BRIEFING

ECON 504 EN

The French Economy

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This Briefing, which outlines the current situation in French economy, was written in preparation for the European Parliament's discussions on the French Stability Programme and the broad economic guidelines for the year 2000.

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General Introduction

Under Article 99 of the Treaty (formerly Article 103\(^1\)), all EU Member States – whether they fully participate in the Single Currency or not – are required to “regard their economic policies as a matter of common concern”, and to “co-ordinate them within the Council”. Coordination is carried out within the framework of recommended “broad guidelines” for the economic policies of Member States.

In addition, under the pre-Single-Currency transitional provisions outlined in Treaty Article 116 (formerly Article 109e), Member States wishing to join the € area were asked to adopt “multi-annual programmes intended to ensure the lasting convergence necessary for the achievement of economic and monetary union”. These formed the basis of the May 1998 decisions on € area membership.

The requirement to submit such “convergence programmes” remains for those countries still outside the euro area. In the case of countries which have already adopted the €, the Stability and Growth Pact calls for similar “stability programmes” to be submitted.

These are three-year rolling programmes, and focus on progress in meeting the Pact’s two major objectives:

- a budget deficit below 3% of GDP in any one year; and
- an overall budgetary balance over the economic cycle.

The annual updates must therefore take account of the budget proposals for the following year.

Each programme is the subject of a Council opinion, and forms part of the input to the broad economic guidelines.

The initial convergence and stability programmes were published in late 1998, before the formal launch of the Single Currency. Most updated programmes became available towards the end of 1999.

\(^1\) The renumbering of the Treaty Articles was the consequence of the Treaty of Amsterdam, which was signed in October 1997, and came into force on 1 May 1999.
Background to the French Stability Programme

In December 1999, the French Government published its “Multi-annual public finance programme 2001-2003” ("Programme pluriannuel de finances publiques, 2001-2003"), in effect the update of its 1998 Stability Programme. When examining it in March, the ECOFIN Council nevertheless regretted that the document did not “publicly and specifically identify itself as a stability programme”.


The Programme itself “provides first and foremost support for the determination to ensure strong, sustained growth to create new jobs, with the ultimate goal of full employment”. It is based on two alternative annual growth assumptions for the period 2001-2003: 2.5% and 3%.

The Commission gave its opinion on the French document on 8 March 2000. The responsible Commissioner, Pedro SOLBES observed that the fiscal position had improved more rapidly than provided for in the initial stability programme (the budget deficit fell from 2.8% of GDP in 1998 to 2.1% in 1999). However, he also noted that these positive results were exclusively due to the dynamism of tax revenues, public expenditure in real terms having been higher than the figures indicated in the previous programme.

For the Commission the assumptions on growth were realistic, with the higher 3% scenario the more probable. It believed that France should take advantage of higher growth to secure even greater improvements in the fiscal position (the programme envisages a budget deficit falling from 1.7% in 2000 to between 0.3 and 0.5% in 2003).

On 13 March 2000, the ECOFIN Council also examined the French programme. It, too, noted with satisfaction that the French fiscal position for 1999 was better than initially projected, providing a sufficient safety margin to prevent the deficit from breaching the 3% of GDP threshold in normal cyclical conditions. However, the Council also noted that the projected evolution of government expenditure in real terms, established in the initial programme, had not been fully met. This was partially the result of higher than expected expenditure, at current prices, in the health insurance and local authorities’ sectors.

The general economic situation

The French economy has recovered faster and more vigorously from the “blip” triggered by the emerging markets crisis than was expected even last Autumn. Consumer confidence reached a new historical high in April 2000, and the general business outlook has remained positive since mid-1999.

French GDP increased by 2.7% in 1999, well up from the expected 2.3%, and reached a year-on-year rate of 3.2% at the end of the year. Once this growth spurt has tapered off, the French economy can be expected to continue growing at a pace of around 3%.

After falling in late 1998, exports picked up strongly in the spring of 1999. These may now weaken as the result of the end of the rebound in the emerging markets; but during the current year at least this effect may be more than offset by the economic upswing in France’s main trading partners, notably Germany. The trade balance and current account remain positive.

Capacity utilisation is markedly above the long-term average, and investment – capital formation is currently running at a rate of around 1.5% a quarter - is likely to remain strong.
In addition, the opportunities and needs created by new technologies could raise investment above the levels suggested by the trend of its usual determinants.

This is the background to the first signs of **renewed inflation**. Initially limited to the direct impact of soaring oil prices, inflationary pressures will gradually become driven by more endogenous factors. They should nevertheless be restrained by productivity gains and stepped-up competition, fuelled by technological progress as well as increasing liberalisation of the goods and services markets.

The mounting vigour of credit demand may be explained by a very marked improvement in household expectations in recent months and moderate interest rates. Household spending rose significantly last year, particularly on housing (up 7.8% after 3.4% in 1998). Moreover lending rates did not firm up until late in the year in connection with the rise in market rates.

**Economic growth**

The Russian and Latin American crises, triggered by the Asian crisis of the year before, curbed activity in France and most of its trading partners during the autumn of 1998. However, French economic growth strengthened steadily in 1999, thanks to an improved international environment and a firm domestic market. The year-on-year gain in GDP rose from 2.4% in mid-1999 to 3.2% at the end of the year, while the annual average rate of GDP growth was 2.7%.

The forecast growth rate for 2000 has therefore been significantly adjusted upward to a range of 3.4% to 3.8%, compared with an earlier forecast of 2.6% to 3%, followed by more moderate growth of 2.8% to 3.2% in 2001. The multi-annual public finance programme is banking on expected annual growth of 3% between now and 2003 or 2.5% annually if the international environment is less favourable. The final year of the programme is thus likely to be the sixth consecutive year of growth at or over 2.5%.

**Chart 1: Real growth of GDP, 1998-2003 (%)**

![Chart 1: Real growth of GDP, 1998-2003 (%)](image-url)
Unemployment

Employment in France increased by more than 450,000 jobs in 1999, including 350,000 jobs in the market sector. This trend can be expected to continue gathering pace in the year 2000, to almost 500,000 new jobs, including 400,000 in the market sector.

While obviously tied to buoyant activity, this momentum is also due to the fact that growth is increasingly “employment-rich”. There are two possible reasons for this: lower taxes and social security charges on unskilled labour; and the effects of the shorter working week. According to the programme, the shorter working week will be implemented widely, applying to 6,700,000 employees by end-2001. It will then account for about one-third of new jobs in the market sector.

Chart 2: French Unemployment rates, 1990-2001, (%)

Source: Eurostat * estimate

Inflation

The upturn in inflation in 1999 (1.3% year on year after 0.3% in 1998) mainly reflected the direct impact of soaring oil prices. Underlying inflation remained remarkably stable. This was possibly due to tight wage control in an environment of still high unemployment and relatively depressed prices. However, this stability may be difficult to maintain given significantly lower unemployment and the first signs of labour shortages in certain sectors.

Chart 3: Inflation (Price deflator of private consumption), 1990-2003 (% change p. a.)

Source: Eurostat * 1999 Stability Programme estimates
Underlying inflation should therefore pick up gradually to 1.3% by the end of 2000 and to 1.6% by the end of 2001. However, headline inflation (HICP) should be lower as a result of declining oil prices in 2000, the cut in the normal VAT rate to 19.6% at the beginning of April and the Common Agricultural Policy (CAP) reforms in 2001. Consumer prices should have increased by 0.9% and 1.2% year-on-year at end-2000 and end-2001, respectively.

In March 2000, the provisional index of retail prices rose by 0.4% on an unadjusted basis and by 0.3% using seasonally adjusted data. The year-on-year rise in the consumer price index stabilised at 1.4% on an unadjusted basis, against 0.4% in March 1999. On seasonally adjusted terms, the year-on-year increase in consumer prices worked out to 1.6% after 1.5% in February and 0.4% in March 1999. The seasonally-adjusted indicator of underlying inflation showed a 0.2% rise in March, or 0.7% over twelve months.

**Budget deficits**

The outlook for public finance in 2000 and 2001 reflects the consolidation underway since 1997 and recently confirmed by the results in 1999. The borrowing requirement of the general government came to 1.8% of GDP in 1999, down 0.9 percentage points from 1998. This stronger-than-expected decrease was mainly due to a sharper growth of tax and social security revenues: the public deficit objective for 1999 was 2.2% in the Budget Bill for 2000.

Combined with buoyant activity, the progress made in 1999 has enabled the government to speed up implementation of tax reduction measures and to reduce the public deficit beyond the objectives laid down in the Budget Act for 2000 (1.8% of GDP). According to the programme forecasts, the public deficit in 2000 should fall to 1.5% of GDP. In 2001, the public deficit should be reduced to between 1.1% and 1.3% of GDP. This bracket reflects the remaining uncertainties surrounding growth in 2000 and 2001, and its impact on public revenue. The programme shows the budget still in deficit, though by less than 0.5%, in 2003.

*Chart 4: French budget deficit, 1992-2003 (as % of GDP)*

Other forecasts, however, indicate that a budget surplus would already be possible in 2001. This would depend, in part, on...
whether the further tax cuts contemplated by the Government, following those in the 2000 supplementary budget, are balanced by reductions in expenditure; and

in part, the possibility of substantial receipts from the projected sale of UMTS mobile phone licences.

Simultaneous reductions in the deficit and of tax and social security rates are made possible by the lower weight of public spending in GDP. Thanks to tight control of government and social security spending, the weight of public expenditure is likely to fall by about 2 percentage points of GDP between 1999 and 2001, dropping from 53.8% of GDP in 1999 to 51.7% in 2001.

The improvement in public finances from 1999 to 2001 will take place mainly at the level of central government and the social security funds. The local authorities and the miscellaneous central government bodies will preserve the surplus recorded in recent years. The borrowing requirement of the central government should decrease by 0.2 percentage points of GDP. After reaching 3.0% of GDP in 1998, it dropped to 2.5% in 1999, and should fall to 2.3% in 2000 and 2.1% in 2001.

For the first time since 1991, the social security funds turned in a surplus in 1999 (0.2% of GDP). Their financial situation can be expected to continue improving by 0.2 percentage points of GDP p.a. in the years ahead. The other general government categories (miscellaneous central government bodies and local authorities) should report an aggregate surplus of 0.4 to 0.5% of GDP during the period from 1998 through 2000.

The Commission’s Recommendation for the Broad Guidelines of the Economic Policies of the Members States (ECFIN/209/00 of 11.04.2000) states that French budgetary policy should now aim to:

- reduce the deficit below the level set in the updated stability programme (“given the better-than-planned outcome” for 1999);
- take prompt corrective measures in the event of any significant slippage from the expenditure targets set in the updated programme;
- give priority to faster deficit reduction rather than to additional tax cuts in 2000 and 2001;
- orient the planned reforms of the pension system “towards long-term sustainability of government finances, taking into account considerations of equity – including between generations”.

**Public debt**

After improving for the first time in 20 years in 1999, the general government debt ratio should continue to decrease markedly in 2000 and 2001. Its sharp reduction in 1999 was partly due to exceptional income, mainly linked to cash movements of the central government. Further reduction of the public deficit would make it possible to squeeze the public borrowing requirement significantly below the point where the weight of debt in GDP will remain stable. After a drop of 0.7 percentage points of GDP in 1999, the debt ratio should drop by 0.6 percentage points in 2000 and 2001 to 57.4% of GDP by the end of 2001. The public debt burden would thus diminish significantly, to 57% or 58% of GDP, according to the assumption made as to growth rate, by 2003.
The Political Background

The French legal system is based on the Constitution of 1958. The bicameral system comprises:

- the **Senate** with 321 seats: 296 for metropolitan France, 13 for overseas departments and territories, and 22 for French nationals abroad. Members are indirectly elected by local councils for a period of nine years, with one-third retiring every three years.

- the **National Assembly**, comprising 577 members directly elected from individual constituencies by a two-ballot system for a period of five years.

The **Head of State** is the President, directly elected by popular vote for a seven year term. Since 17 May 1995 the post has been held by Jacques CHIRAC. The next presidential elections must be held by May 2002.

The **Head of Government** is the Prime Minister, a post held by Lionel JOSPIN since 3 June 1997. The Prime Minister is nominated by the National Assembly majority and appointed by the President. The last elections were held on May 25th/June 1st 1997. The next legislative elections are due in 2002.
There is a clear separation of executive and legislative powers. Constitutionally, the centre of executive power is the Council of Ministers, which is actively overseen by the President. The Prime Minister is appointed by the President, who must consider whether the government can obtain the necessary majority in parliament. According to the constitution, the Prime Minister hands his resignation to the President, but in practice Prime Ministers have been dismissed by the President.

The political system revolves around the following political parties and leaders:

- Socialist Party or PS (Francois HOLLANDE)
- Rally for the Republic or RPR (Michèle ALLIOT MARIE)
- Union for French Democracy or UDF (Francois BAYROU)
- Communist Party or PCF (Robert HUE)
- Radical Socialist Party or PRS (Jean-Michel BAYLET)
- National Front or FN (Jean-Marie LE PEN)
- Democratic Force of FFD (Alain MADELIN)
- Citizens Mouvement or MDC (Jean Pierre CHEVENEMENT)
- The Greens (Jean-Luc BENNAHMIAS)
- Mouvement for France or LDI-MPF (Philippe DEVILLIERS)

Table 2: Presidential Election Results (1995)

<table>
<thead>
<tr>
<th>Party</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jacques CHIRAC (Rassemblement pour la République, RPR)</td>
<td>52.64%</td>
</tr>
<tr>
<td>Lionel JOSPIN (Socialist Party)</td>
<td>47.36%</td>
</tr>
</tbody>
</table>

Table 3: Election Results (1997)

<table>
<thead>
<tr>
<th>Party</th>
<th>Seats</th>
</tr>
</thead>
<tbody>
<tr>
<td>Socialist Party or PS</td>
<td>245</td>
</tr>
<tr>
<td>Rally for the Republic or RPR</td>
<td>140</td>
</tr>
<tr>
<td>Union for French Democracy or UDF</td>
<td>109</td>
</tr>
<tr>
<td>Communist Party or PCF</td>
<td>37</td>
</tr>
<tr>
<td>Radical Socialist Party or PRS</td>
<td>13</td>
</tr>
<tr>
<td>The Greens</td>
<td>8</td>
</tr>
<tr>
<td>Citizens Mouvement or MDC</td>
<td>7</td>
</tr>
<tr>
<td>Mouvement for France or LDI-MPF</td>
<td>1</td>
</tr>
<tr>
<td>National Front or FN</td>
<td>1</td>
</tr>
<tr>
<td>Various left</td>
<td>9</td>
</tr>
<tr>
<td>Various right</td>
<td>7</td>
</tr>
</tbody>
</table>
Annex: Banking supervision

The European Central Bank’s Monthly Bulletin for April contains an analysis of banking supervision arrangements in the different euro area countries. In the case of France, the principal responsible authority is the Commission Bancaire et Financière. This is an autonomous public institution, but with strong links to the Banque de France, which provides the staff and budget of the General Secretariat. It is a collegial body, chaired by the Governor of the Banque de France, and comprising the Head of the Treasury and four other members. Other bodies with responsibility for banking regulation are the Comité de la Réglementation Bancaire et Financière (CRBF) and the Comité des Établissements de Crédit et des Entreprises d’Investissment (CECEI). The Governor of the Banque de France chairs the former, and is a member of the latter.
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