

## **Will France and Germany diverge on fiscal policy?** *Jean Pisani-Ferry (Bruegel)*

In 2005, the landmark economic decision of the German CDU-SPD coalition was to give priority to budgetary consolidation. Instead of putting emphasis on structural reforms as envisaged in Ms Merkel's electoral platform, the two parties agreed on an ambitious retrenchment plan. They have stuck to it since the formation of the government and Germany now envisages returning to budget balance by the end of the decade.

France is unlikely to achieve the same result under its next president and it might diverge from Germany. Here is why.

To start with, the French economy has much less momentum than the German. Over the 12 months to February, industrial production grew 7.6% on the eastern side of the Rhine but only 2.6 on the western side. This has been recognised in the electoral campaign, as candidates from various camps converged in diagnosing a supply-side crisis. This means less tax resources and more demands on spending.

Second, despite having paid lip service to the necessity of reducing the public debt ratio, the two contenders in the second round of 6 May have committed to policy measures that are fiscally costly. Ms Royal has promised more spending on education and social programmes but has ruled out increasing taxes. Mr Sarkozy has been less generous on spending but has promised to reduce taxes by significant amounts.

All in all, either one will find it very difficult to square the circle. A back-of-the-envelope calculation suggests that if output grows as potential and the growth in spending entitlements is contained, the next president will by the end of the legislature have some €25bn at his or her disposal either to reduce the public debt ratio, spend on new programmes or cut taxes (or a combination of the three). Yet the commitments already made on either side amount to some € 50bn.

Third, the next president will be confronted with a choice between structural reform and fiscal consolidation. This is the same choice as the one Ms Merkel's government was confronted with, but the answer is unlikely to be the same. After a series of failed attempts to reform the labour market, the presidential hopefuls are truly convinced that France needs deep reforms. But they are understandably obsessed by the difficulty of building a consensus for them, or at least of getting around sectoral resistance to change. To achieve that goal, the winner will want to invest his or her limited political capital in reforms rather than in fiscal consolidation. This is especially true as the next president will not be able to pretend he or she has received a mandate to reform from the electorate. Nicolas Sarkozy has spelt out his intentions more clearly than Ségolène Royal but has gradually reduced the emphasis on reforms as the campaign has proceeded.

Whoever wins will therefore have difficulty in overcoming resistance and may even have to spend to buy consent on reforms. As spelled out in a recent book by two French economists, Jacques Delpla and Charles Wyplosz (*La Fin des privilèges: Payer pour réformer*, Hachette-Telos, Paris), governments face a choice between overcoming resistance to reform in political battles or compensating the opponents of reform through buying up the rents they benefit from. The latter can be very costly in the short run.

Such behaviour would raise eyebrows in Brussels. But the French president might even be pleased to be blamed. With public opinion in a restive mood, the last thing a pro-reform president would wish is to be pictured as following a Brussels-inspired orthodox agenda. Hence, the benefits of being blamed.

Over the last five years, budgetary deficits in France and Germany have been remarkably similar – most notably in 2003 when the two countries were simultaneously in breach of the EU Stability Pact. This coincidence has contributed heavily to shaping European policy discussions. What we may be seeing in the coming years is – primarily for reasons which have to do with internal politics – a Germany that again (re)takes ownership of fiscal discipline and a France that takes distance from it. The question is, what would be the consequences for the governance of the euro area of divergent policy choices across the Rhine? It is to be hoped that the issue will be taken up in early discussion between Ms Merkel and her French counterpart.