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Financialisation and the Financial and Economic
Crises: The Case of France

Gérard Cornilleau and Jérôme Creel



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Financialisation and the Financial and Economic Crises: The Case of France

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Abstract

The classification of France in any category is generally very difficult when the time dimension is taken into consideration. Indeed, France has gone through different situations, from current account deficit to surplus, and from surplus to deficit, which makes it difficult to apply to France a one-category-fits-all diagnosis. Nevertheless, drawing on the cyclical nature of the public deficit and the steady contribution of households' consumption to the GDP growth rate, a mild domestic demand-led economy is certainly the best approach to describing the French economy and its connections with financialisation. The 2009 crisis has reduced corporate mark ups, as it is normal during a recession, but we do not observe a long term deviation and the mark-up for the whole economy, on a historical basis, is at a relatively satisfactory level as the share of gross operating surplus in value added has remained higher by one percentage point than the average level of the pre-oil-shocks- period. The crises of the 1990s and 2000s did not cut corporate profitability as the first oil shock did. The idea of a structural deterioration in profitability is therefore not confirmed by macroeconomic data. This is certainly worth being brought closer to the change in income sharing which happened in the early 1980s: the policy of wage restraint implemented in 1982, coupled with rising unemployment, brought back wages evolution at a level consistent with a balanced economic growth, hence in line with productivity growth. France has not gone through financialisation-related imbalances like, e.g. a real estate bubble. Fluctuations of the French economy can thus be attributed to external shocks, and not to structural imbalances. This conclusion is at odds with the political impetus in favor of the implementation of so-called structural reforms in France.

Key words: current account imbalances, distribution of income, financialisation, financial and economic crisis, France

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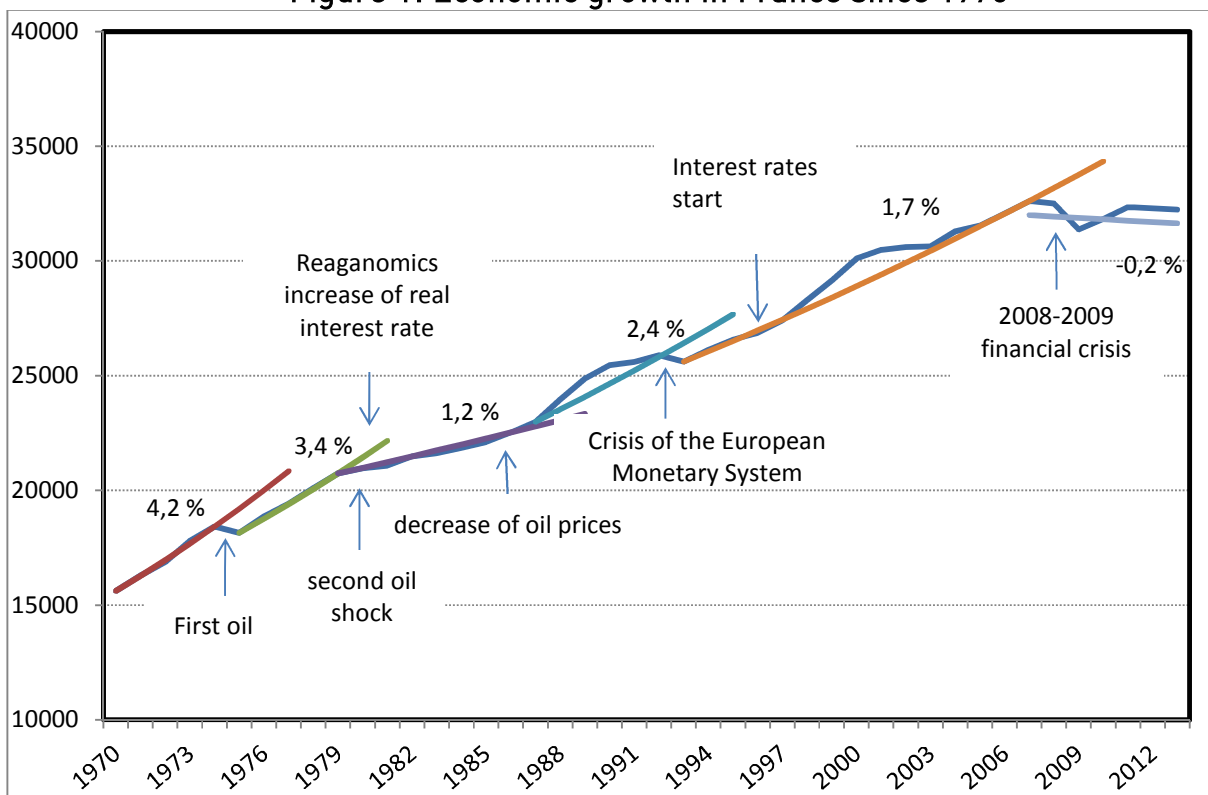
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1. Introduction

Over the past forty years the French economy, like other advanced economies, has experienced several downturns and accelerations of the growth process, but it is not possible to talk about actual endogenous cycles. Changes of the economic trend can be explained almost entirely by exogenous shocks, be they geopolitical, technological, banking or financial. The real economy has responded to these shocks in a very classical way and it is very difficult to identify structural malfunctions since 1990, or a weakening of the growth capacity of the economy in a stable environment.

Figure 1 outlines the different episodes that characterize the period 1970-2012.

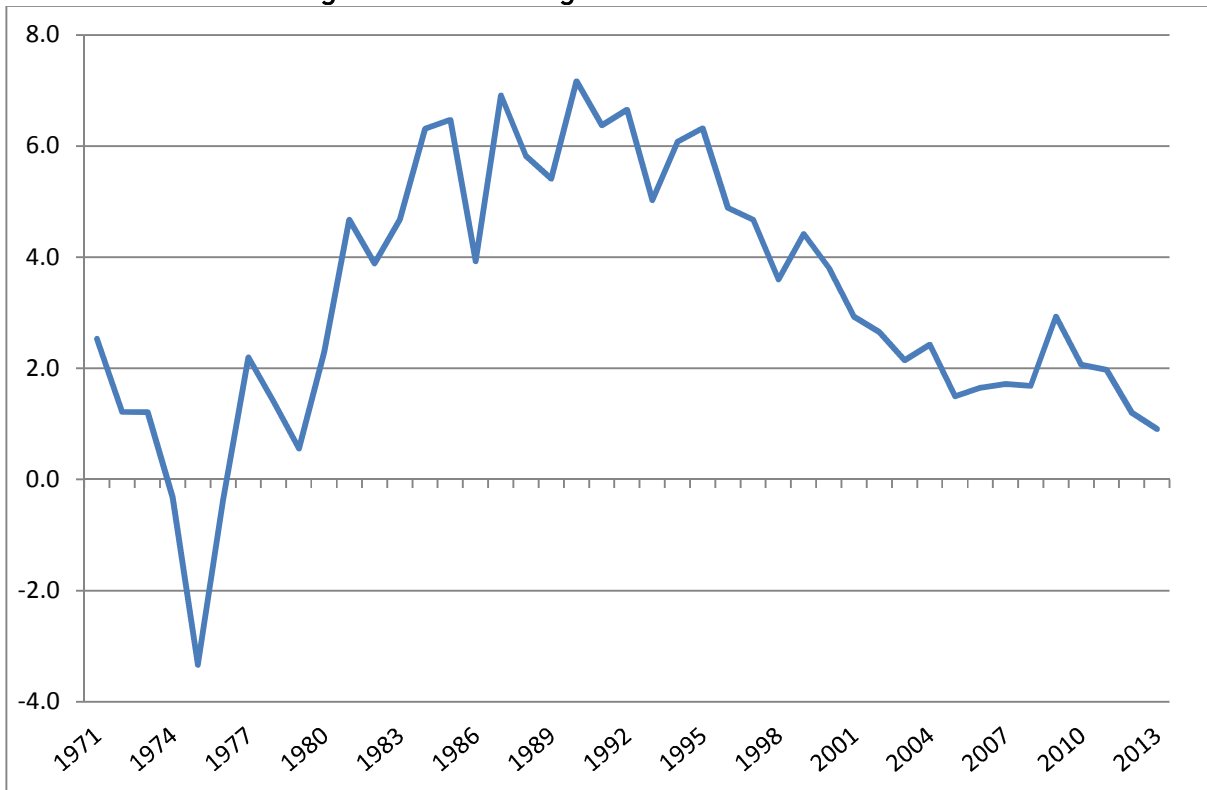
Figure 1: Economic growth in France since 1970



GNP per capita in € at 2010 prices; source: INSEE

In the early seventies, the rate of growth of the French economy was high. This period ended with the first oil shock of 1974 and especially the second one of 1980-81. The rise in oil prices was caused by the conflict in the Middle East, which had no connection with the structural functioning of the French and European economies. The time to adapt to the new situation in the energy sector was relatively long and the effects of the second shock were amplified by the "Reaganomics" and the sharp rise in real interest rates that accompanied it (figure 2).

Figure 2: Real long term interest rate in France

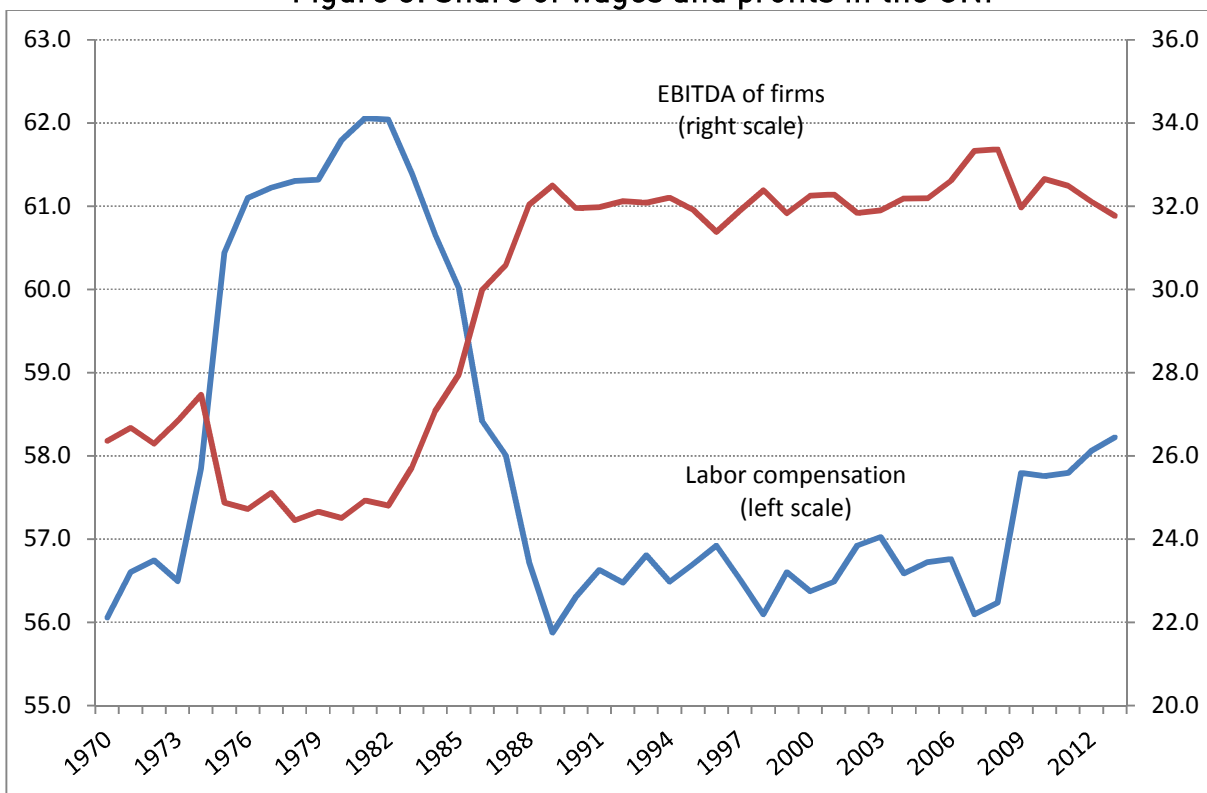


Source: OECD.

In the United States the shock of interest rates was offset by a fiscal policy very favorable to the economic growth. It combined tax cuts and a sharp rise in military spending. In contrast European fiscal policy did not offset the impact of higher rates so that in France the average growth in the years 1982 to 1987 fell to 1.2%. At that time the development of

speculation in financial markets and the constraints on the exchange rate forced the European governments and particularly the French government to align their monetary policies on that of the United States and on those of the most rigorous (inflation-averse) governments. These two shocks, on energy and monetary policy, are enough to explain the sharp drop in growth in the early eighties. However, the period was also characterized by the emergence of a significant imbalance in the distribution of income. The slower growth resulting from the oil shocks and interest rates, had not affected the rate of growth of wages as much as labor productivity which slowed down quite substantially. This resulted in a sharp increase in the share of labor compensation in GDP and a corresponding decrease in the mark up of firms (Figure 3).

Figure 3: Share of wages and profits in the GNP



Source: INSEE



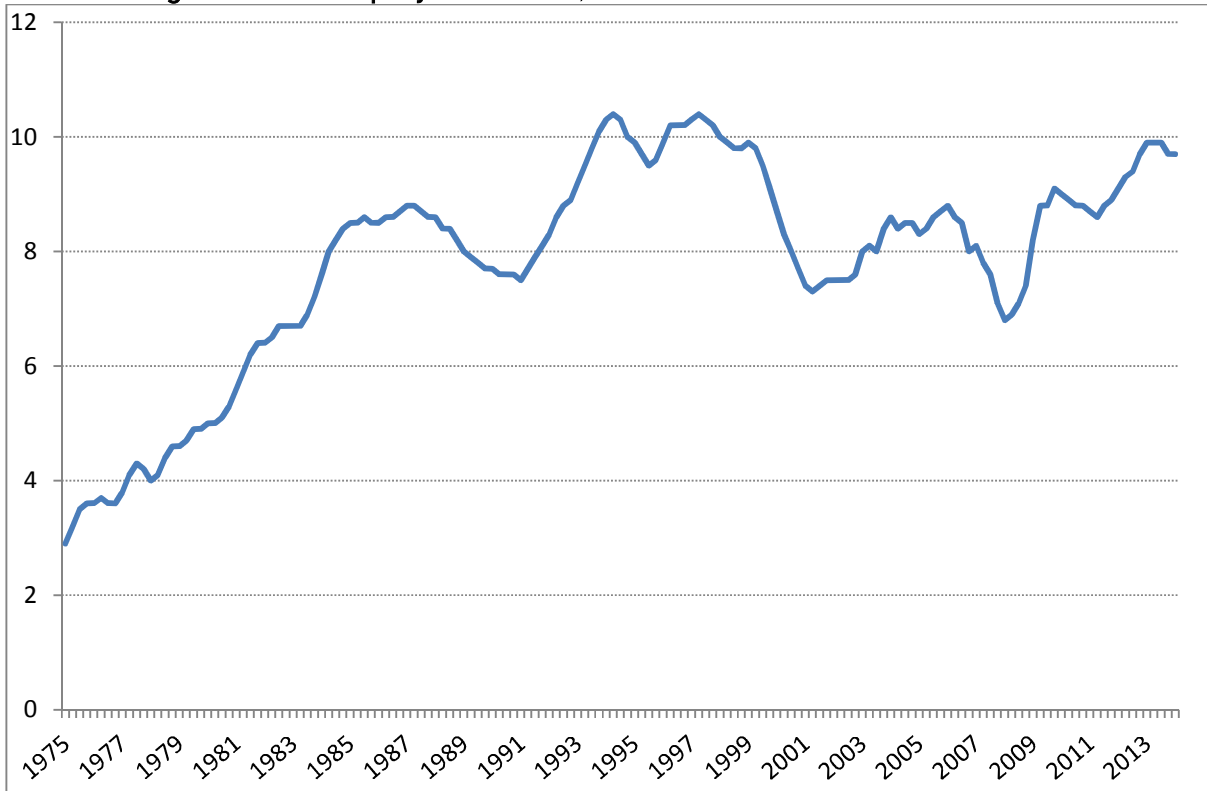
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The excess of wages during the late seventies resulted from the negative gap between the rate of growth of labor productivity and the rate of growth of real wages. This structural mismatch of income sharing has extended throughout the second half of the seventies, but the policy of wage restraint implemented in 1982, coupled with rising unemployment, brought back fast enough the wages at a level consistent with a balanced growth of the global supply and demand, i.e it enabled the return to a situation of equal rates of growth of productivity and real wage. It may be noted that the passage of the legal duration of work at 35 hours in 1997 was carried out under neutral conditions such that the sharing of income between wages and profits did not change.

Due to the demographic trend, France experienced a steady increase in its workforce. In the seventies the maintenance of very low unemployment rate would have meant a surge in growth and / or a collapse in labor productivity. The oil shocks and rising interest rates have complicated the situation and the unemployment rate rose from about 3% to about 9% in 1987 (Figure 4).

Figure 4: Unemployment rate, in % of the labor force (ILO definition)



Source: INSEE

Thereafter the unemployment rate has changed according to the business cycle: it decreased following recovery related to the decrease of oil price; it increased after the EMS crisis; decreased with the introduction of the 35-hour working week and the recovery of the 2000s. Then it was stabilized before it increased again after the financial shock of 2008-2009. In 2008, with an unemployment rate of 6.8%, France had almost returned to full employment without experiencing inflationary pressures. Since the middle of the eighties we can consider that unemployment is essentially of the Keynesian type. Econometric estimates on the evaluation of the French unemployment rate highlight the dominant role of demand in recent years (see section §2.2). One might thus raise doubts about analyses which focus on the functioning of the labor market and on its lack of flexibility to explain the high level of unemployment in France. Under situations of high economic growth, the French economy has been able to create jobs and to reduce



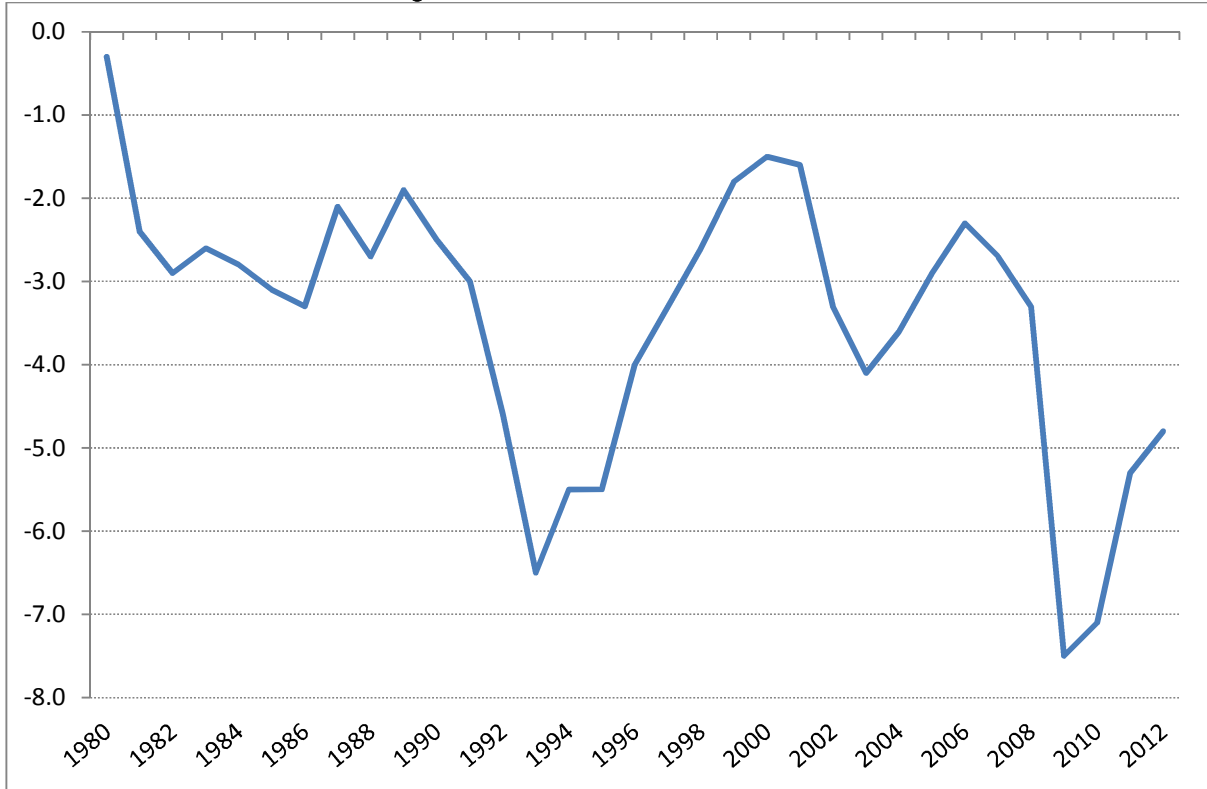
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unemployment without sharp consequences on the income sharing and without jeopardizing the increase in supply.

On the side of public finances, the impact of the business cycle is still the big event (Figure 5): the deficit was almost always below 3 points of GDP until 1991 (with a very small overshoot in 1985 and 1986) despite the sharp rise in real interest rates. It increased sharply under the effect of the economic crisis of 1993, but this was the consequence of accommodative fiscal policy in the pit of the crisis and it recovered rapidly over the following years. Similarly, the crisis of the 2000s was rapidly absorbed and the deficit fell within 3 points of GDP in 2006-2007. The financial crisis of 2008-2009 again caused the deficit to widen but because of the low level of interest and of the early implementation of austerity -oriented policy (too) quickly set up, it has rapidly shrunk. By 2012 it had been reduced by more than 2.5 percentage points of GDP, in line with the reduction in 1996, hence three years after the previous recession.

Figure 5: Public deficit, in % of GNP



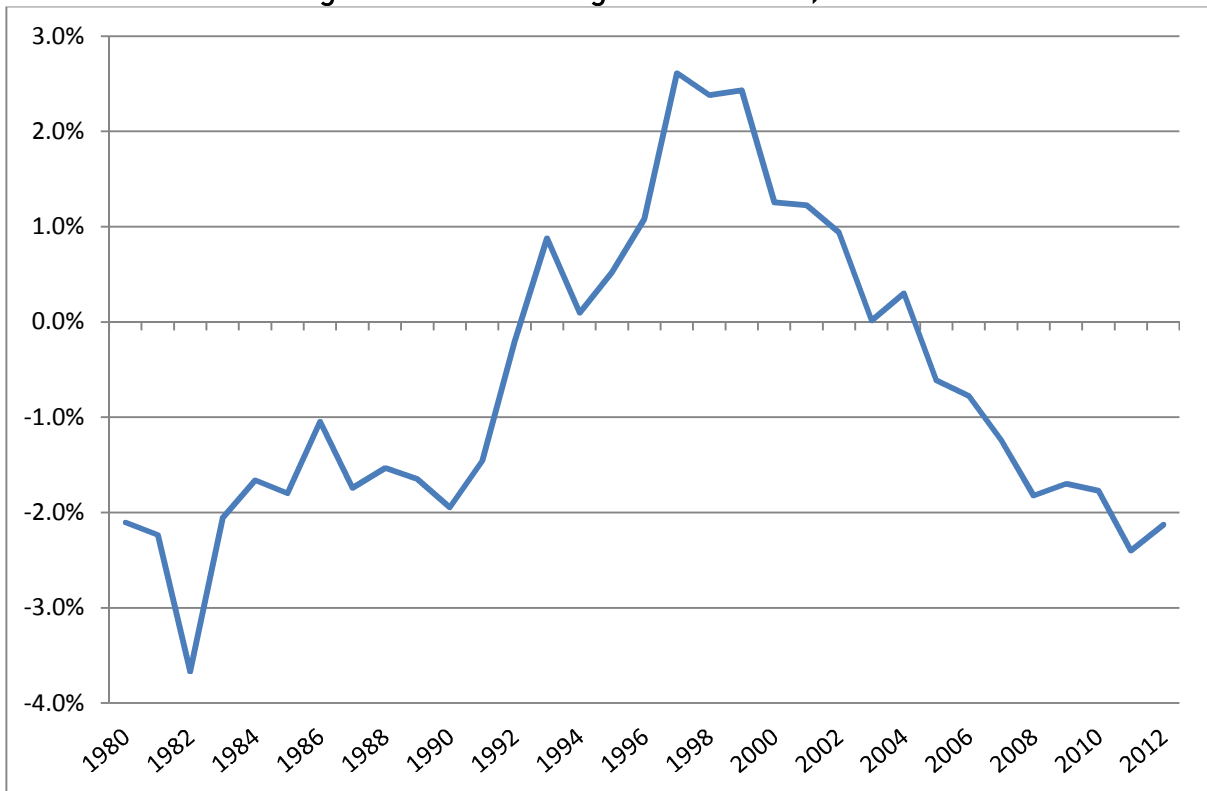
Source: Insee

Contrary to a popular belief, the public budget deficit in France is not structural. The causes of imbalances in the long run, which in particular were related to the effect of population aging on health care costs and retirement, were rather pretty well mastered. Pension reforms in particular – the latest one in 2010 - have helped to extend the duration of activity by delaying the effective exit age from the labor market. They thus improved the long-term sustainability of public social protection. The result in terms of public finances is even more remarkable that France has maintained a high birth rate which has continually required a high level of spending for families and for education.

It is ultimately on the side of external financial balance that the situation of the French economy appears to be permanently the most fragile. Figure 6 reports, in points of GDP, the current level of net lending of the nation. It shows that over the last thirty years the

French economy generated a surplus only during about ten years, between 1993 and 2004, but the current situation is not very different from that which prevailed in the second half of eighties.

Figure 6: Net lending of the Nation, in % of GNP



Source: Insee

As will be discussed later on, the classification of France in any category is generally very difficult when the time dimension is taken into consideration. Indeed, France has gone through different situations, from current account deficit to surplus, and from surplus to deficit, which prevent the application of a one-category-fits-all diagnosis. Nevertheless, drawing on the cyclicity of the French public deficit and the steady contribution of households' consumption to the GDP growth rate, a mild domestic demand-led economy

is certainly the best approach to describing the French economy and its connections with financialisation.

The rest of the paper is organized as follows. Section 1 reviews the long-run developments of France in the era of financialisation, and mentions the costs of the global financial crisis (GFC). Section 2 reviews the different channels of the financialisation of the French economy, via distribution, investment in capital stock, consumption and the current account. Section 3 deals with the GFC and its management by French public authorities. Section 4 concludes.

2. Long run development in the era of financialisation since the early 1980s and the economic and financial crisis

Since the early 1980s, a few developments have reshaped the financial and banking sector and, beyond, the overall financialisation of the French economy: globalisation, disintermediation and competition. At the very beginning of the 1980s, the French banking system was highly regulated, compartmentalized, not open internationally and uncompetitive. Moreover, the French financial markets were underdeveloped. The left-wing government led by François Mitterrand had to face two main challenges: (i) the need to open the financial system internationally, under the impetus of European and global integration and (ii) the crisis in the banking and financial system due to its inconsistent organization and poor profitability. It then undertook profound legal and regulatory changes which modified the banking and financial landscape (Creel, Labondance and Levasseur, 2014).

Indeed, France has gone through an extended process of globalisation, in line with its integration with EU countries. French universal banks have grown extensively, the French stock and financial markets have opened up to foreign capital, and large French multinational companies have grown massively. The French banking and financial system



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is certainly no exception to these trends at work throughout the European Union, though it is worth recalling that the French State has long tried to limit the incidence of globalisation on the nature of French capitalism via cross-shareholdings (Goyer, 2001) or to delay the establishment of the Single market (Grossman and Leblond, 2011).

France is among the countries which have been financialised early. In the 1980s, the French economy has opened its capital markets to foreign capital while French companies were starting expanding abroad. Under the “Franc fort” policy, a commitment to stabilize the value of the French Franc vis-à-vis the German Mark within the European Monetary System, France escaped the issue of foreign-currency denominated external debt: France was able to issue its own public debt in French francs because its commitment was felt to be credible. Since 1999, the adoption of the euro has not changed the currency denomination of the French public debt: it is entirely issued in domestic currency, hence euros.

The opening of the French banking and financial system began in late 1980s, with the dismantling of foreign exchange controls in 1989 and the removal of almost all administrative barriers to foreign entry in the banking sector. Moreover, the French stock exchange watchdog (i.e. Commission des Opérations de Bourse or COB) saw its power and independence strengthened, which enhanced its credibility and therefore the attractiveness of Paris in the eyes of international investors. In a context of higher competitive pressures, a first wave of banking concentration then occurred in 1991/1992 to generate productivity gains and to streamline both structures and activities. Later, the internationalization of French banks gained momentum with the adoption of the Euro. That was conducive to a second wave of concentration, in particular in the field of investment banking. The increase in the size of potential market caused a search for an optimal size and economies of scale. Yet, that was favored by the modernization and liberalization of capital movements, associated with the deregulation of banking and financial activities, in a context of more harmonized regulatory and prudential standards. The result was an

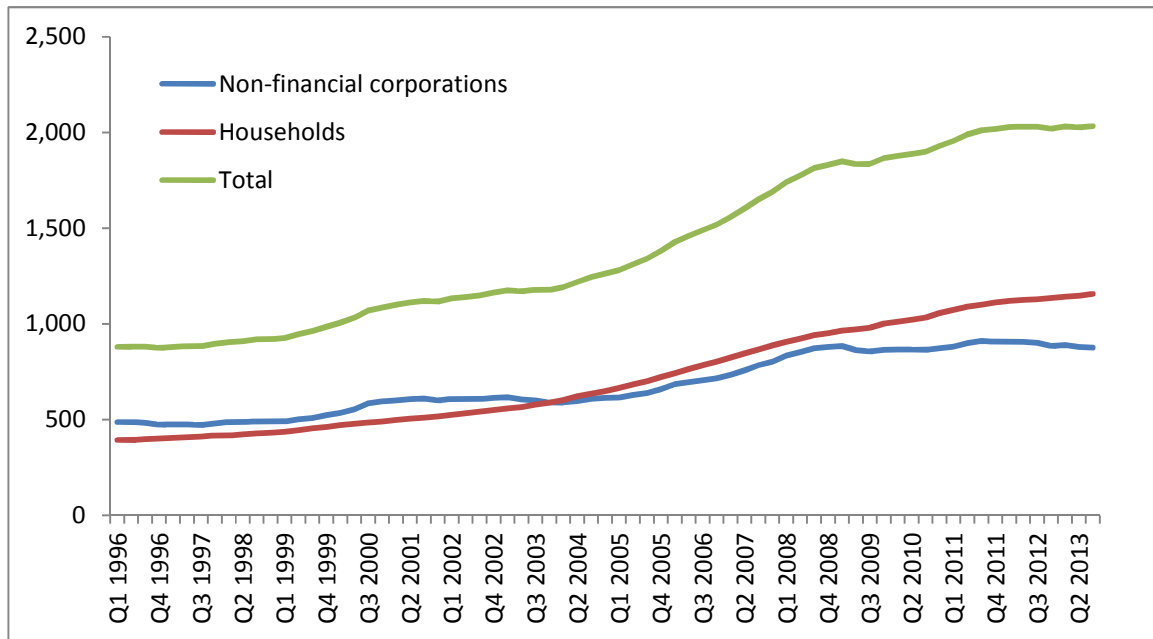
intensification of international competition on the French market, leading the country's banks to diversify into other regions and into the major foreign financial centers.

The French banking sector has thus experienced a contrasted evolution in its competition level. France has had a low concentrated banking sector in the 1990s as regards the Netherlands or Norway for instance but a relatively highly concentrated one as regards Germany. In fact, the deregulation and disintermediation processes cut the French banking sector in two sub-sectors: investment banking in which competition is quite low but concentration high (five major groups), and retail banking in which competition is quite harsh but concentration low.

Two other important trend towards internationalization (or at least Europeanization) of the French financial system have to be mentioned: the participation to mergers and clustering of European stock markets (leading notably to the creation of Euronext) and the adhesion to the 'wholesale' payment system TARGET2 which enables transactions to be settled in real time using central bank money all over the Euro area.

The disintermediation process in the French financial system has been relatively mild, in comparison with other Western countries: the amounts of credit to households and non-financial corporations have kept on increasing until the early 2010s (figure 7), despite the surge in stock and bond markets capitalization. The reliance on loans by non-financial corporate firms has remained high (figure 8). One reason behind the mild disintermediation process lies in the surge of market-related activities by banks themselves. Moreover, the development of a French shadow banking sector, although it has been mostly active abroad (this issue is dealt with in Blot et al., 2013), also testifies for the influence of French banks on the financialisation of the French economy.

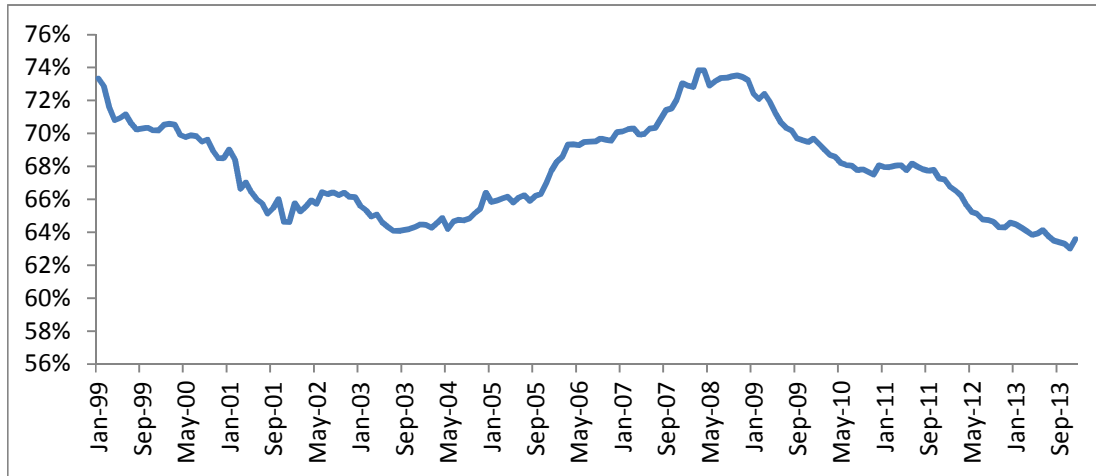
Figure 7: Loans to private sector (outstanding, in € billions)



Source: Banque de France

In this banking and financial environment, financialisation has affected French daily lives in an equivocal way. The French have a strong preference for credit cards, which are a pure product of financialisation of the French banking system. However, they retain a certain caution against new risks that arise from these changes: consumer credits and cash loans are mildly developed, and most public services are still under the aegis of the State. Above all, legislation against financial exclusion and the struggle against over-indebtedness are quite advanced and solidarity seems to be still deeply rooted in the French financial culture through microcredit and solidarity savings. This diagnosis should not be viewed as downsizing the consequences of financialisation on individual behaviors, but it should be kept in mind that despite financialisation, French public authorities implement collective actions to try to curb over-indebtedness and unequal access to banking services.

Figure 8: Intermediation rate of non-financial corporates
 (Share of banking loans in total debt of non-financial corporates, in %)



Source: Banque de France

A common feature of financialisation has been the constitution of real estate bubbles and the risk of their bust which jeopardizes the solvency of households and/or limits their purchasing power. The current situation of the French real estate market, though prices have grown substantially since the 1980s, appears by no way critical, implying no sign of bust. Consequently, the risks – for the banks – coming directly from the real estate sector seem quite limited. The real estate market in France is sustained by intrinsic forces, in particular a strong demographic growth which fuels demand for homes. If the attractiveness of main large cities or regions continues in the future (in first instance, in Paris for young workers and in the south of France for young retirees), a large fall in real estate prices cannot be reasonably expected. It remains that the French authorities of regulation and supervision have recommended that banks continue to follow prudent and safe rules when providing credit to households, though. Indeed, issues on the real estate market may arise indirectly. If weaknesses in the competitiveness of French firms were to persist, the resulting job and income losses would have harmful consequences on the real estate market as some (over)-indebted households might face difficulties to honor their



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reimbursements. The impact on banks and on the stability of banking sector could then materialize.

The analysis of the French interest rate pass-through (Hubert and Viennot, 2013) has shown that it was quite high and significant for money market rates, government debt rates and lending rates to non-financial corporations and that it has almost doubled since the crisis. The bank lending channel appears to be far less important than the interest rate channel but still significant for loan supply to households. This supply has experienced a drop since the crisis. If the interest rate channel is largely effective, the bank lending channel seems not to be: the banks have indeed lowered their rates in the aftermath of a drop in the ECB rate but do not have increased their loan supply so far. This conclusion supports the hypothesis that banks have recently reconstituted their capital ratio while limiting access to credit.

Finally, it is worth recalling that the French economy has been strongly hit by the financial turmoil that followed the subprime crisis and the collapse of Lehman Brothers. Five years after the technical end of the recession, the GDP has still not recovered its pre-crisis level and massive unemployment has not been curtailed. Since 2008, the deterioration of the financial environment and the resulting impact on the real economy have severely tested the strength of the French financial system. The financial turmoil arising from the subprime crisis and from its spread to all segments of the financial market made for a more difficult operating environment for the banks, which also faced a generalized crisis of confidence. The failure of Lehman Brothers overseas was both a direct consequence of these developments and the cause of a sharp aggravation in the drying up of liquidity in the interbank market, which was symptomatic of a crisis of confidence that was relieved only by the interventions of the central banks. The financial crisis primarily affected the finance and investment banks through losses on their assets and increases in refinancing costs. The French banks that made public the amount of their risk on investment banking and asset management had an exposure of 1.3 billion euros (see the report of the Commission



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bancaire, 2009). However, these direct effects of the financial crisis were compounded by the impact of the ensuing economic crisis, which caused a contraction in income from retail banking in particular as well as a loss in the quality of loans to indebted businesses.

Examining the sectoral financial balances of the main sectors of the economy (households, financial and non-financial corporate firms, government and the external sector), one can try to identify the long-run development of the French economy (see Hein, 2012, for a classification). Before we turn to the composition of GDP between its different contributions over a long time horizon (see section 3 and, notably, figure 34), we can draw on growth contributions during the crisis (table 1). The conclusions are fully consistent with the pre-crisis analysis. Indeed, France lies between a domestic demand-led economy and a weak export-led economy. On average between 2009 and 2014, the GDP and imports growth rates have been explained by households' and government's consumption, on the one hand, and by exports, on the other hand. The former part amounts to a domestic-related contribution to growth, whereas the latter is a foreign-related contribution. It is noteworthy that periods of recent high growth, between 2009Q4 and 2012Q1, were explained by high contributions of households' consumption (until 2011Q1) and exports. Although the contribution of exports was offset by high contributions of imports, it must be acknowledged that the latter contribution faltered earlier (2011Q1) than exports'. It may be that imports entered exports as intermediate products and thus permitted a development in the contribution of exports to GDP growth in France.

Table 1. GDP growth contributions of the main demand aggregates

	GDP	Imports (-)	Consumption expenditures by:			Investment expenditures by:				Changes in inventory (*)	Exports	
			Households	Public sector	Total	Non financial firms	Financial firms	Public sector	Households			Total
2009Q1	-1,8	-2,6	-0,4	0,2	-0,3	-0,8	0,0	0,1	-0,3	-1,0	-0,9	-2,3
2009Q2	-0,5	-0,8	-0,1	0,3	0,2	-0,4	0,0	0,1	-0,2	-0,6	-0,7	-0,2
2009Q3	0,0	0,0	-0,2	0,2	0,1	0,0	0,0	0,0	-0,1	-0,1	0,1	0,0
2009Q4	1,1	1,2	0,7	0,3	0,9	0,1	0,0	0,1	0,0	0,2	0,8	0,4
2010Q1	0,8	0,7	0,6	0,1	0,6	0,1	0,0	-0,1	0,1	0,1	-0,4	1,1
2010Q2	1,1	1,4	0,3	0,1	0,5	0,4	0,0	0,0	0,1	0,6	0,4	1,1
2010Q3	1,0	1,0	0,4	0,1	0,6	0,2	0,0	0,0	0,1	0,4	0,5	0,5
2010Q4	0,7	0,6	0,6	0,1	0,7	0,2	0,0	0,0	0,1	0,2	-0,4	0,7
2011Q1	1,3	2,1	0,6	0,2	0,8	0,3	0,1	-0,1	0,1	0,3	1,2	1,0
2011Q2	0,1	0,0	-0,5	0,1	-0,4	0,0	0,0	0,0	0,0	0,0	-0,1	0,5
2011Q3	0,5	0,1	0,3	0,1	0,4	0,0	0,0	0,0	0,0	0,1	-0,1	0,1
2011Q4	0,6	-0,2	0,1	0,1	0,2	0,3	0,0	0,0	0,0	0,3	-0,7	0,5
2012Q1	0,6	0,3	0,6	0,2	0,7	0,0	0,0	0,1	0,0	0,1	0,0	0,0
2012Q2	0,0	0,2	-0,3	0,1	-0,1	0,0	0,0	0,0	0,0	0,1	0,2	0,0
2012Q3	0,6	-0,1	0,1	0,2	0,3	0,0	0,0	0,0	-0,1	0,0	0,0	0,3
2012Q4	0,0	-0,3	0,1	0,1	0,2	-0,1	0,0	0,0	-0,1	-0,1	-0,4	-0,1
2013Q1	0,3	0,0	0,3	0,2	0,4	0,0	0,0	0,0	0,0	0,0	-0,2	0,0
2013Q2	0,7	0,4	0,1	0,2	0,3	0,0	0,0	0,0	0,0	0,0	0,1	0,7
2013Q3	-0,1	0,2	0,0	0,1	0,1	0,0	0,0	0,0	-0,1	-0,1	0,3	-0,2
2013Q4	0,4	-0,1	0,2	0,1	0,3	0,1	0,0	0,0	-0,1	0,0	-0,3	0,3
2014Q1	0,5	-0,1	-0,1	0,1	0,0	-0,1	0,0	0,0	-0,1	-0,2	0,5	0,1
2014Q2	0,0	0,1	0,2	0,1	0,3	-0,1	0,0	0,0	-0,1	-0,3	0,0	0,0
Average	0,4	0,2	0,2	0,1	0,3	0,0	0,0	0,0	0,0	0,0	0,0	0,2

Source: INSEE

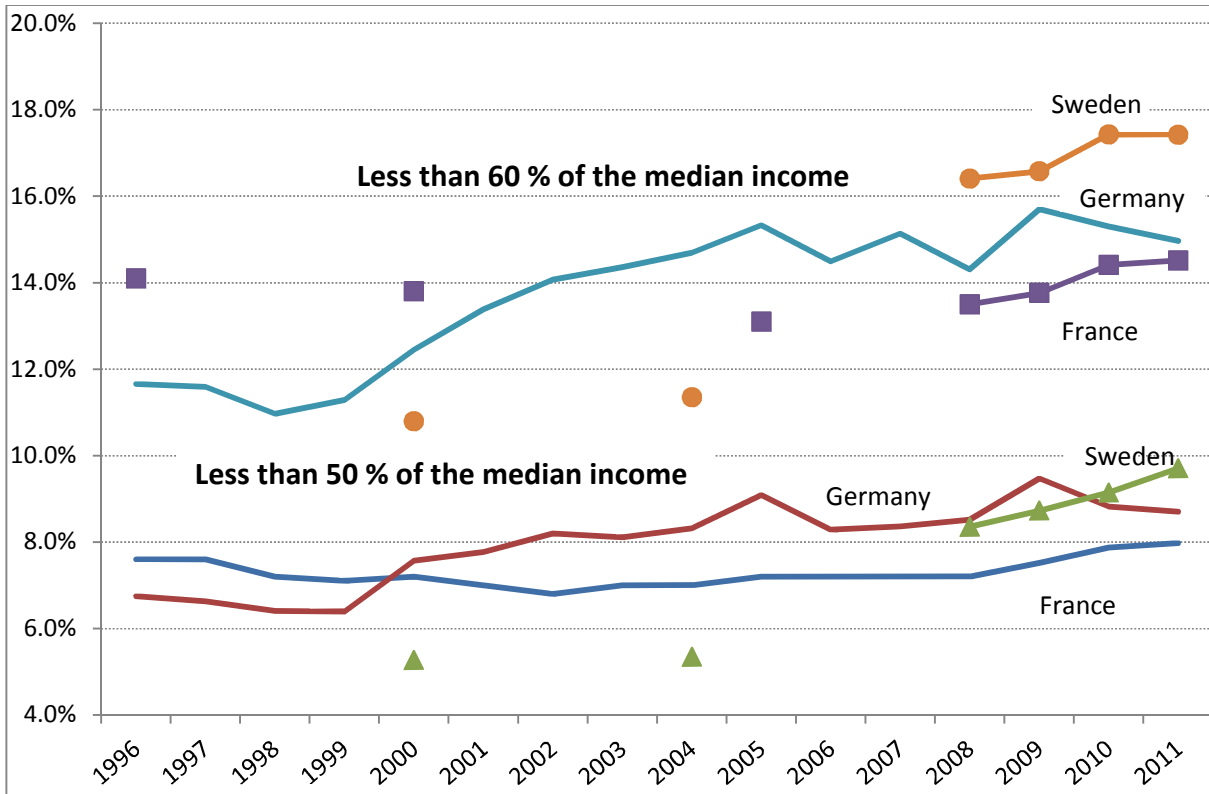
3. Growth in France since 1980

3.1. Income distribution

Like many countries France has experienced an increase in inequalities in income and wealth. However, this trend has been much less pronounced than in most comparable countries primarily because of public income support to the poorest. And moreover, it is difficult to link the evolution of inequality with the financialisation of the economy. The major changes are due to the evolution of the primary distribution of wages and recently to the increase in land prices.

Figure 9 shows the change in the poverty rate for France, Germany and Sweden. Sweden is a very interesting benchmark as it has long been the model of the more equal distribution of income in developed countries. But the 2000s marked a clear break and the poverty rate in the country, was increased from 5.3% (measured at the 50% of median income) in 2004 to 8.4% in 2008. The gap with poverty rate in France, which was 2 points in favor of Sweden is now 2 points in favor of France.

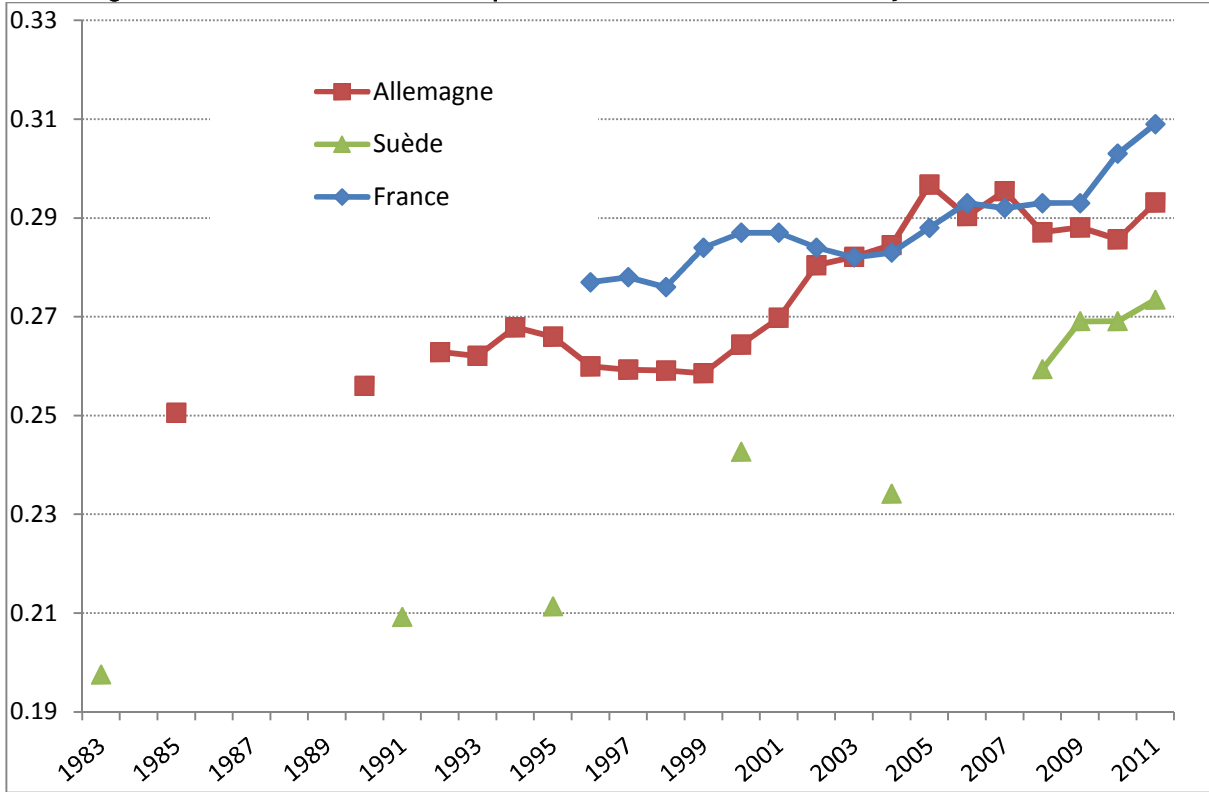
Figure 9: Poverty rates (taxes and social benefit included) in Germany, France and Sweden



Source: OECD

Measured with a threshold of 60% of median income (top of figure 9) , poverty rates are changing in the same way whatever the country, but whereas France was in terms of this criterion the worst country among the three examined here in 1996, it is the opposite in 2011. However the (small) difference with Germany is probably not significant. It remains that, measured by the Gini index (Figure 10), the comparison is less favorable to France.

Figure 10: Gini index for disposable income in Germany, France and Sweden

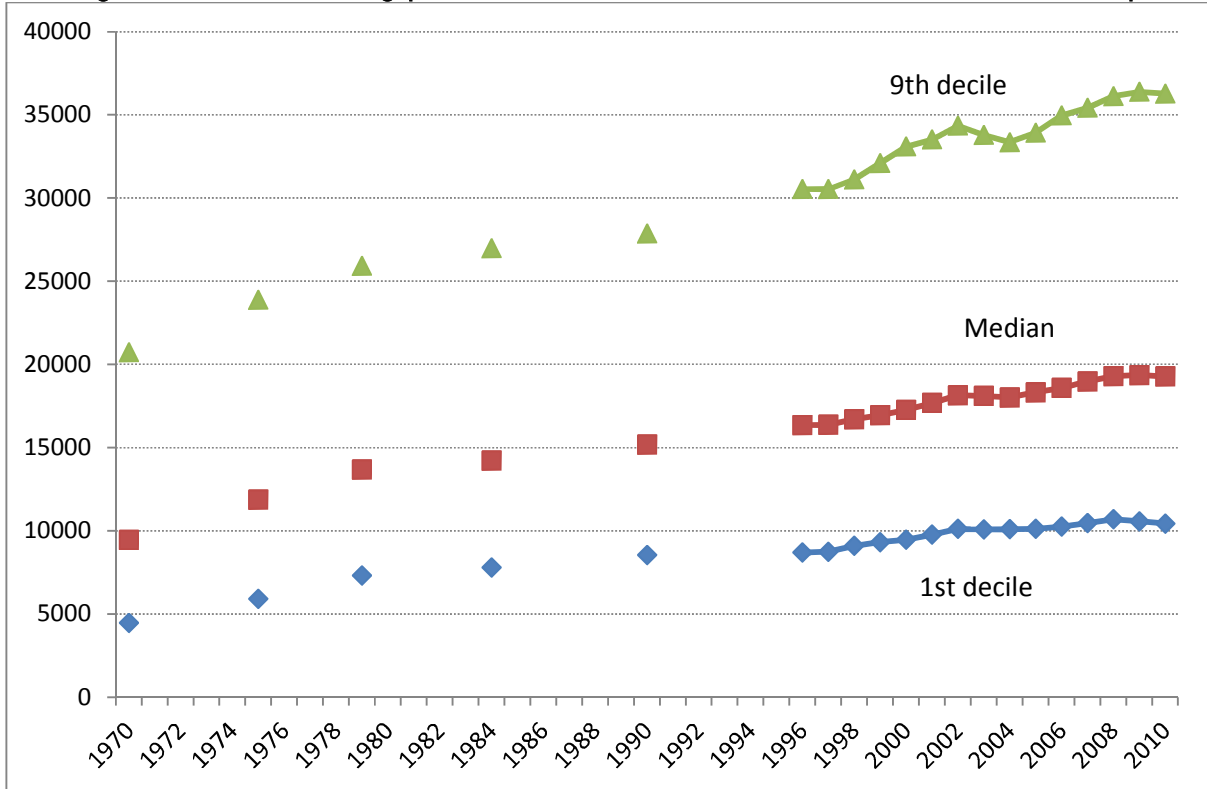


Source: OECD

Indeed, in 2011 the overall level of inequality was still higher in France than in Germany and Sweden. But the trend towards more inequality is less pronounced. Sweden in particular has seen an explosion of inequalities that cannot be found in France.

If inequality has increased much less in France than in other countries, it is mainly due to the continued growth of the incomes of the least-favored, as shown by the changes in the purchasing power of individuals in the first decile (figure 11).

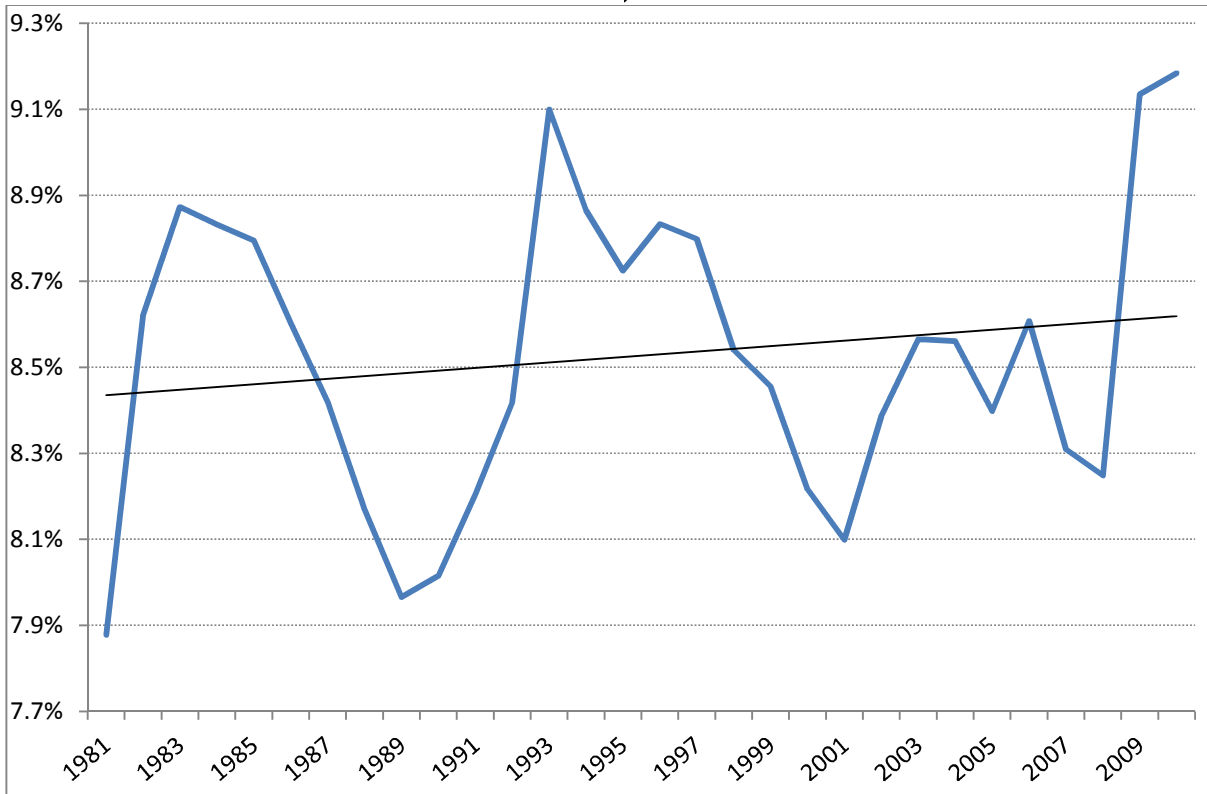
Figure 11: Purchasing power of individuals in France (in Euros at 2010 prices)



Source : INSEE

The increase in high income has been higher than the one of the median, but for the very low income it has been almost identical to that of the median. The overall inequality has therefore increased, mainly due to the faster growth of high incomes, but without increasing poverty. One must of course acknowledge the effect of social protection which avoids skidding low incomes. Figure 12 shows the evolution of the share of social benefits to support income (i.e. housing allowance + benefits for families + unemployment benefit and minimum income + various benefits, excluding pensions and reimbursement of health insurance). Since the 1980s the effort in favor of the less fortunate is on a slightly increasing trend, and it is clear that such benefits have played a counter-cyclical role, with a strong increase in the share of transfer income during crises in 1982-83, 1993 and 2008-2009.

Figure 12: Share of social benefits which support income in % of total disposable income, and trend



Sources: Insee, Drees; computed by the authors.

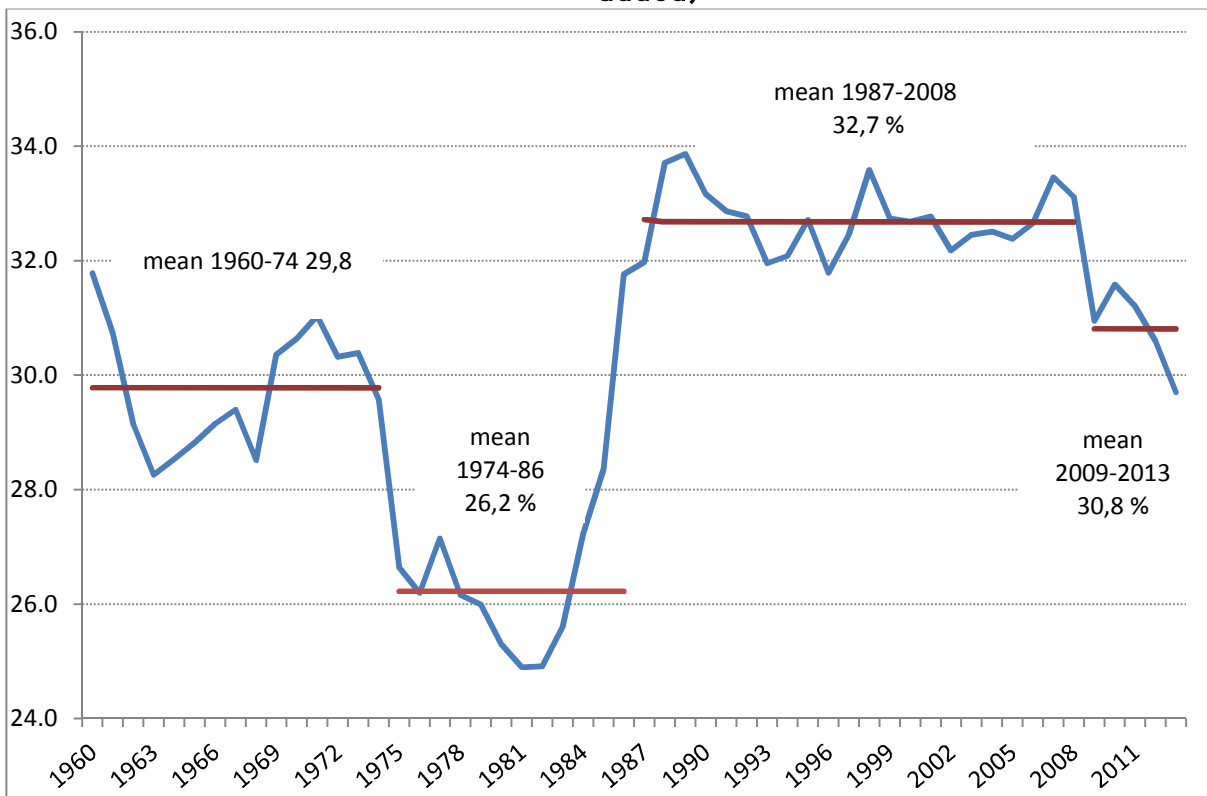
But at the end of the period since the 2009 crisis, there has been a huge unfavorable change in low incomes and rise in poverty despite the continued focus of social protection. Wage deflation and fiscal austerity could probably, if they last, reduce the effectiveness of social stabilization linked to social protection that has characterized the evolution of income distribution in France for thirty years.

2.2. Corporate income, productive investments and their financing

The corporate investment efforts typically depend on expectations of demand and financial conditions. Financial terms reflect both funding constraints and profitability. Since the mid-1980s it is difficult to highlight the constraints on the profitability of productive investment. After the first oil shock, the drift of revenue sharing between wages and profit

had weighed heavily on the profitability of investments. However, this drift was contained in the early 1980s and the level of corporate profitability returned to “normal” (i.e. pre-oil-price-shocks) levels by 1987 (Figure 13).

Figure 13: Profit share for non-financial firms (gross operating surplus / value added)

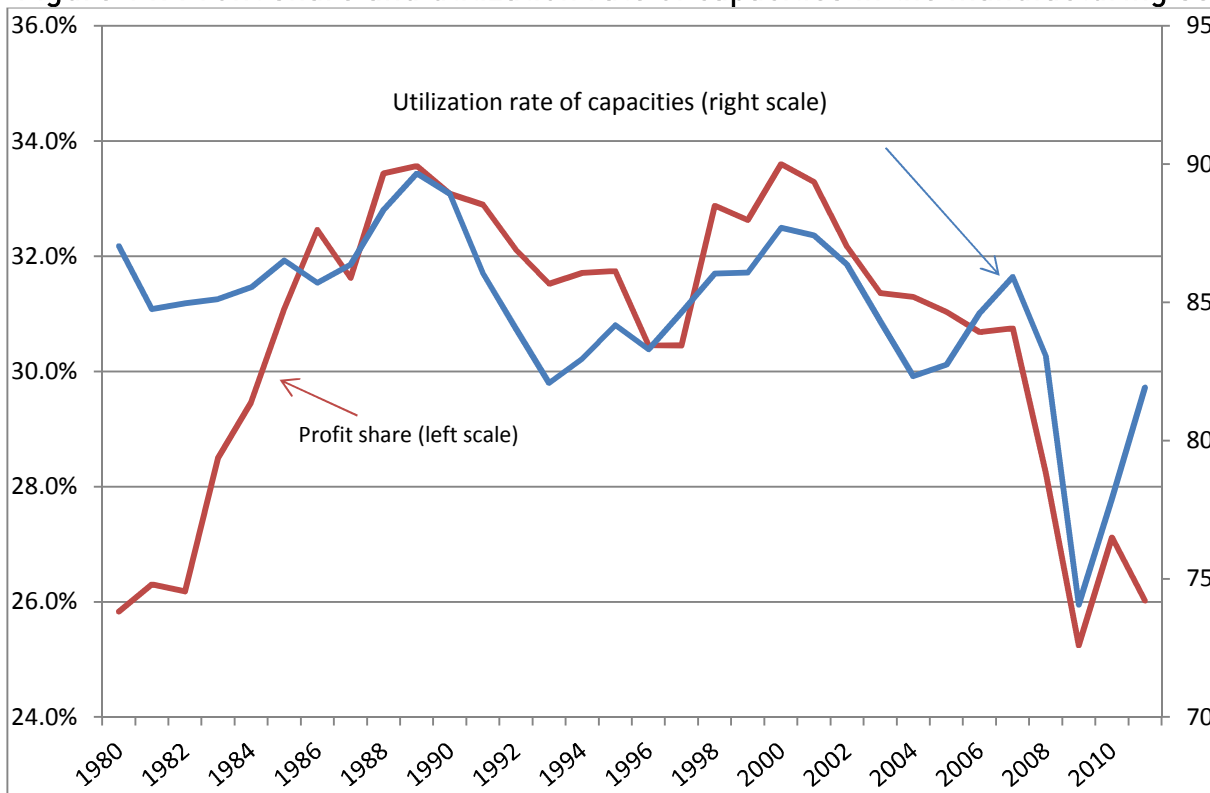


Source: Insee

The 2009 crisis has reduced corporate mark ups, but it has preserved for the whole economy, on a historical basis, a relatively satisfactory level as the share of gross operating surplus in value added remains higher by one percentage point than the average level of the sixties. The crises of the 1990s and 2000s have never cut corporate profitability as did the first oil shock. The idea of a structural deterioration in profitability is therefore not confirmed by macroeconomic data.

This idea is even less founded when one relates profitability and growth and shows that both are moving in the same direction. This is particularly the case in the manufacturing sector where, since the mid-1980s, the mark up of firms evolves almost similarly to the rate of utilization of production capacity (Figure 14).

Figure 14: Profit share and utilization rate of capacities in the manufacturing sector.



Source: Insee.

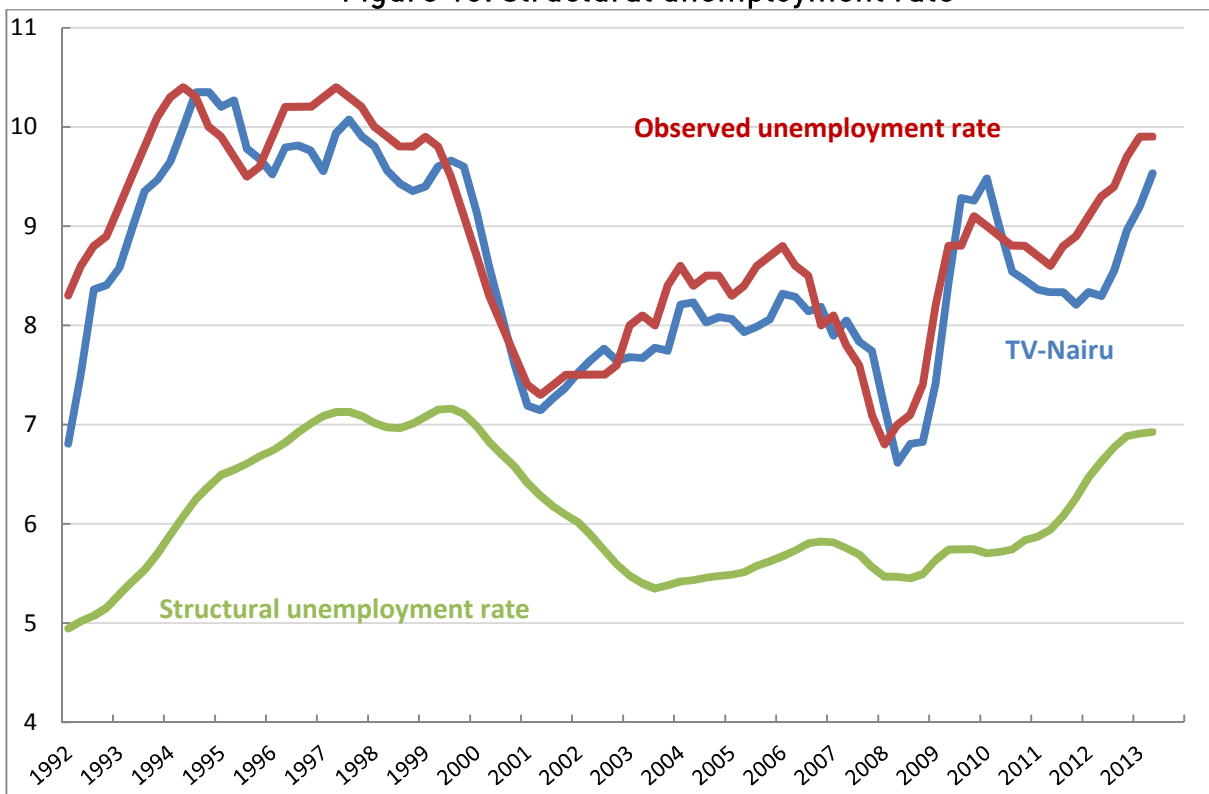
The graphs on figure 14 confirm that the first half of the 1980s has been characterized by a structural imbalance linked to a share of overall income too favorable to wages. But from 1984-1985, we can consider that this mismatch has been corrected. Since then, the mark up rate of industrial firms has been changing, as can normally be expected, depending on the economic situation. The depth of the crisis of 2009 has certainly reduced the mark up in the manufacturing sector to the level of 1980, which is of great concern, but it is difficult to speak of a new structural imbalance. It is the lack of growth which is clearly the cause

of the fall in profitability. As the causal chain that goes from the financial turmoil in the world economy during the late 2000s to the crisis in the real economy at the beginning of the 2010s is well established, there is no reason to reverse this causality to make low mark-up levels in the current period be the cause of the crisis and stagnation in progress. Conversely, if appropriate macroeconomic policies were able to retrieve a more satisfactory growth process, the profitability of firms would soon return to a “normal” level.

Econometric analyses of the structural rate of unemployment in the French economy also suggest that a dynamic process should be set up quickly in the event of renewed growth. It would reduce the unemployment rate to a level of about 7%. Usually the estimation of the NAIRU rests on a reduced form of the system of codetermination of wages and prices. From a theoretical point of view, under the hypothesis of perfect indexation between wages and prices, the rate of unemployment cannot be reduced, in the long term, under the level of the NAIRU which is determined by the rate of growth of the labor productivity and by structural factors related to the functioning of the labor market (level of minimum wages, employment rigidities, etc.). If it happens that a shock pushes the unemployment rate below the NAIRU, the inflation rate is accelerating due to the loop between prices and wages. Finally as a consequence of increasing inflation, employment decreases and the rate of employment return to its “natural” level. The modern estimation of the NAIRU often led to an estimate close to the observed unemployment rate. Heyer and Timbeau (2002) showed that a more comprehensive estimation could be obtained by an econometric method which includes an explicit equation for the structural unemployment rate. They tested many variables for explaining the structural unemployment rate, and found that interest rate, growth of productivity and minimum wage play a significant role. This method was also used by Heyer, Reynès and Sterdyniak (2007) to estimate the structural unemployment rate in France and in the USA. The e-mod model of French economy developed at OFCE includes an estimate of the structural level of unemployment rate

derived from the same model of wages determination. The result of the econometric estimation of structural unemployment rate and time-varying NAIRU is reported on figure 15. As noted above the TV-NAIRU is close to the observed unemployment rate. This means that a decrease of unemployment from the observed level to a low one implies an increase of inflation. But in the long run this increase is limited and the unemployment rate can decrease without permanent acceleration of inflation to a level near 7 %.

Figure 15: structural unemployment rate



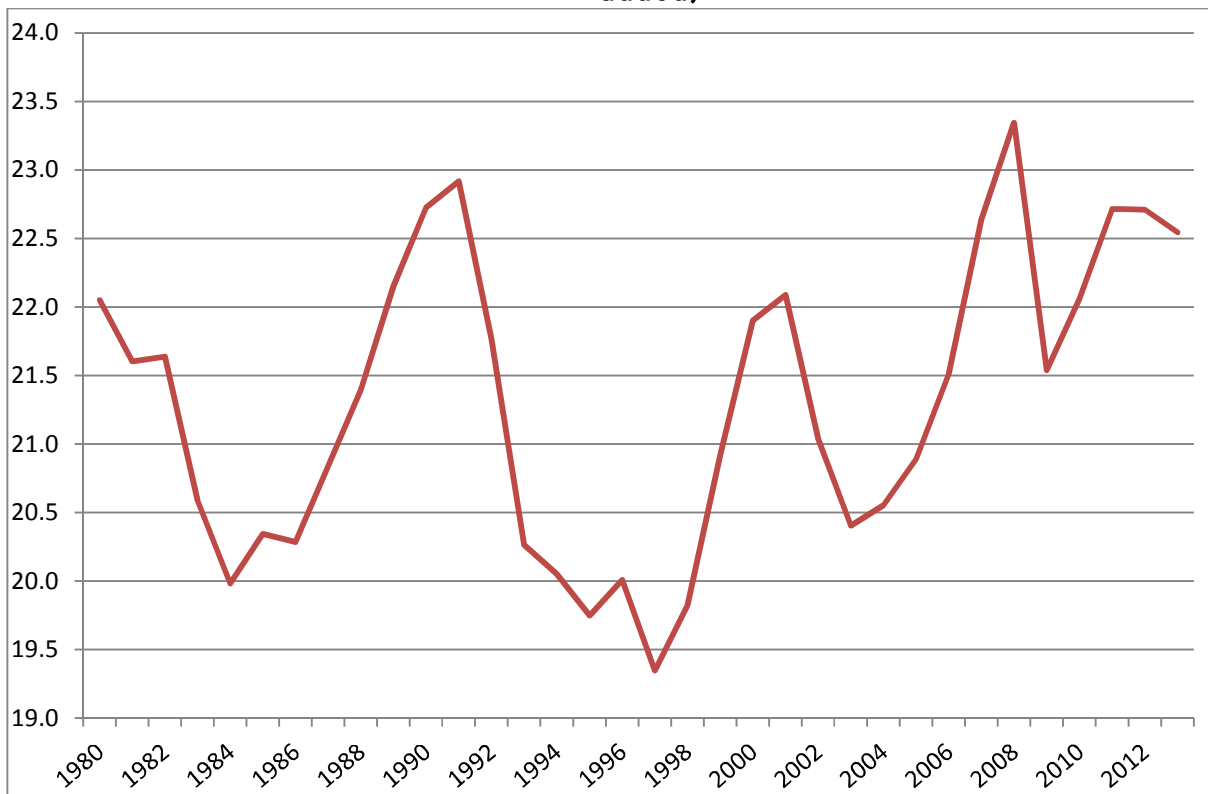
Source: OFCE; e-mod model.

This is far from the situation prevailing in the 1980s when wages grew faster than trend in labor productivity while oil crises brought down the sustainable growth potential of the economy.

So there is no structural obstacle to growth on the side of the labor market. But the recovery of growth implies also that economy renews along with the accumulation of productive capital. Once again it does not appear that there is a structural problem and the

investment rate follows quite closely the economic cycle without noticeable impairments (figure 16).

Figure 16: Investment rate of non-financial firms (Gross investment / gross value added)



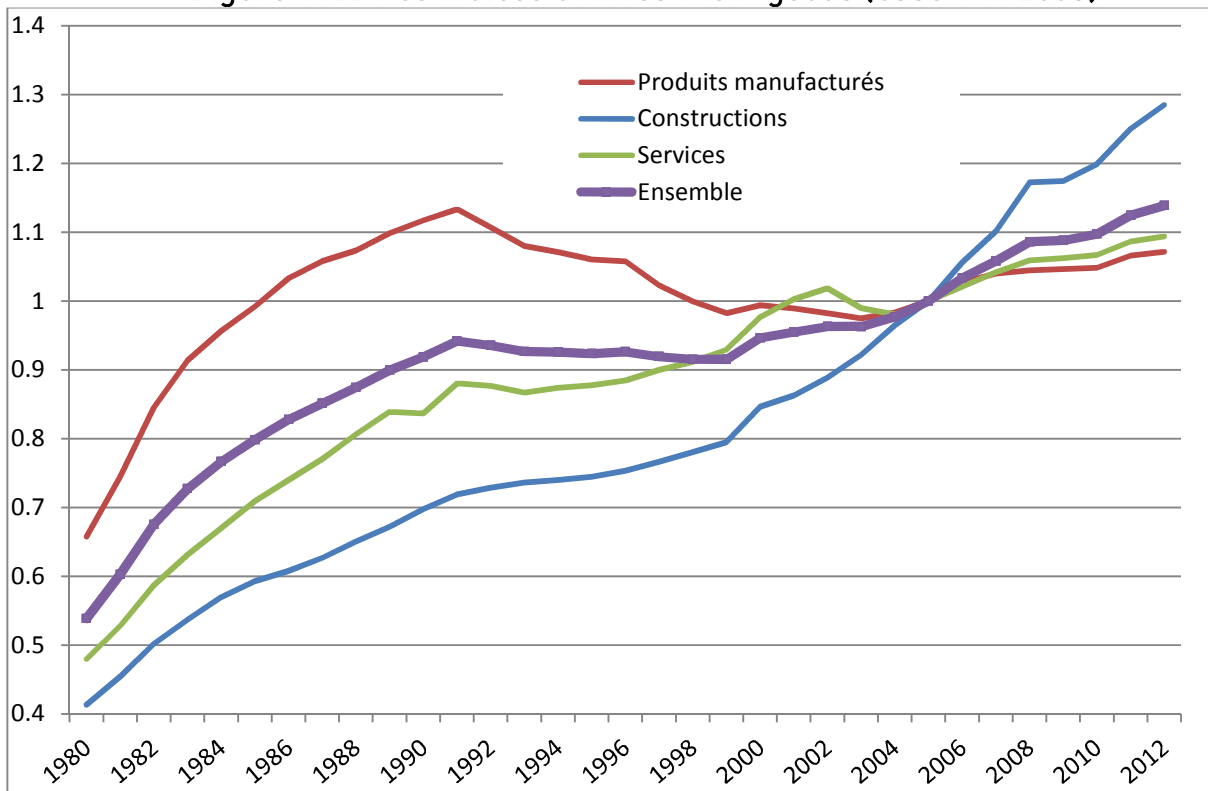
Source: Insee

Private investment rate is particularly high since 2010 even under the low growth rate and negative expectations on its evolution.

We can nuance this observation by taking into account that the structure of the investment was distorted and that the relative prices of capital goods showed different evolutions. The share of services in investment, which was only 10% of the total in 1980 is now 27%. The share of industrial products fell from 49 to 42%, in proportions similar to that of construction which passed from 39 to 31%. This change in the allocation of investment

between services and the industry is certainly consistent with the financialisation of the French economy: the growing importance of services to firms, including banking and financial services, modified the structure of investment. The prices of the different investment goods experienced at the same time very different evolutions (Figure 17).

Figure 17: Price indices of investment goods (base 1 in 2005).



Source: Insee

The prices of goods used for investment, which was increasing until 1991, decreased until 2004, then increased smoothly again. The price of construction was on an increasing continuous trend with an acceleration since 1999. Despite this acceleration, we will discuss the fact later that France has not experienced a real estate bubble. The prices of services used for investment increased regularly. Finally the prices of investment have increased quickly during the eighties then were stabilized during the nineties and increased anew since 2000. The increases of investment rate during recent years

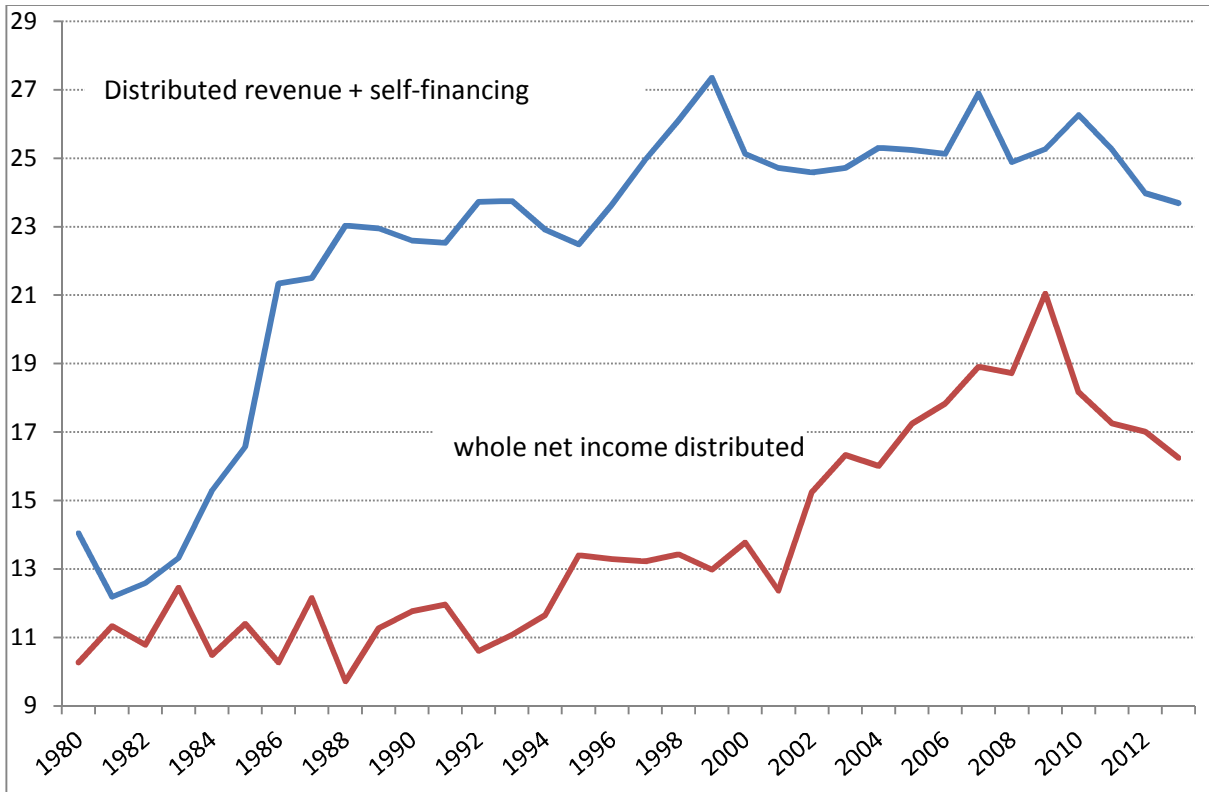
correspond, for a part, to the increase in the relative price of capital which could justify an increase in the financial resources of the firms.

About the financial situation of French companies two facts clearly appear:

- From 1985-1986, the rebalancing of income sharing between capital and labor has helped to restore the financial situation of the firms that has never deteriorated to the level of what happened after the oil shocks. Even during the current crisis the income distributed or invested accounted for a stable share of value added.
- Rebalancing which occurred in the early 1980s was virtuous, investment financing having initially been given preference over the distribution of dividends. Since the 2000s, the structural improvement in profitability was accompanied by an increase in capital income distributed to shareholders, although it never cut off self-financing. During the current crisis, self-financing has been preferred to the distribution of direct income.

This is shown in Figure 18.

Figure 18: Total of distributed revenue of capital and self-financing of investment in % of the added value of non-financial firms

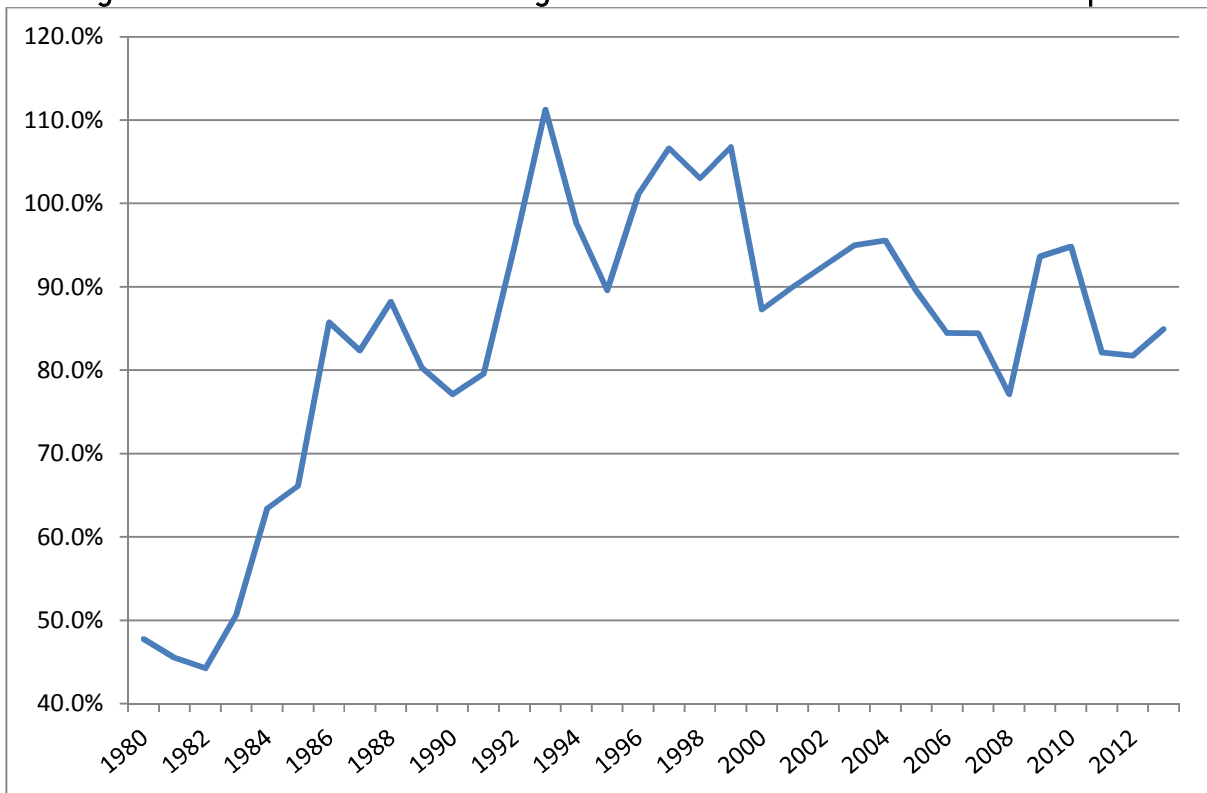


Sources: Insee, national accounting, base 2010, computations by the authors

After structural adjustment in the 1980s, self-financing has grown rapidly and strongly, signaling the return to a "normal" level of profitability of firms. But it was only in the 2000s that the firms have significantly increased the share of dividends. This happened without reducing the share of added value assigned to self-financing. Since 2009, the fall in markup associated with a rather high rate of investment has led to a reduction in the rate of self-financing (Figure 19) but also to a more pronounced decrease of distributed earnings. Overall corporate behavior in investment and financing thus appears rather virtuous in the context of maintaining a level of profitability that does not evoke a particular structural risk of lowering the propensity to invest or a risk on the financing side

of investments. It is the lack of prospects for growth opportunities that now appears to be the major and main obstacle to investment.

Figure 19: Rate of self-financing of investments in non-financial corporations



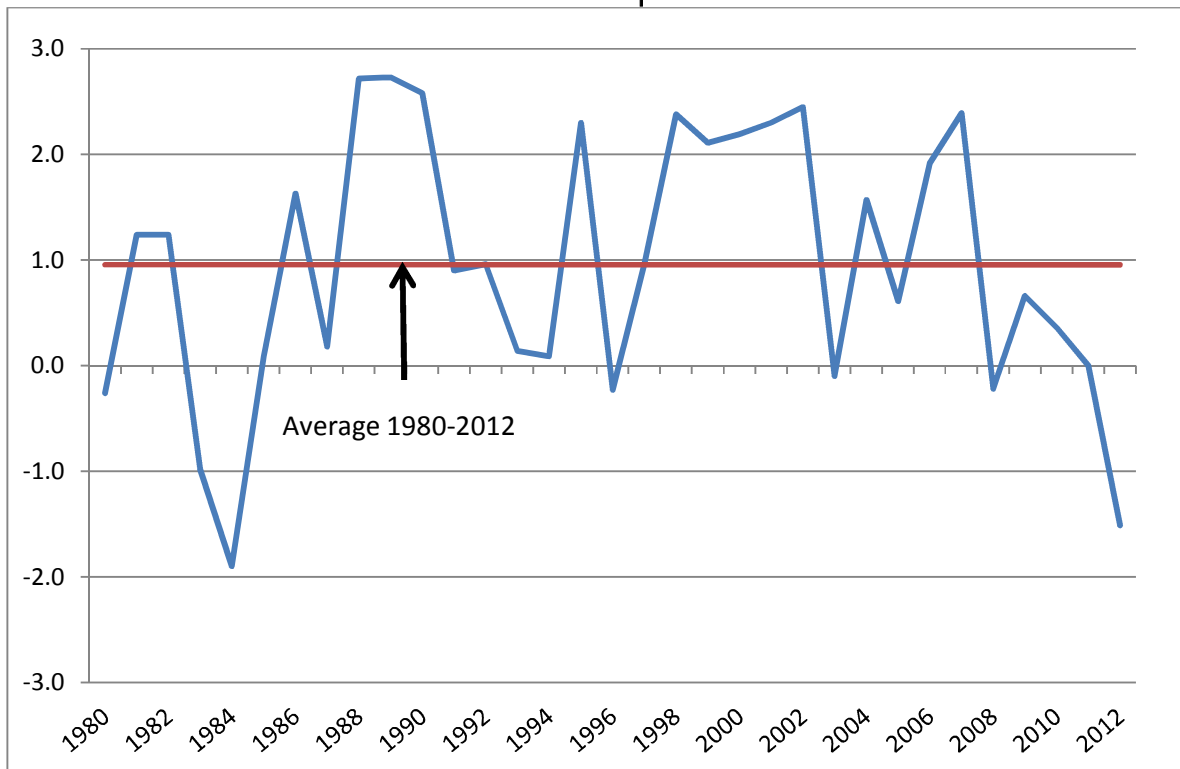
Source: INSEE, national accounting, base 2010

2.3. Income and household expenditure

Since the eighties household incomes have kept in line with the growth of economy and the average purchasing power of gross disposable income per consumption unit has increased by 0.9% per year (Figure 20). Two periods, which correspond to the most marked crises of the period, 1980-1987 and 2008-2012, have shown stagnating purchasing power (Figure 21). We do not observe any significant imbalance that originates in striking changes in household income. The imbalance of the 1980s having been cleared by 1987,

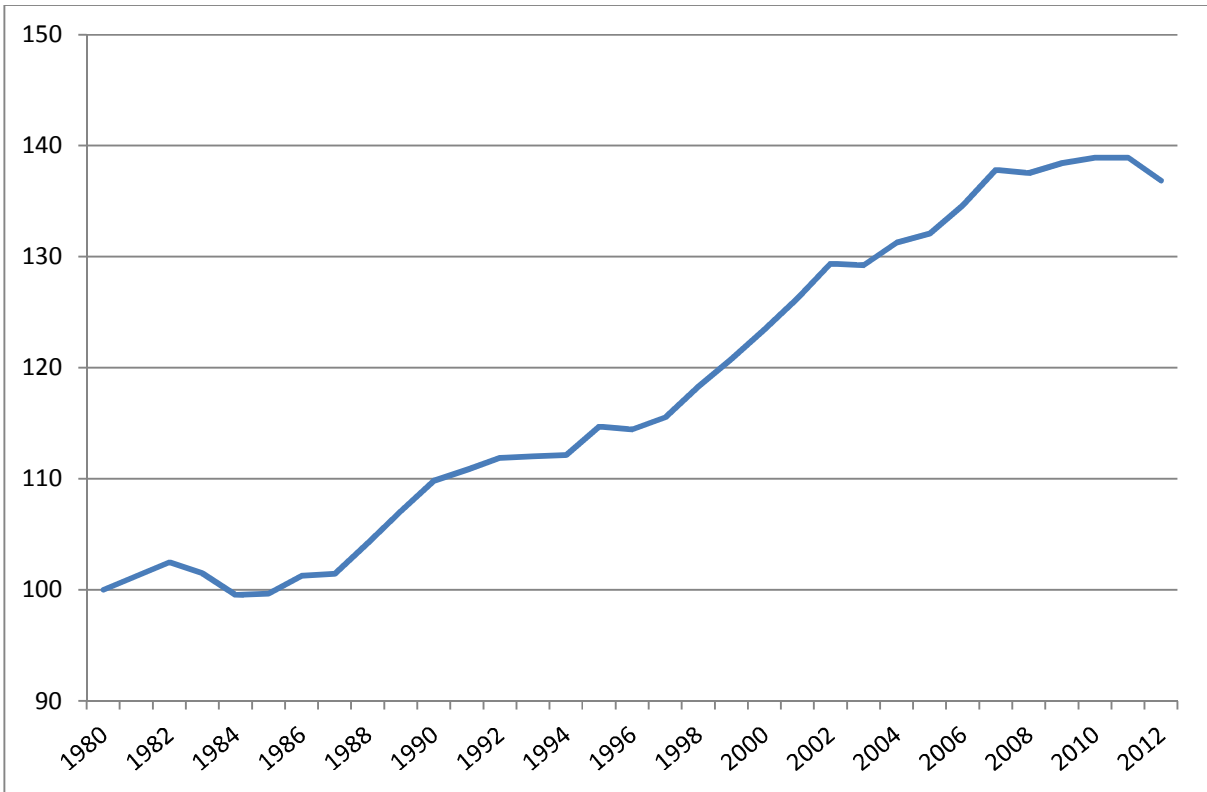
income growth was relatively steady until the shock of 2008-2009. The period between 1997 and 2001 is certainly worth mentioning: while the 35-hour working week was progressively applied, the purchasing power of the gross disposable household income increased substantially. This happened consistently with the steep decrease in the French unemployment rate (figure 4): the creation of jobs, in a period of high growth and labor-market reforms, had a major macroeconomic impact on the French economy.

Figure 20: Growth in the purchasing power of gross disposable household income per consumption unit



Source : INSEE, national accounting, base 2005

Figure 21: Purchasing power of gross disposable household income per consumption unit.

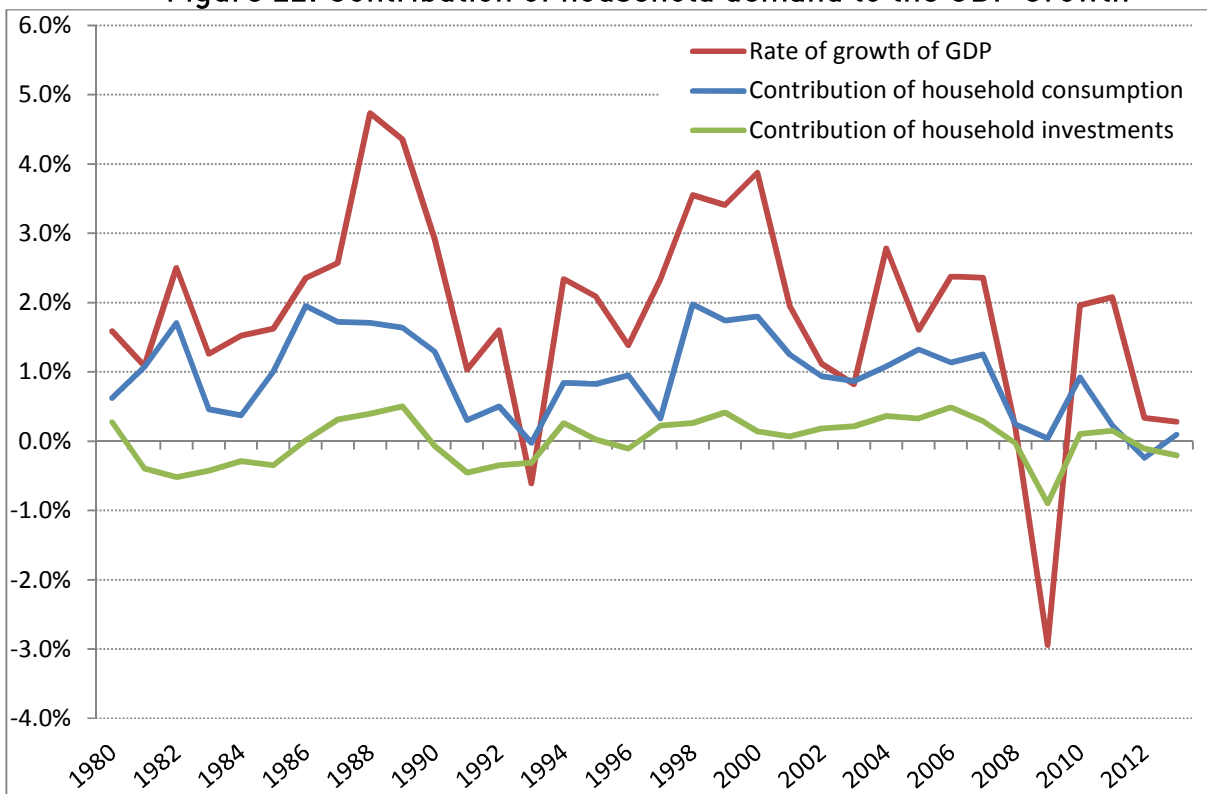


Source: INSEE, national accounting, base 100 in 1980



Figure 22 clearly shows that there has been no sharp rise in consumption and housing investment, hence strengthening the argument that neither a consumption bubble nor a housing investment bubble has occurred in France since 1980. The contribution of household demand to GDP growth remained moderate even during periods of strong recovery, as in 1988-1989 or 1998-2000.

Figure 22: Contribution of household demand to the GDP Growth



Source: Insee, national accounting, base 2010.

The changes in income distribution had a relatively large influence on the structure of household incomes. Labor income (gross salaries including employer contributions + mixed income of individual entrepreneurs) which accounted for 85% of disposable income in 1980 represented about 80.5% in 2013. Since 1994 the share of labor income has stabilized around 80% with no significant trend (Figure 23). Therefore it appears that since

the structural adjustment implemented between 1980 and 1993, which saw the share of labor income lose 6 percentage points, the labor share has remained relatively steady.

Figure 23.1: Share of labor income (Wages + Mixed revenues of individual entrepreneurs) in the total of households' income

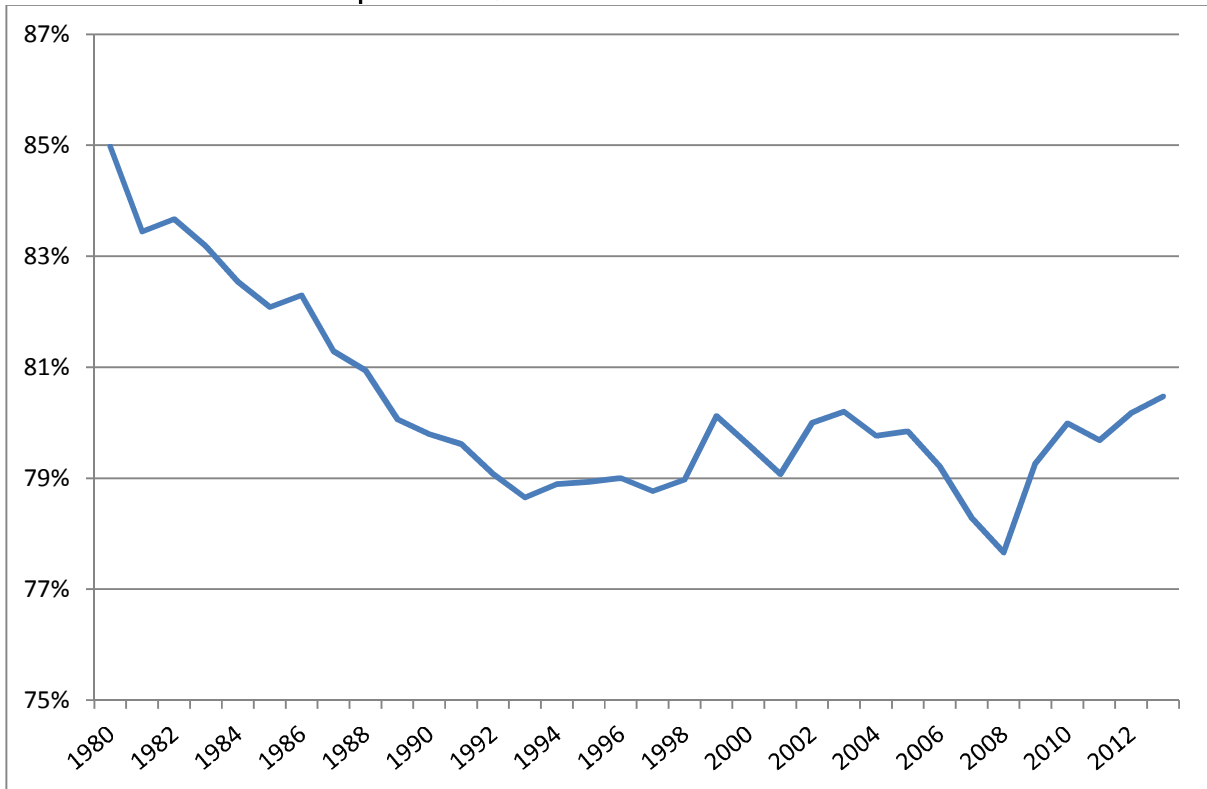
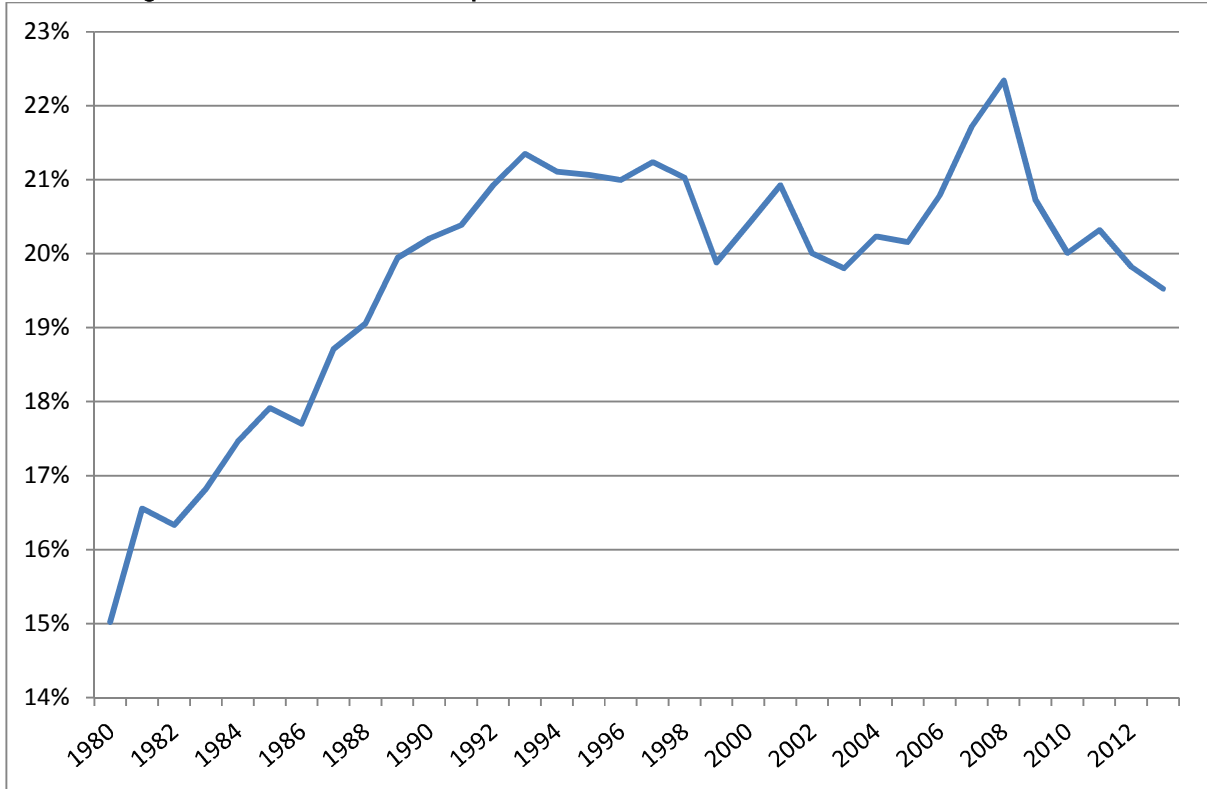


Figure 23.2: Share of capital revenue in the total of households' income

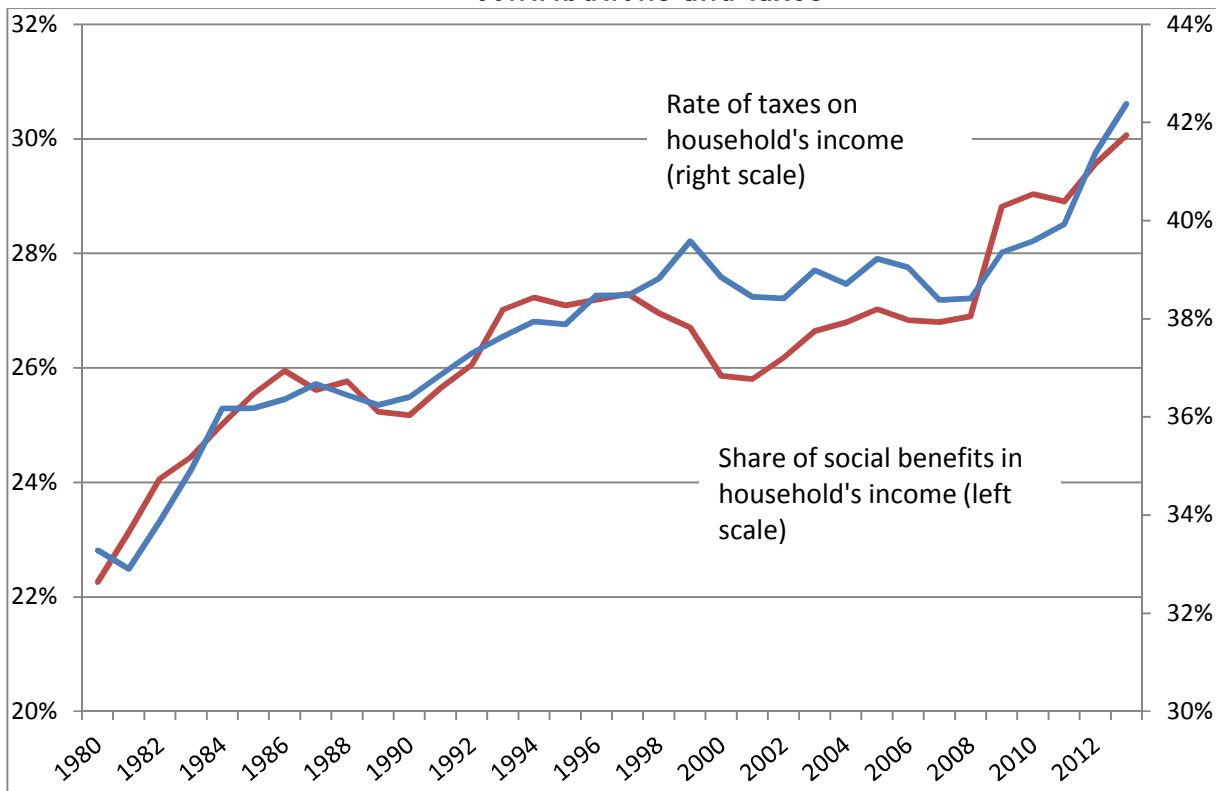


Source: Insee, national accounting, base 2010.

Since 1980 the share of household income related to social benefits has been steadily increasing. It reflects both the trend of increase of pension benefits and the increase in reimbursements by the social security for health spending. In the short term, benefits have played their counter-cyclical role, when periods of rapidly rising benefits corresponded to the phases of low growth or recession while periods of recovery were accompanied by a stabilization of the share of benefits. It must be acknowledged that the average increase in benefits has been financed, via the total social security contributions and taxes on households (here including the so-called employer's contribution, which forms, with contributions paid by the employees, the total labor contributions). Figure 24 shows that during the high growth period of the late 1990s and early 2000s, the reduction in the share of benefit has not been accompanied by a decline in tax rates. The period of high economic activity has been exploited to reduce public deficits and debt. Similarly, the

crisis that began in 2008-2009 was accompanied by an increase in benefits offset by a strong increase in apparent contribution and tax rate. The management of social services has combined in a rather virtuous way, both improvements in benefits designed to meet the increasing trend of long-term social needs (pensions and health), and a contribution to the stabilization of economy with important transfers and rigorous financial management. Here too, it is difficult to suggest a structural drift able to justify reforms designed directly to cut benefits. The example of recovery's years shows that the weight of social protection stabilizes when the output returns to higher growth rate. An economic policy dedicated to sustained growth is able to restore the public finances without burdening the satisfaction of social needs; there is thus no need to strengthen the rigor that has already been implemented with higher tax rates.

Figure 24: Share of social benefits in the household's income and share of social contributions and taxes

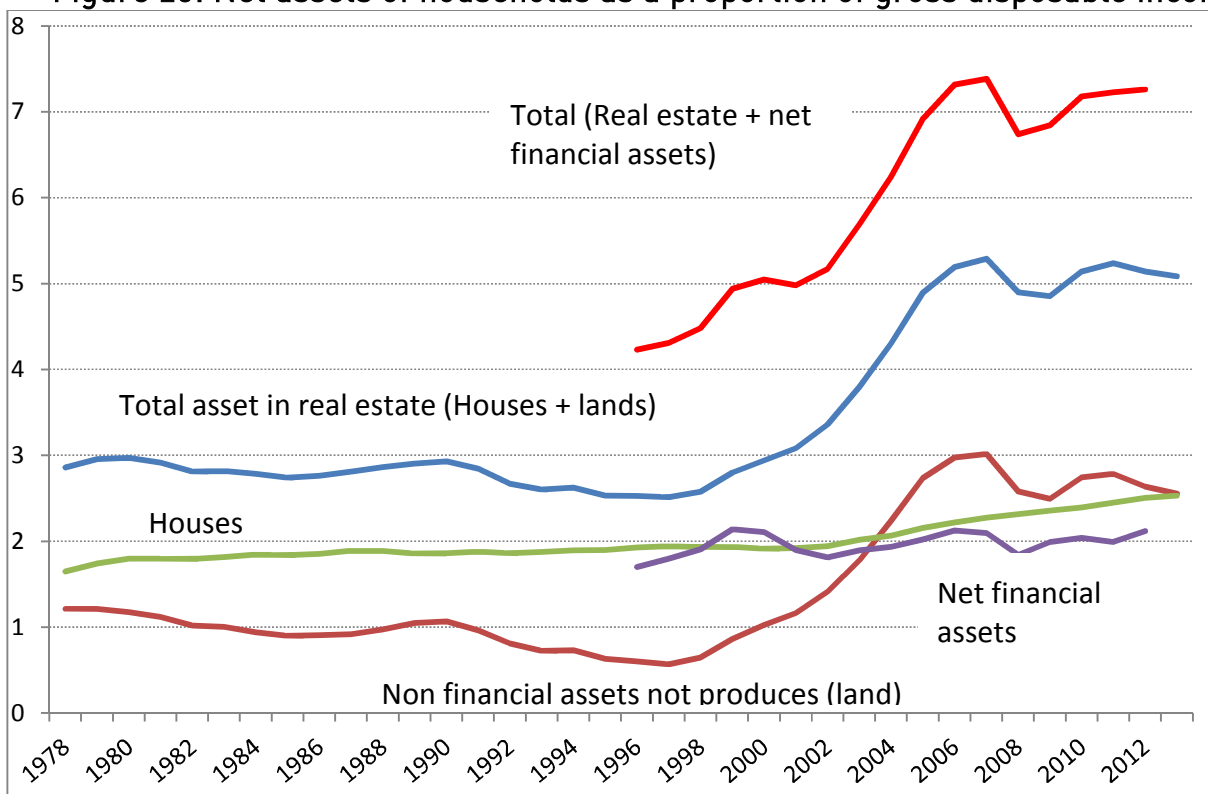


Source: Insee, national accounting, base 2010.



As noted above (section 2.1) inequality has increased less rapidly and less strongly in France than in most other countries. Essentially this moderation in income inequality is the result of the support by social benefits to the most modest households. The situation is quite different for wealth inequalities that were supported by a strong increase of rent during the 2000s until the crisis of 2008 – 2009. Figure 25 depicts the total value of the net assets of households which accounted for just over 4 years of disposable income in 1996 and now accounts for just over 7 years. As can be seen this increase is entirely due to the increase in housing prices which is itself the result of the increase in land prices, due to the decentralization in the political decision of creating new buildings (see Levasseur, 2013). France therefore knew, like many other countries in Europe, a risk of real estate bubble that will not end during deflation, because falling interest rates can strengthen the risk of accelerating housing demand without sowing the seeds of accelerating housing construction (see Timbeau, 2013).

Figure 25: Net assets of households as a proportion of gross disposable income

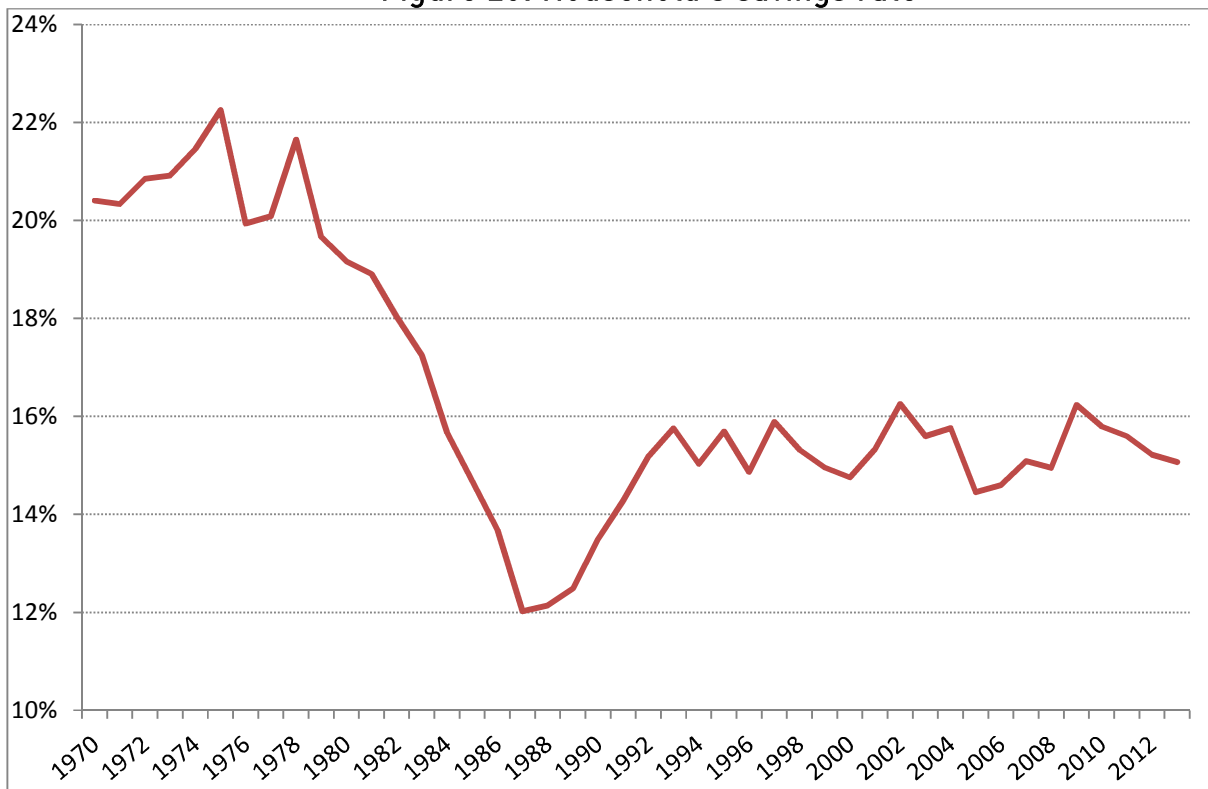


Source: Insee, national accounting, bases 2005 and 2010.

The increase in property values has contributed to a further increase in wealth inequality which could eventually be transformed into income inequality (Piketty, 2014). There is indeed a structural imbalance there. However, it is not characteristic of France. Moreover, it has had no impact so far on the composition and trend of economic growth.

The savings rate, traditionally high in France, had fallen sharply during the process of structural adjustment in the 1980s, but now it oscillates around 15% - which means that there is not much reason for concern about the financing of investment, be it public or private, in the long term - with no significant trend.

Figure 26: Household's savings rate



Source: Insee, national accounting, base 2010.

The determinants of household savings rate has been studied by Heyer and Timbeau (2006). Their econometric analysis (table 2) shows that, during the eighties, the savings rate was boosted by the level of real interest rate. The increase in real wealth linked with real estate has sustained consumption in the late eighties and the beginning of two thousand, but there was no major change in overhaul saving rates. It can therefore be concluded that consumption was mainly driven by the evolution of income, not wealth.

Table 2: Econometric estimation of the determinants of the households saving rate

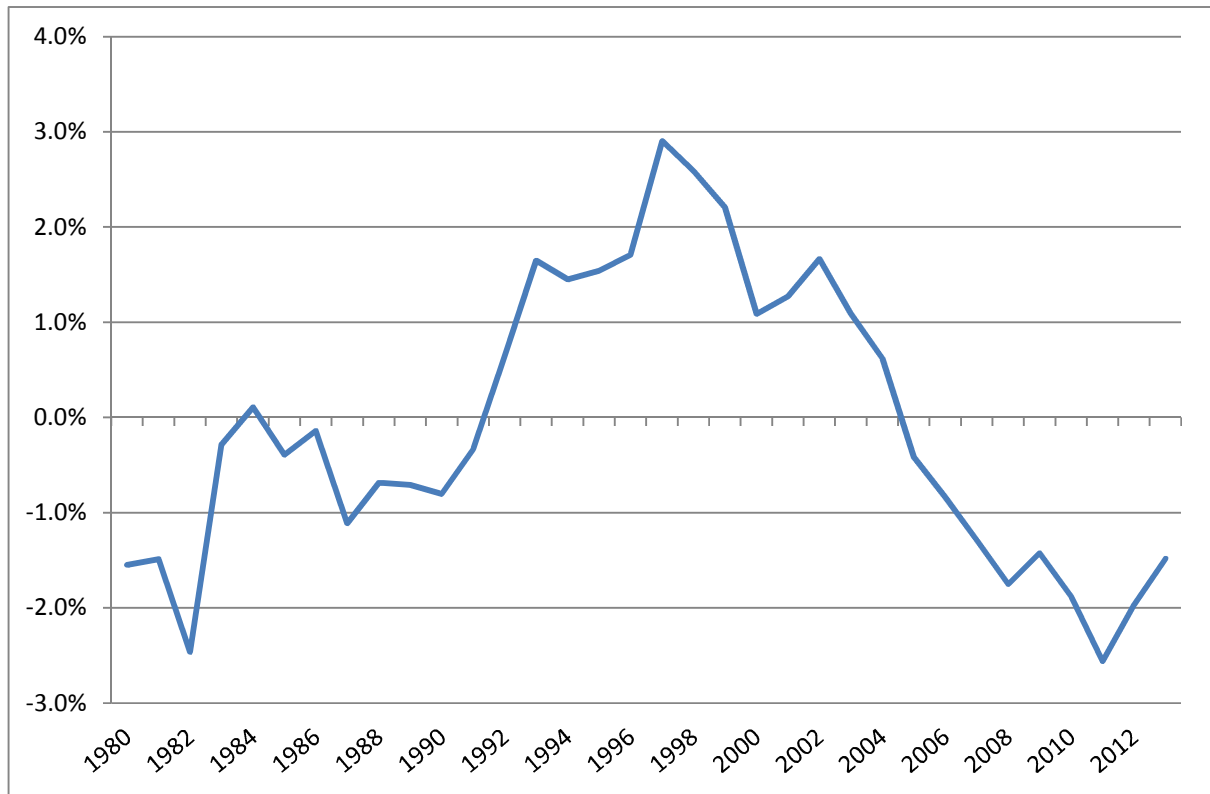
	1988-1990	1990-1994	1994-1997	1997-2003	2003-2008	2008-2011	2011-2013
Observed variations	1,5	1,7	0,8	-0,3	-0,6	0,7	-0,6
Impact of "critical gap" (g - r)**	1.5	2.6	1.3	0.9	-0,1	0,5	0,1
Impact of the real estate wealth	-1.0	0.0	0.0	-1.4	-0,8	-0,2	0,1
Impact of the variation of unemployment	-0.2	0.6	-0.3	-0.4	-0,2	0,4	0,1
Impact of the variation of the total revenue	1.2	-1.5	0.1	0.6	0,1	-0,2	-0,7
Impact of taxes measures and others	0.0	0.1	0.1	0.1	0,4	0,1	-0,2

** The "critical gap" is the difference between the growth rate of household income (g) and the long-term interest rates (r). This difference measure the ability of households to borrow. Sources: INSEE, comptes trimestriels ; Ofce model e-mod.fr.

2.4. Foreign trade and balance of payments

Foreign trade is generally a weak point of the French economy. Over the last thirty years the balance of trade in goods and services was alternately negative from 1980 to 1991 and positive from 1992 to 2005 before returning to negative since 2006 (Figure 27).

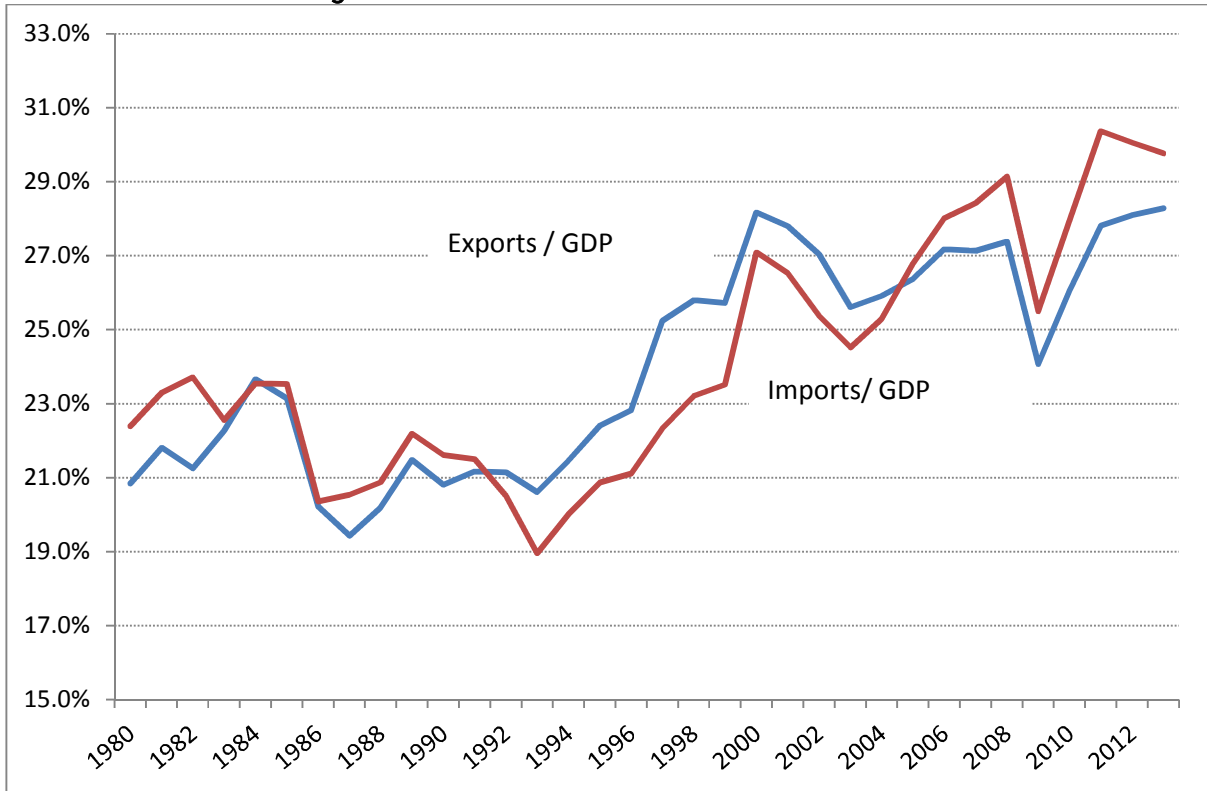
Figure 27: Foreign trade balance of goods and services France, in percentage points of GDP



Source: Insee, national accounting, base 2010

However, the weakness of trade is a relative notion. The openness of the French economy has been increasing since the early 1980s and ratios of exports to GDP and imports to GDP have been at historically high levels despite the crisis (Figure 28). Exports are stable as a percentage of the GDP since the early 2000s, and they are lower than imports since 2005, however the imbalance is moderate and it has not increased during the crisis. In 2013, exports returned to their level of 2000, expressed in percentage points of GDP.

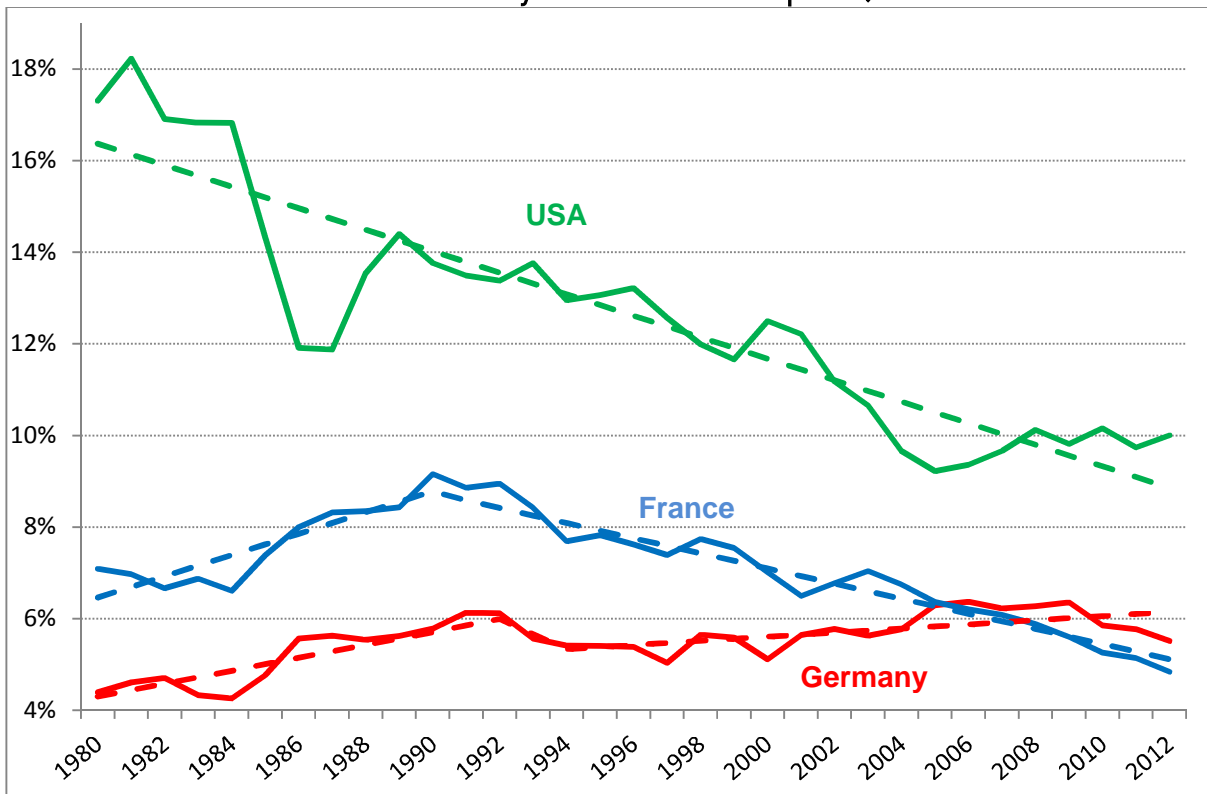
Figure 28: External trade of France since 1980



Source: Insee, national accounting, base 2010

Expressed by products, developments are quite comparable. In the agricultural sector, France increased its share of the global market from 1980 to 1990 and lost it ever since (Figure 29). Over the entire period though, the losses are smaller than those of the United States whose market share has however stabilized since 2005. In comparison with Germany, which was gaining market share like France in the 1980s, France lost ground as Germany continued to gain market shares since its reunification so that it now exceeds France in the global agricultural market.

Figure 29: Agricultural market shares of France, Germany and USA (exports of each country in % of world imports)

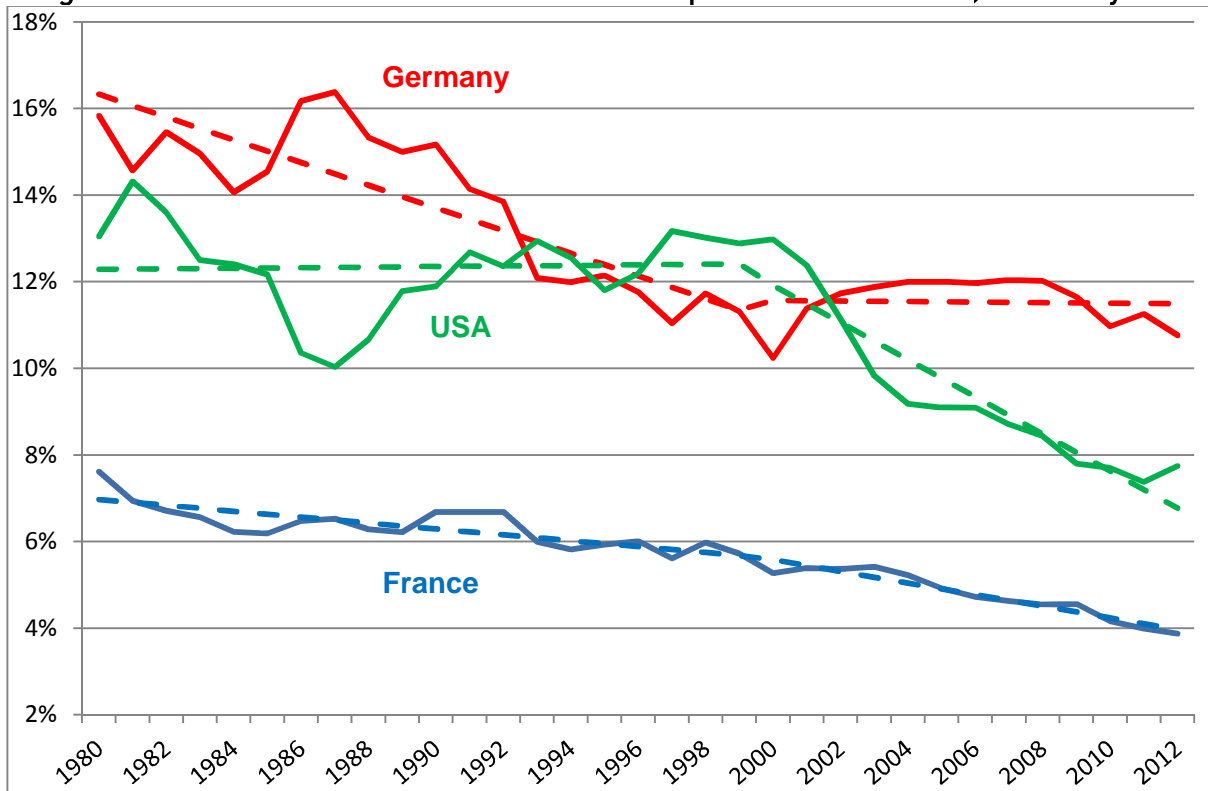


Source: CEPII CHELEM data base.

Regarding the manufacturing sector the situation is a bit different, but again the decline in market share does not appear abnormal French over long periods. From 1980 to 2013 it is comparable to that of the United States which has stabilized between 1980 and 2000, and dropped sharply since. Germany has an inverse profile than the United States with a very rapid decline until 2000 and stabilization since then (Figure 30). France, whose foreign trade remains high, lost market shares despite the rapidly expanding global market. There is nothing particularly worrying here and comparison with the American situation does not require acknowledging an extra structural cause other than the rise of emerging countries. The German situation is pretty much striking with its rather exceptional recent

gains in market shares. It stems from a mercantilist approach which is at odds with the current strategy in the United States or in France.

Figure 30: Market shares for manufactured products of France, Germany and USA.



Source: CEPII CHELEM data base.

During the 1980s, the imbalance of income sharing in favor of wages could be evoked to explain the weakness of French exports. There was at the time a situation of absolute structural imbalance. Can we hold today the same reasoning? A priori the situation is very different because, as we have seen, there is no more, even after the shock of the years 2008-2009, a massive imbalance of income sharing between labor and capital. Globalization and competition from emerging countries could be invoked in order to explain at least a part of the French external trade problem. But, though trade structures might be somewhat different, this argument should also be invoked in the case of Germany... which has run a surplus. A look at the competitiveness of the French economy

is therefore legitimate. An economy could suffer from an excessive increase in wages for two reasons. The first one is a reduction of the profit rate under the level allowing for a smooth financing of investment. This requires a stable allocation of total revenue between wages and profit and, as a consequence, a rate of growth of wages equal to the rate of growth of productivity. The disequilibrium resulting from an excessive increase of wage in this context could be presented as an internal wages problem. The second reason for which a country could suffer from excessive wages rests on the effect on competitiveness of an external differential of wage increases. If the major competitors of a country are on a path of decreasing labor costs the level of wages could appear excessive even if the internal distribution of wages appears compatible with a sufficient level of profitability. This particular problem of excessive wages vis-à-vis other countries could be presented as an external wage problem. Since the end of the eighties the evidence for France is the absence of an internal wage problem. Since the middle of the two thousands and since the financial crisis and its extension in the euro zone, France has suffered from a problem of relative wage costs. A complete analysis of the problem of labor costs in Europe since 2008 can be found in a recent work by Le Bayon, Plane, Riffart, and Sampognaro (2014). The available data make it difficult to trace the entire history of the competitiveness of the French economy. However, the data suggests that a problem of relative wage costs was born after 1990, mainly due to the de-synchronization of economic developments in Europe.

Table 3: Annual growth rates of average unitary wage's costs in manufacturing sector

	2013/2008	2008/2000	1995/2000
Greece	-2,0%	-0,2%	
Ireland	-1,8%	1,4%	
Spain	-1,3%	-0,3%	
Portugal	-0,7%	-0,2%	0,3%
Denmark	-0,3%	0,5%	-0,1%
Sweden	-0,1%	-0,3%	0,8%
Italy	0,3%	0,3%	-1,2%
Euro Zone (12 countries)	0,4%	-0,3%	
UK	0,5%	-0,1%	0,5%
Austria	0,6%	-0,4%	-0,9%
France	0,7%	0,0%	-0,3%
Germany	0,7%	-0,8%	-0,2%
Belgium	0,7%	-0,1%	-0,4%
Nederland	1,1%	-0,3%	-0,6%
Finland	1,2%	0,3%	-1,3%

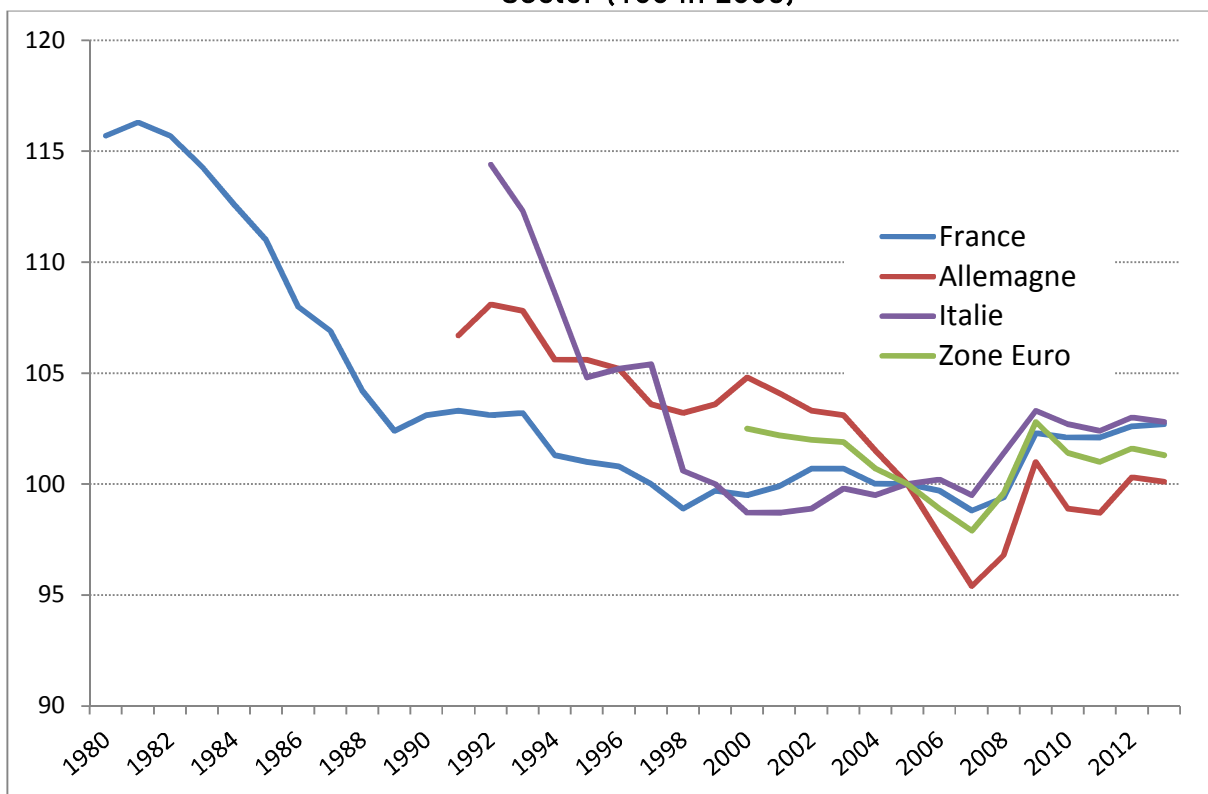
Source: Eurostat

Table 3 reports the change in average annual growth rate of unit labor costs in the manufacturing sector in Europe. It shows that since the crisis the rise in unit labor costs has been relatively rapid in France (+0.7% a year), but the same pace was recorded in Germany, Belgium and the Netherlands. In contrast, the southern European countries experienced a rapid decline in real unit labor costs: 1.3% per year in Spain, 0.7 in Portugal, etc. These developments since the crisis contrast with those that were recorded before it. Between 2000 and 2008, the decline was much lower in southern Europe and much faster in Germany. The labor costs were completely stable in France, meaning the situation therefore deteriorated especially vis-à-vis Germany. To sum up, competitiveness (measured by the differential change in unit labor costs between France and its major partners) has deteriorated due to the declining costs in Germany during the 2000s and in the southern countries since the beginning of the great crisis of 2008-2009.

It is difficult to analyze trends over a longer period; however Figure 31 shows that the evolution of unit labor costs in France confirms the diagnosis of a steady decline in the

1980s when it was necessary to correct the imbalance of sharing wages / profits followed by a long period of stability consistent with the hypothesis of a structurally balanced growth. Italy follows a relatively close pattern, albeit with a more rapid decline in the 1990s and slightly later stabilization. Germany has had a continuous decline until 2007; stabilization and recovery due to the effect of the crisis has therefore come at the very end of the period.

Figure 31: Index of wage unit costs expressed in real terms, in the manufacturing sector (100 in 2005)

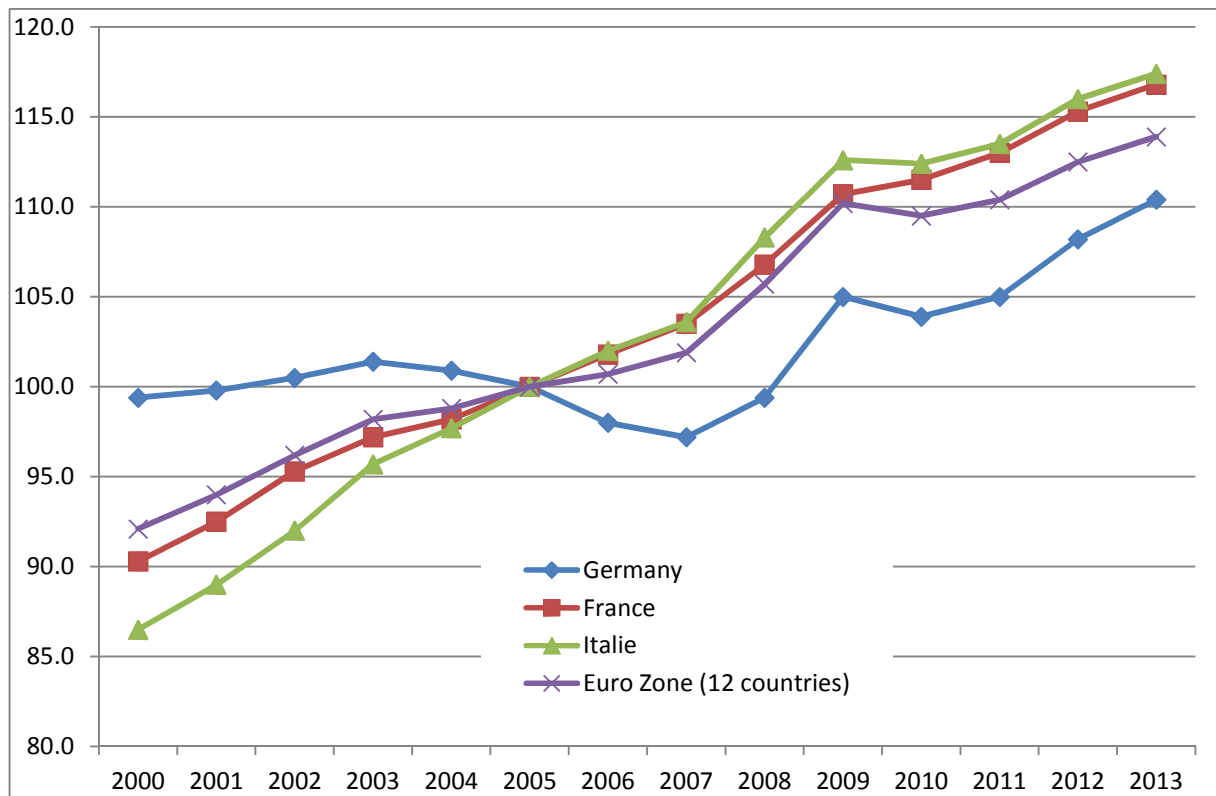


Source: Eurostat

The competitiveness of France has suffered during the recent period of lower labor costs in southern Europe and in Germany just before the crisis (Figure 32). In nominal terms the

cost of labor was stagnant or declining in Germany until 2007 and has increased less than in the Euro Zone since 2007.

Figure 32: Index of wage unit costs expressed in nominal terms (100 in 2005)



Source: Eurostat

France is now one of the countries with high labor cost (Table 4). The paradox is that this high level of labor costs does not reflect an internal imbalance of wages-profit sharing. Consequently reducing the cost of labor would not be beneficial in terms of internal balance. Engaging in this strategy can only lead to the opposite situation of stagnation in production, hence to lower satisfaction of domestic demand. The firms could have more and more resources to finance investment; the profitability of these investments would be guaranteed by a high mark-up rate; but these investments would not be feasible due to lack of prospects for higher demand. The economy would be trapped in a chronic lack of demand. The decline in labor costs would be effective to boost external demand. By



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stimulating exports and limiting imports it would allow, in the long term, to offset the negative impact of wage restraint on domestic demand... provided that the partners of France do not launch a race to lower labor costs. If this were the case, the French economy would be slowed down in a similar fashion as it were after endorsing disinflation policies in the late 1980s: with all European countries implementing the same type of policy, none was able to reap the benefits of limiting wage growth because wage and price differentials remained (more or less) stable.

The current situations of the European economies are diverse: Spain faced the bursting of a housing bubble that was accompanied by very low productivity in the building sector. Limited wage adjustment was probably necessary in this country. As for Ireland, wages were boosted by opportunistic commercial activities of large multinational companies optimizing tax expenditures in a seemingly tax haven quite attractive for capital expenditures. Germany, which has regained its competitiveness since the late 2000s, should instead support its domestic demand. In this economic environment, neither Italy nor France should be encouraged to carry out "structural" policies of wage restraint since the two countries are in a situation of balanced labor costs in terms of internal revenue sharing.

Table 4: Hourly labor costs in 2011, in Euros

	Manufacturing industry	Market services
Portugal	10,40	13,16
Greece	15,77	16,33
UK	21,04	19,77
Spain	21,88	20,04
Italy	26,45	27,50
Ireland	28,29	26,28
Luxembourg	29,68	37,31
Euro Zone	29,71	27,41
Austria	31,91	28,33
Nederland	32,20	30,35
Finland	32,32	28,36
Germany	35,41	28,45
France	35,91	34,45
Denmark	37,95	40,74
Sweden	40,46	38,92
Belgium	40,74	39,42

Source Eurostat

4. Financialisation and economic and financial crises as the crisis of finance-dominated capitalism

Since 2008, the deterioration of the financial environment and its resulting impact on the real economy have severely tested the strength and resilience of the French financial system. The financial turmoil arising from the US subprime crisis which spread to all segments of the financial market created a difficult operating environment for banks, which also faced a generalized crisis of confidence. Overall, the French banking system appears to have weathered the crisis: no major bankruptcy has occurred in the banking sector since 2008 and private agents have kept on financing their activity without substantial credit rationing.

3.1 Channels of transmission of the global financial crisis in France

Drawing on Blot et al. (2012), the first channel through which French activity has been depressed came from the rise in the cost of financing which triggered a demand slowdown (private investment and consumption). Then, as banks were at the heart of the meltdown, they played a large role in the transmission of the crisis, as it is put forward by the literature on the bank-lending channel. From the very beginning of the troubles in the banking system, there was a fear of a credit rationing that could have led to a sharp contraction of spending. No proof can be made of such a situation since it is always tricky to disentangle between supply and demand side effects in the credit markets. But it has nevertheless been recently found out that negative shocks on credit standards caused a contraction of the output. The effect is equivalent to a rise in the cost of borrowing since a tightening in credit standards represents a situation where banks become more reluctant to grant loans. It then puts a downward pressure on internal demand. Besides, the decrease in housing and stock market prices have also reduced spending either through a

wealth effect or indirectly through a reduction in the value of collateral, which amplified the asymmetry of information and the cost of external finance. Finally, the rise in the uncertainty, generally captured by a jump in the volatility of equity index, leads firms to delay or postpone important hiring and investment decisions (Bloom, 2009).

Consequently, the rise in the cost of external finance and of the uncertainty combined with the drop in wealth led French households and non-financial corporations to cut down spending. This was clearly mirrored in the large fall in investment decisions. The investment rate of non financial corporations dropped by nearly 2 percentage points between 2008 and 2009. For households, the decrease of housing investment rate reached 1.4 point. It must also be stressed that housing investment had already slightly decreased in 2008 compared to 2007. The total contribution of investment to recession, including public investment, established at 2.7 points. Households reduced spending since consumption decreased slightly for five consecutive quarters whereas from 2001Q2 to 2007Q4, the average quarterly growth rate of households' consumption increased by 0.5%. The negative wealth effect combined with the increase in uncertainty, and notably the fear of unemployment, induced a rise in the households' saving rate which gained one point (from 15.4% of real disposable income to 16.4%) between 2007 and 2009.

Therefore, the bulk of recession came from the fall in internal demand. In 2009, over a 3.1% reduction in GDP, 1.6 percent of GDP (i.e. over half) was due to domestic demand. It must be stressed that the negative impact of the downward adjustment of domestic demand was dampened by the public sector. Public consumption and public investment indeed respectively increased by 2.6% and 2.5% in 2009 compared to 2008. The rest of the recession was attributed to the net external trade (-1.2 percentage point of GDP) and to changes in inventories (-0.9 percentage point of GDP). In line with the slump in world trade, French exports collapsed. Between the peak and the trough, the fall amounted to 15.6% whereas, during the same period imports decreased by 11.9%. It may also be

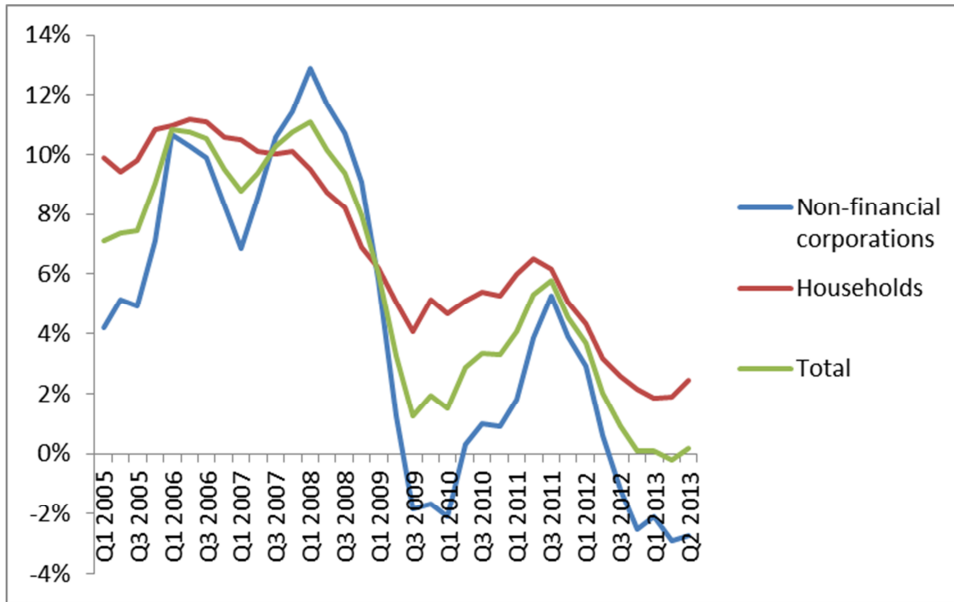
stressed that the negative contribution of stocks reflects the larger negative adjustment of supply (GDP) compared to the decrease in demand.

The decline in demand, then production, has then rapidly entailed an adjustment on the labour market. The unemployment rate inevitably increased from 2008Q4 to 2009Q4. It reached a first peak at 9.6% and then stepped back temporarily. When decomposing the structure of this unemployment rate, the youngest were more strongly hit. The increase in the unemployment rate for people under 25 years old increased earlier, from 17.2% to 23.7%. As far as the macroeconomic outlook deteriorated it became harder for young graduates to find a job since before downsizing firms started to reduce new hires. The bulk of the unemployment concerned nevertheless people between 25 and 49 years old. Finally, we may notice that whereas the unemployment rate of those under 25 years old moved back at the beginning of 2010, it was less marked for the unemployment rate of those over 50 years old. Thus, the probability of older people to be unemployed was less than the one for the youngest but the probability to remain unemployed as the crisis installs was higher. As a corollary, the length of unemployment also increased with the length of the crisis.

3.2. The financial consequences of the crisis

To calm down the markets confronted to a huge rise of uncertainty, major central banks, like the Fed, the BoE and the ECB, decreased their interest rates, innovated in implementing unconventional policies and acted as lenders of last resort. These measures allowed banks to finance themselves with very low interest rates and unlimited amounts of liquidity for a long period of time. Despite the effectiveness of the interest rate channel (Blot and Labondance, 2013; Creel, Hubert and Viennot, 2013), credit growth to the private sector decreased (figure 33).

Figure 33: Growth of loans to private sector (in %, y-o-y, France)



Sources: Banque de France; Creel, Labondance and Levasseur (2014)'s computations.

This is partly explained by the fact that since the crisis, credit conditions have been tightened. Currently, credit conditions depend more on the level of risk than before the crisis. By extension, new firms, smaller firms and firms with a bad rating are now more penalized. Nevertheless, this tightening in credit conditions does not seem to be the main explanation behind low credit distribution to the private sector. The main explanation is that the financial crisis created a negative demand shock (see supra), weakened firms, especially SMEs, that have finally lowered their credit demand (Kremp and Sevestre, 2013).

3.3. The government support to French banks

Soon after the beginning of the financial crisis, the French government undertook various policy actions in favor of the banking sector to avoid negative feedback effects on the real economy. .

Between late 2008 and early 2009, the government granted loans to the five largest banks for a total amount of € 20.75 billion (or 1.1 % of French GDP). Loans bore a high interest rate (around 7.5 %) and were associated with the constraint that every year the beneficiary banks must increase their lending to the private sector by 4 %. Initially granted for five years, almost all banks had repaid these loans within a year after they were granted. The combination of several factors (i.e. a high interest rate, the private credit-growth constraint and the unwillingness to depend on the government support) explain why the repayment occurred so early. An additional explanation is provided by Grossman and Woll (2014) who argue that to avoid stigmatizing a particular bank, the French government would have struck a deal with the main institutions constraining them to be simultaneously beneficiaries of loans although not all of them required it. In the fall of 2009, all major banks had already repaid, except Banque Populaire and Caisse d'Epargne (BPCE).

Recourse to explicit debt guarantees was another important tool to support French banks, especially at the beginning of the financial crisis. The government de facto "lends" its creditworthiness to the beneficiary banks, thereby containing their funding costs and mitigating liquidity risk (Breton et al., 2012). In the case of France, the total amount of guarantees approved by the government (and agreed by the European Commission in conformity with the State Aid Policy) was € 320 billion (or around 16 % of French GDP). But, "only" € 93 billion were effectively used (or less than 5 % of GDP).

Indeed, two French banking institutions had to be recapitalized and/or dismantled. The first one was Natixis, the investment branch of BPCE, which was heavily exposed to both the subprime crisis and the Madoff fraud. By the fall of 2008, the value of Natixis' stock



dropped by 95%. In a deal brokered by the French president Nicolas Sarkozy, the two banks merged to become BPCE. In mid-2009, Natixis received € 35 billion guarantees on toxic assets on its books from BPCE while the French government invested € 3 billion in BPCE's preferred non-voting stock, giving it a 20 percent stake. The second entity is Dexia, a French-Belgian joint-venture, specialized in loans to local authorities. Facing huge liquidity problems, Dexia was gradually dismantled, with a recapitalisation amounting to € 5.5 billion by the Belgian and French States. Another major step in the (French-side) dismantling plan was the sale of Dexia Municipal Agency to the French State, the Caisse des Dépôts and La Banque Postale. The Belgian and French States are now the group's main shareholders, with 50.02% and 44.40% respectively of Dexia SA's capital.

In the context of assets' losses due to euro area debt problems, in particular exposures to the Greek debt, estimates about the needs of recapitalization for European banks were carried out. The first estimates made in October 2011 by the European Commission was € 8.8 billion for the French banks (€ 106.4 billion for the EU banks), accounting for 8.3% of the EU needs for recapitalization. The second estimate (in January 2012) was a bit lower for the French banks, at € 7.3 billion, or 6.4% of EU needs. Considerable uncertainty arises about the quality of the banks' balance sheets, the treatment of sovereign debt and systemic risks (Merler and Wolff, 2013). Consequently, estimates by the European Commission are based on stress tests which should be considered with due caution. For instance, Dexia passed its European Commission's stress test in July 2011 but needed a financial rescue a few months later.

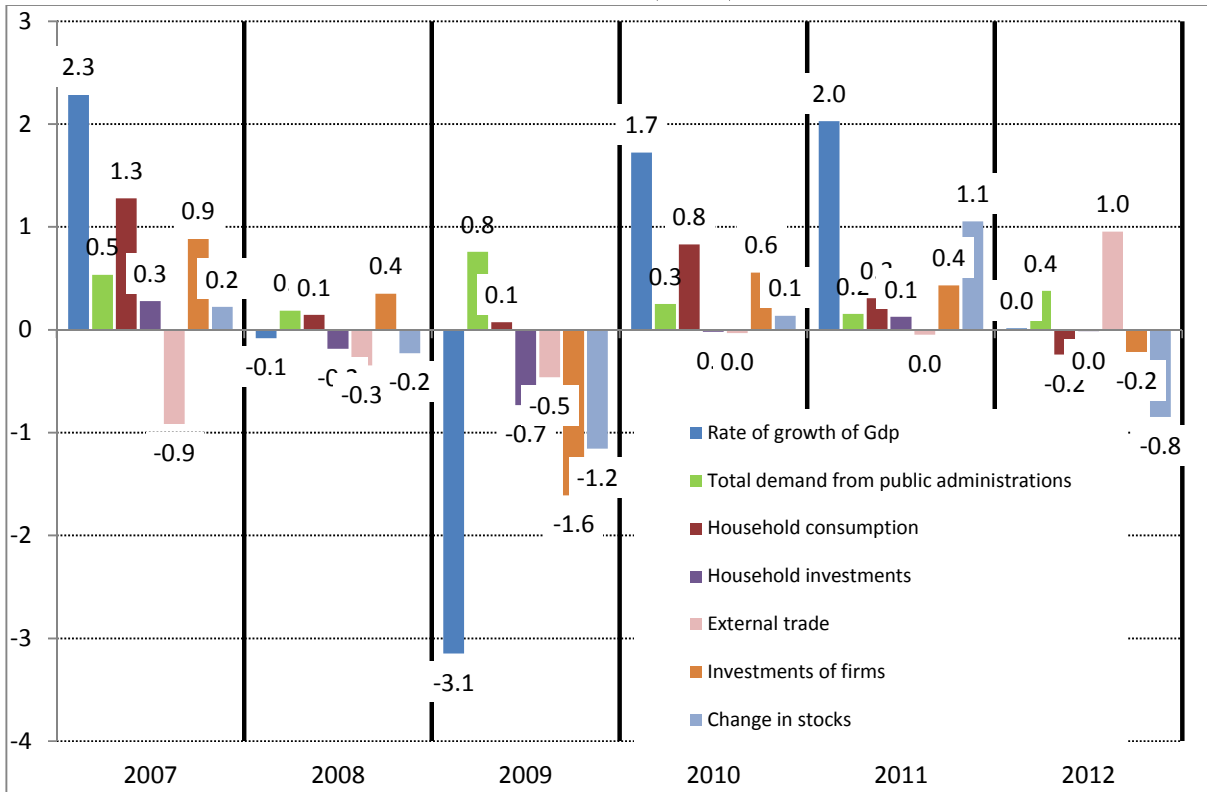
Some argue that the budgetary cost to support the French banking sector would be considerably underestimated (KloECK, 2014; Schich and Lindh, 2012 among others). Implicit subsidies, as opposed to explicit subsidies, would constitute an additional budgetary cost for public spending via a negative effect on the country's rating which would increase the cost of public debt (KloECK, 2014). Implicit subsidies to banks arise in expectation that the government will act as a guarantor of last resort during a financial

crisis. This allows some banks, in particular the largest ones, to borrow at a lower funding rate than otherwise. In the case of French banks, implicit subsidies are estimated between \$ 7.5 and 22.5 billion or between 0.35 % and 1 % of GDP for 2012 (Schich and Lindh, 2012). Moreover, implicit subsidies would have distortionary effects by creating a competitive advantage for banks benefiting from the subsidies, by inducing banks to take more risks, and by lowering incentives of depositors, bondholders and shareholders to monitor the risk profile of banks. The larger the bank the larger the implicit subsidy, in accordance with the “too-big-to-fail” hypothesis.

3.4. The macroeconomic consequences of the crisis

The financial crisis was transmitted to the real economy via a drop in inventories and a freeze of investments from both households and private firms. A very classical chain of consequence has appeared: the decrease in production has led to a decrease of employment and household income which has conducted to a reduction of consumption growth. As usual in an economic crisis, a vicious loop was set up that automatic stabilization was unable to stop immediately (see figure 34 with its decomposition of the French GDP growth rate during the crisis).

Figure 34: Decomposition of the rate of growth of the French economy during the crisis (in %)



Source: Insee

The immediate consequence of the financial crisis was, in France like in other countries, a huge increase of the public budget deficit and of the public debt. Briefly, in 2008-2009, the fiscal policy was expansionary in order to limit the fall of production and the rise of unemployment. But very rapidly this policy was reoriented in the opposite way in order to restore the financial equilibrium of the public budget. This reorientation of the fiscal policy was not imposed by the market as the interest rate on sovereign debt fell to a very low level. The main factor who led to the decision of reorienting the fiscal policy was the fact that the government wished to respect, at any price, the European stability and growth pact. As all European governments did the same at the same moment, it is the whole European economy which was shocked by a recessive economic policy. Table 5 shows that

without any shocks to the French economy it could have reached a steady growth of more than 2 % a year on the period 2010-2014; however the effective growth rate was of 0.4 % a year in 2012-2014. The difference results mainly from the depressive impact of the implemented fiscal policy; the latter cut the GDP growth rate by -0.7 point in 2010, -1.4 point in 2011, -1.6 point in 2012 and -1.5 in 2013. The domestic fiscal policy was thus responsible for 80 % to 60 % of the cut whereas the policies implemented in the other European countries were responsible for 20 to 40 % of the cut. In sharp contrast, the impact of competitiveness on growth was low and never exceeded a cut of the growth rate by -0.4 %.

Table 5: Obstacles to recovery in France

	2010	2011	2012	2013	2014	2015
Actual growth of GDP (1)	1.9	2.1	0.4	0.4	0.4	1.1
Impact of :						
Oil prices	0.0	-0.1	-0.3	-0.1	0.0	0.0
Prices competitiveness	0.2	0.2	-0.1	-0.1	-0.4	0.2
Linked with Euro rate change	-0.1	0.1	0.1	-0.1	-0.2	0.1
Linked with intra Eurozone position	0.3	0.1	-0.2	0.0	-0.2	0.1
Monetary conditions	-0.4	-0.2	-0.3	-0.1	-0.2	-0.1
Public finances policy	-0.7	-1.4	-1.6	-1.5	-1.2	-1.0
Direct impact of French policy	-0.5	-1.2	-0.9	-0.9	-0.8	-0.6
Impact of other European countries (include impact of French policy on others)	-0.2	-0.3	-0.7	-0.6	-0.4	-0.4
Total of shocks (2)	-0.9	-1.5	-2.3	-1.9	-1.8	-0.8
Acquired and others (3)	0.5	1.2	0.3	-0.1	-0.2	-0.5
“Spontaneous” rate of growth (1-2-3)	2.4	2.4	2.4	2.4	2.4	2.4

Source: OFCE, Forecast for French economy, 29 octobre 2014 (<http://www.ofce.sciences-po.fr/pdf/documents/prev/prev1014/france291014.pdf>)

With these data and the analysis which supports them, one can state that the stagnation of the French economy since 2012 is no longer a mystery. It is well and fully explained once taking into account the economic policy of the French and all others European



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governments. The consequences of the financial crisis have therefore been intensified by a misplaced emphasis on a wrong analysis of the actual situation of the European economy as a whole. Like in the 1930s the initial shock was no doubt a financial one. It could have been offset by an appropriate Keynesian stabilization. But, and like during the pre-war years, the policy turned the wrong direction and deepened the crisis instead of solving it. Public deficits are certainly not the cause of the crisis; they are its consequence and its cure.

5. Conclusion

Is the French economy ill and is the current French situation related to its financialisation? The first part of the question is certainly the most difficult, whereas the second one is easier to answer. The most important change to the real economy which financialisation has brought to the real economy in France came early. At the beginning of the eighties, jointly with the development of French financial markets, the French economy underwent a structural change in the partitioning of value added between wages and profits that benefited the launch of the new French stock market.

The current diagnosis is that of a structural disease whose symptoms would be an imbalance in public finances, foreign trade imbalance and high unemployment. Paradoxically the proposed remedy, a cure of "structural reforms" with the principal goals to lower wage costs - or more broadly, the total revenue of labor including the one of self-employed - is ignorant of the evolution of income sharing over a long period of time. The sole observation of the loss of competitiveness in foreign markets or import is enough to justify the diagnosis. The observation of the facts shows that this conclusion is at least short, or even biased. Actually it is not possible today to highlight a change in income sharing that would justify the requirement to achieve a drop in labor compensation. The French economy had undoubtedly a well-known structural imbalance of income sharing.



With an increase of wages systematically superior to the rate of increase of productivity which led to structural high inflation rate, deterioration of profitability and competitiveness. However it happened during the second half of the seventies and a massive correction occurred during the 1980s. The problem with the argument of implementing "structural reforms" is that these reforms have already been put in place and they have produced the desired effects: the level of profitability is now sufficient to guarantee that, to the extent that demand increases, the necessary investment would be made. The internal balance of income sharing is perfectly compatible with a balanced growth that does not need policies to support either demand or supply. Before the onset of the global financial crisis, the French economy was also on the path of a non-inflationary return to full employment. Only a minor foreign trade imbalance would have justified an action to support the firms subject to external competition. An internal devaluation based on a very limited transfer of social contribution from business to households (through e.g. VAT) would have probably been sufficient to return to equilibrium.

Before the crisis the growth of the French economy was based on a fairly healthy balance between rising demand permitted by distribution to employees of the productivity gains and rising supply guaranteed by profitable investments largely self-financed. At no time French growth has relied on a domestic credit bubble or a strong imbalance of financials assets or real estate markets. The growth in demand has therefore not been dependent on asset price inflation or borrowing. Only the recent rise, partly stabilizing, of property prices could have resulted in a cycle of unsustainable growth. This has not been the case as the unaffected level of savings rate has testified.

The main transmission channel of the financial crisis in the French economy in the long run has been the external trade. In the late 1990s, the strong American growth, linked to the financialisation of the American economy, probably boosted the economic activity in Europe and consequently the French economy. But the contagion to France of the American bubble was pretty much attenuated. It is difficult to assess the contribution to



the French growth of European bubbles, mainly Spanish, British and to a lesser extent Irish. It is certain that the strong growth in Spain during the late 2000s has contributed to the French growth rates; the growth that came from the UK also did but to a lower extent. On the contrary the structural adjustment of the German economy during the 2000s has penalized the French growth rate. The overall external factors thus impinged in both directions. It is likely that they have more or less compensated. But, the analysis of all the effects of external factors that have an impact on the growth of a country is a challenge that can only be held in the framework of a global analysis. Recent analysis by OFCE of the transmission of internal policy shocks to European countries shows that the degree of interdependence between the European economies is such that an integrated analysis of the effects of financial shocks of the 2000s would be essential to provide a comprehensive assessment of their effects on each EU economy. This retrospective analysis remains to be done. We have seen in this descriptive contribution that the French economic growth has been based on a rather satisfactory internal balance while external factors have not led to a difference between the growth of the European Union and that of France.

In the recent period, the French economy is facing a paradox. While its internal balances remain good, its trade imbalance is far too high and France can neither restore fiscal balance nor return to full employment. Contrary to what happened in the years 1975-1985 during which an internal structural imbalance prevented the return to growth, this time it is an external stress resulting from wage deflation outstanding in many European countries which is at stake. The return to growth does not require committing to costly structural reforms. It would be enough to release the budget constraints in all EU countries, such as simulations in iAGS project show for the European economy, and consequently the French economy (see Blot et al., 2014). Consequently the return to growth, which France has never really been far from since 1986, would be once again attainable. In Europe, structural corrections should be limited to Spain (real estate bubble), the UK (hypertrophy of the financial sector) or Ireland (operating tax competition).



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In other countries structural interventions are justified when they are linked either to tax policies (Luxembourg, Netherlands, Austria) or to fiscal and budgetary policies (Greece). France, like other countries, should also reform part of its economic infrastructure by changing the distribution of the tax burden among households and businesses, the financing of its social protection, the operation of the administration or by implementing energy policies adapted to future climate crises and the expected end of fossil fuels. All these structural reforms, whatever the macroeconomic circumstances, are helpful to improve the efficiency of the economic system and the level of welfare of the population. They have nothing to do with those discussed today whose sole purpose is to reduce labor costs at any cost, including a new recession.

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