PISM | POLSKI INSTYTUT SPRAW MIĘDZYNARODOWYCH
THE POLISH INSTITUTE OF INTERNATIONAL AFFAIRS

BULLETIN

No. 8 (461), 22 January 2013 © PISM

France's Economic Problems: Consequences for EU Policy and Poland

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France's poor economic performance is diminishing its positive impact on EU policies in favour of Germany as well as its capacity to make good its vision of the future of Europe. This creates a political opportunity for Poland: France's economic problems are one of the reasons to embrace a more open approach to non-eurozone countries. Closer economic cooperation could cement political relations between the two countries, which could also be strengthened substantially by building up the institutional angle of Polish-French relations.

The French economy is stagnating, and may soon enter recession. Growth in 2012 varied at around 0.2% GDP (Eurostat), with just 0.1% growth predicted for this year, according to INSEE, the French statistical office. The government response has been primarily to reduce the deficit in public finances in a bid to convince international markets of an imminent economic recovery. The downgrade of France's creditworthiness by Moody's (to A++ in November 2012, following a similar move by S&P in January 2011) indicates, however, that markets remain unconvinced. These economic problems weigh heavily on French EU policy and diminish the country's influence vis-a-vis Germany, especially as regards the question of financial aid transfers at the EU level.

French Problems. The structural issues hampering French economic growth preceded the financial crisis. The key weakness has long been the high cost of labour, which leads to low competiveness in external markets and to a trade deficit that has lasted for almost a decade (€65.8 billion in 2012). Besides unemployment rates of 9-10 % throughout the last decade, the other problem is the country's trade orientation towards the EU's economically-troubled southern Member States (in 2011, Italy and Spain were among the top five French export and import countries). The financial crisis deepened the deficit and debt, which according to Eurostat amounted respectively to 5.2 % and 86% of GDP in 2011 (in the last 15 years, debt has increased by almost 28.6 p.p.). The high percentage of public-sector spending (56.3%, compared to an EU average of 46%) makes it difficult to balance the budget. France thus needs to improve its economic competitiveness and avoid drastic austerity policy, which could further hamper growth.

Uncertain Cures. Indeed, French President François Hollande's flagship electoral promise was to lower France's budget deficit gradually. In December 2012, the National Assembly approved a public finance law for the years 2012-2017 that was in line with the principles of the EU's fiscal compact. This measure may not, though, provide a solution. First, it foresees a reduction of the budget deficit to a level of 3% in 2013, and then a gradual reduction until it reaches just 0.3% by 2017. It will, however, be difficult to achieve such targets as the government used very optimistic estimates of growth in France (0.8% in 2013 and 2% in the following years). According to INSEE, a figure of just 0.1% is likely in the first half of 2013 and, according to Eurostat, 0.4% in 2013 and 1.2% in 2014. If the non-government predictions hold true, this will hamper the government's plan to reduce the public debt—indeed, the European Commission has already predicted higher levels of French debt than the government did.

Second, the savings in the budget would mainly be found by an increase in taxes and a slight lowering of public spending. This shift is reflected in the 2013 budget with €30 billion of savings to be obtained notably from new taxes (€20 billion) and a reduction in public sector spending (€10 billion). Such an increase in taxes might, however, be harmful for growth, as some estimates predict it could cost the French economy as much as 1.5 points of GDP. France is also undertaking structural reforms to reduce labour costs and boost the competitiveness of French products. A national pact for growth, competitiveness and employment, approved in November 2012, is only a partial solution, though. It focuses on lowering labour costs by 6% through €20 billion in tax relief to companies, more financing options for small and medium-sized enterprises and measures aimed at increasing economic innovation and export volume. The real issue will be to introduce more flexibility into the labour market in 2013—the government will soon prepare a legislative proposal now that it has obtained a compromise from trade unions and employer organisations in January. For now, the government plans to fight unemployment by subsidising additional jobs. In short, the future of the EU's second-ranked economy is clouded with uncertainty, as the government's plans to restore growth and limit the deficit fall short. Some liberal-oriented economists are predicting a bleak scenario—a debt crisis.

Impact of the French Economic Problems on Its EU Policy. The French and German economies together make up more than one third of the EU's GDP (in 2011, France, €1.99 trillion; Germany €2.59 trillion) making them major financial contributors to the EU budget and its anti-crisis instruments as well as being dominant players on other EU policies. One consequence of France's decade-long structural problems, though, is the widening gap with its neighbour. Germany is more than ever the agenda-setter on the future of the EU, and France is trying to counterbalance it by other means, not least in its role as leader of a coalition of southern countries. Even though it has managed to refocus the EU public discourse away from austerity towards more growth-oriented solutions, the overall assessment of recent developments in EU policies, however, shows French bargaining power is constantly diminishing. France has failed, for example, to enforce its vision in terms of banking supervision.

France's economic convergence with the troubled southern countries explains their political alignment in terms of the EU's crisis agenda. Besides continuously promoting the idea of eurobonds, the mutualisation of EU debt and more protectionism in EU external trade, Hollande has put an emphasis on growth measures at the EU level, meaning in concrete terms an increase in financial transfers to the south. The first step was Paris's advocacy of the EU growth pact, in a coalition with Italy and Spain, in June 2012. The second, was to put an end to its calls for massive cuts to the EU budget (motivated also by its desire to secure agricultural funding). Third, and most important, Paris strongly supports the creation of a separate eurozone budget. On the eve of the December European Council negotiations, it backed, together with Spain, the idea of a substantial eurozone budget enabling transfers of financial resources in order to fulfil a counter-cyclical function. Tellingly, this proposal foundered on German resistance.

Conclusions and Recommendations for Poland. French economic problems could have a negative impact on Poland as potentially French foreign investments decrease. According to data from the Polish Ministry of the Economy, in 2011 France was the third largest foreign investor in Poland (about €19.2 billion) and the biggest foreign employer, generating about 200,000 jobs. Almost one third of French investments are in the industrial sector, which is currently most at risk due to economic stagnation. A window of opportunity lies, however, in the fact that Poland's relatively low labour costs attract French companies in search of savings. In the French military sector, for instance, planned public cuts of €2.2 billion are encouraging French companies to look for contracts with Poland, as demonstrated by the joint project on the modernisation of Polish air defences envisaged by Bumar Group and missile developer MBDA or by the talks on the modernisation of the Polish navy between naval company DCNS and Polish Naval Shipyard in Gdynia. In energy policy, if Poland succeeds in its shift to nuclear energy it might decide to collaborate with French industry. In order to exploit these opportunities, business relations between both countries should be enhanced by strengthened public economic diplomacy. The Polish government could organise high-level official visits with the involvement of businesses in France as well as support various business forums at the central and regional levels and strengthen the French activities of the Polish Information and Foreign Investment Agency.

Politically, the mood in Franco-Polish relations has much improved due to France's new openness towards non-eurozone countries. Even though Paris still promotes intergovernmental solutions to EU problems, it accepts the need to include non-euro members into new institutional schemes. Hollande directed such declarations explicitly at Poland during his visit to Warsaw in November 2012, and indeed during the negotiations on banking supervision France showed a willingness to compromise with the Poles. It is also good ground for more diplomatic contacts in EU economic policies, where the two countries have divergent perspectives, as with deepening of the internal market, where France advocates a protectionist position. In other EU policies, both countries have already initiated closer talks on new financial perspective negotiations and CSDP. This start up of talks should serve as a way to tighten Franco-Polish relations in the long term. In order to do so, the institutional angle of those relations must be strengthened: liaison officers can be exchanged often, meetings at the working level can be arranged on an ad-hoc basis and a common Centre for Franco-Polish Studies should be further developed. A long-term upgrade of Polish-Franco relations would be beneficial for Poland as it would involve more interactions with the club of the biggest Member States and as a result might increase its political weight in the EU.