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Which Way for French Economic Policy?

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Since Nicolas Sarkozy won the French presidential election two weeks ago, Europe has been wondering about his policies. Mario Monti, the former commissioner, has called him a "liberal-colbertist".

This combination was apparent in the campaign. Having started off on a classic liberalisation agenda, he turned as competition developed to a more ambiguous stance. Especially noted in Europe were his attacks on the European Central Bank's policy, his emphasis on industrial policy and his call for a more protective trade policy. And while he has softened tone on the ECB, he chose already in his first speech as president-elect to summon France's European partners "to hear the voice of the peoples who want to be protected" and spectacularly went off to Toulouse two days after inauguration to discuss the future of Airbus. The message is crystal clear: don't expect him to be an orthodox. So what will he do?

The first thing to note is that he has won a mandate for reform. In spite of being a sort of incumbent, opinion polls unambiguously indicate that a vast majority identified him with more change than his socialist competitor. Nicolas Sarkozy has clearly learned the lessons from successful reformers: power is not enough, you also need the political capital you earn in a campaign by spelling out your philosophy and your priorities. He has both.

On the domestic front, labour market, tax cuts and the restructuring of state spending are likely to be the priorities. Because he does not want to scrap the 35h-workweek, Mr Sarkozy intends to introduce tax incentives to work longer hours (at the cost of creating a massive distortion in favour of overtime). He wishes to get rid of the duality between permanent and temporary employment contracts (a measure advocated by many economists), and to merge agencies dealing with unemployment insurance and job placement (a fairly straightforward proposal). He has promised to cut, if not scrap, taxes on wealth and inheritance (a questionable move on equity grounds). And he intends to reduce the number of public employees by replacing only each second civil servant who leaves for retirement.

Will labour market reforms be matched by product and financial market liberalisation? For them to have a rapid effect on unemployment, this would be necessary. However Mr Sarkozy seems to have a different reasoning. He has clearly indicated reluctance vis-à-vis further liberalisation externally and has remained rather silent on what he intends to do domestically. Does this mean he is going to combine a liberal labour market policy but protect the incumbents on product and capital markets? This remains to be seen.

In spite of lip service to debt reduction, fiscal adjustment is likely to be a second-order priority. First, Mr Sarkozy has entered into many spending and tax cut commitments. Second, he knows that some reforms are more likely to succeed with budgetary support. Third, he may use the deficit strategically to justify cutting spending. At the time ministers the euro area has committed itself to budget balance by 2010, France is thus unlikely to follow suit. On the contrary, its may well confront partners with an uncomfortable question: do you want reforms or fiscal adjustment?

Will this stance create opportunities for controversies in Europe? France's partners may be tempted to say that they have seen the same before and that Mr Sarkozy will converge on the mean. True, he is likely to realise the strength of his partners' commitment to budget discipline and open trade policy. However from a domestic standpoint, he can hardly afford to wear the clothes of the Brussels-Frankfurt orthodoxy. In a country in which 55% of voters rejected the EU constitution on economic grounds and more than 70% see globalisation as a threat, this would be a sure recipe for losing support. The more Mr Sarkozy reforms, the more he will need to dissociate himself from the European orthodoxy. A difficult game to play.