Does France Have The Right Plan To Revive Its Economy?

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PARIS (AP) — The man charged with reviving France's shrinking economy and attracting businesses to invest there is gaining a reputation for doing the opposite.

As the country's first-ever minister for industrial renewal, Arnaud Montebourg has told the world's largest steelmaker it is not welcome in France; exchanged angry letters with the head of an American tire company he was supposedly wooing; and scuttled Yahoo's offer to buy the majority of a video-sharing website.

Montebourg, a 50-year-old lawyer from Burgundy, is the public face of President Francois Hollande's plan to revitalize Europe's second-largest economy, which is in recession and grappling with 11 percent unemployment. The plan is to make the French economy more competitive globally — especially for manufacturers — by making it easier to fire workers, offering a payroll tax credit and investing in small businesses.

Economists have praised the labor reforms as a step in the right direction. But mostly they say France's economic plan is all wrong: It is too complicated; it favors a top-down approach to innovation; and it ignores some of the most serious problems plaguing France's economy, such as high labor costs.

And then there is Montebourg, whose public spats with international companies and efforts to block layoffs are making France look like an unappealing place to do business.

In fairness to Montebourg, he's not so much the problem as he is the symbol of it, analysts say. Even if Hollande were to replace him — and that's looking increasingly likely — it's unclear whether the substance of the industrial renewal strategy would change.

The sheer size of France's economy has cushioned it somewhat from the worst of Europe's debt crisis, which has brought depression-level unemployment to countries like Spain and Greece. It is home to many huge industrial companies, like EADS, parent company to plane-maker Airbus; Total, the world's fifth-largest investor-owned oil company; and Sanofi, the world's fourth-largest pharmaceutical company. France is also a cradle for design, high fashion and fine wine, embodied by world leaders like LVMH and L'Oreal.

But make no mistake, analysts warn: The French economy, which had no growth in 2012 and shrank at an annualized rate of 0.8 percent in the first three months of 2013, is in slow-motion free fall.

Profit margins at French companies are the lowest they have been in 30 years. In the past decade, one in six industrial jobs has been lost. And economists forecast unemployment will rise to 11.6 percent next year.

Hollande says the decline in French manufacturing — from 16 percent of gross domestic product in 1999 to 10.7 percent a decade later — is at the heart of his country's stagnation. Many European economies have seen a similar trend, but France's slide has been more pronounced than most. Reverse the decline, Hollande believes, and you reverse the stagnation.

"The goal of reindustrialization is a perfectly legitimate goal. The only question to ask for France is ... whether it's too late," says Elie Cohen, an economist at Sciences Po university in Paris. "It's probably too late."

Serge Lelard, who started a plastics company called Microplast in 1984, feels the same way. Montebourg, who buzzes around France touring businesses on a near-weekly basis, recently visited Microplast's factory outside Paris. He held it up as an example of the kind of small manufacturing businesses that France needs to keep and attract.

But Lelard is dismissive of the government's reindustrialization plan. He says there is too much talk and not enough action that addresses the competitive disadvantages French companies face in the global marketplace.

Microplast, which sells plastic bits that connect the wires in cars, has struggled along with the French auto industry. Lelard is pessimistic about the company's chances of survival.

France's economic challenges are rooted in government policies that protect workers at the expense of their employers. It has the highest payroll taxes in the European Union to fund generous health and retirement benefits. It has the highest tax on capital, which discourages investment. It aggressively fights companies that try to outsource jobs. And it makes firing an employee expensive and difficult.

These problems have existed for decades, but a growing global economy and France's control over its own currency and spending policies masked them. Slowly, however, those masks have been removed.

First, the euro was introduced at the turn of the millennium. Europe's strongest economies, like Germany, gained a competitive advantage: The value of the euro, held down by the weaker nations that used it, made German exports more affordable overseas. By contrast, countries like France suffered because the euro was valued more highly than their own currency, making French exports more expensive for buyers outside the eurozone.

Then the global recession dried up demand for French products at home and around the world. Finally, Europe's debt crisis prompted the government to cut spending and raise some taxes to reduce its budget deficit.

With these crutches pulled away, France's industry was pushed to its breaking point.

But Hollande, a Socialist, came to power last year by promising more of the same: He vowed to spark growth without cutting generous benefits.

There are three main planks to Hollande's reindustrialization plan: up to a 6 percent rebate for companies on some payroll taxes, labor reforms that make it easier to fire employees or cut their salaries during hard times, and a public investment bank with 42 billion euros ($55 billion) to invest in small businesses.

But new programs are announced frequently. Millions in grants and other incentives have been promised for everything from spurring the construction of electric cars to bringing robots to factory floors.

"That's exactly what you should not do. They're ... complicating instead of simplifying," says Anders Aslund, an economist with the Peterson Institute for International Economics in Washington. Aslund says the government should avoid giving grants for specific industries and instead help all industries — with permanent tax breaks, for example.

Last year, Montebourg unveiled a plan to give several hundred million euros in grants and tax credits to car companies and subcontractors in an effort to encourage the development of electric cars and batteries.

But economists say the French government should not try to invent successful sectors. Never mind that France is an unlikely place to incubate an auto revolution. Its car industry can't compete with global rivals like Volkswagen and Hyundai that have lower labor costs and stronger cultures of innovation. For example, French research institutions lack the strong links to industry that allow entrepreneurs in other countries to quickly convert lab discoveries into products.

The flip side of France's efforts to create booming new industries is its aversion to letting struggling ones die out.

"A saved job is always a victory," Montebourg, who is on the far left of the Socialist party, said at a recent lunch with journalists. He declined to be interviewed for this story.

But that's not how many economists see it. Part of Germany's success is its willingness to let some lower-level manufacturing jobs move to other countries, says Christian Ketels, a researcher at Harvard Business School. That allows German companies to stay competitive and keep high-skilled, higher-paid jobs at home.

"To my knowledge, France is really the only country in Europe that is upset about outsourcing," says Aslund.

One of the most glaring examples of this no-job-left-behind policy has been France's campaign to block steelmaker ArcelorMittal from shuttering the two blast furnaces its plant in Lorraine, in eastern France — in spite of the fact that local mines are used up, it's far from ports and its furnaces are out of date.

That plant is "a perfect example of what you should close down," says Aslund.

Instead, Montebourg took up the cause, threatening to nationalize the plant and declaring that the company wasn't welcome in France. It's unclear how much of this rhetoric was in line with government policy — the suggestions of nationalization were quickly struck down by the prime minister — but the affair deeply bruised France's reputation as a serious place for business. In the end, the company will shutter the furnaces but other operations at the plant will continue.

Montebourg also tried to save a Goodyear plant in northern France by asking American tire manufacturer Titan if it was willing to invest. The answer from Titan's CEO mocked France's work practices in an embarrassing public letter — and Montebourg took the bait, shooting back an equally chest-thumping missive.

There looks to be little hope of saving the Goodyear plant, but litigation could drag on for months if not years.

Just this month, Montebourg vetoed Yahoo's attempt to take a 75 percent stake in video-sharing website, Dailymotion. Citing concerns about Yahoo's health as a company, Montebourg said the government, which owns a stake in Dailymotion's owner, France Telecom, would only approve a 50-50 deal. Yahoo walked away.

Business owners say that the government remains more of a hindrance than a help. There are too many regulations and too much paperwork even for mundane tasks.

But the fundamental problem French manufacturers face is simple: Workers get paid too much to make products that cost too little.

The French government argues that its hourly labor costs are not much higher than Germany's — 34.20 euros per hour on average in 2012 versus 30.40 euros per hour, according to Eurostat. But France's range of products — with some notable exceptions, like Chanel handbags or Moet & Chandon champagne — is generally of a lower quality than Germany's.

In other words, if it costs the same to make a Peugeot as it does a BMW, guess which company is going to have more left over to reinvest in innovation? And investing in innovation is how you make a Peugeot more like a BMW.

And it's not even that France pays top dollar to attract the best workers. Its wages are above average, though not spectacularly so. But its payroll taxes are the highest in Europe.

The government's new "competitiveness tax credit," which will eventually give companies up to 6 percent back on some workers' salaries, is a step toward lessening this burden for a time. Early surveys, however, show few companies are taking advantage of it, according to study by consultancy Lowendalmasai.

How come? The paperwork is too complex.