



## The race to l'Elysée: Sarkozy in the lead

April 5, 2007

But the French are not clear who/what they want

**Less than three weeks to the first round, more than 2 out of 5 voters are still undecided.** This reflects a lasting confidence crisis in the right and left establishments. French voters have also shown a dislike for pre-written electoral script (surprising all in the last 2002 presidential elections, or by rejecting the EU Constitution in 2005).

**A three-horse race with a frontrunner but anything can still happen.**

The right-wing candidate Nicolas Sarkozy is the most likely president-to-be but socialist Ségolène Royal is not far behind in the polls and the centrist François Bayrou was snapping at her heels in mid-March. Far-right Jean-Marie Le Pen does not appear to be as popular as in the last elections but his vote remains a big unknown.

**More government intervention or the power of market forces – depends on who you ask.**

France is experiencing moderate growth (2% last year), significant public deficit (2.5% of GDP), and high unemployment. All three main candidates address high employment, especially among young people but offer different solutions. Mr. Sarkozy concentrates on incentives for job creation, longer working hours and a more flexible employment contract. Mr. Bayrou offers a milder version of these reforms, as well as fiscal prudence. Mrs. Royal promises a sharp rise in the minimum wage, wider application of the 35-hour working week, and state-funded first jobs.

**I am all for change as long as I don't lose anything!** Although the French see somehow the need for change, they are not yet prepared to give up privileges. The prospect of paralysing strikes and street demonstrations confront any reformer. Even Mr. Sarkozy would probably have to water down his reform ideas substantially.

**Globalisation remains the anathema.** None of the candidates offers a strategy on how France should effectively integrate into the global economy but indeed everybody sniffs at globalisation and tries to score political points. All candidates are united in their opposition to further EU enlargement and membership for Turkey, but favour a revised "mini-treaty" as a replacement for the failed EU Constitution.

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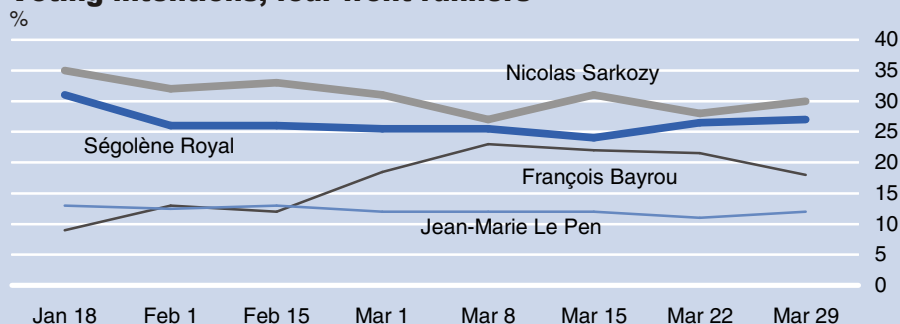
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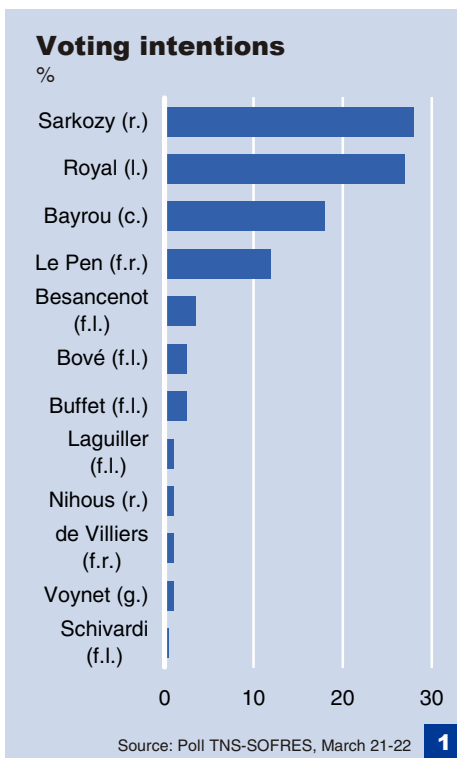
Norbert Walter

### Voting intentions, four front runners



Source: Polls TNS-Sofres





### A plethora of candidates

### A three-horse race: Nicolas Sarkozy, Ségolène Royal, and François Bayrou – with a widening gap

French voters go to the polls on April 22 and May 6 to elect a successor to President Jacques Chirac. Each presidential election is associated with a prevalent theme: the “France unie” in 1988, the “fracture sociale” in 1995, insecurity in 2002. The 2007 election could well be dominated by “la défiance”, the distrust towards the left and the right.

The right-wing candidate Nicolas Sarkozy has been consistently scoring the highest in opinion polls and remains the most likely president-to-be, but the socialist candidate Ségolène Royal is not far behind in the polls and the centrist François Bayrou was at her heels in mid-March. Far-right Jean-Marie Le Pen does not appear to be as popular as in the last elections but extreme votes are notoriously hard to predict and his potential to attract last-minute protest votes for the first round should not be underestimated.

### Une crise de la représentation

The single most important message from the French opinion polls is that, less than three weeks to the first round, more than 2 out of 5 voters are still undecided. This reflects a lasting phenomenon: for a year, 60 to 70% of French have voiced in polls that they trust neither the left nor the right to govern their country, against about 45% ten years ago. This confidence crisis affects more the left-inclined electorate, partly because the left is currently highly integrated into the political system<sup>1</sup>. And this “dissonance” between political tendencies and voting intentions is what propelled François Bayrou to the level of the previous top two contenders, representing the left and the right establishments. They are, however, attempting to position themselves as ‘outside-the-establishment’ candidates – Mr. Sarkozy as the successful non-Enarque immigrant, Mrs. Royale stressing her direct link with the people. French voters see that change is required although they are not yet prepared to give up privileges.

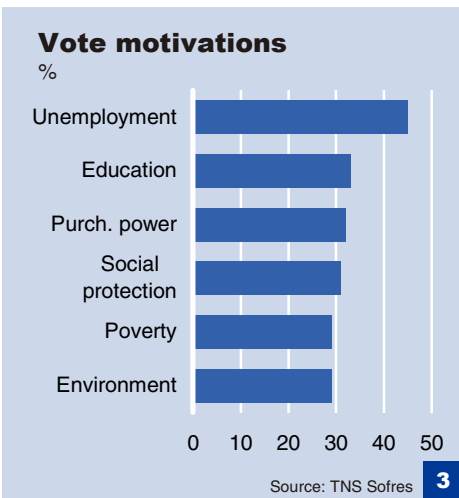
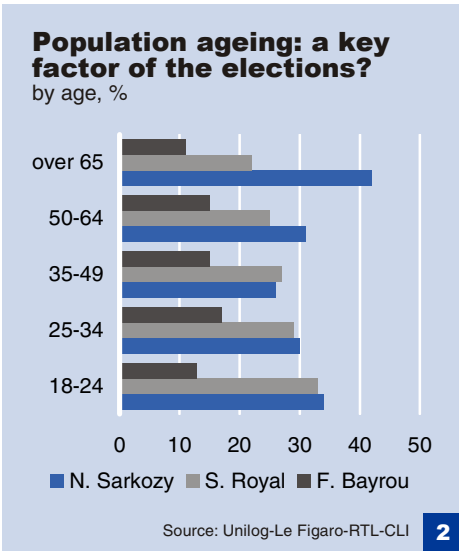
### The campaign dynamics

As many as twelve presidential hopefuls have managed to gather the signatures of 500 mayors, thus fulfilling the requirement to run for the presidential election. These candidates cover the whole political spectrum, with two from the far-right, two from the right, one centrist, one socialist, and six further to the left: one green, one communist, one anti-globalisation campaigner, and three Trotskyites. Ségolène Royal (representing the Socialist party) recently admitted that such a fragmentation on the left could reduce her support and knock her out in the first round of the ballot. This is how Mr. Jospin, the socialist candidate, was eliminated in the first round of the last presidential elections (in 2002) by the far-right leader Jean-Marie Le Pen: he gained only 16.2% of the vote, while his far-left rivals (7 out of 16 candidates) totalled 26.8%.

This campaign started with two front-runners: Ségolène Royal and Nicolas Sarkozy (leader of the UMP and until recently Mr. Chirac’s Interior Minister). François Bayrou, leader of the centrist UDF party

<sup>1</sup> The concepts of “left” and “right” appear clear to the French people, although the nature of the right/left cleavage has changed over the years and has narrowed. In February 2007, only 44% of socialist-leaning voters claim they trust the left to govern, whereas 61% of the supporters of the ruling centre-right UMP party trust the right to govern.

**The Le Pen vote: a big question mark**



**High taxes and high public spending hinder private activity**

**What France can learn from Germany...**

joined the race in early March, capitalising on the widespread confidence crisis, and positioning himself as an agent of change “par le rassemblement”. Having risen rapidly, voting intentions in his favour are starting to slip, as many French voters are not prepared to support a first-round candidate with no strategy for the second round and no clear type of government/coalition in case of victory.

The far-right Mr. Le Pen lags behind the three leaders but opinion polls notoriously underestimate extreme votes. Voting intentions in his favour are higher than in 2002 and the most robust among the four top candidates so far (75% of vote certainty). These protest votes could help Mrs. Royal if they are taken away from Mr. Sarkozy, but this is probably not enough to propel her to the pole position.

In fact, a voters’ segmentation according to age may also help explain why the left is losing ground. In line with the popular adage that individuals tend to lean increasingly towards the right as they age, the left seems to be bound to lose in an ageing population.

Asked to list up to three topics weighing most heavily in their selection of the top candidate, voters showed in a recent opinion poll that unemployment is the major concern (mentioned by 45% of the people surveyed). If the sample is broken down between left-leaning and right-leaning voters, the priorities differed as expected. The most striking deviation occurs for the ranking of safety, second-highest among the right-leaning voters against a ranking as number 7 for the left-leaning voters. The main motivation to vote for Mr. Le Pen appears to be by far concerns about immigration, followed by safety.

Of course, current events have a significant potential to upset priorities. For instance, the riots in Gare du Nord last week have momentarily turned the election focus to law and order and probably benefited the right-wing candidates.

**The challenges ahead**

Parts of the dirigiste French model work well. They have delivered the country efficient public transport, nuclear energy, and first-rate health-care. But this model is unsustainably expensive and has not been effective at reducing unemployment. Its rate has not gone below 8% for 25 years, despite heavy spending on subsidised jobs. The figure reaches 21.5% for the under-25 year-olds, and close to 50% in some *banlieues*. Since tight job protection now deters job creation, young people spend years on short-term contracts, undermining the concept of protection that the system is supposed to guarantee.

At the same time, the burden of regulation has stifled innovation and growth, and the high cost of administering is piling up debt for future generations. Over the past 20 years, a million extra civil servants have been recruited, although plans had been announced to reduce public payroll. Despite mini-reforms of pensions and health-care, public debt is around 65% of GDP. And although France’s world-class commercial giants – l’Oréal, Michelin, Total, Carrefour – reaped record profits last year, the French corporate middle is failing to benefit from the expansion of global trade.

Germany has become part of the presidential campaign as France’s failure to face up to these shortcomings during the Chirac presidency is often contrasted with Germany’s recovery. France’s neighbour has passed reforms, and business has made a huge effort to regain lost competitiveness. France is often quoted as



having replaced Germany as the biggest drag on the euro area's growth.

Some data do support this statement. Indeed, between 1999 and 2006, the share of French exports outside the euro area dropped by 18%, while Germany's share grew by 15%. France's GDP growth was 2% last year, below the 2.7% in Germany and a euro-zone average of 2.8%.

**... and what should best be avoided**

But, looking more closely, average GDP growth per year in the period from 2003 to 2006 was 1.6% in France vs 1.2% in Germany. And like Germany, France is expected to grow by 2% in 2007. It is also true that unemployment has been receding fast in Germany but it had reached an appalling level (5m in 2005). The recovery took place at the price of considerable sacrifices as companies drastically restructured with cost-cutting, frozen wages, offshoring. The German economic recovery was also firmly led by exports, at the expense of consumption: between 2003 and 2006, consumption grew on average per year by 2.4% in France, vs 0.2% in Germany. It is doubtful that this part of Germany's restructuring is actually understood by the candidates and it is even more unlikely that it could be pushed through in France.

**The programs of the top three candidates (see also chart 4)**

***Labour market: a top priority***

**Private sector employment needs to be invigorated**

Plagued with high unemployment in a two-tiered labour market and a decelerating trend in consumer spending, French voters can choose between two clearly contrasting mindsets. On the one hand, Mrs. Royal offers government intervention, particularly through a rise in minimum wages. On the other hand, Mr. Sarkozy and Mr. Bayrou are basically proposing to boost job creation with more flexibility in labour market regulations and reduced charges. All three candidates are suggesting to increase back to work incentives for beneficiaries of unemployment support.

***Goods and services market***

**There are few proposals about market liberalisation**

Mr. Sarkozy is in favour of voluntary store opening on Sunday. In case of an industrial dispute leading to a strike stretching up to one week, he proposes a compulsory secret vote ballot on whether to pursue.

**Mrs. Royal eager to regulate banks**

Anxious to move the campaign away from the current safety and immigration topics, Mrs. Royal came up last Tuesday with a "plan to fight against indebtedness and banking abuse". She promised to put a ceiling on banking fees and to force banks to pay interest on current accounts. She also proposed to make overdrafts calculated on an annual basis, to scrap time lags on interest payments, to introduce more transparency on banking fees and to allow customers to switch banks without penalty. The French banking federation responded that French banking fees were in line with the European average and pointed out that they employ 400,000 people in France while producing 3 per cent of the country's wealth. In any case, Mrs. Royal may have appealed to some voters since an opinion poll published earlier this week found that 86% of people think banks should be more transparent on fees.

**Addressing the need to provide sustainable financing for the health and pension systems*****Pension and health systems***

To counter population ageing, the “loi Fillon” set up the 2003 pension reform. There are two current issues, addressed by the three candidates. First, it is necessary to merge the generous special regime (for public sector and transportation employees) and the general private sector regime. Second, the pension age has to be postponed further.

The 2004 health insurance reform (addressing the gradual drug reimbursement termination and the development of generic drugs) also needs to be extended further as a first measure to secure healthcare funding.

**The French are increasingly aware of the need to restore public finances*****Public finances***

The public deficit finally made it under 3% last year (in line with the Maastricht treaty), but remains high (2.5% vs 1.7% in Germany). Mr. Bayrou first made it a priority and the other two candidates followed.

**The real battle lies ahead**

As in any country, electoral platforms are designed to be elected but offer little hint about what will take place after the elections. In Germany a much too plain-speaking Mrs. Merkel nearly lost the national election which was by all opinion polls hers to win comfortably. In France, where people are not yet ‘sold’ on the inevitability of free trade and globalisation with all the pains and gains that it brings, the reluctance of candidates to spell out what is necessary is perhaps understandable.

French governments of all stripes have been unable to seriously reform an economy that, for two decades, has delivered fairly high unemployment, moderate growth and a growing sense of despair. Torn between fears of joblessness and the costly risk of reforms, the politicians have often concluded that France cannot be reformed.

**Whether driven by revolutionary fervour or anti-market ideology, French strikes and street demonstrations are to be expected**

The next government will need to “take the French people along with them” or the “Juppé event” of 1995 may give a taste of what could be coming. In his first years as president, Mr. Chirac appointed a reformist government, under Alain Juppé. But his attempts to curb public spending by pushing through bold welfare reforms were defeated by strikes and demonstrations. Mr. Chirac then lost his majority and spent five years “cohabiting” with a Socialist-led government, which brought in the 35-hour week, the source of so much consequent upheaval (contrasting the job creations they allowed vs their economic cost). The subsequent prime ministers Mr. Raffarin and Mr. Villepin have also had to drastically water down their proposals.

**Still not clear whether the political leaders are ready to be frank with the French about the need for change, and courageous enough to implement it**

Mr. Sarkozy comes closest to talking the language of bold reforms. He has (some would say naively) argued that, by explaining the need for reform in simple language, he can win over public opinion and face down vested interests. To this end, he favours some new legislation early in the mandate, while public opinion is in favour of change. But it is not a given that Mr. Sarkozy would be a much more determined reformer than Mrs. Royal. First, the Socialists in power have often turned out to be less left-leaning than on the campaign trail. For instance, it was Lionel Jospin who privatised Air France, France Telecom and Aerospatiale. Second, Mr. Sarkozy, if elected, may prove less bold than expected. After all, previous would-be reformers also promised to change France, only to give up in the

face of hostility. Mr. Chirac and his cabinet have proved to be no exception.

## **Implications for Europe and the German-French relations<sup>2</sup>**

As in previous election campaigns, Europe bashing appears to be a must for French presidential candidates – including labelling the EU as “Trojan horse for globalisation” and the ECB “as autism”. While this can largely be dispatched as populist rhetoric, it reflects to some extent the French attitude towards the EU.

### ***ECB and monetary policy in the euro zone***

While Mr. Bayrou surprisingly argues in favour of ensuring the ECB's independence, Mr. Sarkozy and Mrs. Royal plead for a stronger say of (national) politics in monetary policy and a commitment of the ECB to support job creation. They even demand respective changes in the ECB's statute (also with regard to exchange rate policy).

### ***Economic policy and the EU single market***

In favour of a positive discrimination towards national and European companies to strengthen them for global competition, Mr. Sarkozy prones a change of rules to foster European champions in the corporate sector. In this context, Mrs. Royal and Mr. Sarkozy have revived the issue of a “gouvernement économique”. Mrs. Royal argues for a further weakening of the rules of the stability pact and supports stronger harmonisation of both fiscal and social policy to avoid unfair competition within the EU. In an EU-27 there is, however, no majority for those initiatives.

### ***Constitution***

Stalled after the French referendum, the process of EU institutional reforms has been revived under German EU presidency, aiming at a new treaty in time for the 2009 election of the European Parliament. While Mr. Sarkozy has indicated that he will ratify the new treaty in parliament – which should be without problems, Mr. Bayrou and Mrs. Royal both would hold a referendum on any new text. This strategy implies a high risk of failure even if the new treaty has been largely streamlined and the French electorate is in general pro-EU.

### ***Enlargement***

In line with France's consistent position on this issue, all three candidates have strong reservations against further enlargement at this point. Mr. Bayrou and Mr. Sarkozy advocate a strategic partnership with Turkey instead of its EU membership.

It is likely that Europe and Germany would have an easier life with Mr. Sarkozy (or Mr. Bayrou) than with Mrs. Royal. Given his approach towards the treaty's revision, enlargement policy, and a more relaxed attitude towards the US, French and German policies would have more in common than otherwise. With regard to economic policy and the ECB, even if we expect Mr. Sarkozy to be realistic, the well-known differences over the right balance of state intervention and liberal markets between France and Germany will remain.

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**Proposed changes irritate EU partners and, in the long run, could even affect markets**

**Mr. Sarkozy and Mrs. Royal portray the EU as a shield against globalisation and unfair competition**

**All three candidates agree on a revised “mini-treaty” focusing on the institutional issues but clearly differ regarding the ratification process**

**France's scepticism towards new members now more widespread in the EU**

<sup>2</sup> This section by Barbara Böttcher

**Main economic measures proposed by the three top candidates**

	Nicolas Sarkozy (UMP)	Ségolène Royal (PS)	François Bayrou (UDF)
<b>Labour market</b>	1- Overtime exempt from tax and payroll charges (100%) 2- Freedom to work extra hours 3- A single, more flexible contract 4- Unemployment benefits cut after 2 job offers turned down	1- Minimum wage up to EUR1,500 2- Consolidation of 35 hour week 3- 500,000 starter jobs 4- Increase income for minimum support recipients returning to work	1- Overtime exempt from charges 2- Higher overtime pay 3- A single, more flexible contract 4- Option of creating 2 jobs free of charges for 5 years
<b>Goods and services market</b>	1- Stores open on Sundays 2- Vote after one week of strike 3- Minimum service in public services	Regulate bank charges: cap fees, more customer friendly overdrafts and interest payments	Minimum public transport services
<b>Pensions and health</b>	Extend 2003 reform: align public and private sector regimes 1- Flat rate contribution 2- Align GP rates with specialists	1- Start reform from scratch 2- Increase minimum pensions 3- Develop the pension reserve fund 1- Social regime for self-employed 2- One free consultation per week for the 16-25s	Extend 2003 reform with universal points system
<b>Public finances</b>	1- "Tax shield" at 50% of income 2- Abolish inheritance tax 3- Vary corporate tax according to allocation of profits 4- Reduce wealth tax for SME investment 5- Review of public programmes 6- Half of civil servants retiring not replaced	1- Cancel "tax shield" and increase rate for high incomes 2- Vary corporate tax according to allocation of profits 3- Link subsidies and charge reductions with job creations	1- Large basis but low tax on high incomes 2- Increase "generalized social contribution" 3- Limit tax shelters 4- Small business act 5- Implement a ban on operating deficits except during recessions
<b>Europe</b>	1- Creation of a eurozone govt. (full employment an objective) 2- Vote on a new European treaty by parliament 3- Devaluation of the euro	1- Creation of a eurozone govt. (full employment a priority) 2- Negotiation of an institutional treaty subject to referendum	1- Keep the ECB independent 2- Write a new constitution to be voted by all French

Source: candidates' proposals and speeches, Deutsche Bank Research

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