

## 2013 Coface Country Risk Conference

### Key issues



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## A day to decrypt the risks and opportunities for 2013

The 17<sup>th</sup> Country Risk Conference held by Coface on 22 January 2013 has confirmed the complexity of a situation where, more than ever, the world seems to be *«split in two»*: advanced versus emerging countries.

If the declining power of the United States still appears very relative, it is facing serious problems concerning the reduction of its fiscal deficits. And although the financial markets no longer believe in the breakup of the eurozone, the European Union is striving to think of itself collectively. Growth will remain negative in 2013 in many member states and the rise in unemployment poses a key problem: people's patience. Some of them, as in Germany, consider that the crisis is the result of non-virtuous states' excesses. Others find it more and more difficult to accept the consequences of necessary but too brutal austerity measures and of structural reforms, the benefits of which will only be felt in the long-term. Nevertheless, more than a tiny-stepped federalism is necessary in order to resume healthy growth and for a sustained revival of European industry.

The emerging countries, for their part, are likely to post above 5% flattering growth, according to Coface's forecasts. But although their reactive and cautious policies have enabled them to withstand the global crisis, their vulnerabilities remain all too real: fragile financial systems, poor governance, and difficult economic, social and thereby political change to manage. These countries have introduced a new dynamic to the global financial and economic game. But without asserting themselves as a driving force for change within the G20, nor accepting the counterparts of further international integration.

In commercial terms, while everyone welcomes the absence of soaring protectionism, subtler measures that hinder access to emerging markets are being implemented. And we should not forget the problem of exchange rates that disadvantages eurozone companies to the benefit of their American and Japanese competitors.

But this globalisation under pressure offers many opportunities. The rise of the middle classes in emerging countries is one of them, provided one takes into account the sheer diversity of countries such as China, India, Brazil or Russia.



**Jean-Marc Pillu**  
CEO, Coface

## Challenges for a world divided into two parts

One of the strengths of Coface is to follow in real time the pulse of businesses worldwide, which makes it a privileged observer of the global economy. It is clear that between the 2008 financial crisis and the crisis within the real economy we are facing today, the respite for companies has only been six quarters. This breathing space is much too short for the countries in difficulty within the eurozone to restore their profitability and self-financing capacity. For a year and a half, we have watched their payment pattern, to which we pay great attention in our profession, deteriorate sharply. And we are not very optimistic about the future, at least in the short-term.

In fact, the economic environment is complicated and will remain so in 2013. Even though it is likely to continue to grow at the same rate in 2013 as in 2012 (2.7%\*), the global economy will face two major obstacles. The first is the huge debt accumulated by advanced countries, and above all, the way they are trying to reduce it. In this case, the remedy being applied accentuates the damage and the debate on the extent of austerity policies grows. The second obstacle comes from the emergence of a multi-form political risk: political clashes in the United States that prevent it from clarifying its fiscal strategy, political evolutions in a few European countries especially in Italy, incomplete institutional progress in the European Union, the rise of unemployment in Southern Europe, worldwide terrorist troubles of all kinds.

There is no doubt that only the emerging countries will come out unscathed in 2013. The world will continue to be divided in two: the struggling advanced countries on the one hand, and the emerging countries giving us cause for hope on the other.

Overall, advanced countries are weakened by the recession in the eurozone (-0.5%\* in 2012), which is struggling between its deleveraging problems and promoting growth when it faces a sharp increase in unemployment. The United States seems to be in a somewhat more favourable position, even though growth is expected to slow to 1.5% in 2013, compared to 2.1%\* in 2012, while the astounding spectacle of its talks on the 'Fiscal Cliff' will cause concerns in the rest of the world.

The other block, the emerging countries, has comfortable monetary and fiscal leeway. It will be the area of economic stability in the world, with growth that we estimate above 5%, higher than in 2012 (4.8%\*). But emerging economies are maturing. They now wish to develop their own industries, their own brands and have more high-end products. And they no longer hold back, if necessary, from protecting their domestic companies.

For 2013, the question is whether or not this source of growth in emerging countries and the efforts of advanced economies, particularly in Europe, can create opportunities for businesses and improve the low confidence of economic players, an absolute precondition of any upturn in growth.

\* Estimate revised in February



**Nouriel Roubini, Ph. D.,**  
Chairman of Roubini Global Economics,  
Professor at the Stern School of Economics  
and at New York University

## The United States, a declining power?

Nouriel Roubini, usually more alarmist than most economists, has painted a relatively optimistic picture of the US economy, which is in better health, he said, than most of the other advanced countries. The United States maintains an economic, financial and political potential envied by many emerging powers. In short, its decline will remain very relative, although there is no shortage of challenges, either regarding the public deficit or domestic policy.

### An enviable growth rate...

For Nouriel Roubini, the sluggish growth in advanced economies is no surprise. Resolving a financial crisis of the magnitude we experienced requires a long and painful process of debt reduction. The public and private players must spend less and save more to reduce accumulated debts and deficits. States had to support demand from the beginning of the crisis, massively increasing public debt to unsustainable levels in the long run.

While all advanced countries have been affected by the recession, some, including the United States, have managed to maintain growth rates of about 2% per year. This is not the case for eurozone countries, with many of them experiencing several quarters of recession. The cause of this divide is «*fiscal austerity that the European countries have introduced*» to prevent the widening of deficits. Raising taxes and cutting State spending and transfers almost immediately weighs negatively on growth, in particular through the reduction in disposable income. The US has delayed this fiscal adjustment, at least until now. Its high fiscal deficit has buoyed private consumption and safeguarded growth. In addition, US household consumption has been heading in the right direction for two years. This is not due to higher wages or greater dynamism in economic activity, but to «*a stimulus plan estimated at 1.4 trillion dollars, comprised of tax cuts, increases in transfers and unemployment benefits, financed entirely by public debt.*» It is also due to rising levels of debt in public institutions which has enabled private sector deleveraging.

### ... but threatened by economic and political challenges

Control of public debt is, in itself, a threat. A budget deal between Democrats and Republicans on this subject will slow growth in 2013. In fact, the Federal Government must increase taxes and cut government spending, which will reduce disposable income growth and thus private consumption. It is therefore probable that, after having increased by more than 2% in 2012, growth will be limited to 1.6% in 2013.

The US economy will benefit from positive factors such as the upturn in the property market, the third round of quantitative easing by the Federal Reserve, the shale gas revolu-

tion and gradual reindustrialisation. But «*we must not be unduly optimistic.*» Monetary easing by the Federal Reserve will have a limited impact on activity. The effects of the shale gas revolution will only really be felt by 2020. And the slow reindustrialisation of the US economy will be highly capital intensive and thus create few jobs. There is currently «*one worker for 1000 machines*» reveals the economist!

Another threat to the US economy is the risk of a political stalemate in Congress. Besides the agreement that Republicans and Democrats must reach on the details of reducing public expenditure, policy makers will have to agree in May, on raising the debt ceiling. Nouriel Roubini assesses the fiscal adjustment at 1.4% of GDP, resulting in slower growth of 0.6%. The systematic postponement of the resolution in the medium-term of the growing burden of the debt may be punished by the markets, even if the United States can afford such political indecision thanks to the still considerable role of the dollar in the world.

### The advantages of the dollar, geopolitics and innovation

Overall, the US fares better than the eurozone, the UK and Japan. Productivity growth is more robust, the aging population less marked and growth potential is higher. In the long term, US GDP – but not GDP per capita – will be lower than that of some emerging markets, including China, but not until ten or twenty years time. Similarly, the monetary decline will be relative, as the dollar currently has no competitor in the world: the renminbi may be a strong currency one day, but again not until ten or twenty years time. The United States has a second advantage on the geopolitical front, remaining, by far, the leading diplomatic and military power in the world.

Future growth in the United States will depend on its ability to be successful in five innovation areas: energy, biotechnology, information technology, defence technology and automation/robotisation of industry. However, it seems that the United States, and this is their third major advantage, innovates more than many other countries to master these future technologies. The decline of US power in the coming years will therefore be very relative.



## Round table



**Robin Niblett**  
Director Chatham House



**Patrick Artus**  
Director of research and studies, Natixis



**Javier Díaz-Giménez**  
Professor of economics at IESE Business School



**Kit Juckes**  
Head of Forex research, Société Générale



**François Heisbourg**  
Special advisor, foundation for strategic research

# Eurozone How can it grow? How can it last?

2012 was marked by growing rumours of a break-up of the eurozone. The support mechanisms announced by the European Central Bank and European institutions reassured the markets. But the impact on the real economy remains to be seen. Growth remains negative in many countries in the eurozone and the rise in unemployment increases the risks of social tension in 2013.

### A very discreet European federalism

Faced with markets that «*seem to have decided that the eurozone crisis is over*» and which are once again interested in Greek and Spanish assets, Patrick Artus remains cautious. Some issues still exist. In his opinion the eurozone crisis comes from the member states heterogeneity, symbolised by an industry weighting from 1 to 4 depending on the economy. As the crisis reduced competitiveness and undermined industrial production capacity, the situation worsened. The fact that eurozone countries could not pile up external debt forever, due to the risk of facing external solvency crises, triggered the crisis. The majority of governments have intensely sought to reduce their public deficits at a time when demand for imports from other European Union (EU) countries contracted. This intensity has led, for countries whose industry is not large enough, to a fall in exports and an impoverishment of households that has resulted in a drop in domestic demand. The problem comes from European countries that can only curb the crisis by internal devaluation of wages.

Patrick Artus is not very optimistic for 2013 and believes that the fiscal adjustment in Europe will continue and that the

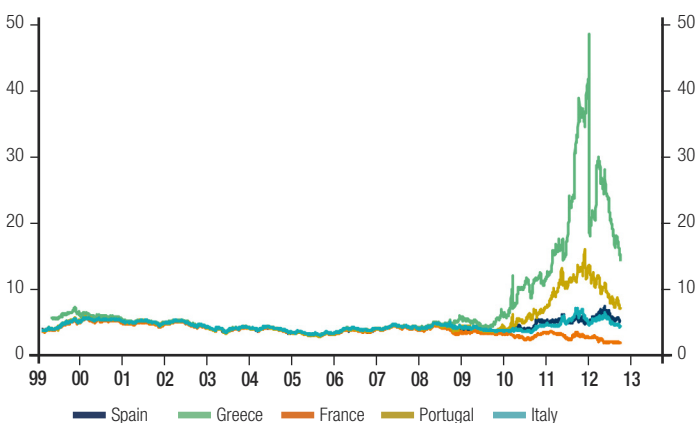
main work still needs to be done. For example, Spain only managed to reduce its public deficit to 7.5% in 2012 instead of the expected 4.5%. The comparison with the United States is striking: interest rates on European public debts have fallen substantially since the European Central Bank (ECB) measures taken in the summer of 2012, but they are still well above the growth rate, which is not the case across the Atlantic.

According to Patrick Artus, the various EU institutional developments in 2012 are all about some «*institutional marketing*». The content of the banking union is quite weak to say the least: bank recapitalization has not been achieved; OMT (Outright Monetary Transactions) which allows the ECB to buy government bonds in the secondary market will only be triggered if the requesting country accepts a strict conditionality (a macroeconomic adjustment programme); pooling of sovereign risk (under the European Stability Mechanism), is impossible to implement without real political union. Only «*discreet federalism*» seems feasible to him.

Kit Juckes shares this opinion and contrasts the current financial markets' optimism with the difficulties of the real economy. The euro is saved, but many problems have not been resolved. However, the markets are reassured and, according to him, investing in Spanish bonds can be a good investment, given the very low level of US spread and still sometimes risky spreads of the emerging countries. The fact remains that European spreads are still much higher than growth rates. The very survival of the euro is no longer at stake; the EU crisis is now a crisis of growth and competitiveness.

For Kit Juckes, the supervisory role of the banking union planned in the coming years, will be effective and will most certainly enable an over-indebtedness crisis to be avoided. But it will not prevent the next crisis, which will be that of private sector investment. Kit Juckes believes that the positions of the EU will become closer and that the banking union will facilitate reciprocal investments.

**GRAPH 1**  
Interest rate on 10-year government bonds

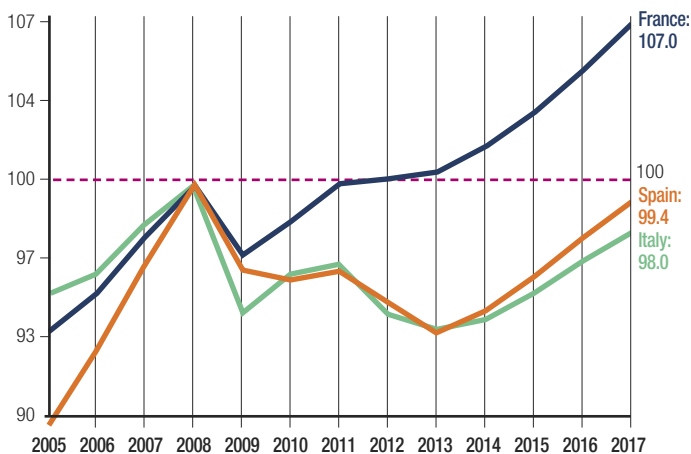


Sources: Datastream, Natixis

## France, Italy, Spain The long road towards growth

Javier Díaz-Giménez emphasises that the Spanish, French and Italian economies have had similar economic cycles since the introduction of the euro in 2002. Growth was strong (particularly in Spain) until 2008, followed by a phase of recession and then of slow growth. «Whereas in 2012 France almost regained its pre-crisis level of GDP, this is far from being the case for Spain and Italy». The IMF estimates that these two countries will have to wait at least until 2017 to achieve this.

GRAPH 2  
Real GDP: IMF scenario see attached



Source: WEO October 2012

Regarding debt and public deficits, three trends emerge. Spanish public debt had been reduced drastically in the mid-2000s, before quadrupling from 2008, due to growing public deficits. On the other hand, Italy had no choice but to limit the widening of its fiscal deficits due to already very high public debt. Lastly, in between the two, France will return to a deficit of 3% of GDP in a few years, but its public debt has already increased by 50% since 2008.

In the light of these figures, for Javier Díaz-Giménez, it seems difficult to maintain cohesion within the EU. There is increasing division between countries, which, like Spain and Italy, are experiencing a «lost decade» and are seeing social resentment rise day after day, and others, such as Germany, which are managing to maintain positive growth rates. The economist is nevertheless optimistic about Spain, in light of the Ireland, which carried out the same fierce fiscal adjustment a few years ago, and which, in 2013, will see the strongest growth in the eurozone. He sees this as a proof that an internal devaluation through wage moderation can help Spain.

Javier Díaz-Giménez recalls that three «schools» of thought advocate different growth drivers. The first is the Keynesian school that relies on increased public spending and lower taxes. Although the Spanish economist recognises the positive short-term impact of such an economic policy, he believes that its long-term effects are more ambiguous. The crisis has shown that the Keynesians are wrong when they think that the private sector will eventually take over public spending to boost the economy. «The Keynesian magic has not been verified in practice and has led to soaring debt and public deficits.»

The second school of thought is that of austerity, widely followed in Europe today. It advocates fiscal adjustment through lower spending and higher taxes with varying degrees depending on the country, and which will enable solid growth in the medium and long term. Defended mainly by Germany, austerity is less popular in Southern Europe, which asks for these measures to be moderated, while France is in an intermediate position. However, there is still the debate about what type of expenditure should be cut while taking into account a number of economic, political and social factors.

Lastly, the third school of thought is based on Edward Prescott's observation that if you do not know what can help restore growth, you need to identify what are the obstacles to it. In this regard, European countries still have a long way to go to facilitate the business environment.

In response, Robin Niblett recommends that governments use 2013 as a year of structural reforms preparing the return to growth in 2014-2015 and not as another lost year. He calls for increased support of the services sector, the fastest growing sector for European economies, which involves greater openness to competition. Whereas this sector represents 70% of GDP in the eurozone, only 20% in each country is open to competition with other countries in the zone, which creates barriers to a return to growth. In his opinion, it is not only a case of improving the business environment as mentioned by Javier Díaz-Giménez, but also of implementing strategic reforms.

For Patrick Artus, there are two goals in Europe: employment and growth, requiring, as Robin Niblett says, strong support for the services sector, the only sector able to re-start full employment but also a need to make industry more sophisticated, with more high-end positioning. To his mind, this second objective is unattainable for some countries. There is a choice between two strategies: a cooperative one, aiming to help countries in difficulty to achieve a sufficient level of competitiveness, and the other one is non-cooperative, resulting in an adjustment of the labour market. It is this latter strategy that is currently being developed.

## The unknown in the European equation People' patience

In response to this pessimistic economic news, François Heisbourg has a positive point to make: democracy has not disappeared anywhere in Europe, despite the existence of technocratic governments, such as in Italy. Populism, which some thought would explode, has remained moderate in Spain, France and Italy. Nevertheless, social demands and identity assertions are on the rise in some regions, which is currently the most significant political risk. In fact unlike a war that unites people, an economic crisis divides them. In addition, the European people are not all experiencing the current crisis in the same way. The Germans believe that it is a lack of economic virtue that has plunged some countries into crisis. Faced with the recession forecast for 2013, what will be «the degree of patience of voters subjected to a purge, the curative virtues of which are not strikingly evident»? The window of opportunity for introducing more federalist measures will, according to François Heisbourg, close very quickly as the political situation is changing profoundly, especially in the Southern countries.

Robin Niblett concludes the discussion with the case of Britain. The announcement by Prime Minister David Cameron of a referendum by the end of 2017 on Britain staying in the EU does not come as a surprise. With a Europe in search of more federalism since the ravages of the crisis, David Cameron faces a widely eurosceptic electorate. In a context of sluggish growth, he will have no other choice if he wants to ensure his re-election, than to put this question at the heart of the debate. Not to mention that the European issue

will enable him to rally the Conservatives. A difficult wager that has led him to announce his willingness to renegotiate certain treaties to ensure that his country has access to a strengthened single market before going through a referendum on EU membership. Robin Niblett recalls the danger of referenda whose outcome is always uncertain, but believes that pragmatism will prevail. Let us be wary of the polls, he says, and not overestimate the willingness of the British to leave the EU.



## INTERVIEW

**Patrick Artus**  
Chief Economist, Natixis

*«A positive momentum encouraging the role of the US dollar»*

**To what extent will the US mini-budget adjustment agreement reached on 31 December 2012 (which will be reviewed in March) weigh on economic growth in 2013?**

There are two issues that need to be addressed in 2013: public spending cuts and the debt ceiling. The US Congress will find a compromise, even if it is somewhat messy, because nobody wants to see a fiscal shock that would threaten growth. I foresee a reduction in the public deficit of one point of GDP per year in 2013 and 2014, giving a deficit equivalent to 4.5% of GDP in 2014, which is easily financed in the United States. This will cost 0.5% growth over the next two years. After that, there are other outstanding issues regarding US public finances. The most serious problem, but that will not be discussed at the moment, is the sharp increase in public spending on health care, which will jump from 7% to 14% of GDP over the next twenty years. The Americans know they have five years to address this issue. Let us not forget that slowly dealing with these questions weighed heavily on growth in late 2012. It will weigh on growth again in early 2013, in particular with the measure that provides for an increase of 2% in the payroll tax paid by employees. There are, however, some countervailing forces: business investment has begun to surge, and residential real estate is starting to really take off. Finally, the United States can afford to reduce their public deficit relatively slowly as they have no financing problem. For instance, in 2012, non-residents bought USD 700 billion in Treasuries, which over-funded the trade balance deficit and 60% of the budget deficit.

**Do you think the May deadline for raising the debt ceiling will help to finally resolve the problem of the sustainability of medium term US debt?**

The American problem is well known, it is 2020-2040. If there is no policy change, as from 2013-2014, public debt relative to GDP should begin to decrease and increase again in 2020. There will have to be a real substantive debate on the high levels of Medicaid and Medicare spending. The Democrats want to increase the tax burden

in order to finance these expenditures, while the Republicans are keen to encourage households to seek insurance with private entities. However, policy makers have a number of years ahead of them to have this debate. Today, there is renewed confidence in the United States thanks to the prospect of reduced energy imports because of the shale gas revolution. In short, the dynamic is favourable to maintaining the dollar's role in the future.

**Let's talk about the eurozone. After having presented fiscal austerity as the cure to the sovereign debt crisis, many economists, including within the IMF<sup>(1)</sup>, are now stressing that the impact of such policies on growth has been underestimated. In 2013, do you think that the eurozone countries which have already initiated austerity programmes will be able to temper them down?**

This is an absolutely key issue. With regard to the fiscal multiplier, I think it is risky to work with complex and fragile statistical models such as the ones used by Olivier Blanchard. The first question to ask is whether we can have a fiscal multiplier which is higher than it has been in the past. The answer is yes, for three reasons. First, the countries are implementing their restrictive fiscal policies simultaneously. Second, short term interest rates are close to zero, so there is no room for an expansionary monetary policy. Third, Europe is going through a deleveraging period, which prevents having Ricardian neutrality. According to this notion, if public spending goes down today, households will pay less tax tomorrow, and so they will consume more today. However, to do this, households must have easy access to credit to raise debt, which is not currently the case. In short, the combination of these factors tends to make the fiscal multiplier higher, around 1.2 on average. This explains why Spain has only gained one percentage point of deficit instead of four as anticipated by the budget in 2012.

(1) Olivier Blanchard and Daniel Leigh «Growth forecast errors and fiscal multipliers», IMF Working Paper, January 2013





Interview de  
**Patrick Artus**  
(continued)

If there is a consensus on this, the strategy needs to change. I think there are two possible paths ahead. The first one involves taking account of the fact that the fiscal multiplier is greater than 1 and therefore spreading the effort to restore the public finances over time. In this strategy, we would be concerned primarily by the government deficits of the countries in most difficulty (like Spain or Ireland). Only after that would countries with more moderate deficits implement fiscal adjustment programmes. In the second strategy, we could work on the fiscal multiplier by taking measures to reduce it. Countries could, for example, recapitalise their banks, which would restore investor confidence and therefore lower financing costs.

It is urgent for Europe to start to consider such strategies; otherwise it is heading for disaster. But given the reluctance of the North to relax the pressure on the South, these strategies do not seem to have much of a future. The former are concerned by the creation of moral hazard, in other words that countries in most difficulty might feel less committed to making the necessary adjustments. There is therefore a considerable risk that the current strategy will not be questioned and therefore that Europe will sink into a deep spiral of depression.

**The financial markets seem to have regained confidence in the eurozone, which can be seen through the strong increase in stock prices in Europe. Do you think this trend is sustainable?**

This confidence may well last because it is based on the certainty of financial markets that the European Central Bank will intervene heavily if prices fall, to avoid a rise in interest rates, what we can call «*Draghi put*» in reference to the «*Greenspan put*» in the second half of the 90s. Investors, faced with cash piles they hold, are deciding to buy large amounts of European equities and peripheral debts in the euro area, which are deemed safe thanks to the «*Draghi put*». However, this is equivalent to denying the actual development of the economies in the euro area: decline in activity and investment, decline in production capacity of the industry, deterioration of the creditworthiness of banks and political and social risks because of rising unemployment. In sum, we are confronted to of a bubble: there is plenty of liquidity, yields are high and there is movement on a number of assets, risky for the most part.

*In the eurozone, we are confronted to a bubble and even a minor event could cause it to burst.*

In this context, no-one can predict when and what event might trigger a return to pessimism on the financial markets in the euro zone. It could arise, for example, from the Cypriot banking crisis or from an escalation in the political and social tensions in southern Europe.

**Against this difficult background, even if there is no break-up of the eurozone caused by the attitude of the countries, as considered and much feared last year, do you think that a break-up driven by the people themselves is possible?**

What is surprising in this regard is that populist movements are developing in countries which are faring relatively well rather than in those experiencing more difficulties. For example, in Italy, populist movements have lost ground while in the Netherlands and in Austria they have won support. It must also be remembered that in the South, there is a powerful underground economy which coexists with a strong family solidarity that helps people to withstand the crisis. For example, in Spain, this explains the low default rate on household loans. Consequently, the risk of a social crisis is not necessarily greatest in these countries. On the other hand, there are major political differences between the North and the South of Europe, which I am very concerned about, because it means that an event, even minor, could burst the bubble that has formed on European assets.

**Can the banking union be efficient when only the large banks are subject to the common supervisor?**

It is not only the big banks that will be subject to the common supervisor, but all the banks that the ECB decides to monitor. There are only two exceptions: German savings banks and German public banks. What bothers me about the banking union is not the supervision, it is the fact that old bank losses are not within the remit of the banking union. On top of that, the process is not binding: the European supervisor cannot force a bank to recapitalise and therefore we will not quickly resolve the issue of confidence in banks. We ought to require States to recapitalise the banks that cause problems as soon as possible, and to make progress in the resolution of old arrears.

**What should have been the strategy?**

A complete clean out, like the US banks did. That means provisioning for everything that may, in the future, become dubious and recapitalising or nationalising the banks in order to spread the message «*there are no more problems*». However, the banking system in southern Europe, except for France, is in a difficult situation. In addition, the example of Cyprus shows that European stakeholders do not necessarily apply the principles that have been up for debate: the principle of not lending to a country with a solvency problem and the crisis resolution principle. Would it not be better just to establish simple rules? For example, you could restructure 30% of all debts that exceed 80% of GDP and nationalise all the banks which do not have enough capital instead of letting them generate new doubtful loans.



## Interview Patrick Artus

(Continued)

### **How can the fiscal union work when, as things stand, we have been struggling to agree on a budget? What sort of progress can we expect on this subject in 2013?**

I approve and respect the very clear position that the Germans have adopted, whereby they do not want to pool major public debt without a fiscal union. Progress would require the States agreeing on a number of budgetary principles with a European budgetary authority which would have a veto over national budgets. This would make it possible to pool a large portion of the debts. But this will take years because of fears about loss of sovereignty.

In short, at some unknown date and for some unknown reason, the sovereign debt crisis in the euro area will make its return. We will see then that the institutions we have put in place are not up to the problem. This will in turn cause a very strong impulse to move towards the creation of a European budgetary authority with the power to change countries' budgets.

### **Some European companies say we should devalue the euro to regain competitiveness: what do you think?**

If we devalue the euro, all European industries which export outside the euro zone will benefit from it. For a country to benefit overall from a devaluation, the gains made by its industry must not be outweighed by losses related to higher import prices. Italy would be particularly favoured because it has a large industrial sector characterised by a strong sensitivity to prices. The risk would be to create more unemployment, because of the costs of paying for more expensive imports. On top of that, we do not know how to devalue the euro. Because interest rates are close to zero, the only solution would be to buy foreign exchange reserves in dollars, like the Chinese, at the risk of channelling European savings to the US Treasury at the expense of European investment.

### **If devaluation is not possible, how can we restore the competitiveness and profitability of European companies without worsening the current social situation?**

First note one thing: German and Spanish companies have no competitiveness problems. Only France and Italy do. In Italy, this is mainly due to productivity gains that have remained around zero for fifteen years. In this country, we can see that technological progress comes to a standstill, due to financing problems, ageing of capital, and arrears in payments by the authorities that have pushed companies to stop investing. In France, the problem is one of quality range. We have labour costs that would be bearable only if we produced high quality products.

### **The press has reported widely on the competitiveness of France as compared to Germany. How did it come to this?**

This is a problem that could be relevant to sociology. French companies have two weaknesses. First, a network of traditional and highly conservative SMEs that invest and export very little: about 80% of SMEs do nothing in terms of economic dynamics and even strong SMEs, instead of developing in size as in Germany, are often sold early by their managers. Second, when we look at the large groups, growth is almost always realised through acquisitions: when one of them wants to develop a new product, it looks for an SME that has already developed it and buys it. It is therefore easy to understand that without large SMEs, our country cannot go upmarket in terms of quality.

In France, all the SMEs that were created recently and which have been successful have been sold, with the exception of Free. In contrast, in Germany, business practice encourages the reinvestment of profits to develop the firm. We need a real debate: why do French entrepreneurs not want to become leaders of large groups? You have to remember that only one CAC 40 company started as an innovative SME, Gemalto. Another telling figure: every year, 17% of SMEs with more than 250 employees are taken over by a large group. However, it is precisely the generation of such large groups that creates growth.

*German and Spanish businesses*

*have no problem of competitiveness.*

*Just France and Italy do.*

### **Where does the problem come from?**

The problem is not only political. The administration has a violent anti-industrial and anti-entrepreneurial stance. This is particularly evident when we observe the excessive number of standards. I am not surprised that, in such a hostile environment, some people succumb to the millions being offered by the private equity funds. However, in macroeconomic terms, we have numerous strengths. We are still at the same level, or above, as our neighbours in many areas: R&D, public infrastructure, educational system, banks. However, our country is still unable to take off, which can only be explained by looking beyond the objectivity of economics. Finally, I observe that there is an increasing trend towards conflict within French companies. This comes from our corporatist tradition that has nurtured «*a society of distrust*<sup>(2)</sup>» where social dialogue is made difficult because of the structure of our trade unions. Entrepreneurs are forced to build up a heavy bureaucratic apparatus when their business grows. In my opinion, that is the main obstacle to business growth.

Interview conducted by Coface  
on January 29 2013

(2) Yann Algan and Pierre Cahuc, "La Société de Défiance, Comment le modèle social français s'autodétruit", Cepremap, 2007.



## Round table



**Marc Auboin**  
Economic advisor responsible for trade and finance issues and consistency in economic policies, WTO



**Yves Zlotowski**  
Chief Economist, Coface



**Frédéric Sanchez**  
Chairman of the Board of Directors, Fives



**Peter Luteka**  
Global Head, Export Credit and Global Specialised Finance, HSBC

## Protectionism, financing problems: Globalisation under pressure?

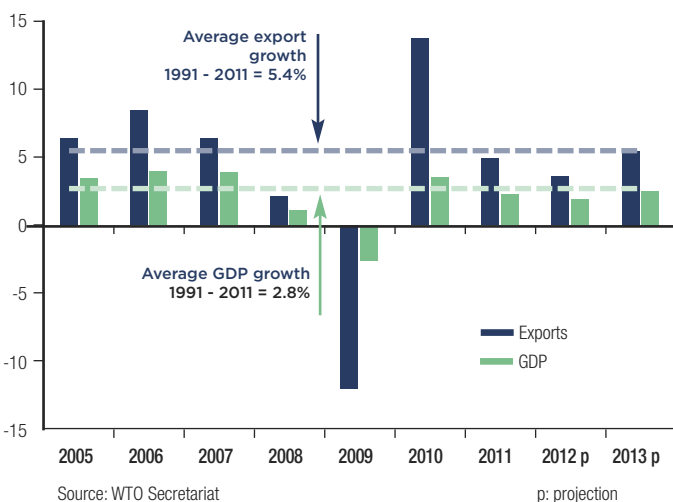
«We are not yet out of the woods» declared Pascal Lamy, Director-General of the World Trade Organisation. Since 2008 the advance of globalisation seems to have slowed somewhat. Difficulties in accessing trade financing and sometimes uncooperative practices of States are partly responsible. In this context, the question is whether we could see an enduring deceleration in globalisation. Some answers from Marc Auboin, Yves Zlotowski, Frédéric Sanchez and Peter Luketa.

### There is no resurgence in protectionism...

Marc Auboin is reassuring about global trade development. If trade has been affected by the 2008 crisis, this has not been a long-term trend. In fact, the growth in trade volume has remained higher than that of global GDP since 2010, driven by the new growth areas that are the emerging countries.

According to the WTO, global trade, adjusted for inflation, has tripled in volume over the past twenty years with an average growth of 6% per year. And it will continue to grow at a steady pace over the next fifteen years. Chinese demand alone is expected to double over this period.

**GRAPH 1**  
Growth in volume of world merchandise trade and GDP, 2005-13  
(Annual % change)



With regard to protectionism, Marc Auboin says that traditional measures, such as increasing customs duties are not, or are very little, used because imported products subject to taxes are often intended for the manufacture of end products. He adds that the import content of exports amounts to 40%, on average, for developed countries and 60% for emerging countries. This reflects the extent of economic integration on a global scale and the resulting fragmentation of goods production. Admittedly, this situation makes traditional protectionism more difficult but, as pointed out by Yves Zlotowski, we must keep in mind that there is a stock of protectionist measures, accumulated since the 2008 crisis, and it decreases only very slowly. Marc Auboin estimates this affects 2 to 3% of global trade. To encourage countries to end these measures, most of which were in principle temporary, the WTO regularly publishes a list to exert a kind of 'peer pressure' on states.

### ... but more subtle measures are implemented

Some measures are now being implemented by emerging and developed countries, which Frederic Sanchez refers to as 'low intensity' protectionism. He gives, as an example, the implementation of specific standards for certain products. Another example, highlighted by Yves Zlotowski, is the new strategy of administrative barriers in emerging countries, which reserves infrastructure projects for national production, such as in Brazil where the BNDES (Brazilian Development Bank) only finances projects if the products are designed and manufactured locally. This support of national companies is coupled with increasingly frequent capital controls, which take different forms depending on the objectives of the emerging countries. Brazil has therefore introduced taxes on imported goods, while other countries seek to

restrict currency convertibility. The IMF has published a study on this subject acknowledging that, in certain cases and for a limited duration, such controls are legitimate. Yves Zlotowski quotes Joseph Stiglitz: «*financial regulation is not just a stop-gap measure, but must really be integrated into the strategy of financial markets.*» He believes that this new pragmatism reflects the willingness of emerging countries to refocus their economic policies on their domestic markets and to protect their economies from the adverse effects of economic and financial crises caused by developed countries, as was the case with the subprime crisis and that of the eurozone. This mistrust contrasts sharply with the previous period where globalisation was seen as a growth game in which it was necessary to take part.

### Strategic business responses must be diversified

Businesses must establish in these countries whenever «*they have the means to do so*», recommends Frédéric Sanchez. Targeting a small number of countries with differentiated products, which is what Fives has done in China, India and Brazil, ensures strong export growth. But in the short term European companies will continue to lose market share due to their low cost and price competitiveness. Returning to growth rapidly requires establishing oneself in the current growth centres, i.e. the emerging countries, even if the initial cost is substantial: around 1 to 1.5 million euros.

The round table participants naturally come round to the current big issue: the tripartite agreement between Areva, EDF and the Chinese company CGNCP, which highlights the risks associated with international technology transfers. Frédéric Sanchez notes that companies do not really have a choice if they want to maintain market share in strategic sectors such as energy. For Marc Auboin, there are great opportunities in emerging countries as they are now seeking high-tech products. As an example he cites the agreement signed in January 2013 between the Brazilian national oil company Petrobras and Vallourec for the supply of high-tech seamless pipes for the exploration and exploitation of offshore oil. Nevertheless, Frédéric Sanchez explains that Fives tries not to export the highest levels of technological skill, in order to limit the extent of technology transfer, and to always stay ahead in terms of expertise so as to gain more market share in emerging countries. But for him, the main obstacle to export development is certainly the erratic movements of developed countries currencies, especially those of Japan and the United States. This uncertainty, coupled with strong risk aversion in Europe, weighs heavily on company export decisions. Marc Auboin raises the question of the currency dumping that resulted from the disorganisation following the end of the Bretton Woods system. Addressing this is not included in the mandate of international institutions such as the IMF or the WTO. Marc Auboin recalls that the IMF advises states not to «*manipulate their currency,*» but no one controls what happens beyond this advice. Is the WTO likely to take on board and monitor the IMF's recommendations on currency dumping? This is a substantive issue that is currently being debated at the WTO.

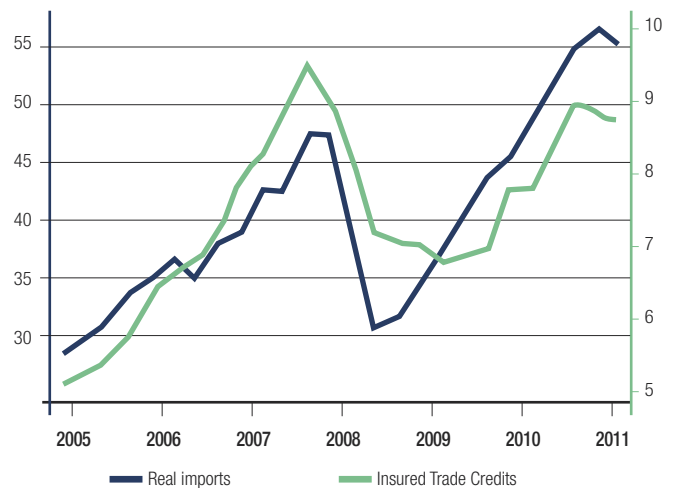
### The market is financed, but by new players

Marc Auboin recalls that global trade is 80% or even 90% dependent on trade financing. It is a low-risk activity as shown by a default rate of only 0.2%, but it is vulnerable in the short term to a tightening of credit in the context of global financial turmoil. This explains the contraction of this market during the 2008 crisis and, as a result, that of global

trade. Difficulties in trade financing have largely faded today. As proof, international trade is growing faster than global GDP.

However, the Chairman of the Board of Directors of Fives notes that financing pressures do exist and are very localised. On the one hand, there is pressure on long-term financing in dollars where Europe is increasingly less involved. And on the other hand, there are difficulties with very small financing operations due to restructuring and new regulations, such as Basel III, which must be faced by European banks.

GRAPH 2  
Strong link between trade volume  
and Export Credit Agencies business



Source: WTO Secretariat

However, corrective measures are being implemented on this second point. In addition, in view of what has been said above about the change in the import content of our exports, Frédéric Sanchez proposes a change in financing patterns. Trade finance must adapt to this new order where one would recognise added value rather than raw data.

These points of view complement each other and lead to an optimistic conclusion: the market remains financed. Yves Zlotowski emphasises that it is the presence of new players that has prevented the drying up of funding. Banks, particularly in Asia, and especially in China and Japan, have taken over. This shift to new issuers is also noted by Frédéric Sanchez and Peter Luketa. For Frédéric Sanchez, this trend tends to weaken the strategic sectors due to obvious problems of independence. Meanwhile, Peter Luketa notes that European banks remain competitive in the export credit market whose development over the past ten years has been very strong. He recalls that this market amounted to about 35 billion dollars ten years ago, compared to 120 billion dollars today. The major European banks have in fact found new ways to access dollar liquidity, particularly on the capital markets. But, as Peter Luketa recognises, it is true that Asian and American banks are currently more competitive for long-term financing in dollars.

In short, «*we are not yet out of the woods*» but this round table opens up avenues for reflection about the controlled international development of companies.



## INTERVIEW

### Frédéric Sanchez

Chairman of the Executive Board, Fives  
Chairman of the International trade,  
currencies and monetary system commission, Medef<sup>(1)</sup>

*«A too strong euro hampers European companies in comparison with their American and Japanese competitors»*

**Fives, which has experienced significant international growth, is a good observer of the changing trends in world trade. Although we haven't seen a sudden rise in protectionism with the crisis, did you have to cope with more subtle barriers to freedom of trade? And if so, what are they and from which countries?**

We did not have to cope with such difficulties. First of all because we provide technologies and solutions essential for the performance of our customers, which are not subject to any restrictions, as they contribute to the development of major local players.

In addition, we don't have a presence in countries with proven protectionist tendencies, such as Argentina.

**How can the measures taken by some emerging countries to get around the standards set by the WTO be avoided? Are the issues of intellectual property or access to government contracts still cause for concern?**

A level playing field should be established by encouraging the major emerging countries, but also the major partners (Japan and the United States, for example), to follow the same game rules, like the WTO's or even the OECD's, whether it involves trade, SRB<sup>(2)</sup>, financing, development assistance, or intellectual property. It's true that we consider the issues of intellectual property and access to government contracts to be a cause for concern. For the Medef, these two components, as well as protection and access to investments or even dispute resolution, must be systematically understood and addressed in multilateral and bilateral negotiations.

**At the European level, many are invoking the principle of 'reciprocity'. How can it become a reality?**

The golden rule of international trade should be reciprocity and symmetry, but with regard to access to foreign government contracts, this is unfortunately still far from being the case. This reciprocity must be obtained in GPA<sup>(3)</sup> negotiations (plurilateral negotiations, which are specific to certain WTO countries) but also in European free trade agreement negotiations. The Medef believes

the European Union must unilaterally adopt a legislative instrument allowing it to apply reciprocity in the event that its trading partners refuse to open their government contracts to European companies.

**Between a 'strong' euro, a weak yen, and the US 'benign neglect' on the dollar, do European companies risk being the fall-guy of what some denounce as monetary dumping? If so, how can this handicap be limited?**

Of course, we are feeling the effects of an overly strong euro, which hurts us particularly in relation to our US and Japanese competitors. Above all, the euro's current level in no way reflects the purchasing power parity of the currencies. Such a level of euro/dollar and euro/yen exchange parity is not sustainable long-term for our industries.

Admittedly, from a more macroeconomic perspective, a strong euro also reflects the relief of the markets in the face of the risk of a break-up of the euro zone, which has now been completely ruled out, thanks in particular to the resolute action of the European Central Bank (ECB).

In general, a drop in the euro especially favours export businesses and sectors for which price competitiveness is an influencing factor. Conversely, a rise in the euro leads to a decline in the price of imports, which is particularly favourable to export businesses whose business model calls for assembling, designing, and manufacturing key equipment in France but sub-contracting the production of sub-assemblies and/or components outside of the eurozone. That is the business model that Fives has chosen over the past ten years.

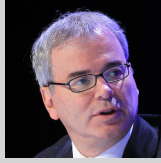
The Medef praises the action of Mario Draghi, the governor of the ECB, who has managed in the past few days to find the words to push the euro down. However, to prevent the euro from being the adjustment variable of other countries' issues, it would be worth considering a clarification of the ECB's missions, particularly regarding growth and therefore exchanges.

(1) French business confederation

(2) Social Responsibility of Businesses

(3) Government Procurement Agreement





Interview  
**Frédéric Sanchez**  
(Continued)

**Is exchange risk hedging more difficult today for a «global» company like yours?**

It's actually the opposite. I would also like to stress that the exchange risk insurance offered by Coface<sup>(4)</sup> at the tendering stage, even before the contracts are signed and implemented, is a remarkably effective tool for hedging exchange risk.

The Medef welcomes the fact that the Government has decided to leave this procedure in its current state, which should benefit both SMEs and intermediate-sized businesses.

**Regarding export financing, have you been affected by liquidity problems, particularly in dollars? Do non-European banks such as those in China or Japan seem particularly dynamic or aggressive to you?**

Fives is not faced with this type of difficulty, which especially affects long-term contracts. This is particularly the case in industries where the dollar is the functional currency such as in the aeronautics, defence, nuclear, and transport industries. In these business areas, it is clear that since the 2008 crisis, European banks for the most part have pulled out of this market segment by selling off their portfolio of receivables in dollars, and they have left the lion's share for their Chinese or Japanese but also US counterparts. Paradoxically, and disturbingly, the sales of our Airbuses are financed today by Chinese, Japanese, and US bankers.

**The automotive sector is still important for Fives. How do you explain the international future of this sector full of contrasts, to say the least, in Europe?**

The market is promising overall, particularly in the mechanical field, for which the world's major automakers are looking for ever more efficient solutions in terms of energy consumption. However, the European market is suffering from significant overcapacity, particularly on the entry-level and mid-range vehicle segment.

I do not see any signs that this market could recover in the short or medium term under the influence of, for example, the economic policies of lower spending implemented in Europe.

Although Fives is still exposed to the situation of French automakers, their share in our overall turnover has continued to decrease in recent years. Today, excluding nuclear activity, Fives generates only 5% of its turnover in France.

**Is the rise of the middle classes in emerging countries an important factor for your company? If so, which countries seem most promising to you?**

The rise of the middle classes is a great driving force for investment and consumption, which benefits Fives both directly and indirectly. Clearly, the development of infrastructure and housing needs and the phenomenon of urbanisation lead to increased requirements for steel, aluminium, cement, glass, etc. Added to this is a rapid increase in demand for consumer goods. For example, since 2010, China has become the world's leading automotive market.

As far as Fives is concerned, China and Brazil are two powerful driving forces for our organic growth. India and Russia currently do not represent the same potential, but we are continuing to strengthen our presence in these two countries because we consider them to be true growth opportunities for Fives.

**What role can be played by the 'Business 20', the annual forum of business leaders in which you participate, in parallel with the G20, to make it easier to emerge from the crisis?**

Under Laurence Parisot's leadership<sup>(5)</sup>, our ambition in Cannes 18 months ago during the B20 was to be an integral part of the G20. Our desire was for the community of businesses and their representative organisations to be a relevant, legitimate, responsible partner of the States, working together to build lasting conditions of fair competitiveness based on the rules of fair and transparent competition. The gamble and ambition have paid off, since the recommendations made by the businesses are now incorporated into the closing statements of state leaders during G20 summits. We make 100% entrepreneur recommendations, and, need I remind you, we are business leaders and creators of growth and employment. Lastly, by establishing this G20/B20 interaction, businesses are committing to and concretely participating in building the world of tomorrow.

(4) Cover managed by Coface on behalf and with the guarantee of the State

(5) Chairwoman of the Medef

Interview conducted by Coface on 19 February 2013

# Speech by

**Nicole Bricq**  
French Minister for  
Foreign Trade

## Fifth largest worldwide exporter, France can do better

Absent from Paris on the day of the Coface country risk conference, the French Minister left a video message (available on [www.coface.fr](http://www.coface.fr)) to tell the audience about her plan of action to support French exporters who by chance belong to the European Union. The European Union, she recalled, is the leading economic market, the leading investor and the leading exporter in the world. France, meanwhile, is still the fifth largest worldwide exporter of goods and services: «we are successful, but we must do better.»

She assured her audience that France is actively ensuring, within the WTO, compliance with free trade, when faced with protectionist measures that do not only affect emerging countries.

The Minister also outlined the structural reforms undertaken by the Government: the national pact for growth, competitiveness, and employment and modernisation of public policy, as well as the creation of the public investment bank, which will support French exporters from this year.



**Claire Waysand**  
Deputy Director-General of the Treasury  
and Chief Economist,  
Ministry of Economy and Finance

## 2013 Leeway for French and European public authorities

The eurozone is not in an atypical economic situation. Its public and private debt is lower than that of the United States and Japan. None of its macroeconomic indicators show significant economic imbalances. However, fiscal adjustment efforts cloud the outlook for 2013. In order to get back on the path to growth, Claire Waysand sets out several plans of action at European and national level.

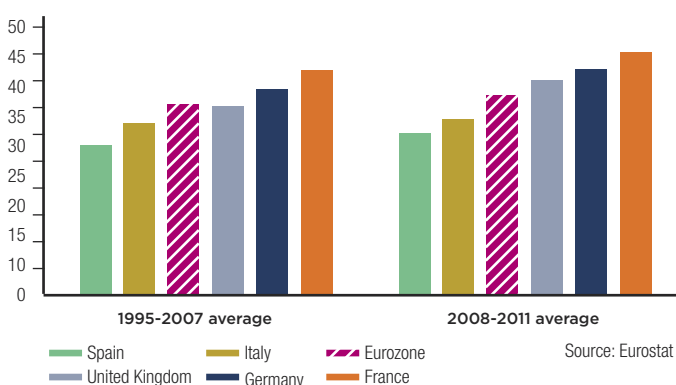
After developing the main advantages of France in the eurozone (demographic dynamism, hourly productivity, low surplus pension expenditure over the medium term, compared to its European neighbours such as Germany, Spain and the United Kingdom), Claire Waysand emphasises that the eurozone has emerged from an existential crisis thanks to the measures taken by the European Central Bank and fiscal austerity policies of the European States. These efforts affected growth in 2012, but allowed Europe to regain market confidence, thereby entering a new phase marked by major institutional developments such as the banking union. It is now a matter of continuing these efforts at European and national level to address a difficult situation of growth and employment.

We must first consolidate the economic and monetary union, both from a fiscal point of view, with the support of the IMF, and from an institutional point of view. These efforts must be accompanied by national public policies oriented towards two main objectives:

The first is to continue to put public finances in order to maintain market confidence and low financing rates. In 2013, France is committed to «an unprecedented recovery effort»: 2 points of GDP to lower the public deficit from 4.5% to 3%. The French Government is aiming particularly at revenue growth in the short-term, in order to avoid limiting growth too much. Indeed, the work of Olivier Blanchard and Daniel Leigh (IMF) shows that in the short-term the effect on growth of public spending cuts is stronger than revenue increases. It is only in the mid-term that 60% of the effort will be focused on cuts in public spending.

The second objective is to restore the competitiveness of European companies so that they can «fit fully into globalisation and benefit from it». Measures have already been initiated in France: the national pact for growth, competitiveness and employment and tax credit. In addition, we must continue our efforts to modernise support programmes for foreign trade. In particular, all European countries must improve support for SMEs and intermediate-sized companies (ISC) through strengthened institutional support or even a mechanism of direct public funding, currently under study in France. This is necessary for these companies to regenerate growth and employment in Europe.

Real labour productivity in number of hours worked  
(in euro per hour worked)





**Louis Gallois**  
General Commissioner for Investment

## Revival of competitiveness: Tools for European industry

If the eurozone trade balance is equilibrated, it is due to Germany's trade surplus. Macroeconomic indicators in the zone actually mask considerable differences in competitiveness, which have increased during the last decade. To promote convergence, we need to understand the origin of these disparities and initiate major reforms in each European country.

### Learning from the German example

An examination of the foundations of German industry helps us to understand, in part, why it is so competitive: a diversified structure, a solid training apparatus, apprenticeship development, research apparatus closely related to industry and broad support for SMEs from local banks. The quality of the social dialogue between employers and trade unions, which helps maintain a favourable climate within companies, is also an important advantage. In fact, the whole country is united behind its industry, and this goes back to the emergence of *«mittelstand»*, independent medium-sized family businesses, which were the drivers for reconstruction after the Second World War.

At the highest level, the federal government places companies' competitiveness among its priorities. This national cohesion has led to higher-quality products and good management of the internationalisation of production, which is conveyed by the desire not to relocate the technical or sensitive industrial processes in order to avoid technology transfer. German competitiveness is also due to wage moderation efforts and the deregulation of the labour market as a result of the Hartz plan. However, the downside has been more low wages and part-time jobs, in short workforce insecurity, which Louis Gallois would not like to see exported to France.

Another major factor explaining the differences between countries in the eurozone is their resistance to the appreciation of the single currency since 2005. This did not harm Germany because of its international specialization that allows it to 'set its prices'. However, other European countries, especially France and Southern Italy, have been subjected to strong price competitiveness on mid-range products, particularly from emerging countries. They have lost market share in exports, even though France has not lost any for a year and a half.

### Finally heading towards designing a proper European Industrial strategy

Countries, such as France, with a trade deficit must go upmarket to improve their price competitiveness which requires companies to invest heavily in research and development.

Governments must encourage them to do so by providing future visibility, particularly in the field of taxation and by favouring long-term savings. But the problem is not only governments, it is also the weak link between research and industry, as is the case in France.

It is also essential to improve cost competitiveness – and not only through wage moderation – to rebuild margins. We must also develop apprenticeship; ensure a strong consensus of the national community; and create a healthy and constructive dialogue between employers and unions. On this last point, the General Commissioner for Investment considers that the labour agreement of 11<sup>th</sup> January 2013 in France «gives cause for hope» as it offers more flexibility on permanent contracts and more security for precarious work.

Regarding surplus countries, such as Germany, they should use their room for manoeuvre to generate growth that will benefit not only themselves but also their European partners. *«When there is a surplus of €170 billion and 0.5% growth, we have a problem»* states Louis Gallois.

At the European level the *«lack of concrete consistency of our industrial strategy»* is also worrying and policy support for competitiveness must be increased. Although Louis Gallois believes that the proposals of the European Commissioner Michel Barnier to develop the domestic market are headed in the right direction, other policies are conspicuous by their absence – those of energy, raw materials or research.

And the European Union must develop a proper reciprocal policy in terms of foreign competition. It is currently too legalistic and lacks responsiveness to current challenges, particularly in terms of access to public procurement, intellectual property and non-tariff barriers. We must also not forget to review the exchange rate policy of the Union, so we do not let Japan play the weak yen or the United States the *«benign neglect»* vis-à-vis the dollar.

In conclusion, Louis Gallois denounces the *«defeatism of the French»* when their country is rich and a provider of *«great adventures»*.





**Pierre Sellal**  
General secretary,  
ministry of foreign affairs

## The emerging countries: New order, new stakes, new strategy?

The emerging countries are characterised by higher growth rates than that of developed countries and by a political commitment, which led them, at the end of the 2000s, to organise themselves as a coordinated force. However, they do not form a uniform block. Each of them has its own unique characteristics. This diversity of trends and behaviours creates various issues and requires diversified diplomatic, political and economic strategies.

### A capacity for resilience, more than a true proactive force

During the last decade, GDP growth in emerging countries averaged 4.5% per year, compared to 1.15% for the G7 countries. This growth is conveyed by a sharp increase in exports, expanded market share, a rise in their populations' standard of living and a rapid increase in domestic consumption.

Beyond this economic performance, these countries have asserted, from 2000 onwards, the desire to be a political force. Their coalition has crystallised around a body of doctrine: respecting the sovereignty of states; commitment to the principle of non-interference; the priority defence of national interests; aversion to armed interventions, including exercising its responsibility to protect; and, finally, distrust of all economic sanctions policies.

In order to have more influence in international negotiations, they have sought to become a structured force, as evidenced by the first BRIC summit, organised under the aegis of Russia in 2009. But the following summits struggled to develop substantial joint projects. In total, these coordination attempts have more often conveyed a capacity for resilience and blockages, rather than a driving force for alternative propositions.

All in all, *«the image that stands out at the political level is that of the diversity of their attitudes, which corresponds to the diversity of their situation»*. Their interests diverge according to the political systems, development models and economic structures of each country.

### A difficult equation, the challenges of increased international integration

The emergence of these economies creates challenges for developed countries that seek to integrate them as much as possible in the handling of world affairs and in international dialogue. This is why the G20 was created in 2008 and why the OECD is currently undergoing an enlargement process. In return, emerging countries are expected to take more responsibility and contribute more to the handling of major international issues. However, the implementation of this equation is difficult, as evidenced by the successive tensions in the Doha Round talks and the questioning of the status of developed countries in the international arena, particularly in the context of the eurozone crisis. Lastly, the European Union, the leading global economy and market, and by far, the most open, *«hardly enjoys, in developing countries, the same advantages as those it offers to companies from these countries»*.

### Four lines of action for France

To cope with these challenges, France must firstly establish increased dialogue with the emerging countries: implementation of bilateral and multilateral dialogue structures within international organisations and negotiation forums (UN, G20, Climate Conference).

For the second line of action, it must play on its added value in multiple areas of cooperation (political, economic, security, defence, culture) to strengthen its positions, those of its companies and build stronger relationships.

To strengthen its image and attractiveness, France must, thirdly, attract a greater number of researchers, investors, students, representatives from the business world but also tourists, through targeted policies. This involves increasing the offer of specific training in areas closely related to the export targets of France and an attractive visa policy not designed as a security tool for controlling access to national borders. The fourth line of action will be an active policy of promotion of major contracts.

In addition, the EU must introduce instruments to ensure effective reciprocity in access to markets, in order to develop trade based on fair exchange. Moreover, it must persuade emerging countries themselves to share this need for regulations and standards because their own economies will have a growing need for instruments of regulation and protection of rights. It is *«a matter of education and we have embarked upon it, including on the fairly delicate subject of intellectual property with China»*.

### Two notable paradoxes

Finally, we should mention two paradoxes. Firstly, the refusal of some emerging countries to be qualified as such. Some of them want to continue to be described as developing countries, while others already assert themselves as established powers. Different strategies are therefore required to take into account the aspirations and positions of each one.

Then we should also remember that emergence is a temporary condition and not sustainable: any emerging country, barring accidents, is expected to become developed, and must share interests or concerns, but also meet all the requirements in economic exchanges. It is up to France, and western countries in general, *«to show that it is with the prospect of success, convergence, parity that we envisage our relationship with them»*.

## Round table



**Catherine Girard**

Corporate Economist,  
Renault



**Amitabh Kundu**

Professor of Economics,  
Jawaharlal Nehru  
University



**Zeina Latif**

Economist, doctorate  
degree at the University  
of Sao Paulo, partner at  
Gibraltar Consulting  
Economia



**Natalia Zubarevich**

Professor of Moscow  
state university,  
Director of regional  
program of independent  
institute for social policy



**François Heisbourg**

Special Advisor,  
Foundation for Strategic  
Research

## The emerging middle classes, the key to success?

The middle classes contribute to the growth of emerging countries and offer new opportunities for companies in advanced countries. But they are heterogeneous across countries and within the same country. These are elements that companies in advanced economies must take into account, as well as the influence that these emerging middle classes can have on the stability of the regime in place. Focus on India, Brazil and Russia.

### Several emerging middle classes coexist...

According to Amitabh Kundu, the middle class in India, composed of persons with revenue of 10 to 15 dollars per day, represents 2 million individuals, which is low compared to countries such as Brazil, Russia or China.

Educated, modern and technologically advanced, it has turned to the West. It aspires to an opening-up of markets and to competition, enabling it to benefit from a wider choice of products, whether durable goods or financial products. These are opportunities for domestic companies, but also for those in the West.

But while the middle class aspires to lesser involvement of the State in managing the economy, it seeks, paradoxically – and often succeeds – in using subsidies and programmes to fight against poverty for its own benefit.

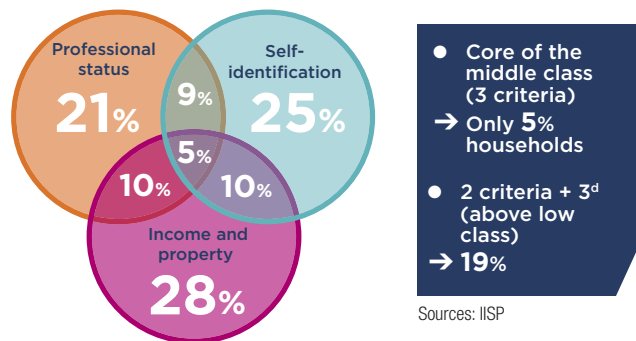
Besides this common ground, there are differences between categories of the population that live in rural areas (30%), small and medium-sized towns and cities (35%) and large cities (35%). Those who live in the large cities 'prohibit' the migration of those from small towns and villages, thus slowing the growth of this type of population in large cities.

In Brazil, Zeina Latif states that 35 million people have entered the middle class over the past decade. These are families whose monthly income per capita is between 291 and 1,091 Brazilian reals (i.e. between USD 150 and 500). In total, in 2012, they accounted for 100 million people, or 52% of the country's total population. But this group is very heterogeneous, although mostly very urban.

According to Natalia Zubarevitch, the situation in Russia is different in every respect from that of the other emerging countries. Only 20% of the total Russian population has seen its income grow by 350% since 1998, and 80% has experienced no significant improvement since the end of the Soviet regime. This category of the population can be grouped together using three criteria: income and real estate, professional status and self-identification as belonging to the middle

class. Only 5% of the Russian population meets these three criteria and is, according to Natalia Zubarevitch, the true middle class.

**GRAPH 1**  
Middle classes criteria: Law consistency, 2011 % households



Above all the very urban young – mostly aged from 25 to 49, this middle class is mainly employed in the private sector (36%) but it increasingly works in the public sector (23%).

The way to understand these middle classes for a company from the automotive sector such as Renault is very pragmatic, states Catherine Girard: the identification criterion is that of the level of income that enables someone to purchase a new vehicle. Renault has highly accurate databases that identify, country by country, the income threshold for making this purchase. This threshold is \$500 per household and per month in India. In Brazil, it is close to 1000 dollars and 1300 in Russia. This threshold allows the French group to define the proportion of households that are likely to actually purchase a new car: 18% of households in India, 30% in Brazil and almost 50% in Russia.

*Continued on page 18*



## INTERVIEW

### **Zeina Latif**

Economist, doctorate degree  
at University of Sao Paulo, partner at Gibraltar  
Consulting Economica

## « *Brazil: A remarkable success with decreasing poverty, but inflation is a threat* »

### **To what extent can we speak of a decrease in inequality and poverty in Brazil? What do you think are the factors behind this progress?**

Over the past ten years, 25 million people have moved above the poverty threshold in Brazil and 35 million people have entered the new middle class, which is formed by families whose monthly income per capita is between 291 and 1,091 Brazilian reals (i.e. between USD 150 and 500). At the same time, the gap between the rich and poor has decreased. It is a remarkable success. Today, the middle class includes over 100 million people, or more than half of the total population of the country.

According to data provided by the Brazilian Strategic Affairs Secretariat, the emergence of this middle class is due 40% to increased productivity, 30% to income transfer programmes and 20% to demographic factors. In fact, numerous adults have entered the labour market and the dependency ratio has fallen. The remaining 10% can be attributed to the increase in the level of employment. There are, of course, links between these factors. The Government's economic policies to integrate employment in the formal economy have boosted productivity, as well as the establishment of new credit instruments and improving the education system. Therefore, the productivity gains we have seen, have actively contributed to the development of the middle class.

The decrease in poverty in Brazil over the past ten years cannot only be explained by favourable economic conditions, but also and particularly by a better distribution of wealth, which is due, above all, to local policies.

### **Can the protectionist measures taken by the Rousseff government (support for national companies and trade barriers) stimulate medium-term growth?**

I do not think that this policy will stimulate growth even in the short term. The overall competitiveness of the Brazilian manufacturing sector has eroded in recent years due to the rising cost of labour and infrastructure spending. Restricting the access of foreign products to the Brazilian market will not be enough to offset the loss of competitiveness and sustain growth.

In the medium term, protectionism may have a negative impact. Sectors that have benefited from protectionist policies at the expense of other sectors are less productive, implying a fall in overall economic productivity and growth potential.

*Protectionist measures will not stimulate growth, even in the short-term*

Moreover, we should not completely exclude the possibility of a negative reaction from business partners, which would penalise Brazilian exports.

### **What are the main risks affecting Brazilian growth in 2013?**

China's performance is a critical variable for Brazil, not only because of trade between these countries, but also and particularly because of investors' appetite for projects in emerging countries. The external economic climate could also have a negative impact on the confidence of the business community. At the national level, the main threats to growth are rising inflation and energy supply disruptions. These factors could delay investment, already falling since the third quarter of 2011.

### **Just how far will President Dilma Rousseff go in her fight against corruption within her own party, without compromising her chances of being chosen as the candidate of the Labour Party in the next elections?**

The strength of the labour market and the high popularity of the President are the main elements that support her candidacy. Other factors, for the moment, seem to remain in the background. In any case, I do not think the fight against corruption is the foundation of her political agenda. While Dilma Rousseff is undoubtedly opposed to it, her action against corruption seems more unintentional than intentional.





Interview  
**Zeina Latif**  
 (Continued)

**Does the middle class, which represents over 50% of the population, still support Dilma Rousseff? In time could the political spectrum change this?**

The rate of satisfaction obtained by the President in December was 78%, a remarkable score: in 2004, President Lula got 62% satisfaction during his first term. This high popularity can mainly be explained by unusually low unemployment, now at a seasonally adjusted rate of 5.3%, which is also reflected by substantial increases in wages, of the order of 4% a year.

In general, the new middle class is very heterogeneous and does not seem, for the moment, to have clear political aspirations. Its main desire seems to be to consume more and to construct its life plans around the acquisition of goods and services. On the other hand, it seems that a new variable has appeared: middle class consumers

are demanding products and services of a better quality. The price is not the only parameter taken into account by these consumers. It could also be interpreted as a sign of a growing demand for quality public services, which could lead to a greater desire for political representation.

*For the middle class, the parameter is no longer the price of a product but its quality*

If we consider the positive development of the education level in Brazil (79% of active employees have more than 8 years of education, compared to 65% ten years ago), the current apparent indifference to political issues may not last.

Interview conducted by Coface on January 30, 2013

**... but form a new consumer market**

According to the World Bank and the Brooking Institution, the global middle class is expected to increase in the next two decades exponentially, by some 10 million individuals, which will benefit consumption. With regard to India, Amitabh Kundu believes that this portion of the population represents between 60 and 70% of the total of consumption. As it shows significant rates of savings and investment, it plays a role as a driver of growth, a role set to grow strongly if one believes the Brooking Institution. According to its estimates, India will represent 30% of total consumer spending of the middle classes by 2030, overtaking the United States and China - figures considered by Amitabh Kundu to be very ambitious. He argues that middle class demand, concentrated in large cities, for durable consumer goods is lower than that of small and medium towns. In addition, the rate of population growth slows in urban areas and that should affect the progression of the overall consumption of the middle class. Overall, there are great opportunities in small and medium sized towns in the

next ten years and companies that take into account this variable will successfully penetrate this class of consumers. However, this presupposes an Indian infrastructure development.

A sectoral approach confirms the potential of consumers from the middle classes. The automotive market, which recorded strong growth in emerging markets (Brazil +6%, Russia +11%, India +8%, and China +4%), testifies to their role. Catherine Girard notes that the BRIC countries represent 35% of the global automotive market and 55% of emerging markets. In ten years, Renault should sell 100 to 105 million new vehicles per year, a 30% increase. And emerging markets could represent, by themselves, 80% of this increase.

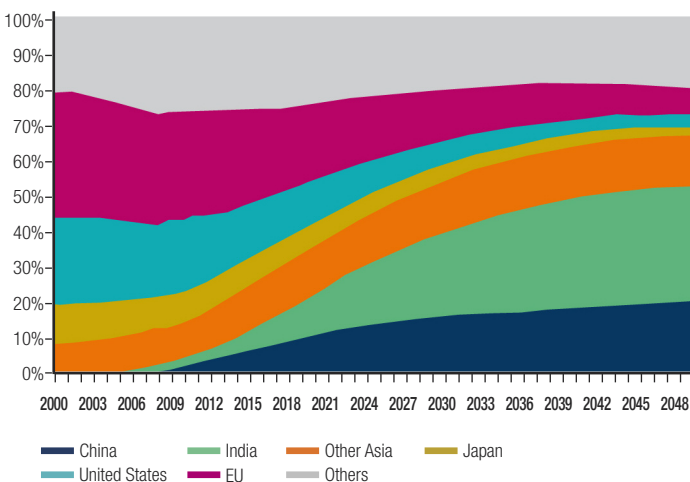
To meet this demand, Renault has adapted products to several customer segments of the middle classes, e.g. vehicles with interior spaces for families, more modern for the young population, aged around 40. Not to mention that these potential consumers are experiencing a movement of modernity and upward mobility. There is therefore no question of offering them an inferior product.

Beyond a commercial strategy, companies wishing to invest in emerging countries must also, in the future, measure the influence of the middle classes on the country's political stability.

**As «Opinion formers», middle classes will influence the political and social future of their country**

The Indian middle classes are «*opinion formers*» says Amitabh Kundu. At the origin of recent protests against government inefficiency, corruption and poor public services, they also aspire to political stability. And they use, in this sense, their networks within the bureaucracy at different levels. In other words, for Amitabh Kundu, «*the Indian middle classes will be politically and socially powerful in the coming decades*».

**GRAPH 2**  
 Share of Global Middle Class Consumption



Source: Brookings Institution

For Natalia Zubarevitch, the Russian population can be divided equally into «*three Russias*»: the large cities, the medium-sized industrialised cities and small outlying towns. However, these three Russias have different political behaviour. During the last presidential election, votes in favour of Vladimir Putin were concentrated in the suburbs, while the middle classes mainly located in the large cities did not or hardly voted for him.

Despite the rising dissatisfaction of the middle classes, Natalia Zubarevitch believes that the political environment should remain stable. Indeed, it is difficult to estimate the proportion of Russians who want political change. The Russian middle class is marked by contradictions: one part wants to move more towards modernity, while another more traditionalist part is easily manipulated by propaganda. Moreover, the population is ageing and the country has a shortage of young people wanting real change.

The situation in Brazil is very heterogeneous too. The middle class is not seen as a group and does not seem, for the moment, to have clear political aspirations. Its main desire is to consume more and at a fair price. The political question is therefore secondary. However, Zeina Latif stresses, «*if we con-*

*sider the positive development of the level of education in Brazil, the apparent indifference to political issues may not last*».

For his part, François Heisbourg stresses that the emerging middle classes are a force for profound transformations of societies. It goes without saying that we can use consumption to define them. But in the expression «*middle class*» there is the concept of «*middle*», but of class as well. It is not simply seeing access to new consumption patterns, but the social transformation that it leads to. Thus, we find the same types of socio-political behaviour as those observed in the middle classes in Western countries over the last two to three centuries – and this is not without risk.

Firstly, these expanding middle classes have demands. Then they begin to have access to property ownership and develop a heightened attachment to this right. Finally, they will want to be the defenders of the national idea. Here we witness a social transformation that can be revolutionary.

In a context where social mobility increases, the process of class struggle can be more or less peaceful but the risk of nationalist drift remains. When social mobility decreases, however, the situation can obviously be much worse.



## INTERVIEW

**Natalia Zubarevitch**

Professor of Moscow state university,

Director of regional program of independent institute for social policy

*«In order to stay in power, the kremlin dangerously reinforced inequalities»*

**In your view, do 2012 March's demonstrators who protested against the election process form a homogeneous group (socially, economically and/or politically)?**

No. It is an economically, socially and politically diverse group. You have young people with a high level of education and liberal values, next to another group composed of intellectuals with a high level of education, varying levels of income and democratic values. Then you have the nationalists, the communists and left-wing radicals. In the absence of leadership, these protests remain heterogeneous. We should keep in mind that middle class households have adaptation and survival strategies in the face of the state degradation.

**Since then, would you say the government has started taking the expressed demands into account?**

The government has rocked, but just for a little while. After Putin became President he began a crackdown on the opposition. Putin's power is shored up by bureaucrats and traditionalists. What is worrying is that the Kremlin is not only facing inside enemies but it is not afraid of exacerbating negative reactions from outside Russia. This is very dangerous for the development of Russia.

**What event could trigger new demonstrations?**

It's difficult to say. If a new wave of economic recession hits the country, we will probably see protests escalate in small and medium size cities. However in the big cities,

the main locations of middle class households, I would rather think a scenario of a gradual growth in dissatisfaction likely. The rural areas should remain silent. On the other hand, the trigger for last January 2013's demonstration was the inhuman law banning US adoption. The demonstration was joined by new people who are not politically active. They were protesting against an inhuman law. At the end of January a similar demonstration was held in Saint Petersburg against the converting of a children's cancer hospital into a facility for Supreme Court judges. Humanitarian protests are becoming as large as the political protests.

**Do you consider the current household consumption boom sustainable?**

Consumer credit grew by 40% in 2012, while household income grew by 4%. That represents a very high risk.

**According to you, what are the main risks weighing on social, political and economic stability in Russia?**

Mainly corruption and inefficiency of the authorities. But as well their paternalism along with the apathy of the majority of the population. The fragmentation of the society is certainly a risk. One can observe that the Kremlin is promoting these divisions in order to protect its own power.

Interview conducted by Coface  
on February 8, 2013



**Yves Zlotowski**  
Chief Economist, Coface

## Coface overview of risk countries worldwide

The situation of advanced countries is delicate. While the systemic financial crisis in the eurozone is receding, the credit crisis affecting European companies is far from over. In 2013, Coface forecasts the eurozone will remain in recession. Sluggish domestic demand is unlikely to be offset by exports and the lack of visibility regarding the evolution of European institutions will weigh on business investment decisions.

The outlook is more favourable in the United States and in Japan. But concerns are still lingering on the policy-makers' ability to reduce the fiscal deficit in the United States and in Japan, on the evolution of exports to China.

The outlook is far more encouraging in emerging countries. They proved resilient in 2012 with growth expected to reach 4.8%\*. According to Coface's forecast, it is likely to accelerate over 5% in 2013, thanks to the dynamism of domestic demand and the implementation of reactive and prudent economic policies. However, these good figures should not mask vulnerabilities.

### ADVANCED COUNTRIES: PROLONGED CRISIS IN THE EUROZONE, A SHOCK TO GROWTH IN EMERGING EUROPE

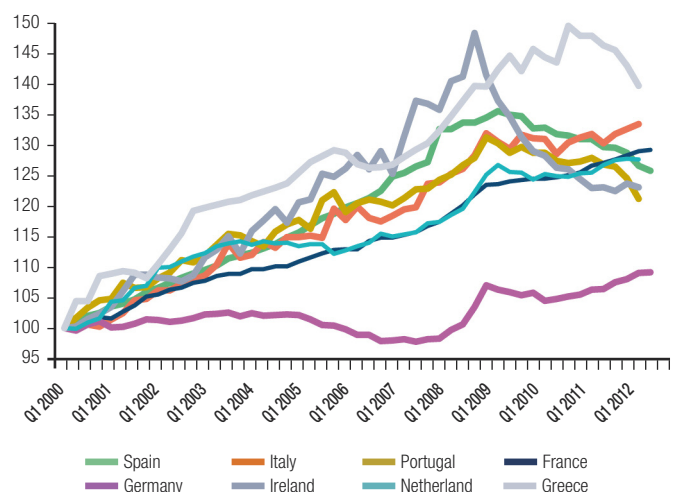
In the context of a eurozone crisis and given the rate of company bankruptcies, the credit risk is likely to increase in France, Spain and Italy. This trend reflects businesses' weak financial situations, except in Germany although here bankruptcies turn out to cost more when they occur. In contrast, American and Japanese companies have a more favourable profile but confidence remains a problem, as evidenced by the volatility of SME confidence indicators in both of these countries.

#### European companies face a degraded macroeconomic environment...

The weakness of domestic demand largely explains the expected contraction in the economic activity of the eurozone in 2013. Firstly fiscal adjustment efforts restrict public demand and will therefore have a negative impact - even more negative than expected - on growth. Secondly, household consumption, despite a comfortable level of net wealth in some countries, will be restricted by the social impact of internal devaluations stemming from declining real incomes and the deteriorating labour market. The significant steps made by European institutions have helped calm the markets, but have not yet been felt in the real economy. Thus, investor confidence, which is a leading indicator of GDP growth, will remain at levels consistent with a recession in the next six months.

Exports, meanwhile, will play a limited role given the low share of exports to emerging countries and competitiveness problems. Indeed, some countries such as Spain, Portugal and particularly Ireland have started a process of adjusting their cost competitiveness. But this is not the case in France and Italy.

**GRAPH 1**  
Eurozone: Unit labor costs (Jan. 2000 = 100)



Source: Eurostat

\* Estimate revised in February

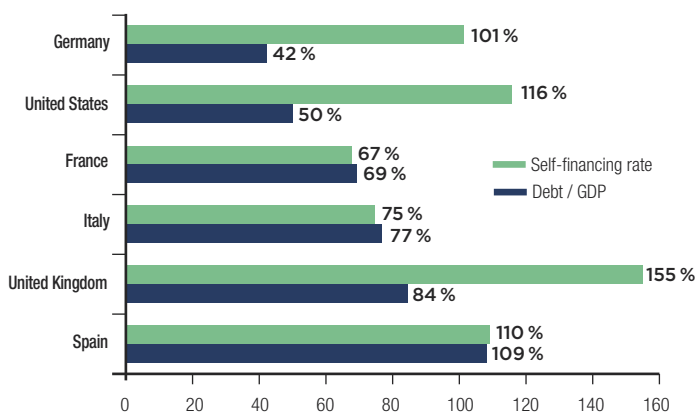


In addition, cost competitiveness does not necessarily result in price competitiveness. Companies are trying to rebuild their margins and accumulate cash to repay their debts rather than to invest. The last element explaining the limited contribution of exports to growth is the fact that emerging countries tend to implement protectionist measures to protect their own industries.

### ... and their capacity of resilience is uneven

The situation of companies differs greatly from one country to the next. In Spain and in the United Kingdom, companies have high profits but are also highly indebted. Their profits are therefore primarily dedicated to repay their debts. French and Italian companies have a much lower level of debt but the weakness in their self-financing and profit levels makes them vulnerable. By comparison, American and German companies are more resilient with high profits and a high self-financing rate for a low level of debt.

GRAPH 2  
Corporate Debt and Self-financing (%)



Sources: Datastream, Banque de France

In terms of business sectors, the credit risk increased in distribution, food processing and services, sectors sensitive to household consumption. Coface also recorded payment incidents in the metals sector, which reflects the difficulties in the automotive and construction sectors. But the economic downturn is not solely responsible for these sectoral risks. Most of these sectors have long-term structural weaknesses that the economic situation has merely revealed. One case stands apart: that of German companies which have proven highly resilient to economic conditions due to a comfortable financial situation and export dynamism since 2010.

### Credit risk is deteriorating in France and in Southern Europe

The way Germany managed to stay ahead during the crisis contrasts sharply with the French situation where the number of company bankruptcies has been double the number in Germany since 2007. It is true that, when they occur, German bankruptcies are generally more costly but in France, they have an increasingly high financial and social cost. This worrying dynamic is explained by French companies' high dependence on household consumption. In 2013, Coface expects a slight contraction in private spending, which should increase the number of bankruptcies.

Spanish and Italian companies have also been weakened. This situation is explained in Spain by the purging of the debt and, in the short term, by the banking reform underway. In Italy, electoral uncertainties and the contraction in bank credit since last summer should result in increased credit risk.

In the United States and in Japan, companies are in a better position, but SME confidence indicators show that concerns persist. In the United States, they are concerned about political gridlock around the budget. In Japan, confidence has been affected by the problem of exports to China, a key driver of growth.

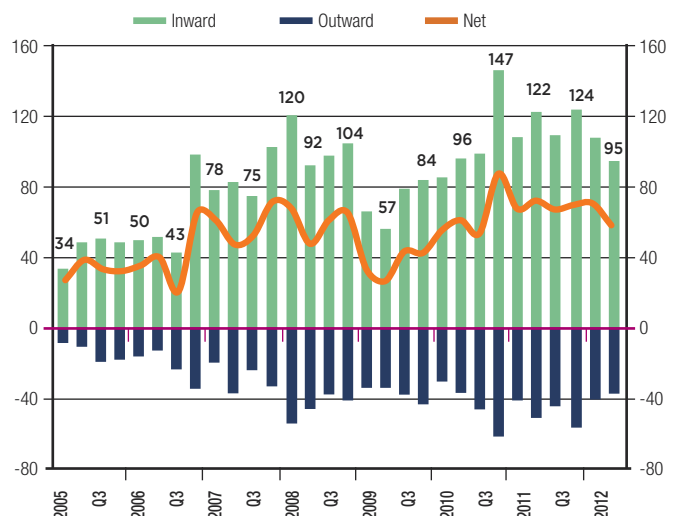
In conclusion, after last October's decision to place a negative watch on the assessments of a few core countries of the eurozone (Belgium, France, the Netherlands), Coface has lowered its assessments on Italy and Spain, and put the assessment of Japan under negative watch.

## EMERGING COUNTRIES GROWTH IS ACCELERATING BUT VULNERABILITIES REMAIN

Compared with the mixed but globally sluggish picture of advanced economies, the evolution of emerging countries may appear enviable. But despite strong growth, emerging countries remain vulnerable to external shocks that are felt through two channels, trade and finance. There is a negative correlation between the growth rate in emerging countries and their rate of openness. The emerging countries in Europe, which are very open and dependent on Western European demand, are suffering from the prolonged crisis in the eurozone. As for the ASEAN countries, they continue to show very dynamic growth, whatever their degree of openness. The Philippines and Indonesia remain relatively closed, but are faring remarkably well thanks to high domestic demand and expatriates' remittances. Thailand and Malaysia, which are very open countries, had to resort to counter-cyclical economic policies to mitigate the impact of the global slowdown on their activity.

The transmission of the European crisis through the financial channel is more complex. Foreign direct investment has decelerated but remains substantial<sup>(1)</sup> and loans from European banks have fallen but have not collapsed. We are clearly witnessing a gradual withdrawal of funding from European banks<sup>(2)</sup>, especially in emerging Europe and the CIS.

GRAPH 3  
IDE Flows BRICS + Poland + Turkey (in billion of dollars)

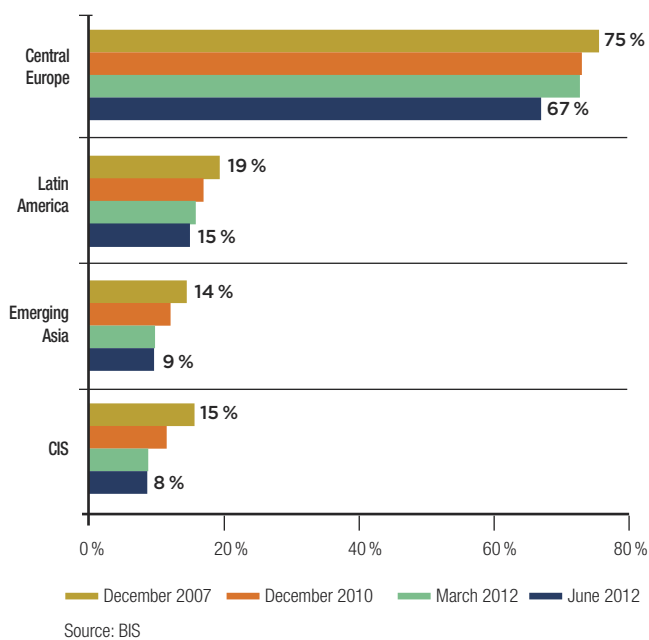


Sources: Central Banks

(1) In 2012, FDI flows towards BRICs, Turkey and Poland totalled 95 billion dollars.

(2) According to data from the Bank for International Settlements, the exposure of European banks to emerging Europe fell from 75% in December 2007 to 67% in June 2012.

**GRAPH 4**  
Exposure of European banks (in % of GDP)



### Development of domestic financial systems under control

In order to reduce their dependence on external funding, emerging countries are trying to develop their own financial markets, with varying success. There are three groups of countries. First, there are those with oversized credit markets (around 125% of GDP), such as China and Vietnam. Here credit certainly plays a role as a significant growth driver, but the rate of non-performing loans on banks' balance sheets has grown. The challenge for these countries is twofold: to restrict the size of the market, but also to improve lending practices.

The second group consists of countries such as Turkey, India or Russia, which still have a moderate stock of domestic credit (around 50% of GDP), but where expansion has been very rapid in a catching-up dynamic. Paradoxically, although the market is weak, credit bubbles may develop.

The third group of countries consists of economies marked by undersized credit markets (less than 20% of GDP) such as Argentina and Algeria, which are characterised by an investment rate which is too low and an underdeveloped private sector.

When domestic credit is insufficient, the companies fund themselves in international markets. A too rapid and high debt level carries greater risks so it is generally undertaken in foreign currencies by a small number of large firms, as is the case in India.

### A «quasi-sovereign» risk to be monitored

A weak sovereign risk must not be confused with the risk on public sector entities. Indeed, since the 2009 crisis we have seen a number of defaults in *quasi-sovereign* public entities, which were heavily indebted (BTA in Kazakhstan, Dubai World in the United Arab Emirates), where state support seemed to have been acquired. Borrowers and lenders have played on the ambiguity of this support. However, emerging countries that have become good sovereigns are not guarantors for *quasi-sovereign* entities if they have not given a formal guarantee.

### Circumventing economic policies

Furthermore, certain economic policies do not always work effectively, despite a comfortable financial position and a very low sovereign risk. The case of China is quite telling. The authorities are trying to reverse the growth model where investment is oversized and household consumption under-represented, a trend which began in the 1990s. One of the ways is to control access to credit, which is almost in its entirety devoted to investment<sup>(3)</sup> and, in particular, to the financing of small non-viable players. Bank credit is now under control but businesses and households have succeeded in circumventing the directive of the central authorities by using 'shadow banking', causing an explosion of poorly-regulated loans at very high rates, which carries risk.

### Governance: A burning issue

Governance is the latest risk to emerge. On the socio-political level it is certainly the major challenge that emerging countries are facing today. This issue has become increasingly topical due to the expansion of the middle classes who are more demanding in terms of transparency and the combating of corruption. They ask the public authorities to be accountable for their actions, as in the «Arab Spring» but also in Russia and in India.

As a result, Coface has lowered its assessments for South Africa, the Ivory Coast and India, countries where the central question is not growth, but rather the capacity of political institutions to cope with social change.

(3) Investment represented 46% of GDP in 2011 in China, and household consumption 35% of GDP.



## INTERVIEW

**François Heisbourg**

Special advisor, Foundation for Strategic Research

### *«Intervention in Mali: Europe is no longer thinking collectively»*

#### **What is your analysis of the economic and social situation in the euro zone in 2013?**

The economic situation in the euro zone is likely to worsen in 2013, if we take into consideration the new fiscal multipliers revised upwards by Olivier Blanchard and Daniel Leigh (IMF). Political and social tensions could increase, and even more so with elections due in the coming months, notably in Italy and Germany. People's patience has its limits and it is already noteworthy that the rise in populist parties has remained restrained in Europe, most certainly due in part to Mario Draghi who put out the fire. But are the euro zone countries going to seize this window of opportunity to ease off on fiscal austerity? This is not certain, because to achieve this would require a collective movement, which is hardly conceivable at this stage. In fact, a country that would take such a risk in isolation would be made to pay a very high price by financial markets.

#### **France intervened in Mali alone, with African armies but without the collective support of the European governments. Does this confirm the failure of the common European security and defence policy?**

What was lacking was a coordinated response from the European Union. France did receive significant financial support from the member states, particularly for military transport aircraft, surveillance and provision of supplies, of which there were shortages. However, Europe showed that it was unable to react in unison to such an event. Nevertheless, it does have a rapid reaction force called the Battle Group (currently French-German-Polish). At least the EU could have collectively decided to bring together the resources needed for the African armies. What is striking about the French intervention in Mali, in contrast to the Libyan conflict, is that no one has questioned its validity. In short, Europe is no longer thinking collectively, hence the absence of a common security and defence policy.

#### **In Mali, the Islamists are retreating to the north-east in an avoidance strategy: are we heading towards static warfare? Do you envisage a stalemate in the conflict?**

What must be understood is that the Jihadists lost their military potential when France intervened. They made a strategic error in attempting to take Bamako, even if they could not foresee such a rapid and strong reaction from the French army. They have been weakened by losses to equipment due to the French bombings. In a desert region like the Sahel, this means that they have lost their ability to destabilise the country and its surroundings.

This is especially true given that Algeria has now closed its borders and therefore access to its gas stations, without

which the military strike force of Jihadists cannot hold up. Despite all this, the Jihadists are still a threat since this will not prevent them from resorting to 'traditional' terrorist acts, such as suicide killings.

In my opinion there is no risk of stalemate in the conflict. But the French army must not stay. The Malian army, along with African armies, must take over. They have the capacity to do so, with some assistance, just as Mali has the capacity to rebuild itself. The country has a civil society and a network of institutions that need to be further developed, but which are able to function. However, it is obvious that this is not going to be an easy task considering the risks of reprisals, in particular towards the Tuaregs of the MNLA, who initially supported the Jihadists.

#### **Let's turn our attention to the Arab Spring: what is the current situation? And to what extent can we speak of the Islamisation of Egyptian and Tunisian societies?**

I naturally draw a parallel with the revolutions of 1848, when the expression 'The Springtime of the People' was first used to define a revolutionary wave with a similar triggering process. Nevertheless, it is a process of differentiation that has quickly prevailed. In the case of the Arab Spring, it is much the same: there was a common starting point, but now we must differentiate between the countries, case by case, because they are undergoing very different changes.

Egypt is in a chaotic situation, the start of anarchy that is very worrying. The army seems unable to act in a consistent way, President Morsi is facing growing discontent and violence seems to reign, particularly in Port Saïd. Of course, chaos is not a situation that can last for a long period of time, so things will change. But for the moment it seems difficult to foresee towards what and how it will change.

*«Arabs Spring»: A common starting point, then a process of differentiation arose*

Next we have Tunisia, which does not face such an anarchic process. We can envisage stabilisation of the political and economic situation. This divergence with the situation in Egypt stems from very specific sociological foundations. Here we have a society of educated middle classes, which, whatever their political orientation, will not remain passive if threatened by the Islamists.





Interview de  
**François Heisbourg**  
(continued)

In the case of Syria, Bashar-al-Assad is, in my opinion, likely to be ousted very soon, in the weeks or months to come. Nevertheless, the post-Bashar situation is going to be very difficult since the civil war is deeply entrenched. Therefore, the most probable hypothesis is continued chaos in Syria.

Lastly, the Gulf States are strongly tightening their control further. We have seen expulsion of numerous NGOs in the Emirates and violent repression of all demonstrations, particularly in Kuwait.

**What will be the major consequences of the change in political direction in China?**

The change in political direction in China involves two major issues. In the short term, China must set out a clear and consistent position in its foreign and security policy. In fact, over the past few years this has not been the case, which has caused tensions with some of its neighbours. One thinks in particular of the escalation of events around the Senkaku-Diaoyu Islands with Japan, and the situation in the South China Sea. The absence of a clear diplomatic line on these subjects create a high risk of destabilisation of the region, and even the world, since it is a major shipping area. In the medium term, China must choose its development model, with growth driven more by domestic consumption. This choice, and the decisions that will result from it, will be decisive for its trading partners in Asia and in the euro zone.

*China: The absence of clear diplomatic line creates a high risk of destabilisation in the region*

**Do you think that the political liberalisation process (relaxation of censorship and release of political prisoners including Aung San Suu Kyi) at work in Burma is sustainable?**

It seems difficult to reverse such a process when the international community is involved. Of course, opposing forces, which tend towards a return to authoritarianism, persist. But these individuals are increasingly seeing the benefits of the country's economic openness (foreign

capital inflows, tourism, etc.). This will of course take time and does not exclude the continuation of a vigorous policy against ethnic minorities, such as in Turkey towards the Kurds. We should remember that democracy is not necessarily conveyed by reconciliation with national minorities.

**Do you think that the mining of shale gas by certain countries (especially the United States) could change the global geopolitical balance in years to come?**

The revolution has already taken place in the United States, and in very little time, over five or six years. This shows that market signals are universally applicable, so also in the field of energy. Of course Hubbert's peak depends on geological factors, but the quantity extracted also depends on the state of technology, which is itself sensitive to market signals. In fact, it is because the markets signalled, five years ago, that the price of oil was high (around 147 dollars) that it became financially interesting to invest heavily in new drilling and new extraction technologies. The result is that the United States is recovering its energy independence and is ceasing to be dependent on the old world for oil. Thus, the volatility of the oil price has a low impact in the United States on the price of gas and energy in general. Consequently, American companies benefit from low energy prices, which facilitate the re-industrialisation of the United States.

As for Russia, it is suffering from this revolution as the price of gas, unlike that of oil, has not returned to its pre-2008 level. For the moment, the country is still benefiting from long-term contracts with European countries (eg France, Germany and Italy), which explains why gas consumption prices have not fallen in these countries.

**In your opinion what will be the most significant geopolitical developments of 2013?**

Firstly I would put the change in political direction in China because this country is now the principal factor for movement in the global landscape. Next would be the evolution of the situation in the euro zone - are the member states going to exploit the window of opportunity opened by Mario Draghi? Lastly, attention needs to be paid to the discussions on fiscal adjustment in the United States - what will be the scope of the sequester<sup>(1)</sup> and what will be its impact on growth? I would also like to raise the question of a major development in the medium term, which is that of the succession of King Abdullah in Saudi Arabia.

Interview conducted by Coface on January 29 2013

(1) Cuts in public spending.

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**RESERVATION**

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