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The Yellow Vests Set Paris on a Delicate Path to Reform

(ZAKARIA ABDELKAFI/AFP/Getty Images)

Highlights

- *In the coming months, Paris will seek a balance between pushing ahead with its reform agenda and maintaining a lid on more extreme social unrest.*
- *As a result, the French government is likely to scale down or postpone some of its original plans.*
- *Slowing economic growth and a worsening deficit will reduce the room for Paris to honor its promises to lower taxes, while circumstances might also force the government to introduce unpopular spending cuts.*
- *While the French government has flirted with the idea of a referendum on reforms, it would only be a last-resort decision, considering the high risks associated with holding a vote at a time of popular discontent.*

Editor's Note: *This assessment is part of a series of analyses supporting Stratfor's upcoming 2019 Second-Quarter Forecast. These assessments are designed to provide more context and in-depth analysis on key developments over the next quarter.*

The past three months have provided more than a few trials and tribulations for French President Emmanuel Macron. Starting in November 2018, the nation was rocked by the "yellow vests," a heterogeneous movement that initially hit the streets to protest rising fuel prices before evolving to demand higher living standards and greater social justice. The protests grew to such size that Macron announced a series of measures in mid-December 2018 to appease the demonstrators, including a raise in the minimum wage and the abolition of a controversial carbon tax.

To some extent, Macron's reaction to the yellow vests took the sting out of the crisis. While some protesters continue to take to the streets of Paris and other cities each week, the demonstrations have shrunk significantly since their peak in late 2018, while opinion polls also suggest popular support for the movement has decreased. What's more, Macron's popularity has improved slightly in recent weeks — although it still stands at a meager 30 percent, suggesting that conditions for protest remain ripe. The president's concessions have bought him some time, but France still needs reform. Faced with such a delicate situation, Macron is likely to take the cautious road, spreading the reforms throughout the year so as to make time to negotiate with trade unions and business organizations and — more important — head off the possibility of new social unrest.

A Long List of Reforms

One of the first items on the French government's agenda for 2019 is a change in the way it calculates and pays unemployment benefits. Aiming to save around 4 billion euros (about $4.5 billion) in public spending over the next three years, Paris wants to tighten the eligibility criteria for unemployment benefits and cut the highest monthly payments. At the same time, it will present plans to encourage companies to offer workers permanent contracts instead of short-term contracts. The first round of consultations among the government, unions and business associations ended without an agreement in early March — not long after Prime Minister Edouard Philippe said the Elysee would proceed with the reforms — perhaps by imposing them by decree in the summer — even if unions and businesses object to them. But while such a move would demonstrate Paris' commitment to reforms, it could also bring unions and the unemployed out onto the streets for anti-government protests.

The changes to unemployment benefits are just a foretaste of a more ambitious plan — to merge France's multiple pension schemes into a single system. During his electoral campaign in 2017, Macron promised to create a universal retirement system in which the state would calculate all pensions in the same way and abolish special regimes that facilitate early retirement. The government began conversations with trade unions and business organizations on the changes in October 2018, but it has made little progress so far. In the coming months, the government, unions and employers will have to make decisions on crucial issues such as whether the retirement threshold (which is currently 62, but even earlier in some sectors) will rise, as well as a means of calculating pensions. Because of the sensitivity over the issue, the government is likely to delay reforms on the matter until later in the year or even early 2020. If approved, the new system would enter force in 2025.

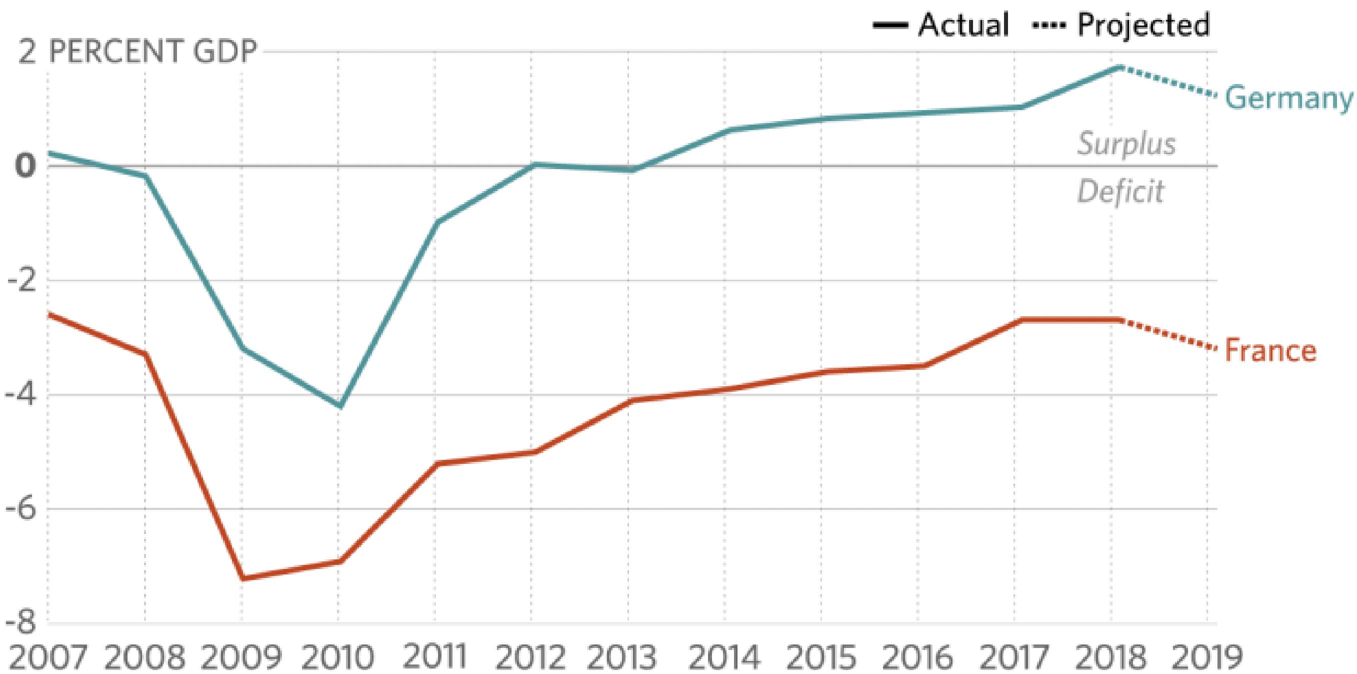
Indeed, the French government is already treading cautiously on some fronts. In mid-February, Paris presented reforms to the public sector that included changes to the way it hires public officials and calculates their salaries. The project, however, does not contain any references to Macron's electoral campaign promise to lay off approximately 120,000 public sector workers by 2022. Nevertheless, unions that include the General Confederation of Labor have criticized the plans and threatened labor action.

Fixing the Finances

Macron's concessions to protesters helped calm the country's unrest, but they also raised questions about France's fiscal deficit and public debt. When Macron announced 11 billion euros in tax cuts and additional welfare assistance for low-income households in December 2018, he pledged to compensate the extra spending with spending cuts elsewhere. The government, however, later admitted that the concessions to protesters would expand France's fiscal deficit to 3.2 percent of gross domestic product in 2019, breaching the EU ceiling of 3 percent. France's state auditor duly warned the government last month that its December 2018 measures had put the country's public finances in a "worrying" state.

France's Fiscal Deficit

According to EU rules, member states' fiscal deficits should not exceed 3 percent of their gross domestic product. Germany has had a fiscal surplus since 2014, a situation that is expected to continue in 2019. France has been reducing its deficit every year since 2009, but projections suggest that the deficit will increase in 2019.



Sources: Eurostat, French government, German government

To complicate things further, Europe is facing a general economic slowdown, with Germany narrowly avoiding a recession coming into 2019 while Italy has already entered one. While the European Commission expects the French economy to grow by an acceptable 1.3 percent this year (down slightly from 1.5 percent last year), a slowdown in its main economic partners is likely to negatively impact France. This could force Paris to make additional savings this year if it wishes to stop the deficit from deteriorating. But such belt-tightening measures — like tax hikes or spending cuts — could spark a public backlash.

At the same time, a worsening deficit could force Paris to abandon some of its plans, such as lowering France's corporate tax from the current 33.3 percent to 25 percent by 2022 or reducing the tax burden on French households. Late last year, the European Commission accepted France's extra spending as a one-off measure that the country would eventually compensate with other actions. Should France fail to correct its course, Brussels may have little option but to take a hard line on Paris and demand that it reduce the deficit. The Italian government, for one, has already accused the commission of being too lenient with Paris at a time when it is insisting Rome reduce its deficit.

The Peril of a Referendum

In January, the French government launched the "Great National Debate," a series of public meetings across the country to give people the opportunity to speak their minds and discuss policy with government officials. Macron himself attended some of the meetings, striving to quell criticism of what some have perceived as a distant style of governing. After the consultations end March 15, the French government will present a series of legislative proposals to address some of the population's major economic, political and social concerns. But lending an ear to the people and translating their suggestions into policy are two very different things, meaning the task awaiting French officials will be monumental, especially as roughly 10,000 public encounters have occurred over the past two months.

Last month, French officials said the government was considering putting some economic and institutional reforms to a referendum. While Macron's administration has not officially announced any plans, French media speculated that the vote could occur May 26, the same day as the election for the European Parliament and that the questions could include issues that emerged during the Great National Debate. This is not the first time rumors have swirled about a possible referendum: Last year, French media reported that Macron would submit some of his promises for institutional reform (such as reducing the number of lawmakers in the National Assembly) to a popular vote.

A referendum, however, would be a double-edged sword for Macron. It could lend popular support and legitimacy to his planned structural reforms, thus reducing the chances of protest against the government, but it could also become an informal vote on the president, weakening his authority if voter turnout is too low — or the populace rejects the proposals outright. France staged its last referendum in 2005, when people rejected a plan to create a constitution for the European Union. Thus, given Macron's low popularity, the government is only likely to opt for a referendum as a last resort. French presidents also have the power to dissolve the National Assembly and call for an early legislative election but, just like a referendum, this would be an emergency decision that Paris would only consider if more palatable options fail.

Should social unrest escalate, or should Macron's party perform poorly in European Parliament elections in May, the president would have a host of less risky options at his disposal, ranging from a Cabinet reshuffle to new rounds of public consultations on policy, before he would ask the French to vote in a referendum or early legislative elections. In any case, the combination of social unrest, slowing economic growth and a rising deficit will limit the French government's room for action in the coming months. But tricky though his task may be, Macron will probably seek a balance between introducing reforms and keeping social discontent within tolerable margins.

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