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EIR Economics

New banking crisis is set to rock France

by William Engdahl

A new phase in the French banking crisis is programmed to erupt early next year, just as the country and the government are struggling with the most serious economic crisis since the 1930s. The intersection of the two interconnected processes, will create one of the most unstable political and financial conditions in the industrial world, potentially rivalling the ongoing Japanese banking crisis, which was examined by Kathy Wolfe in *EIR* two weeks ago.

This past summer, just weeks after Jacques Chirac won French Presidential elections, sweeping the Socialist Party of former President François Mitterrand out of power, the European Union Commission in Brussels agreed to permit the French government to make a second, extraordinary State bailout of 145 billion French francs ($30 billion) to prevent the collapse of France's largest commercial bank, Crédit Lyonnais. In return for their approval, necessary under the terms of the European Union Single Market directives, the French government agreed to a massive restructuring of the bankrupt State-owned bank. Part of this restructuring involves taking the huge portfolio of non-performing real estate assets from Crédit Lyonnais, putting them under a separate agency, Consortium de Réalisation, a mini-version of the Resolution Trust Corp. in the United States, which handled and sold off real estate assets of defunct savings and loan associations in the early 1990s.

Here is where the danger lies. Beginning early next year, this state consortium is mandated by Brussels to sell, "at market price," $10.3 billion worth of the real estate formerly held by Crédit Lyonnais. Three years ago, the largest real estate speculative binge in French history came to a halt, as the Bank of France was forced to sharply raise its interest rates to defend the French franc from speculative attack. Under terms of the proposed European Monetary Union (EMU)—the so-called Maastricht Treaty—France must have a "stable" currency for a considerable period, before it can be admitted as a participant in the new European currency.

The high interest rates and simultaneous severe economic recession in Germany, France's largest export market, in 1993, collapsed demand for expensive new office space which was being built, notably around Paris, as France's economy went into recession. At present, an estimated 5 million square feet of new office space stand vacant, a testimony to the frenzy of the speculation over the past decade. According to informed accounts, just as in the S&L speculation in the United States, a significant portion of the funds which poured into real estate projects in France, was tied to the international laundering of illegal narcotics profits. Law enforcement sources report that France became a focus for such illegal fund flows after 1992, when political corruption scandals in Italy forced a shutdown of many of the previous Italian-Swiss money-laundering routes.

France's real estate bubble

But regardless of the source of the funds which went into the French real estate bubble, the problem now, is that all French banks have heavy exposure on mortgages on the now-empty real estate holdings. In addition to Crédit Lyonnais, the largest creditors include Groupe Suez, Paribas, and BNP. If they were all to mark the valuation down from the high levels hit during the bubble speculation, many banks would show huge losses, rather than their currently reported small profits. Until October, an informal, air-tight pact among

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French bankers, had been keeping the non-performing real estate on the books of French banks as assets at the peak price levels of three years ago. All had agreed not to sell those assets, so long as the market for real estate remained depressed.

But after almost three years, and severe economic recession, French banks are now finding it increasingly difficult to make profits in other banking areas; the bad real estate hangs like a millstone around their neck. Two weeks ago, Barclays France became the first bank to break the pact. Barclays France revealed that it had vigorously sought to dump some $414 million of its real estate onto the market at huge discount, but had so far failed to find buyers. Now Crédit Lyonnais' $10 billion will force real estate prices across the greater Paris region to plunge in nominal value.

As a Paris real estate analyst put the problem, "Right now, the market is overvalued, simply because there are no transactions. But any attempt to sell large amounts of real estate would shatter the market." Estimates are that prices would immediately be marked down by at least 30%. In Japan, real estate valuations have fallen by about 60% since the peak in 1990 (see graph in *EIR*, Nov. 24, 1995, p. 13).

Such a sharp collapse in paper assets on the books of French banks will have a devastating impact on their overall credit standing, some more than others, but also on their willingness to lend to business. Here is where the banking problems intersect a disastrous French government economic policy.

Maastricht: France's Gingrich austerity

In early November, after months of vacillation, the government of Prime Minister Alain Juppé announced that its "top priority" would be to impose sufficient budget cuts and tax hikes, in order that France qualify as one of the founding countries in the proposed Single European Currency. In December 1991, in the wake of German reunification, the 12 Heads of State of the EU met in Maastricht, the Netherlands to sign a Treaty on European Union. The heart of this document, is a plan to create one currency out of the disparate economies by 1999 at the very latest. Since this is a ratified treaty approved by national parliaments, any proposed change reopens the entire ratification debate in national parliaments. Four years ago, when the treaty guidelines were agreed upon, the assumed outlook for EU economic growth was optimistic. The conventional wisdom was that the new markets of eastern Europe would create the basis for enormous economic expansion in EU industries, making the Maastricht convergence targets feasible.

The opposite has been the result, largely because of ideologically motivated insistence by the French and the British, that German economic expansion be "controlled." Tragically, France has been plunged into its deepest postwar recession since 1991, largely as a result of its effort to sabotage a successful German economic strategy to rebuild eastern European economies, instead of moving to have French industry play an essential cooperating role with Germany in that task.

Another victim of British geopolitics

Underlying this destructive French policy impulse, is the doctrine that caused two world wars in this century: Halford Mackinder's British geopolitics. Under that doctrine, first made public in 1904, British geopolitics seeks always to prevent the emergence of a Eurasian economic sphere, based on strong economic and political alliances between the countries of Central Europe, with Russia and the surrounding States. The argument is that this combination would create an overpowering combination which would end British global hegemony. British elites, most notably former Prime Minister Margaret Thatcher, adamantly adhere to this doctrine, which has shaped British policy toward France and Germany.

Rigid adherence to the strict Maastricht Treaty conditions were sold to Britain and France in 1991, as a way to contain German economic domination of eastern Europe, and hence of all Europe. This attitude remained French national strategy until the end of the Mitterrand era in May 1995. During the following six months, it appeared that his successor, President Jacques Chirac, was having grave doubts about the wisdom of continuing the Maastricht monetary austerity; he had won the election largely on his pledge to create hundreds of thousands of new jobs in a revived French economy. The Maastricht regimen, however, forces the opposite: Through its strict budget austerity—a European version of the discredited Gingrich "balance the budget" folly—Maastricht forces severe cuts in State spending. In France, where State sector industry is a major part of the overall economy, such cuts immediately cause soaring unemployment.

Following his London meeting on Oct. 29 with Britain's Prime Minister John Major, Chirac reneged on his campaign promise, and announced that henceforth, his "top priority" would be to meet the severe austerity demands of Maastricht, and to bring France's budget deficit down from its current 5% of Gross Domestic Product, to 3% by 1997. To reach the Maastricht-mandated goal would mean severe budget cuts or tax hikes equal to $27 billion. Such severe cuts in less than two years, at a time when the same Maastricht austerity demands are pushing the German economy and the rest of Europe into a new recession or worse, are all but politically impossible. Recent strikes which have brought French transport to a standstill, as well as sit-ins in schools and universities across France, are merely the first, modest response to the proposed cuts.

In early November, Prime Minister Alain Juppé announced draconian cuts in health care and social security and state pension benefits in order to reduce the deficit (see *EIR*, Nov. 24, 1995). Major had evidently convinced Chirac that Maastricht containment of a growing Germany was more

important than the health of France's own national economy.

But already, French official unemployment is 11.5% and rising. An even more alarming sign is youth unemployment in France, currently running over 23% officially. The series of measures being proposed in the past month by the Juppé government—sharp cuts in social security and health benefits, severe rationalization of the state railway, and general budget cuts and new taxes—guarantee that, all else being equal, the French economy over the coming months will plunge far deeper into depression.

To reduce the French budget deficit from 5% of GDP to 3% by 1997, will mean that hundreds of thousands will be forced out of state jobs, from the state railways, the airline, and public services. It is a cruel irony that the austerity will only worsen the deficit, as overall tax receipts to the government fall. France's public sector forms a predominant share of the overall economic activity—some 40% of GDP, far higher than in Germany or the United States—so cuts here hit the economy most directly.

Caught in a blind alley of debt

The present situation underscores the trap waiting for most governments of the European Union. Ever since the oil shocks of the 1970s, most European governments have gone deeply into debt to finance oil imports and maintain "full employment." France today has a total national debt of more than $828 billion. Germany's public debt will top $1.4 trillion by year-end. Italy has well over $1 trillion debt. The Maastricht Treaty, under these conditions, imposes the worst possible deflationary engine upon the European economies, just when their economic necessities demand radical new job and infrastructure-creation expansion policies.

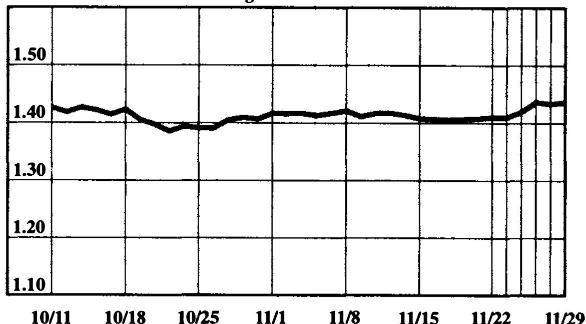
To reduce deficits, France, Germany, and other European Union countries are also introducing severe new tax burdens on industry. This, in turn, is accelerating the trend to industrial "globalization." Large French and German multinationals are going to cheaper production sites in Asia or eastern Europe in order to lower production costs, leaving a growing army of unemployed behind, who draw even more on the State welfare deficit.

The situation is a vicious, self-feeding downward spiral. On the one hand, the Juppé government demands that State employees work several years longer to qualify for pension benefits. But that only means fewer workplaces for young workers, as the economy contracts. The high interest rates of the Bank of France, needed to keep the franc stable for the Maastricht Treaty, prevent significant business and job creation in France. Massive job eliminations in State companies from railways, aerospace, and electricity generation further ensure loss of tax revenue. Into this volatile situation, the triggering of a new banking crisis through liquidation of billions of dollars of French office space at fire-sale prices in coming months, gives us all the ingredients for a financial and economic explosion.

Currency Rates

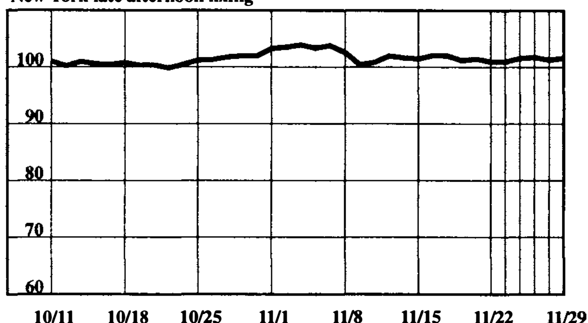
The dollar in deutschemarks

New York late afternoon fixing



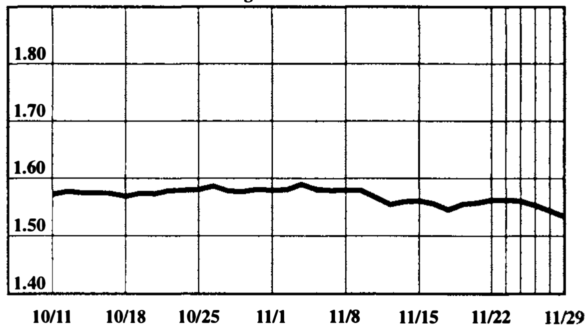
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing