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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

France After Devaluation: Present Economic Policies And Prospects

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
February 1970

INTELLIGENCE MEMORANDUM

France After Devaluation: Present Economic Policies And Prospects

Introduction

During his forthcoming visit to the United States, French President Pompidou will leave behind an economy in which his own policies play a crucial -- but still not fully tested -- role in achieving a viable balance between internal and external economic forces. Faced after his election with an overheated domestic economy and a steadily deteriorating international economic position, Pompidou devalued the franc by 11.1% (i.e., a 12.5% increase in the cost of dollar exchange to French importers of foreign goods) on 10 August 1969 and followed up this move with wide-ranging policies designed to cool the domestic boom and bring the international accounts into balance within a relatively short time. This memorandum assesses the French government's present economic policies and their prospects for success.

Events Leading to the Devaluation*

1. Following the student-labor crisis of May-June 1968, the French economy staged a remarkable recovery, marked by the relative lack of government

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intervention. Imbalances in France's external financial accounts soon developed, however, caused both by trade deficits and by speculative outflows of capital, which probably totaled about $1 billion during the year. During the last half of 1968, anticipation of further price increases, a sharply rising government budget deficit, rapidly rising wages, and speculation on a franc devaluation all combined to produce a rapid expansion in consumer outlays and private investment expenditures. During this period the rate of increase of consumption exceeded that of disposable income.

2. When the speculative outflow of capital, which peaked during the international monetary crisis of November 1968, threatened the parity of the franc, the government shifted to a more restrictive economic policy. Price surveillance was intensified and stricter fiscal and monetary measures were adopted.

3. These measures were instrumental in slowing the growth of domestic economic activity during the first half of 1969, but inflation accelerated. Industrial production, which by December 1968 had risen almost 10% above the pre-strike level, grew only slowly in the course of 1969, as shown in Table 1. This slowdown was due partly to the attainment of near-capacity production levels and partly to a slower growth of domestic demand. Real wages, which had increased about 10% from June to December 1968, rose only slowly through most of 1969, as the cost of living climbed steadily. Investment expenditures, although considerably less dynamic than in the last half of 1968, continued to rise. In general, both excess demand and cost-push conditions persisted, although to a reduced extent.

4. While domestic production slowed, imports continued to boom, particularly in the second quarter of 1969, as shown in Table 2. Unlike the increase in imports in the second half of 1968 which reflected a sharp revival of economic activity after the May-June riots, the renewed spurt in imports in the second quarter of 1969 appears to reflect to some extent the existence of excess demand but mainly speculative buying in anticipation of a devaluation of the franc. [redacted] the rate of inventory accumulation was high as business accelerated its purchases of investment and consumer goods. As speculative fever grew, foreigners tended 25X1

Table 1

France: Selected Economic Indicators

1963 = 100

1968	Industrial Production a/	Wages b/	Real Wages b/	Retail Prices	Wholesale Prices c/
January	125	130.9	113.8	115.0	103.1
February	126			115.1	103.7
March	128			115.2	101.6
April	128	132.6	114.8	115.5	100.9
May	89			115.8	101.0
June	104			116.2	101.9
July	130	146.7	125.8	116.6	102.4
August	130			117.2	102.9
September	131			117.9	104.0
October	137	149.9	125.8	119.2	104.8
November	139			119.6	105.1
December	141			119.9	108.9
1969					
January	140	152.0	125.4	121.2	109.6
February	137			121.6	109.9
March	137			122.1	110.4
April	142	155.0	126.3	122.7	111.5
May	143			123.3	111.8
June	140			123.7	112.7
July	141	158.6	127.7	124.2	113.1
August	141			124.5	114.5
September	142			125.2	115.6
October	146	162.1	128.7	126.0	117.4
November				126.5	118.1
December				126.8	

a. Seasonally adjusted.
b. Hourly rates for manufacturing workers.
c. Intermediate products.

Table 2

France: Imports of Industrial Equipment and Manufactured Consumer Goods, Quarterly Data a/

Million US $

1967	Industrial Equipment	Manufactured Consumer Goods
1st quarter	519	406
2d quarter	516	407
3d quarter	419	350
4th quarter	499	436
1968		
1st quarter	528	471
2d quarter	520	454
3d quarter	535	453
4th quarter	674	660
1969		
1st quarter	637	680
2d quarter	757	755
3d quarter	709	683

a. Francs were converted to dollars at the par value rate of exchange of 5.55419 francs to US $1.

to postpone their purchases from France in anticipation of lower prices. As a result, exports declined slightly in the two months preceding the devaluation.

5. The boom in imports and the slowing down of exports increased the trade deficit. The gap between imports actually entering the country and exports actually leaving it, however, accounts for only a part of the massive deficit in the French balance of payments, which totaled almost $1.9 billion in the first half of 1969 (see Table 3). The deficit was smaller than the $2.4 billion in the second half of 1968 because of the elimination of a net outflow of about $1 billion on capital account by means of tight exchange controls. Exchange controls, however, were unable to prevent a heavy loss of foreign exchange through changes in the timing of payments on commodity transactions.

6. Anticipating higher import prices following a devaluation, French importers sought to prepay their foreign purchases to the extent possible. At the same time, foreign buyers of French goods attempted to postpone payment until after the devaluation. The French government instituted controls to curtail forward transactions in foreign currencies, but these controls were not effective. Payments for imports exceeded receipts for exports by $0.5 billion in the second half of 1968 and by $1.3 billion in the first half of 1969. However, the trade deficit as recorded by French customs -- that is, the value of imports actually entering the country less the value of exports leaving it -- was only $0.1 billion and $0.3 billion, respectively, in the same periods on the basis of comparable valuations (see Table 4). The difference between these two measures of the deficit on commodity transactions ($0.4 billion in the second half of 1968 and $1 billion in the first half of 1969) is, in effect, a capital outflow due in large part to speculative leads and lags in payments. During this period the Bank of France recorded steady losses of reserves, with the exception of a few months following the temporary resolution of the November 1968 monetary crisis. From 31 March 1968 to 31 July 1969, gross reserves (including the IMF gold tranche) declined $3.3 billion, and an additional $1.5 billion in swap credits was used up.

Table 3

France: Summary Balance of Payments Outside Franc Zone a/

Million US $

	First Half 1968	Second Half 1968	Total 1968	First Half 1969
Goods and services	-128	-904	-1,032	-1,603
Merchandise trade balance (f.o.b./f.o.b.)	-79	-537	-616	-1,318
Services	-49	-367	-416	-285
Transportation	-69	-93	-162	-131
Travel	35	-179	-144	-16
Other	-15	-95	-110	-138
Unilateral transfers	-216	-279	-495	-313
Current account balance	-344	-1,183	-1,527	-1,916
Long-term capital	-276	-435	-711	165
Basic balance	-620	-1,618	-2,238	-1,751
Short-term capital	-456	-543	-999	-121
Other b/	168	-209	-41	14
Total	*-908*	*-2,370*	*-3,278*	*-1,858*

a. Because of rounding, components may not add to the totals shown.
b. Includes (1) Merchandise Transactions Abroad, (2) Multilateral Settlements, and (3) Errors and Omissions.

Table 4

France: Commodity Trade Flows and Payments

Million US $

	Payments Basis			Customs Basis			Adjusted Customs Balance
	Exports (f.o.b.)	Imports (f.o.b.)	Balance	Exports (f.o.b.)	Imports (c.i.f.)	Balance	(f.o.b./f.o.b.)
1968							
First half			-79	5,116	5,735	-619	-46
Second half			-537	5,899	6,675	-776	-108
Total	*11,195*	*11,811*	*-616*	*11,015*	*12,410*	*-1,395*	*-154*
1969							
First half			-1,318	6,569	7,648	-1,079	-314
Second half				7,115	8,308	-1,193	-362
Total				*13,684*	*15,956*	*-2,272*	*-676*

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On 8 August 1969, gross reserves, which had totaled $6.9 billion on 31 March 1968, had dwindled to $3.6 billion (see Table 5). During the same period, the liabilities of the Bank of France increased from zero to $2.4 billion.

Economic Policies After the Devaluation

7. Immediately following the devaluation on 10 August, the Pompidou government initiated a comprehensive stabilization program designed to aid in accomplishing three linked objectives: (a) to balance the central government cash budget by January 1970 and keep it balanced throughout the year; (b) to curb excess consumer and investment demand in the economy as a whole by March 1970; and (c) to balance France's foreign trade account by July 1970.

8. As part of its deflationary fiscal program, the government reduced the anticipated 1969 budget deficit from $1.2 billion to $650 million. This was accomplished essentially through acceleration of corporate income tax payments, increased collection of customs duties resulting from a higher-than-planned level of imports, a freeze on certain government expenditures (for example, new government hiring), and cancellation of the 1969 special tax credit for investment goods purchased after 3 September 1969. The 1970 budget bill, approved in late November, projects a small surplus, primarily from a reduction in the rate of growth of expenditures. Government expenditures in 1970 are to increase 6.2% over those of 1969, substantially less than the average annual increase of 12.1% in the three years 1967-69 and the 1969 increase of 16.1%. Because of prior commitments in several major areas of current spending (for example, education), a major part of the expenditure cuts has fallen on government capital expenditures. Funds authorized for public works are slated to decrease by 7% from the 1969 authorization. The existence of "optional credits," however, allows the government to inject additional funds into the economy on short notice if this should seem desirable. If optional credits are included in the 1970 budget, capital expenditures could increase by as much as 4% rather than decreasing by 7%.

Table 5

French Gross Reserves, Quarterly Data

Million US $

1968	Gold	Foreign Exchange	IMF/GAB	Gross Reserves	Change of Gross Reserves
31 March	5,235	788	883	6,906	
30 June	4,739	778	--	5,517	-1,389
30 September	4,166	208	--	4,374	-1,143
31 December	3,877	323	1	4,201	-173
1969					
31 March	3,827	159	1	3,987	-214
30 June	3,552	58	1	3,611	-376
31 July	3,551	43	1	3,595	-16
Total					*-3,311*

9. In monetary policy, aside from extending credit controls to mid-1970, the principal innovations were to close the many loopholes in existing controls and to force the banking system to observe the credit quotas imposed by the monetary authorities. The French government now has in effect probably the stiffest credit controls of any Western country. The discount rate, raised by the Bank of France to 8% in October, is, with the exception of Denmark's 9%, the highest in Western Europe. The Bank also increased minimum reserve requirements, tightened the criteria for rediscounting medium-term loans for investment, and included previously exempted operations within the credit quotas. Consumer credit also was tightened. Minimum downpayment requirements were increased from 30% to 50% for autos and to 40% for most other consumer durables, and maximum repayment periods typically were reduced from 18 to 15 months. The government also introduced a variety of incentives designed to increase personal savings. These include higher interest rates on savings accounts, special premiums for those depositors who leave their funds in such accounts for extended periods, and increased tax exemptions for bond interest and life insurance premiums.

10. Still, the total package of policy measures in the government's stabilization plan does not represent a severe austerity program. Fearful that too strong deflationary measures would cause a recession, as well as political unrest, the Pompidou government is trying to achieve a slowing of inflation and a balance in its foreign trade accounts by mid-1970 without absolute price freezes, declines in production, or large increases in unemployment. For political as well as economic reasons the government is unwilling to curb demand drastically by increasing taxes. Furthermore, the reductions in government expenditures in 1969 and in the budget planned for 1970 will inevitably take time to have a significant impact on the level of economic activity. The effects on economic activity are planned to be moderate -- a 4% growth of GNP in real terms and a 4% rate of inflation are expected in 1970. This would preserve most of the competitive edge gained from the August devaluation and, by reducing the pressure of domestic demand on productive capacity, would facilitate the expansion of exports.

The Economy Since Devaluation

11. Trends since the August devaluation in both domestic economic activity and foreign trade and payments are encouraging. The tightening of monetary policy has already brought about a decline in credit creation, and the resulting high interest rates have contributed to a substantial increase in domestic savings. In November the rate of growth of private savings was the highest ever recorded. Although figures are not available for total savings, net deposits in savings banks, which had totaled only $300 million during the first half of 1969, had reached $1.7 billion by the end of December. At the end of 1969 the money supply was increasing at an annual rate of less than 6% -- half the rate prevailing in December 1968.

12. Tighter money and more restrictive credit policies appear to be affecting consumer expenditures. Although little data are yet available, a November study of retail merchants' opinions indicates that a slackening of consumer demand is expected. In December, automobile and appliance sales reportedly fell sharply from normally high seasonal levels. Inflation showed some signs of slowing as retail prices rose only 2.5% in the second half of 1969 compared with 3.2% in the first half, in spite of the increase in prices of imported goods as a result of devaluation.

13. France's trade balance has improved. The French government had predicted in October that stabilization policies would result in a balance in foreign trade by mid-1970. ("Balance" in this context is defined as a ratio of exports (f.o.b.) to imports (c.i.f.) equal to 93%.*) Substantial increases in exports during September-December and a decline in imports after October (see Table 6) brought a balance far ahead of the government's original schedule (see Table 7). The government is now projecting a small surplus by mid-1970.

** The French government uses the trade balance based on monthly customs data, and thus the 93% benchmark, as a proxy for more complete data on trade and current account payments because of the delay in collecting and publishing balance-of-payments figures.*

Table 6

French Trade Outside Franc Zone
Seasonally Adjusted a/

Million US $

1968	Exports (f.o.b.)	Imports (c.i.f.)	Trade Balance
January	811	855	-44
February	814	866	-52
March	829	869	-40
April	804	878	-74
May	616	624	-8
June	591	858	-267
July	982	1,028	-46
August	870	957	-87
September	842	976	-134
October	914	1,036	-122
November	887	1,042	-155
December	876	1,077	-201
1969			
January	949	1,081	-132
February	926	1,059	-133
March	890	1,046	-156
April	993	1,195	-202
May	978	1,226	-248
June	1,022	1,234	-212
July	1,012	1,289	-277
August	955	1,260	-305
September	1,075	1,349	-274
October	1,183	1,397	-214
November	1,130	1,227	-97
December	1,198	1,290	-92

a. Francs were converted to dollars at the par value rate of exchange of 5.55419 francs to US $1.

Table 7

Exports as a Percentage of Imports
in Trade Outside Franc Zone

	1968	1969
January	0.95	0.88
February	0.94	0.87
March	0.95	0.85
April	0.92	0.83
May	0.99	0.80
June	0.69	0.83
July	0.96	0.79
August	0.91	0.76
September	0.86	0.80
October	0.88	0.85
November	0.85	0.92
December	0.81	0.93

14. Devaluation does not appear to have stemmed the outflow of capital until after Germany revalued the Deutschemark on 26 October 1969. Until that time, French capital continued to flow to Germany, and official French reserves continued to decline, necessitating a $500 million drawing on the $985 million standby credit granted by the IMF. Following the German revaluation, however, substantial reflows of capital from West Germany enabled the French government to reduce its short-term foreign indebtedness, thereby increasing its net monetary reserves by $200 million in November and $250 million in December. As a result of further reflows of capital, the reversal of leads and lags in payments, and the allocation of $165 million in Special Drawing Rights (SDR's), net monetary reserves rose almost $400 million in January 1970. As of 31 January 1970, they were estimated at $2.1 billion, up from $1.2 billion on the eve of devaluation.

Prospects for 1970

15. Prospects are for a large improvement in France's balance of payments during the first half of 1970. Basically, the improvement will reflect a

reversal of the speculative transactions in goods and currencies which were responsible for most of the deficit in 1969. Inventory accumulation of imported goods, which was large before the devaluation, should be reduced. The reversal of leads and lags in France's foreign trade payments should have an even larger effect. Some of this improvement will appear in the balance of payments for the last half of 1969, but most of it will be registered in 1970 balance-of-payments data. It is impossible, however, to predict the magnitude of the reflux of speculative funds into France. The amount of French funds being held outside France is still very large. Probably some two-thirds of the cumulative balance-of-payments deficit of over $5 billion during 1968 and the first half of 1969 was due to one or another form of speculation or capital flight. With the franc devaluation and the Deutschemark revaluation accomplished and the gold market depressed, much capital could return to France. On the other hand, confidence in the franc and in France's economic and political stability clearly is not as yet strong, and many people may await developments in France before bringing their money home.

16. Much will depend, therefore, on the ability of the Pompidou government to slow inflation, while avoiding serious labor unrest. There appears to be a fair chance of slowing inflation. Although business investment plans as of November indicate further expansion of investment expenditures, largely due to continued strong foreign demand for French industrial goods, the rate of increase is expected to decline somewhat. Consumer demand appears to be slackening. The government estimates that productive capacity in industry will increase faster than industrial output. However, upward pressure on prices and an inflation psychology persist. Although the devaluation of the franc has not led to any acceleration in the rise of prices so far, it will no doubt be instrumental in at least maintaining some cost-push inflationary pressure in early 1970 despite the gradual slackening of home demand. The November survey of French business opinion mentioned earlier suggests 1970 price increases in the order of 5%, somewhat higher than the government's forecast of 4% for 1970.

17. The government must also obtain the cooperation of workers and trade unions in moderating their demands for large wage increases. The government

thus far has been able to maintain the offensive in labor relations with the more militant unions. Within the past few months, Pompidou and Chaban-Delmas have announced several innovations, including a participation plan for workers in the nationalized Renault plant and a minimum salary schedule based on cost of living and production indexes. Four major unions in the nationalized gas and electricity industry (EGF) -- but not the Communist-dominated General Confederation of Labor (CGT), which represents more than half of all EGF workers -- have signed a new two-year labor contract providing, effective 1 January, for wage increases based on the increase of gross domestic product, worker productivity, and other economic indicators. In 1970 the new formula should permit a 7% increase in wages in these industries. The contract also provides for a three-month period of negotiations following a union's announcement of its intention to strike and prohibits work stoppages during the negotiation period. The government recommended this agreement as a model for general wage and labor negotiations next spring. The CGT rejected the contract in a referendum held on 14 January, but it is unlikely that the CGT will strike at this time as there appears to be widespread popular support for the government's negotiating position. A compromise agreement must now be reached, probably with a modification of the no-strike clause.

18. The Pompidou government appears to be solidly installed in power, and is working effectively. Public support is probably as positive as can be expected in a period of forced economic slowdown also characterized by rising prices. The government thus far has been generally successful in containing labor union unrest. There are two major reasons for this public relations success. First, the rehabilitation package contains a surprisingly high number of measures in favor of the underprivileged classes. These measures do not represent much of a fiscal cost even in combination, but do create the impression of concern with, and concrete steps toward, "social improvement" on the part of the regime. Second, the brunt of the direct burden of eliminating the budget deficit is made to appear to fall on "big business" although ultimately the consumer will pay.

19. It is likely that the Pompidou government will continue its present economic policies through mid-1970, the target date for the end of the government's short-run stabilization program. At that time, a slight cooling off of the domestic economy, coupled with improvement in the payments balance, should allow the government greater leeway in instituting economic policy reforms. However, the transition period may be prolonged by the projected slowdown in worldwide economic activity, especially in West Germany and the United States, in the second half of 1970. The anticipated slower economic growth in these two countries, which together account for more than 30% of total French trade, may force the government to continue its restrictive economic policies beyond mid-1970.

20. In the longer term and if domestic political stability prevails, the outlook for the French economy seems favorable. Speculative forces aside, France is probably not very far from equilibrium in its balance of payments. A basic imbalance developed during 1968 as French prices and costs increased a great deal more than those in most other industrial countries. This worsening of France's competitive position, however, has probably been offset by the franc devaluation and the Deutschemark revaluation, the effects of both of which on trade will not be fully felt for many months. French exports have continued to grow rapidly and should hold their own in the future. This in turn should permit a sufficient growth in imports to support a respectable rate of economic growth.

Conclusions

21. The devaluation of the franc and the revaluation of the Deutschemark have in large part removed the speculative factors which, between June 1968 and August 1969, had created a huge French balance-of-payments deficit and a rapid decline in gold and foreign exchange reserves. Most of the loss in reserves during that period was the result of a lack of confidence in the franc (reflected in large-scale anticipatory buying, adverse leads and lags in trade payments, and capital flight) rather than of a fundamental disequilibrium in France's international trade position.

The government's moderate deflationary program, introduced soon after the devaluation, includes a balanced budget and tighter monetary and credit policies. The program is designed to produce a balance in the foreign trade account by mid-1970, primarily by curbing the growth of domestic demand and thereby of import demand as well as freeing more industrial capacity for the production of goods for export rather than domestic consumption. Preliminary indications of the results of the program are encouraging. Domestic demand appears to be slowing, savings deposits are increasing rapidly, and the trade deficit has been sharply reduced. Real gross national product in 1970 is expected to increase at the relatively moderate rate of 4%, and inflation should also be reduced from the 1969 rate of 6%.

22. In the first half of 1970, the government's stabilization program, combined with a reversal of speculative leads and lags in trade payments, should produce a trade surplus more than sufficient to offset continuing deficits in the service and transfer accounts in the overall balance of payments. Nevertheless, confidence in the franc and the French economy remains the key to any longer run stabilization plans of the government, and such confidence has not yet been fully restored. For the immediate future, actions of the labor unions remain a big question mark. Signs of imminent social crisis are few, but the possibility that continuing sporadic student and labor strikes might erupt into a repeat of the events of May-June 1968 cannot be ruled out. Also, French exports and economic growth could be hampered by the widely expected slowdown in worldwide economic activity in the latter half of 1970.

23. The real test of the government's ability to steer the economy to higher growth rates without balance-of-payments deficits may therefore not come until the second half of 1970. If this test then is met successfully, confidence in the franc and the French economy undoubtedly will rise. When more rapid expansion is resumed by France's principal trading partners, French exporters should be able to reap the full benefit of the 1969 devaluation with resulting longer run improvements in the French payments position.