

**CONTINUING CONCERNS EVEN PRESIDENT MACRON CANNOT ELIMINATE
—RECURRENT OF FRANCE’S EU EXIT RISK IS POSSIBLE DEPENDING ON HIS REFORM—**

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**PRESIDENTIAL ELECTION SEES MACRON VICTORIOUS WHILE DIVISION AND
DISSATISFACTION AMONG THE PUBLIC IS HIGHLIGHTED**

On May 7, Emmanuel Macron, the former economy minister and the leading light of the pro-European Union centrist political movement “Republic on the Move (REM)”, won the French presidential election in the final round, defeating Marine Le Pen, the leader of the far-right party, Front National (FN), which supports an anti-European Union stance and is anti-euro and anti-immigrant. The result of the presidential election at this time saw Macron become the youngest French president in history, despite unprecedented events during the election such as neither of the candidates from the two dominant political parties, the republican party (center-right) and the socialist party (center-left), not proceeding to the final round, and the left-wing party leader, Jean-Luc Mélenchon, who supported an anti-European Union stance like Ms. Le Pen does, gaining nearly 20% support in the first round of voting.

According to the interior ministry, Mr. Macron gained 66.1% of the vote, and thus it can be said he reached a level of complete victory. However, the voting rate was 74.6%, which was the lowest level ever since the presidential election in 1969. Also, blank votes and invalid votes accounted for 11.5 %, which is the highest percentage on record. The voters who casted their votes for Mr. Macron accounted for only about 44% of all voters. He did not necessarily gain the public’s support as much as the apparent voting rate showed. In contrast, the far-right candidate, Ms. Le Pen, won 33.9% of the voter turnout, which greatly exceeded the 17.9% the candidate from the FN received back in 2002 when an FN candidate proceeded to the final round for the first time.

Against a backdrop of public dissatisfaction with the current situation such as the continuously stagnant economy and severe employment situation, Ms. Le Pen and Mr. Mélenchon can be said to have extended their political power. Since the 2008 financial crisis, the unemployment rate has risen from 7% level to around 15% in France. Even as recently as March, that rate still remained at a high 10.1%. In particular, the current unemployment rate of the younger generation (age 15-24) is 23.7%, which admittedly shows a more serious situation. Former President Francois Hollande focused on a policy of giving priority to growth, converting fiscal austerity policies at the start of his presidency in 2012. However, the negotiations to relax the application of the EU financial agreement (the agreement requires that EU member countries strengthen their financial discipline), which Mr. Hollande demanded the EU, was not realized. As a result, financial reform efforts through restrictions on revenue and tax increases were compelled to be conducted. As for the efforts on employment, Hollande tried to implement structural reforms such as the labor law amendment, which enables labor conditions to be changed in line with a company’s intention. However, those reforms were difficult to implement because of objections by labor unions. So far, effective results have not been achieved as expected. These failures in

implementing policies have partly caused the current plight of the French economy. Most recently, the sluggish pace in reforming the employment situation in France has become apparent, compared with other euro area countries (Figure). According to the Opinionway research, more than 50% of those in the 18 to 34 year old demographic support Ms. Le Pen and Mr. Mélenchon, and that support rate becomes lower, the higher the supporters age group is. That is to say, the older age groups, who have already achieved a certain amount of property accumulation, have concerns about the policies of Ms.

Le Pen or Mr. Mélenchon as they could bring about drastic changes in society. On the other hand, the younger age groups, which are suffering most from the severe employment situation, are more inclined to support political parties advocating extreme policies, including anti-European Union stances, to demonstrate their dissatisfaction.

In the future, Mr. Macron will need to tackle the above issues through implementing his campaign pledge. Already, a policy of prioritizing employment reform has been indicated, and the goal of reducing the unemployment rate to 7% has been set (Table). To this end, the following actions are intended to be executed: 1) flexibility in the application of legal work hours (35 hours per week) based on an agreement between labor and management ; 2) Investment Plan of 50 billion EUR for 5 years; and 3) corporate tax reduction (33%→25%).

Figure: Unemployment Figures Transition
(As of January 2014 = 100)

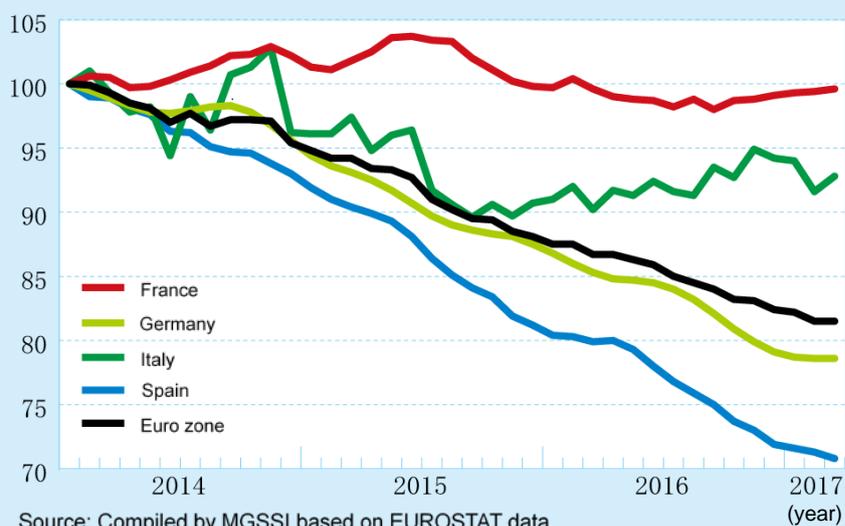


Table: Main Policy of President Macron

EU	EU Reconstruction with Franco-Germany cooperation, Common budget in Euro zone and new establishment of economic and financial minister
Finance	Maintaining financial discipline by investment of 50 billion euro for 5 years and reduction in expenditure of 60 billion euro for 5 years, reduction of 120,000 public employees, compliance with financial deficit standard (3% of GDP)
Tax System	Reduction and exemption of inhabitant tax, reduction of corporate tax (33% -> 25%)
Immigrant/Refugee Policy	Promoting refugee assimilation, strengthening repatriation of illegal immigrants, strengthening check at the border
Pension	System integration in public/private sector
Employment	Lowering unemployment rate into 7%, pursuing labor negotiations at the corporate level
Labor Policy	Promoting flexibilization of legal work hours (35 hours per week)

Source: Compiled by MGSSI based on various materials

Largely due to the fact that public commitments seal off pursuing “quick fix” policies such as expansion of the civil service, which has an immediate effect in improving employment, rapid implementation of these policies is required to achieve a prompt improvement in the unemployment rate.

PACE OF REFORM AND SUPPORT RATE ARE KEYS TO DOMESTIC POLITICS

The French National Assembly Elections on June 11, and 18, 2017 will draw attention in terms of judging the effectiveness of Mr. Macron's policies. This national assembly election (577 total legislative seats) uses a two-round voting system for the small electoral districts. When no candidate gains a majority of votes, the candidate with 12.5% or more of the votes is set to be able to stand in the final round of voting. Compared with the presidential election in which national constituencies are competed over, major parties tend to take advantage of their own superior organizational power and traditional support bases in the assembly elections. Particularly, the Republican Party gained nearly 20% of votes in the first round of the presidential election, despite the scandal of the former French Prime minister Fillon. Voters considered the Fillon scandal as a private matter, and strong voter support for the Republican Party can be seen. While in the recent poll, there was a projection that REM would gain a large number of legislative seats, it is highly likely that either the Republican Party or REM will become the leading party.

In the case that the Republican Party becomes the leading party, the party which the President belongs to and the leading party will be different, and consequently administration of the national assembly will likely get harder. However, considering the process of its defeat in the presidential election, supporting Mr. Macron at least for the time being and restraining the far-right and far-left parties is a legitimate action for the republicans. Rather, REM itself is concerned. The candidates of REM constitute a mix of the left wing and the right wing, and half of the total REM members do not have political careers. If Mr. Macron does not demonstrate powerful leadership, the potential risk of internal trouble cannot be denied.

Mr. Macron's structural reform include certain policies such as the flexibilization of the 35-hour legal work week system, which labor unions strongly oppose. If the support rate for the President is lowered as a result of this reform, it is likely that continuation of structural reforms will become difficult. On the contrary, if the president can realize a substantial decrease in the unemployment rate, by taking advantage of the improvement of the momentum in the current global economic recovery, which can serve as a spur, that support rate will be increased and further structural reform can be promoted. The president's support rate over the next half year to one year when the people will calmly start to assess the progress of his national policies, as well as the results of the national assembly election, might attract attention as the key factor for determining Mr. Macron's ability to execute his reform plan.

Meanwhile, as for other domestic policies, the measures dealing with the issues of immigration, refugees, and terrorism are being focused on. If Mr. Macron seems to take a soft stance toward those issues, FN will likely benefit from.

These issues that Mr. Macron with his unknown political skills is facing are very wide-ranging and enormously difficult to solve. He cannot avoid the rocky road ahead when embarking on his practice of politics.

RISKS OF FUELLING ANTI-EU SENTIMENT STILL REMAIN

If Mr. Macron were to fail in pursuing the reforms in the same way as Mr. Hollande did and betray the public's expectations, calls for radical changes in society would inevitably be further strengthened in the 2022 election. In particular, if the high youth unemployment rate were to continue, the rate of generation with voices calling for breaking through current situation would be higher. On top of that, increased security concerns associated with the increase of immigrants and refugees, and increased dissatisfaction with the erosion of French culture and values due to the side effect of EU integration such as transfer of sovereignty to EU are expected to lead to a shift of support from conservatives to those parties holding extreme policies, including anti- EU stances.

As mentioned earlier, both Ms. Le Pen, who is regarded as far-right wing, and Mr. Mélenchon, who is regarded as far-left wing, advocate an anti-EU stance. This fact suggests that pro-EU and anti-EU positions exist regardless of the differences between the existing left wing and right wing. According to a survey, about 40% of voters, who casted their vote for Mr. Mélenchon in the first round of votes, abstained from voting in the final round. Therefore, if the contested ground will be concentrated on anti-EU arguments in the next election, it is likely that anti-EU forces will gather in the final round of voting and oppose pro-EU forces.

However, the point that her anti-EU policy could be something of an Achilles heel for Ms. Le Pen also needs to be considered. Immediately prior to the final round of voting, Ms. Le Pen softened her anti-EU stance through proposals such as hammering out a plan to use France's own currency in combination with the Euro. This plan is considered to be an about-face by the FN based on the fact that the traditional supporters of FN are executives of SMEs who do not necessarily favor an EU exit. Currently, supporters of an EU exit account for only around 40% of the population at most. Anti-EU came to serve as a key to attracting new proponents who were dissatisfied with the current situation. However, at the same time, it became difficult to find a way to set out the FN's direction to satisfy both traditional proponents and new ones. How FN will hammer out an anti-EU policy and sell it to the public deserves continuous attention, because this move could greatly impact the French political situation.

Depending on the progress of Mr. Macron's reform agenda, Ms. Le Pen's aim to win the presidential election in 2022 becomes more likely.

DISCUSSION OVER GOVERNANCE OF EURO ZONE IS INTENDED TO BE DONE AFTER DOMESTIC REFORMS

As external policy, Mr. Macron holds commitments such as strengthening dumping system, and prioritizing European companies through government procurement. Basically, he places an emphasis on free trade, but based on the premise of protecting domestic companies and employment. Moreover, he had the actual achievement of being engaged in company management. For example, when having served as economic minister, he had a confrontation with Renault (the major French automobile and motor carrier manufacturer, whose top shareholder is the French government) over the application of a law which gives double voting rights to long-term shareholders, which he promoted by buying more shares in Renault prior to the general shareholders' meeting in 2015. Mr. Macron should be seen not as someone with a single-minded pursuit of a free economy, but as a man who partly supports the idea of protectionism and government interventions.

In addition, Mr. Macron focuses on the cooperative relationship with the EU, especially Germany. Germany is also in favor of Mr. Macron, who is pro-EU. Regardless of the results of the parliamentary election in September,

both countries seem likely to continue to maintain their good relationship. The stabilized relationship between Germany and France, which are the core countries of the EU, is desirable as it maintains the EU's centripetal force. Because there exist anti-EU forces in France, it is desirable for Mr. Macron that the loss of Britain after Brexit would be huge. Therefore, he would be expected to go into the Brexit negotiation with the tough stance. Concerning Russia, he supports the continuation of the EU's sanctions imposed on that country. Including Russia's alleged intervention in the French presidential election, he should continue to maintain his severe attitude against Russia. Mr. Macron has a difference of opinion with US President Trump over the policies for trade, immigration and refugees, and therefore a subtle distance between the US and France might be caused.

As for the reform of the Euro zone, Mr. Macron intends to proceed with domestic reform in France first. Then, after recovering its status as on an equal economic footing with Germany, he will deepen the discussion over the reform of the Euro zone. His reforms, such as the introduction of the Euro zone budget, and installation of the Euro zone finance minister, provide the discussion which is integral to solving the contradiction that financial and political integration is not proceeding in the Euro zone while integration of monetary policy is prioritized, and also integral to avoiding the resurgence of an economic crisis. However, Germany has been showing a cautious attitude toward those reforms because they would discourage each country from undertaking fiscal reconstruction and bring about a moral hazard. Those ever existing issues are expected to be resolved in the Germany-France relationship that could be a good one in general. However, it is not easy to achieve real progress on the resolution of such issues.

If the success of the reform in Euro zone would result in the shrinkage of disparity within its region, in addition to the economic merit, French people's dissatisfaction that only Germany would gain benefits is also expected to be eased off. However, there would still be a long way to go before that reform is realized.

(Written on May 30, 2017)