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1. Policy Instruments

In France, monetary policy is conducted by the National Credit Council, which is nominally headed by the Minister of Finance, while the Governor of the Bank of France serves as Vice President. As a rule, however, the Minister is absent from the Council's meetings, and the operation of the Council is directed by the Bank's Governor. Although the Bank is theoretically only the executive agency of the Council, carrying out the latter's policy, in practice the Bank of France brings recommendations for policy actions before the Council, and the Council's staff is provided by the Bank. The Council may thus be viewed as the means by which the Bank of France submits its suggestions to representatives of the public and the banking community for approval, and by which it coordinates its policy with that of the government, particularly the Ministry of Finance. In this way, the Bank of France enjoys a smaller degree of formal independence than do most central banks, but this does not mean that the Bank is in a subordinate position: it probably wields greater influence on the operation of other government organs than do central banks in most other countries.

While there are many deposit banking facilities in France, banking is quite concentrated, both in number of banks and in location; the greater part of banking transactions is conducted by seven banks, only one of which has its headquarters outside Paris. More than half of the banking business, measured by the amount of deposits or by total assets, is concentrated in the four largest banks, all of them in Paris. These four banks have been nationalized since the end of World War II, yet they still operate as private enterprises. Despite the high degree of concentration and the nationalization of banking establishments, there are no indications that informal associations within the banking

community, or "moral suasion" by the central bank, play an important part in the conduct of monetary policy in France.

The Bank of France uses all of the classical monetary instruments, but in forms and combinations that are uniquely its own.

Discount Policy. Rediscount policy—effected through changes in the discount rate and in rediscounting quotas—is the major instrument of monetary policy in France. Because of the massive amount of rediscounting at the Bank of France, changes in the discount rate are bound to be effective, for they operate on both the supply of credit and the demand for it. A semi-rigid relationship is maintained, by regulation, between the discount rate and the commercial banks' interest rates on customer loans. Formerly, the difference between the interest rates and the discount rate was fixed; a change in the discount rate thus led to a similar change in rates charged by commercial banks, leading in turn to a change in the amount of credit demanded by the public. Since November 1963, however, the regulations allow the commercial banks' lending rates to change only half as much as the discount rate changes.¹ A change in the discount rate thus affects the profitability of commercial banks' credit transactions (combined with rediscounting) and the supply of credit.

Since 1948, discount policy has also included the establishment of a ceiling for each bank, up to which it can discount at the Bank of France at the basic discount rate. Further rediscounting (or selling paper to the Bank of France with a repurchase stipulation) within a limit of 10 per cent of the discount quotas has been allowed since 1951, but a penalty rate, higher than the basic discount rate, is applied to such transactions. Since 1957, still further discounting has been permitted at a second, higher, penalty rate. Both changes in the ceilings and changes in the penalty rates are among the discount policy measures used. Unlike the situation in a country like Japan, where the basic discount rate was rather meaningless during most of the period in which penalty rates were in effect, it appears that in France the basic rate has been significant; that is, for most discounting transactions, this basic discount rate is relevant at the margin. Discounting at the penalty rates is usually taken only for brief periods, as a last resort; the very high level of the penalty rates forces the banks generally to stay within their basic rediscounting quotas.

¹ This change in the relationship between the rates was officially introduced in early 1960, but from then until late 1963 the change was applicable only to discount-rate movements outside the range of 3.5 to 4.5 per cent, and in fact the discount rate remained within this range during those years.

Reserve Requirements. The minimum-reserve requirements customary in most countries—requirements for the holding of deposits at the central bank, or cash, at a certain ratio to designated bank liabilities—did not exist in France during the period under review. Usually, commercial banks in France have maintained only small working balances at the Bank of France—not more than 2 to 3 per cent of their deposit liabilities. There have been, however, liquidity requirements of a somewhat different form considered secondary to, and intended mainly for the support of, rediscounting policy.

When the rediscount ceilings were introduced in September 1948, commercial banks held sizable amounts of Treasury bills. By selling these, the banks could have overcome the restrictive effect of the limitations imposed on rediscounting by the ceilings. In order to prevent such circumvention, the rediscount ceilings were accompanied by Treasury-bill “floors”: banks were required to hold Treasury bills to the value of a given minimum amount. At first, each bank was required to maintain the amount of Treasury bills in its portfolio at the time the system was introduced; for all commercial banks at that time, the average was 28 per cent of designated liabilities. Each bank was also required to hold additional bills to the value of 20 per cent of the increase in its designated liabilities since the base date. In 1956 this mixture was replaced by a uniform ratio of 25 per cent of all liabilities, which was the average ratio for all commercial banks.

Early in 1961, a more inclusive reserve requirement was introduced. Under the new regulation, the banks were required to maintain portfolios of several types of assets, *including* the Treasury bills held under the floor regulation, at a given minimum ratio to the liabilities specified under the floor regulation. In addition to Treasury bills, these assets include certain commercial bills, all of which can be discounted at the Bank of France beyond the limitations of the ceilings under the existing regulations. Thus, this measure, too, was enacted as a supplement to discounting policy. Because of these new reserve requirements, the floor regulation ceased to be a necessary part of monetary policy, and changes in floor ratios were thereafter determined primarily by the needs of the Treasury. Consequently, the floor ratio has, gradually and substantially, declined from the level of 25 per cent at which it was maintained before 1961.²

² The system of floor ratios and reserve requirements described here was replaced in 1967 by a system of reserve ratios in which deposits at the Bank of France constitute reserves.

Open-Market Policy. Open-market operations have been a minor, subsidiary part of the management of French monetary policy. Banks were assigned open-market quotas which gave them limited recourse to open-market selling before starting to rediscount at the Bank of France at the penalty rates. In effect, then, open-market operations did not function as an independent instrument, but rather as part of the discounting mechanism.

Other Measures. The Bank of France has considerable power to intervene in the granting of credit by commercial banks; to grant various forms of credit, beyond some given size of transaction, the banks must obtain prior authorization from the Bank of France. This regulation has been used to control the allocation of credit, i.e., to discourage lending to certain industries, and encourage lending to others, but not, apparently, as an instrument of general monetary policy. Monetary circumstances influenced the regulation of instalment credit, but there is not enough of this instalment credit in France for direct intervention by the Bank of France in that area to make any substantial impact on the total amount of credit.

On occasion, however, direct control has been exercised over the credit volume. From February 1958 to February 1959, the total amount of credit which could be granted by each bank was frozen by directive of the monetary authorities at its level for the last quarter of 1957; expansion up to 3 per cent of that base was permitted only when credit for exports was concerned. Direct control was introduced again in early 1963, and was maintained throughout the rest of the period.

FISCAL POLICY AND THE TREASURY'S FINANCIAL TRANSACTIONS

Because of the Treasury's functions and the structure of its operations, its role in French economic life is rather complicated. The French government's budget is divided into two parts. One, by far the larger, includes "permanent items." On the expenditure side, this includes the government's real transactions and transfer payments; on the revenue side, it covers taxes and similar items. Generally speaking, this part of the budget is roughly balanced. The other part includes "temporary items," and essentially consists only of payments in the form of loans granted by the government (net of repayments), primarily for development purposes. These loans (the acquisition of financial assets) are financed mostly by sales of various government financial obliga-

tions; but the proceeds from these transactions are not recorded as revenue in the budget. The temporary-items part of the budget, hence the budget as a whole, thus necessarily shows a deficit, roughly the size of the expenditures on temporary items. This deficit does not therefore indicate the government's "excess demand," which would approximately correspond to a deficit in the budget of permanent items.

As is implied above, the government is heavily involved in the capital market, mainly in the sale of Treasury bills. These are of two kinds: "paper" bills are sold to savings institutions and other firms and to households in order to channel savings through the government; "current account" bills are the Treasury bills sold to commercial banks. Since the banks are compelled to buy the latter under the "floor" regulations, there is strong incentive for the Treasury to set low yields for the bills; consequently, the banks tend to invest as little as possible in Treasury bills. As a rule, then, the amount of acquisition (or disposition) of Treasury bills by commercial banks is determined by changes in their deposit liabilities and the floor ratio. During the last few years of the period surveyed, the strong financial position of the government led to a marked decline in the amount of outstanding Treasury bills which, in turn, made possible the abolition of the floor requirement in 1967.

The Treasury also influences the monetary situation in many other ways. It holds large sums on deposit for individuals, firms, special agencies, and governmental units, such as local authorities, and the governments of overseas members of the franc area. Some of these deposits, such as those widely held in the postal system, are even considered part of the French money supply. Changes in these accounts will, in turn, be reflected in the Treasury's accounts at the Bank of France, for the Treasury does not maintain deposits in commercial banks.

It is clear that while the government's deficit, and changes in it, must be related to the government's net indebtedness to the Bank of France, there is no necessary correspondence between the two. The latter reflects not only the size of the deficit but also the form in which it is financed (whether by sales of Treasury bills or by a change in the government's indebtedness to the Bank) and changes in the Treasury's monetary accounts, some of which move independently, while others are related directly to the budget.³

³ An important instance of the latter case is given by budgetary allocations to governments of other countries of the franc area, which are accomplished by crediting the account of the government concerned at the Treasury, and do not

It is also clear that neither the budgetary balance nor changes in the government's net indebtedness to the Bank of France accurately reflect the expansionary or contractionary impact of the government's transactions. For the reasons just explained, the cash deficit, as it is measured, does not represent the government's excess demand, while the change in the government's indebtedness to the Bank does not take into account the effect of changes in accounts held at the Treasury, and thus does not fully represent the effect of the government on the economy's liquidity.

2. Statistical Analysis

The study of monetary and fiscal reactions to balance-of-payments disturbances in France is restricted to a rather small number of observations. For about half of the total period—from the beginning of 1959 to the end of 1966—the balance of payments showed continuous surpluses, and external reserves increased monotonically. Episodes of balance-of-payments fluctuations are thus limited to the 1950's. Nevertheless, conclusions are suggested by the data.

First, as may be seen from Chart 5-1 and from column 2 of Table 5-1, movements of the discount rate appear consistently in the direction indicated by the need for balance-of-payments adjustment. This is certainly true for the years 1950-60; in later years, there were hardly any movements in the discount rate—only two minor changes in 1963 and 1965—and the changes were apparently unrelated to the movements of external reserves.

This impression is supported by Table 5-2, in which all changes in the discount rate are recorded. From column 1, it may be seen that almost all of these changes were in the direction required for balance-of-payments adjustment. The single apparent exception during the 1950's is the lowering of the discount rate in the third quarter of 1953, when external reserves were falling. The fall of reserves during that quarter was, however, minor; moreover, when the discount rate was

give rise to any immediate change in the Treasury's accounts at the Bank of France. In the longer run, however, these allocations will take the form of an excess of imports from France by the country concerned. This, in turn, must be reflected in a transfer of accounts at the Treasury from the foreign government to a French bank, which will lead to an increase in bank liquidity and corresponding increase in the Treasury's net indebtedness to the Bank of France.

CHART 5-1
FRANCE: TIME SERIES OF SELECTED VARIABLES

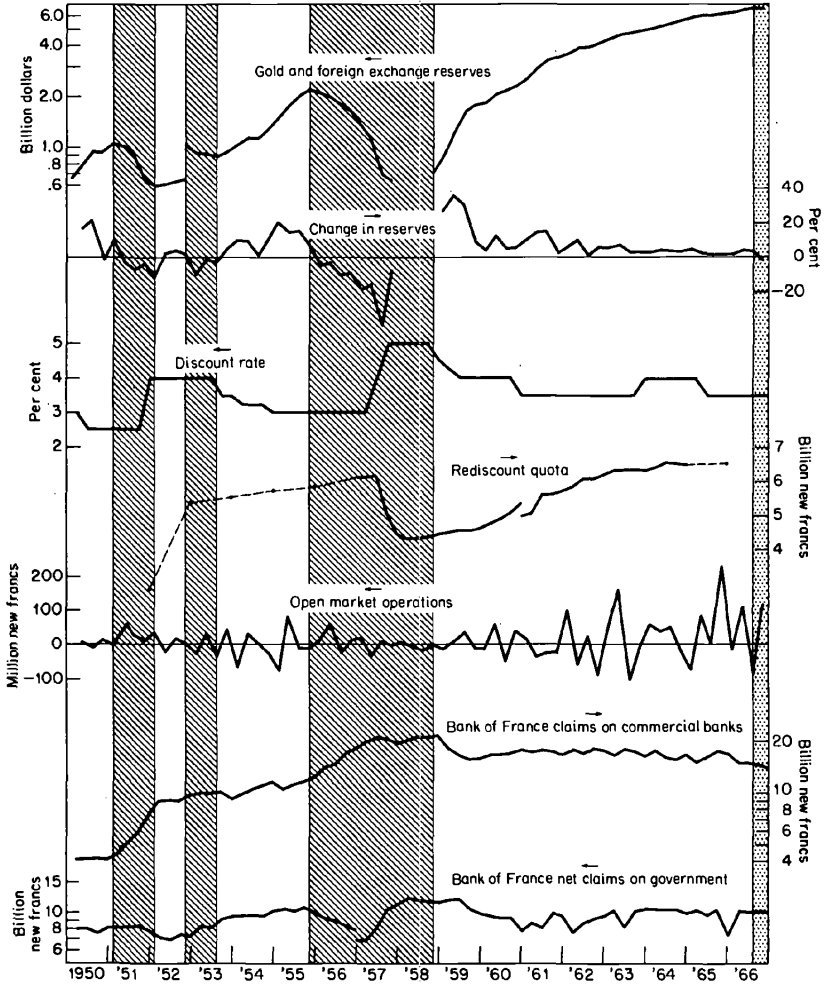


CHART 5-1 (Continued)

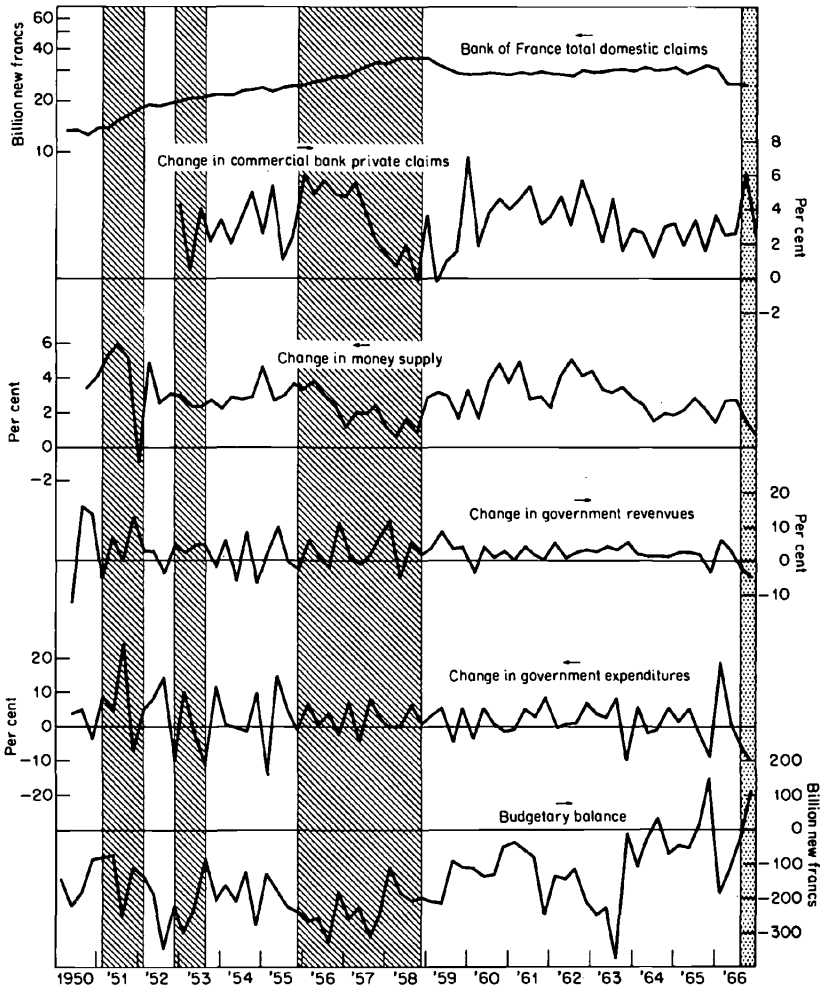
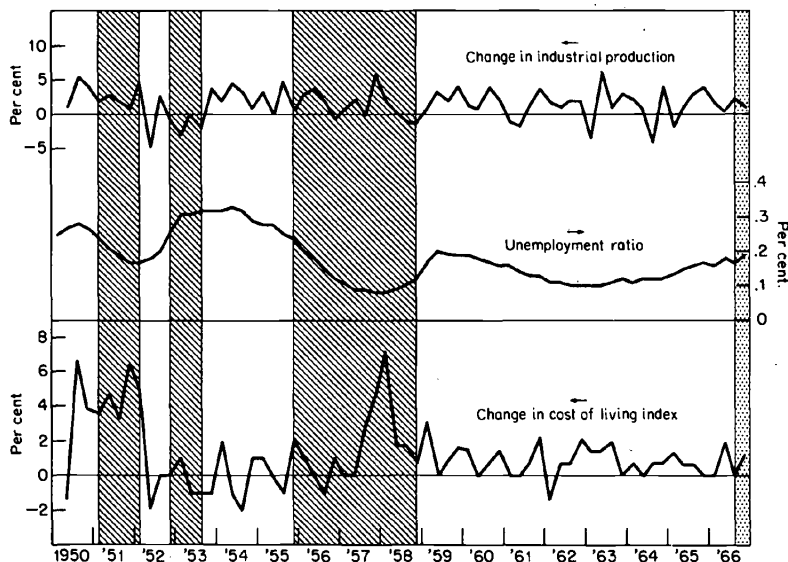


CHART 5-1 (Concluded)



NOTE: Diagonal-line areas represent period of downward imbalances; gray areas represent stability; white areas represent upward imbalances.

actually changed, in September 1953, external reserves were already slightly rising. This episode thus cannot be considered an exception either.

Table 5-2 also provides an indication of the influence of targets other than the balance of payments on the movements of the discount rate. Unemployment, even at its peaks, was so low throughout the period that its fluctuations could not conceivably bring about monetary policy reactions. Table 5-2 is therefore confined to two other target variables. The rate of change of industrial production is represented in column 2; movements of the discount rate show no consistent association with this variable. But the rate of change of the cost-of-living index (column 3) seems to perform quite well. It appears that, on the whole, there was no contradiction between the requirements of balance-of-payments equilibrium and those of price stability. A fall of external reserves was more often than not accompanied by a greater than usual increase in prices, so that both targets required (or did not contradict the need for) an increase in the discount rate, whereas the opposite was usually true for periods of balance-of-payments surpluses.

TABLE 5-1
FRANCE: MOVEMENTS OF POLICY VARIABLES DURING SUBPERIODS OF IMBALANCES

| Subperiod | External Reserves | Discount Rate | Bank-of-France Lending to Banks (compared with trend) | Bank-of-France Lending to Government | Bank-of-France Total Domestic Claims (compared with trend) | Money Supply (quarterly rate of increase, per cent) | Budgetary Balance (quarterly average, in billions of francs) |
|--------------------|-------------------|---------------|---|--------------------------------------|--|---|--|
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| I 1950 - I 1951 | rise | + lowered | - falls | * stable | - falls | (+) 4.4 | (*) -.25 |
| I 1951 - I 1952 | fall | + raised | - rises | + falls | - rises | (+) 3.9 | (-) -1.36 |
| I 1952 - IV 1952 | rise | * stable | * stable | + rises | * stable | (-) 2.9 | (+) -2.47 |
| IV 1952 - III 1953 | fall | - lowered | + falls | - rises | * stable | (+) 2.5 | (+) -2.02 |
| III 1953 - IV 1955 | rise | + lowered | * stable | + rises | * stable | (+) 3.2 | (-) -1.65 |
| IV 1955 - IV 1958 | fall | + raised | - rises | * fluctuates | - rises | (+) 2.0 | (-) -2.29 |
| IV 1958 - IV 1965 | rise | * no trend | - falls | * fluctuates | - falls | (+) 3.1 | (-) -1.32 |

NOTE: For explanation of symbols, see Chapter 3, explanatory note.

TABLE 5-2

FRANCE: CHANGES IN THE DISCOUNT RATE AND POSITION OF TARGET VARIABLES

| <i>Discount Rate</i> | <i>External Reserves</i> (1) | <i>Industrial Production</i> (rate of increase) (2) | <i>Cost-of-Living Index</i> (rate of increase) (3) |
|----------------------|---------------------------------|---|--|
| Raised: | | | |
| IV 1951 | + fall | * normal | + high |
| II 1957 | + fall | - low | - low |
| III 1957 | + fall | - low | * normal |
| IV 1963 | - rise | * normal | + high |
| Lowered: | | | |
| II 1950 | + rise | + low | + low |
| III 1953 | - fall | + low | + low |
| I 1954 | + rise | - high | + low |
| IV 1954 | + rise | - high | + low |
| IV 1958 | * stable | + low | * normal |
| I 1959 | + rise | + low | * normal |
| II 1959 | + rise | * normal | * normal |
| IV 1960 | + rise | - high | + low |
| II 1965 | + rise | + low | * normal |

NOTE: For explanation of symbols, see Chapter 3, explanatory note.

The long period of continuously rising external reserves deserves a special examination. During most of this period—throughout the 1960's—the discount rate was practically stable, while balance-of-payments adjustment would have called for a lowering of the rate. It is conceivable, however, that even though the discount rate was almost stable during these years, its *level* may have been determined by a consideration of the fact that the balance of payments was in a continuous surplus. If this is true, the level of the discount rate would be low, in comparison with other periods, but this is not what actually took place. The average, almost stable, level of the discount rate from 1960 or 1961 onward was about the same as the average, much more fluctuating, level of the rate during the 1950's. Therefore, by this yardstick, too, discount-rate policy cannot be said to have conformed to the requirements of balance-of-payments equilibrium during the 1960's. But, as the analysis of the over-all view in Chapter 2 has shown, a

different conclusion is reached when the rising trend of discount rates in other countries is taken into consideration: in relation to rates elsewhere, the discount rate in France was indeed lowered during the 1960's.

It may be worthwhile to inquire whether the *level* of external reserves fulfilled a function in the determination of discount-rate policy. If it did, reversals of policy should follow, in general, reversals of movements of external reserves only after the latter have persisted over a long period of time, so that this cumulative effect on the level of reserves is significant. By and large, this does not seem to be the case. The only important episode in which the policy pattern would conform to this hypothesis is that of 1956–58. The decline of reserves in this period followed a very sharp increase which brought reserves to a high level. Indeed, discount-rate policy came to be restrictive only in the second quarter of 1957, after a sharp decline of reserves had already been in progress for a year and a half. But, contrary to the hypothesis under examination, discount-rate policy became expansive at the end of 1958, continued to be expansive in 1959, while reserves were rising but still below their 1955 peak. From the middle of 1959, the discount rate remained almost stable while reserves were rising rapidly and surpassing by far any previous level. In the latter part of 1951, the raising of the discount rate followed soon after a fall in reserves after a sharp rise. In late 1953 and in 1954, when reserves were only starting to rise from a low level, the discount rate was lowered a few times, whereas in 1955, when reserves were rising fast to much above previously maintained levels, the discount rate remained stable. On the whole, then, the proposition that the *level* of foreign-exchange reserves—as distinguished from the direction of change—fulfilled a significant role in determining the movements of the discount rate must be rejected.

The two “penalty rates” (not shown in Chart 5-1) may be seen to have played a supporting role to the basic discount rate: the movements of the former were always in the same direction as those of the latter. The penalty rates seem to be important mainly during 1957–59, when their movements and the basic discount rate conform to the requirements of balance-of-payments adjustment: the penalty rates were raised (the second, in effect, only introduced) during 1957 and the first half of 1958, when external reserves were falling; lowered slightly during the second half of 1958, when the balance of payments stabilized; and lowered considerably during 1959, when reserves were rising rapidly.

The movement of the basic rediscount quotas shows, as Chart 5-1 indicates, a slight upward trend most of the time. The increase in the quotas was very sharp during 1952. External reserves were, indeed, rising during that year, but this rise was only slight, and is not likely to have been the proper explanation for the increase in the quotas. The other deviation from the trend—a substantial decline in the quotas during the second half of 1957—is more significant; and it conforms to the movements of the basic discount rate and the penalty rates, and to the requirements of balance-of-payments adjustment during that period.

The floor regulations for the holding of Treasury paper (not shown in Chart 5-1) do not seem to fulfill any independent function. From the introduction of those regulations to the end of 1960 the floor ratio was stable, except for the previously noted change in structure, and consequently in its “marginal” level from 20 to 25 per cent, in 1956. On the other hand, as has been mentioned earlier, since the introduction of a more inclusive reserve ratio in 1961, the floor regulations have been of little relevance to over-all monetary policy. The reserve ratio, which was stable during 1961, increased in number of steps from early 1962 to the middle of 1963, then decreased from late 1964 to the end of 1965. All these changes took place during the period of a consistent, large rise of external reserves, and cannot thus be explained by the position of the balance of payments. In a rough way, they corresponded to changes in the same direction in the discount rate, and were, presumably, intended to reinforce discount-rate policy during these years.

Substantial changes in the amount of the Bank of France's lending to commercial banks clearly were opposite in direction to changes in external reserves, as may be seen from Chart 5-1 and from column 3 of Table 5-1. These movements in the Bank's lending to commercial banks appear to be related to three factors: the movement of external reserves, discount policy, and Bank of France lending to the government. Commercial-bank borrowing from the bank, generally rather stable, rose substantially during 1951 and from the end of 1955 to the middle of 1957, both of which were periods of substantial declines in external reserves. From mid-1957 to the end of 1958, the amount of such borrowing was stable, although foreign reserves were still falling sharply. This must have been due, first, to the discounting policy, which became restrictive during this period, and, second, to a substantial increase in the Bank of France lending to the government. It may

be assumed that a fall of the latter during 1956 was a contributing factor to the rise of borrowing by commercial banks that year. In 1959, with the sharp increase in external reserves, commercial-bank borrowing from the Bank of France declined, despite the reduction of the discount rates. During 1952-55 and from 1960 onward, when external reserves were rising substantially, the commercial banks' borrowing was roughly stable. Given the fact that the commercial banks' lending to the public increased continuously during these periods, it is clear that the rise of external reserves relieved commercial banks from the need to resort to borrowing from the Bank of France as a means of financing this credit expansion. In sum, therefore, the relationship between external reserves and Bank of France lending was unmistakable: a fall of the former led to an increase in the latter, while a rise of the former brought a fall, or prevented a rise, in the latter. In France, as in other countries, the "automatic" disadjusting effect of commercial bank borrowing from the central bank clearly seems to be operative.

Fluctuations in Bank of France claims on the government, on the other hand, apparently have no consistent relation to the balance of payments, as may be gathered from Chart 5-1 and from column 4 of Table 5-1. The most important movement of disadjusting nature took place during 1957, when this lending increased while external reserves were falling, but a positive correspondence between the movements of the two variables is found on other occasions, until about the middle of 1961. From then on, claims on the government, while sometimes fluctuating, have been relatively stable, while external reserves have risen rapidly.

The movement in total domestic claims of the Bank of France—which is primarily the combination of the previous two components—seems to follow the same trend as the Bank's lending to commercial banks. The result, as Chart 5-1 and column 5 of Table 5-1 show, is that such changes are largely in a disadjusting direction. This holds true both for shorter-term movements and for longer-term trends: at the end of 1958, external reserves were on the same level as in 1950 (while fluctuating mildly between those years), whereas the Bank of France's total domestic assets increased appreciably over that period; from 1959 to 1966, on the other hand, the latter variable remained stable, or even declined slightly, while external reserves rose substantially. The inverse relationship frequently observed between a central bank's foreign assets and its domestic assets is clear in the case of France.

Data on lending by commercial banks to the public, presented in Chart 5-1 (i.e., commercial bank private claims), are available only from 1953 and thus do not cover earlier instances of imbalance. But in subsequent years—which comprise most of the total period—the amount of commercial-bank lending does not seem to be related in any consistent way to imbalances of payments. The rate of expansion of credit was rather stable throughout, and averages for subperiods are very similar to each other. The only important deviation from the average trend occurred from the middle of 1957 to the end of 1959, when credit expansion was particularly low. This covers a period when external reserves fell sharply during 1957; a period when they fell slightly during most of 1958, and a period when they increased sharply during 1959. The decline of the rate of expansion of credit during 1957–58 was probably due to the restrictive measures of those years (including the direct control of credit during 1958), which measures, in turn, were most probably taken as a response to the imbalance of payments. But this single episode—followed immediately by a reverse relationship in 1959—would not allow one to conclude that commercial-bank lending showed a regular response to imbalances of payments.

It is worth noting, however, that during the long period of uninterrupted accumulation of external reserves in the 1960's, the rate of expansion of commercial-bank lending does seem to be correlated, in a rough way, with the *rate* of expansion of reserves. Thus, if this period is divided into two—1960–62 and 1963 through the third quarter of 1966—changes in these two variables between the two subperiods appear to be similar. The quarterly rate of expansion of external reserves declined from 7.6 per cent in 1960–62 to 3.4 per cent in 1963–66, while the rate of expansion of commercial-bank lending fell from 4.8 per cent to 2.5 per cent. The particularly fast expansion of credit during the early 1960's might have come about without the rapid accumulation of external reserves, but this accumulation enabled the banks to maintain the rapid credit expansion without borrowing from the Bank of France. During 1963–66, on the other hand, credit expansion was restricted by direct control measures. It is sometimes argued that these restrictions were due to the declining balance-of-payments surpluses and the declining rate of accumulation of external reserves. If this is true, credit policy during this period would appear to be responsive to balance-of-payments fluctuations in a manner which as-

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sumes not balance-of-payments equilibrium, but a given, high rate of accumulation of external reserves to be the external target.

Money supply clearly seems to respond to changes in external reserves in an adjusting manner. This may be observed from Chart 5-1 and from column 6 of Table 5-1. The rate of expansion of money supply was, almost invariably, positively related to the movement of reserves. The only exception is the subperiod 1952, when the rate of increase of money supply fell and external reserves increased slightly.

Table 5-3 presents episodes in which the rate of expansion of money supply deviated markedly from its trend; that is, the expansion was particularly fast or particularly slow (it was practically never negative). It may be seen that, until 1960, such episodes could be explained by the need for balance-of-payments adjustment much better than by other targets. From 1960 onward, on the other hand, none of the targets appears to provide a good explanation of the developments in this instrument variable.

Like the amount of credit, money supply in the 1960's appears to be related to the rate of accumulation of external reserves: between 1960-62 and 1963-66 the quarterly rate of expansion of money supply fell from 3.8 per cent to 2.6 per cent. This association is almost inevitable: of the three major factors which contribute to the creation

TABLE 5-3
FRANCE: SIGNIFICANT CHANGES IN MONEY SUPPLY
AND POSITION OF TARGET VARIABLES

| <i>Period</i> | <i>Rate of Increase of Money Supply (1)</i> | <i>External Reserves (2)</i> | <i>Industrial Production (rate of increase) (3)</i> | <i>Cost-of-Living Index (rate of increase) (4)</i> |
|---------------------|---|--------------------------------------|---|--|
| II 1951 - II 1952 | low | + fall | + high | + high |
| I 1956 - III 1958 | low | + fall | * normal | * fluctuates |
| III 1958 - III 1960 | high | + rise | * normal | * normal |
| I 1961 - IV 1961 | low | - rise | * normal | * normal |
| IV 1961 - IV 1962 | high | + rise | * normal | + low |
| I 1964 - IV 1965 | low | - rise | - low | - low |

NOTE: For explanation of symbols, see Chapter 3, explanatory note.

of money, the stock of the central bank's net lending to the government was found to be rather stable during the 1960's, while the rate of expansion of commercial-bank credit and the rate of accumulation of external reserves—the other two major factors which determine money supply—moved, as has just been observed, in the same direction. The association of the rate of increase of money supply with the rate of accumulation of external reserves during the 1960's is similar to its aforementioned association with credit supply.

Movements of the budgetary deficit, which are represented in Chart 5-1 and in column 7 of Table 5-1, do not seem to have any consistent relationship to imbalances of payments. This would also be true if the deficit were calculated not in absolute terms but, say, as a ratio of the size of the budget, or of the national product. As has been explained before, the size of the budgetary cash deficit in France does not represent the government's excess demand for goods and services. Since data on this excess demand are not readily available, no presumption about its relationship to balance-of-payments adjustment can be offered. From Table 5-4, which lists episodes in which the budgetary deficit was clearly rising or falling, it appears that no alternative target could explain the movements of the budgetary deficit. A comparison of columns 4 and 7 in Table 5-1, or the corresponding series in Chart 5-1, will also show no consistency in the movements of the budgetary deficit

TABLE 5-4

FRANCE: THE BUDGETARY BALANCE AND POSITIONS
OF TARGET VARIABLES

| <i>Period</i> | <i>Budgetary Deficit</i> | <i>External Reserves</i> | <i>Industrial Production (rate of increase)</i> | <i>Cost-of-Living Index (rate of increase)</i> |
|---------------------|------------------------------|------------------------------|---|--|
| | (1) | (2) | (3) | (4) |
| II 1951 - II 1953 | high | * no trend | + low | * fluctuates |
| I 1955 - III 1956 | high | * no trend | - high | + low |
| III 1957 - III 1961 | low | - rise | * normal | * fluctuates |
| III 1961 - III 1963 | high | + rise | * normal | * normal |
| III 1963 - IV 1965 | low | - rise | - low | - low |

NOTE: For explanation of symbols, see Chapter 3, explanatory note.

and of the government's borrowing from the Bank of France. This illustrates the point made earlier, that the government's cash position in France is affected significantly by components other than the budgetary deficits.

3. Summary and Interpretation

In examining policy patterns in France, a distinction should be made between the 1950's, a period of fluctuations in the balance of payments, and the 1960's, a period of consistent surpluses and continuous accumulation of external reserves.

During the 1950's, a consistent response to imbalances of payments is evident, and a regular pattern emerges. In the event of a deficit or a fall of reserves, the discount rate is raised. Such changes in the discount rate are the most important measure of over-all discount policy, which is, in turn, the major instrument of monetary policy. In addition to the basic discount rate, the penalty rates may also be raised in response to the deficit of payments. During the substantial downward movement of 1957, the discount quota was lowered significantly, as an added measure. The contractionary discount policy is not associated, however, with a contraction of commercial-bank borrowing from the Bank of France. In itself, the discount policy must obviously have this contractionary effect, as is clearly revealed by the movements of commercial-bank borrowing which follow the discount policy measures. But this would only partly offset the tendency of banks to increase their borrowing from the Bank of France during a period of falling external reserves, in order to overcome the reduction of their lending capacity which the fall of reserves must involve. In such a period, commercial banks' borrowing from the Bank of France increases, rather than diminishes: the rise of demand for this lending more than offsets the increase in its cost. In France, as in other countries, one encounters the paradox of increased bank borrowing from the central bank at times of a rise in the discount rate.

Bank-of-France lending to the government does not seem to respond in a consistent manner to a balance-of-payments deficit. Movements of total domestic assets thus tend, following the movement of the Bank's lending to commercial banks, to be in a disadjusting direction: when the Bank of France loses external assets its domestic assets tend to rise

fast, whereas at other times they tend to be stable or to rise only slowly.

Commercial-bank lending to the public does not reveal any consistent pattern. This, as has just been mentioned, is true also for the Bank of France's net lending to the government. These two components participate, along with external reserves, in determining the size of money supply. Since the first two components do not as a rule contradict the movement of external reserves, the rate of expansion of money supply is correlated with the latter: in times of declines of reserves, this rate falls.

For this period, no asymmetry between upward and downward imbalances is evident: when external reserves rise, the opposite pattern appears. Therefore, it may be said that the discount rate—or discount policy in general—was manipulated, as a rule, in an adjusting direction. The rate of expansion of money supply also moved in an adjusting direction during this period whereas total domestic assets of the central bank behaved in a disadjusting manner. The latter phenomenon conforms to the findings by Nürkse and by Bloomfield on the assets of the central bank. By the Nürkse criterion, this monetary policy would then be classified as one which contradicts the "rules of the game." On the other hand, by the definition which employs the variables of the discount rate and the money supply, this pattern would be described as one which follows the "rules" rather consistently.

While consistency of the pattern during the 1950's seems evident, it cannot be ascertained whether the movements of the policy variables were indeed a response to the needs of the balance of payments. The movements, it was observed, could be interpreted almost as well as being directed by the "domestic" target of price stability. During the 1950's in France, these two targets usually appear to require the same policy response rather than to have contradicting requirements. This would suggest, in turn, that balance-of-payments fluctuations were normally due to changes in internal circumstances—and, presumably, to internal policy measures—rather than to external changes: balance-of-payments deficits went along with domestic inflation and price rises, whereas balance-of-payments surpluses were accompanied by domestic contraction and price stability.

Unlike monetary policy, fiscal policy does not reveal any consistent pattern of reaction, either by itself or in some "mix" with monetary policy. It does not appear that this was due to the employment of fiscal policy in the service of some other major target; this is not a surprising

finding in view of the observation that other targets did not usually require measures opposite to those intended to bring about balance-of-payments equilibrium. Fiscal policy might, of course, have been aimed at some other target not examined in the study. It must also be remembered that data on the cash budgetary deficit, which were used to identify budgetary policy, may not have been on many occasions even a good approximation of the size of the government's excess demand. Thus, it is conceivable that more relevant data, if available, would have revealed some other pattern.

During the period extending from 1960 or, perhaps, 1959 to the third quarter of 1966, the pattern is significantly different. External reserves kept rising during these years at a very substantial rate. A monetary policy responsive to the need for balance-of-payments equilibrium should have been generally expansionary. Actual policy might be interpreted to have been such, but the evidence is not clear-cut. The discount rate was kept rather stable, instead of being lowered, and the two slight variations in it cannot be interpreted as having been motivated by balance-of-payments developments. Moreover, the level of the discount rate over this period as a whole was not lower than its average level in the preceding years, as an adjusting policy would have required. In relation to discount rates elsewhere, on the other hand, the discount rate does appear to have been lowered. The rate of increase of money supply seems to be roughly correlated with the rate of accumulation of external reserves—the two are considerably higher during 1960–62 than during 1963–66. But the average rate of expansion of money over this period of rising reserves as a whole is roughly equal to its rate of expansion during 1951–58, when no over-all trend of increase of external reserves existed. In these years, the only variable whose pattern of movement appeared to be similar to that observed for it in earlier years was the Bank of France's total domestic assets (and as part of it, the Bank's lending to commercial banks): it remained stable during the rapid increase of external reserves, while it increased substantially in the earlier period in which no over-all increase of reserves took place. This is yet another demonstration of the generally negative correlation between the two parts of the central bank's assets.

The conclusion that emerges is that monetary policy during this period was not meant to adjust the upward imbalance of payments. Nor does fiscal policy seem to have been used for this purpose: the budgetary deficit for these years was, on the average, smaller even in

absolute terms than in the earlier period. Claims of alternative targets which have been examined do not seem to explain this lack of response of the policy variables. It is conceivable, of course, that other target variables, not observed here, could provide the explanation. But it seems more likely that the continuous and substantial accumulation of reserves during the 1960's was not considered a disturbance which should be corrected. It might even have been regarded as a desirable target. The fact that the rates of expansion of money and credit appear to be roughly correlated with the rate of accumulation of external reserves gives added credibility to the assumption that a high rate of accumulation of reserves was indeed a policy target during these years.

In this connection mention should be made of the French devaluations of 1957 and 1958. Both, unlike the changes in the rate of exchange in Germany and the Netherlands in 1961, were rather substantial: the first, taken in a few steps during the latter half of 1957, brought the rate of exchange from 350 to 420 (old) francs per dollar—an increase of 20 per cent; and the second, taken at the very end of 1958, raised the rate further to 490 francs per dollar—an increase of about 17 per cent. The first devaluation was taken at a time when external reserves were very low and still falling rapidly, and at about the same time as a contractionary monetary policy was undertaken. It may certainly be regarded as intended to adjust the balance of payments. The second devaluation, on the other hand, came at a period in which a balance had already been achieved. This devaluation might have been due to a fear that stability was only temporary and further deterioration likely. While this is a possible explanation, it is not supported by the fact that, by that time, discount policy had already become expansionary. It seems more likely that the devaluation was in fact caused by the low *level* of reserves, and was intended to raise that level. It may have been related also to the need to insure the success of external convertibility, undertaken in conjunction with devaluation.

The situation in France during the 1960's is thus very similar to that of Germany during the 1950's: the two countries may be said to have exchanged their roles around the late 1950's. In both situations, a devaluation (in Germany, that of 1949) is followed by a substantial, long, and uninterrupted accumulation of reserves; by the yardstick of maintenance of equilibrium in the balance of payments, the currency is undervalued. Yet no policy is undertaken to reverse this situation, apparently because it seems desirable. It may also be mentioned that a

remarkable similarity exists between the situation in France during the 1960's and from 1926 to the early 1930's.⁴ In 1926, too, the rate of exchange was determined (following a period of a fluctuating rate) at too high a level, and reserves started to accumulate rapidly.⁵ Thus, as in the 1960's, this accumulation was apparently deemed desirable, and possibly even intended when the rate of exchange was determined.

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⁴ See Nurkse, *op. cit. passim*.

⁵ Even the developments of the composition of reserves seem to be similar, in a very rough way, in the two episodes: first came a rise in both foreign exchange and gold; then the former stabilized, but not the latter; eventually, the amount of foreign-exchange was reduced, while the amount of gold kept rising at a rapid rate.