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French Economic Stagnation

Karina Vasavada

Abstract

This analysis explores the reasons behind French economic stagnation and discusses why this stagnant state is seemingly irrevocable. Based on a detailed look at the economic regime changes, market restructuring, and the resultant policy direction changes in France starting post-World War II, I contend that the reason for France's current economic stagnation was their decision to join the EU, resulting in the shift away from *dirigisme*, a government interventionist economic approach, and toward a market oriented economy. While this assertion goes against the prevalent economic assumption that the market can efficiently govern itself, given the trajectory of the French economy post-market orientation this assumption does not hold true. Finally, as a result of the attenuating effects of market restructuring, the state promised excessive social protections to its citizens paralyzing future administrations in the way of policy reforms. Each subsequent attempt has resulted in either minimal change or uprisings and government acquiescence, thereby making stagnation inexorable.

Introduction

Post-World War II, the European economies were in shambles. For France, however, that did not last long. The French economy bounced back quickly, hitting its peak during the post-World War II economic boom termed "Les Trentes Glorieuses" (Rabault, 2011). The swift economic recovery was due in part to its "ideal...post-war state capitalism" (V. Schmidt, 2003). Characteristic of this post-war state capitalism was the heavy emphasis on state-led intervention in the economic system known as *dirigisme* (Clift, 2006; Levy, 2008). The first half of this regime lasted from 1945-1968 and was

predicated on the state acting as guiding factor in economy activity, funneling resources away from the labour market and consumption and toward industrial investment (Levy, 2008). The second half of *dirigisme*, from 1968-1983, was characterized by the state shifting their policy direction and subsequently undertaking policies that supported the labour market and consumption while slowly breaking away from industrial investment.

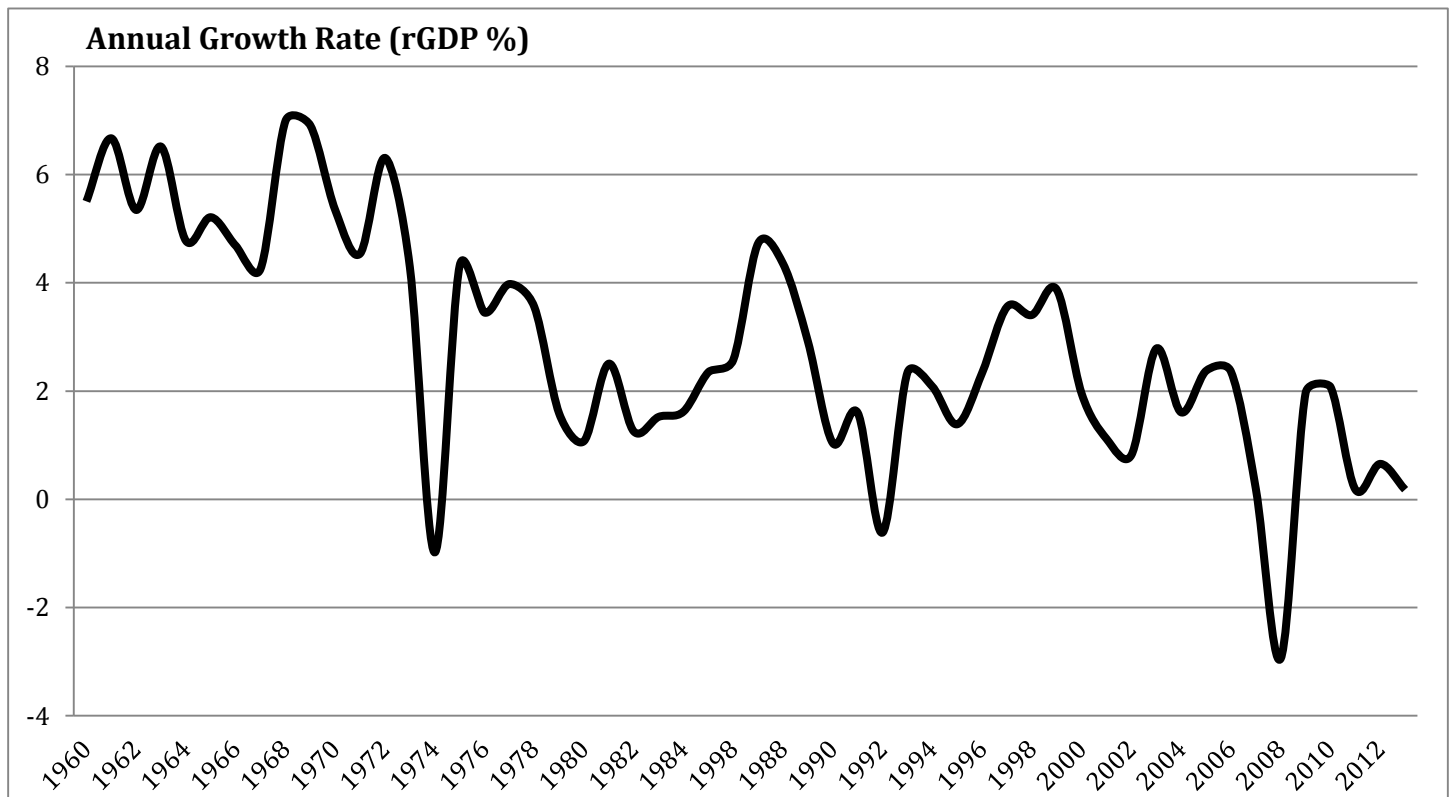
The end of the prosperous era of *dirigisme* was marked by the “1983 U-turn” (Clift, 2006; Cohen, 2007; Levy, 2005) when former President François Mitterrand decided to completely dismantle the *dirigiste* system. This replaced state-led intervention with the control and constraints enacted by the European Union (Levy, 2008). The new economic regime that took over was what I term the *social pacification* (also known as *social anaesthesia*) state, characterized by economic liberalization yet maintaining an emphasis on social and labour market policies (Levy, 2005). The government emphasized the welfare of the population and tried to protect those affected by the restructuring of the market. While the citizens reaped the benefits in the beginning, toward the end of the regime there was a general awareness that the initial benefits negatively affected economic growth, which in turn was cause for a change. In 2002, the newly elected Chirac administration was faced with the task of reforming the *social pacification* state (Levy, 2005) into one in which French society would return to prosperity.

From the end of *social pacification* in 2002 to today, the French economy has become characterized by difficulties in exiting economic stagnation, with unemployment at an all time high, the government deficit spiraling out of control, and economic growth at a standstill (Carter, 2014). While efforts have been made by various presidential administrations, no real intended change has come to fruition. In taking a hard look at the

current economic situation in France, one has to wonder how the country went from post-World War II prosperity to an economic stalemate. Through an analysis of the economic transformations in France starting post-World War II, I intend to answer the question of how France's economy assumed its stagnant state. To answer the question, this thesis takes a detailed look at the policies intended to control for the detriment of market restructuring.

Before we turn to a survey of policies and economic decisions, we want to gain a better understanding of the trajectory of the economy from prosperity to stagnation. The most important indicator of economic stagnation is the decrease in the annual growth rate. Below is **Figure 1.1** charting the changes in the economic growth rate (rGDP) from 1960 to 2015.

Figure 1.1



(Data source OECD)

As **Figure 1.1** demonstrates, the current state of economic growth in France is well below that achieved during *dirigisme* in 1960. What can be observed is that economic growth slowed significantly after 1983, remaining approximately between -3% and 4% from 2002 onwards, being just above 0.18% as of 2014. Across a survey of literature pertaining to this subject, research indicates that much of the trouble in other areas also arose after the break from *dirigisme* in 1983. In an overview of France's economic performance, we see that since 1983, the unemployment rate has remained high, government deficit has steadily increased, and the inflation rate has continually decreased [**ref. Appendix i-ii, Figures A.0-A.3**]. Unemployment has been more volatile, experiencing spikes and dips starting from 1983, and today it is nearing the previous peak at approximately 10% while inflation has experienced a steady decline reaching a rate of 0.5% as this was the primary objective of the EU (Howarth, 2005). Government expenditure and revenue have both increased, but expenditure has experienced a proportionately greater increase resulting in increased government deficit.

Now with our understanding of the trajectory of the French economy, we turn to a survey of literature that contributes to my analysis. Many researchers have taken an analytical approach, studying the economy over time and making projections for the future direction of economic policy. While this paper follows a similar analytic approach, the projections for the future indicate that there is no solution and that France will not be able to exit stagnation.

This review is separated into three distinct sections: first two will be a discussion of the *dirigiste* regime and the subsequent *social pacification* state, respectively, detailing the characteristics, goals, and policies of/under each. Additionally, these two sections will

identify economic “missteps” that I attribute to the problem of stagnation, to be further discussed in the proceeding section. The third section will be comprised of my analysis and will furnish an explanation for why the French economy is stagnant.

Dirigisme: 1945-1983

The *dirigiste* regime marked the period of the most rapid growth in the French economy (Carré, Dubois, & Malinvaud, 1975) . As Lynch argues, the growth in the economy was due to a more optimal allocation of resources stating, “...there was a massive shift in resources from traditional, stagnant activities (mainly agriculture) to the modern sectors of industry and urban services” (Lynch, 2006). In conjunction with state-led interventionism, another important attribute of this system is the policy direction termed *voluntarisme*, which indicates the importance of policy-makers’ discretionary actions (Clift, 2006). *Dirigisme* is also classified as France’s first attempt at establishing a “modern capitalist economy in the absence of a modern capitalist class” (419) (Levy, 2008) in that the government was intervening and investing to promote long-term economic growth.

Part I: 1945-1968

The early part of *dirigisme* was predicated on the attempt to industrialize and modernize industry while maintaining high production at a low cost, rather monopolizing on economies of scale (Levy, 2008). With the state acting as the guiding force for economic activity, the government’s policy direction was geared toward an economic emphasis, channeling investments into the industrial sector and away from labour and consumption (Levy, 2008; Rabault, 2011). This allocation of financial capital was made

possible because of an inflationary growth strategy called “the inflationist social compromise” (Clift, 2006) , concentrated on deficit spending, loose monetary policy and periodic aggressive currency devaluations (Levy, 2005; Levy, 2008). Additionally, this policy made for wage and price freezes and restraints on demand, allowing financial capital to flow into industry (Lynch, 2006). During this period, the state acted as the source of national investment employing deficit spending to promote long-term economic growth as opposed to short-term consumption. To this end, the investments that resulted were precisely what helped to rebuild the French economy post-World War II, bringing France’s burgeoning industrial sector into a leading position in the world market as a producer of “nuclear energy, high speed trains and digital phone switches” (Levy, 2008). Conversely, this policy direction also caused inflation to begin to fluctuate in an upward direction, as can be seen in **Table 1.1** below.

Table 1.1

	1961	1962	1963	1964	1965	1966	1967
rGDP (%)	5.51	6.67	5.35	6.52	4.78	5.21	4.69
Inflation rate (%)	2.41	5.25	4.94	3.23	2.71	2.57	2.82

(Source OECD)

Additionally, due to the emphasis on allocating resources toward industrial investment, labour and welfare costs were maintained at a relatively low rate, which meant that social spending was held to a minimum (Levy, 2008). The containment of excessive welfare spending was due, in part, to the reelection of President Charles de Gaulle, and his appointment of Jacques Rueff as his economic advisor in 1958 (Bliet & Parguez, 2008) . Rueff was a huge proponent of *dirigisme* with his belief that state

intervention is necessary to the end of political and economic liberalization (Bliek & Parguez, 2008) . Rueff's economic thought demonstrates a stark contrast to the widely accepted economic assumption that the market can and should successfully allocate resources without the help of an external authority. However, contrary to the popular assumption, his policy direction was an economic success.

By the time of his appointment, the economy had recovered enough such that France's low capital stock produced a high enough rate of return to prime France's economy for growth. As can be seen in **Table 1.1** above, the growth rate reached 5.51% in 1961, just three years into Rueff's term. The rapid growth rate achieved during this period are attributable to Rueff's pursuit of economic stability through his economic goals, as rebuilding the economy was no longer necessary.

One of his first goals was to keep excessive spending down, which he argued could be accomplished by the government living within their means, or rather not spending outside of the financial capital that they possess. Furthermore, this idea would help to keep inflation rates low and contain public debt. As can be seen in **Table 1.1** above, Rueff successfully brought the inflation rate down from 5.25% in 1962 to 2.82% in 1967. One of his pillars was founded on the idea that consumption is a barrier to effective investment and that wage deflation would lead to a positive trade balance, resulting in higher public saving (Bliek & Parguez, 2008) . Additionally, he regarded inflation as one of the largest problems facing the state and therefore, to avoid increased inflation, the state should only finance public spending through tax revenue (Bliek & Parguez, 2008) .

The state followed the Rueff's platform and held wages down to promote and maintain industrial investment (Levy, 2008). As a result, this expanded the labour force and allowed for resources to move into the industrial sector, promoting increased productivity. Subsequently, France attained the peak growth rate of 6.52% in the 60s as a result of a variety of state policies with the goal of increasing the productivity of large firms, global competitiveness and protecting the domestic markets (Hancké, 2002). Though economically successful, this platform gave rise to a body of dissatisfied students and workers, causing the largest social revolution that France had ever faced in May of 1968. The policies the government implemented to favour industrial growth resulted in increasingly lower wages and sub-par working conditions in conjunction with an uneven distribution of wealth due to the regressive treatment of public finance, thereby provoking the strikes and protests that ensued (Levy, 2008). The result of the protests was the government becoming exceedingly conflict-averse, backing down and acquiescing the public's demands at the first sign of dissatisfaction (Levy, 2005; Levy, 2008).

Short-lived were the days when the government implemented policies to favour industrial investment and modernization, evidenced by the resultant shift in France's economic goals in 1968. The earlier part of *dirigisme* emphasized an economic frame of thought, favouring the growth of the economy over the welfare of the population (Ancien, 2005). The transition to the latter part of *dirigisme* produced a shift in the frame of thought as well as the ultimate shift toward a market orientation, rather creating a modern capitalist economy with the reduction of government involvement in industry, to control for uneven taxation and reunify the working class. A focus on labour market policies and fostering consumption was the policy direction that was intended to reduce

the marginalization of the population (Levy, 2008). While economists argue that a market orientation is the ideal state for an economy, I view the change in the government investment decision as first “misstep” toward current economic stagnation.

Part II: 1968-1983

President Charles de Gaulle stepped down in 1969 giving way to the rise of the Giscard administration and the transition to the latter part of *dirigisme* (Levy, 2005; Levy, 2008). The new emphasis was on a social framework, this time channeling deficit spending away from long-term investment and toward short-term consumption for the benefit of the population (Levy, 2008). The social emphasis was a product of both the industrial restructuring that occurred as a result of the trajectory toward the creation of a capitalist economy as well as the social revolution in 1968. The French government was cognizant of the fact that many people would lose their jobs, and as a result, welfare benefits were created to soften the blow and take an ‘early prevention’ approach to public unrest (Palier, 2008). Essentially, the government ultimately put too much heart into their social policies and not enough thought into long-term effects of excessive expenditure, promising the French citizens extensive social protection from economic restructuring, which subsequently augmented their expectations and now poses the main obstacle in exiting stagnation.

Among the first policies put in force was the “extension procedure” characterized by a rapid increase in the minimum wage (Levy, 2008). The goal of this policy was to increase the benefits for labour and control for the projected job loss of further restructuring. With this policy, unemployment benefits increased to cover 90% of

previous income for a maximum of one year of unemployment. In addition, the lay-off policy was adjusted to require approval for any lay-offs as a result of economic problems (Levy, 2008). The extension procedure provided for increased job and unemployment security, however it also caused the first drastic increase in public spending, against the real financial assets the state possessed (Cohen, 1995; Levy, 2008). This was the second misstep in the direction of stagnation.

A subsequent policy measure was taken to reverse the effects of the recession that hit in the 1970s. This was a counter-cyclical expansionary fiscal policy characterized by the reallocation of the budget to provide income to lower social groups to the end of promoting investment, creating jobs, and reducing unemployment (Clift, 2006). The result, however, was less than ideal causing a decline in revenue for the state and creating a fiscal imbalance. Furthermore, the government maintained their high levels of spending, in spite of the loss of revenue, propelling the state into further public debt (Levy, 2008), with expenditure at 157153.9 million euros and revenue at 150892.9 million euros in 1978. Moreover, the state was unable to implement any policies to reduce the minimum wage and suspend the funding of the lower social groups, lest that produce another social revolution, which the government was not equipped to handle (Levy, 2008).

The third and final misstep leading directly to the progressive economic decline came with the election of the Mitterrand administration in 1981. President Mitterrand played a large role in deviating from the trajectory toward the market capitalist orientation due to an aspect of his policy platform that emphasized revitalizing industrial policy and reestablishing growth and employment by protecting faltering industries and

regaining control of the domestic markets (Bliek & Parguez, 2008; Levy, 2008) . He began the process by re-implementing a voluntarist industrial policy, nationalizing industrial conglomerates and banks to save the industrial sector (Clift, 2006; Levy, 2008). Due to the previous bailout plan of nationalizing bankrupt industries under the Giscard administration, Mitterrand faced numerous obstacles in the way of shifting resources from the traditional sectors to the newer ones(Levy, 2008). Ultimately, Mitterrand's promise to save the domestic markets through an industrial revitalization forced him to continue along the path of reallocating resources toward these industries. His overzealous promise resulted widespread misallocation of resources to sectors that clearly presented no strategic advantage for France, such as the bankrupt steel industry.

The ideas of the Mitterrand administration were well founded, but the results were less than desired. The subsequent policy direction was meant to pacify the general public, as the restructuring of industry resulted in a social upheaval due to increased unemployment. President Mitterrand took measures to buy social peace, subsidizing firms that were spiraling toward bankruptcy as well as protecting those who lost their jobs through economic restructuring (Levy, 2008). Not only did this continue to increase the welfare expectations of the public, but it also marked an exceedingly inefficient distribution of capital. Furthermore, because the firms were so extensively subsidized, it eventually became more lucrative for the state to pay people not to produce.

To further the depreciation of the French economy, the desire to create a single European market began to impose constraints on French policymakers (Cohen, 2007). From the 1980s onwards, the once “industrial powerhouse” (218) was slowly re-structuring to prepare itself for the EU, subjecting itself to the regulations that their

economy was no longer prepared to adhere to. Thus, the decline of *dirigisme* became imminent. Government spending began to rise at an increasingly rapid rate, and, as demonstrated below in **Table 1.2**, the inflation rate was excessively high at 9.46% while economic growth began to slow reaching a rate of 1.26% in 1983. As a result, President Mitterrand finally began to realize that the *dirigiste* regime was beyond repair.

Table 1.2

	1968	1969	1970	1971	1972	1973	1974	1975	1976
rGDP(%)	4.26	6.99	6.91	5.35	4.54	6.31	4.29	-0.98	4.31
Inflation Rate (%)	4.55	6.04	5.85	5.40	6.06	7.38	13.65	11.69	9.63
	1977	1978	1979	1980	1981	1982	1983		
rGDP(%)	3.45	3.98	3.56	1.59	1.08	2.51	1.26		
Inflation Rate (%)	9.49	9.25	10.65	13.54	13.33	11.98	9.46		

(Source OECD)

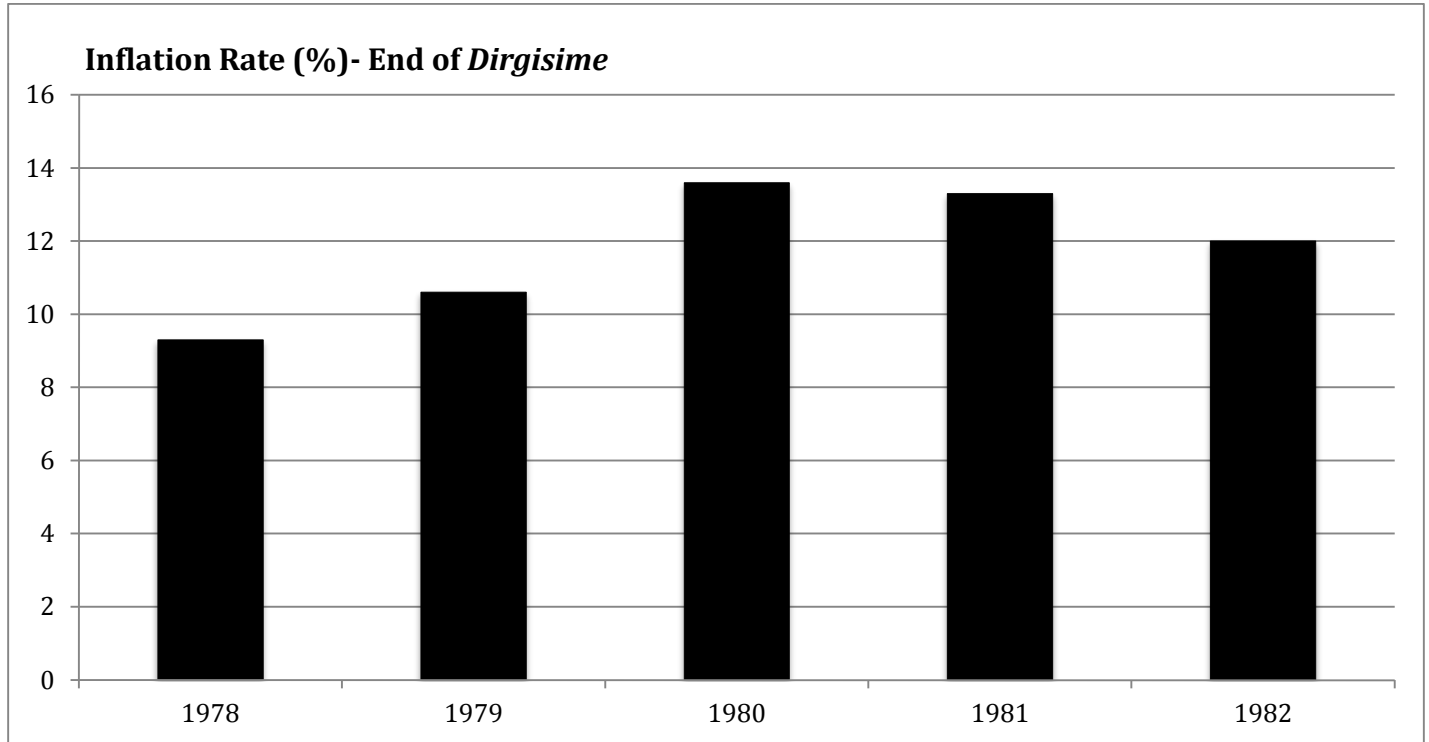
Social Pacification: 1983-2002

Exiting this era of economic success turned economic turmoil; France entered a period called *social pacification*. Industrial relations were dismantled and decentralized; giving way to a weaker, locally regulated enterprises as opposed to the government regulated industry that was present before (Hancké, 2002). This regime presented a variety of extensive policy changes and a further emphasis on social protection, continuing the slowing of economic growth. However, the primary reason for the decision to exit *dirigisme* and enter into *social pacification* was influenced by the desire to join the European Union. Talks about creating the EU had started just after the war to

prevent Germany from deviating again, and France was a major player in the discussion and creation. The primary goal of the European Union was to establish a cohesive fiscal and tight monetary policy base across the member states, which involved having an economy that was set up for exterior regulation and not one that was predicated on the discretionary actions of the individual government. While the previous Giscard administration was successful in beginning to shape such an economy, Mitterrand's decision to turn back toward industrial investment halted and reversed any progress that had been made. Due to the nature of *dirigisme*—the government interventionist framework—France had a great distance to travel in order to create an economy that was ready for exterior regulation, as was to be imposed by the EU. To begin to accomplish this objective, France first had to transform their economy into one that was suited for the EU regulations, which meant dismantling every aspect of *dirigisme*, specifically eliminating governmental economic control (Clift, 2006; V. A. Schmidt, 1993).

The first break from *dirigisme* and attempt to reform the economy into one that followed EU standards was aimed at controlling inflation in 1983. **Figure 2.1** demonstrates the changes in France's inflation rate, which, when exiting *dirigisme*, was 13.3% in 1981 reaching the ultimate rate of 12% by the end of 1982, thus tasking them with the initial objective of disinflation.

Figure 2.1



(Data source OECD)

The EU's decision was to implement a policy promoting competitive disinflation as opposed to the previous "inflationist social compromise", as aggressive devaluations were no longer possible due to the regulations of the EMS (Clift, 2006; Levy, 2008; V. A. Schmidt, 1993). The objective was to keep France's inflation rate below that of their competitors to maintain a strong value for their currency. Through austerity measures, the de-indexation of wages, and tight monetary policy, contrary to the previous loose monetary policy and deficit spending, France successfully managed the inflation rate, recording one of the lowest in Western Europe in the 1990s [ref. **Appendix ii, Figure A.4**] (Levy, 2005). At this point, France had met the criteria that the EU initially set. Although inflation was contained, the same could not be said for the budget, as no cost was spared in deflationary measures (Levy, 2005; Levy, 2008).

The EU's secondary goals were to ameliorate unemployment and promote economic growth (Howarth, 2005) , two problems that persisted in France towards the end of *dirigisme* [ref. **Appendix iii, Figures A.5 & A.6**]. However, because President Mitterrand was dedicated to aligning with the EU and the European Monetary System (EMS), France had to tackle the issues that the EU deemed important to be able to become a member state, instead of addressing the prevalent domestic problems of unemployment and decreased economic growth (Clift, 2006; Levy, 2005; Levy, 2008) as a result of Mitterrand's steps away from the market-economy. This was another misstep as France began to ignore the issues that have become increasingly prevalent today.

The next two steps toward breaking from *dirigisme* and moving toward a EU regulated economy were meant to stop French government intervention, specifically pertaining to their involvement in industry. While at the beginning of his administration François Mitterrand nationalized industry, the subsequent step was expansive privatizations, leaving only energy production, public transport, and weapon fabrication as responsibilities of the state (Clift, 2006; Levy, 2008). As industrial promotion slowed, so did the economic performance of France. This was another misstep, guiding France toward stagnation. Subsequently, Mitterrand put an end to government assistance for struggling industries by reducing the bailout budget to control the government deficit (Levy, 2008). This measure was intended to create industries that were “too big to fail” (Levy, 2005), allowing firms to become independent, unionize and raise their funds while decreasing their dependence on governmental assistance (Levy, 2008). At this point, *dirigisme* had virtually disappeared, and state-led intervention was no longer a part of France's economy. As a result, corporate profitability increased and for a brief period of

time France was effectively able to abide by the EU's 3% deficit limit rule. However, the lack of a bailout budget caused a wave of bankruptcies for struggling industries, leaving widespread firm failures in its wake, resulting in an unemployment rate that increased from 7.4% in 1981 to 9.53% in 1984. Although these first measures were initially successful, the long-term effects started the path toward a widespread government deficit and France's ultimate inability to abide by the EU's deficit rule (Howarth, 2005) .

Having initially ignored unemployment and the welfare of the general population, the state was now tasked with increasing social and labour market provisions to control for their failures in the labour market as they were now a part of the EU (Levy, 2008). The next series of policies were implemented to provide a cushion for the attenuating effects of market restructuring, such as firm failures and increased unemployment, and to prevent another social revolution as was seen under the DeGaulle administration.

The first policy implemented, termed "conversion poles", made the government responsible for providing subsidies to retrain workers, modernize industry, and clean up old factories (Levy, 2008). To control for unemployment under the conversion poles policy platform was a reduced age requirement for retirement, age 50, to receive full pension benefits. The idea was that with more people retiring, more, younger people could enter the work force (Levy, 2005). However, this policy measure actually disincentivized workers from continuing to work past age 50, causing only a third of the labour force to still be gainfully employed at age 60. Not only did this cause the government deficit to increase, but also production from the labour force slowed.

To further these effects, two additional social protections were created— *revenue minimum d'insertion* (RMI) and *couverture maladie universelle* (CMU), also known as a

guaranteed minimum income and universal healthcare (Clift, 2006; Levy, 2005; Levy, 2008). Both of these were created in the face of an increased unemployment rate and disgruntled citizens with sufficient education who were not awarded any income or healthcare coverage due to their lack of employment. Again, this was to control for a social upheaval. The effects were a pacified, yet increasingly demanding public, and a qualified workforce with no incentive to find work due to increased unemployment benefits. Naturally, what was observed was decreased production and slowed economic growth. Finally, to solidify the increasing public debt, the workweek was changed into the “socialist work week”, requiring only 35 hours a week (Levy, 2005). This was a result of the transition from “une société de consommation” to “une société de loisirs”, in other words, a society predicated on consumption to a society that focused on leisure (Rabault, 2011). This transformation further augmented public spending, increasing the government debt due to the necessity for cost shuffling (Clift, 2006).

Each of these policies contributed to increased government spending on social protection, which led to increased citizen expectations and government deficit [ref. **Appendix iv, Figure A.7**]. These two consequences are what I contend are the obstacles to effective reforms and exiting stagnation.

Ultimately, the attenuating effects of the *social pacification* state were recognized not only by analysts looking back on the French economic changes, but also by citizens and the government toward the end of the era (Levy, 2005). While this regime did begin to reduce the costs of *dirigisme*, it incurred costs of its own, exacerbating previous problems, such as unemployment, and creating new and enduring problems of its own, such as the government’s inability to reform (Clift, 2006; Cohen, 2007; Levy, 2005).

From here on out, the economy was stagnant, characterized by sluggish growth, high unemployment, and a ballooning government deficit (Carter, 2014; Levy, 2005) [**ref. Appendix iv-v, Figures A.8-A.10**].

Where the literature ends: Stagnation

My research ends about six years prior to today, when the economy truly presented its perpetually stagnant state that currently exists. In contrast to other analysts' positions, this thesis comes from a more reflective standpoint in that I have witnessed the trajectory of the economy since stagnation. Additionally, the projections that many economists have made in terms of the direction of the French economy have never come to fruition, as their economic situation has not changed since stagnating.

The next section of this paper synthesizes all of the above policies and culminates in an explanation for the stagnant state of the French economy. Below is **Table 3.1**, which compares the components that classify a stagnant economy across the various time periods discussed in this paper. This will be a useful tool in visualizing my analysis.

Table 3.1

	Economic Growth (rGDP)	Unemployment	Inflation	Deficit
Dirigisme Part I: 1945-1968	4.25%	(Not recorded until 1980)	4.5%	(Not recorded until 1983)
Dirigisme Part II: 1968-1983	1.26%	7.9% %	9.5%	-2.0%
Social Anaesthesia: 1983-2002	1.12%	8.7% %	1.9%	-3.10%
Today, 12/2015:	0.18%	10.60%	0.5%	-4%
Peak	12.50%	10.80%	18.80%	-1.50%
Trough	-3.95%	7.20%	-0.70%	-7.50%

(Source OECD)

Analysis

The general assumption in economics is that the market facilitates the effective allocation of resources and that the government does not necessarily have the responsibility of guiding economic activity. While in many cases this assumption holds true, in the case of France the economic period in which the economy reached maximum prosperity was during *dirigisme*, when the government acted as the guiding force for economic activity characterized by state-led economic intervention. As this thesis argues, the explanation for the current state of the French economy was due to the shift away from *dirigisme* and the resulting policy changes to transform the economic system, rather ending government involvement in industry. The first misstep was the change from industrial investment to investment geared toward consumption and the labour market. Resources were no longer promoting industrial growth therefore production slowed sufficiently because the government no longer protected industry. France had previously attained a growth rate of 5.5% in the 60s, but the realized need for a market orientation to

become a player in the European economy caused them to ignore the importance of sustaining a healthy level of economic growth. Contrary to the economic belief in a free market economy being the optimal way to allocate resources, do not think that this was the ideal direction for France to go in as growth slowed when the government exited industry.

I attribute current French economic stagnation to Mitterrand's decision to join with the EU (Levy, 2005). Though this is not singularly attributable to Mitterrand himself, the inefficiencies of *dirigisme* as a product of the shift from an investment focus to a consumption focus as well as his attempts to revert to the initial goals of the regime led to his **choice** to succumb to the external pressures of the European Union (Levy, 2008). Despite France's role in its creation, the EU required the full-on attack and dismantling of the French economic system, i.e. the *dirigiste* regime, which was the mistake that propelled France into stagnation. In theory, joining the EU should have reduced France's deficit spending, as it required extensive fiscal responsibility to abide by the EU's 3% rule. However, the effects were just the opposite as evidenced by the increase in deficit spending for short-term consumption, rather on social protections, after the 1990s. The reason this result was not realized was due to Mitterrand's steps backward, trying to reverse the changes toward a market-oriented economy and his initial promise to revitalize industry and regain control of the domestic markets. The economy was already on the direct path to be a part of the EU, but the difficulties in re-allocating resources caused useless spending to save un-strategic industries, ultimately further propelling France into economic turmoil. Therefore, when Mitterrand decided to, once

again, create a market-oriented, EU acceptable economy, the economic situation had worsened to the extent that the only viable solution was to dismantle *dirigisme*.

This transition proved to be more difficult than anticipated because the French economy was set up for the implementation of discretionary policies, having the ability to adapt to different economic problems. Characteristic of the EU was tight monetary policies that were inflexible, a level deficit requirement of 3% and spending to be kept to a minimum. France was not only tasked with adapting their policies, but also changing their regime in its entirety. This was not something that would come easy, and their lack of forethought caused them to incur more problems than were previously existent. Furthermore, the EU had their own agenda, placing the problem of inflation above other problems such as economic growth and unemployment. As a result, France was forced to neglect these pertinent issues facing the domestic economy. This forced negligence set France's economy up to enter into stagnation as they were unable to adjust the domestic problems until they reformed their economy into one controllable by the EU.

Because the government was aware of the detrimental effects of EU market restructuring, they began to put too much heart in their policies to avoid social rebellion. As a result of the revolution in 1968, the government began to back down at any indication of conflict. This is something that ultimately has trapped the state, in that currently, whenever there is unrest, the citizens go on strike and ultimately the government acquiesces the demands of the people. This is a point of weakness in the way of effective reforms. In looking at social spending as part of GDP, it was only 21.3% in 1980, compared to 26.5% in 1990, and 29.5% in 1998, thus transforming France into a welfare state (Levy, 2005). Other administrations have tried to ameliorate this image,

such as the Sarkozy administration in their attempt to reform their pension plan. While the reform was a success, it was not nearly enough to bring down the public debt and ultimately did not have any lasting effects.

Furthermore, with increased social protection needed to cover for increased unemployment, the government had to continue to partake in deficit spending for short run consumption. However, the revenue from income taxes, which Rueff argued was the only money that the government should be spending, decreased drastically because of the amount of people out of work, thereby perpetuating the deficit. Unfortunately, the government was paralyzed by their social responsibility and could not evade this outcome. As evidenced by the increased inflation rate during *dirigisme*, this was less than ideal. Much like President Mitterrand, the government was trapped by their promise of social protection provisions, not allowing them any room to return to an interventionist society and reallocate financial capital to invest in long-term economic growth.

One analyst argues, however, that the French were playing a “*dirigiste* long game”, stating that, despite the EU’s push for the dismantling of *dirigisme*, France has been slowly planting seeds to maintain some of its regulatory control and that *dirigisme* still exists today (Clift, 2006). Clift’s view of French policymakers is one that portrays them thinking about the long run outcome of building credibility with the EU while still making moves toward independent, government regulated policies. Though France has assumed the role of the degenerate of the EU by refusing to adhere to regulations and deficit rules, I stand with Levy in arguing that *dirigisme* was virtually non-existent after the 1983 U-turn (Levy, 2005) and herein lies the problem France is faced with today. While we believe that the market will effectively allocate resources, set prices, and

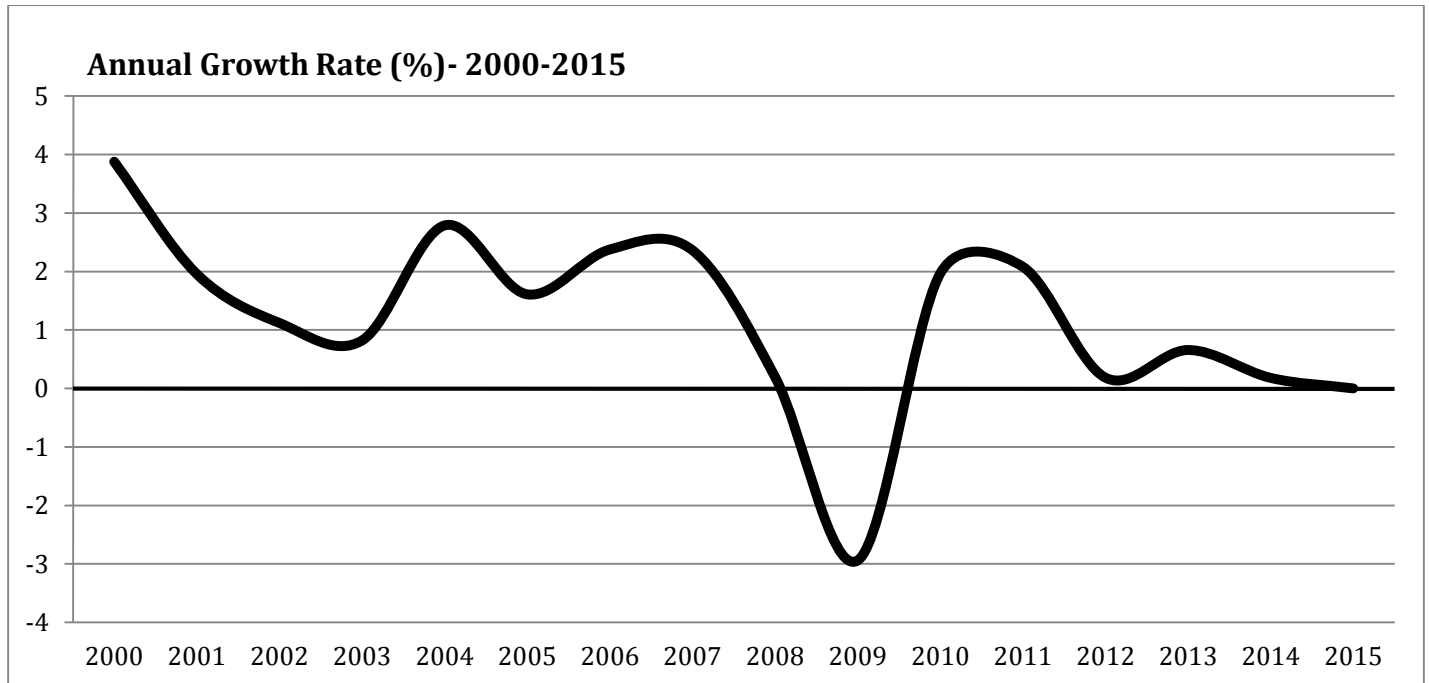
produce economic growth, France's case demonstrates that when government intervention stopped, their situation worsened and the market capitalist orientation did not actually help the economy to mend itself.

French economist Élie Cohen stated "...history has taught us that the visible hand of the state has played a significant role every time an economy has taken off." (Cohen, 2007) This is consistent with what I believe, in looking at the trajectory of the French economy. The government previously had holdings in all industry, promoting extensive growth procedures, but they surrendered that role when they joined the EU. Cohen further argues, "R&D or technology policy tends to create positive externalities of the whole economy" (Cohen, 1995; Cohen, 2007). What this means is that resources put into research and development, as well as technology are important to induce economic growth. Unfortunately, however, the French government stopped funding these two areas and significantly reduced the bailout budget for struggling industries, stunting growth and increasing unemployment. Furthermore, in the world we live in, a generally accepted concept is that continual innovation is necessary for a healthy economy and efficient competition, but the government has no capacity to finance this area even though it would surely increase production and promote economic growth.

The high levels of unemployment and government deficit in conjunction with the low level of economic growth have rendered a stagnating French economy. Though stagnation is generally evitable, because of the augmented expectations of French citizens, fueled by continual pacification measures and social acquiescence, the government is paralyzed and reforms are impossible. Some researchers have argued that eventually an administration will "bite the bullet" and make the necessary reforms.

However, the economy entered stagnation in 2002 and it has endured until today as shown in **Figure 3.1** below.

Figure 3.1



(Data source OECD)

Conclusion and Suggestions for Further Research

History has shown that since 1968, France made a series of short-term beneficial, but long-term detrimental economic and policy decisions to arrive at the current economic state. It is evident that France once had the capacity to sustain a prosperous economy during the period of industrial focus and government intervention. Granted, with the reparations necessary to repair the devastated economy post-World War II, it was not difficult to gain support for industrial investment. However, that has long since disappeared. Changing the investment decisions and subsequently the policy direction were the steps that led to the 1983 U-turn and the difficulty in turning back. This raises the question of whether or not France can or should revert to *dirigiste* policy measures.

As previously mentioned, the economic assumption is that the market can “fix” itself was undermined by France’s demonstrated rapid economic growth during the period in which the government was the guiding force of economic activity. Granted, one must take into account the post-war context when considering the efficacy of *dirigisme* as the war caused the destruction of France’s capital stock. Because the state’s capital holdings were severely depleted, the rate of return on their investment into industry was very high, which prepared the economy for rapid economic growth. Now, however, the capital stock in France has increased, and as observed by the developing/developed country output dichotomy, investments might not ultimately produce the same rate of return. The economy experienced these effects when François Mitterrand realized the difficulties in resource reallocation when trying to save the floundering industries toward the end of *dirigisme*, after the amount of capital the state possessed had already increased. While I think that, contrary to the economic assumption, the government can recreate the once efficient allocation of resources to revitalize the French economy; given Mitterrand’s experience I do not believe that it would be possible. I do, however, believe that this could be a way to patch the current holes in France’s economic system.

This thesis simply furnished an explanation for the stagnant state of the French economy through a historical meta-analysis of economic transformations. However, an issue left untreated is the resolution of this problem. This is a point of further research to be conducted in the future. While I believe that there is no current solution as the continual misallocation of resources prevents the government from enacting effective policy reforms, the rate at which the world and economic systems are changing might present a “fix” in the future. Moreover, the government’s perpetual fear of another social

uprising, as a result of that under DeGaulle in 1968, is limiting the authoritative power that the administrations once had. Each politician has attempted to implement changes, but each change has caused a social uprising and has led to the government backing down and acquiescing the demands of French citizens. Therefore, administrations are paralyzed and no change will be effectively implemented to pull the economy out of stagnation.

Despite my bleak outlook about France's economic stagnation, other researchers maintain hope because France always finds a way to stay afloat. The lack of policy changes is not sustainable in the face of the world's changing economic system and future generations will be the ones to realize this fact. For now, based on my conversations with a few French residents, they all choose to ignore the glaring problem of economic stagnation, stating that what I am suggesting is that France's economy is failing. My concern is not that France's economy will flounder, but rather that it will lose its position among the global competitors. And, unfortunately, it seems that that position is not likely to change in the foreseeable future.

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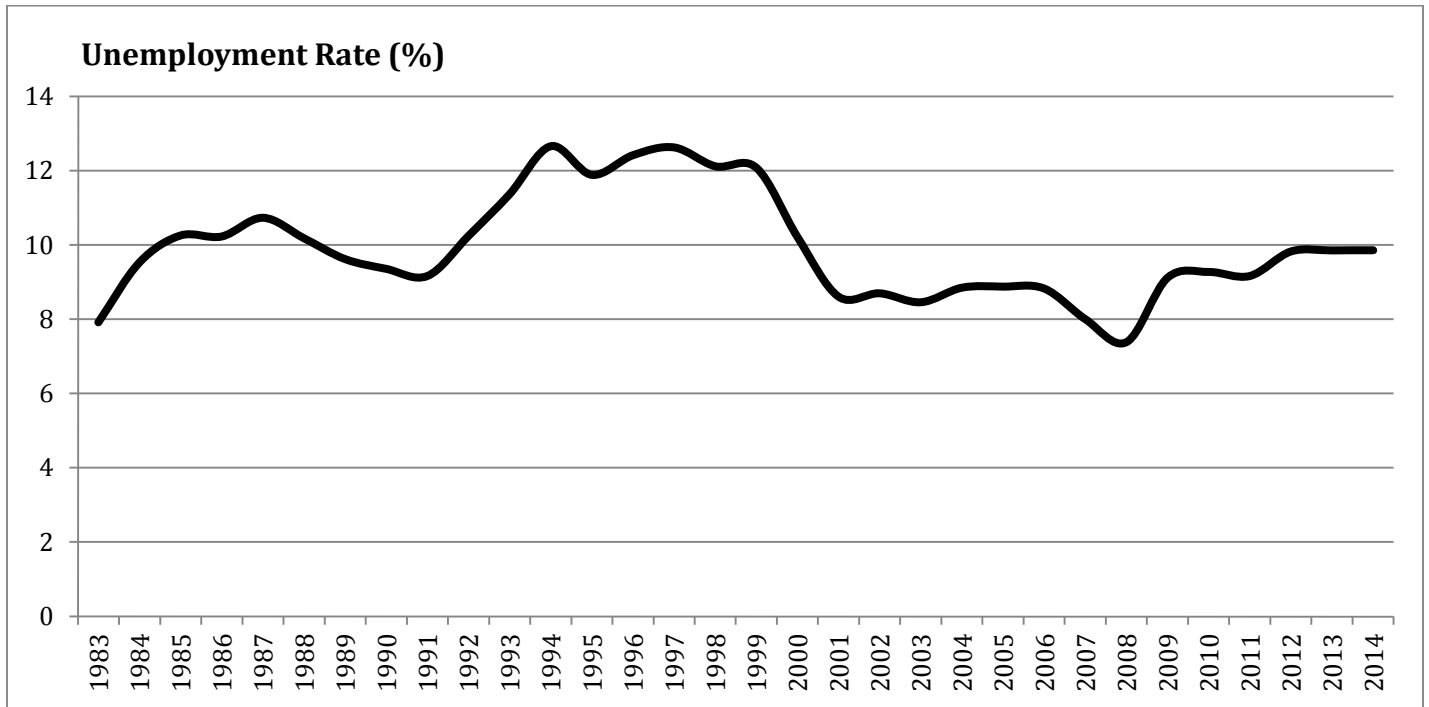
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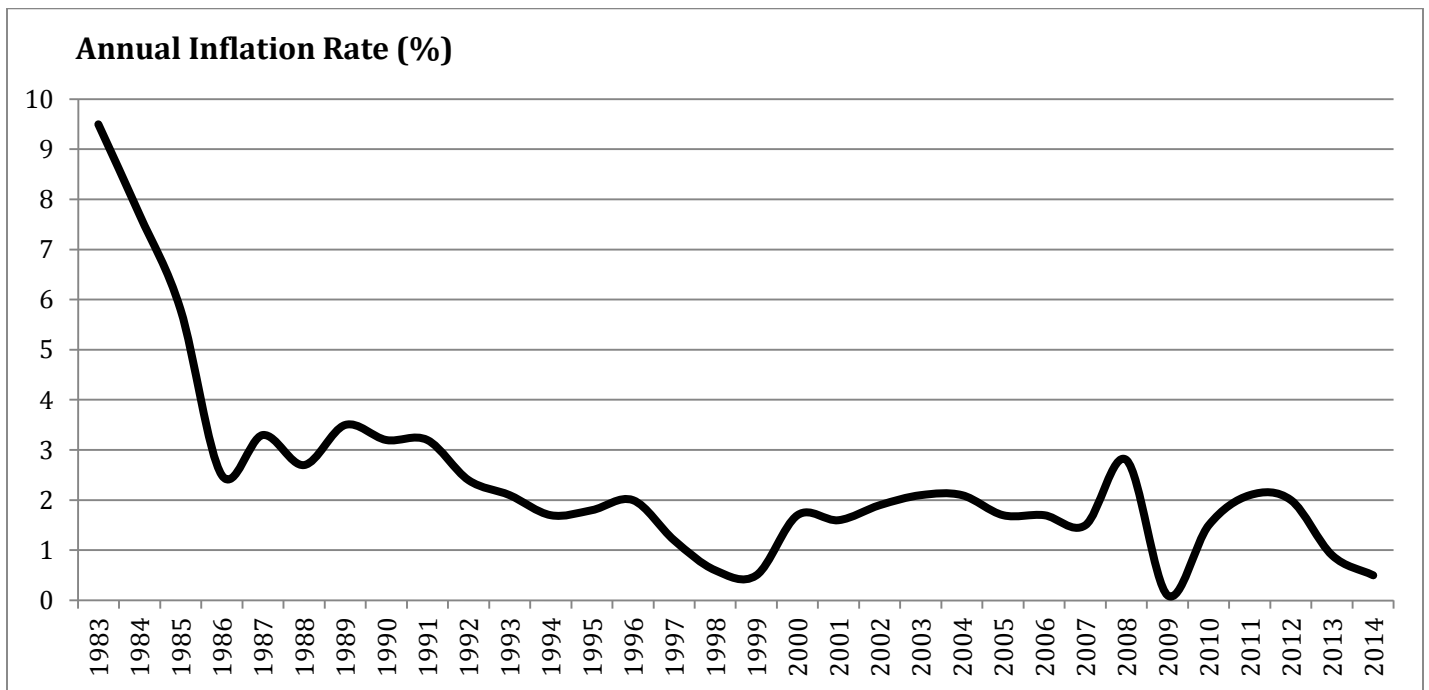
Appendix

Figure A.0



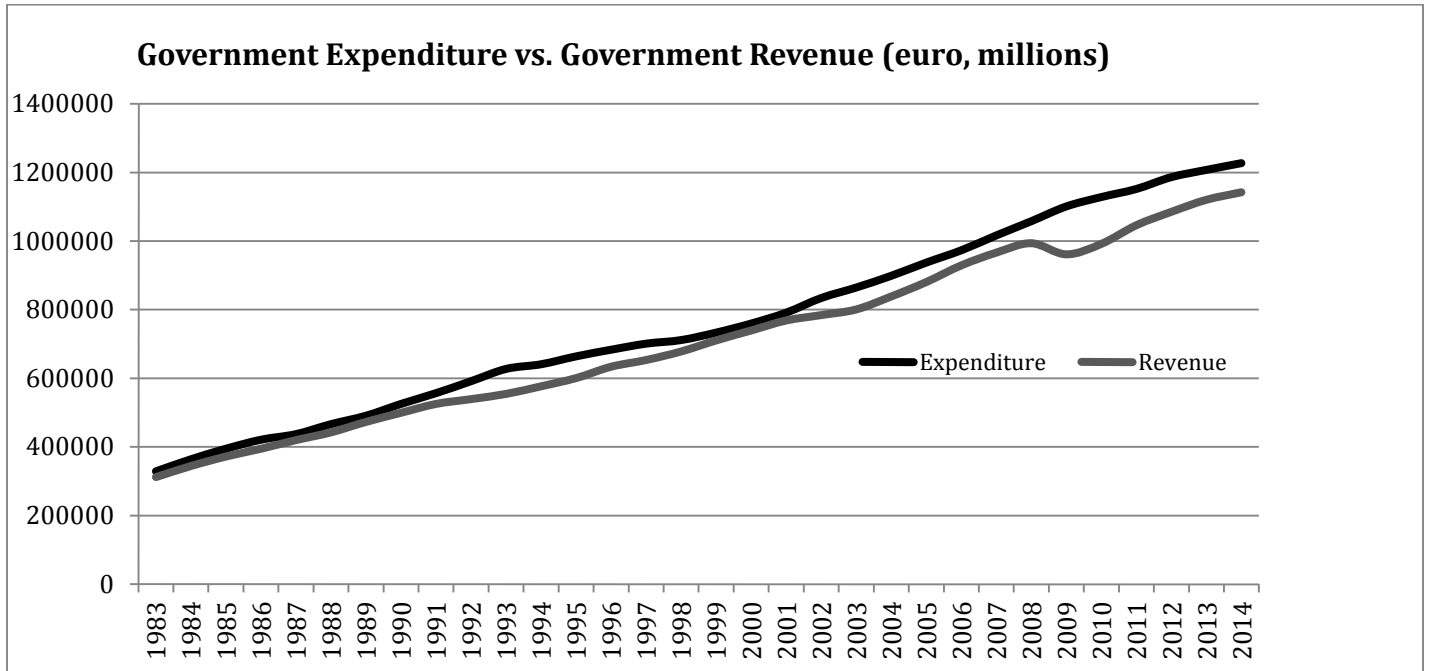
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Figure A.2



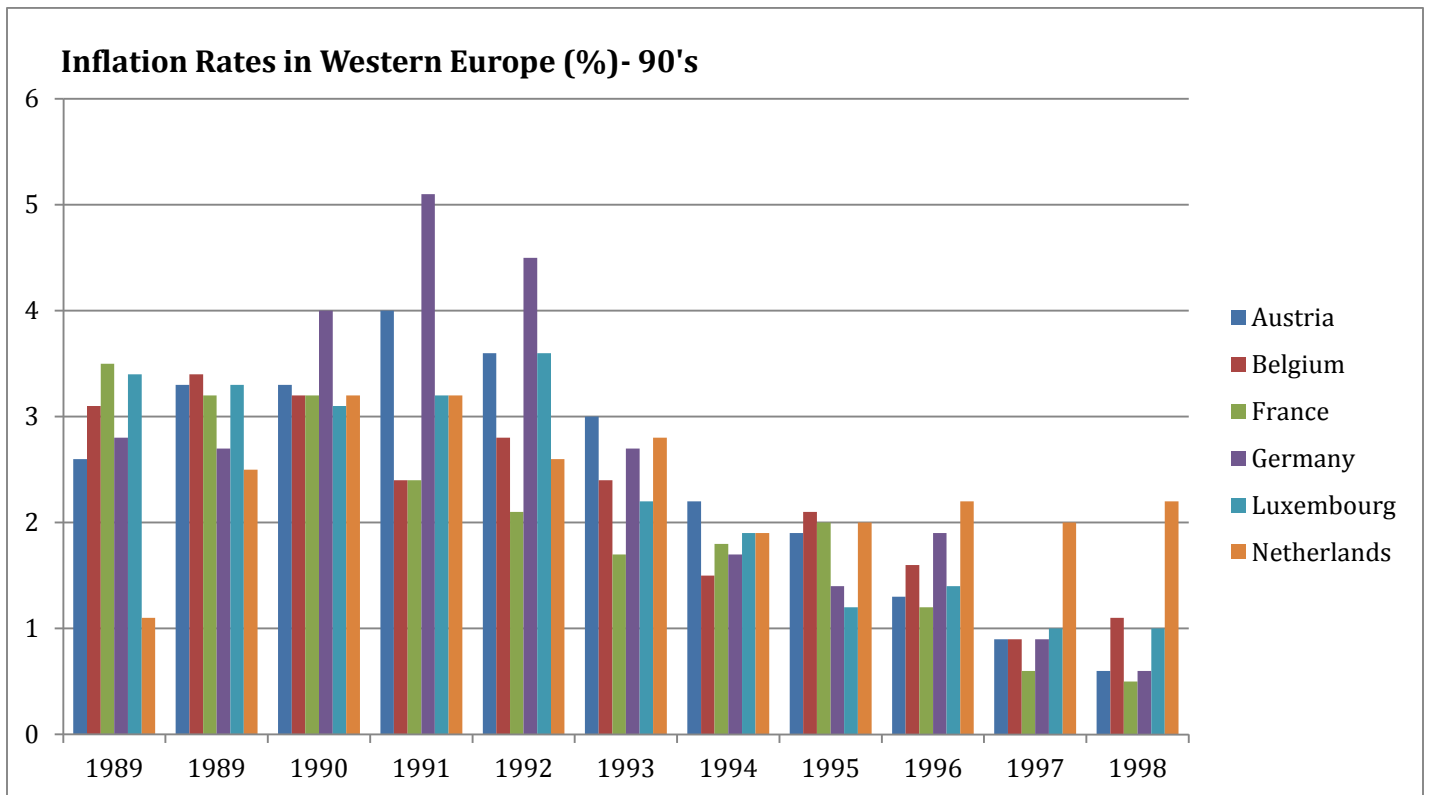
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Figure A.3



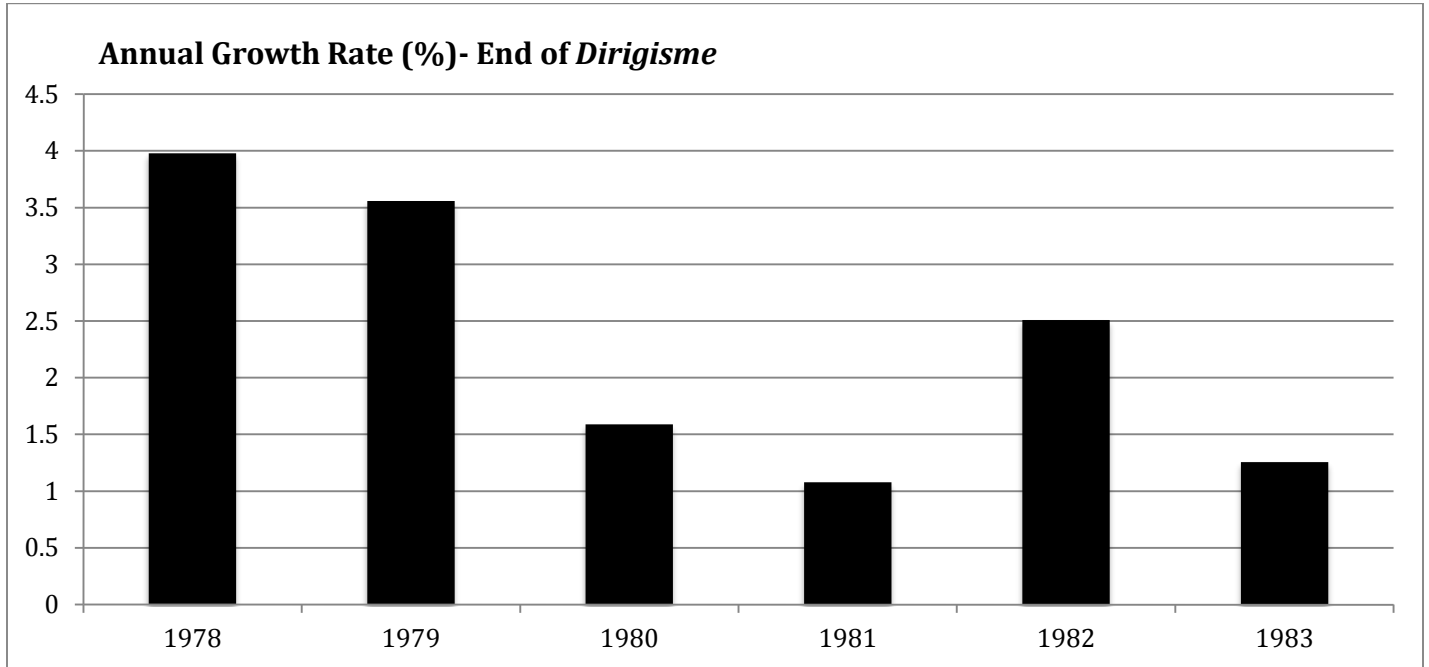
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Figure A.4



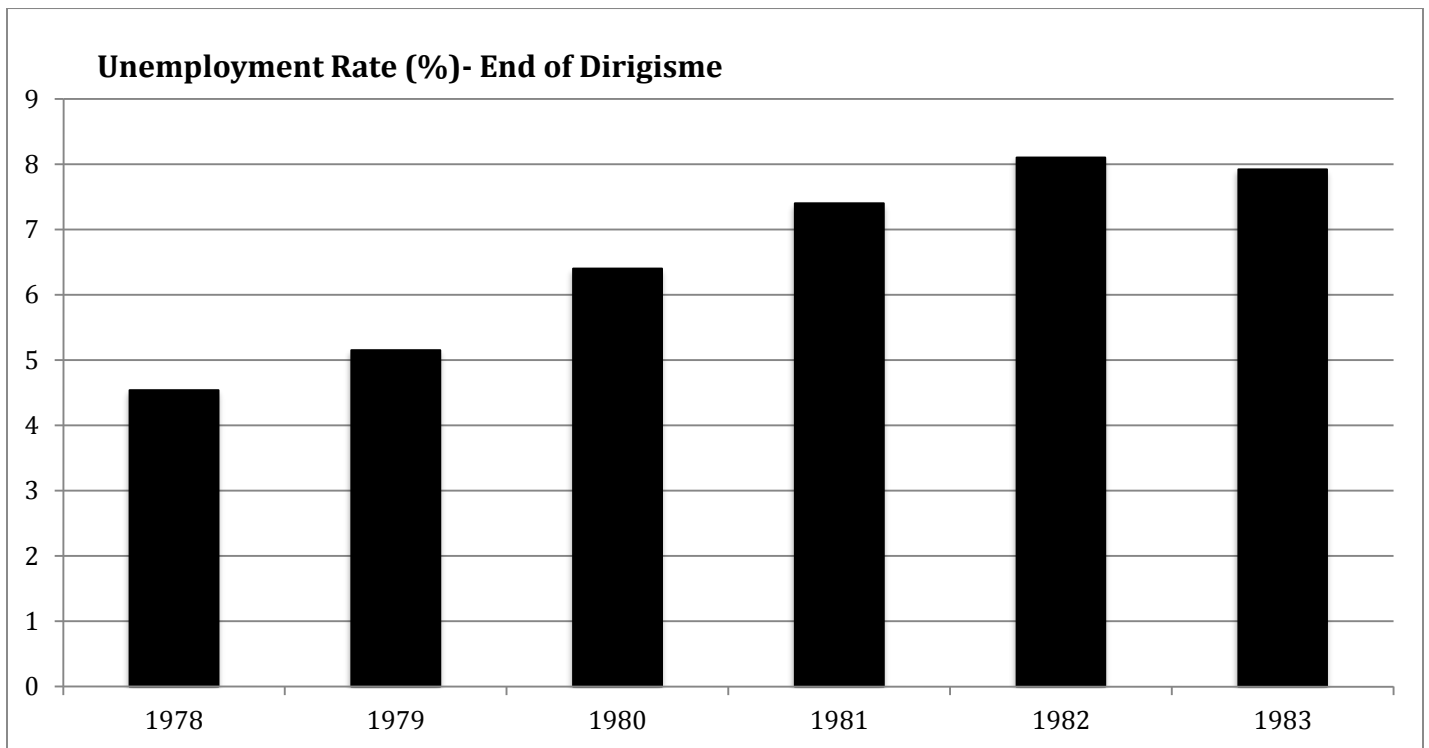
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Figure A.5



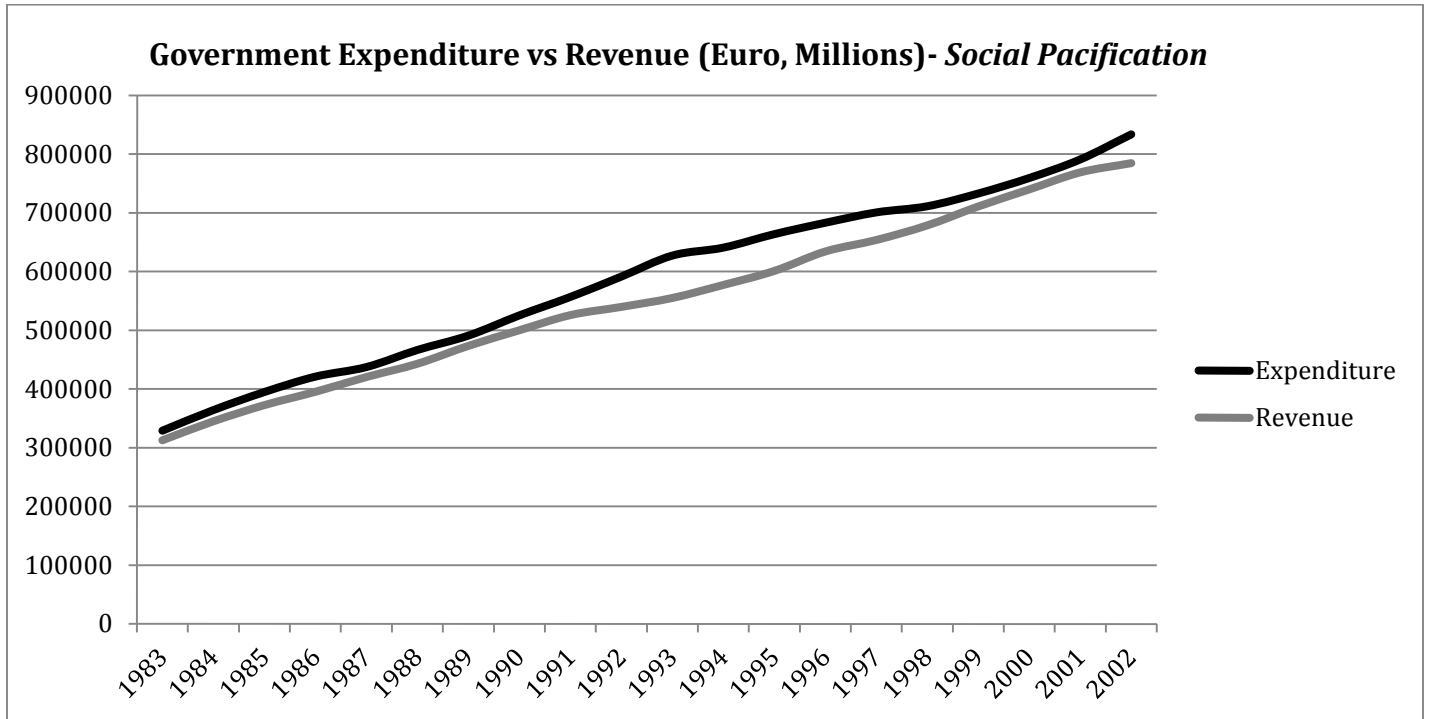
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Figure A.6



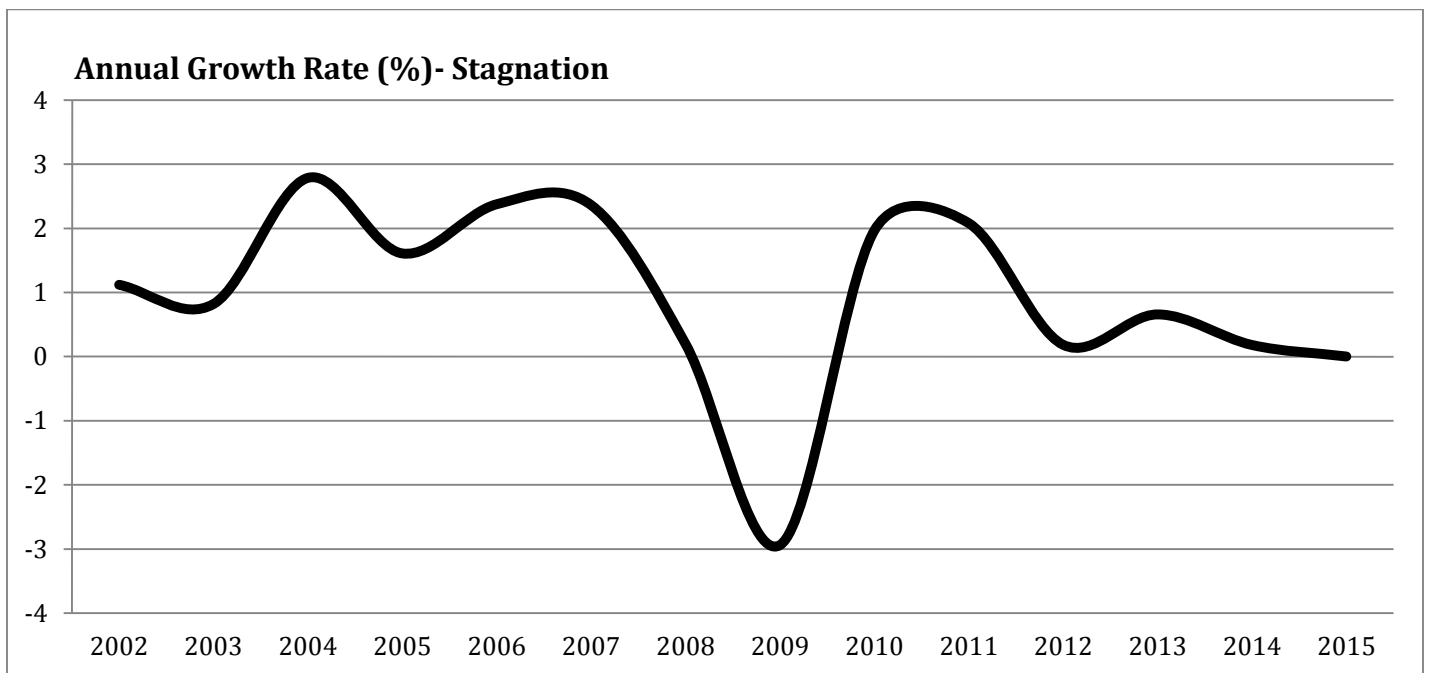
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Figure A.7



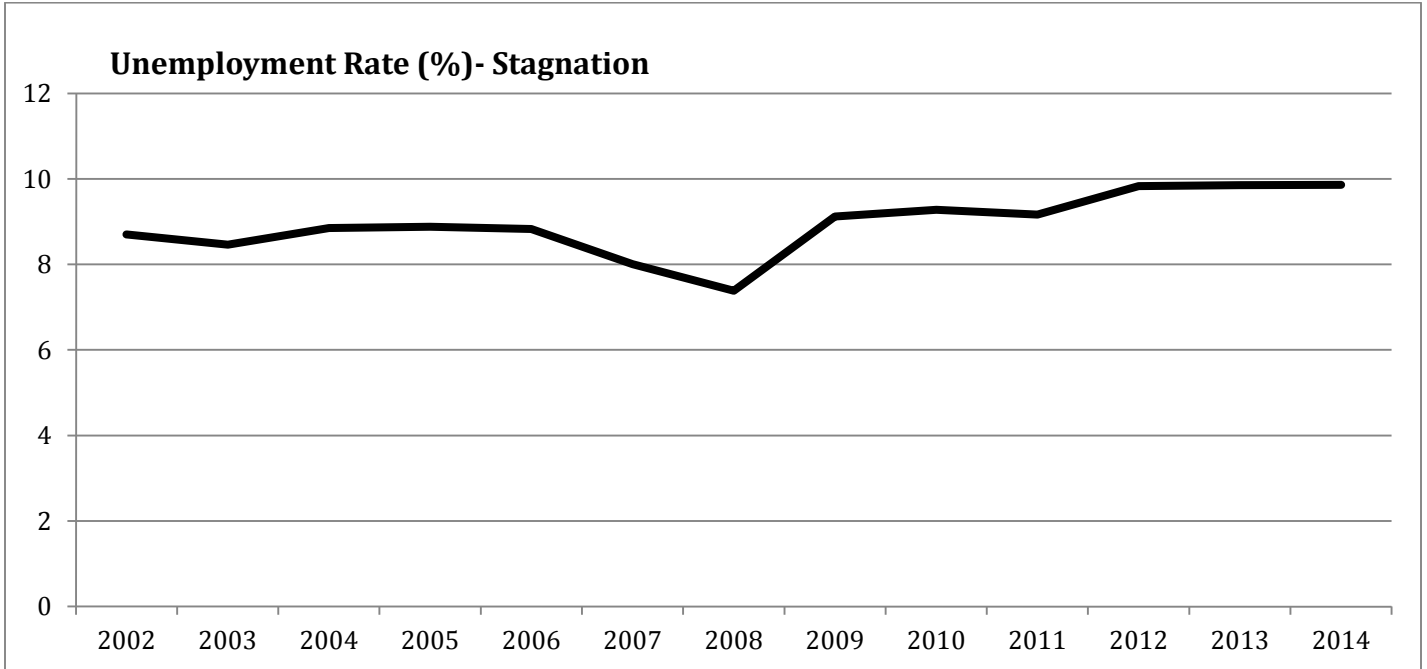
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Figure A.8



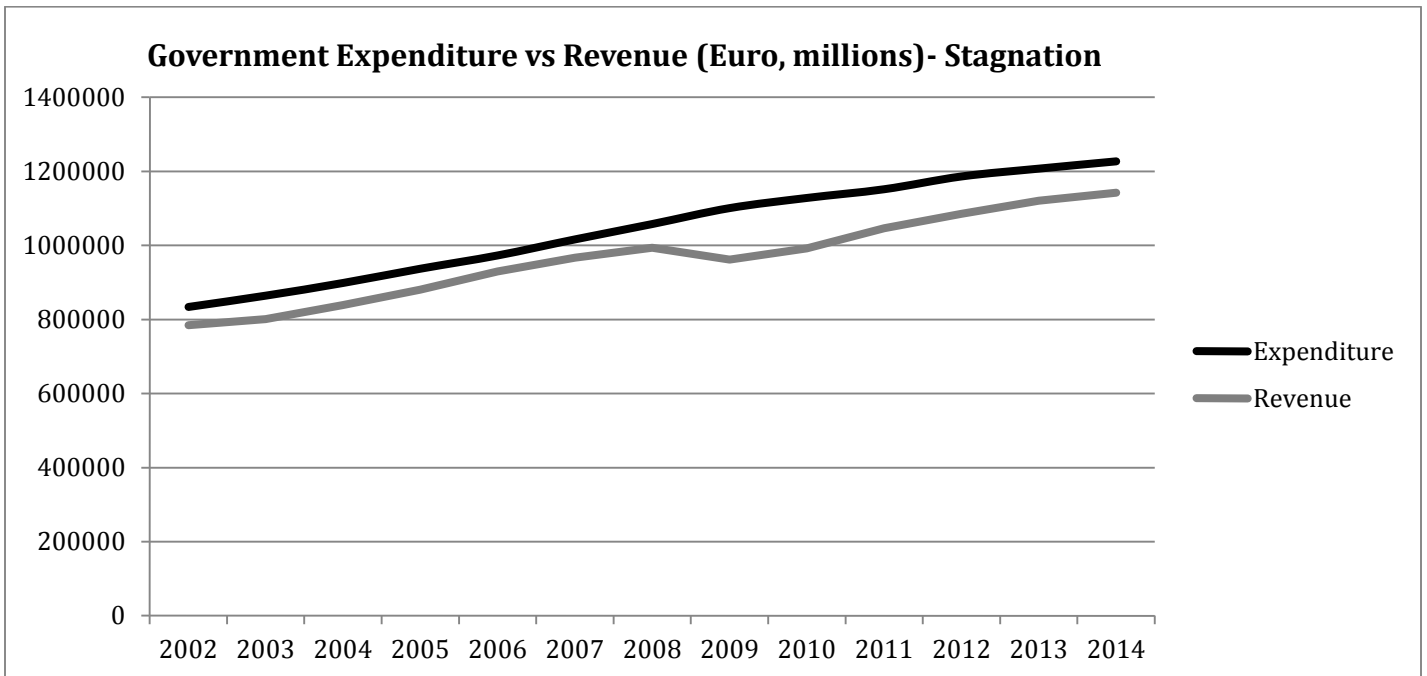
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Figure A.9



(Data Source OECD)

Figure A.10



(Data Source OECD)