Chapter 12
A French Perspective on the Financial Crisis

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Over the past few months, France has displayed exceptional energy on the international scene to push for globally co-ordinated answers to the financial crisis. President Nicolas Sarkozy's willingness to take such a lead in advocating for new regulations in global capitalism is not just a consequence of his well-known lively temperment or of France happening to hold the rotating presidency of the European Union until the end of December 2008. Domestic stakes, both political and ideological, are also high for him. A crisis in global capitalism provides the French political left with a blessed opportunity to rebuild its strength in a country traditionally uneasy about so many tenets of the free market ideology and always prone to revert to state-centred solutions.

Sarkozy was elected president in 2007 on a program that took the risk — rarely taken by French politicians — to introduce further liberal elements into the French capitalist culture, with ideas such as a smaller but more efficient state or by providing increased incentives to work more for earning more. Just as the world is experiencing a crisis with free capital markets — a key engine of globalization — France may go through an ideological reconfiguration of political discourse, on both the right and left of the political spectrum. In the end, the president may have had no other choice, from a domestic point of view, but to take the lead on current attempts at reframing global capital markets. The alternative would be for him to let the political gains of the crisis be cashed in directly by a slowly reforming French political left, one still marked by deep internal divisions, unclear leadership and a lack of a clear project, as its own supporters loudly acknowledge.

A French Push for Global Regulation

As head of the EU, France has been very active in the weeks leading up to the G20 Summit, trying to foster a global response to the global turmoil. Sarkozy convinced U.S. president George W. Bush to convene the leaders-level meeting on November 14–15 in Washington DC. Sarkozy made it clear that he was aiming, along with other European leaders such as British prime minister Gordon Brown, for a large renewal of supervision of capital markets, with increased regulation, transparency and a new international financial architecture that was more inclusive of emerging economies. The French president consequently intensified meetings and negotiations within the EU to define a common position. Along the way, he has hurt some of his European partners by arguing for a strengthened economic governance centred on the Euro zone, or by raising doubts about the optimality in times of crisis of the EU's rotating presidency system. Countries such as the Czech Republic (next to head the EU) or Germany (wary of any politically driven economic governance) have so far resisted such perspectives. France has

[1] The views expressed here are the author's alone and do not represent either the Agence française du développement, where he works, or the London School of Economics, where he is currently based.

nevertheless proved able to gather European voices around a common set of proposals for the G20 meeting.

This list goes beyond stabilizing financial markets: its embodies the reversal of the hands-off regulatory approach that has dominated financial markets since their rapid liberalization in the 1980s. Those proposals aim to curb "short-termism" in the functioning of these markets and improve accountability and responsibility. Hedge funds and private equity are also to face increased regulation. At the G20 meeting, the EU will thus suggest new regulations for all financial actors, including hedge funds, ratings agencies and tax havens. The EU will also try to convince its partners to reinforce the role of the International Monetary Fund (IMF) to make it a credible "financial cop" able to manage an early warning-and-response system to financial imbalances. The 27 EU members will also commonly defend the idea of a convergence of accounting norms and standards as well as a code of good practices to avoid excessive risk taking, notably in the incentives plugged into employers' benefit systems. To ensure that the reform is on its way, the EU will also call for a second world meeting to be held 100 days after the 15 November meeting — in February 2008 — to monitor the implementation of the upcoming and hoped-for operational decisions. In this EU co-ordination process, French views have prevailed to a large extent, although some partners have been wary of some of the approaches and statements. London and Stockholm feared excessive regulation, especially on hedge funds, while the German minister of finance clearly opposed the principle of "international macroeconomic regulation," a line that seemed to open the way for the French idea of a "European economic government."

But the biggest negotiations still lie ahead. Many observers doubt that strong decisions will be taken. First of all, the EU will likely face the resistance of the United States to any strong changes in global regulations. President-Elect Barack Obama is not set to participate in the conference, while the current U.S. administration has always favoured domestic regulations in the face of multilateral mechanisms. Moreover, for new regulations to be applied anywhere, the proposals must have international backing to avoid giving any country a competitive advantage. France thus felt it critical in the diplomatic run-up to the G20 meeting to secure an EU-Asia consensus on its vision. This, it seems, was achieved in Beijing in early November at the Asia-Europe Meeting (ASEM). The conference resulted in a large consensus of 43 heads of state and government regarding the urgency of clarifying the responsibilities of government, firms and market authorities. Chinese prime minister Wen Jiabao called for "financial innovations" and increased "control to ensure financial security." Asian countries said they expect the summit be conclusive and lead to operational decisions. Although France did not persuade the Chinese revise their monetary policy, it hopes that this Euro-Asian consensus will carry some weight when negotiating with the United States to go beyond declarations of principles. Finally, a meeting on November 9, held behind closed doors in Brazil, led the G20 finance ministers to pledge, in a final statement and in view of the November meeting, to act "urgently" to bolster growth and called on governments to cut interest rates and raise spending.

Domestic Challenges and Stakes

Signs of economic slowdown are multiplying in the French economy, giving the G20 summit much media coverage and high expectations in French public opinion. The

Institut national de la statistique et des études économiques (INSEE) recently provided a grim picture of the economic outlook. It expects France's gross domestic product (GDP) to contract slightly in 2008, after three trimesters of negative growth. World demand for French products is slowing down from a 6% increase in 2007 to an expected 2% growth in 2008. Private consumption is stagnating along with purchasing power. Car sales declined, for instance, by 7.3% in October alone. Real estate is showing clear signs of tension, with prices falling by 2.9% during the third trimester of 2008. Investment is slowing down, jumping back from a 7.3% increase in 2007 to an expected 2,4% growth in 2008. Unemployment was already on the rise before the financial crisis heightened, with data showing a jump in the number of jobless in August; since then, however, the credit crunch has worsened the economic outlook. There could be as many as 52,000 jobs lost during the second semester of 2008, increasing the unemployment rate to 7.4% by the end of the year. In its 2009 budget, the French government still bases its calculations on an expected 1% of GDP growth in 2009, a limited inflation rate of 2% (versus 3.5% currently) and a public deficit of 2.7% of GDP. But the European Commission is more pessimistic. It expects a zero growth rate for next year, with 0.8% growth in 2010 and a public deficit rising to 3.5 % in 2009 and then 3.8% in 2010.

France responded to the crisis by trying to deal with the concerns of both the financial community and the wider population — "Wall Street" and "Main Street," as American observers would put it in their own national context. As did other western governments, the French government insisted on the benefits for the common people in protecting French banks, using mechanisms that bore little or no costs to the taxpayer … if everything goes well.

First came the bank rescue package, a multi-billlion euro commitment eventually approved by the Senate on October 15. This vote came after a meeting in Paris at which European leaders hammered out an agreement to bring capital into the most affected banks and to underwrite massive loans between financial actors. Under the plan, the French state is set to provide up to €320 billion in inter-bank loan guarantees and €40 billion to recapitalize weakened banks. The package will have France create an agency that will borrow funds on the inter-bank credit market with state guarantees and loan those funds to banks, charging for the service — a mechanism that makes the French government insist that taxpayers could actually make money out of the crisis. The state will hold a 34% stake in the agency, presided over by Michel Camdessus, a former IMF director general. As expected, the opposition socialists abstained from the parliamentary vote, calling for the plan to be matched by a broader economic package to create jobs and help low-income families.

Second came a commitment to help local authorities — such as French *départements*, regions and city councils — face their credit needs with €5 billion in loans — half of it granted by a public institution (*Caisse des dépôts et consignations*) and the other half to be delivered by commercial banks. Facing a slowdown of their tax revenues and losses related to the slowdown in the real estate market (which provides key tax revenues to local authorities, through the so-called *droits de mutation*), French local authorities are indeed experiencing a severe credit crunch. But the crisis may run deeper than expected for years to come. Since the mid 1990s, and markedly since 2005, these public entities have been heavily contracting "exotic loans" with variable rates linked to the future evolution of indicators, such as the exchange rates of the euro, the dollar or the

American central bank interest rates. According to some estimates, up to 25% of French local authorities' debt may be based upon such products, spread by banks with aggressive commercial methods. These products may constitute a time bomb: local authorities may not be led to bankruptcy but may have to scale down their investments and raise taxes. "These are the French subprimes," says Claude Bartolone, president of the Seine-Saint-Denis Department, who recently discovered that 98% of his department's debt (about €800 millions) was linked to such exotic products.

The third step in the government's answer to the crisis has been a plan, announced on October 23, to help the businesses community cope with the global turmoil. Among its key features was the establishment of an "active, mobile" sovereign wealth fund to protect key French industrial assets against foreign raiders that would like to buy them "on the cheap." Temporary tax cuts (on the *taxe profesionnelle*) will also be offered until 2010 to help stimulate investments on the part of small and medium-sized businesses.

As evidence mounted that many workers would fall victim to the financial crisis, the fourth and most recent action plan launched by the French government was a set of measures to protect jobs and warn companies against excessive layoffs, unveiled by the president himself on October 28. News of mass employment cuts from major French companies (such as Renault and La Redoute) put pressure on the government to match its multi-billion euro bank package with a plan for ordinary people. Among the measures to be taken are easing restrictions on the use of short-term contracts by small and medium-sized businesses, extending support for subsidised training programs and making it easier for people to work on Sundays. These actions may be labelled "liberal measures," but the most one most commented upon is the plan to create 100,000 more "state-aided contracts" by 2009 (that is, subsidised work contracts), a long-standing French approach to crisis "air bags."

It is clear from its various plans that the French government is trying to show pragmatism and ideological openness in its response to the financial crisis. But there remains a risk that these plans may be interpreted politically as a volte-face in Sarkozy's rather liberal master plan for France. What the economic slowdown might mean in the long run for French politics and capitalism remains to be seen, but the liberal turn is undeniably challenged. Much will depend on the outcome of the G20 meeting on November 14–15, how effective those outcomes are and how they will be interpreted by the French public opinion.