WHICH WAY FOR FRANCE?

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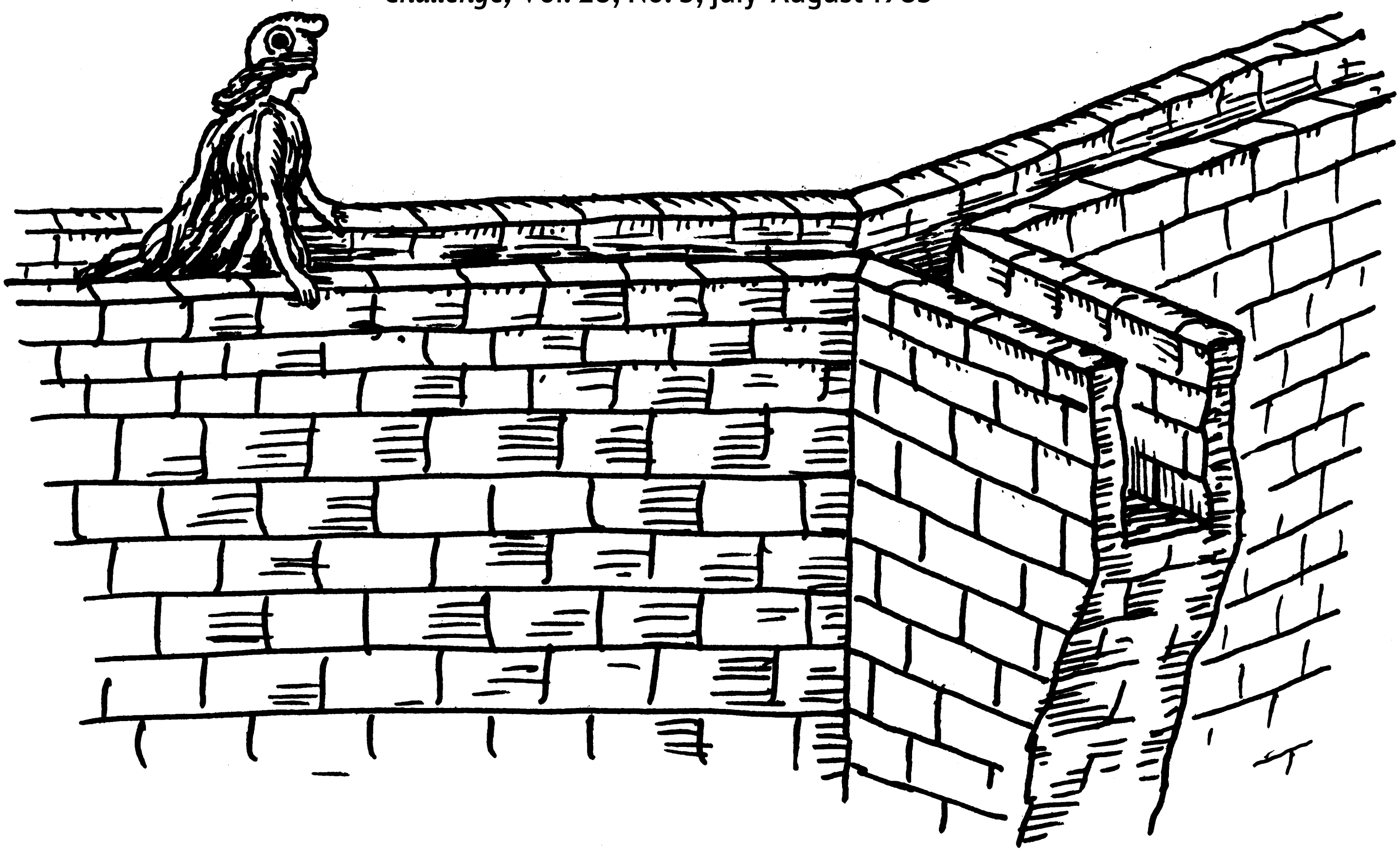

An obsession with foreign payments deficits and collapse of the franc has led France to unwise austerity measures. A better solution would be investment to spur growth and a floating franc to help adjustment.

When the French Left came to power two years ago it surprised the French people and much of the world by moving swiftly to carry out its campaign promises. Major firms and banks were nationalized, offering the government ready means for decisive influence over the economy. The welfare state was extended significantly: the retirement age with full social security benefits has been lowered from 65 to 60; a fifth week has been added to normal annual vacations; there have been major increases in the minimum wage; and reduction of the regular working week from 40 to 35 hours, in stages, has begun.

Now with the Ninth Plan for the years 1984 to 1988, a grand design for the flowering of social democracy is in preparation. Will it prove the disaster anticipated by its critics on the Right? Or will it set a path for unparalleled well-being in a mixed economy?

Prospects in the spring of 1983 do not seem propitious. To the dismay of many of its supporters on the Left, the Socialist government has taken at least one step backward, moving to depress the economy in order to stem foreign trade deficits and reduce inflation. How did it come to this turn, what does it presage for the future, and what alternatives are there?

Past and present

From 1967 to 1973, France enjoyed phenomenal growth. Real gross domestic product (GDP) rose at an average annual rate of 5.6 percent, compared to 5.0 percent for the countries of the European economic community (EEC) as a whole. Over the period from 1973 to 1980, growth averaged only 2.8 percent, but still more than the 2.3 percent of the EEC. And then France slipped into recession and the Socialist-Communist coalition came to power.

The new government made determined efforts to stimulate the economy and to slow and then to reverse the rise in unemployment which had accompanied the downturn in economic growth. France in fact did swim against the tide as GDP grew by 1.5 percent while the rest of the world stagnated at about zero.

Unemployment was on a roll, rising almost steadily from 2.8 percent in 1974 to 6.3 percent in 1980, 7.3 percent in 1981, and some 8.6 percent in 1982. The government claimed that the rise was finally stopped by the end of that year. Unemployment in the rest of Europe, however, was at least trivially higher than in France, and it was of course significantly higher in the United States, reaching 10.8 percent in December, with an annual average of 9.7 percent.

It is the French inflation story which has been most unfavorable by comparison with other nations. Consumer prices reached a rate of increase of 13.4 percent in 1981. While they slowed to 11.6 percent in 1982 with the apparent aid of a wage and price freeze, inflation remains sharply higher than the 5.3 percent for France's major trading partner, West Germany, and the 3.9 percent December to December figure in the United States.

Finally, and of critical concern, the French deficit in the balance of payments on current account rose to 0.8 percent of GDP over the period from 1973 to 1980, after the first petroleum shock. It stood at 0.8 percent again in 1981, and rose to some 2.2 percent in 1982. This deficit contrasts with 0.5 percent for all of the OECD countries.

And there's the rub! To the French, a foreign trade deficit conjures the same horrors, real or imagined, as a government budget deficit does in the United States. With little subtlety, it is associated with increasing foreign debt, the specter of national bankruptcy or "having to go to the IMF," and the collapse of the franc. And the value of the franc is something to which the French body politic is most sensitive. On March 21 the franc went through its third devaluation in the European monetary system since the Left came to power. That to many is a supreme failure.

The Ninth French Plan

With all of this developing crisis, or sense of crisis, some seven broadly representative working commissions have been sketching the Ninth Plan, the blueprint for the France of the next five years. The central themes are "a new technological revolution to achieve the highest possible rate of growth, cooperative effort to increase employment and reduce inequality, and national independence within a framework of international cooperation and the maintenance of international commitments," this last replete with ambiguity. Can France follow its own path of change and growth and yet keep in step with the rest of the world? The work of these commissions is outlined in the box on page 37.

France's international relations

Because the work of Commission Number 6 on international affairs focuses so sharply on issues which have proved crucial to government policy, its report merits extended discussion.

This Commission sees the French economy as closely tied to the world outside and held back by the prospect of slow economic growth in major industrial nations. It accepts the view that France must move to balance its current account but rejects protectionism; it rejects, as well, devaluation or adjustment of exchange rates as self-defeating and contributing to renewed inflation. The solution, it insists, must be found in slowing French inflation and increasing French competitiveness on international markets, while preserving the French domestic market.

Commission Number 6 does not hold out hope that the French economy can grow much more rapidly than the economies of its trading partners. It therefore seeks a solution to the employment problem in reducing hours of labor and sharing existing jobs. The group sees a conflict between preserving or raising wage levels and aggregate demand, on the one hand, and competitiveness and hence employment on the other.

The Commission on International Relations views rates of exchange as dominated by speculative forces. It refers to "the most competitive nations" without taking into consideration the relative costs of currencies, although it does elsewhere mention the goal of "restoring the role of rates of exchange in adjusting balances." While acknowledging that French investment in foreign countries is greater than foreign investment in France, this group believes national independence is jeopardized by the recent growth in French debt to foreigners. It notes a 1981 foreign deficit of 46 billion francs, more than accounted for by a deficit of 62 billion francs to the OPEC nations, and cites a 45-billion franc surplus in military sales.

The Commission calls for more vigor in combating "dumping," but characterizes as successes trade subsidies which produce export surpluses in agricultural products for which domestic prices were above world markets. It looks to the maintenance of trade relations between East and West but warns against an "excessive" competition for Soviet-bloc markets which would prove injurious to "political cohesion."

The group notes a French surplus in trade with countries of the Third World and looks to the transfer of technology to less developed nations. It stresses the extension of international cultural relations, the exchange of scientists and writers and artists as well as their products, the promotion of audiovisual contacts through the modern media, and the teaching of the French language.

The report of the Commission puts macroeconomic policy in the context of a set of econometric model "scenarios" prepared for the *Commissariat du Plan*. A number of presumed French domestic fiscal options are crossed with three possible states of the world involving foreign GDP growth rates of from 1.1 to 2.7 percent for 1983, and from 1.5 to 2.8 percent over the life span of the Ninth Plan, 1984-88. Foreign inflation would range from 4.5 percent to 7.1 percent.

But French unemployment would rest between 9.2 percent and 10.1 percent in 1988, depending on the foreign and domestic scenarios, while real wages would rise at an average annual rate of 0.1 percent to 1.5 percent. All of the scenarios indicate a slow diminution of the current account deficit to between 0.4 percent and 1.3 percent of GDP by 1988. The Commission judges this reduction insufficient. Yet conventional deflationary policies to reduce the foreign deficit further would only aggravate the unemployment problem.

The Commission would hence reduce inflation by minimizing supply-side taxes such as those on value-added and employer payrolls, and by cutting interest charges to lower capital costs. It sees in devaluation of the franc only a deepening of the deficit ("J-curve effect"), even if it is temporary, and further inflationary pressure. It looks to structural change and investment to increase productivity and restore international competitiveness, while warning against the strategy which supports only industries on the technological frontier. It calls for a continued struggle to reduce the energy deficit and for support of agriculture and selective efforts to "reconquer" the French domestic market.

Some of the central problems of French planning and French policy have thus come to the surface. The members of the Commission have assumed low rates of growth for the world economy; they are convinced that there is little opportunity for France to exceed these rates significantly without unacceptable deficits and increases in foreign debt. Even with prudence and presumed realism—in an analytical framework little different from that of the previous government—there seems to be no substantial way out of the dilemma. The Commission hence falls back on labor-sharing—or unemployment sharing—as the alternate means of meeting the Plan's priority on employment. But to combat inflation, labor would be shared without increasing costs. Thus, except for an increase in productivity, real returns per worker would be reduced. This, I might observe, is exactly what those most interested in shorter hours, longer vacations, and earlier retirement do *not* have in mind.

WORKING COMMISSIONS FOR THE NINTH FRENCH PLAN

Commission Number 1. Scientific, technological, and cultural conditions of development.
Theme. "France does not lack the means, she must only develop them."
Recommendations.
- Increase R&D spending from 2.05 percent to 2.5 percent of an expanded GNP by 1985—40 percent by government, 60 percent by private enterprise.
- Major improvements in educational system. Bring tools of the new technological revolution into the schools; extend on-the-job training for youngsters in school and further education for older workers.

Remarks.
Whether the Commission has been sufficiently bold is questionable. Only one-quarter of French students receive the baccalaureate, the equivalent of an academic high school diploma—perhaps plus a year—in the United States. Common reports are that the quality of education is uneven, that emphasis in general education remains largely on traditional subjects, that vocational training is inadequate and out of date. At a higher level, universities are sadly starved. Facilities are clearly overcrowded. The administrative staff is underpaid and underworked. (It is not clear that they are underpaid for the hours they actually put in.)

Commission Number 2. Economic development.
Theme. Modernization combined with management-labor negotiations and cooperation to share the gains of technological advance.
Recommendations.
- Encourage self-financing; lower interest rates; more funds for risk capital; redirect system of public subsidies to research, development, and intangible investment rather than final output.
- Preserve points of strength, such as aeronautics, telecommunications, nuclear energy, public transportation, and liquid gas; but focus special attention on industries critical to the balance of payments, especially energy and agriculture. Public enterprises should make a decisive contribution to this: they account for 25 percent of the industrial labor force, 30 percent of sales, 50 percent of investment, and 55 percent of industrial research.

Remarks. The Commission indicates clear reservations about the thread in French policy which would combat unemployment by sharing existing jobs—through shorter hours, longer vacations, and earlier retirement. (See discussion of Commission Number 6.)

Commission Number 3. Financing the economy.
Theme. Return to equilibrium in the balance of payments and fight inflation, both through a *politique de rigueur.*
Recommendations.
- Increase productivity and industrial renovation.
- Control public expenses and social insurance charges.
- Stimulate demand, especially investment demand, to achieve the highest possible level of economic activity consistent with equilibrium in the balance of payments.
- Reform the tax system: shift taxes from enterprises to households; withhold taxes on income (a major innovation for the French).

Commission Number 4. Employment, income, and solidarity.
Theme. Reduce unemployment, despite a slowdown in economic growth, in a manner consistent with the goals of greater equality and justice.
Recommendations.
- Reform the social insurance system, which now has some 383 special retirement funds, so varied and complex that no one—insurees, management, or economists—has any clear notion of costs and benefits.
- In view of large increases in health costs, place greater emphasis on preventing illness.

Remarks. In connection with social insurance, the Commission observes that—if only because of correlated differences in longevity—retirement and old age assistance programs have tended to redistribute income from workers to professional and managerial personnel, and from the poor to the rich. Ceilings on employer contributions per worker have had the perverse effect of discouraging the hiring of low-wage workers while extending the hours of those with jobs.
The Commission also expresses great reservations toward recommendations for a sharing of risks by those insured.

Commission Number 5. Decentralized development and regional balance.
Theme. Full development of all resources in each region of France in a period of rapid change.
Recommendations.
- Decentralize administration of the environment.
- Procure financial resources to meet the problems of urbanization.
- Decentralize education and training.
- Dialogue between regions, and between large national enterprises and the state.
- Institute regional tax systems, make transfers on a regional basis tying into regional economic plans.
- Modernize agriculture.

Commission Number 6. International relations—economic, financial, and cultural. See an extended discussion in text.

Commission Number 7. Social education and cultural development.
Theme. Respond to the crisis of modern society in ways that go beyond the narrowly economic. This crisis is expressed in shifting values and attitudes toward consumption, production, and work; an erosion of confidence in public institutions; changes in the very fabric of a diversified society; problems of the young, women, the middle-aged (*jeunes vieux*), and of immigrants; regional inequalities.
Recommendations.
- Consolidate, reorganize, improve efficiency, in order to stop the steady growth in the ratio of public spending going to social expenditures (from 46.7 percent—17.1 percent of GDP—in 1977 to 51.6 percent—25.9 percent of GDP—in 1981.
- Reorganize health care to emphasize intermediate health services short of hospitalization.
- Dedicate the nation to the improvement of education, including better vocational training.
- Make preschool care fully available; use mass media for education; promote state support of the arts and culture; increase teacher quality.

Must rigor mean stagnation?

French economic planning under the new Socialist-led government points to policies vastly different from those current in the United States. There is repeated emphasis on human capital and on the texture and solidarity of society as contributors to both economic growth and general well-being. Planners seem to be aware that social effort is important to make good the deficiencies in the areas of research and other nontangible investment which are endemic in purely market-oriented economies.

The recurrent themes of justice, equity, and equality in France contrast strikingly with recent American moves to lessen the social commitment to reduction of inequality, on the thinly veiled premise that helping the rich will result in an optimal "trickle-down" to the poor.

A code word in discussions of French economic policy has been *rigueur.* To some it has meant responsibility, to some austerity, and to some both. Economists must applaud commitments to rigor, in its broader sense. There is no denying real economic constraints, a limit to resources, an interdependence of policies and costs. Economic planning must entail choices, hard choices which may be costly to some elements in the population, in the short run at least. Planners must have a sufficiently long horizon and recognize the wisdom of current sacrifice for appropriately discounted future benefits. They must recognize risks; they must combine boldness and imagination in optimal fashion as they seek progress, while at the same time they evaluate prudently the costs of possible failures.

But must rigor imply stagnation? It has been argued cogently that the Achilles heel of a free-market, capitalist economy is unemployment; it is frequently high and in periods of recession many people view it as unacceptably high. This entails a huge waste, not only of human resources but of the capital recources simultaneously left idle. A Socialist-led mixed economy cannot defy economic laws and relations, but can it not eliminate involuntary unemployment?

With its nationalization of the banking system and key industries and its solid legislative majority, the French government should have all the tools of fiscal and monetary policy to provide the level of aggregate demand appropriate for full employment. As a government of the Left, backed by workers and their unions, it should be in a position to tie appropriate restraints on the escalation of labor costs to a policy of full employment. Indeed, it has already moved to limit the full structure of indexation, which has contributed significantly to French inflation.

The government can use its nationalization program to direct supply, within a framework of market forces, to those forms of investment and consumption, public and private, which correspond to people's social and individual preferences. There is no need to rearm, as Nazi Germany did, in order to bring about full employment. And, as Keynes suggested facetiously a half-century ago, there is no need to resort to wasteful projects such as paying some of the unemployed to plant bottles containing currency in garbage dumps and offering the rest of the unemployed the job of finding the buried bottles, so that they could collect the money for their wages. Indeed, the ambitious plans for a new technological revolution in France offer ample scope for fully productive full employment.

Obsession with the trade deficit

But popular French thinking seems to have elevated the matter of the foreign trade deficit to a national obsession. French deficits have not in fact been overwhelming, and have been more than fully accounted for in net imports of petroleum. Yet, the French rarely perceive that as long as the OPEC cartel is effective and the oil-producing nations insist upon preserving an export surplus, it is quite impossible for the rest of the world to avoid a deficit. The competitive struggle of industrial nations to do so is foredoomed. What has been going on indeed has been the exchange by oil-producing countries of their capital buried in the ground for capital in the form of financial investments in other countries. There is no good reason for France to struggle to avoid its share of the foreign debt which is the counterpart of the new OPEC assets.

But further, trade deficits and borrowing from abroad may well persist for long periods in rapidly growing countries, witness the United States of more than a hundred years ago. If France is serious about investing heavily to spur productivity and growth, it should have no compunction about international borrowing to finance that investment. Anticipated increases in product should offer ample means to pay the real interest costs of the debt and repay the principal. If there is decisive doubt that the added investment will actually be able to repay its costs, it should not be undertaken anyway, regardless of considerations of foreign balance.

It should be observed that even at its elevated level of 93 billion francs in 1982, the French foreign trade deficit came to no more than 3 percent of GDP. The OECD estimated French borrowing from foreign countries in 1982 in dollar terms at $14.5 billion. This also came to about 3 percent of GDP. Finance Minister Jacques Delors reported an increase in foreign debt of only 8.8 billion dollars, less than 2 percent of GDP. Total French external debt, net, has been estimated in OECD reports at 45 billion dollars, some 9 percent of GDP. At a real rate of interest of 5 percent, the cost of servicing this foreign debt is only 0.45 percent of annual national product and little more than 2 percent of the value of exports. If the real rate of interest were twice as high (that is, 10 percent) and the external debt were twice as high, the cost of debt servicing would still be only 1.8 percent of gross domestic product, approximately 9 percent of the value of exports. Are any of these figures adequate justification for slowing the French economy to a crawl?

The extreme focus on external balance may well be driving French plans out of kilter and running grave risks for the French economy. For it leads to an implicit and explicit emphasis on export industries, which tends to put France at the mercy of the rest of the world. It is one thing to aim at the technological frontier and hope that one will be so successful that the rest of the world will furnish its products cheaply in exchange for one's own advanced goods. It is another to mortgage the future on the ability and willingness of the rest of the world to buy one's products.

A Socialist regime can control its own market. If it produces useful goods efficiently, its citizens will enjoy them. It is safer to produce directly for home consumption than to rely excessively on exports to buy the imports for home consumption.

Of course, a full measure of international trade should not be discouraged. But the allocation of resources should not be distorted in the direction of *more* foreign trade than would be dictated by free play of the law of comparative advantage and international specialization, with due attention to risk.

Even if these deficits were serious, is not the long-run solution free exchange rates? The French, like many Americans, have a remarkable propensity to talk of loss of "competitiveness" in foreign markets while ignoring the basic exchange rate component of international relative prices. I doubt that the franc is currently overvalued with respect to the dollar. If it is, floating exchange rates as between the currencies of the European monetary system and the rest of the world will in the long run lead to appropriate adjustments. Preserving an overvalued currency to secure better terms of trade is surely a losing proposition. That *does* create deficits, so that foreign imports are being paid for with fewer current exports and more borrowing against the future.

The franc was probably overvalued with respect to the West German mark and the Dutch florin, or those currencies were undervalued. The devaluations and revaluations of March 21 may or may not have been a sufficient corrective. France might have been better served by acting on her threat to pull out of the European monetary system and let the franc float. For sovereign nations—France and West Germany in particular—cannot keep their currencies moving in unison with divergent economic policies. Economic independence, *without* protectionism, may require a France fully dedicated to economic growth and the reduction of unemployment to free itself from the bind of German deflation.

The alternative to free or realistic adjustment of exchange rates is the attempt to manipulate domestic prices and income. Reducing the domestic rate of inflation is all well and good, if not undertaken at the cost of real output and employment. Efforts to increase productivity are, of course, always in order for their own sake; but if successful, they can slow inflation only if productivity gains are not fully reflected in higher nominal wages and profits.

An overvalued currency creating a trade deficit can be met by efforts to direct domestic production to export industries and to import substitutes, efforts with strong support in France. But these involve a waste of resources to the extent that costly domestic production is undertaken to pay for foreign imports which have been made too cheap because of an overvalued domestic currency. It may be viewed as devoting national resources and sending extra goods abroad to enable rich Frenchmen to buy expensive German Mercedes-Benzes at artificially low prices.

Dangers of slowing the economy

If trade deficits are not allowed to run their course with the exchange depreciation which would ultimately follow from free exchange rates, then there can be a veiled, partial devaluation. This can be achieved by imposing a general surcharge on all imports and, if foreigners accept it without retaliation, a subsidy of exports as well. The surcharge on imports would have the advantage of keeping francs at home, but would inevitably have at least some unfavorable impact on French exports. Yet all of this would be far preferable to the classical turn the French government has now taken—reducing foreign deficits by slowing the French economy.

For on March 25 the direction of French economic policy was changed abruptly, at least for the short term if not for the next five-year plan. *Rigueur*, despite repeated disavowals by members of the government, was translated into austerity. A package to reduce consumer spending by some 2 percent of France's annual output included a one percent surcharge on income tax payments to be made in 1983 on 1982 income; a forced loan at "attractive" interest rates equal to 10 percent of taxes; increased taxes on tobacco and liquor; higher prices in state-owned industries, including an 8 percent rise in charges for electricity, gas, and passenger train service; a special tax on gasoline to prevent declines in retail prices to match the fall in the world petroleum markets; and special restrictions on the amount of currency that the French can use when traveling in foreign countries.

The new measures are expected to reduce gross national product by some 2 percent in one year, slow economic growth to between zero and 0.5 percent in 1983, and add correspondingly to unemployment.

Will all of this work? Was it necessary? To the extent that their forecasts of continued world stagnation are correct, the French may learn that it will take a depressed economy indeed to bring forth a major turnabout in the balance of payments and a reduction in long-term pressure on the future.

Yet the French "scenarios" which seem to call for these sharp austerity measures—twice as great in projected magnitude as the stimuli introduced by the Socialist government in its initial move to growth—were remarkably pessimistic. They projected rates of growth for the outside world of from 1.5 percent to 2.8 percent over the years to 1988. The current U.S. forecast of the Council of Economic Advisers is for growth of 4 percent per year.

And the French scenarios projected annual *real* increases of 4 percent in the price of petroleum over the course of the Ninth Plan. These hardly look likely in view of the sharp declines in petroleum prices which have already taken place. Increases as against 1981 by no more than the world rate of inflation would imply, far from a 4 percent per year increase, a decline in real oil costs, if the franc does not depreciate further against the dollar. If France's worst-case fears are realized, they may well need further and further deflation to "correct" their balance of payments. And if petroleum prices stay down and U.S. and world recovery proceed, as well they may, with this American administration or the next, the French may have destroyed the Socialist dream for naught.

There are other directions, explicit or implicit in the developing Ninth Plan, which may still be followed. Inflation more rapid in France than elsewhere will worsen the trade deficit and bring an inexorable pressure on the franc. But inflation can be slowed without depressing the economy. Taxes and other charges may be shifted from the supply side to the demand side of transactions, from value-added and employer charges to progressive withholding taxes on income. The large, nationalized industries and public services can adopt price and wage policies consistent with national objectives. These would be important both in themselves and as guides to private industry.

Further, credits from the banking system can be made subject to acceptance of appropriate price policies. And as I have suggested, unions generally identifying themselves with the Left may be persuaded, as part of the full employment policy, to enter pacts involving wages and prices fair to all concerned. Even direct wage and price freezes and controls, about which I have deep reservations, would be vastly superior to the deflation that might be achieved by sustained high unemployment.

But if the economic plan for 1984-88 were to treat current policy reversals as a temporary aberration, it might still rededicate itself to maximum employment and growth. It might call for and set forth a full inventory of national resources, human, physical, and institutional. Where is there idle labor and unused capacity? What are the needs that should be met? More housing? Better transportation facilities? Improved health care? Improvement in public and private service industries? Telecommunications? Video-tape recorders? Computers? Education? More and better trained teachers? Painting and cleaning up the universities and improving their functioning? The list can and of course would go on and on.

A realistic appraisal would be undertaken of what France *can* do. Market forces and individual initiative would be given full scope in the implementation of the broad goals that are chosen. And then the Plan would lay out the path for France to do everything it wants to do and can do. That would be a path of maximum potential growth, full employment to the extent people wish to work, and widely perceived success of the Socialist experiment.

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