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**The Legacy of State-led Finance in France
and the rise of Gallic market-based banking**

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Abstract

Despite the far-reaching liberalization of the French banking system over the past quarter century, French banks suffered far less in the recent international financial crisis than banks in the United Kingdom and Germany. However, the French system also suffered far more – at least in the first stage of the crisis – than the banking systems of Southern Europe. By several measures, French banks were world leaders in financial innovation and the French banking system was highly exposed to international market movements. The limited impact of the crisis, however, owed to the specificities of French ‘market-based banking’. Deliberate state action over the two decades prior to the crisis created a specific kind of banking system and encouraged forms of financial innovation, the unintentional consequence of which was the limited exposure to the securitization that caused the damage wrought during the financial crisis.

Introduction

French banks and their representative associations explain the comparative stability of the French banking system during the international financial crisis that erupted in 2007 in terms of a ‘balanced business model’ with both a strong retail base and a full

range of investment banking activities (Lee 2010; Pauget 2009; Ministry of Finance officials 20 October 2010). This article explains this ‘balanced business model’ as the product of French state disengagement from the financial sector since the mid-1980s but also continued state intervention. The specificities of this intervention involved the creation of national banking champions, a highly consolidated, saturated and competitive retail banking sector, cross-shareholding networks centred around banks, a closed banking system with only limited foreign presence due to both de facto protectionism (despite the encouragement of open equity markets) and a legislated bias towards retail for some of the mutual banks. The French state also deliberately – and very successfully – encouraged specific forms of financial innovation, notably derivatives. The unintended consequence of this action was that French banks downplayed securitization and the purchase of securitized products, thus limiting the impact of the financial crisis. The state was less successful in its repeated efforts to facilitate securitization. Banks themselves were agents of change, notably through their efforts to expand in the context of sluggish domestic economic growth and a saturated domestic retail market. French banks engaged increasingly in ‘market-based banking’ activities and expanded their retail operations abroad. The focus of this analysis parallels that of Mary O’Sullivan (2007) which emphasises the French state’s role in directing financial market reform but also highlights the post-liberalization role of economic actors in shaping the financial system. However, the focus here is on how the intended and less deliberate effects of state action shaped the features of French banking that can be described as systemic.

John Zysman’s (1983) analysis of France as the best example of a state-led credit-based financial system provides little guidance as to the French variety of financial

capitalism today. However, the footprint of the state, through a directed and incomplete liberalization, has created a specific kind of financial system, the intended and unintended features of which have been revealed in the impact of the international financial crisis on the system since 2008. The argument of this paper thus builds upon the CPE literature that stresses the transformation of French capitalism away from a state-led model yet struggles to categorise France in the Liberal Market Economy (LME) / Coordinated Market Economy (CME) dichotomy of the Varieties of Capitalism (VoC) literature (Hall and Soskice 2001; Culpepper 2008) or depicts it as a unique hybrid form (Boyer 1997; Hancké 2001).¹ The argument here about the development of the French banking system also aligns with the conclusions reached by Vivien Schmidt (2003, 2009) who describes France as a state-enhanced / state-influenced form of capitalism. However, the claim of an important legacy of state intervention does not suggest, let alone prove, continued state intervention, even of a more modest kind.

Similarly, France's financial system cannot be easily categorised. It contains features of the liberalized, deregulated and more capital market-based British system but also features of the more protected, regulated and bank credit-based financial systems of Southern Europe and Germany. In Zysman's (1983) depiction of the French financial system as 'state-led credit-based', the French state directed finance through state owned banks in the *Circuit du Trésor* system (see also Loriaux 1991). Despite liberalization and the privatization of most of the large French banks from the mid-1980s, studies from the mid-1990s continued to assign a central importance to the state in the context of a 'financial network economy' (Story and Walter 1997; Underhill 1997). This description was already being challenged (Morin 1998; 2000)

and had become less valid by the early 2000s. Yet France remained difficult to situate in terms of the credit-based / capital-based dichotomy, with Andreas Hackethal (2000, 13) describing the French financial system as a ‘special case which seems hard to classify’.

Indeed, snap shots of the French financial system tell us very different stories if we look at non-financial company (NFC) external finance or total financial system assets – two typical measures used to categorise financial systems. French NFC external finance moved from heavy reliance on bank lending prior to the 1990s to heavy reliance on equity finance by 2000 (see Table 1). The French financial system had, by this important measure, become more ‘Anglo-Saxon’ than the United Kingdom (UK) by the late 1990s (80 versus 70 per cent equity in 2000).

<TABLE 1 ABOUT HERE>

However, if we look at total financial assets (which is standard for categorising financial systems, see Allen and Gale 2000) banks continued to dominate the French financial system. Bank assets increased significantly rising to 334.8 per cent of GDP in 2007 (up from 140 per cent in 1993). The French banking system was one of Europe’s largest, and broadly similar in size to Germany’s despite the smaller French economy. In terms of bank assets to GDP, France’s banking system was only somewhat smaller than the UK’s (399.7 in 2007) and considerably bigger than Germany’s (195.5 per cent).² Equity market capitalization also increased significantly in real terms reaching a peak of 105.5 per cent of GDP in 2007 (up from 36 per cent in 1993).³ However, the importance of bank assets increased as a percentage of total

French financial assets, which paralleled the trend in most advanced industrial economies (Figure 1).

France thus might be best described as having an ‘equity-dependent but still largely bank-based financial system’ an apparent contradiction explained largely in terms of the limited position of domestic lending in total bank assets (see Figure 2 below). Yet in the 2000s, bank lending rose in real and relative importance as a source of finance for NFCs in relation to equity issuance and securities (Table 2), paralleling developments in several advanced industrialised economies, including the US and UK (Hardie and Maxfield 2011). Contradicting previous trends and expectations, this largely reflected the end of big privatization programmes, bear equity markets and low real interest rates. As will be shown below, ‘market-based banking’ also contributed to the real and relative rise in bank lending.

<TABLE 2 ABOUT HERE>

<FIGURE 1 ABOUT HERE>

Before proceeding, it is helpful to explain the concept market-based banking as used in this paper and its significance in terms of how we should understand financial systems. The concept encompasses a variety of new types of banking business – rather than the ‘traditional’ banking of deposit taking and lending – that burgeoned in the two decades leading up to the crisis (see Hardie and Howarth 2011). It includes the trading of a range of derivatives – equity, interest and exchange rate. It also involves selling loans rather than keeping them on the banks’ books as traditionally done. Securitization is part of this process, meaning that the loans are pooled and then

re-divided into a new financial product containing ‘pieces’ of many different loans. A second new type of business was selling loans, not just to any other institution through the market, but ‘selling’ loans to arms-length but related ‘special purpose entities’ or ‘structured investment vehicles’ (SIVs). This type of business also sometimes involved trying to protect against the risks involved by buying or selling credit default swaps (CDSs). Both securitization and hiding risk through CDSs were also involved in a third type of new business: holding loans on the books but using them as collateral to borrow several times the value of the loans. These are the main activities behind what is called ‘wholesale’ financing. The rise of market-based banking undermines the distinction between bank credit-based and capital market-based financial systems, in that the provision of bank credit becomes more closely linked to the market. Through an examination of the different features of market-based banking, Hardie and Howarth (2011) develop a matrix that provides a more nuanced understanding of national financial systems. Challenging the dichotomous description of national financial systems also potentially undermines distinctive features of CMEs and LMEs, with the decline of ‘patient capital’ in the former and the increased reliance on banking and bank lending in the latter.

The significant but comparatively limited impact of the financial crisis on France

Total French bank losses have been lower than those in the US, UK and Germany, and losses to bank assets and GDP have been far lower than a range of additional European countries, including the Netherlands, Belgium and Switzerland (see Table 3).⁴ Moreover, French banks needed far less government support to cope with the crisis than the banks in these other countries. At the same time, France was far worse

hit than the financial systems of Southern Europe. French bank losses have been on an unprecedented scale: total write-downs for the 2007-2010 period for the five largest banks reached US\$72.4bn (Reuters 2011). Table 4 sets out French bank losses from 2007 to 2010 and the announced areas of those losses, sourced from the banks' reports and accounts. The data are possibly partial because they show what the banks have deemed material enough to highlight. However, they are very likely to highlight the main areas of loss.

<TABLE 3 ABOUT HERE>

<TABLE 4 ABOUT HERE>

The information about bank losses points to important features of French bank liberalization and investment banking activities which will be linked back to state intervention in the analysis below. Notably, the crisis affected both commercial and mutual banks alike. Mutual banks are majority-owned by their depositors and, at least in principle, operated for their benefit, rather than, as with the listed commercial banks, for the benefit of private shareholders. Given their more limited exposure to commercial pressures, many observers were taken by surprise by their losses (Hardie and Howarth 2009). Two mutual banks, Banques Populaires and the Caisse d'Épargne were badly affected through the difficulties faced by their common investment banking arm, Natixis, and merged in 2010 to form BPCE. Crédit Agricole, the part mutual bank, suffered significant losses, notably through its investment banking arm, Calyon (renamed Crédit Agricole CIB in 2010), which was badly exposed to US subprime. These losses demonstrate the shift in mutual bank operations that took place in the decade prior to the financial crisis.

However, the figures also show that individual French banks were in good shape comparatively. In terms of total write-downs, the biggest French loser, BNP-Paribas, was (at the end of 2010) in sixteenth place globally and in distant seventh place in Europe (Reuters 2011). The two largest French commercial banks – BNP-Paribas and Société Générale – and Crédit Agricole – reported profits in both 2008 and 2009, with each suffering only one quarter loss during the two year period despite rising write-downs in 2009. The persistently high French bank leverage ratios (assets / shareholder equity) suggest a weak capital position (an average of 46 in 2010, well above the European average of 35) (Crédit Suisse 2010) and a high potential exposure to the financial crisis. However, these concerns over the leverage of French banks were mitigated by their comparatively strong tier-1 capital ratio (Crédit Suisse 2010; *Financial Times*, 23 July 2010). French banks were exposed to the secondary effects of the financial crisis but less to domestic write-downs caused by slow domestic economic growth and more through their portfolio of international loans and government sovereign debt. French banks were heavily exposed to several Euro area countries more at risk of default—notably the Southern European countries – and thus the impact of a traditional banking crisis. Much of the exposure in Italy and Greece owes to the expansion of retail banking activities in those two countries, an important feature of French bank internationalization.⁵

How Gallic ‘market-based banking’ limited the impact of the financial crisis upon France

French banks and government officials claim that the large retail banking businesses and diversified operations of the French banks – that is, their ‘balanced business

model’ – lessened the overall impact of the crisis. Retail banking continued to dominate domestic banking activities with over three-quarters of total domestically-held bank financial assets throughout the 2000s (Table 5). Retail bank lending (both domestic and international) declined significantly as a percentage of the total bank financial assets between 2000 and 2007. Retail lending nonetheless increased significantly in total terms at both the domestic and international levels (Table 5). The internationalization of French banking contained an important retail element (see also Table 6). In comparison, the internationalization of German and British banking was almost exclusively in corporate lending and investment banking (on the UK see Hardie and Maxfield 2011; on Germany see Hackethal 2004, 77). The internationalization of French bank assets and liabilities increased significantly in the decade prior to the crisis. However, this internationalization remained moderate compared to other large banking systems at just over 30 per cent of the total for both assets and liabilities and 100 per cent of GDP (2007 figures).⁶

<TABLE 5 ABOUT HERE>

<TABLE 6 ABOUT HERE>

Despite the comparative importance of retail banking and the comparatively limited internationalization of assets and liabilities, French banks were still heavily engaged in market-based banking. Indeed, by two measures – reliance on loans and deposits as a percentage of, respectively, total assets and liabilities, the French banking system was one of the most market-based on the planet (see Figure 2) and had moved furthest from the ‘traditional’ model of banking of deposit taking and lending. It is necessary

to examine the patterns of French market-based banking in order to get a fuller picture of the limited impact of the financial crisis on French banks.

<FIGURE 2 ABOUT HERE>

Assets. The trading activity of French banks and, in particular, the use of derivatives in trading activities increased rapidly in the decade leading to the crisis (see Table 7). Taking the banking system at large, financial assets held for trading *exceeded* both German and UK levels in 2008 (38 per cent versus 34.5 and 36.7 per cent) (ECB Statistical Data Warehouse). French banks specialised in equity, interest and exchange rate derivatives. Over the two decades prior to the crisis, French banks consistently engaged in approximately a quarter of global equity derivatives trading (Fédération Bancaire de France, 2007). For several years (2003-2007) Société Générale was one of the world's leading traders of equity derivatives and for five years running (2003-07) reported more profits from equity derivative trading than any other bank globally. Earnings growth from these business lines mitigated the impulse to extend into credit derivatives (securitization) to the same extent as UK, US or even, German banks and thus decreased the relative exposure of French banks to the immediate effects of the financial crisis which hit hard trading in asset-backed securities (ABS), asset-backed commercial paper (ABCP), collateralized debt obligations (CDO) and credit default swaps (CDS).

Yet some French banks were also heavily involved in the forms of market-based banking that were most linked to the financial crisis. Crédit Agricole, through its investment bank Calyon, was the world's sixth largest trader of CDOs (Barnett-Hart

2009: 19; with figures from Credit Rating Agencies), more than any European bank apart from UBS and more than several of the largest US investment banks combined.⁷ Two French banks were heavy traders in CDS. When the recipients of collateral postings for CDS by the American insurance giant, AIG (using US government support) were revealed, Société Générale headed the list, receiving US\$11bn, 22 per cent of the total. Calyon, the Crédit Agricole subsidiary, received a further US\$2.3bn. Named UK and German banks received less than their French counterparts, respectively, US\$12.7bn and US\$7.7bn. Luck therefore helped to diminish the impact of the financial crisis on French banks. The decision by the US Federal Government to bail-out AIG meant that French bank losses were considerably lower than they could have been.

<TABLE 7 ABOUT HERE>

Liabilities. On the funding side, French banks relied *more* on wholesale markets than banks in most other European countries (59.4 per cent of total liabilities in 2007, see Figure 3). The high level of French bank trading activities explains this heavy dependence on wholesale funds.

<FIGURE 3 ABOUT HERE>

As with the assets-side of the balance sheet, it is necessary to enter into the details on French bank liabilities to explain the comparatively limited impact of the financial crisis on French bank funding. French banks were less exposed to funding through off balance sheet SIVs and Asset Backed Commercial Paper (ABCP) vehicles than banks

in several other countries (Financial Intermediation Research Society 2008).⁸ Banks were forced to bring these vehicles onto their balance sheet at the time of the financial crisis and find liquid funds to cover them. Globally, French banks were the fifth largest issuers of ABCP. However, liquidity support to ABCP vehicles⁹ in France reached only US\$90.66bn in 2007 or 3.5 per cent of GDP, far lower than in those European countries most affected by the crisis (Table 8). Twelve of the fourteen largest French banks did not sponsor ABCP vehicles at all.¹⁰ Further, the limited securitization of bank lending in France diminished the effects of the financial crisis on the supply of credit. Outstanding collateral in securitizations at the end of 2008 was only 1.4 per cent of GDP in France – one of the lowest levels in Western Europe – compared to 3.5 in Germany, over 10 per cent in Italy, over 20 per cent in Spain and over 30 per cent in the UK.¹¹ The figure for ABCP Collateral is 0.8 per cent of French GDP versus 4 per cent for the UK. Unlike in the UK, the Netherlands and even Spain, securitization was not crucial to the rise of French bank lending in the 2000s.

<TABLE 8 ABOUT HERE>

The sources of French bank funding help to explain their relative stability in the context of the financial crisis. French banks financed themselves through debt securities more than the banks in more exposed European countries (€984bn outstanding versus the UK's €553bn) (although much less than Germany's €1638bn) (ECB Statistical Data Warehouse). French bank debt was of a much lower maturity by euro area standards, with 36.6 per cent up to a year in 2007 compared to German figures of 3.8 per cent.¹² French banks were thus potentially exposed to the difficulties of refinancing given the market conditions following the collapse of Lehman brothers.

However, refinancing was made easier because “French banks' net foreign position (foreign claims minus foreign liabilities) was almost entirely denominated in euros, which could be financed directly by domestic sources. ... UK, Swiss, German and Dutch banks built up large net foreign positions denominated in US dollars” (BIS CGFS 2010, 1).¹³ This was largely a reflection of the comparatively limited exposure of French banks to the dollar-denominated securities of US banks, which is explained below. French bank funding relied considerably less on short term interbank lending and considerably less on interbank lending from beyond the euro area and, specifically, from US banks – which froze up during the financial crisis – than funding in several other European countries. Only about a quarter (25.6 per cent in 2007) of French interbank lending came from beyond the euro area, compared to over half (51.7 per cent) for the Netherlands (BIS data).

How declining state intervention shaped French ‘market-based banking’

French banks were engaged in many of the same market-based banking activities as British and German banks. However, French banks were far smaller investors in the assets that became toxic (notably financial products based on American sub-prime mortgages), less involved in setting up off balance sheet vehicles, relative to their size, less engaged in the securitization of lending and less reliant on short-term interbank lending. These features of French banking can in part be explained in terms of bank strategy – some aspects of which are specific to individual banks. However, most of these features are broadly similar to all or most of the largest French banks (both the mutual and commercial banks) and should be described as systemic. They can ultimately be traced back to government policy: deliberate state efforts to build

the French financial system in the 1980s and 1990s, strategy on national champions and explicit and implicit forms of protectionism.

The liberalization of the French financial system since the mid-1980s has been substantial. All French banks were subject to the same broad legal framework, adopted in 1984, which allowed them to become universal banks. Prior to 1987, all the largest French banks were state-owned. With the privatizations of 1987 – 2002, four of the largest French banks – Société Générale, Banque Nationale de Paris (BNP), the now defunct Crédit Lyonnais and Crédit Commercial de France – became fully commercial operations, listed on the French stock exchange, the CAC-40. BNP's take-over of Paribas, an investment bank, in 1999, further expanded its trading activities. However, the comparative strength of all these banks remained in retail. Several others, most importantly Crédit Agricole, opted to become non-listed mutual banks, owned by smaller regional cooperative banks.¹⁴ Three of the six largest French banks were mutuals (and one part-mutual in the case of Crédit Agricole) and engaged principally in retail banking. The late arrival of the mutuals to investment banking (starting in 1999) may explain the difficulties faced by their investment banking arms – and Calyon's heavy exposure to CDOs – given the push to expand rapidly. However, the retail focus of Natixis' and Calyon's parent mutual banks limited the overall damage. German Landesbanken (LB), the publicly owned regional banks, did not have this retail focus which explains why their expansion owed more to investment banking activities to which they similarly came late (Hardie and Howarth 2009). Further, the two French commercial banks and Crédit Agricole were also big and listed (and thus could issue equity to fund foreign acquisitions) an option unavailable to the German LB and banks in some smaller European countries.

The ‘balanced model’ of French banking – and the relative importance of retail – can in part be explained by regulatory constraints. By the 2000s, French regulation was far less restrictive of investment banking than in some European countries, notably Spain or Italy, where regulation made it prohibitively expensive for banks to create off balance sheet vehicles (Royo 2008). All French banks were encouraged by French governments to engage in a full range of investment banking activities, including off balance sheet securitization. Further, French banks were able to avoid building capital reserves in line with assumed risks. Neither the Basle II capital adequacy requirements and the EU capital requirement directive nor domestic legislation addressed this issue (Bank of France officials 29 January 2008; Banking Commission officials 9 December 2009). By the mid-2000s, World Bank indicators gave France comparatively low scores in measures of ‘capital stringency’ (2, with 5 being the highest score assigned) and of ‘restrictions’ imposed on banks’ activities (6, with 14 being the highest score assigned). Italy in comparison is assigned a 4 and a 9 and the so-called ‘light touch’ regime of the UK a 3 and a 5 (Laeven and Levine 2008; data from Barth, Caprio and Laeven 2006).

However, the history of French regulation on securitization and off balance sheet activities helps to explain comparatively limited usage. The French state actively encouraged banks to engage in securitization, starting with the creation of a legislative framework in 1988 which was intended to boost confidence in the financial technique by creating clear legal, accounting and tax rules, unlike the UK which opted for a *laissez-faire* approach (Baum 1994). The official aim of the French Treasury at the time was to help French banks cope with new BIS solvency ratio guidelines and EC

rules (Directive no. 89/647, Solvency I) set to come into force at the start of 1993. The French state also wanted to support the international competitiveness of French banks and was concerned that British banks and American banks based in London would dominate securitization in Europe (Baum 1994, International Securitisation Report 1993). Securitization would give French banks access to the same funding options available to American and British competitors, in order to replace traditional funding sources, such as retail deposits and commercial paper, the costs of which were rising in the 1980s. Further, French governments saw in securitization a mechanism to increase lending to NFCs, especially medium-sized companies. Securitization, however, took off only slowly due in part to the intentional and unintentional technical, legal and financial obstacles in the 1988 legislation (Baum 1994), which limited the types of assets that could be securitized and created disincentives through rigid bankruptcy provisions that stemmed from existing French law. These obstacles were only gradually and partially eliminated over the next decade – the result being more limited securitization than in most other West European countries (relative to banking activities) into the 2000s. A significant part of the problem was the application to securitization of existing French investor protection rules – notably lengthy procedures and safeguards in the creation of SIVs – and accounting rules which discouraged off balance sheet securitization into the 2000s. French governments pushed through a series of legislative changes starting in 1993 to facilitate securitization (Touraine & Gillo 2004; Ministry of Finance officials, interview, 20 October) with significant changes in 2003 (Doat & Nugue 2005) and as recently as 2008 (Burnat 2009).

Limited French government success in encouraging banks to increase their engagement in securitization owes in large part to the success of state action encouraging other forms of financial innovation. In particular, the French state encouraged the trading of equity, interest rate and exchange rate derivatives, on which French investment banking became more heavily reliant than banking in other European countries. In February 1986, the Socialist government established the French futures market, the MATIF, and appointed a senior Treasury official and financial inspector, Gérard de la Martinière, to run it. The MATIF served several purposes (Mamou 1988; Story and Walter 1998). It provided market-enabling institutional investors to hedge against the risk of volatile interest or exchange rates. It represented France's response to the creation of the London-based LIFFE in 1982. It brought the Paris market into the world web of futures markets. Above all, the MATIF was a central element in modernising issuance of state paper. All its major derivative products originated with the Treasury. The French state floated a long-term ECU contract in October 1990 with the specific aim of developing Paris as the centre for trade in ECUs, the euro's predecessor. Paris rapidly became the second market for futures in Europe and by the early 1990s, the MATIF was engaged in trading levels that were only marginally lower than the LIFFE. In 1987, Société Générale started derivatives trading within two months of being the first state-owned bank privatised. The rapid expansion of bank trading activities in the decade leading up to the crisis (Table 7) both reflects the saturation of domestic markets and the relative strength of French investment banking.

Other forms of state intervention help explain the retail focus of the French banking system and bank internationalization. Government legislation strongly affected the

composition and allocation of a large part of financial savings through numerous schemes to mobilize and direct savings and credit towards programs judged to be in the public interest. These schemes encompassed certain controls on interest rates and fees, the design by the government of various savings products (notably the *Livret A*), the centralization of about a quarter of bank deposits in a fund managed by the state-owned CDC, restrictions on the use of funds collected through some savings products, and significant differences in tax treatment between financial products. In 2003, about 80 per cent of bank deposits (including checking accounts) were subject to significant product and/or price prescriptions, and differences in tax treatment have steered household savings towards life insurance products and saving for house purchases (IMF 2004). Amongst other effects, these policies distorted competition in the banking sector by restricting the distribution of certain products with only certain institutions, notably the public sector or mutual banks, allowed to offer specific tax-exempt or high rate savings products, thus placing commercial banks, both domestic and foreign, at a competitive disadvantage (Candida 2000). For example, the Post Office and two mutual banks, *Crédit Mutuel* and *Caisse d'Épargne*, were alone allowed to maintain the tax-exempt *Livret A* — until the start of 2009 from when all banks could offer this savings vehicle.¹⁵ Fiscal policy thus unintentionally contributed to the retail-focus of the French mutual banks, a highly saturated domestic retail market, into which few foreign banks entered,¹⁶ and a strong retail component to French bank internationalization – the saturated domestic market forced French banks to expand internationally. The kind of protectionism that persisted in Germany was markedly different. German Lander governments continued to provide guarantees to the LB until 2005 and the LB and Sparkassen continued to operate in what were in effect fiefdoms closed to other public sector banks. The comparison of French and

German protectionism is revealing. French protectionism encouraged domestic retail activities, resulted in the saturation of the domestic market and retail expansion abroad. German protectionism created a moral hazard for German public banks to invest actively in ABS created by American banks.

In the 1980s and 90s, French conservative governments encouraged the emergence of a limited number of large, vertically integrated banking groups controlled by French corporate shareholders – in a complex network of cross-shareholding with national firms, both to improve the stability of the system and to foster national champions – and a reflection of longstanding industrial strategy (Cohen 1995; Hayward 1995; Schmidt 1996). In response to increasing international and domestic competitive pressures, economic recession and sluggish growth from 1993, there was considerable concentration in the French banking sector, with eight of the largest banks created (or transformed) as the result of mergers (often steered by the French state) from 1995 to 2004 (Fédération bancaire française 2009).¹⁷ The French banking system became one of the most concentrated in the EU. Figures from 2007 show that the five largest French banks had 51.8 per cent of total assets, compared to 22 per cent in Germany, 33 per cent in Italy, 41 per cent in the UK and 41 per cent in Spain (ECB 2008). By the late 1990s, four French banks were in the top 15 European banks by asset size.

Morin (2000: 37) describes the France of the 1980s and 1990s as a ‘financial network economy’. The French government aimed to emulate the long-standing German practice of cross-shareholding networks, centring these around the then three largest commercial banks (BNP, Société Générale and the now defunct Crédit Lyonnais) and the insurance giant AXA – a central feature of the national champion strategy – with

the state retaining, indirectly, part ownership through the *Caisse des Dépôts et Consignations* (CDC), the para-statal financial institution that manages state pensions, and NFCs part-owned by the state. The ‘hard core’ concept reserved 25 per cent of privatised firms’ capital to major bank or corporate shareholders, selected by the state. The expectation was that the state would be able to manipulate this ‘hard core’ to influence strategic management decisions and block takeovers by foreign banks. Most of the largest banks were directed by former ministry of finance officials, advisers to the finance minister and, in several cases, members of the financial inspectorate, the elite network, *grand corps*, of financial sector administrators (Schmidt 1996; Maclean, Harvey and Press 2001). ‘Security and market transparency’ legislation adopted in 1989 strengthened the *Commission des Opérations du Bourse* to protect companies against hostile takeovers by other companies by forcing owners of over 33 per cent of a listed company’s shares to make a bid for at least 66 per cent of shares. Despite increased competition among French banks, the government also encouraged the practice of ‘interbancaire’, with cooperation amongst the biggest banks through an electronic banking card system (Story and Walter 1998). The minitel information system, developed by the state-owned telecommunication monopoly, France Telecom, enabled French banks to access households directly, over fifteen years prior to the advent of internet banking in other countries (*Le Monde*, 22 October 1992). Thus while no explicit law blocked foreign take-overs of banks, throughout the 1990s it was widely believed that no French government would sell a privatised bank to foreigners and that the state would also step in to block foreign firms from taking too large a shareholding of the listed banks. The decision by the Socialist-led Jospin Government to allow the London-based HSBC to take over the regional branches of France’s seventh largest bank *Crédit Commercial de France* (CCF) in 2000 could be

seen as a sign of changing government attitudes (see *Le Monde*, 4 April 2000). However, no other French bank has since been taken over by a foreign bank and in 2008 Banques Populaires bought these branches back from HSBC.

There is a caveat to this picture of a protectionist French banking system. Within a few years of privatization the cross-shareholding networks began to unravel and foreign control of the largest national banks increased (Culpepper 2005; Clift 2007; Maclean, Harvey and Press 2001). Although French banks dominated the domestic banking system, the actual equity ownership of the two large commercial banks became increasingly foreign owned in the 1990s and 2000s. In 2002, foreigners owned 67 per cent of BNP-Paribas' equity capital and 50.8 per cent of Société Générale's. The two large French commercial banks were similar to other EU commercial banks in this regard with rapidly rising foreign ownership over the past two decades.¹⁸ Despite the decline in cross-shareholding portfolios, important features of the 'financial network economy' remain (Dudouet & Grémont 2010; Clift 2011b), including shareholding pacts as between BNP Paribas and AXA. French mutual banks mostly did not open their capital, but Crédit Agricole – one of the largest retail banks in Europe – was partially opened to private shareholding in 2001. The actual impact of rising foreign ownership on bank operations is hard to isolate. Nevertheless, this opening and partial breakdown of cross-shareholding in French banks – and thus the decline of an important form of patient capital (Culpepper 2005) – is a likely influence on the pursuit of increased profits through more aggressive strategies including investment banking. Sluggish economic growth in France over much of the decade prior to the financial crisis encouraged expansion abroad. The relationship of French banks with NFCs – never as close as in Germany – became more distant

(Bertero, 1994; O’Sullivan, 2007) as elements of the ‘financial network’ economy deteriorated (Morin, 1998, 2000). The importance of bank finance for French companies – especially the largest CAC-40 listed companies – declined dramatically in the 1980s and 90s, and large French banks compensated by expanding retail operations abroad and by developing investment banking activities (Bank of France officials 29 January 2008).

To conclude, French banks operated as profit-maximisers and pursued domestic and international expansion. However, the manner in which they did this was dictated by conditions in the French banking system established to a large extent deliberately by the French state. State efforts in actively prodding recently privatised banks to engage in derivatives trading and securitization also point to the relevance of work by scholars who point to continued but more limited forms of state intervention to cope with contemporary challenges in global capitalism – in addition to Schmidt (2003, 2009), see Levy (2006) and Ben Clift’s (2011a; 2011b) elaboration on *post-dirigisme*. French government efforts to facilitate financial innovation fit well with Chris Howell’s (2009) ‘paradox of French state intervention’ which suggests that the French state is engaged in new kinds of state activism – but that the upshot of this activism is a retreat from interventionism in the economy, and the increasing exposure of the institutions of the French economy to international market forces.

Conclusion

This article has sought to explain the limited but significant impact of the international financial crisis on the French banking system. The rise of market-based banking

significantly changed the country's financial system over the past two decades, notably through the substantial rise in derivatives trading in the 2000-7 period. However, retail banking remained important both at home and in international operations. The strong retail component to French bank internationalization is in marked contrast to the internationalization of German and British banks which had, on average, far greater exposure to securitized assets and liabilities. For Italian and Spanish banks, meanwhile, internationalization was largely about the expansion of international retail banking activities (IMF, 2006a&b; Quaglia, 2009; Royo, 2009), even though their engagement in securitization was, on average, at a higher level than French banks.

The crisis did not bring substantial changes to the French banking system and even encouraged certain trends. The scaling down of some trading activities amidst the rhetoric of governments and many banks themselves for a necessary 'return' to traditional banking activities represents a time-honoured, and most likely time-limited, response to business problems (*Financial Times*, 10 September 2008). A retreat to the more cautious nationally-oriented banking of the past was highly unlikely in all but the very short term: the opportunities in domestic markets were limited and the lure of profits in risk-taking connected to derivatives trading remained. French banks – commercial and mutual – sought to expand their foreign retail and trading operations in order to increase profitability after the lean years of the mid-1990s. The result was record levels of profits for all six of the largest banks in the 2003-7 period.

Soft forms of protectionism and limited foreign penetration remained features. The upswing in state intervention as a result of the crisis was temporary. The state emerged as a substantial shareholder, in the case of BNP-Paribas the largest, but without voting rights. These shares were bought back by the banks in 2009 and 2010. The state-led merger of Caisse d'Epargne and Banques Populaires appears something of a throw-back to state interventionism. However, despite government rhetoric to the contrary, there was no state involvement in the micromanagement of the new bank. Rather the merger should be seen as an opportunistic move to further concentrate the banking system – by 2008 only 415 banks (715 credit institutions) continued to operate in the country down from 481 (975) in 2002 (Fédération Bancaire de France, 2009; IMF 2009).

There was no significant overhaul of French regulatory and supervisory regimes that by 2008 provided full support to market-based banking, encouraging off balance sheet activities and other financial innovations made difficult in the banking systems of Southern Europe. The domestic regulatory response to the worst financial crisis affecting French banks since the Second World War was negligible (Hardie and Howarth 2009). The Bank of France and the government repeatedly challenged the assumptions behind 'Too big to fail' concerns (Noyer 2010; *Financial Times*, 16 November 2009). BNP-Paribas – actively supported by the French government in its take-over of Dexia and Fortis' Belgian and Luxembourg operations (Hardie and Howarth 2009) – became the largest bank in the world by assets, recording an increase of 34 per cent in three years. While the financial crisis resulted in a retreat in the international activities of British and German banking activities, the

internationalization of French banking, principally in retail operations, proceeded apace.¹⁹

Over the twenty years prior to the international financial crisis that erupted in 2007, French governments repeatedly sought to facilitate securitization. However, the French state was more successful in encouraging banks to develop other operations – which resulted in the downplaying of securitization and the construction of a ‘balanced business model’ which sheltered French banks from the impact of the crisis. The French state deliberately – and very successfully – encouraged derivatives trading through the creation of the MATIF and through Treasury issues. Ironically, it was the failure of repeated state efforts to facilitate securitization – in part due to well-rooted regulation that effectively hindered this form of financial innovation – that helped to shelter France from the financial crisis. Deliberate state efforts – reflecting a long-standing ‘national champions’ strategy – resulted in the construction of a small number of large French banks with a strong retail base and international retail presence – the unintentional consequence of which was to create a buffer for French banks facing significant losses due to the financial crisis. This construction of large retail-focused national champions was helped by a lingering protectionism that contributed to a highly saturated and foreign-bank unfriendly domestic retail market. Clearly, a crucial transformation in French political economy remains the move to a ‘financial market’ form of capitalism, as large and many medium-sized NFCs turned increasingly to the equity markets (often foreign) for finance and French banks looked abroad and to other activities to compensate (Morin, 1998, 2000). The drive of French banks to expand, with foreign equity issues and forms of market-based banking, contributed to the unravelling of the cross-shareholding groups created in the 1980s

and 90s and centred around the largest commercial banks. This article does not deny the importance of bank or NFC agency in reshaping the French financial system (Culpepper 2005; O’Sullivan 2007). However, state action played a crucial and largely deliberate role in shaping the French bank business model, internationalization and the peculiarities of French market-based banking.

Notes

¹ France has also been described as a Mixed Market Economy (MME) along with Southern European forms of capitalism, but this is a broad category containing considerable institutional variety (Hancké, Rhodes and Thatcher 2007).

² The French financial system remains considerably smaller than the British owing to the comparatively limited development of other financial market actors (including hedge funds).

³ As a percentage of total financial assets, equity rose from 3.7 per cent in 1980 (a third of UK levels) to 21 per cent in 2000 (just short of British levels at 24.1 per cent). Equity market capitalization as a percentage of GDP can fluctuate significantly. The figures used (from 2000 and 2007) represent peaks: the relative size of bank assets was larger between these years.

⁴ One international comparison (Xiao 2009; IMF 2009, p. 15) on the direct cost of the crisis for large international banks shows that the direct cost for French banks (to April 2009) was about 18 per cent of Tier 1 capital, lower than that of Germany (about 33 per cent), the U.K. (about 37 per cent), the U.S. (about 86 per cent), and Switzerland (about 87 per cent).

⁵ Total French bank exposure to the so-called PIGS (Portugal, Ireland, Greece and Spain) reached €334.8bn in 2010 (BIS, December 2010). French banks were the most

heavily exposed to Greece (€67.8) and the second most exposed to Spain. French banks were also the most exposed to Italy at €336.3bn (end September 2010 figures, BIS).

⁶ The internationalization of British assets and liabilities was far higher at well over 60 per cent of the total for both and 250 per cent of GDP. German internationalized assets were at 55 per cent of the total and at a similar level of GDP (ECB Statistical Data Warehouse).

⁷ Calyon issued more CDOs than Goldman, Lehman, Bear Stearns, Morgan Stanley or JP Morgan.

⁸ See Hardie and Howarth (2011) for a further discussion of off balance sheet activities with regard to banks.

⁹ Liquidity support to ABCP vehicles shows the exposure of a country's banks to being forced to accept assets fully onto their balance sheets, with capital and liquidity implications, as a result of ABCP funding being unavailable.

¹⁰ Société Générale and Natixis were exposed to a total of US\$0.72bn and US\$2.82bn of ABCP respectively and only Natixis suffered major losses in ABCP. In contrast more British and German large banks sponsored ABCP vehicles (5 out of 11 and 14 out of 25, respectively) (Arteta, Carey, Correa and Kotter 2010).

¹¹ Author's calculations from European Securitization Forum figures, available at www.afme.eu/document.aspx?id=2878, accessed 8 November 2010.

¹² ECB figures:
http://www.ecb.int/stats/money/aggregates/bsheets/html/outstanding_amounts_2007-12.en.html, accessed 17 November 2010.

¹³ The euro denominated net foreign position owed to limited French bank exposure to US assets (including securities) and the euro area focus of French bank internationalization.

¹⁴ Crédit Agricole was later part-listed on the CAC-40 stock exchange.

¹⁵ A significant part of the *Livret A* financed social housing (and was placed on the balance sheet of the CDC) and thus did not constitute a resource for other banking activities. Nonetheless, the *Livret A* effectively distorted competition in retail banking.

¹⁶ In 2008, France was in fourth place in the EU for the number of branches per capita (ECB 2008). French owned credit institutions held 85 per cent of bank-held assets throughout the 2000s (IMF, 2004, 103; IMF, 2009, 44). This was lower than some parochial continental European banking systems – domestic banks controlled 92.8 per cent of bank assets in Spain (December 2005) (IMF 2006b) – but far below the foreign presence in the British banking sector, reaching up to 55.2 per cent in 2005 (ECB 2010).

¹⁷ The number of French credit institutions declined from 1556 in 1984 to only 959 by 2003 and 450 by 2008

¹⁸ For example, Deutsche bank, the largest German bank, was foreign-owned at 55 per cent in 2007, while the second largest Spanish commercial bank, BBVA, was foreign-owned at 45 per cent in 2008. See Deutsche Bank. 2010. “Shareholder Structure.” Available at http://www.deutsche-bank.de/ir/en/content/shareholder_structure.htm

¹⁹ The non-French financial assets (loans, securities, shares and other financial products combined) held by French monetary financial institutions rose from 36.4 per cent of total financial assets at the end of 2007 to 38.1 per cent at the end of 2010. See Banque de France. ‘Statistiques monétaires mensuelles : France, Bilan des Institutions Financières et Monétaires hors Banque de France (encours)’. Available at

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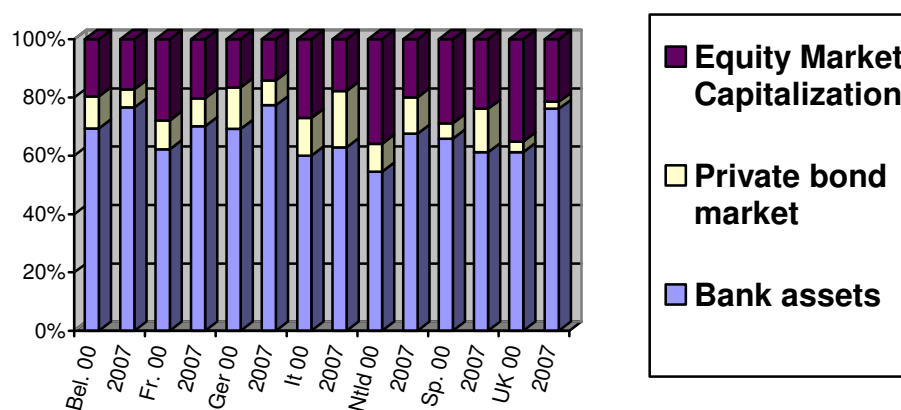
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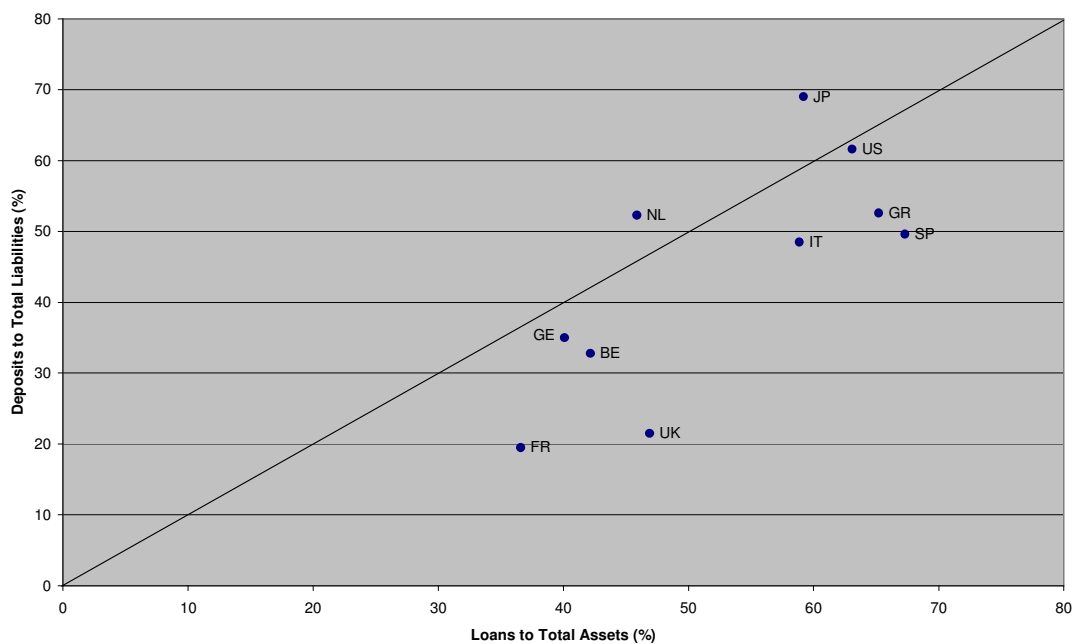
Figures

Figure 1: National Financial Systems, Selected Countries (2000 and 2007)
Bank assets, Private debt market, Equity market capitalisation as a percentage of total financial system assets.



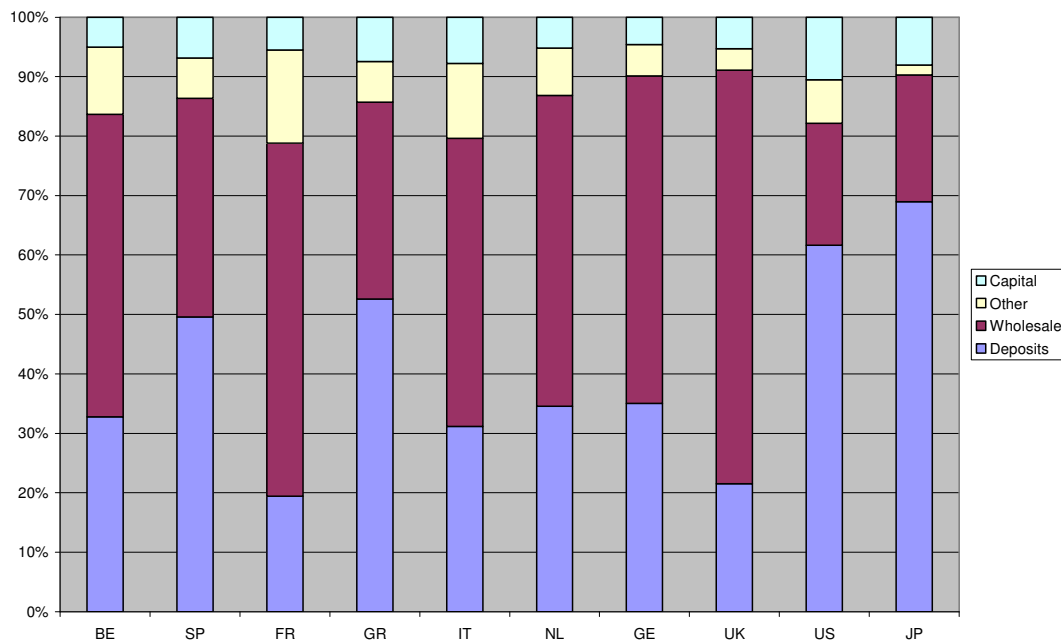
Sources: For credit institution assets see ECB 2004 and 2008. For Private bond market and equity market capitalisation see Thortsen Beck and Asli Demirgüç-Kunt, "Financial Institutions and Markets Across Countries and over Time: Data and Analysis." *World Bank Policy Research Working Paper* No. 4943, May 2009. For Equity market capitalisation see also World bank data bank: <http://databank.worldbank.org/ddp/home.do?Step=3&id=4>

Figure 2: Loans to Assets and Deposits to Liabilities, Selected Countries, end 2007.



Sources: Hardie and Howarth 2011; ECB (www.ecb.int/stats/money/consolidated/html/index.en.html); Cabinet Office 2008; Federal Reserve (www.federalreserve.gov/releases/h8/current/default.htm); IMF 2010: 16.

Figure 3: Breakdown of Bank Liabilities, Selected Countries, end 2007.



Sources: Hardie and Howarth 2011; ECB (Authors' calculations from: http://www.ecb.int/stats/money/aggregates/bsheets/html/outstanding_amounts_2007-12.en.html); IMF 2010: 16.

Tables

Table 1: NFC finance 1970s to 2000

	Bank lending	Debt securities	Equity (listed and unlisted) ¹⁹
1978-84 average*	67.4	3.5	29.1
2000**	16.1	3.4	79

Source: 1978-84 figures from Cobham and Serre 2000, 49; 2000 figures from Byrne and Davis 2002, 89.

*The NFCs do not include state-owned companies and public utilities. The total figure covers only lending, bonds and equity, excluding trade credits and other sources of external finance.

**The remaining 1.4 per cent consists of monetary market instruments.

Table 2: Finance raised by French NFCs since 1990 (outstanding, €bn)

Funds by source* / date (end of year)	Bank loans from domestic credit institutions only	Securities (in all currencies combined)	Equities (listed only)
1990	440.6	101.1	206.2
1995	441.5	134.1	308.4
2000	507.3	233.1	1235.3
2005	579.6	279.3	1119
2006	630.5	280.1	1379.2
2007	713.3	275	1501.1
2008	781.6	295.9	891.7
2009	769.3	345.9	1080.2

Source: 'Loans : Banque de France, Credit Institution Credits to NFCs.' Available online at <http://www.banque-france.fr/fr/statistiques/base/statmon/telnomot/mh.m.ec.credit.3.r.1b.to.t.m.x.b.x.csv>. Securities and equity, ECB Statistical Data Warehouse.

Table 3: Write downs and public support for banks, Selected countries.

	Belgium	France	Germany	Italy	Japan	Netherlands	Spain	UK	US
Securities Write downs as a % total bank assets (2007)	0.44 (08-09 only)	0.38 (7.07 to 4.10 only)	2	.086% (07-09 only)	.22%, (April 2009 est.)	1.8	0.17	0.52	2.6

Public funds drawn upon by banks (% 2007 GDP) by end 2009	6	1.1	4.9	0.3	0.2	2.5	1.1	6.5	4.8
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Sources: National Central Banks, 'Financial Stability Report' and IMF 'Global Financial Stability Report, April / October 2010 for figures on securities write-downs and public funds drawn.

Table 4: French Bank Losses

	Total Write-downs 2007-2010 (\$ US)	Write-downs 2007-2010 / Total Assets (at end 2007) per cent	CDO / MBS	LBO	Mono-line*	ABCP / SIV	Other Trading	Iceland/ Lehman / Washington Mutual
BNP-Paribas	28.3	1.67	X	X	X		X	X
Société Générale	18.6	1.74	X		X			
Crédit Agricole	18.6	1.32	X		X		X	
Crédit Mutuel	N/A	N/A	X				X	X
Caisse d'Épargne	Share of Natixis 6.9	N/A	X		X	X	X	X
Banques Populaires	Share of Natixis 6.9	N/A	X		X	X	X	X

Source: 'FACTBOX-U.S., European bank writedowns, credit losses', Reuters, 24 February 2011. Available online at <http://www.reuters.com/article/2011/02/24/banks-writedowns-losses-idUSLDE71N1J720110224>. Reuters/annual reports/company filings/registration documents. Author's own calculations. Estimates based on writedowns and losses from sub-prime securities, mortgages, CDOs, derivatives and SIVs, and losses on bad loans, or non-performing loans.

* Exposure to insurance companies that provided guarantees for various types of securities.

Table 5: (on additional document file)

Table 6: French Bank Internationalization (lending exposure)

BNP-Paribas	Lending outside France rose from 61 per cent in 2001 to 65 per cent in 2007. Lending business to the rest of the European Economic Area rose from 18 per cent of total in 2001 to 30 per cent in 2007.
Société Générale	Lending outside France rose from 35 per cent in 2003 to 50 per cent in 2007. Exposure outside Europe rose from 10 per cent in 2003 to 19 per cent of total in 2007.
Crédit Agricole	Lending outside France rose from 18.4 per cent 2001 to 56.3 per cent in 2007. Lending business in the rest of the EU increased from 4.9 per cent to 33.9 per cent. Lending to the rest of the world increased from 14.5 per cent in 2001 to 22.4 per cent.

Source: Bank registration documents. Authors' own calculations.

Table 7: Increased Bank Trading Activity

BNP-Paribas	Trading assets 51.8 per cent of total assets in 2007 (14.2 per cent in 2002).
Société Générale	Trading assets peaked at 31.9 per cent of total assets in 2006 (more than double 2002). Fall to 28.6 per cent in 2007.
Crédit Agricole	Trading assets 30.2 per cent of total assets in 2007.
Caisse d'Épargne	Trading assets 10.5 per cent of total assets in 2007.
Crédit Mutuel	Trading assets 13.8 per cent of total assets in 2008 (2007 not available).

Source: Bank registration documents; author's own calculations.

Table 8: Liquidity Support to ABCP vehicles by Country

	Amount (US\$bn)	% of GDP
Belgium	52.33	11.52
France	90.66	3.5
Germany	310.84	9.36
Italy	2.72	0.13
Netherlands	173.87	22.37
Spain	7.08	0.49
United Kingdom	214.25	7.75
United States	356.83	2.58

Source: Fitch Ratings (2007: 7-8); see also Acharya and Schnabl, 2010: 54