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The euro-zone economy
Grounded

The French strikes are winding down. But a comparison with Germany shows that the country still has deep economic problems to address

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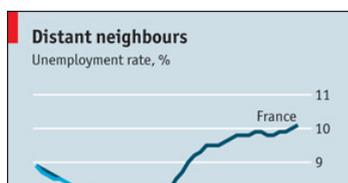
MICHAEL PORTER, a management guru, warned businesses not to be "stuck in the middle." Firms that use a mix of strategies to appeal to all customers might end up appealing to none. If Mr Porter's claim applies to countries as well as to firms, then France has reason to worry. In terms of the make-up of its economy, France sits at the centre of the euro zone. Concerns about its positioning, and envious gazes across the Rhine, have been spurred by a strong revival in Germany's economy. The recent battle over raising the retirement age (see [article](#)) shows how reluctant the French are to acknowledge that deficit-financed spending for household spending cannot go on forever.

Ignore minnows like Cyprus and Malta, and a bit more than two-fifths of the euro zone's GDP comes from its high-saving, export-intensive countries: Germany and its close neighbours, plus Finland. A slightly smaller fraction is accounted for by its southern and western "periphery"—Ireland, Italy, Spain, Portugal and Greece—a group united by weak public finances, poor export competitiveness and big trade deficits. France, which accounts for the remaining fifth of output, is a mix of the two. It has some of the industrial strength (if not the export dependence) of the euro zone's "core". But it also has milder forms of the fiscal laxity, labour rigidities and trade deficits that plague the periphery.

At the nadir of the recession, this middling course served France better than Germany's served it. The French economy fell less hard than the others because it was not as reliant on exports as Germany, or as hooked on credit-financed consumption as Spain and Ireland. The state plays a big role in France, which cushioned the downturn. A dollop of discretionary fiscal stimulus (2.25% of GDP in 2009-10, on the IMF's reckoning) helped.

But the recovery has proved disappointing, particularly in comparison with Germany and other core countries. French GDP rose by 0.7% in the second quarter of this year. Germany's GDP rose by 2.2%, the best quarter for that country in decades. Unemployment in Germany is also falling, in contrast to the trend in France (see chart). More recent figures suggest the German recovery is still going strong. An index of business confidence published by Ifo, a Munich research firm, jumped to a three-year high in October. Germany's economics minister, Rainer Brüderle, announced on October 21st that the government was revising its GDP growth forecast for 2010 up from 1.4% to 3.4%. In contrast, the French government had already cut its forecast for next year from 2.5% to 2%. Even that may prove optimistic. Private-sector forecasters reckon France's economy will expand by around 1.5% this year and next, well below the 2.4% annual growth it managed in the decade before the global financial crisis.

One response is to dismiss Germany's lead as temporary: its economy fell harder in recession so it ought to bounce back stronger. But some sense a growing anxiety in France that a consumer-led economic model fuelled by deficit-financed transfers from government may be



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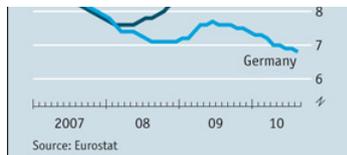
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reaching its limit, as public debt spirals upwards. Germany's recent success makes export-led growth seem attractive. "There's a realisation that the world has changed," says Marco Annunziata, at UniCredit. "Tapping into strong emerging-market demand has lifted Germany. But France has lost its way in this regard."



France moved from a current-account surplus of 3.1% of GDP to a deficit of 2.2% in the space of a decade.

A casual survey of big global firms suggests France ought to be able to match Germany's export prowess. Germany has 37 companies in *Fortune's* list of the top 500 global companies ranked by total revenue. France has 39. But many big firms are clustered around Paris, and in industries that rely directly or indirectly on state support. Germany's large firms are more diffuse. French industry has no answer to Germany's *Mittelstand*, the niche firms that make high-quality capital goods and can charge premium prices for them. "There is no bottom-up culture of innovation in France to match Germany's," says Thomas Mayer, at Deutsche Bank.

France's elite industrial model means big firms take the pick of graduates. Its rigid job-market rules hurt small firms in particular. The tax "wedge" between a firm's wage costs and what employees are paid is one of the largest in the rich world (although Germany's is bigger) and militates against small firms hiring, as does the high cost of firing. As a result, small firms struggle to reach the critical mass needed to be exporters, says Laurence Boone, at Barclays Capital in Paris. High minimum wages make it costly to hire inexperienced workers and help explain why youth unemployment in France is higher than the European average. The government has raised the retirement age to maintain solvency, but early retirement holds back the economy in other ways. Only 39% of people aged between 55 and 64 are in work in France, compared with 56% in Germany.

The French may envy Germany's recent GDP growth and employment record, but France has its admirers too. "France competes very well with its elite model: good human capital, and high-quality state institutions and infrastructure," says José Luis Escrivá, at BBVA, a Madrid-based bank. It is still treated by bond markets as a country that hugs closer to Germany than to Italy or Spain. That could change if the government proves unable to tackle its budget deficit, likely to be 8% of GDP this year. Then France really would be stuck.

Europe

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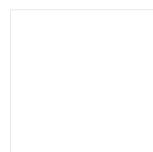
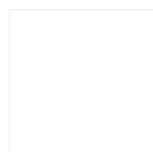
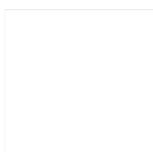
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