



Game Change for France?

Nicolas Véron assesses the latest cabinet shakeup by President François Hollande, who appears more determined to carry out structural reforms to accelerate economic growth.

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Steve Weisman: For the third time since his election in 2012, President Francois Hollande of France has reconstituted his government. It appears [he has] lurched a bit to the right or maybe a lot to the right. Nicolas Véron, Visiting Fellow at the Peterson Institute and Senior Fellow at Bruegel is here with me, Steve Weisman, to discuss the latest developments in French politics. Nicolas what actually happened?

Nicolas Véron: President Hollande appointed Manuel Valls as prime minister in early April, but at that time he appointed a government which sent very mixed signals in terms of policy and tried to reconcile the irreconcilable. I believe that's not proper English, but ...

Steve Weisman: It is perfect English.

Nicolas Véron: And the symbol of that was the coexistence of Finance Minister Michel Sapin, pragmatic, aligned with the alliance that Valls embodies himself, which is partly reformist and reasonably market-oriented as these things go in France on the one hand and on the other hand, Arnaud Montebourg is a flamboyant, very talented economics minister, who made no mystery of his preference for economic nationalism, deficits to finance growth and less orthodox policies. Let's put it this way.

So this has now been replaced with a much clearer alignment in policy terms and more symbolically the replacement of Arnaud Montebourg with Emmanuel Macron, who is not unknown to this team, because he used to be the Chief Economic Advisor to Hollande until June, and he's now at the very young age, 36, the Economics Minister and clearly embodies a similar line of pragmatic reform and general alignment with the economic policy objectives that are expressed at the European level.

So of course a big event or some other changes in the lineup in the Education Ministry and the Cultural Ministry, but by far the most important and symbolic move is on to Economics Ministry and the departure of Montebourg.

Steve Weisman: Europe is at a delicate stage, not just France, of maybe their economies slipping back into recession or not growing as fast as everybody wants. There's talk, not just on the left, policies need to be more pro growth. But what does that mean for France now with this new team?

Nicolas Véron: In a way it's sort of an alignment of France with Italy where we also have this situation of a very difficult Parliament with a different breakdown, of course, with existence of the Five Star movement in Italy in which a strong Parliament doesn't have an equivalent in

France. But a government which is undoubtedly committed to reform, but has to deal with a difficult political environment. In the case of Prime Minister Matteo Renzi in Italy and now with the removal of the Montebourg lack of clarity also in France with Manuel Valls. So the question is no longer, is the government committed to reform, which clearly it is now, but how far can it go given the political environment and also the Parliamentary context?

Steve Weisman: We always hear about structural reform. Explain what that means, also in terms of fiscal and tax policy?

Nicolas Véron: Right. There is this question of complementarity of supply side and demand side reform in the European debate and I guess there is an increasingly broad consensus, especially after the recent speech by Mario Draghi at Jackson Hole, that the fiscal side has to comply with the Stability and Growth pact and the Fiscal Pact and the different straitjackets that exist at the European level, but there should be as little constraint as possible there. So basically the flexibilities that exist in the European commitment should be used. The European commitment should not be thrown to the bin, but there should be flexibilities there.

Steve Weisman: Let me interrupt you, I'm not following you. Does this portend more—or maybe this is too simplistic—deficit spending?

Nicolas Véron: Yes. I was going to come to this. Basically this portends a bit more deficit spending or less deceleration, in deficit reduction. But the margin of maneuver here is not great. It's not great for France, it's not great for Italy, because their debt levels are already very high and there is a credibility issue that means they basically cannot do a credible, effective fiscal stimulus that would add to growth without undermining confidence at the national level.

Steve Weisman: And in the markets?

Nicolas Véron: The markets are pretty stable these days, so the market constraint is not immediate, but over the medium term that's obviously what is also at stake. But also in terms of the interaction among European leaders and the perception that if you do have to do a mix of supply and demand side reform, clearly Italy and France so far have done much less in terms of supply side reform and structural reform than countries like Spain, Portugal, Greece or actually Germany in a slightly less recent period.

Steve Weisman: A lot of people are critical, though, of the German-led campaign to continue, for lack of a better word, austerity, which is deficit reduction in another guise. What do you think of that?

Nicolas Véron: It's sort of a dirty secret of Italy and France that they haven't done austerity in recent years really. I mean there has been a constraint on public spending, but nothing that would really count as austerity. Certainly nothing comparable to what has been observed in countries that have been more directly affected by the crisis like Spain and Portugal.

Steve Weisman: And Greece.

Nicolas Véron: Let alone Greece. But the austerity is a bit of an exaggerated label to describe what happened recently in France. And on the fundamental debate, while many economists agree that there would be a case in principle for a similar situation in the European

situation. The problem is that the institutions of Europe don't allow the stimulus to be done at the European scale where it would be most effective and relevant and therefore you're left with national environments where actually the margin of maneuver is certainly larger in Germany than in other countries, but overall, not great.

Steve Weisman: OK.

Nicolas Véron: So basically the lack of the fiscal union—if you want to simplify with slogans—makes it operationally difficult to have a stimulus strategy in Europe even though there would be an economic case for it. And therefore you're left with what is realistic at this point, which is exploiting the flexibilities of the fiscal compact and the agreements at the European level, which is a way to say, "Given the bad economic environment, actually it's fine for governments not to reduce their deficits now." And this is probably what European leaders will agree to among themselves in the next few weeks. That's certainly is the signal that Mario Draghi has given last week.

So it is true that you would want Europe to have a fiscal union and it would have a much more reasonable fiscal stance if it had a fiscal union. But in the absence of a fiscal union, it's not a huge game changer for growth whether you go to the limit of market confidence in terms of deficit spending or whether you take a more prudent stance as is the case now.

Steve Weisman: Having said that France has not done very much on the fiscal side, what do you think about how much is done on the so-called supply side of structural reform including labor market reforms?

Nicolas Véron: Yes. First, what are we talking about when we talk about structural reform? Because that's in a way useful summary expression for economists, but it's used by different people in different ways especially in different national debates. In the French case, structural reform, which would be reforms that increase the growth potential of the economy, would be about labor market reform, better market access and perhaps less protections for corporate incumbents to give more space for new entrants—young companies to grow.

That includes also competition policy, some sectoral regulation, financial system reform. There is a very strong bank oligopoly, for lack of a better term, in France and the public sector intervention in the financial system has a lot of impact in that location which may not be optimal. And some aspects of reform of the state itself, not just the quantitative aspect of deficit reduction or expenditure cuts, but really the structures of the state decentralization territorial reform basically making the state more efficient and better able to support the economy.

All these different clusters of issues are summarized under the term, "structural reform," and it would be unfair to say that France has done nothing until recent years. There have been some actions, but they're very limited, they are very tentative, they don't move the cursor a lot compared to what the country would need to grow more.

Steve Weisman: And do we think, just to conclude, that this new cabinet reshuffling will compile a more impressive record on that score?

Nicolas Véron: On the face of it, certainly it is more committed in terms of the personalities and the policy orientation to this reform without the ambiguities that existed in the previous team. Also,

you could argue that there is a favorable political alignment of conditions because the majority cannot afford not to vote what the government will propose because otherwise the President has a credible threat of a dissolution where he would probably gain on a personal level because a cohabitation scenario would maximize his own chance of re-election. But of course members of Parliament as the majority would, for most of them, lose because many of them are unlikely to be re-elected if there is a snap election.

So you could say there is a balance of forces which limits ability of a reluctant Socialist party to block the structural reforms that the government would propose. But of course, this has to be squared with the state of public opinion which is very wary about change and also tensions in French society. This is what will be important to observe in the weeks and months ahead.

Steve Weisman: I'm tempted to say, "plus ça change," but from the tenor of the interviews you and I have done over the last couple of years, it sounds like Hollande is facing the same dilemma's he always has. Anyway, yes and no, right?

Nicolas Véron: I would say Hollande is often described as a master of ambiguity. In this choice of government lineup, he's actually much less ambiguous about what policy he wants to pursue than he has ever been. So from this perspective there is something new in this reshuffled team, but whether it will lead to a dramatic shift of policy, of course, remains in Parliament.

Steve Weisman: Thank you very much Nicolas.

Nicolas Véron: Thank you Steve.

