A Progressive Growth Strategy for France

PIERRE-ALAIN MUET
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By electing François Hollande President of the Republic and then giving the Left a large majority in the Parliament, French voters were expressing a desire for a new kind of politics. In order to exit a crisis that has hit Europe particularly hard fundamental change is needed on a European level to establish the solidarity that at present is largely lacking.

The Situation in France

For the past five years, there has been null growth in France and when the Ayrault government took office GDP per capita was still 3 per cent below its 2008 level. The brief upturn that followed the 2009 recession did not, indeed, overcome that recession, the euro zone crisis having plunged Europe into a new recession before the economy was able to recover from the first. Unemployment had been growing continuously since 2008, as a consequence of null growth giving rise to the usual vicious circle: weak growth – job losses – falling purchasing power – a further fall in growth.

Added to this situation, due in large part to the crisis, were two characteristics that can be ascribed more to previous policies than to the crisis: debt that had doubled over ten years of right-wing government and which rocketed as a result of five years of massive structural deficit in public finances; an external deficit without precedent in recent history resulting from industrial decline and a deterioration of competitiveness that has been ongoing since 2003.

In June 2012 France thus combined four deficits: an employment deficit, a demand deficit, a lack of competitiveness and a structural deficit afflicting the public finances. Confluence of both a supply problem and a demand problem is rare. Even rarer is having to solve them when debt reduction calls for a rapid decrease of the public deficit, thus depriving the government of the usual methods of economic stimulus, which necessarily have a budgetary cost. Sorting out the French economy required that all four deficits be addressed, but it had to be done in order and based on social justice, giving priority to debt reduction and jobs before tackling competitiveness.

François Hollande's Economic Policy

Since July's supplementary budget the Ayrault government's three policy priorities have asserted themselves and are to become the main strands of the 2013 budget: debt reduction, maintaining jobs and fair taxation.

In July 2012 three important measures were adopted in a bid to rectify previous economic policy: abolition of subsidies for overtime, which made no sense in a context of massive unemployment; cancelling the previous government's decision to drop the introduction of so-called social VAT, whose implementation – scheduled for autumn 2012 – would have depended strongly on growth that was already very weak; and, finally, the re-establishment of the solidarity tax on wealth abolished by Nicolas Sarkozy at the end of his term of office.

These urgent measures corrected the trajectory, while the 2013 budget aims to decisively influence the direction of deficit reduction, fair taxation and the priorities announced during the presidential campaign: jobs, education, housing and justice.

The 2013 Budget: Reducing the Deficit without Imposing »Too Much« of a Drag on Growth

During François Hollande's presidential campaign it was proclaimed that France's public finance deficit had to be brought back to 3 per cent in 2013. This aim enabled the left-wing government to make deficit reduction one of the priorities of its first year in office, while, at the same time, not making this nominal deficit a taboo in order not to have to sign up to austerity policy if growth did not meet expectations.

Throughout the debate on the organic law transposing the European Treaty the Socialist Group had, indeed, insisted on the fact that the relevant objective for public finances was the structural deficit, since it enabled the budget to reflect the current economic situation by letting the »automatic stabilisers« operate and, furthermore, respecting the policy choices embodied in the adopted budget.

The preoccupation that dominated the run-up to the 2013 budget was twofold: reduce the deficit rapidly while minimising the negative impact on growth and on the lowest incomes. This was reinforced because fair taxation, leading to the abolition of unfair and inefficient loopholes and putting the onus on the wealthiest French citizens, was not supposed to encroach upon consumption. In the situation likely in 2013, in which growth would be limited by demand, any further dampening of already subdued consumption had to be avoided.

The budgetary effort was in the amount of 30 billion euros: 20 billion in revenues and 10 billion in spending cuts. This two-thirds, one-third option was judicious. In the short term, spending cuts have a more depressive effect than increasing revenues (in the long term it is generally the other way round). Furthermore, the choice of measures has been extremely selective on both the spending and the revenue sides in order to impinge as little as possible on growth.

On the spending side the cuts in the amount of 10 billion euros resulted neither in cuts across the board nor in brutal spending cuts. Instead, a selective policy was applied, eliminating inefficient spending, while pursuing three priorities: jobs, education and housing.

Not only were the employment-policy outlays maintained, but the creation of 100,000 future-oriented jobs in 2013 was an apt response to current economic needs: creating future-oriented jobs gives young people a sustainable income and restores their confidence, along with that of their families.

On the revenue side, the 2013 budget did not entail any general tax increases, either on households or on companies. On the contrary, it abolishes unfair and inefficient loopholes. It re-establishes progressive income taxation. It corrects the major tax-related inequalities characteristic of the French tax system: those between large and small enterprises and between labour and capital. By focusing more on the highest incomes it re-establishes fair taxation, while maintaining consumption and growth.

An Important Fiscal Reform

The major income tax-related reform is undoubtedly the abolition of levy at source *(prélèvements libératoires)* on interest and dividends and of flat-rate levy *(prélèvements forfaitaire)* on capital gains on the sale of securities. The 2013 Finance Act will result, for the first time in France, in capital income finally being taxed like labour income at the income tax rate. Progressive taxation is being enhanced with the establishment of a marginal rate of 45 per cent on incomes above 150,000 euros and the ceiling on the »*quotient familial*« (factor applied during calculation of the income tax due by a French household), which benefits in particular the highest incomes, has been reduced from 2,300 to 2,000 euros.

With regard to enterprises, three arrangements that had enabled in particular large companies to significantly reduce their taxes have been reformed. First of all, the difference in treatment between dividends (included in taxable profits) and interest on loans (which were tax deductible in their entirety). Large and multinational companies have made extensive use of this discrepancy to reduce their taxable profits. The Finance Act thus reduces the deductibility of interest on loans to 85 per cent in 2013 and to 75 per cent in 2014. The advantage accruing from the exemption of long-term capital gains realised on the sale of securities is also being reduced significantly. Finally, the deferral of previous losses will be limited to 50 per cent of income.

Revision of Prospective Growth and Nominal Deficit

At the start of 2013 it became evident that the growth prediction for 2013 would not be met. The government made it clear that it would not apply an austerity programme in pursuit of the 3 per cent target because this would only drive the economy deeper into the recession that is already under way in Europe. As part of the stability programme already discussed in the Parliament in April 2013 and submitted to the European Commission, the predicted deficit for 2013 was revised to 3.7 per cent as a result of the worsening economic situation. The structural effort would remain unchanged – at 1.9 per cent – in conformity with the adopted budget.

After negotiating with the European Commission France obtained a two-year respite to achieve a headline deficit of 3 per cent of GDP, giving it room to manoeuvre in which to prioritise restoration of growth.

The Importance Attributed to Social Dialogue

The most fundamental structural reform implemented by the Ayrault government, the importance attributed to social dialogue, will assert itself in two areas: competitiveness and employment.

Since 2003, France's external deficit has steadily deteriorated, reaching 75 billion euros in 2012, having achieved surpluses of between 20 and 30 billion euros between 1995 and 2002. The lack of industrial policy over the past 10 years has exposed the two major weaknesses of French industry. First, the excessively wide gap between large enterprises – which globalisation suits perfectly – and small and medium-sized enterprises, whose presence in external markets is limited. Secondly, a product range that lacks sophistication and relies insufficiently on innovation, which makes French exporters more vulnerable than others to price variations – and thus the euro exchange rate – and the development of wage costs. The sole measure taken by the Right in the past ten years was the vote held before the presidential election on reducing social security contributions to be financed by a rise in VAT, due to come into effect after the election, in autumn 2012.

After abolishing it in July 2012 the government replaced it with a tax credit for competitiveness and employment (*Crédit d'impôt pour la compétitivité et l'emploi* or CICE) corresponding to a reduction in employers' contributions of 20 billion euros from 2013, funded fifty-fifty from 2014 by a further reduction in the deficit and through taxation (VAT and environmental tax). This measure was part of a Pact for growth, jobs and competitiveness, which included many structural measures intended to restore competitiveness.

This pact gave a pivotal role to social dialogue, highlighting its role in a nation's competitiveness. But bargaining will clearly take its proper place in the area of employment, illustrated especially by the conclusion of negotiations on inter-generational contracts as well as by safeguarding career paths.

The first measure taken by the government was direct job creation in the non-profit sector (subsidised jobs and future-oriented jobs for young people). This is the measure best adapted to the current economic situation, characterised by weak demand and declining purchasing power. By increasing the income of workers who find or are reinstated in a job it increases national income and quickly enhances economic activity.

The second measure, inter-generational contracts, is more structural. It encourages enterprises to hire young people and, at the same time, to retain older workers, thus responding to weak participation rates at both ends of working life.

The third is the conclusion of negotiations on safeguarding careers. It involves a major change: for example, one of the elements in these negotiations and the law that transposes it – the development of short-time working – has enabled Germany to get through the crisis by reducing unemployment.

However, growth is not possible solely on the basis of national policies.

Towards a Progressive European Growth Policy

The sovereign debt crisis affecting the euro zone, although Europe is much less encumbered with debt than the United States or Japan, illustrates Europe's main failing: the lack of solidarity. By raising doubts concerning the solidarity which brought them together European states have managed to transform the rescue of Greece, a country responsible for only 3 per cent of European GDP, into a general crisis of the euro zone.

Europe is currently dominated by conservative parties applying the same recipes that plunged the world into crisis: free trade as the horizon of external relations and austerity to the exclusion of any other policy. It is time to restore its original meaning to the European construction: an area of solidarity.

Social and fiscal dumping run counter to the European project. Solidarity has been replaced by confrontation between countries, competition between employees, reduction of social standards, exploitation of resources and depletion of biodiversity. After decades of rivalry, what makes Europe strong must be restored: cooperation, which has made possible the upward convergence of living standards and social protection. This cooperation must apply in all areas: in the macroeconomic domain to implement deficit-reduction policies that do not sacrifice growth; in the fiscal and social domains to avoid uncooperative behaviour; and in the domain of innovation in order to benefit from economies of scale.

Combating unemployment and inequalities must constitute the main objective of the next stage of European construction: this is how the European project will once more inspire popular confidence and hope. We must aim at introducing a »European social treaty«, advocated in particular by the European Trade Union Confederation (ETUC). Such a treaty must guarantee such fundamental rights as labour rights, the level of social protection, trade union rights and favourability clauses. The European Commission should also call on the ETUC when it comes to working out any text concerning the rights of employees and labour regulations. Finally, youth employment must be a priority.

Single currency, the Schengen area, Airbus, the financial transactions tax backed jointly by the French PS and the German SPD in their respective parliaments before becoming the object of closer cooperation, many achievements of the EU have been negotiated and supported by a limited number of member states, going out on a limb, before being joined by others and sometimes by all. This approach must be extended to other areas in order to make progress in social and fiscal harmonisation (common corporate tax base) and the launching of major projects in infrastructure, industry, technology, science and energy. A policy of future-oriented investments funded by the European Investment Bank is indispensible for developing Europe's long-term competitiveness, making Europe the first eco-continent on the planet and compensating for the depressive impact of budget consolidation policies. The first step must be the rapid implementation of the growth pact.

In contrast to liberal free trade we propose fair trade, based on respect for human rights, democracy, social progress and protection of the environment, including the implementation of a carbon tax at the borders of the European Union.

About the author

Pierre-Alain Muet is Member of Parliament for Lyon and vice-president of the French National Assembly's Finance Committee.

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Hiroshimastr. 28 | 10785 Berlin | Germany | Tel.: ++49-30-269-35-7745 | Fax: ++49-30-269-35-9248
E-Mail: info.ipa@fes.de | www.fes.de/ipa

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