

French Economic Recovery

By

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"The road is hard, but it is beautiful", said General De Gaulle a year ago. "The end is difficult but it is great. Allons!"

Under De Gaulle, France has gone forward with a series of economic reforms, almost as radical as the political. The reforms are having startling results. At the moment, the French economy is probably stronger than at any time for three decades. The new economic policy is described in this article written specially for "Review".

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Aron is that rare combination of scholar and journalist commentator on the current economic and political scene. Observers have compared him with Walter Lippman of the United States in an endeavour to "fix" his position in present-day France.

Over the last five years, Australia's exports to France have averaged nearly £70 million a year (Imports £12 million). France has been Australia's third largest customer.

IN spite of the wars in Indo-China and in Algeria, in spite of lack of government stability, and in spite of inflation, the French economy has made remarkable progress in every field since the end of the second world war in 1945.

Industrial production has increased by more than 50% since 1952. Key industries, such as the chemical industry, have actually doubled their production. In 1938, the French automobile industry produced some 230,000 vehicles; in 1959, more than 1,100,000 vehicles will leave the French factories. These are remarkable results, indeed, particularly in view of the fact that the overall

labour force in France has not yet started to increase. (This increase will, in fact, only be felt a few years from now when the stronger post-war birth-rate will show its effect on the labour market). Even industrial manpower has increased only slowly, much more slowly, at any rate, than industrial productivity. Labour productivity in industry, in 1955, 1956 and 1957, increased by some 7% per year. (In the coal mines, for instance, the average output per miner in the pit increased from 1.229 tons in 1938 to 1.660 tons in 1956).

In agriculture, progress is not as spectacular. Still, the improvement has been substantial. Although

agriculture loses some 50,000 labourers every year, the index of agricultural production (end products) has increased by 20-25% since the pre-war period. Output per acre has risen by more than 30% for wheat, and by more than 25% for barley. Average meat production exceeds that of pre-war years by about 50%.

Finally, the decrease in the birth-rate which threatened a population decline similar to that experienced by other outstanding civilisations in earlier periods of human history, has stopped; in fact, the movement has been reversed. This, in its long-term implications, may well be the "French Miracle" of today. Instead of 734,000 children born in 1931, and 612,000 in 1938, there were 840,000 in 1946 and 804,000 in 1956. The annual excess of births over deaths, ranges between 250,000 and 300,000. Improvement in public health is continuous. Before the second world war, there were 66.4 cases of infant mortality for every 1,000 new-born infants; in 1956, this rate had dropped to 31.6 (against 25 in Great Britain, 42 in Western Germany and 51 in Italy).

Abroad, France has frequently been described as the sick man of Europe. Partly this was due to the frequent changes in government — in fact, public opinion abroad may have had a tendency to over-rate the seriousness of this lack of stability. The other reasons were the constant increase of prices on the domestic market and the deficit in France's balance of payments.

It is true that from 1945 to 1958, France had had only two short periods of stability, the first one in 1949 to 1950 (terminated by the effects of the Korean war) and the second in 1952 to 1955. During the second, very favourable period, expansion, although it meant a 10%

increase in the index of industrial production in 1955, did not lead to any rise in domestic prices, nor to any shortage of foreign currency. On the other hand, during the reconstruction period from 1945 to 1949, from the summer of 1950 to the spring of 1952, and from the winter of 1956 to the summer of 1958, there were both serious inflation and a deficit in the external balance of payments.

When General de Gaulle resumed the reins of government in France, the essential task he had to tackle in the economic field was the rehabilitation of the internal and external finances of the country. (1) This task was accomplished in two stages: a preparatory stage from June, 1957 to December, 1958, and the implementation of a general policy, synchronised with the 1959 budget, which was issued by government decree during the last days of 1958.

Inflation

In the United Kingdom and the United States, lengthy discussions have taken place, and a lot has been

(1) The Poincare government in 1926 successfully faced a similar task as far as the external finances of France were concerned. The combined figures for gold and foreign currency holdings in 1925 showed France in difficult straits. Poincare succeeded in achieving a rather sensational reversal of capital flow, and even before the 5:1 devaluation of the French franc in 1928 pegged French currency at a new level, the French Treasury was well on its way to achieve what was then one of the world's soundest positions, as far as gold, foreign currency and other holdings abroad were concerned. Statistics show, for these three items combined, the following figures:

December, 1926,	1,480 million dollars.
December, 1927,	1,640 million dollars.
December, 1928,	2,580 million dollars.
December, 1929,	2,700 million dollars.
December, 1930,	3,190 million dollars.
December, 1931,	3,560 million dollars.

It should be kept in mind that these are American dollars before the 1933 devaluation of that currency.

Another interesting feature of the Poincare experience is indicated by the changes in the bank discount rate. This is shown as having been in, July, 1925 6%, July, 1926 7½%, December, 1926 6½%, February, 1927 5½%, after which it was progressively reduced until it reached 3½% in January, 1928.

written, on the various forms of inflation in modern society, particularly in the United States. Many questions were raised. In the absence of excess demand, can inflation be caused by the impact of a rise in cost, where workers obtain wages increases that are not justified by increased productivity, where employers translate the increased production cost into a higher sales price and where the consumer is unable to resist?

The case of France did not raise any complicated questions or problems. The 1956 to 1957 inflation was strictly of the conventional type. The deficit in public finances was such that real savings were insufficient to cover the gap between public expenditure and fiscal revenue. At the same time, industrial expansion proceeded at such a rapid pace that the narrow labour market felt an acute shortage of labour; to recruit the workers they needed, and particularly skilled workers, employers did not hesitate to bid up wages. In turn, a too rapid increase in nominal salaries intensified the effects of the deficit. In 1956, the government, in addition, made the mistake of trying to achieve the impossible; they wanted to maintain stability of retail prices and of money wages. The result was, over a period of just one year, a deficit in the external balance of payments of over 1,000 million dollars. In fact, at the end of 1957, France had practically reached the bottom of the till as far as foreign currency reserve coverage was concerned and had to borrow slightly over 500 million dollars from the United States and from the funds of the O.E.E.C.

The Impasse

Yet, it must be said that the last government of the Fourth Republic

had taken energetic measures — but too late. The 1958 budget was a severe one and the "Impasse" ⁽²⁾ was clearly below 600 thousand million francs.

In terms of the budget in Great Britain this (French) budget showed a favourable balance since part of the capital investment programme was financed from fiscal sources. (The British budget of 1958, expressed in French terminology, would have had an impasse of approximately 900,000,000 or, 1.15 billion French francs).

In addition to this severe budget, the authorities had also strengthened the measures restricting credit, by fixing an overall volume, which could not be exceeded at any cost. Previously, the banks only had to pay a higher discount rate when they exceeded their rediscount ceiling.

First Measures by de Gaulle

After a temporary disruption caused by the political crises of May and June 1958, the policy initiated at the end of 1957 overlapped, in its effects, the first steps taken by General de Gaulle's government and the psychological repercussions of stabilisation of France's government.

The rise in prices showed a tendency to stop on its own account. The Pinay loan brought more than 150 million dollars of gold back into the currency stabilisation fund. Capital ceased to flow out of France, and there was even a beginning of

(2) In French budget terminology, "impasse" (literally translated, dead-lock or dead end) is the theoretical deficit, taking into account on the debit side, funds ear-marked for government investment. Although the figure is a theoretical one and actual long-term public investment may vary, it is generally considered that the budget is "balanced" when this gap (the impasse) does not exceed 600 thousand million francs, or 1,200 million dollars, at the present rate.

a flow of capital back into the country.

Finally, foreign trade was balanced during the last quarter of 1958: exports (f.o.b.) covered more than 90% of the imports (c.i.f.). (Imports 136 and 133 thousand million francs — Exports 128 and 131 thousand million francs).

It was at that point that the 1959 budget was promulgated. It marked a decisive choice of a clearly defined policy.

The New Policy

The new government policy used as its basis the report made by the Committee of Experts, presided over by Mr. Jacques Rueff. Still, it gave rise to diverging, if not contradictory, comments from various quarters. Some people saw it as a political doctrine, inspired by the principles of economic liberalism, while others laid more stress on the specific economic position of France and the obligations arising from that position.

Reasons

Let us indicate first the circumstantial reasons for the strategy adopted by the de Gaulle government, and then the long-term significance of this strategy.

As we have seen above, the French balance of trade at the end of 1958 was almost in equilibrium, prices on the domestic market were practically stabilised — but, at the same time, expansion had come to a standstill. Thus, taking an index of 100 for 1952 as a basis, the index of industrial production in the building trade was 160 in January, 1958, rose to a maximum of 168 in May and fell back to 159 in December. The trend is practically the same, if you correct the index by eliminating normal

seasonal variations: 155 in January, 158 in April and 152 in December. In other words, for the year 1958: high level of production — no expansion.

First Decision: Expansion or Consolidation?

The first decision had to be taken: either the new budget would give priority to resumed expansion or the main emphasis would be on an attempt to consolidate the first results obtained in the fields of domestic prices and the balance of payments.

This question was subject to very lively controversy. Yet, those who were informed about all the elements of the situation could not have any doubt about what had to be done; the primary objective had to be to achieve a favourable balance of payments and to restore the reserves of the currency stabilisation fund. The policy recommended by the Committee of Experts and applied by Mr. Pinay under the direction of General de Gaulle and Mr. Michel Debré, aimed first of all at giving France the means to meet commitments abroad, and hence, to enjoy full and complete independence.

Once this premise is accepted, the logic of the policy can easily be grasped. To achieve a balance in external trade, the primary condition is the absence of inflation on the domestic market. In turn, the primary requisite in the struggle against inflation is to keep the impasse (see footnote 2) within such limits that the gap can be bridged by the real savings of the public without having to fall back on indefinite loans or advances made by the Bank of France.

This was the principle underlying the policy. At the same time, the

experts found that the administrative forecasts for government expenditure and revenue indicated a gap of approximately 1.2 billion francs. They unanimously felt that this gap had to be narrowed down to half that amount, that is, 600 thousand million francs. To achieve this end, they recommended 300 thousand million francs in supplementary taxes and a cut in government expenditure of the order of 300 thousand million francs.

Cuts in Government Expenditure

The significance of the breakdown of the 300 thousand million francs of new taxes is more social than economic; hence, we can limit ourselves to a consideration of the breakdown of the reductions in government expenditure.

There was no possibility of immediate important savings of interest on the public debt, nor of civilian expenditures (the population increase makes additional expenditure for education a must), nor on military expenditure because of the events in Algeria, nor even on building expenditure, as the housing shortage is far from solved.

Finally, there remained only three items in the budget where cuts could be envisaged: capital investment, State intervention into the economy (subsidies etc.), and social expenditure. Experts estimated that the appropriations for capital works had to be maintained at all costs, since they were the guarantee of future economic development. They proposed certain reforms in the legislation covering social benefits and recommended that the loans earmarked for economic intervention by the State be reduced.

This latter recommendation referred mainly to subsidies, some of

which were intended to cover the deficit of a nationalised public service (French railroads), others to depress the price of certain consumer goods.

In their main outline, these recommendations were accepted by the government.

Eliminating Subsidies

The savings on the amounts earmarked for economic intervention were suggested partly for reasons of expediency: expenses had to be cut. But they were also in line with a basic economic concept: subsidies which decrease the price of goods below their real market price are always an unfortunate solution. If assistance is to be given to the underprivileged groups of the population, measures affecting incomes directly are better than a subsidy which favours the rich and the poor equally.

On the other hand, the elimination of the subsidies resulted in a rise of certain prices (transport and freight rates, coal, some food staples). Against this, the exchange rate, although it was not directly endangered, left no operational margin. The rise in prices, inevitably resulting from the elimination of 160 thousand million francs' worth of subsidies, provided an additional reason for a devaluation of the franc — and for proceeding with such a devaluation at a moment when the currency was not under direct pressure.

Devaluation

This devaluation was to have a dual aim. First to establish an exchange rate which, unlike the previous rates of the franc, would show promise of being a permanent one. Second, to promote exports and to reduce imports, in accordance with the conventional mechanism of devaluation.

Of course, devaluation did mean a risk of a new rise in prices on the domestic market. These prices had only just been stabilised. Would the new budgetary and financial measures unleash the movement again? The experts kept this peril in mind, when they invited the government to do two things: 1. to open the French borders as widely as possible to foreign goods and, 2. to do away with all contracts, public or private, that involved the indexing of one commodity or service on another, as such contracts would, in their application, have unavoidably led to a generalised rise in prices.

Accepting these recommendations, the French government pushed the percentage of liberalisation of external trade to 90% and it has been pushed even higher since then. And the only indexing maintained was that of the State-guaranteed minimum wages of workers and employees. The latter remained linked to the price indices of a government-established list of consumer goods and services.

The Government Plan

These, then, seem to be the four principal instalments of the government plan — *a cut in government spending, elimination of government subsidies, devaluation, and trade liberalisation*. They are linked logically, one to another, and, together, form a coherent entity.

Doctrine or Expediency

At the same time, this enables us to answer the question of whether the plan is based on doctrine or on expediency.

The report of the Committee of Experts is the exposé of a *strategy of rehabilitation*. It is not a theory of inflation or a doctrine of economic

liberalism. The experts simplify, or even ignore, the technical problems to concentrate on recommendations that are politically feasible. For instance, when they write that 600 thousand million francs are the maximum "impasse" that can be covered with certainty, without causing inflation, the experts expressed themselves as if they were addressing laymen. In reality, the volume of the impasse unlikely to cause inflation in a given national economy, depends on various circumstances, such as the available means of production, the state of the labour market, etc. The very notion of "real savings of the public" which make it possible to finance this deficit (the impasse), without inflation, is poorly defined from a scientific viewpoint.

The subordination of the whole policy to the external balance of payments was also linked to the specific situation of France. Not only had France lost all her foreign currency reserves, with the exception of the gold stock of the Bank of France — 590 million dollars — but she had debts abroad which exceeded the total amount of gold and dollars held by the French authorities.

While obligations for re-payment were below 200 million dollars in 1959, they were supposed to go up to 500 million dollars each, for 1960 and 1961.

Gold in Private Hands

At the same time, however, the French, as individual citizens, owned gold and dollars in various forms. Nobody knows exactly how much gold is in private hands, but the estimates vary between 3,000 and 4,000 tons, in other words, between 3,000 and 4,000 million dollars. An additional few thousand million

dollars are estimated to be in private hands in the form of foreign holdings, and accounts owned by French citizens and deposited in foreign banks.

In the circumstances, it is easy to understand that the reversal of capital flow was one of the primary aims of government policy. Let the French, as private citizens, place at the disposal of France, as a country, just a part of their foreign currency reserves, and the elements of the problem of the balance of payments may undergo a sudden change — and a very drastic one, at that.

The European Common Market

Economic rehabilitation and liberalisation achieved by this new policy tend to align France's position with that of her neighbours and partners in the European Common Market. If France had been compelled to prolong the suspension of trade liberalisation which the foreign currency crises had forced her to declare, how could she have applied the Treaty of Rome and reduced customs' duties by the 10% stipulated by that Treaty?

The countries of Western Europe did not apply the same degree of liberality in their commercial policy, judging by the percentage of goods freed of the quota system and by the level of Customs' duties. On the basis of either of the two criteria, Western Germany shows the strongest degree of trade liberalisation. France, on the other hand, has not suddenly passed to the top of the list; she has only joined the bulk of the other countries.

In the same vein, as far as domestic policy is concerned, France has abandoned the unfortunate habits of State intervention into individual sectors of the economy,

and administrative subsidies. These devices had resulted in many artificial prices and imposed heavy burdens on France's Treasury. There again, however, the change meant, above all, doing away with a special position occupied by France. All the countries of Western Europe had already returned to a more orthodox economic approach and to the commonsense of true price levels; France has only followed their example.

Three Lessons

What lessons of a general nature can be drawn from the French economic rehabilitation strategy, which has just recently been imitated by Spain?

The first lesson is that the conventional economic and financial techniques continue to keep their validity. The struggle against inflation, the restoration of a valid currency do not call for any special degree of imagination, nor for complicated measures. A severe budget, credit restrictions, a well-pegged currency exchange rate, liberalisation of international trade, the latter with a view to depressing domestic prices — all these are well-known formulas. To use Napoleonic terminology: economic strategy, just as military strategy, is an art, simple in its principles, but in which execution is everything. The difficult part is to have the willpower and the courage to take all the necessary steps simultaneously, to take a rigorous stand on wages, prices, and credit, to the extent that proves indispensable — in spite of inevitable protests, and even in spite of legitimate demands. We might add here, that in the case of France, production, productivity and the standard of living, had made such progress in the preceding years,

that the sacrifices demanded were actually accepted without too lively protests.

The second lesson is not particularly original either. In the Western World, in spite of currency controls, (the effectiveness of such measures has decreased very noticeably), there cannot be an equilibrium in the balance of payments unless the public has faith in the currency involved. Even a currency such as the French franc, which is not widely used for purposes of international payments, is dependent upon the day-to-day assessment of its holders. Currency control is all very well — but exporters delay the return of their foreign currency holdings and importers take their own precautions. Even leaving aside illegal capital exports (and these can amount to quite considerable sums), the attitude of exporters and importers can be sufficient to cause, at least on a short-term basis, differences of several hundred million dollars in the balance of payments.

The third and last lesson is even more self-evident. A modern industrialised country cannot, in the long run, remain isolated from the economic context of the world at large. As a member of the O.E.E.C. and of the European Common Market, France could not indefinitely sacrifice her currency to the concept of expansion, or impose quotas on her imports, while at the same time enjoying the benefits of trade liberalisation. The present economic system of Western Europe does not exclude certain singularities in the economic policy of individual countries, but these specific features, must remain within reasonable proportions. Even Spain has just bowed to this law of the Western World.

Results

What, then, are the results of the new French economic policy?

As we have seen, the first aim was to restore the foreign currency reserves. This aim has been achieved to a satisfactory degree. The reserves on 30th June, 1959 amounted to 1,633 million dollars, in other words, 1,000 million dollars in addition to the stock of gold of the Bank of France. In the meantime, between 400 and 500 million dollars must have been spent for the payment of foreign debts. This means that the capital flow back to France must have been between 1,000 and 1,500 million dollars during the first six months of 1959. Out of this amount, some 500 million dollars may well be the result of the change in attitude of exporters (bringing their capital back more quickly) and importers, who, unlike before, did not feel they had to "cover" themselves. Foreign tourists now buy their francs from the banks and other official sources, Frenchmen have repatriated money that they used to keep in bank accounts in Switzerland or in the United States, and foreign investors have placed money on the Paris Stock Exchange.

As an inevitable result of the devaluation and of the elimination of government subsidies in the budget, prices of manufactured products rose during the first few months of the year. Yet, between December, 1958 and May, 1959, the increases in the retail prices of industrial products amounted to only 5.8%; this figure is below the rate that could have been expected on the basis of direct calculation of the effects of the new measures. The rate of price increase tapered off, as the months went on; 2.5% in January, 1959, 1.6% in February,

.8% in March, .5% in April, and .4% in May. For the economy as a whole, price increases were even less important, since there was a trend towards decreasing food prices. Hence, it can be said that by spring, 1959, prices were stabilised.

Economic activity continued at a high level. The index of industrial production, corrected for seasonal variances and compared to a basis of 100 for 1952, was 159 in May, 1959, against 156 in May, 1958. It is true that there has been no resumption of the expansion witnessed during the last few months. We are far from the 10% rate of progress in industrial production to which French public opinion had become accustomed.

The figures for foreign trade also show considerable improvement. In June, 1959, imports amounted to 165 thousand million francs, against exports totalling 176 thousand million francs. Even if exceptional circumstances are taken into account, such as American steel purchases because of the impending steel strike in the United States, it has been clearly demonstrated that France's economy, when placed in normal conditions, is just as capable as any other country's to finance the purchase of the necessary raw materials out of the country's exports.

The overall picture we have just drawn is an encouraging one. It is not our aim to conceal the dark spots, or to convey an erroneous impression that French recovery is achieved beyond all doubt.

Part of France's agriculture and part of her industry are still in need of modernisation. Although housing construction is now at the rate of some 300,000 lodgings per year, building construction remains too

low and too expensive, and the housing shortage will no doubt remain an acute one for years to come.

Stabilisation is still precarious; whether it is a solid one will only be seen under the acid test of resumed expansion. For the time being, the price paid for the halting of inflation and for equilibrium in the balance of payments has not been too heavy, as economic activity has not slowed down to any noticeable degree.

Yet, the necessary economic rehabilitation has had, as its counterpart, the end of economic expansion. When will this expansion resume? And, when it does, will prices remain stabilised and will it be possible to stop wages from progressing more rapidly than productivity?

In spite of the flow of capital back to France, long-term credit remains expensive: lowering of the interest rate will probably be one of the primary conditions for the resumption of a healthy expansion in a stabilised economy.

These are the questions confronting the observers when they try to look into the future.

The keynote, however, is confidence. The period from 1946 to 1958 has demonstrated the capacity for economic and technological progress. The ability to achieve internal and external stability is in the process of being demonstrated. At the same time, the trend is favourable with regard to both the material and the human elements. Thanks to the strengthening of her birthrate, France today has more children below the age of fourteen than Western Germany. Thanks to the Sahara, France in 1961, will have at her disposal 18 to 22 million tons of

crude oil, payable in French francs. By 1965, this figure is supposed to rise to some 50 million tons. On the labour market, manpower is on the increase for the first time in the century. The danger of foreign currency or raw material shortage has been removed.

Thus, *providing France can find a solution to the Algerian problem*, she can look forward to the prospect of unprecedented prosperity. During this second half of the twentieth century, France is assured of an honourable place among the industrial nations of the world.



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