



## Is France Too Cautious on Reform?

*Nicolas Véron discusses the perhaps overly slow approach to reform and fiscal consolidation of President François Hollande of France, where markets are at least giving him some breathing space.*

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Steve Weisman: Six months after taking office as President of France, Francois Hollande faces an array of political, economic, and market related problems. Nicolas Véron of Bruegel and the Peterson Institute for International Economics is here with me, Steve Weisman, to explain the situation in France and the dangers that are posed by its struggles. Nicholas, give us a sense of President's Hollande's problems.

Nicholas Véron: There is no acute problem for France right now. The borrowing costs of the French government are lower almost than they have ever been. Investors are still ready to buy French government bonds for the time being. The question is how stable is the situation and—given the general turmoil in the euro zone and the fact that the crisis hasn't been resolved, but we've seen successive waves of contagion—can France be secure that the next wave of contagion will not be hitting it?

Steve Weisman: Are the markets delivering a vote of confidence in Hollande?

Nicholas Véron: It really depends of your interpretation of market movements. One way to look at it is, yes, they're giving a vote of confidence because the spreads of French sovereign debt are over German debt are fairly low. They're around sixty or seventy basis points at the moment, when the German borrowing rates themselves are historically low. But you can also see it as a phase in which there is huge market demand for safe, or relatively safe sovereign assets and there is just not enough supply. There is not enough supply from Germany, so US Treasury Bonds are great but the US has a fiscal cliff. Japan is great, but Japan has its own policy and political deadlock. The UK is great but has a lot of question marks about its economic future. So really, France is just benefiting from a situation of imbalance between supply and demand of so called "safe" government assets.

Steve Weisman: That doesn't sound confidence inspiring.

Nicholas Véron: Exactly. And indeed, when you look further than just yields and spreads, there are a lot of question marks about the French economy, especially in view of the lessons of the European crisis so far, about its financial system, about its structural rigidities, about its fiscal position. This is what investors are raising questions about, in ways that don't show in market prices, but that are sufficiently clear to prompt some pretty candid thinking in France and outside France about the country.

Steve Weisman: There are a lot of reforms and fiscal challenges facing Hollande. If carried out—for instance increasing taxes— some are likely to suppress the economy. How is he doing in his agenda?

Nicholas Véron: Hollande is a very cautious politician. He governs a country which is in a sort of limbo, not really as self confident as Germany is right now. The Germans are convinced that they have a very robust economic model. This is not the case with France. At the same time, the crisis hasn't hit France the same way as it has hit some economies more to the south of the European Union. There is no blatant evidence that the model has to change, so the French system is in an in-between space, where there is a widespread feeling in the country that some things have to change, but it's not really forced by external pressure.

And Hollande is adapting to this. He's commissioning reports. He's prompting substantive debate on policy and what transformations need to take place in the French political framework. He's taking some steps towards reform, but he's not really proactive in terms of changing the policy landscape periodically to make sure that no accident will happen.

Steve Weisman: Do you think he's moving too cautiously?

Nicholas Véron: The European crisis is always taking place at two levels. It takes place at the level of individual member states and at the level of Europe and the dysfunctional policy framework, at the European level, which explains a lot of the contagion. If the European framework were fixed, probably there would not be a need for dramatic change in France itself.

There's need for long-term reform but nothing really urgent. At the same time, because there is this dynamic of gradual contagion, because of the dysfunction of the central European policy framework, probably France has to act more quickly to address long-term concerns than would be the case otherwise. And from that perspective, assuming there is no dramatic move to fix the deficiencies of the European policy framework, yes, I think Hollande is too slow and France would need more decisive structural reform.

Steve Weisman: Tell me three things that you would like to see it do.

Nicholas Véron: One thing is to make France a better place, not just to do business but to grow a business. There are impediments to the growth of companies that have high potential in France and they come from various places. There are issues about labor market regulations. There are issues about the financial system and its dominance by very limited, very large banks. There are issues about competition policy which perhaps could be more assertively enforced in some sectors. There are issues about sector regulation, particularly of some professions or some service sectors, where regulation doesn't allow enough for new entrants to come into the market.

There are issues about innovation policies and university governance that don't make universities autonomous enough to build enough connections with the private sector at the local level, even though there has been some reform by the previous government of how French universities are governed. It doesn't go far enough. So you have all these issues of the structures of the economy I think that are important. And there are issues about the fiscal situation and the burden of the government on the French economy.

Steve Weisman: Hollande has signaled something different than Americans are talking about, which is doing it through the tax increases rather than going after the social safety net. Is that right?

Nicholas Véron: You have it broadly right. I think that I may not have the most data numbers, but the fiscal consolidation of course in France is about two thirds tax increase and one third expenditure cuts. The big difference between France and the U. S. is that the French are surprisingly willing to pay high taxes. Tax collection is quite efficient in France. Tax rates are high and it somehow feels to many governments that they haven't reached the pain threshold yet, so that they can continue to increase. Of course, that's not entirely true and it harms France in terms of international competition. So I personally believe that there is more to be done in terms of expenditure cuts. Of course they shouldn't be too radical or too quick, but there are pockets of inefficiency in the French state that could be better addressed.

Steve Weisman: Thank you very much, Nicholas.

Nicholas Véron: Thanks, Steve.

