

The Evolution of Economic Policy

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Despite their highly-developed production regimes, modern capitalist economies are rarely static. Their prosperity stems from a capacity to promote ‘cycles of creative destruction’ (Schumpeter 1949) in which firms abandon older modes of production in order to exploit emerging technologies and new market opportunities. The French economy is no exception: in recent years, it has been called upon to reinvent itself in response to many developments. Foremost among these is the expansion of world markets, as declining barriers to trade, new forms of communication and political liberalization open attractive new markets and production sites around the globe. Rapid technological advance in microprocessors and bioengineering have generated a new industrial revolution, creating entirely new sectors and transforming production across the economy. To exploit these developments, new managerial techniques have been adopted by companies all over the world, including just-in-time inventory systems, team production, closer client-supplier relations and new forms of quality. If the French economy cannot keep up with these changes, it cannot expect to flourish.

However, developments such as these pose profound challenges to governments that find themselves caught between two sets of demands. If the national economy is to flourish, a government must encourage *economic flexibility*. That is to say, it must find ways of facilitating the movement of resources, whether capital, labor or technology, from traditional activities now in decline to new ones providing more opportunities for

growth and more efficient forms of production. But the very effort to secure flexibility generates social dislocation. Some who once had secure jobs may be forced onto the labor market or required to obtain new skills. Others may be called upon to perform new tasks or to work under different conditions. Faced with this kind of economic turbulence, the populace demands *social protection* whether in the form of guarantees of job security, access to new skills, or social support during periods of unemployment. The central challenge facing French governments today is much like that confronting many others: how can it enhance the flexibility of the economy while providing enough social protection to avoid the social or electoral conflict that all governments fear? This balancing act is especially difficult if the means used to deliver social protection impair the flexibility on which prosperity depends (Rodrik 1997).

In France, these problems are unusually acute because the state has traditionally had a more prominent role in the economy than in many other nations. In Britain and the United States, the role of the state has been more limited and resources allocated primarily through competitive markets. Although their market-based approach privileges economic flexibility over social protection, it can be an appropriate response to the problem. But the French are more ambivalent about markets, more accustomed to looking to the state both for social protection and for effective resource allocation, and they are, therefore, less certain about how the nation should respond to the problems of globalization. Instead of making minor adjustments to its economic system, France has had to invent a new economic model to cope with the challenges of the contemporary era. Efforts to improve economic flexibility have inspired a profound shift in the role of the government in the economy, while large segments of the electorate still look to the state

for protection. Thus, the story of recent economic policy-making in France is one about the political problems accompanying the reinvention of its economy. To understand it, we must begin with some historical perspective.

The Postwar Modernization Strategy

In the thirty years that followed the Second World War, France developed a *dirigiste* economic model in which the state took on the task of modernizing the economy. Fearful that small businesses and antiquated firms would not be able to compete effectively against German and American firms as trade expanded in the postwar world, the French policy-makers of the 1940s and 1950s used the resources of the state to encourage French industry and agriculture to increase the scale of production through mergers and acquisitions, to shift capital and labor into high-technology sectors, and to eliminate less-efficient producers in favor of firms that could prosper on international markets.

President Charles de Gaulle, a strong supporter of this modernization strategy, described the firms he was trying to create as ‘national champions’ carrying the banner of France onto world markets. Like many in the postwar world, he believed that the geopolitical power of the nation would depend on its economic strength.

To implement this strategy, the state established a planning system that set investment and production targets for major industrial sectors in consultation with leading firms, and successive governments used their influence over large, state-owned banks to channel resources to firms identified as most promising. The government exploited its control over nationalized enterprises in coal, steel, energy, and automobiles to induce other firms to cooperate with national plans for growth (Cohen 1979; Zysman 1984; Hall 1986). Industrial policy-makers in Paris managed a large portion of the

national economy. Trained at the *Polytechnique* and *Ecole Nationale d'Administration* (ENA) to see themselves as strategists for industry on behalf of an overarching public interest, these officials became the architects of the new French economy. After some years in government service, it was customary for them to 'parachute' into the private sector where, as top executives, they became elements of a cohesive elite linking French corporations closely to the state (Suleiman 1996).

For many years, this modernization strategy was highly successful. The French economy grew faster than any other in Europe during the 1950s and 1960s. It developed a powerful presence in steel, armaments, aircraft, consumer goods, and agricultural products. Although many factors contributed to this rate of growth, French planners and politicians were delighted to take credit for it, and the fruits of growth were used to fund generous social and industrial subsidies to ease the pain of those employed in declining sectors..

The Years of Transition

By the 1970s, however, French policy-makers began to confront a new set of economic circumstances that *dirigiste* economic planning was not well-designed to address.

Planning had been effective for building infrastructure in basic sectors, such as steel and transport, where France needed investment. It helped many firms secure economies of scale. But bigger is not always better. As the provisions of the 1958 Treaty of Rome that brought France into the European Economic Community came into full force at the end of the 1960s, France had to reduce its barriers to trade and face more intense foreign competition. To survive, its firms had to be competitive, but the competitiveness of a firm depends on astute daily management that industrial policy-makers in Paris, far-

removed from each enterprise, could not supply. Thus, the nation found itself saddled with huge coal, steel, shipbuilding, and automobile companies that were absorbing public funds but had substantial overcapacity and could not produce as cheaply as their competitors overseas. Subsidies to high-technology firms in semi-conductors and consumer electronics failed to build viable enterprises, as Japanese and American competitors made better technological choices and began to set the market standards (Zysman 1977). By the end of the 1970s, the planners began to realize that French firms would have to become less-dependent on the state and more responsive to market forces if they were to prosper in an open economy marked by intense international competition.

At the same time, the large oil prices increases of 1974 and 1979 plunged Europe into recession, cutting rates of growth in half and increasing unemployment. Politicians who had been happy to take credit for high rates of growth now sought ways to escape blame for poor levels of economic performance. Thus, politicians and officials alike began to suggest that resources should be allocated by markets rather than the state. Prime Minister Raymond Barre took several steps in this direction in 1976, but he was ousted in 1980 on a wave of dissatisfaction with poor economic performance that brought the left to power for the first time during the Fifth Republic.

At that point, the newly-elected President, François Mitterrand, embarked on one last effort at *dirigiste* modernization. Vowing to support entire industries and not just the most profitable firms among them, he tried to use public investment as a substitute for private investment, increasing state aid to industry from 35 billion francs in 1981 to 86 billion francs in 1985. At the same time, he increased the minimum wage and social benefits, hoping to stimulate enough economic demand to jump-start French growth. But

the results were disappointing. The budget and trade balance went sharply into deficit. The exchange-rate, pegged to the German mark since 1979 in a European Monetary System (EMS), came under severe pressure, and France was forced to devalue the currency several times. In March 1983, Mitterrand faced a turning-point. Under pressure to devalue again, he considered leaving the EMS, pulling France back from its commitment to European economic integration in order to pursue domestic expansion at the cost of limiting the flows of goods and capital across French borders. After much consultation, however, Mitterrand opted for open European markets and accepted far-reaching budget cuts to stabilize the value of the franc on the foreign exchanges. This marked the end of efforts to use public funds as a substitute for private investment and the demise of a modernization strategy in which the state had taken the lead in directing the allocation of resources across the economy.

A Neo-Liberal Modernization Strategy

By this time, French governments were already searching for an alternative economic strategy. Step-by-step, they put into place one that remains the touchstone for economic policy-making in France today. In general, the new approach is neo-liberal: it accords markets the primary role in the allocation of resources. But we can think of it as a 'modernization strategy' because, although the means are now different, the objectives are broadly similar to those of the preceding strategy, i.e. to modernize the economy by forcing firms to reorganize so as to become more competitive on global markets. The initial steps taken in this direction during the 1970s and 1980s were halting and experimental, as policy-makers felt their way forward (Levy 1998). By the 1990s,

however, enough elements were in place for it to be described as a coherent strategy. At its heart are five central components.

The first is a profound commitment to European economic integration. Shortly after deciding to remain in the EMS, Mitterrand signed the Single Europe Act of 1985 that pledged France and the other nations of the European Community to remove almost 300 barriers to trade so as to establish a single continental market by 1992. This move had great significance for French firms. It meant that they would have to face growing competition from abroad. Many would have to reorganize to survive this competition and take advantage of the opportunities offered by the new market. The result was a wave of cross-border alliances, mergers, and acquisitions, as French firms sought strong positions in a continental market.

What gave real bite to this new modernization strategy, however, was its monetary dimension. For decades, French governments had been tolerant of exchange-rate depreciations that raise the price of imports and lower the price of exports, thereby protecting French producers from foreign competition and offsetting the effects of wage increases on the competitiveness of exports. By deciding to remain in the EMS, Mitterrand pegged the value of the franc to the German mark at a relatively high exchange-rate, and the effects of this decision were intensified in 1996 when France agreed to adhere to strict monetary and fiscal targets in order to meet a set of ‘convergence criteria’ that would qualify it for entry into full monetary union with ten other European nations in 1999.

The implications of these decisions for French firms were profound. The latter already faced more intense product-market competition from elsewhere in Europe. Now

they would have to do so in the context of a high exchange-rate that made French goods expensive compared to those produced abroad. Companies that might have retained their traditional practices if exchange rates remained low were forced to reorganize to survive. They lost the protection that devaluation and other less-obvious barriers to trade hidden in French regulations once provided. As it had before, the French state was forcing firms to modernize, but now it was not telling them how to do so or providing them with substantial subsidies to get the job done. Instead, firms were to modernize on their own in response to market forces.

The third component of the new strategy was openly neo-liberal. Successive governments sold off many of the holdings of the state in banking and industrial enterprise and began to deregulate national markets. Within two years of becoming Prime Minister in 1986, Jacques Chirac privatized thirteen large companies, bringing 78 billion francs into the public coffers. After 1993, the government again sold shares worth 114 billion francs in Crédit Local, the Banque Nationale de Paris, Rhône-Poulenc, Elf-Aquitaine, Union des Assurances de Paris, Usinor-Sacilor, Renault and Péciney. In 1986-88, the Minister of Finance, Edouard Balladur, removed price controls, abolished exchange controls, eliminated the lending quotas that once underpinned the state's influence over the financial system, and took significant steps to increase competition in markets for transport, telecommunications and petrol. A system of corporate finance heavily-oriented towards state-sponsored loans was dismantled between 1984 and 1993, leaving firms to find funds on international capital markets, and substantial efforts were made to expand the Paris stock exchange (Schmidt 1996).

In order to modernize, many French firms had to lay-off workers and reorganize work processes which meant overcoming resistance from the trade unions. Accordingly, the fourth element of the new economic strategy was a series of steps limiting the power of the trade unions over economic issues. The Auroux laws passed in 1983 established councils in each workplace with which employers could negotiate working conditions. Ostensibly designed to strengthen the unions, these councils actually allowed many employers to bypass them (Howell 1992). The government used its control over the minimum wage (to which roughly 40 percent of the wages in the French economy are tied) and the public sector to resist demands for wage increases, and high levels of unemployment during the 1980s and 1990s reduced the power of the trade unions to resist lay-offs or the reorganization of work. By the end of the 1990s, the major union confederations, and most notably the FO and CFDT, were exploring new forms of cooperation with employers.

Finally, the government changed the character of its supply-side policies in order to accommodate the new modernization strategy. It eliminated most of the large industrial subsidies once provided to firms for capital investment. Although the state rescued a few faltering giants, spending as much on *Crédit Lyonnais* as it had on the channel tunnel, for the most part, French companies had to find capital on world markets. Instead, the government has been concentrating its resources on two kinds of programs, those fostering research and development and those in the area of manpower designed to create jobs or improve the skills of the workforce.

Almost 40 percent of the research and development activity in France still takes place under the aegis of the public sector, often in publicly-financed research institutes, a

much larger proportion than those found in Britain or the United States (Ziegler 1998). The defense sector still accounts for much of this expenditure, but many small-scale programs, often administered at the regional level, provide companies with support for developing new technology. Derided as *meccano industriel* by some and so dispersed that one cannot be certain how effective they are, this network of programs is nonetheless the basis for much of the new-found economic activism of many local and regional authorities in France (Levy 1999; Schmidt 1996).

The shift toward activist manpower policies begun in the 1980s is more significant. These policies can be seen as a new form of social protection, replacing those once provided by depreciation and trade barriers. They offer those who do not have a job compensatory social benefits, subsidized positions in the public or private sectors, or the skills with which to seek employment. Successive governments have made such policies a central pillar of their efforts to resist 'social exclusion' – a term with great political resonance in France that refers to the development of an underclass cut-off from the job market and mainstream society.

French manpower programs take several forms. During the 1980s, substantial funds were used to subsidize early retirement programs to the point that that only 38 percent of men between the ages of 55 and 64 are in active employment today compared with 70 percent in 1970. Because they are expensive, these programs were used more sparingly in the 1990s but, as recently as 1999, the government provided the support for 35,000 automobile employees to retire at age 55. The state also offers firms a variety of subsidies, often in the form of reductions in the social charges they pay, for taking on young workers just entering the labor force or people who have been unemployed for six

months or more. By 1997, when unemployment rose to 13 percent of the labor force, the government was spending 5 percent of gross domestic product (GDP) on such programs.

Equally important are the governments' efforts to improve the skills of the labor force. Two new vocational qualifications after the *baccalaureat* have been introduced. Apprenticeship programs coordinated by business at the regional level have been enhanced, and substantial growth in the university system mandated. Despite cutbacks elsewhere, spending on education rose by 25 percent between 1988 and 1991 alone, with dramatic results. By 1994, more than 63 percent of those at the relevant age took a *baccalaureat* compared to 28 percent in 1980, and the majority of young French workers now have at least two years of education beyond the 'bac'. Few nations have managed to increase the skills of their workforce to this extent in such a short period of time.

In sum, French economic policy has changed dramatically in two decades. Policy-makers continue to operate a 'modernization strategy' but one that is now distinctly neo-liberal. They no longer tell companies how to improve their operations but force them to do so by exposing firms to intense international competition. The state has stepped back from the allocation of resources and expanded the role of market forces. But government spending remains high, much of it directed at manpower policies designed to provide social protection while also increasing economic flexibility by raising the skill levels of the labor force.

The effects on economic performance have been profound if uneven. French business has responded with alacrity to the pressures placed on it. Many firms have undertaken alliances or acquisitions that give them access to technology and markets abroad. Most have rationalized their production processes in response to the challenges

of the new European market. For example, Renault, the French automobile maker, reconfigured its design processes and relations with suppliers to increase productivity by 50 percent between 1985 and 1991 (Hancké and Soskice 1995). French firms are now the most profitable in continental Europe, and unit labor costs, a key measure of productivity, have declined by almost 20 percent since 1986. Rates of growth in France have been close to or above the European average since 1986 and are now converging to American levels. Between 1996 to 2001, the economy created over 1.6 million new jobs and the rate of unemployment declined dramatically to 9 percent of the labor force.

However, the population has paid substantial costs for this economic adjustment. Living standards, which grew by 4 percent a year during the 1970s, increased by only 1 percent a year in the 1980s and 1990s. By 1997, almost a quarter of those under the age of 25 were unable to find work, and levels of unemployment had become a national preoccupation. Although manpower policy brought official levels of unemployment down, the French approach to this problem, which emphasized early retirement, extended education, and maternity benefits, has reduced the overall size of the workforce. By 2000, barely half of all adults in France were actively employed, compared with about three-quarters of the adult population in Britain, the United States or Sweden.

Contemporary Economic Policy-Making

This is the context for economic policy-making in France today. The political elite is firmly committed to international economic integration, but many in the populace are worried about its consequences. There is a widespread sense that France is suffering from the pressures of ‘globalization’ understood as a threat both to jobs and to French culture (Forrester 1999). Although a majority of the electorate still supports the

European Union, many resent the insecurities associated with a more open economy, and large numbers continue to look to the state for protection from the vicissitudes of the market, in keeping with the traditional French view that the state is the guardian of social welfare or 'social solidarity'. As a consequence, French politicians walk a tightrope, encouraging firms to reorganize and adjust, while promising the populace that these adjustments will not affect their income or security.

Jacques Chirac walked this line during his campaign for the French presidency in 1995. He committed France to membership in Europe's new Economic and Monetary Union (EMU) but promised to reduce unemployment and maintain social benefits at the same time (Euzeby 1996). Faced with this balancing act, however, the conservative government he named under Prime Minister Alain Juppé soon lost its footing. When Juppé proposed a reform of social security designed to reduce its deficits by cutting benefits and raising contributions, he inspired widespread protests culminating in a mammoth strike by public transit workers that evoked considerable popular support even though it paralyzed many cities for three weeks in December 1995. Similar strikes in 1996 generated enough public support to force the government to retreat from plans to reduce the generous pensions of public-sector workers. When Chirac suddenly called legislative elections in 1997, hoping to secure a firm mandate with which to impose the budget cuts required to bring France into EMU, the Juppé government was defeated.

Its replacement was a coalition of Socialists, Greens, and Communists dubbed *la gauche plurielle* and led by Prime Minister Lionel Jospin. The nation waited with bated breath to see how he would respond to what seemed an insuperable set of dilemmas. Jospin soon proved himself an adroit politician. He reaffirmed France's commitment to

monetary union and the tight budgets it required. To confirm that, he named Dominique Strauss-Kahn, a sound economist and pronounced European, as Minister of Finance. Within a year, Strauss-Kahn had increased the rate of corporate tax to 42 percent, doubled the supplementary income tax (*contribution sociale generalisée* or CSG) to 7.5 percent of earnings, and raised substantial sums from sales of government holdings in France Telecom, Air France, and other companies. France became a founding members of the new currency in 1999.

At the same time, Jospin promised the populace that he would reduce the rate of unemployment, by creating 700,000 new jobs, of which half were to be in public services and half in the private sector, fed by legislation to reduce the statutory work-week from 39 to 35 hours without loss of pay. To spearhead this campaign, he named Martine Aubry, a rising star in the Socialist party with a strong base in the union movement, as Minister for Employment and Social Affairs. She was the counterpoint to Strauss-Kahn. Within a year, 12 billion francs had been allocated to the creation of 150,000 public-sector jobs for young people, many of them serving newly-invented ‘social needs’ such as ensuring security on public transport and providing home-care for those discharged from hospitals. The object was to provide job experience for young people who might otherwise find it difficult to enter the labor force with funds that would otherwise be devoted to social assistance.

By far the most controversial component of this platform was the reduction in the workweek. Medef, the French employers confederation, opposed it with unusual vehemence, and many economists argued that it would undercut the competitiveness of French industry by raising labor costs. However, Jospin’s calculation was a shrewd one.

The plan was to phase in the 35 hour week over five years. Given high levels of unemployment and weak trade unions, he assumed that firms could substitute reductions in working-time for what would have been wage increases. If those working 35 hours a week in 2002 were paid the same nominal wages they had earned in 1997, at a two percent rate of inflation, they would be earning per hour just about the same amount in real terms that they had in 1997. Labor costs would not rise. At the same time, the shift in the workweek was expected to induce a reorganization of work that might generate substantial productivity gains in many firms.

In economic terms, the measure was a gamble: whether it worsened or improved the productivity of any specific firm depended on the outcome of bargaining between employers and their workers. But in political terms, it was a brilliant stroke. The program persuaded many in the French electorate that Jospin was serious about reducing unemployment. Since entry into monetary union imposed constraints that meant macroeconomic policy could not be used as actively as it once was to increase employment, Jospin turned to supply-side policies to address the problem.

The deficits in the social security system on which Juppé had foundered proved more intractable. Here, France faces two problems. On the one hand, its population is aging: by 2025, 30 percent of the adult population will be 65 years of age or older compared to 22 percent today. A smaller workforce will have to support a larger number of pensioners. Unless those now scheduled to retire do not, pension benefits must fall or contributions rise. Without any changes, the French social security system will be in deficit by 170 billion francs by 2020. On the other hand, France pays for its social benefits largely through social charges levied on employers and employees as a

proportion of the wage bill. At the low end of the pay-scale, these charges can amount to 30 percent of wages, substantially raising the cost of hiring a worker. At the minimum wage, a new worker costs his employer in France a sum that is more than that paid for almost a quarter of the workers currently employed in the American economy. As a result, it is difficult to expand employment. Most of the growth in employment now takes place in the service sector. Business services, health-care and education pay high wages, but, in retail trade, restaurants, and personal services, wages must be low if there is to be a demand for such services (Iversen and Wren 1998). Thus, if France is to create jobs, social charges may have to be reduced, at least on low-wage labor.

In short, the French government is squeezed. To provide the pensions required to support an aging population, it needs a large working population and revenue of the sort secured from social charges. But, if it does not lower social charges, it may reduce levels of employment to the point that too few people work to support those who are retired.

There are two potential solutions to this problem. The government could cut pension benefits. But how will the aged then support themselves? Some suggest they do so out of their own savings and urge the government to develop private pension plans or tax-free savings accounts, leaving it up to the individual to save enough to support himself in old-age. But those who did not save might then live in misery. Alternatively, the government could raise taxes on income or goods in order to secure the revenue it needs to pay social benefits from sources that do not raise the cost of labor and inhibit job growth. Britain and the United States use both of these strategies, but they have done so for some years. In France, such changes are difficult to make. The trade unions and political left resist cutbacks in social benefits. Many see private pension schemes as an

insidious effort to relieve the state of its responsibility for social welfare. But much of the French electorate is unwilling to countenance increases in income taxes, especially when those are used to reduce taxes that would otherwise be paid by their employers. French policy-makers face some real dilemmas.

To date, the government's approach to such problems has been cautious, if creative. Mindful of the uproar provoked by Juppé's effort to reduce pensions, Jospin left the generous pension schemes of the public sector largely intact. When confronted with large-scale public protests, Jospin generally gave in to them. After farmers flocked to the streets of Paris to protest reductions in agricultural subsidies proposed during the Uruguay round of trade negotiations, Jospin resisted such reductions. When truckers mounted blockades to demand government subsidies in the face of low-cost foreign competition in 1998 and higher oil prices in 2000, Jospin quickly settled the conflicts, offering them millions of francs in subsidies.

However, his government took a series of steps to improve the structural context. It targeted social benefits, once paid to all, on those with lower incomes, to reduce the total cost of those benefits. It doubled the tax levied on incomes in the name of social solidarity (the CSG), even though that tax was supposed to be temporary when invented in 1991. Using these receipts, Jospin reduced the social charges levied on low-wage labor, making jobs more attractive to those who might otherwise remain on social benefit and encouraging firms to increase the numbers they hire. Wages were removed from the base used to calculate the *taxe professionnelle* levied on many companies. Despite some opposition within his own party, Jospin also accepted an initiative, proposed jointly by the CFDT and employers confederation, to use current surpluses in the social security

system to subsidize social charges on low-wage labor, increasing the incentives of those on social benefit to seek work. By 2000, the labor costs associated with employing a person at the minimum wage had been cut by 18 percent relative to the level of 1993. In these respects, the Jospin government began to move France in directions it will have to take in the coming years with an emphasis on job creation for those at the bottom of the income hierarchy.

At the same time, however, the government assiduously pursued the neo-liberal modernization strategy begun by its predecessors. Although Jospin put rhetorical emphasis on the importance of social solidarity, his government took several steps to intensify market competition in France. In 1998, it opened the telecommunications market to serious competition and did the same for 20 percent of the electricity sector a year later. Although foreign investment has been a sensitive political issue ever since Servan-Schreiber (1969) warned of ‘the American challenge’ in the 1960s, the government gave tacit support to incoming foreign investment on a scale that is virtually unprecedented. Over forty percent of the shares of the top 100 companies listed on the Paris stock exchange are now foreign-owned.

Few nations have deregulated their financial markets as extensively as France over the past fifteen years. Although cross-shareholdings are still extensive, the ‘core shareholdings’ in newly-privatized firms that the government initially allocated to key industrial groups have been wound down. As a result, hostile mergers and acquisitions, once almost unheard of in Europe, are now a regular feature of French corporate life. In order to improve the access of French firms to international capital markets, the government supported reforms to corporate governance that provide for more

independent directors and open financial reporting. In the spring of 2000, it announced a 1 billion franc program to encourage entrepreneurs to begin new companies.

With respect to social protection, the strategy of the Jospin government was to emphasize measures that enhance, rather than inhibit, economic flexibility. Although Jospin protested loudly in 1997 when the employees of a French firm in Belgium were laid off without a proper ‘social plan’, he refused to intervene when Michelin reduced its French workforce, signaling employers that the government would accept lay-offs that could be justified in economic terms. As noted, the government made substantial efforts to raise the skill-levels of the workforce and to offer firms tax subsidies to reduce the cost of new hires. It was also attentive to the incentives facing those on the edge of the labor market. Since 1988, the long-term unemployed and disabled have been guaranteed a minimum annual income (*revenue minimum d’insertion* or RMI), but Jospin introduced provisions allowing those who take jobs to retain a portion of these benefits, thereby reducing their disincentives to seek employment.

With adroit political maneuvering and cautious economic management, Jospin managed to remain popular throughout his term in office. More than half the electorate still approved of the government’s management of the economy in 2000. But the government also had good fortune. The European economy began to improve just as it took office and, after a decade of reorganization, French firms were well-placed to take advantage of the upturn. Flush with the new prosperity and inspired by similar measures in Germany, the government bolstered its popularity with a series of tax cuts worth 120bF between 2000 and 2003, including 43bF in tax cuts for the less well-off, a gradual decrease in the rate of corporate taxation from 36.6 to 33.3 percent, and 25bF to reduce

social charges on low-paid labor. In the run-up to the regional elections of 2001 and the presidential elections of 2002, the watchword was 'steady as she goes'.

The Coming Challenges

After some years of discontent, then, France enters the twenty-first century with greater economic optimism. The 'new economy' built on microprocessors, telecommunications, and bioengineering that fueled American growth in the 1990s is gradually being developed in Europe as well. Although only 10 percent of French families were connected to the internet in 2000, compared with 40 percent of Americans, that proportion is rising rapidly. Independent public offerings on the European stock exchanges are growing, and the value of the shares traded on the Paris *Bourse* has increased exponentially since the 1980s. If rates of economic growth continue to reach three percent a year, the challenges facing French policy-makers will remain manageable.

However, those challenges are considerable. As noted, the future of social security is far from assured. Unless France can increase the proportion of its adult population in work, it will have difficulty supporting the generous pensions that its aging population expects. As a result, we are likely to see continuing efforts to draw women into the labor force, to extend the retirement age, to expand part-time employment, which already encompasses 17 percent of those employed, and perhaps even a new tolerance for immigration. At the same time, the government is likely to explore new forms of savings schemes that shift the burden of funding retirement away from the public purse. Although France has had some such schemes in place for a number of years, there are likely to be more modeled on the PPESV (*plan parerarial d'épargne salariale volontaire*) that the new Finance Minister Laurent Fabius introduced in the summer of 2000. Progress on this

front will be hard-won, however, as those with substantial pensions defend them and others remain skeptical about private savings plans that might benefit the affluent more than the poor.

Entry into monetary union also poses new challenges for the nation. In large measure, it is simply the capstone to a long-term strategy that has integrated France deeply into European markets. French officials took some of the key initiatives to create such a union, hoping that the 'euro' would be a worthy rival to the dollar on international markets and that a European Central Bank (ECB) would be more attentive to issues of unemployment than was the German central bank to whose interest rates France had been tied in the EMS. To date, both expectations continue to seem reasonable, even if the value of the euro in its opening years was lower than expected. But monetary union has other implications as well.

Since monetary policy is now controlled by the ECB and fiscal policy conditioned by targets imposed in the Growth and Stability Pact agreed prior to union, this development takes control over macroeconomic policy out of the hands of national authorities. As a result, they face renewed pressure to devise supply-side policies to cope with unemployment. In addition, it means that many of the most important economic issues affecting France will be settled in the coming years, not in Paris, but through international negotiations among the member-states of the EU, where France has a strong voice but only one voice among many. If the rate of inflation increases, these negotiations could be difficult, since moves by the ECB to tighten monetary policy could create concerns about growth and potential discord over fiscal policy and European-level institutions to coordinate fiscal policy are still underdeveloped. Those interested in

French economic policy will now have to watch developments at the European level as well as those in Paris.

Many in France are already doing so. Monetary union has dramatically raised the profile of the EU in domestic politics. Because they now have substantial responsibilities for the economy, EU institutions have become a target for those dissatisfied with French economic performance. The result is a new, and increasingly important, political cleavage between those supportive of European integration and others skeptical about its value, a cleavage with the potential to cut into existing political coalitions on the left and right.

The deepest dilemmas facing France today originate in the transition from a *dirigiste* economy to one in which markets are more central to the allocation of resources. In many respects, the pace of transition has been striking. Most of the major banks and industrial enterprises once owned by the government have been privatized. A financial system in which public officials had considerable influence over the allocation of credit has been replaced by one in which firms seek funds in international markets and compete in open markets for corporate control. Many of the most protected markets in France, in telecommunications, energy, and government procurement, now feature more extensive competition. Part-time employment and short-term employment contracts have become prominent features of the labor market. The government has retreated from many of the roles it once played in the economy.

However, there is no clear consensus, even among those who have orchestrated these changes, on the endpoint at which they should aim. Few want to see France move all the way toward a liberal market economy of the sort found in Britain or the United

States. *Dirigisme* is dead but it is not clear what should succeed it. Markets are seen by many in France as pitiless institutions that can wreak havoc with the lives of individuals who lack market power by virtue of birth, education, or circumstance. Most view the French republic, not as a set of markets over which the state presides, but as a community of people bound by mutual ties for whom the state has ultimate responsibility. As a result, the concept of ‘social solidarity’ has great resonance in French political life. It suggests that the republic has an obligation to protect those who might suffer at the hands of the market. As a result, demands for social protection have special meaning in France and the state considerable legitimacy when it acts in this sphere.

Many continue to look to the government to resolve conflicts over the allocation of resources that might elsewhere be left to markets to resolve. Medical interns, high-school students, farmers, truckers, and railway workers have blocked the streets of Paris to demand that the state settle their disputes and subsidize their endeavors. In most cases, the public has been sympathetic and the government forthcoming. Mass demonstrations that turn material issues into matters of public order are a commonplace of political life, and the government is widely thought to be responsible for devising solutions to such problems. When truckers blocked the roads of Britain and France demanding relief from higher petrol prices in 2000, Tony Blair turned them away on the grounds that a British government would never negotiate in such circumstances. Lionel Jospin met with their leaders and eventually accorded each operator subsidies worth about \$2400 a year.

Given this context, it is not surprising that France’s movement away from *dirigisme* has taken a specific trajectory. Even though markets have been deregulated, public spending has continued to grow. At just over 50 percent of GDP, it now rivals the

levels found in Scandinavian nations. The Jospin government was only the latest to match each step toward deregulation with new spending designed to ease the pain of those facing more intense competition. Active use of the public sector to create jobs means that a quarter of those employed in France now work for the state. Rates of corporate and personal taxation in France are correspondingly high. In these respects, France remains quite different from Britain or the United States.

In short, the movement toward markets has not yet been fully matched by a commensurate shift in the role of the state. Exponents of the market may claim that its ‘invisible hand’ translates the self-interest of individuals into outcomes that benefit all, but many of the French still see the state as the guardians of an overarching public interest that markets cannot satisfy. Even those who bemoan the inefficiencies of the state still accord it substantial responsibilities.

Underlining this perspective is the international character of the markets that France has embraced. Much of the movement away from *dirigisme* has been dictated by efforts to integrate France into a transcontinental market under the aegis of the European Union and thence into global markets. Thus, many in France are inclined to equate market forces with foreign influence. The term ‘globalization’ is unusually prominent in public life, and it summons up images of forces that are not only impersonal and inexorable but foreign and corrosive of the social bonds constitutive of the French community. Nor are such fears entirely misplaced: international commerce carries new cultural forms into all nations and English has become its *lingua franca* much to the chagrin of the French.

As a result, the French state is in a paradoxical position. On the one hand, its officials endorsed the international agreements that gave free rein to global markets (Cohen 1997). On the other, those who fear the foreign influence that accompanies these markets look to the state for protection from them. The result has been an unusually bitter politics, marked by a resurgence of nationalist sentiment on the far right and widespread sympathy for quasi-anarchic acts of defiance, aimed as much at the defense of French culture as at the depredations of the market. They have made an unlikely hero of José Bové, the seemingly-simple farmer from Larzac with a sophisticated background in civil disobedience, who was prosecuted in 1999 for damaging a local MacDonalds restaurant while protesting American sanctions on Roquefort cheese. More seriously, these sentiments have allowed parties such as the National Front and its splinter groups to build electoral support on platforms that were initially based on hostility to immigrants but now target the EU as well. Today, the old division between Paris and the provinces often appears as one that divides a cosmopolitan political and commercial elite that sees international economic integration as inevitable, if not wholly desirable, from local people in less-advantaged regions who fear its effects on their culture and livelihood.

While these divisions are being worked out in the political realm, however, market forces and a new business culture are gradually eroding the relationships that once underpinned the position of the French state in the economy. One of the legacies of the *dirigiste* state was a career system that drew the best and the brightest into a few leading schools devoted to public administration, such as the *Sciences Po* and the *Ecole Nationale d'Administration*, from which they would then proceed through high-level positions in the public sector into managerial jobs in the private sector, forging a

cohesive economic elite with close ties to the state. But many young people no longer want to enter public service even for the brief period that this track imposes on them. Instead, they are seeking technical qualifications or business degrees, sometimes from foreign institutions, and careers that lead directly into the private sector, in some cases with a view to making their fortune in the 'new economy'. Coupled with demands to improve the quality of university education across the board, these developments threaten the privileged position of the *grandes écoles* and *grands corps* that have long fed the top-echelons of the French state and economy. If these institutions decline, so may the prestige of public service that has sustained the leading role of the state in French society.

In sum, France is now well into a grand experiment that has tied its economy into global markets and dismantled many of the instruments once used to implement a distinctive economic *dirigisme*. But the transition from *dirigisme* is far from complete. The government's efforts to enhance economic flexibility have generated demands for social protection that raised levels of public spending and now influence the character of political conflict in France. That conflict now reflects a search for ways in which the nation can prosper amidst global markets without sacrificing the values of social solidarity associated with its republic. This is a search that will define the economic policies and politics of France for some years to come.

Guide to Further Reading

The best recent survey of French economic policy is Levy (1999). Good accounts of postwar French economic policy can be found in Shonfield (1969), Zysman (1977, 1984), Hayward (1986), Hall (1986) and Cohen (1989). Policy-making during the 1980s is covered in Ross, Hoffmann and Malzacher (1987), Machin and Wright (1985), Bauchard (1988) and Favier and Martin-Roland (1990). For treatments of specific themes that extend into the 1990s, see the essays by Berger and Cameron in Flynn (1995), Geledan (1993), Taddei and Coriat (1993), Daley (1996), Schmidt (1996) and Suleiman (1996). Albert (1991), Cohen (1996) and Seguin (1996) provide a sense of recent debates, and useful material can be found in the publications of INSEE (Institut Nationale Scientifique des Etudes Economiques) and OFCE (Observatoire Francais des Conjonctures Economiques) including their annual, *L'Economie Francaise* (Paris: La Decouverte) as well as the annual edition of *L'Etat de la France* (Paris: La Decouverte).

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