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Free Minds and Free Markets

The French Implosion

Tax-and-spend politics has driven Paris to the brink.

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While commentators remain captivated by the bleak saga of such Eurozone basket cases as Greece, Portugal, Spain, and Italy, another European Union member is quietly slipping into economic despair. After years of fiscal mismanagement, France is in a bad, bad place.

France spends more of its GDP on government-57 percent-than any other country in the Eurozone. The country's unemployment rate is at a 16-year high of 11 percent, and a startling number of richer and younger French people are leaving for more hospitable economic environments abroad.

It has gotten so bad that France's crisis-wracked neighbors might be catching up: A November 2013 Organization for Economic Co-operation and Development report warned that Paris is "falling behind southern European countries that have cut labor costs and become leaner and meaner."

The data is even more striking when compared to Germany. With an unemployment rate of 5 percent and a private savings rate of 12.1 percent, Germany has been growing at 1 percent annually while France sputters along at 0 percent.

It is tempting to blame this on the 2007 recession, but the reality is that France hasn't been doing well in years. Since the creation of the Eurozone in 1999, France has only managed a 0.8 percent annual growth rate. Germany, by contrast, has grown three times faster over those 15 years.

Across all available indexes of national economic freedom, France scores very poorly for a developed nation. The 2013 Economic Freedom of the World Index, published by the Fraser Institute and Cato Institute, aggregates and weighs national data on five broad categories-size of government, rule of law and property rights protection, sound money, freedom of international trade, and regulation. How does France rank? An unimpressive 40th, down from 25th in 1980.

This effect is echoed in a similar but more qualitative survey from *The Wall Street Journal* and the Heritage Foundation. Their Index of Economic Freedom for 2013 ranks France 62nd in the world, right between Thailand and Rwanda. And the trendlines in both studies are similar: The country's good or average scores in the areas of rule of law, regulation, and free trade are dragged down by bloated government and high taxes. Economic freedom is a good indicator of prosperity, and France's is sorely lacking.

Unfortunately, the French government's response to anemic growth and higher unemployment has been to tack toward less economic freedom, not more. Loyal to his promises on the campaign trail, President Francois Hollande of the Socialist Party has refused to trim France's social-welfare spending-the highest of all developed economies-and has chosen instead to chip away at the country's huge deficit by raising taxes.

Hollande's more right-wing predecessor, Nicolas Sarkozy, was only slightly better on taxes. In fact, data compiled by tax-watchdog groups and the media in 2012 show that during Sarkozy's rule, from 2007 to 2012, taxpayers were subjected to 205 separate increases, including excise taxes on televisions, tobacco, and diet sodas, multiple increases in capital taxation, and a wealth-tax hike. Sarkozy is also responsible for increasing the top marginal income tax rate from 40 to 41 percent in 2010, and again to 45 percent in 2012.

Analyzing data from the Ministry of Finance since 2009, the center-left newspaper *Le Monde* published a special report in September 2013 showing that 84 new taxes have been instated under both presidents. The article also noted that Sarkozy increased tax revenue by €16.2 billion in 2011 and €11.7 billion in 2012, while Hollande added another €7.6 billion shortly after his election and planned to raise an additional €20 billion in 2013. That's €55.5 billion in new tax revenue in four years, with more than half of the total collected from businesses.

France's tax haul stands at more than 45 percent of GDP-one of the highest in the Eurozone. Sarkozy did implement some small but beneficial pension reforms, which Hollande promptly overturned and replaced with a measly and insufficient increase in the pension contribution period. Not only is the new president unconcerned with the sustainability of the French pension system, but he refuses to follow the example of Europe's periphery by liberalizing French labor and product markets.

Hollande's commitment to big government hasn't won him any friends. The French rank him as the least popular president of the Fifth Republic, and young people are voting with their feet. According to the data from French consulates in London and Edinburgh, the number of French people living in London is probably somewhere between 300,000 and 400,000. That's more than the number of French people living in Bordeaux, Nantes, or Strasbourg.

In a stunning display of hubris, Hollande responded to this tax flight not by implementing beneficial reforms but by beefing up the exit tax that Sarkozy created in 2012. Sarkozy's penalty taxes capital gains at the rate of 19 percent, plus a 15.5 percent payroll-tax-like penalty, payable when exiles sell their assets any time within eight years after leaving the country. Under Hollande, that period is now being expanded up to 15 years.

For cockeyed optimists, there are still slivers of hope. During his New Year address, Hollande turned into a rhetorical supply-sider, making the case for cutting taxes and public spending, improving competitiveness, and creating a more investor-friendly climate. He also promised French businesses a "responsibility pact" to cut labor-force restrictions and thus promote increased hiring.

While free market economists don't believe a word of this, it is worth noting that France has reformed successfully before. Both the 1980s and the '90s saw large waves of privatization, marginal tax cuts, and slighter spending increases. To secure robust prosperity for new French generations, leaders should extend the lessons of these brief shining moments by seriously tackling government spending and reining in destructive tax rates.

Is it possible? Maybe. Many of the countries that have managed to engage in true reforms were led by left-leaning parties at the time. In Canada, the Liberal Party reduced the debt-to-GDP ratio from 67 percent to 29 percent in a few years by cutting spending in absolute terms and engaging in serious structural reforms. And while it's not exactly the same, President Bill Clinton kept the size of government in check in a way Republicans didn't when they were in control. He signed welfare reform, too.

If we're lucky, Hollande will want to make history by being the Socialist who turned France around. If not, the next Greece may well speak French.