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U-turn in Paris

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Again, a new government

President François Hollande's latest reshuffle reminds one of the troubles of his predecessor François Mitterrand more than thirty years ago. Elected in 1981, Mitterrand embarked on some markedly socialist policies: he nationalised the French banks, and a number of leading industrial firms too; and he launched a number of impressive state projects.

The projects mostly survived; they include the Bastille opera house, which resembles an electronics factory but sounds better than it looks; the vast, richly-stocked but inconvenient Bibliothèque Nationale; and the successful reorganisation and expansion of the Musée du Louvre. But Mitterand's nationalisations were deemed as acceptable as flat champagne.

His presidency opened with the French economy in poor shape. The budget and trade balances were in deficit; in 1982 the unemployment rate was over 8%, the inflation rate nearly 10%; the franc had to be devalued in 1981, in 1982, and in 1983. Something had to give. By 1983, less than two years after Mitterrand's election, denationalisation was under way.

Hollande's socialistic policies have been much less drastic than Mitterrand's. The most prominent have been the notorious 75% tax rate on high incomes, which, though said to be temporary, has prompted some affluent taxpayers to emigrate;

and the appointment of minister of the economy Arnaud Montebourg, who has pursued a muscular strategy of state intervention in industrial affairs. This led to the state acquiring substantial shareholdings in motor manufacturer Peugeot Citroën, and in energy and railway equipment specialist Alstom.

A la mode, or bust

Business people are annoyed by unfashionable moves like those. And, in a world of open borders, one cannot afford to annoy them. Whether they are French or foreign, if they dislike the French government's economic strategies, they will take their capital and their business elsewhere. Henri de Castries, chairman of leading French insurance group AXA, remarked recently that *when we develop new activities, we often find London more attractive than Paris*[1] because, across the Channel, highly-paid staff are less heavily taxed.

That is just one example of what has been happening recently; it explains in part why France has been finding recovery and growth impossible. Economists tell us that worldwide free movement of capital, goods and people is a wonderful thing. But it means that a country like France, or even a continent like Europe, can hardly get away with policies that are disapproved in the wider world outside. We are all compelled to follow global fashion.

So Hollande's new team will have to eliminate, as quickly as possible, those things in the French economy that international business opinion finds repellent. For example, the rent-control plan in the *loi Duflot*, adopted last March; this discourages investment in residential buildings for rent, and thus the construction of new ones. The building trades are among the most depressed in France today, despite the widespread shortage of housing and the exceptional cheapness of mortgages. So the rent-control plan is to be shelved, except for an experimental scheme in some parts of Paris, where the problem of excessive rents is especially troublesome.

Monsieur Montebourg's young successor, Emmanuel Macron, will doubtless have to make further reductions in local spending, though our towns and cities need to spend more on housing and transport; and in Social Security spending, though austerity leads to more unemployment, requiring more benefits. He will likewise have to attack 'rigidities in the labour market', to make it simpler for employers to take on new workers – and to ditch them at will.

The downside of flexibility

Unfortunately, the 'flexible labour market' too often means a raw deal for labour. In Britain and America, where unemployment has diminished, many of the new jobs are very much part-time and precarious. We are having to accept worse jobs in order to have more jobs. But that has always been a problem in liberalized economies, where the consumers' appetite for low prices trumps the workers' need for good steady jobs. French free-marketeer Frédéric Bastiat (1801 – 1850) is said to have died with these words on his lips: *one must consider the economy from the point of view of the consumers.* Never mind the point of view of the poor old workers. Their interests have low priority.

Tougher times for the workers are, as Adam Smith told us,[2] a logical consequence of competitive price-cutting. We would do better to put a floor under prices and compete instead on quality of products and services. That would require more employment.

The ogre of deflation

But we French, or we Europeans, cannot do that on our own. It can only happen with a worldwide change in attitudes. That may, at last, be on the horizon. For as long as we can remember, we have been struggling to restrain inflation; hence our overemphasis on price-cutting competition. Now, however, we are beginning to worry instead about *deflation* (falling prices). Deflation is bad because it decelerates our buying; why buy today when it may be cheaper in a month's time? That is recessionary.

And, in this debt-ridden age, there is worse: deflation makes it harder to pay down debts. It reduces prices and incomes; but our debts do not deflate, unless we go bankrupt and have them written down. So we have to pay off the same amounts out of less revenue.

Normally, a Central Banker announcing that we have too little inflation is almost as unthinkable as a Cardinal saying you can have an abortion. For our official financial watchdogs regard inflation as something close to mortal sin. They consider it their prime duty to squash it. But listen…

We see rising risks of deflation, which could be disastrous for the recovery…deflation is the ogre that must be fought decisively. (Christine Lagarde, director-general of the IMF, 15th January 2014)

Persistently low inflation poses a more immediate threat to the US economy than rising prices. (Janet Yellen, chair of the US Federal Reserve, 16th April 2014)

Inflation expectations exhibit significant declines at all horizons…we stand ready to adjust our policy stance further. (Mario Draghi, president of the European Central Bank, 22nd May 2014)

It sounds as though the penny is dropping at the highest levels; we are coming, at last, to see that our obsession with competitive price-cutting has gone too far, and is now damaging rather than helping us. We actually need rather more inflation, to encourage us, both as private individuals and as business managers, to get out there and spend while prices are low, rather than hoarding our cash and waiting for them to fall. Whatever the puritans of this world may say, the fact is that too much austerity is bad for us.

Recently the *Fédération des entreprises du commerce et de la distribution* (French association of retail traders) has called for the suppression of publicity that compares the prices of goods in different supermarkets. These comparisons on TV, in the press and on the internet *contribute to the environment of price war. It would be better if everyone gave them up* says the *Fédération*'s spokeman Jacques Creyssel.[3] The price war may seem good to us consumers, but we are not consumers only; some of us work in the shops, others in the production of fruit, vegetables, bread, meat, fish… Price wars put pressure on all those who do so, crimping their pay and working conditions, putting some of them out of work. And we have the same problem in other business sectors. *To pamper ourselves as consumers, we squeeze ourselves as workers.* This mug's game is keeping us in chronic stagnation.

Freedom from hydrocarbons

What are we to do about the current Russian leaders and their reprehensible behaviour in Ukraine? Sanctions can make them uncomfortable, but may also play into the hands of the xenophobic elements in Russia, who argue that we in the West are always trying to do Russia down. The best way to mitigate Vladimir Putin's power to cause trouble in future, is to hit his country in the wallet by ceasing to depend on her oil and gas. Russia earns more than 70% of her export revenues[4] by exporting these fuels. And we should be using less of them anyway.

Orthodox economics teaches us to 'heed the market's price signals' by buying our energy (and everything else) where we can buy it cheapest. But geopolitical common sense tells us that we should not rely for our supplies on unfriendly or hostile countries; ecological concerns tell us that we must stop deranging our climate by burning hydrocarbons; medical science warns us against persisting with the use of diesel engines, whose emissions can cause cancer of the lungs, one of the least treatable forms of the disease.

So what Europe needs is a programme to develop non-polluting electric power generation, and electric transport, as fast as possible, on as vast a scale as possible. That means substantial investment projects that would make real inroads into unemployment. You say governments cannot do it, because they are too deeply in debt? Then the private sector must do it. At a meeting on 2nd September, Ulrich Grillo, president of the German employers' confederation, observed that *there is plenty of money. We need to put it to use. It is a question of confidence*; and Angela Merkel commented that *we need to guide private capital in the right directions.*[5] At present, large corporations have so much liquidity on their hands that they lap up government securities that yield next to nothing – or even less than nothing! Today, if you buy ten-year French Government bonds, you get a return of less than 1.5%.

If you buy short-term *bons du Trésor* (treasury bills), you get no return at all; you even have to pay (just a little) to hold them. The interest rate is *negative*! Why, then, do corporate treasurers buy such things? Well, if they won't spend their cash, they have to keep it somewhere. It earns hardly anything in the bank, and large-scale bank deposits are not guaranteed by deposit insurance. They could stuff their safes with 500-euro notes, the biggest available, but that could involve buying costly new safes, and hefty spending on secure transport of banknotes.

The error of hoarding

Aristotle argued that it was unnatural for "money to breed money", that is, for money to earn interest;[6] he regarded money in itself as barren. Today, except in the Muslim world, that ancient condemnation of interest is generally considered archaic and misguided. Yet money is indeed "barren", unless it is put to some kind of productive or profitable use. So it is logical that idle cash earns no interest. Zero or negative interest rates are symptoms of non-productive hoarding of capital, which is both economically and socially unhealthy. For it implies deficiency of spending, which induces unemployment and inhibits recovery.

European governments can impose greatly increased investment in renewable energy, by insisting that users of oil and gas cut back their consumption by a substantial percentage every year for the next ten or twenty years, using 'clean' energy instead. Of course, the industries that use oil and gas (or electricity generated by burning them) will scream: *this makes us uncompetitive with the world outside Europe.* The dogma of competitivity on price strikes again! But the

European Union can also impose import tariffs on goods from countries that persist in polluting. And it can use the proceeds to help European exporters.

Eurosceptics will hate me for saying this. But what do they want? Recurrent trouble from places east of Suez or Kiev? Continuing climatic degradation? Persistent atmospheric pollution? Chronic stagnation in Europe?

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[1] Henri de Castries, *Le Monde* (Paris), 27th August 2014.

[2] Adam Smith, in *The Wealth of Nations* (book I, chap. 10, part 2), wrote that abolition of tradesmen's guilds, which restricted competition, *would reduce the profits of the masters* [master craftsmen] *as well as the wages of the workmen. The trades, the crafts, the mysteries, would all be losers. But the public would be a gainer, the work of all artificers coming in this way much cheaper to market.*

[3] Interview in *Le Monde* (Paris), 2nd June 2014.

[4] Figures for 2012 from US *Energy Information Administration*, see www.eia.gov/countries/cab.cfm?fips=RS.

[5] Report in *Le Monde*, 6th September 2014.

[6] Aristotle, *Politics*, book I, chap. 10 (1258b).