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Economic Developments in France in 1967

This paper reflects the personal opinion of the author and must not be interpreted as representing the opinion of the Board of Governors.

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Summary

The performance of the French economy in 1967 was disappointing. The Fifth French Economic Plan calls for growth of real Gross Domestic Product averaging 5 per cent a year in 1966-70. Although this rate was reached in 1966, it was missed last year by a fairly substantial margin. The official French estimate published last October was that GDP in real terms expanded 4.2 per cent, but other forecasters think that the rate will have been lower than that. From the data now at hand it seems that the rise in 1967 may have been between 3.6 and 3.8 per cent.

Expansion was slowed down by several factors, but predominantly by serious weakness in domestic consumer demand and reduced aggregate demand in some of France's main trading partners. The generally sluggish demand conditions abroad greatly slowed the growth of French exports; internally, there was no growth in volume of residential construction in 1967 and a year-long stagnation in industrial production persisted through August of last year. However, in September the seasonally adjusted index of industrial production rose by over 2 per cent, and by the end of the year had risen by 3.3 per cent from the August level. These improvements resulted from increased consumer buying and higher exports.

The French economy escaped a recession in 1967 because of several factors. First, French agriculture (which accounts for nearly 9 per cent of GDP) performed exceptionally well in 1967, registering

a volume increase of at least 6 per cent over the 1966 level. Second, output in the investment goods industries performed better than did general industrial production--for 1967 as a whole, total business investment in real terms is expected to show an annual increase of about 8 per cent over 1966 (which had shown an increase of 6.7 per cent over 1965). Third, French exporters were able to compensate for some of the impact of German recession and British slowdown by increasing their sales in other foreign markets.

The most important cushion against recession, however, was public sector spending and the moderately reflationary policies of the authorities. Public consumption is expected to have shown a rise of 6.2 per cent in real terms in 1967 and public investment a gain of more than 7 per cent. Because of balance of payments considerations and fears of inflation, the authorities stopped short of vigorous reflation, but the various measures undertaken were at least sufficient to sustain the level of industrial production and bolster sagging private consumption expenditures.

Despite the economic slowdown, consumer prices in France rose fairly sharply in 1967. The consumer price index in December 1967 was 3.4 per cent higher than in December 1966, compared to 2.8 comparable increase in 1966. The bulk of the increase occurred in the second half of the year and was largely caused by deliberate government efforts to eliminate deficits in the Social Security System and some nationalized industries.

Externally, France appears to have experienced a moderate current account deficit, but the overall balance of payments for the year was in surplus. There were continuing inflows of long-term capital as well as large short-term money inflows following the sterling devaluation of mid-November.

At the turn of the year, the outlook for the French economy was still uncertain. The scattered signs of improvement have not been present long enough to permit a very optimistic evaluation of prospects for 1968. Unemployment was rising continuously throughout the year, but towards the end of the year, the rate of its increase slowed down drastically. The mid-December inquiry of the National Statistical Institute (INSEE) revealed that French businessmen expected only a very moderate expansion during the first half of 1968. On the other hand, the continuing German recovery and the expected termination of inventory disinvestment at the retail level, which preceded the introduction this year of the value added tax system, was expected to reinforce expansionary tendencies.

During 1968, the French economy will operate under the influence of four special factors, which will affect it mainly adversely, though in varying degrees. These are: the British devaluation, the U.S. balance of payments measures, the abolition on July 1 of the remaining inter-EEC tariffs, and, finally, the adoption on July 1 of the EEC common external tariff which, for France, will result in substantial reduction in the level of tariff protection. In particular, the approaching removal of inter-EEC tariffs is causing a great deal of concern in France. In order better to prepare the economy for this step, the authorities embarked on a series of structural reforms in 1967. Generally these reforms aimed at encouraging and facilitating greater rationalization of French industry. The effects of these measures will not be felt for a long time, but a series of other structural reforms, designed to eliminate deficits in nationalized enterprises and the Social Security System, will exert a distinctly deflationary impact during 1968.

Recognizing the need of some stimulant to achieve the desired real expansion of 5 per cent in 1968, the French Government announced a series of reflationary measures on January 24, 1968. The program gives marked priority to direct stimulants to consumption, including a 5 per cent tax cut for the majority of French taxpayers this year, increases in old-age pensions and family allowances, and a substantial cut in the sales tax on meat. Together with investment and construction credits, the program will inject about Fr. 3 billion ($600 million) into the economy during 1968 (about 0.6 per cent of GDP). With these additional expenditures, the projected budget deficit in 1968 will be about Fr. 5 billion, compared to well over Fr. 7 billion deficit in 1967.

Consumption sluggish, unemployment higher

Domestic consumption expenditures slowed down appreciably during the second half of 1966, with purchases of higher-priced consumer durables declining particularly sharply. After the turn of the year the slowdown became more accentuated and, certainly, more general. Seasonally adjusted sales in department stores (at current prices) increased in value by only 1.4 per cent from December 1966 to September 1967, which meant a slight decline in volume terms. New car registration began to decline after May and continued to do so despite the liberalization of installment contract restrictions. The quarterly household consumption indicators, computed by INSEE, show that during the second quarter of 1967 there was an absolute decline in the volume of consumer purchases including, surprisingly, food purchases. Scattered data indicate that some pickup in consumer buying did occur during the summer and apparently continued through the fall; for example, installment sales registered a fairly sharp seasonally-adjusted rise in the last quarter of the year. However, for most of the year consumption sluggishness continued to be the most important reason for the economic slowdown in France.

Disposable household incomes continued to increase in 1967, though at a much slower rate than in 1966. This development occurred despite a slight drop in total employment and average work week (see Table 1 and Chart) as wages continued to increase at about the 1966 rate of 5.6 per cent, more than offsetting these declines.

The sluggishness of consumption spending, therefore, must in large part be assigned to an upward shift of the French propensity to save. For the first eleven months of the year, liquid savings in France increased by 20 per cent, compared with an 11 per cent increase

Table 1. France: Selected Economic Indicators, 1966-67

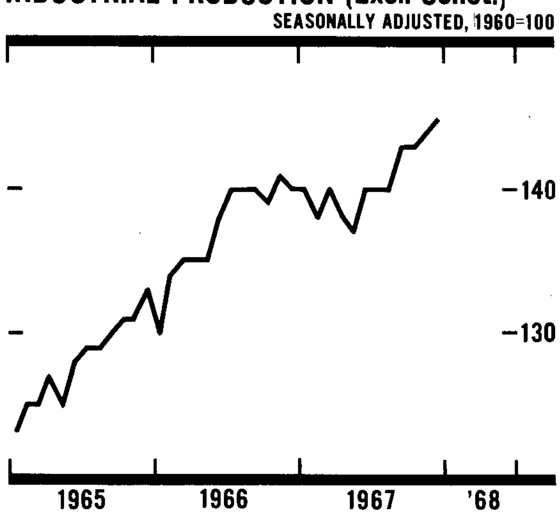
	Industrial Production[a/] (Seas. Adj.) (1960=100)	Hourly Wage Rates (1960=100)	Consumer Prices (1960=100)	Interest Rates: Call Money[b/]	Interest Rates: Bond Yield[c/]	Foreign Trade:[d/] (Seas. Adj.; $ millions) Imports c.i.f.	Exports	Balance	Official Reserve Change[f/]
Quarterly									
1966 - I	134	147.7	122.2	4.24	6.37	949	878	- 70	+ 118
II	136	150.2	123.1	4.65	6.53	968	924	- 44	+ 288
III	139	152.2	123.8	4.72	6.66	1,012	925	- 87	+ 199
IV	140	154.2	124.6	5.45	6.76	1,043	909	- 134	- 145
1967 - I	139	156.3	125.7	5.22	6.72	1,056	932	- 124	- 13
II	138	158.8	126.1	4.70	6.70	985	945	- 40	- 32
III	141	161.4	127.0	4.34	6.67	1,036	942	- 95	+ 62
IV	144	--	128.9[g/]	4.76	6.76	1,072	978	- 94	+ 235
Monthly									
1967 - January	140	156.3	125.5	5.57	6.78	1,059	948	- 112	- 9
February	138	--	125.6	5.06	6.73	1,052	919	- 133	+ 6
March	140	--	125.9	5.02	6.64	1,057	929	- 128	- 10
April	138	158.8	126.0	5.03	6.72	997	947	- 50	+ 12
May	137	--	126.2	4.79	6.67	998	910	- 88	- 69
June	140	--	126.2	4.29	6.71	959	977	18	+ 25
July	140	161.4	126.6	4.76	6.68	1,000	954	- 46	+ 41
August	140	--	127.0	4.46	6.63	989	885	- 104	+ 8
September	143	--	127.4	4.34	6.71	1,120	986	- 134	+ 13
October	143	163.3	128.1	4.48	6.69	1,061	967	- 94	+ 21
November	144	--	129.2[e/]	4.67	6.77	1,051	991	- 61	+ 289
December	145	--	129.3[e/]	4.76	6.83[g/]	1,103	976	- 128	- 66

a/ Excluding construction.
c/ End-of-month composite yield on public sector bonds.
e/ Converted to 1960 base from INSEE index.
f/ Gold, convertible currencies and IMF position.

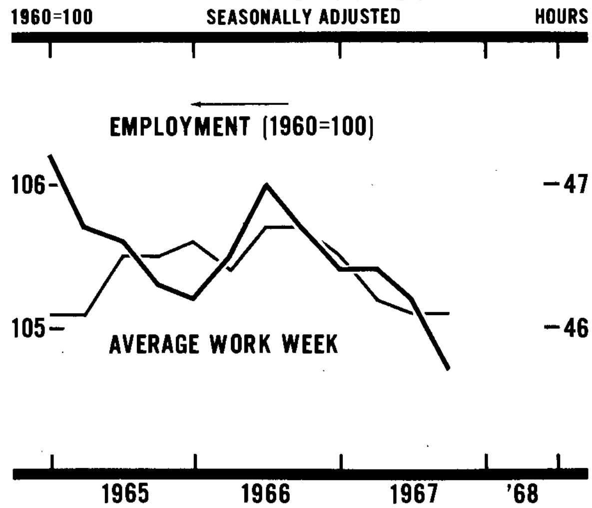
b/ Against private paper; monthly average of daily rate.
d/ Monthly average; balances shown may not reflect differences in trade totals because of rounding.
g/ Estimated.

FRANCE: MAIN ECONOMIC INDICATORS

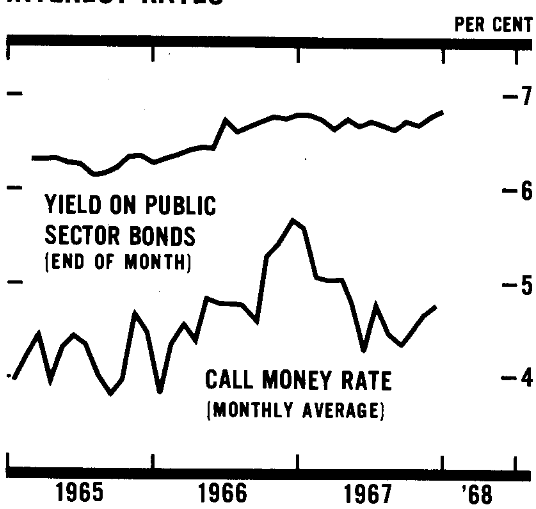
INDUSTRIAL PRODUCTION (Excl. Const.)



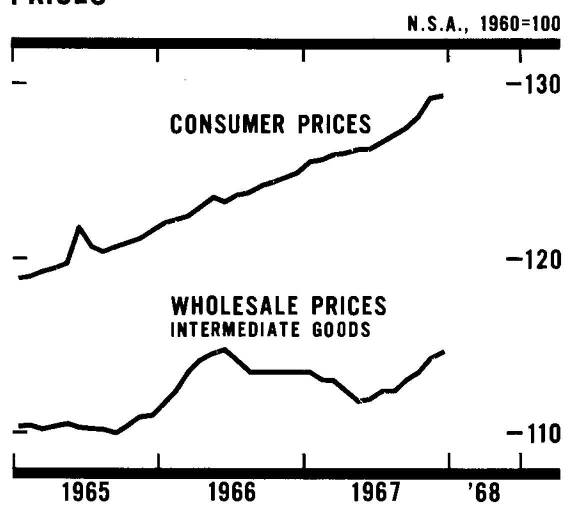
EMPLOYMENT AND WORK WEEK



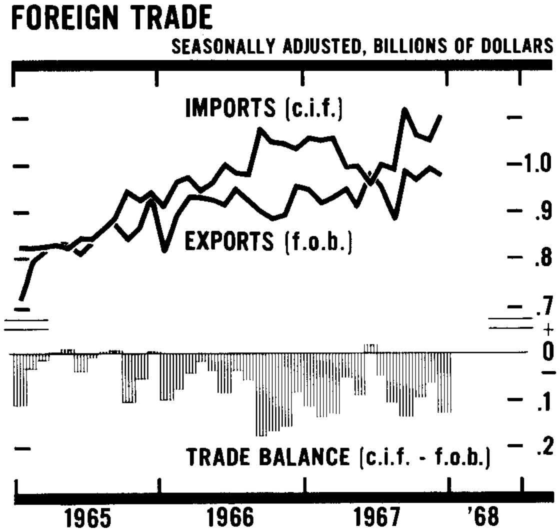
INTEREST RATES



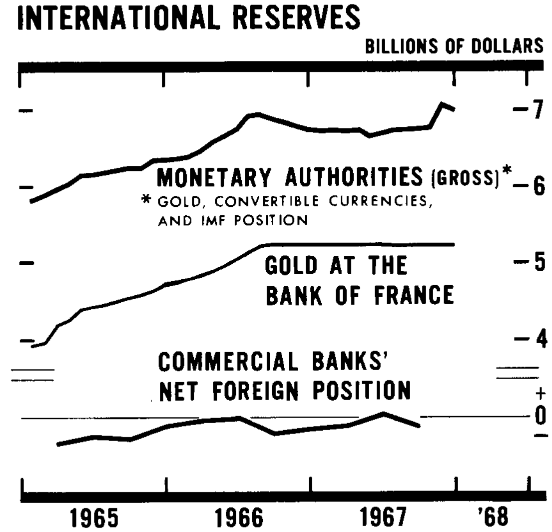
PRICES



FOREIGN TRADE



INTERNATIONAL RESERVES



in the corresponding period a year earlier. The increased savings appear to be largely precautionary and must be related primarily to uncertainties about the future.

The number of registered unemployed increased by 43 per cent during 1967 and, at the end of the year, was over 248 thousand. The total number of persons actually out of work at year-end--estimated at nearly 450 thousand--exceeded 2 per cent of the French labor force, a very high level in terms of French experience. However, the rise of unemployment became noticeably slower towards the end of the year and was only nominal in December.

Slower growth of foreign trade

Because of less favorable demand conditions in France's major trading partners, French exports in 1967 grew at a slower rate than in 1966. (See Table 1 and Chart.) The slower rate of growth of French exports to Western European countries was partially offset by increases of exports to countries outside the OECD and to Eastern Europe. French exports in 1967 increased by 4.4 per cent over a year earlier, while the increase in 1966 was 7.3 per cent. Generally, French exports (seasonally adjusted) flattened out in the second quarter of 1966 and remained roughly level for over a year; there was a sharp pick-up in late 1967, which reflected the recovery in Germany, the most important of France's trading partners.

French imports reacted to the sluggishness in domestic demand, although, with a lag, they did not start to decline until the spring of 1967. The decline was pronounced through the summer months but, beginning in September, French imports began to increase again. In 1967, seasonally adjusted French imports increased by 4.7 per cent, compared to a 14.8 increase a year earlier.

The much sharper decline in the rate of growth of French imports diminished the French trade deficit, which, on a balance of payments basis, was close to zero from about mid-year.

Due in part to the introduction in January 1967 of laws liberalizing capital movements, French balance of payments statistics for 1967 will not be available earlier than June 1968. However, for the year as a whole, France will apparently show a small current account deficit, a net inflow of capital and therefore an overall balance of payments surplus. Prior to the sterling devaluation this surplus was estimated at $100 -- $150 million for the full year. The British devaluation was followed by additional and substantial inflows of funds into France and, by the end of the year, only a relatively small part of this inflow has been reversed. At the end of 1967, gross official French reserves, including IMF position, were $6,994 million, showing an increase of $261 million during the year. French official holdings of gold remained unchanged throughout the year at $5,234. (See Table 1 and Chart.)

Industrial production generally stagnant

Weakened domestic and foreign demand caused a complete stagnation in the level of French industrial production from the fall of 1966 through August 1967. (See Table 1 and Chart.) In September, the index rose by 2 per cent and continued to rise, though more slowly, through October and November. The improvement in early fall largely reflected a substantial increase in automobile production, which had been declining steadily through August. Increased exports to Germany probably also contributed to the improvement.

The depressing influence of generally weak private demand on industrial production was supplemented by fairly substantial inventory declines at retail level, generated in part by uncertainties connected with tax treatment of year-end inventories under the new value added tax system. The complicated method of computation associated with this system, which went into effect on January 1 of this year, evidently led most French retailers to reduce inventories sharply.

The chief factor which prevented an absolute decline in French industrial production in 1967 was the continuing strong demand for investment goods, in both the public and private sector. In the public sector, investment in nationalized industries last year was apparently more than 7 per cent higher in real terms than in 1966. This performance reflected a deliberate effort of the authorities to sustain economic activity as well as implementation of long-term plans. In the private sector, the iron and steel industries were scheduled to increase their investment in 1967 by 30 per cent under a modernization plan supported, in part, by the state. Preliminary data for the private sector (other than iron and steel industries and residential construction) indicate that last year its fixed investment increased by about 5 per cent over the 1966 level. This apparently countercyclical development of investment expenditures in the private sector can in part be explained by the efforts to rationalize and concentrate the French industry and, in part, by tax inducements offered in 1966. Under these inducements, businesses were granted substantial tax reliefs for investment orders placed before the end of 1966 provided they were completed during 1967.

Monetary policy liberal

The authorities pursued a non-restrictive monetary policy throughout the year. The last quantitative ceilings on bank credits were removed during 1967, restrictions and limitations on capital and exchange transactions with foreigners were abolished and, through a series of steps, the commercial banks moved smoothly to a system of partial compulsory cash reserves.

The call money rate (see Table 1 and Chart) declined steadily from the high level in the fall of 1966, but it began to firm towards the end of the year. This rate is strongly influenced by market interventions by the Bank of France; throughout 1967 it had been the Bank's policy to maintain this rate in step with comparable rates abroad so as to discourage hot money movements both into and out of France. The Bank's basic rediscount rate remained unchanged at 3.5 per cent throughout 1967 and the bulk of refinancing of bank credit was done at that rate. Borrowing by banks in excess of rediscount ceilings was done at the (higher) call money rate, but involved a relatively small amount in 1967.

The money supply in the twelve months ending in October 1967, increased by 4.8 per cent, compared to an 8.1 per cent increase in the corresponding period a year earlier. By contrast, bank credit to the economy during the same period increased by 17.2 per cent in 1967, compared with only 10.4 per cent in 1966; on the bank liabilities side, a sharp rise in time deposits was also registered in 1967. The acceleration in bank credit extension was the result of a shift in financing by industry from capital market issues to bank loans. The stock market was unreceptive to new issues as share prices, apart from a temporary revival late in summer, declined slowly throughout the year. Despite the efforts of the authorities to improve long-term financing, the French capital markets continued to be quite tight and yields on bonds were at very high levels. (See Table 1 and Chart.)

Fiscal policy reacts to conflicting needs

Late in the spring of 1967 the Government recognized that the economy was in need of a stimulant, but its freedom of movement was restricted by fears of accelerating inflation and possible loss of external reserves. Moreover, France's remaining tariffs vis-à-vis her EEC partners were due to be removed on July 1, 1968. The EEC common external tariff is scheduled to go into effect on that day and it would mean lowering of French tariff levels, since they were higher than the EEC average. This effect will be compounded by a two-fifths tariff reduction under the Kennedy Round due on the same day.

The existing French intra-EEC tariffs are actually quite low, but they represent the last and marginal protection for French industries, which had been notoriously overprotected in the past. The authorities were certain that in its present condition, the French economy was ill-equipped to face strong tariff-free Common Market competition and were, moreover, anxious to remove some structural deficits existing in the economy.

To this end, the Government asked for and obtained--over vigorous opposition and labor protest--plenary powers to rule by decree from June to December 1967, in order to correct some structural imbalances and prepare France for free trade within the Common Market.

The needs for short-run stimulation and long-run reforms were somewhat conflicting and the actual policy adopted was necessarily a compromise. In 1967, it was undoubtedly reflationary, and largely investment-oriented. In the longer run, and certainly in 1968, some of the reforms adopted will have a distinct deflationary impact.

The short-run reflationary measures adopted in 1967 consisted of limited demand stimulants: family allowances were increased in July, well ahead of schedule; civil servants' pay was also increased ahead of schedule; some minor tax reductions were granted to low-income groups;

the minimum guaranteed wage was raised and installment buying terms were liberalized. Despite the obvious weakness of consumer demand, however, most of the reflationary measures were investment-oriented. Thus, nationalized industries' investment plans were sharply accelerated; additional funds were allocated to local authorities for investment purposes; certain public works planned for 1968 were undertaken in the fall of 1967; funds were allocated for construction of 6,000 low-rent housing units additional to those originally scheduled for the year; and, finally, the National Equipment Loan was launched in May instead of October, as originally planned. A quarter of that loan, amounting in all to Fr. 1.25 billion, was relent to private industries for investment projects in depressed areas.

Almost coincidentally with the adoption of the above reflationary program, the Government decided to eliminate certain structural deficits from the public sector. Thus, passenger fares in the Paris region were raised very sharply, by more than 60 per cent, passenger fares and freight charges on nationalized railways were increased moderately, charges went up for electricity and gas, and rent ceilings for rent-controlled housing were raised. The most serious problem, however, was presented by the Social Security System, as it was clear that its deficit in 1967 would exceed Fr. 3 billion. The Government decided to subsidize the System in 1967 to the full extent of its deficit, but, beginning in October the social security contributions were raised sharply and certain medical and drug benefits reduced, thus placing the System on a self-financing basis for 1968.

All these measures came into effect on various dates, after mid-July. The effect of them on consumer demand in 1967 was, therefore, relatively slight. Nonetheless, their combined effect raised the consumer price index significantly and, in 1968, they will exert a definitely deflationary effect.

The long-range structural reforms passed under the Plenary Powers Act of 1967 were varied, and their impact necessarily will not be felt for a long time. Profit-sharing in all enterprises employing more than 100 workers was made compulsory. Some reforms of the stock exchange were decreed and a French equivalent to the SEC created. Reforms designed to streamline discounting procedures for commercial banks with the central banks were decreed following the recommendations of the so-called Gilet Committee. Government grants for industries creating jobs in depressed areas were created. A real effort was made to improve labor mobility, which has been one of the chief factors in the rigidity of the French economic system, by creating regional employment agencies, and by increasing unemployment and retraining allowances.

Finally, a series of decrees were passed to facilitate economic concentration in French industry and commerce. Mergers were made more attractive through a system of tax incentives and the relaxation of certain restrictions. The number of industrial and commercial mergers in France appears to be increasing. Although the declared objective of the decrees relating to mergers was "to improve the competitiveness of French firms within the Common Market," it also undoubtedly represents an effort to combat the increasing penetration of American firms into the French economy. Although the French approach seems to concentrate on a sort of economic giantism--as though size alone was a cure-all for French industrial weakness--the Government measures should help to modernize the French industrial structure.

Budget impact stimulating

The original 1967 estimates envisaged an evenly balanced budget. However, a slight shortfall in revenues from expected levels, owing in part to economic slowdown, as well as the absorption of the Social Security deficit into the general budget and the sharply increased Government expenditures detailed above, combined to create a very substantial deficit. (See Table 2.) The Supplementary Budget, passed

Table 2. France: Budget Developments, 1966-68
(in millions of francs)

	1966 Final Results	1967 Revised Estimate 1/	1968 Original Estimate	1968 Revised Estimate 2/
A. Current (Above the Line) account:				
Receipts	107,066	118,421	127,967	127,057
Expenditures	104,178	119,600	127,812	128,232
Balance	+ 2,888	- 1,179	+ 155	- 1,175
B. Capital Accounts (loans and advances less repayments)				
Balance	- 6,340	- 6,030 3/	- 1,944	- 3,729
Overall Surplus (+) or Deficit (-)				
A + B	- 3,452	- 7,209	- 1,789	- 4,794

1/ Including supplementary budget passed in December 1967.
2/ Estimated from announced details of the January 1968 reflationary program.
3/ Includes a special contribution of Fr. 3 billion to the Social Security System.
Sources: Ministry of Finances and Government announcement summarized in Le Monde.

by the Assembly in December 1967, estimated the final deficit for 1967 at Fr. 7.2 billion, although the size of the Treasury cash deficit at the end of September indicates that this deficit may well have been higher than this figure.

The outlook for 1968

On January 24, 1968, the French Government announced a series of measures designed to reflate the economy. In contrast to the previous practice, the measures are distinctly oriented towards direct stimulation of consumption, and will pump about Fr. 3 billion into the economy this year through a mixture of expenditure increases and reductions in tax rates. The most important part of these measures concerns cuts in personal income taxes and some indirect taxes, but family allowances and old-age pensions were also increased, as were state expenditures for investment in depressed areas and construction subsidies.

The launching of this (for France vigorous) reflationary program suggests a brighter outlook for the French economy in 1968 than could have been previously expected. Before this program was announced, preliminary estimates, based on an assumed (but unlikely) real expansion of 5 per cent, called for a 1968 budget deficit of only about Fr. 2 billion (see Table 2), which was over Fr. 5 billion less than the actual 1967 deficit; thus, the impact of the budget would have been restrictive. Over Fr. 3 billion of the reduction in the deficit resulted from increased social security contributions, both by employers and employees. The consequent reduction in employers' profits, however, will be more than offset by tax reductions of over Fr. 2 billion resulting from reductions of the value added tax rates. Thus, the main impact of the social security reforms would have fallen on the consumers, and the current individual income tax reduction is obviously designed to offset this impact.

The Government apparently considered the original 1968 budget reflationary enough and it was stressed that, for the first time in several years, the preliminary estimates called for a deficit. However, at the time the original estimates for 1968 were made, the authorities were evidently counting on a vigorous revival of foreign and domestic demand. But such data that we have do not offer evidence that such a strong revival has been, or is, taking place. Certainly the upward momentum is not as strong as the Government appears to have expected. The current reflationary program offers evidence of the Government's awareness of this development.

The injection of a further Fr. 3 billion of deficit spending is bound to have a reflationary effect. It is difficult to judge whether the current program will prove sufficient to restore the desired growth rate of 5 per cent. It is also far from certain whether the French will be prepared to pay for domestic revival with a balance of payments deficit. A more worrying aspect of the present official policy is the fact that the desired growth rate of 5 per cent per year is almost certainly insufficient to absorb the excess capacity now existing in France. However, France continues to experience a substantial rate of increase in consumer prices of close to 3 per cent a year. This inflation appears to be of the cost-push variety. Nevertheless, the French authorities fear it would be aggravated if demand expansion were so strong as to pull the annual rate of rise of real GDP above 5 per cent.

The two major uncertainties for 1968 are the effects on France of the British devaluation and of the U.S. balance of payments program. The sterling devaluation and other parity changes should have a comparatively small effect on French foreign trade. The major devaluing countries (the U.K., Spain and Denmark) account currently for only about 10 per cent of French exports, although some additional indirect effects may be felt by French exporters on other markets, where they compete with the British primarily in automobiles, textiles and machinery. The British devaluation may have a more serious impact on the French balance of payments through its effects on tourism. According to French data, British tourists spent over $100 million in France in 1967, and this sum may be substantially reduced in 1968.

The impact of the U.S. balance of payments program on France is more difficult to assess. The direct investment embargo should theoretically deprive France of about $100 million in 1968, the rough average of U.S. direct investments over the last two years. It appears, however, that the effect of this measure will be much smaller than that figure this year. A straw poll, conducted by a French newspaper among American firms in France, indicates that most of their investment programs will not be seriously affected this year by the embargo since their financing had already been arranged. Any impact of the embargo may be offset by still further recourse to the Euro-dollar and Euro-bond markets by American firms operating in France. The repatriation of earnings measure should not affect France at all. The limitations on bank lending may, at the outside, involve an outflow of about $40 million from France this year, but could be considerably less than that. The impact of restrictions on tourist spending on France is potentially very serious, but its size will depend on the effectiveness of implementation of measures now before Congress. According to French balance of payments statistics, American tourists spent more than $400 million in France in 1966. However, U.S. statistics place it at only $116 million. The difference probably stems, at least partly, from the inclusion in the French data of spending by persons such as U.S. military personnel who are not really tourists.