. Finally, people cannot be expected to work more simply by fiat; rather, they must be offered incentives to forgo leisure, especially in the form of early retirement, in favor of work. At the same time, additional work hours must be available for those willing to take them, and incentives must be offered to employers to encourage the creation of new jobs and overtime opportunities.

The proposed program is therefore one of marginal changes intended to *preserve* the French welfare state. Sarkozy is best understood as a moderate conservative, not a radical free-market ideologue in the mold of Margaret Thatcher and Ronald Reagan. Although his campaign

slogan "Work More in order to Earn More" might be interpreted as an appeal to individualism, his concrete policy proposals instead suggest that he plans to use individualist incentives to effect incremental improvements in the balance sheet of the social welfare system to make it sustainable over the long term. Indeed, as French diversity increases and a common culture can no longer be taken for granted as the basis of the state's coherence, "social solidarity" takes on increasing importance for a nationalist like Sarkozy. As interior minister, he demonstrated a willingness to tolerate a greater degree of cultural diversity than many other French political leaders do. To hold this diverse society together, he believes that the state must continue to provide substantial benefits to its citizens. For these reasons, privatization of state services, including the national railroad and higher education, is *not* his goal. Nor does he show any sign of believing that private firms are necessarily better managed than state firms. He has not been reluctant, moreover, to use the resources of the state to advance the interests of the latter. One of his first moves in foreign policy was designed to benefit the nuclear power firm Areva, a 90 percent state-owned enterprise. His negotiations with the government of Libya are said to have guaranteed Areva access to a 1,600-ton Libyan uranium reserve and to conduct advanced talks related to Libya's desire to purchase two European Pressurized Reactors from Areva at a price of \$4.3 billion each.<sup>7</sup>

**The Likelihood of Success.** If the goal of economic reform is to preserve the welfare state, several questions arise. First, will "working more" solve the problem? Second, will Sarkozy's reforms

both encourage and enable the French to work more? And third, can he gain acceptance of his proposals by the legislature, Constitutional Council, and key social actors, such as employers, unions, minorities, university administrators, and students?

Will more hours at work produce a significant reduction in unemployment and more rapid growth without deepening the budget deficit to unacceptable levels? To be sure, the diagnosis of insufficient effort has some merit. The productivity figures reveal that, while France's economy is efficiently organized and technologically advanced, the French do not devote as many hours of their lives to work as do citizens of some other countries. According to Eurostat figures for 2005, the hourly productivity of the French worker slightly exceeds that of the American worker—index of 118.1 for France, 116.9 for the United States, and 109.5 for Germany. But if we turn from *hourly* productivity to productivity *per worker*, we find a different story: 135.7 for the United States, 119.2 for France, and 102.5 for Germany. The difference lies in the number of hours worked per year. The French, with their shorter work week, longer vacations, and penchant for early retirement, work fewer hours per person—indexing the United States at 100, the French stood at just 67 in the year 2000; the comparable figures for 1970 were 100 and 99.<sup>8</sup> The French appear to have a somewhat higher preference for leisure over work than do citizens of other countries. Yet there are many who would like to work but cannot find jobs. The unemployment rate, which counts only people actively seeking work and unable to find it, had remained above 10 percent for an extended period, though in the past year it has declined to

8.1 percent, last seen in 1982.

Will employers see the elimination of payroll taxes on overtime as an incentive to offer more jobs?<sup>9</sup> Although the impact is likely to be marginal, it will perhaps influence only those already employed, and will do little to increase the hours worked per person. The main impediment to an increase in work hours is a combination of high unemployment levels and the low workforce participation rates in the 50-64 age group, which stands at 53 percent for France compared to 69 percent for the United States. The anticipated reforms to the special retirement regimes will encourage a rise in the participation rate of older workers, but more so in the public sector than in the private sector, which has already been subjected to the Fillon reforms. Sarkozy intends to *reduce* employment in the public sector overall. Substantial reductions in the number of teachers and ministry personnel have already been announced—as many as 27,000 jobs will be eliminated. The single labor contract may do more to encourage investment in new jobs by reducing the associated risk. Firms will be able to downsize at lower cost if market conditions change and may therefore be less reluctant to take on new workers during a positive phase of the business cycle. Additional employment should lead to increased demand for products, thereby producing a positive feedback effect. Nevertheless, it is misleading to think of France as a country in which firms are reluctant to invest due to labor-market rigidities. Indeed, France is one of the most attractive countries in Europe for foreign direct investment: in 2003 it received approximately \$160 billion of FDI, or roughly 6 percent of its GDP, including \$80 billion from the United States.

It is clear that Sarkozy is not an

uncompromising supply-sider, nor is he systematically hostile to the state. Inevitably, however, he has been cast by some opponents as the thin end of the "Anglo-Saxon neoliberal" wedge, whose true aim is to dismantle the social welfare system, slash taxes, widen inequalities, and deliver France into the hands of capitalist buccaneers, many of whom he counts among his friends. Hostility to his program is therefore strong in certain quarters, and although there is no doubt that with his party holding an absolute majority of seats in the National Assembly, Sarkozy can enact any law he deems important. Bernard Thibault, the head of the CGT trade union, which represents many of France's transport workers, has called the minimum service law an "attack on the right to strike," and the Socialist Party has laid the issue of the law's constitutionality before the Constitutional Council.<sup>10,11</sup> If the single labor contract ultimately resembles the proposals laid down by a 2003 Economic Analysis Council report to the prime

the Socialist Dominique Strauss-Kahn for the position of head of the International Monetary Fund has made it more difficult for Socialists to argue that his economic reforms make no sense, and the appointment of several other Socialists to important cabinet and advisory posts has similarly dampened opposition.

Interestingly, the main resistance that Sarkozy has faced thus far has come from outside France. Criticism has been heard from another moderate conservative, Germany's Chancellor Angela Merkel, and from a number of finance ministers and central bankers, including Jean-Claude Trichet, the head of the European Central Bank (ECB). There is concern about the cost of Sarkozy's reforms. Christine Lagarde, the minister of the economy, estimates a net cost of the program at \$14 billion to \$16 billion in 2008, and \$20 billion when fully implemented. That makes up between 0.5-0.8 percent of the French GDP of \$1.9 trillion. Under the European Union's Stability and Growth Pact,

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minister, one or more of the major unions will likely mount protests.<sup>12</sup>

Yet Sarkozy has thus far shown himself to be adroit in dealing with opposition. Initially, both student unions and the Association of University Presidents opposed his university reform. When his minister of higher education, Valérie Pécresse, had difficulty placating the opposition, Sarkozy intervened personally and, with a combination of charm and readiness to compromise on key issues, overcame all objections. His backing of

France has pledged to keep its budget deficit under 3 percent of GDP and total deficit under 60 percent of GDP. In 2006, France stood at 2.4 percent and 63.9 percent, respectively, and both numbers were trending downward.<sup>13</sup> The addition of at least \$14.5 billion of debt annually will reverse this trend unless a spurt of economic growth increases tax revenues.<sup>14</sup> Indeed, even before the tax package was passed, it was announced that unemployment in France had declined to 8.1 percent. Although the French

recovery has not been as robust as that of neighboring Germany, there has been some improvement. Sarkozy has never claimed that deficits are not important, but he is gambling that they will not get out of hand and that his reforms will indeed stimulate new employment and new tax revenues that will defray much of their cost. He has also been critical of the ECB for attaching too much importance on price stability and too little on growth and exports. This cavalier attitude toward the principle of central bank independence—regarded as sacrosanct in financial circles as well as in countries that fear inflation—has rankled many officials, including Trichet and German Finance Minister Peer Steinbrück.<sup>15</sup>

Economists too have weighed in with their own criticisms. A study by Alpha Etudes contends that the government has underestimated the costs and overestimated the benefits of eliminating overtime taxes.<sup>16</sup> Three respected labor economists, Patrick Artus, Pierre Cahuc, and André Sylberger, produced a report for the Prime Minister's Council of Economic Analysis in which they noted that the measure may also provide an incentive to substitute overtime for new hires and perhaps even to engage in fraud, disguising regular work hours as overtime to take advantage of reduced taxes.<sup>17</sup> Yet many economists believe that the central labor-market reforms are reasonable if they are solely used to address problems that have not been resolved for years. The tax package is more controversial, especially the reductions of the estate tax, and runs the risk of increasing inequality without stimulating sufficient growth. The popular mortgage interest deduction may stimulate employment in the construction industry, but will also add about \$11.5 billion to the budget deficit.

**Conclusion.** In the months since President Sarkozy's election, there can be no doubt that he has successfully become a European cynosure. He surprised the French and disarmed his enemies by opening his government to members of the Socialist and centrist opposition. With great artistry, he set out to change the image of the French presidency from an aloof, almost otherworldly office, to a paragon of energy and engagement. The senescent torpor of Chirac's *fin de règne* gave way to months of seemingly ceaseless activity and the promise of fundamental constitutional reform. Yet the impression of renewal may be somewhat misleading. The key economic reforms outlined above are essentially reformulations of ideas that have been debated for years. As a campaigner, Sarkozy pulled off the remarkable feat of appearing to run against the extremely unpopular Chirac, who had been his mentor and for whom he had served as minister and party leader. For now, pouring old wine into new bottles seems to have worked wonders. The vast majority of Frenchmen seem eager to drink a toast to the new regime. Yet pockets of virulent resistance remain. The "anti-liberal left" remains unalterably opposed to reforms largely accepted by both the center-left and the center-right.<sup>18</sup> More serious still, despite the nomination of members of France's "visible minorities" to important cabinet posts, Sarkozy remains extremely unpopular, if not detested, in the *banlieues*, where unemployment runs high.<sup>19</sup> The rap musician Doc Gynéco, who supported Sarkozy, was recently driven from the stage in Geneva by an angry crowd that denounced him as a "collaborator" with "Sarko *facho*," Sarkozy the fascist. Despite the apparent success of his first hundred

days in office, virulent emotions lurk just below the surface. Any number of things could set off an explosive reaction similar to the riots of the fall of 2005. How Sarkozy might meet such a challenge remains to be seen. For now, however,

the suburbs seem resigned; the Socialists are routed, confused, and unable to regroup; and two-thirds of France's population remains pleased with the government to a degree that seemed unthinkable six months ago.

#### NOTES

1 In the first weeks from 63 to 65 and then 67 percent, heights not seen since the days of General de Gaulle. On Le Pen's appreciation. See <http://artgoldhammer.blogspot.com, 8/7>.

2 The tax package is officially known as the Law on Work, Employment, and Purchasing Power. A presentation of its principal points by finance minister Christine Lagarde can be found at [http://www.lefigaro.fr/debats/20070801.FIG000000014\\_travail\\_emploi\\_pouvoir\\_d\\_achat\\_une\\_loi\\_pour\\_redonner\\_confiance\\_aux\\_francais.html](http://www.lefigaro.fr/debats/20070801.FIG000000014_travail_emploi_pouvoir_d_achat_une_loi_pour_redonner_confiance_aux_francais.html).

3 A study has shown that 85 to 90 percent of the French who don't own homes would like to. The home ownership rate in France is just 52 percent, compared with 80 percent for Spain. See [http://tempsreel.nouvelobs.com/actualites/opinions/3\\_questions\\_a/20070530.OBS9463/cette\\_mesurene\\_se\\_traduirapas\\_en\\_inflation.html](http://tempsreel.nouvelobs.com/actualites/opinions/3_questions_a/20070530.OBS9463/cette_mesurene_se_traduirapas_en_inflation.html).

4 For a thorough analysis of the influence of French labor-market institutions on unemployment, see Olivier Blanchard and Jean Triole, "Protection de l'emploi et procédures de licenciement," report for the Conseil d'Analyse Economique, available at <http://www.cae.gouv.fr/>.

5 The Fillon Law aligned the retirement regime that applies to civil servants with the "general regime" that applies to most private-sector employees. It left in place a number of "special regimes" applicable to railway workers, employees of certain state-owned utilities, sailors, fishermen, and employees of the Paris Opera and the Comédie Française. Only about 550,000 active workers and just over a million retired workers are covered by the special regimes, out of a total work force of some twenty-seven million.

6 The law requires workers and management to consult about grievances in order to head off potential strikes; prior notice of any strike; individual notice to management of the intent to walk off the job forty-eight hours in advance; and a vote on whether to continue after a week off the job.

7 Sarkozy has denied that any deal was concluded regarding the EPR.

8 Lecture by MIT economist Olivier Blanchard. See [http://econ-www.mit.edu/faculty/download\\_pdf.php?id=1505](http://econ-www.mit.edu/faculty/download_pdf.php?id=1505), slide 3.

9 Some believed that ambitious workers would be free to extend their working hours voluntarily. As enacted, however, the law makes it clear that the offer of overtime is entirely at the employer's discretion.

10 See <http://abonnes.lemonde.fr/web/article/0,1-0@2-3224,36-937490@51-925281,0.html>.

11 See <http://abonnes.lemonde.fr/web/article/0,1-0@2-3224,36-942724@51-925281,0.html>.

12 By Blanchard and Triole, see note 4 above.

13 <http://mediaserver.fxstreet.com/Reports/043510df-a836-4b86-a9b3-a88c80ec83c3/dfde3902-6a7d-490d-8a2b-d5d5f14d3be5.pdf>.

14 On 14 August, estimates of French economic growth in 2007 were revised downward. See [http://www.latribune.fr/info/Croissance-decevante-de-0-3--en-France-au-deuxieme-trimestre--ID682CECFA6DE62E6FC1257337002709DB-\\$RSS=1](http://www.latribune.fr/info/Croissance-decevante-de-0-3--en-France-au-deuxieme-trimestre--ID682CECFA6DE62E6FC1257337002709DB-$RSS=1). Only a month earlier, the ministry of the budget had argued that growth estimates might be too low and that France therefore had more headroom to remain under the SGP ceiling.

15 For the reaction of Steinbrück and other finance ministers to Sarkozy's appeals to a meeting of EU finance ministers, see [http://www.liberation.fr/actualite/economie\\_terre/266835.FR.php?rss=true](http://www.liberation.fr/actualite/economie_terre/266835.FR.php?rss=true).

16 Alpha Etudes, "Travailler plus pour gagner plus: quels effets ?" available at [http://www.alpha-etudes.com/lire\\_publication.asp?id\\_publi=222](http://www.alpha-etudes.com/lire_publication.asp?id_publi=222).

17 See <http://www.liberation.fr/actualite/politiques/256832.FR.php>.

18 The "anti-liberal left" includes a faction of the Socialist Party together with all of the Communist Party and several small parties of the extreme left, as well as social movements opposed to globalization, such as ATTAC.

19 The phrase "visible minorities" is preferred in France to designations such as racial or ethnic minority.