

France and the Euro: the political management of paradoxical interests

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French participation in the Euro Area is to be seen principally as a *self-imposed* 'semi-sovereignty game'. From the creation of the European Monetary System (EMS) in 1979, French political leaders have seen a European monetary constraint as a tool to reinforce domestic economic restructuring. In this sense, President François Mitterrand's March 1983 decision to keep the franc in the Exchange Rate Mechanism (ERM) represented the final decision to end socialist deflation, embrace market integration in the EC, and conform largely to the German economic standard. Yet the French pursuit of Economic and Monetary Union (EMU) and the policies of various French governments on EMU reform since the signing of the Maastricht Treaty in December 1991 must also be seen in terms of loosening the external constraint on French monetary and fiscal policies. The tightness of this constraint was blamed for a serious decline in French economic output and rise in French unemployment, particularly in the period following German reunification in 1990. The operation of the EMS resulted in French policy makers having to follow German monetary and fiscal policies or risk speculation against the franc. EMU was thus supported because it eliminated both the need to follow German monetary policy and speculative pressures against the currency. The fiscal policy constraints of the convergence criteria of the

Maastricht Treaty and the Stability and Growth Pact (Stability Pact) have still allowed considerable government margin of manoeuvre which has been used by French governments struggling with low economic growth since 2001. Yet at the same time, the return to relatively high real interest rates in France—albeit still far below those under the ERM—undermines the claim that the move to EMU would result in a more accommodating monetary policy than under the EMS. It thus appears that France suffers from its position as one of the lowest inflation countries in the Euro Area: in third place below only the Netherlands and Finland in the first half of 2007 and at 1.4 per cent significantly below the Euro Area average of 1.8.

The first section of this chapter briefly explores the context and initial conditions of EMU in France. The pursuit of low inflation through the external constraint of the EMS and then EMU reflected real economic needs linked to developments in French capitalism and notably financial market liberalization. The discursive/ideological structure underpinning and shaping the impact of EMU involved a dialect between a conservative liberalism—in the ascendant given the economic constraints reinforced by monetary integration—and a rearguard interventionism that is bolstered by widespread public hostility to economic liberalism and globalization. The decision to embrace EMU should furthermore be seen in terms of French strategy to increase monetary policy-making power in relation to both the Germans and the Americans (Howarth 2001) which is not explored further in this chapter because it is of limited significance to the politics of EMU in post-1999 France.

The second, third and fourth sections examine substantive reforms to, respectively, the French polity, politics and policies both in terms of this dialectic

between conservative liberalism and interventionism but also in terms of Europeanization. EMU embodies a paradox for French policy makers. The project can be seen in terms of meeting long-standing French macro-economic goals of achieving competitiveness through disinflation, the elimination of the German-centred EMS and sheltering France from speculative pressures. Yet the EMU also involves an institutional framework and rules that ostensibly decrease policy making margin of manoeuvre. The third and fourth sections of this chapter are, in effect, studies of the French political management of this paradox.

1. The Context: Reforming French Capitalism and Competitiveness as Justification

The decline of French State-led capitalism and EMU.

The operation of the EMS and the move to EMU coincided with processes of liberalization, privatization and budgetary restraint in France, developments that have contributed to the decline of the State-led model of capitalism. Yet the EMS and EMU are only in very small part responsible for this decline—through ‘top down’ Europeanization. Indeed, linking this change to European market integration more broadly is open to challenge (Schmidt 2002). Rather, French interest in monetary integration was reinforced by the perceived need to reform French capitalism. Initially, President Giscard d’Estaing saw in the EMS a mechanism to contain the inherently inflationary effects of the *circuits de trésor* system, in which French businesses depended principally upon state-allocated credit. Subsequently, the deflationary effects of the EMS supported the drive to reform the ‘overdraft’ economy (Mamou 1987; Loriaux 1991) through financial market liberalization started in 1984 by Pierre Bérégovoy as Minister of Finance

with the creation of the MATIF (the French futures market). Financial market liberalization was encouraged by EMS membership—the search for non-inflationary sources of finance. Liberalization also reinforced continued EMS membership because it increased the need for monetary stability to attract foreign capital. The challenge of controlling inflation also provided a useful logic that helped overcome the institutionally-rooted reluctance to accept financial liberalization in the Treasury, which had blocked previous reform attempts (Loriaux 1991).

Financial market liberalization in turn reinforced the ERM constraint and increased the logic of moving to EMU. The limited development of French institutional investors resulted in the rapid growth of French dependence on foreign-held—largely American-held—debt, which amounted to roughly 40 per cent of total debt by the early 1990s, far higher than any of the larger EU member states. In consequence, French governments had to be particularly cautious about the perceived strength of the franc and attractiveness of French interest rates (Reland 1998). Liberalization created new controlling interests—American pension funds—which increased the importance of shareholder value and discouraged interventionist strategies that were inconsistent with this value. Increased reliance on foreign capital reinforced the interest of the large-scale (principally CAC-40) business constituency in the ‘sound money’ goals of the EMS and EMU. Foreign capital needs and the desire to build Paris as a financial centre also undermined the economic logic underpinning French capital controls. In consequence, France had less to lose from capital liberalization, which the German government had established as a precondition for discussions on EMU. The pursuit of low inflation in France—principally to achieve national

competitive advantage—has also been closely connected to support for monetary integration. The apparent success of the policy of ‘competitive disinflation’—measured in terms of the record French trade surplus during the second half of the 1990s and impressive productivity gains in many French companies—helped bolster support for EMU amongst policy makers despite the perceived price of high unemployment and slower economic growth. Support has been potentially undermined by the return to French commercial and current account deficits from 2003 (24 billion euros in 2005, a level not attained since 1982) combined with several years of poor economic growth below the Euro Area average and well below the EU-25 average, and persistently high-levels of unemployment hovering just below the 10 per cent figure.

Reinforcing the Conservative Liberal Agenda

The French politics of EMU is shaped by the dialectic between ‘conservative liberalism’ in the ascendance and a rear-guard interventionism, expected by French public opinion. Conservative liberalism is a label that describes the dominant economic ideology in the Treasury division of the Ministry of Finance, the Bank of France, and the Financial Inspectorate, the *grand corps* which forms the leading part of the French financial administrative elite. The influence of this ideological framework has always been limited by its fragmentation and weakness in French party politics (Dyson, Featherstone, and Michaelopoulos 1994: 35; Hazareesingh 1994). The creation of the EMS in 1979 corresponded to the hitherto rare predominance of conservative liberalism in government under Valéry Giscard d’Estaing as President and Raymond Barre as Prime Minister.

This ideological framework was inspired more by the German model of low inflationary economic growth than Anglo-American liberalism (Dyson 1994; McNamara 1998). Neo-liberalism has few adherents in either political or policy making circles in France. Anglo-American economic arguments opposed to both the EMS and the EMU project had little presence in national debates on monetary integration (Rosa 1998)—even if many of the economic reforms adopted since the 1980s, such as privatisation, can be described as neo-liberal. The term ‘conservative liberalism’ is not one that these officials have applied to themselves nor is it used by academic or journalist observers in France. However, the term is of explanatory use. Conservative liberals uphold the self-adjusting nature of market mechanisms and reject state-led reflation. They also seek exchange-rate stability, low inflation, balanced budgets, and current account surpluses—none of which are liberal economic goals per se. Conservative liberals embraced the EMS and EMU as useful means to import German ‘sound’ money policies and budget and wage discipline. Core conservative liberal economic ideas formed the bedrock of ‘competitive disinflation’, the major French macroeconomic policy from the mid-1980s (Fitoussi 1992; 1995). The value of ‘sound’ money was linked to the idea that the weakening competitive position of French exports was due to structural problems that could not be resolved through competitive devaluations. Finally, conservative liberals respect technical expertise in economic policy and the maintenance of a measure of autonomy from political interference in the formulation and implementation of economic policy—which serves the interests of the Treasury and the Bank of France. EMU reinforced conservative liberalism through the convergence criteria and the transfer of monetary policy to technocratic control in the Bank of France and the ECB.

In decline since the 1960s with the opening of the French economy to international markets, *dirigiste* strategies have been restricted in the context of the operation of the EMS and the EMU project. *Dirigisme* reflects a strong mistrust of market mechanisms, the economic utility of which is nonetheless accepted. It insists on the need for active state intervention in the economy, labelled *volontarisme*. *Dirigisme* has influenced a wide spectrum of French political and public opinion to different degrees, notably the Gaullist/neo-Gaullist parties on the right, the Socialist Party on the left, in addition to the elite technical corps of the French state. *Dirigistes* tend to prefer the conservative liberal goals of a strong currency, monetary stability and a trade surplus, although normally for different reasons. But these goals are secondary to state-led economic growth. *Dirigistes* also seek to place constraints on the operation of international financial markets and speculative capital.

In the 1980s and 1990s both the neo-Gaullists and the Socialists rejected many elements of *dirigisme*. At the same time electoral constraints—the public sanctioning of perceived excessive liberalism and expectation of robust state interventionism—forced both parties to continue to emphasize state-led action. There have been active government responses to the challenges of ‘modernization’ in industrial, social and employment policies. The idea of regulating and controlling markets in the context of what Prime Minister Jospin labelled a ‘modern socialism’ was an important element of Socialist Party discourse in dealing with the constraints of globalization (Jospin 1999; Marian 1999; Cambadélis 1999). Even conservative liberals like Edouard Balladur, Edmond Alphandéry, and Alain Juppé have made a spirited defence of French public services against European competition rules. Since 2002, centre-right UMP

governments have intervened in a range of areas, under the banner of ‘economic patriotism’, blocking foreign take-overs of French companies, insisting on the need to restrict foreign ownership in a range of economic sectors, providing state subsidies illegal under EU competition rules and foot-dragging on the privatization of state-owned gas and electricity firms and the liberalization of the energy sector required by EU-level agreements.

2. EMU and French State Reform

Adjusting to Independent Monetary Authority

In terms of polity reform, the EMU project functioned as ‘top-down’ Europeanization. Its role as an independent variable was seen in the imposition of central bank independence, sought by few French policy-makers and politicians, and opposed by many. Compared with other central banks, the Bank of France was normally considered to be one of the more ‘dependent’, with monetary power concentrated in the Finance Ministry (Goodman 1992) and efforts to increase central bank autonomy were blocked. The conservative liberal admiration of the ‘German model’ did not necessarily extend to support for central bank independence (Howarth 2001). The rapid move to independence in 1994—the start of Stage Two of EMU—was justified in terms of building confidence in the franc in the context of record levels of speculation and the possibility of a rapid move to Stage Three, not the desirability of independence per se.

From 1994, the Bank of France had to accommodate itself to a more active and public role in promoting ‘stability’ culture in France. Jean-Claude Trichet, the first governor of the independent Bank of France, made several thinly veiled

attacks on presidential and government economic and monetary policy statements and economic policy decisions which appeared to menace the pursuit of ‘sound’ money policies, the move to EMU, and respect for the Stability Pact (Aeschimann and Riché 1996; Milesi 1998). The very public role of the Bank was short-lived. Since the start of EMU’s Stage Three, there has been a significant cut to the Bank’s staff total and closure of two-thirds of its branches in France. In 2006, its Monetary Policy Committee was replaced by a smaller Monetary Council. The Bank has failed to strengthen its position as an independent source of economic expertise. Efforts by supportive politicians and elements of the administration to increase the Bank’s role in banking supervision and competition in the financial sector have not yet been successful.

As an independent variable, EMU was a catalyst for several reforms directly affecting the powers of the Treasury division of the Ministry of Finance. The Treasury’s loss of control over monetary policy contributed to the decline in its power caused by financial market liberalization, privatization and the imposition of European competition rules. Yet, the influence of the Treasury in the context of domestic policy-making has increased, consequent on reinforced EU-level surveillance of fiscal policies, the medium-term stabilization plans required by the Stability Pact and through the Lisbon process which have largely corresponded to conservative liberal reform priorities. With persistently high French public spending deficits and the repeated failure to meet medium-term targets, the Ministry of Finance plays the central galvanising role in governments’ efforts to contain state spending—leading, for example, the annual conference on the national budget that was launched in 2005 by Thierry Breton, the Minister of Finance.

3. The French Politics of EMU

We can apply Radaelli's (2000) analytical framework which examines Europeanization in terms of the scope of domestic change to the politics of EMU in France and several domestic policy sectors. This framework includes the concepts of transformation, accommodation, absorption, retrenchment ('negative' change) and inertia (resistance) (see also Heritier et al. 2001; Cowles, Caporaso and Risse 2001). The possibility of retrenchment was strongest between 1992 and 1996, when record high real interest rates, sluggish economic growth, and rising unemployment, combined with republican and nationalist opposition to EMU, made the government's support for EMU problematic (Howarth 2001). Yet public opposition at the time was due principally to the perceived negative economic implications of EMS asymmetry and the EMU convergence criteria. Throughout this period, polls showed that a majority of French voters supported the core elements of EMU (see Table 1), and, unlike in some countries, the mainstream French press was on the whole supportive of EMU (Balleix-Banerjee 1999). The normally acquiescent business community began to turn against the ERM constraint from 1992, although the leading peak association of large-scale companies—the *Conseil national du patronat français* (CNPFF) renamed from 1998 the *Mouvement des entreprises de France* (MEDEF)—continued to support EMU (Aeschmann and Riché 1996).

Both the Centre-Left and Centre-Right were significantly divided over the desirability of the EMU project and all the political parties have sought to manipulate frustrations with EMU-linked constraints against opponents. No political party collapsed over the issue of monetary integration, despite the strong

opposition of Eurosceptics in the Gaullist Rally for the Republic (RPR), including the large majority of the party's National Assembly deputies and leading members Philippe Séguin and Charles Pasqua. The surprise election victory of the Plural Left in 1997 created the threat of retrenchment but the promises of creating a more 'social euro' and an end to budget cutting proved to be only temporary. Since the start of EMU's Stage Three, opposition to EMU in the Socialist left and the Gaullist right has dwindled to the extent that no leading members call for French withdrawal. Rather, frequent criticism has instead been directed at the design of EMU and ECB monetary policies (discussed below). The Socialist Party has justified its support for EMU along similar lines to its defence of the Single Market Programme from the mid-1980s: as a mechanism to make the economy more competitive while preserving the relatively generous French social security system and working conditions (*les acquis sociaux*).

The EMU constraint was manipulated explicitly by the candidates and parties in the 1995 presidential and 1997 legislative elections. During the 2002 presidential and legislative election campaigns, the principal economic policy differences between Chirac and Jospin and the UMP / Socialist Party camps had to do with tax and the European constraint (Howarth 2004). On the one hand, Chirac and the UMP played the more traditional tune of the Right promising significant cuts in taxes on income (a third in the life of the next government and five per cent immediately), corporate (to the EU average) and value added taxes (on CDs and the hotel sector). On the European constraint, Chirac and the UMP took a more ambiguous line: accepting the need for budgetary restraint and accepting the desirability of the goal of balanced budgets while refusing to commit to the balanced budget goal of 2004, to which the Jospin Government had

agreed. There was a marked element of rebellion in Chirac's policy: challenging the constraints of the Stability Pact if these constraints made the fulfilment of his promises on tax cuts and government spending unrealistic. On the other hand—and this has to be the most significant irony of the 2002 electoral campaign—Jospin and the Socialists found themselves in the completely reverse position from where they had been in the Spring of 1997: defending the constraining rules of EMU and the Stability Pact and presenting themselves as more financially responsible than the conservative opposition.

Between 1994 and the start of EMU's Stage Three, French government and opposition leaders regularly used the Bank of France and notably its governor, Jean-Claude Trichet, as scapegoats. Once independent, the Bank was blamed for the high interest rates needed to keep the franc in the EMS. With the transfer of monetary policy to the ECB, the target of scapegoating shifted. Since the start of the economic down-turn in 2001, French political leaders—including presidents Chirac and Sarkozy—have engaged actively in attacking the ECB for being excessively hawkish in its singular pursuit of low inflation and have challenged both the goals and independence of the bank. Nicolas Sarkozy—as minister of finance, UMP presidential candidate and then president—has regularly criticised the ECB's monetary policy calling for it to adopt a Federal Reserve-style target that includes economic growth (*Financial Times*, 11.6.2004; *Le Monde*, 23.2.2007). was equally critical. Several leading French politicians—including Chirac, Sarkozy, Prime Minister de Villepin and Ségolène Royal, the Socialist Party's candidate in the 2007 presidential elections—have also made both veiled and direct attacks on the ECB's goal-setting independence (see, for example, *Le Monde* 9, 19 and 22.12.2006).

An ambiguous public and the euro

French public opinion on EMU and the EU has fluctuated markedly over the past fifteen years with virtually no correlation to levels of economic growth (a standard correlation of 0.073) (see Table 1). Broadly negative political discourse on the institutional framework of EMU and ECB monetary policy—the most consistently negative in any Euro Area member state—must contribute to negative perceptions. Yet, French support for EMU has also been amongst the highest in the Euro Area—with France consistently placed in fifth place in Eurobarometer polls in terms of net support (‘Is the euro globally positive for one’s country?’) with only Luxembourg, Belgium, Italy and the Netherlands higher. Net support since 1999 has been, on average, higher than support prior to Stage Three and the percentage of those in favour of the euro has averaged at just below 73 per cent. Despite these findings, there are indications that the persistently mediocre levels of economic growth from 2001 have contributed to rising public concern about the impact of EMU and responses to more specific polling questions demonstrate more nuanced public opinion. In December 2003, a Sofres poll conducted for the centre left magazine, *le Nouvel Observateur* (no. 2044, 8 January 2004) showed that a growing minority (over 40 per cent) were of the opinion that the introduction of the euro ‘was a bad thing’ for the country. Yet according to this poll, 45 and 50 per cent believed that the euro had a negative effect on, respectively the economy and employment, whilst 56 per cent felt that the euro had a negative effect on their own situation personally. Only 1 per cent thought that the euro was advantageous to French citizens, versus 52 per cent who thought that the financial markets were the main beneficiaries. A September 2006

Gallup Poll for the European Commission recorded that only 51 per cent of French people found the euro to be ‘broadly advantageous’ with 30.9 per cent saying that the inconveniences outweighed the gains (Gallup for the European Commission, *Le Monde*, 30.12.2006). In late 2006, two polls recorded majorities (52 per cent) of the opinion that the introduction of the euro ‘was a bad thing’ for ‘France, economic growth, employment and them’ (TNS Sofres, *Le Monde* 26.12.2006) with only 46 per cent finding it to ‘be a good thing’. The results follow four years of poor economic growth, suggesting that the legitimacy of the EMU is linked to its perceived economic output. Curiously, these findings run counter to the Eurobarometer polling that indicate consistently high public support for EMU. Poorer socio-economic categories were particularly negative on the impact of the euro.

4. Policy Regime Reform

Policy Regime Reform should be seen principally as ‘bottom-up’ Europeanization, in which the EMS and EMU have operated as intervening variables shaping the operation of the French state and French policies to achieve economic ‘modernization’ (Alphandéry 2000; Boissonnat 1998). Prior to 1999, the EMS constraint and the EMU project were used by successive governments to justify a range of reforms: budgetary, welfare state, administrative, labour market, and privatization. Yet, the extent to which EMU has itself brought about ‘transformation’ in France—as argued by Schmidt (2002)—should be qualified. The ‘transformation’ disguises developments which have worked to increase government margin of manoeuvre rather than decrease it. Rather than restricting the macroeconomic framework in which French governments must operate, EMU

has in some respects decreased constraints on French governments. There is greater margin of manoeuvre in fiscal (and other macroeconomic policies) despite (or even because) of the Stability Pact. As EMU removes the possibility of speculation against national currencies, greater deficits are less problematic in the short-term for governments in the management of their macro-economic policies as they are effectively sheltered by the single currency. The Stability Pact—created ostensibly to restrain the spending of profligate governments—in fact increased adjustment time for governments. The clearest manifestation of this margin of manoeuvre is the persistently high French public sector deficits since the start of EMU (well above pre-1992 average) and the rise of national debt to record levels (see Table 2). When respecting the Maastricht Treaty’s fiscal policy rules became politically difficult from 1993, French governments tried to change them. After the start of EMU’s Stage Three, it became possible to flout and then change the rules (the March 2005 Stability Pact reform) to ensure continued margin of manoeuvre. Since the creation of the Stability Pact in 1997, no French governments have respected the medium term target of a budget that is balanced or in surplus. Thus ‘transformation’ in the realm of monetary policy has, at best, allowed for ‘accommodation’ and ‘absorption’ in fiscal and macro-economic policies and at worse ‘retrenchment’—higher budget deficits and debt load—and ‘inertia’—failure to engage in structural reform. Yet the most politically difficult feature of the EMU project for French governments has been respecting the short and medium term fiscal policy goals of the Stability Pact. In 2005, the European Commission (2005) placed France in the category of EU member states with unsustainable public finances. Prior to the start of Stage Three, the justification of budget cutting by both conservative and left-wing governments involved a

reinvention of discourse appealing to the preoccupation with unemployment: a lower deficit could result in lower taxes which would result in job creation. For the left this reinvention was particularly challenging, with Finance Minister Dominique Strauss Kahn announcing that there was nothing ‘Socialist’ about public spending deficits.

When politically convenient, French governments have deliberately sought to link policy reform to the pressures created by EMU. This connection was made most prominently in the 1994 Minc Report (Minc 1994) the most comprehensive package of public sector reform recommendations to date. EMU as a justification for reform was presented as the central message of Chirac’s public U-turn on economic policy on 26 October 1995, the Juppé Plan of the following November, and the shift in the Jospin government’s budget policy in the summer 1997. At the time of the 2002 elections, Prime Minister Jospin justified limited margin of manoeuvre in Socialist Party tax and spending policies in terms of Stability Pact rules. While the Raffarin Government was willing to break these rules, emphasising the general goal of debt reduction rather than specific rules, the de Villepin and Fillon governments raised debt-cutting to highest echelon of government priorities and renewed their commitment to the pact’s medium term goals. However, the ability of the Fillon government to respect French commitments remains to be seen.

EMU as a justification for reform has run up against competing values. Ideologically inspired political opposition to reforms has combined with labour union opposition to modifications to social security regimes and the privatisation of public services which are seen as disadvantaging public-sector employees. The result has been some degree of inertia. The political difficulties of reform were

manifested in the widespread strikes and public demonstrations of December 1995 over the Juppe Plan and of March 2006 over proposed labour market reform of the *Contrat Premier Emploi* (CPE) proposed by the de Villepin Government. President Sarkozy's promise of a dramatic rupture with the past and far-reaching reform proposals must be juxtaposed with his preference for compromise with trade unions and the modesty of the policies adopted to date (the end of 2007). Public administration staff cuts—the non-replacement of retiring staff—have been recommended in diverse reports but consistently avoided or significantly watered down by governments with an eye on the unemployment figures. The French public sector spending as a percentage of GDP has been consistently one of the highest in the European Union (after Sweden and Denmark) and has risen over the past fifteen years when there has been a decline in most of the other EU member states (Table 3) and is forecast to reach the top position in 2007 at 53.2 per cent of GDP (European Commission 2007). The European Commission, the ECB and other Euro Area Member State governments have repeatedly criticised French governments for pursuing inadequate reform but to little avail and with limited impact on French public opinion. Recently, in September 2007, Trichet took the unusual step of appearing on French television in an hour-long interview to explain why French economic difficulties owed nothing to ECB monetary policies and everything to the inadequate economic policies of French governments (*Financial Times* 24.9.2007).

Careful political management, increased emphasis on consultation, negotiation, the building of supportive coalitions, open debate, good relations with labour union leaders and gradualism have become core elements of government reform strategies (Marsh 1999). On social security reform,

government strategy has had to overcome a tradition of conflictual relations with the ‘social partners’ and in particular labour unions. In 1995, Prime Minister Juppé discovered the dangers of foregoing consultation on social security reform and relying on the historic necessity of EMU membership to push through changes. The Raffarin Government’s 2003 public sector pension reform was successful precisely because of the government’s engagement in strategic consultations and its ability to divide the unions (Schludi 2005). Likewise, President Sarkozy’s governance style centres upon engagement with a diverse range of groups. In addition to placing emphasis upon a dialogue with labour unions on reform proposals and compromise, the President has also co-opted leading political figures from the political left and centre into his government—a policy known as *l’ouverture*—in order to extend support for reform.

French governments have also taken to soliciting expert (including academic) opinion to inform government economic and social reform proposals—a practice of President de Gaulle. In 1997, Prime Minister Jospin created the Council for Economic Analysis (CAE) which, attached to the prime minister’s office, consists of top—mostly academic—economists who meet on a monthly basis to discuss matters chosen by the prime minister or other ministers in advance. The CAE’s public ruminations on reform—diverse views are published—are supposed to help legitimise policy positions taken by the government (interviews with CAE members; Victor 1999: 427). Reflecting a busy reform agenda, in September 2007, Prime Minister Francis Fillon requested the CAE to prepare six reports over the following six months. Successive governments have requested reports on social security reform from the Economic and Social Council (ESC)—the institution created after the Second World War to

organise the consultation of the social partners on government policy. Dominated by the social partners, ESC reports on social security reform are unlikely to conform to government objectives. Thus in 2000, Jospin created the Advisory Council on Pensions—which continues to exist—as a mechanism to solicit alternative reform proposals to those offered by the social partners in the ESC. In 2006, Prime Minister de Villepin supplemented the CAE and the Advisory Council with the Centre for Strategic Analysis, a modest successor to the defunct General Planning Commission, which also engages in the frequent soliciting of expert opinion on public sector reform. In August 2007, President Sarkozy reinforced the president’s role in the consultations process by creating yet another advisory body, the ‘Commission for the liberation of French growth’. The Commission’s 43 top economists, business leaders, former ministers and others—from France and beyond—are to advise the President on necessary economic and labour market reforms. Sarkozy appointed Jacques Attali, formerly a top adviser to President Mitterrand and the Socialist Party, to head the Commission.

Improved budget management came on to the agenda as another example of ‘bottom up’ Europeanization. The Juppé centre-right government (1995-97) brought about institutional changes to extend some parliamentary (and thus government) control over the operation of the semi-autonomous social security budgets, controlled hitherto solely by the ‘social partners’—employers’ representatives and trade unions. Decrees were also adopted to reform hospital administration and to control more effectively medical practitioners’ standard consulting fees. In 1998, the Jospin Government introduced a medium term budgetary strategy based on the setting of a target for the cumulated increase in real government expenditure over a three-year period. In practice, real

expenditure was planned to increase more slowly than potential real GDP. The strategy was created to enhance the transparency of the budgetary framework and help form expectations. However, as it failed to lead to expected results and initial targets were missed by a large margin, attempts have been made to modify the strategy.

The importance of debt reduction has come to take a leading position in UMP government discourse. Thierry Breton, Minister of Finance from February 2005 to May 2007, called himself the ‘anti-debt’ crusader. In 2006, he introduced the annual national conference on public finance under his chairmanship and the presence of the Prime Minister, as a device to reinforce efforts to cut spending in government departments. Breton also held press conferences every quarter with the participation of all the central government department directors. The Balladur Government had commissioned the well-known French business leader, Alain Minc, to prepare a report (*La France de l’an 2000*) with high public profile that could then help to legitimise public sector reform through the guise of non-administrative business expertise (Minc 1994). Thierry Breton similarly hired the services of Michel Pébereau, président de BNP Paribas, who chaired the commission which prepared a report on French debt (Pébereau 2005) which he presented to Prime Minister de Villepin in December 2005. In response, de Villepin presented a five year plan to reduce French debt to the 60 per cent threshold and meet the medium term goal of the Stability Pact by 2012. President Sarkozy claims to be personally engaged in the struggle to lower French debt. He attended the July 2007 meeting of the Eurogroup, promising to do everything he could to meet this medium term goal.

With the failure of the Jospin Government to make sufficiently large cuts to the budget, the economic slow-down from 2001 resulted in the rapid rise of the deficit towards the 3 per cent figure, exceeding this figure for four years in a row from 2002 before dropping below in 2006 (see Table 2). The Raffarin government's prioritisation of tax cutting over deficit cutting in the context of an economic slow down did not help matters. In the meantime, French debt exceeded the 60 per cent figure in 2003, rising to 66.2 in 2005 before dropping in 2006. With the launch of the Early Warning and then Excessive Deficit procedures (EWP and EDP) against France and the stubborn refusal to move rapidly to cut the deficit, President Chirac and the Raffarin Government called for a temporary 'softening' of the Stability Pact (*Le Monde*, 14.7.2003) and even a rethink on the Pact. Repeated German failure to meet the 3 per cent deficit figure from 2002 gave the French greater political margin of manoeuvre on the Pact rules and the two countries demanded the suspension of the EDP at the 25 November 2003 Ecofin meeting (Howarth 2007 ; Schwarzer 2007).

The restriction of interest-rate and exchange-rate policies in the EMS and their loss with EMU, combined with the intensified wage competition in the Euro Area, has reinforced pressures on French governments to modify labour-market policies and increase wage flexibility: an example of 'soft' Europeanization. Governments have attempted to undertake reform in a context of high structural unemployment. The lack of centralized wage bargaining in France makes negotiated solutions to labour market rigidities more difficult. Conservative governments have sought to respond to these rigidities by relaxing rules on hiring. They have allowed greater scope for the creation of jobs of a limited duration—*contrats de durée déterminé*, CDD—the non-enforcement of rules that standard

wages—as under *contrats de durée indéterminé*, CDI—apply to these jobs and the toleration of a significant increase in part-time work, not remunerated at SMIC (the minimum monthly wage). The de Villepin Government failed in its efforts through the CPE to extend existing provisions for limited duration contracts for younger workers from SMEs to all companies. This followed the failure over a decade earlier in 1994 of the Balladur Government to introduce a youth SMIC to address high youth unemployment. The Jospin government created the possibility for greater flexibility in the context of the 35-hour week policy. It allowed companies, in collective bargaining on the implementation of the 35-hour week, the possibility of freezing wages and spreading the calculation of the 35-hour week over the period of a year. President Sarkozy and the Fillon Government have sought to increase further the flexibility in the 35-hour week policy by adopting a law allowing companies to pay staff for supplementary hours without the imposition of income tax.

French companies have taken full advantage of the fixed duration contract, 35 hour week provisions and holes in French labour law to increase competitiveness in the context of the Single Market and EMU (see Hancké (2002) for an overview of firm-led adjustment in France). The percentage of full-time salaried workers on CDD rose from 1.4 per cent in 1983 to 10.8 per cent in 2000 with considerably higher percentages for younger workers (Blanchard and Landier 2002; Insee 2007). The estimated percentage of part-time employees as a percentage of total salaried workers increased markedly in the period prior to EMU when French unemployment reached high levels, rising from 11.9 per cent of salaried workers in 1990 to just under 18 per cent in 2005. French temporary employment rates are similar to those in Germany but temporary rates fall well

behind those in Spain at about 30 per cent. Part-time rates fall below those in Germany (25.8 per cent in 2006) and well behind those in the Netherlands (46.2 per cent in 2006) (Insee 2007). The 35 hour week policy has allowed company level negotiations to fit hours worked per week with business needs.

The pursuit of EU-level 'governance économique'

All French governments since 1991 have placed emphasis on counter-balancing both the 'sound' money bias of EMU and the power of the ECB in the Euro Area by strengthening European 'economic government', and by reinforcing European social and employment policies. Yet the ostensible desire for tightened coordination (the implication at the supranational level of the interventionist legacy) is contradicted by consistent French insistence upon national margin of manoeuvre. Because of this contradiction, French policy makers have been unable to spell out very clearly what they mean by EU economic governance (Howarth 2007) and their pronouncements on the subject take on a variety of meanings, from effective policy mix, to interventionism, to enhancing EMU and ECB credibility and legitimacy but also as direct challenge to ECB independence. For domestic political consumption, French governments have repeatedly exaggerated the importance of subsequent institutional and policy developments at the EU level to the process of constructing an economic government—the creation of the Euro-group, the informal intergovernmental gathering of Euro Area finance ministers and its reinforcement, the creation of the new Economic and Financial Committee (*Libération*, 13 January 1999), consisting of EU treasury and central bank officials, the Cologne Macro-Economic Dialogue and the Lisbon process more generally.

Regular French initiatives on interventionist EU strategies demonstrate the extent to which French governments, be they on the Right or the Left, still feel the need to call for deficit spending in order to stimulate the economy. Yet no such initiatives—principally infrastructural programme proposals—have actually resulted in EU-level agreements that involve significant spending on programmes. Some of these projects are presented as Franco-German joint initiatives. The Franco-German growth initiative of 18 September 2003 attacked the Commission for being excessive in its drive for budget cutting and ‘anti-industry’, pledging further tax cuts in both countries and 10 major jointly funded infrastructural projects (*Le Monde*, 19.9.2003). In April 2006, Chirac joined with Chancellor Merkel to launch a ‘Europe of grand projects’ which involved the allocation of €1.7 billion French funding. In June 2006, Chirac and Merkel announced additional joint projects to focus on areas such as education, research and energy policy.

Economic government as expressed through the creation of a substantial EU employment policy and reinforced social policy was of particular importance for the Plural Left government as a reinforcement and legitimization of activist domestic employment policies. The Socialists have placed emphasis on the construction of ‘social democracy’ at the European level as a means to counterbalance the monetary power of the ECB and to ‘manage’ the effects of globalization (Jabko 2006). Prime Minister Jospin reached a compromise with the Germans that involved the creation of the employment chapter, the resolution on growth and employment, and the formulation of a European employment strategy. The resolution involved only vague objectives. The employment chapter involved no additional spending or obligatory measures but focused on information

sharing, pilot projects, and benchmarking, as agreed at the Luxembourg and Cardiff jobs summits. French Socialist ministers consistently stressed, if not exaggerated, the significance of EU policy developments in this area (Howarth 2002). Since 2002, UMP governments have been considerably less activist in these areas. However, in the context of challenging opposition to the Draft Treaty Establishing a Constitution for Europe and then building support for the Reform Treaty, successive UMP governments placed considerable emphasis upon EU-level social and employment policies as a buffer against the perceived liberalising bias of European integration. Prime Minister Raffarin listed the Draft Treaty's provisions on employment and social policy and the goals of 'employment and social progress' as forming one of the most important reasons for voting yes in the June 2005 referendum (*Le Monde*, 5 March 2005). Opinion polls in the aftermath of the referendum no vote further demonstrated the importance of social policy considerations to French voters (Eurostat 2005).

Modifying the terms of the Stability and Growth Pact has been another constant objective of French governments. President Chirac and the Juppé and Jospin governments very reluctantly accepted the creation of the Stability Pact to meet the demands of the Kohl government and to counter strong public and political opposition to EMU in Germany (Milesi 1998; Schor 1999). Following the November 2003 suspension of the EDP, the Raffarin Government presented reform proposals which sought a more flexible application of the Pact that would—officially—take into consideration the economic situation facing a participating member state and—in practice—allow more scope for political bargaining and thus margin of manoeuvre for French (and other) governments in the determination of excessive deficits. The Raffarin Government wanted a

reformulated Pact to take into consideration deficit spending on public investment, contributions to the EU budget and defence—eliminating this for total public deficit considerations (*Le Monde* 3.12.04). Conveniently, this reform was defended in a report by the Council for Economic Analysis (18 November 2004).

Conclusion

On EMU institutional design and fiscal policy rules misfit has been long emphasized by both governments and the political opposition. It was tolerated because of the perception of real economic gain in the context of EMU, reinforced by relatively strong economic growth at start of Stage Three and the corresponding perception of ECB policy aligning with French economic preferences. Since 2002, UMP governments have blamed the strong euro for France's commercial and current account deficits and low economic growth. Yet French public support for the euro remains consistently high. This high level of support is all the more remarkable given the persistently low public confidence in the state of the French economy and the effectiveness of the government's economic policies (see Tables 4, 5 and 6). Yet the growing perception that EMU has had a negative impact on the French economy and individual citizens' financial situation perhaps contributes to the generally weak economic policy reputation of French governments. In the years leading to 2002, one of the consistently positive public impressions of government managerial competence concerned the introduction of euro notes and coins (see Table 6) which thus suggests that EMU membership bolstered confidence in the government. However, in following years, the almost universal opinion that the introduction of euro notes and coins had significant inflationary effects (TNS Sofres, *Le Monde*

26.12.2006) no doubt contributed to negative impressions of government competence.

There has been no retrenchment in France to date because of monetary integration. Strong growth from 1997 to 2001 made it politically easier for French governments to respect the deficit criterion of the Maastricht Treaty and Stability Pact. The low economic growth of the past half decade has increased the possibility of retrenchment but the unexpected flexibility of the EMU project has given recalcitrant UMP governments fiscal policy room to manoeuvre. Europeanization as transformation has been seen principally in terms of institutional reform—central bank independence—and budget management—which has in turn reinforced the position of the Ministry of Finance in government policy making. With EMU participation allowing France more fiscal policy margin of manoeuvre, persistently high deficits and a rising debt load, it can be argued that EMU has contributed to inertia in public sector and social security reform. Yet, the fiscal policy rules of the Stability Pact remain a very important ostensible constraint that governments can use to justify reform. It is problematic to claim any clear impact of EMU on French state power. Debt itself has created greater constraints on state power but has also resulted in a new sense of urgency that has both encouraged French governments to initiate reform and forced a strategic engagement with labour unions and expert opinion to bring about that reform.

EMU has contributed to the impressive productivity gains in the French private sector. This owes in part to the policy of competitive disinflation, the effects of which persisted after 1999 because comparatively low inflation means that real interest rates in France have been higher than in most other Euro Area

member states. The record level of profits of the ten largest French companies in 2005—a year of sluggish French growth—was due to company sales and activities outwith France. Many French companies have responded to the gradualism of French governments on labour market reform by making full use of short-term and irregular contracts, just as many have taken full advantage of flexibility provisions in the 35-work week legislation to match hours worked with cyclical needs. Unemployment remains high in France due to the combination of productivity gains and the sluggishness of the state on labour market and public sector reform.

French governments are engaged in the political management of a paradox of being constrained by an EMU project initially accepted to reduce constraint and of a project that has failed to meet economic expectations. French governments have insisted upon national margin of manoeuvre (in fiscal and other policies) and have engaged keenly in the scapegoating of the ECB. In doing so, however, they likely undermine the legitimacy of EMU and, in turn, their own reputation for governing competence to the extent that French governments cooperate fully in a maligned system. French governments have also sought to qualify the sound money policies of EMU through active state responses to the challenges of the single European market and globalization, in social, employment and interventionist industrial and infrastructural policies, at both the EU and domestic levels. Most French efforts to build EU economic governance have been frustrated not only by German and other member state opposition but also by contradictions within French policy, given the repeated refusal to accept binding European constraints. The very limited success of French governments in

their pursuit of these policies potentially further undermines their reputation for governing competence.