François Hollande's Hollse Debate

This issue is not France versus Germany.

It is France versus the United Kingdom.

ompetition between nations helps populations and entire economies to get in shape and improve their standard of living. But it is critical to go after the correct target.

Pick the right one and you may succeed. But pick the wrong one, and you set

yourself and your supporters up for failure.

François Hollande has made Germany the target of his ambitions. That is in line with a presidential campaign where much of the real debate between the two main presidential contenders centered on the secrets of Germany's economic success—a rare occurrence in a country traditionally as proud as France.

However, in Mr. Hollande's conception, it is not the innards of the German industrial and labor strategy that matter. He has made the debate over austerity versus growth his preferred ground of engagement, positioning himself as the champion of growth. This has garnered him political support, from the United States all the way to Greece.

But in the real world of economic reform, abstract pronouncements about preferring

"growth" matter very little to improving one's own country's economic fortunes. Mr. Hollande has, in effect, set up a false debate. A simple comparison between GDP statistics for Germany and France shows that the German government is obviously not "anti-growth."

To improve his own country's economic performance, the new French president must abandon the lofty heights of campaign rhetoric and buckle down quickly to do the hard work that is required to succeed on economic reform.

The German government's main worry is that the pattern of Nicolas Sarkozy's start in office back in 2007 will repeat itself. He, too, wasted quite some time with ill-fated ideas before eventually choosing to deal with reality. Given the intensity of the euro crisis, this is not a good time for the requisite sense of realism to be delayed once again.

The best antidote to the lingering crisis is to deal with the homemade sources of economic trouble. It is they that truly matter for a growth agenda, from sector-specific micro reforms to pruning expenditures and tax reform. These are

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the measures that allow a government to free up resources for new initiatives and to set the correct long-term economic targets.

France's labor costs matter, too. They have continued to run ahead of productivity gains and reduced not just France's international competitiveness, but also the profitability of French companies. That may have been good for domestic demand over the short term, but because French companies have paid out more to workers than what they gained in the market, French firms have not invested enough in their own future.

But invest they must, as the French economy—with the exception of a few sectors, including luxury goods generally lacks the degree of product specialization that positions it favorably for a prosperous future.

There are, of course, straightforward ways to deal with that challenge. Making the structure of the labor market more flexible and reducing labor costs, including trimming non-wage benefit payments, would help position the French economy for growth and generate jobs.

That is indeed the strategy chosen by France's closest competitor in Europe, which is not Germany, but the United Kingdom. For a decade or so, there has been a see-saw battle between the two countries as to who had the upper hand, whether in terms of overall GDP or per capita GDP.

For quite a few years, it looked as if the French would have the upper hand. With the increasing financialization of the British economy due to the dominance of the City, the United Kingdom was on a worrisome trajectory toward deindustrialization. However, the Cameron government has been focused on rectifying this dangerous choice. It is determined to rein in the financial sector as well as to promote manufacturing.

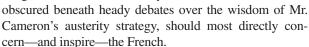
In that endeavor, the United Kingdom certainly benefits from a depreciating exchange rate, an instrument to which France as a member of the eurozone cannot resort unilaterally. But the efforts in Britain to change the course go well beyond this tool. Productivity on the plant floor is being increased, causing inflows of foreign direct investment, in addition to more domestic readiness on the part of

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Francois Hollande's wrong target: The Cameron government is determined to rein in the UK's financial sector as well as to promote manufacturing.

UK firms to invest in the economy's future.

The industrial turnaround underway in the United Kingdom, while currently



The simple but pivotal question François Hollande must answer is this: If optimizing labor productivity works for the United Kingdom, why not adopt the same strategy in France?

The option he seems to have chosen instead—going after Germany and asking it to be more relaxed about inflation, wages, and investments—will not cure the French malaise. Telling the French people that it is not they who must change, but the Germans, is bound to lead nowhere, other than setting up his voters for sore disappointment.

Here is why: The odds are that the Germans will prove quite flexible in pursuing the much talked about growth agenda, simply because to them growth and austerity are not mutually exclusive choices. Rather, they are two sides of the same coin. If this proves right, it would put Mr. Hollande into the calamitous position of claiming (falsely) that he made the Germans change their minds, while at the same time failing to bring about a noticeable improvement in the French economy.

Paying lip service to a growth strategy and just looking for funds to underwrite the French economic model, as presently constituted, is not a winning strategy.

The fact of the matter is that only those advanced economies that are prepared to constantly optimize their domestic ways and means, rather than clamoring to hold on to a bygone status, will succeed. That Mr. Hollande's broader goal can be accomplished without shedding the social welfare state has been convincingly proven by the Scandinavian economies, which have a similarly high state share of GDP as does France.

Reflecting on what makes the Scandinavian economies tick and succeed, as well as the economy of the United Kingdom, ought to be on the forefront of the new president's mind, rather than obsession with Germany. The first shows the path to France's future. The latter makes it sulk in the past.

