

Stormy weather reforms

Jean Pisani-Ferry

Nicolas Sarkozy could not have put it more clearly a few days ago: he now intends to 'ensure that all the reforms which have not been carried out in France for so many years are finally done' (interview in the Figaro newspaper, 6 March). But the lull for the local elections has been anything but a sideshow. The president is now setting off again with his political capital eroded and in a much worse economic environment. In a matter of a few weeks, the financial situation has gone downhill fast, the euro and oil prices have shot up, uncertainty has given way to alarm. A number of urgent questions have arisen: can the reforms give growth a boost? Can they be funded? What are the priorities? Are they socially acceptable?

As for the economic outlook, the government committed the error of creating a hostage to fortune. In summer 2007 it fed a sense of impatience by promising that growth of 3% was around the corner and with that a surge in disposable incomes. But measures with immediate effect are rare. Reform is an investment, expecting quick returns leaves one open to reverses. Reforming the labour market, competition or taxes is not a matter of pushing a switch, it involves a transition. Since change generally triggers concern, it is common that growth should initially take a hit. A flourishing global economy could have substituted home-made growth, but it has taken a dip. So a sober rethink is needed, first and foremost for 2008, but also for the years thereafter. It would be reasonable to expect the reforms to yield an increase in growth potential over the five-year period, but an increase from 2% - the average of the last 15 years – to 2.5% would be an impressive result indeed.

How are the reforms to be funded? In contrast to Chancellor Merkel, Nicolas Sarkozy has given precedence to his reforms over reining in the budget and has thus given himself room, if needed, to buy consensus on one or other measure. However, his margin for manoeuvre for carrying out this strategy, initially logical, of painless reform is limited. The fiscal measures of summer 2007 consumed much of it. The shock which has affected growth, and thus revenue, has since reduced it to nil. At the very moment when France will take over the presidency of the EU, France cannot afford a war of words with a born-again fiscal conservative Germany. Nor can France risk tarnishing its credit rating in an environment where markets are discriminating between good and bad borrowers. In order to overcome resistance along the way, it will perhaps be necessary to pay for reforms, but at the cost of cutting elsewhere and thus causing further political pain. Nicolas Sarkozy is today saddled with a fiscal discipline which he had not anticipated and tomorrow, if the situation gets any worse, the need to juggle both reforms and belt-tightening.

What are the priorities? By proposing a shopping list of 316 measures, all of which are said to be 'vital for the success of the overall effort', the Attali commission has left itself open to irony. But international experience teaches that the effects of reforms do not only add up but also multiply. A labour market which works better because matching of jobs to job seekers is quicker and more accurate (the merger of unemployment insurance and placement agencies should help here) creates even more jobs if the product market eases the entry and development of new companies and they have access to adequate finance. From this angle, the hunger for action of the governing team is preferable by far to the overcautious piecemeal strategy of the past. Now it is a case of moving from the proactive to the strategic and of selecting the critical mass of reform which will get results at the lowest cost. This is even more necessary today than yesterday.

Are the reforms socially acceptable? Nicolas Sarkozy has won the intellectual battle: the need for deep economic reform has been broadly accepted on both the right and the left. He has the merit of having campaigned on this platform and of having received an implicit mandate to carry out reform. But on the debit side his fiscal package in summer 2007 allowed a whiff of inequity about his policy to arise. However trust is all in matters reform, because the impact is necessarily uncertain. Citizens are prepared to run the risk if they see reforms as necessary, not if they have the impression that they are part of a one-sided or socially skewed agenda. So signals count. In order to correct the impression left by its initial decisions, the government must now flag clearly its will to be even-handed. The way to do this is to attack the economic rent accruing to a part of his electorate. The Attali report provides a comprehensive A-Z catalogue to draw upon.