

## The Abolition of Official Minimum Loan Rates in French Banking <sup>(1)</sup>

In 1965 the French authorities introduced the first of a series of changes designed to reform the structure and operations of the French banking system. One of the most widely-heralded reforms was the abolition (on March 18, 1966) of the official minimum loan rate on discounts and advances (2). As the floor rate on bank loans had been a key element in the pre-reform regulatory structure, its elimination has been widely acclaimed as a major move towards greater competition in French banking. It is the purpose of this paper to evaluate the probable market impact of that reform.

Whether the abolition of the minimum loan rate *per se* is likely to unleash a significant amount of competition to reduce loan rates depends on two key questions: (1) How strong are the competitive forces in French banking? and (2) To what extent (if any) did the existence of an official floor rate impede interbank competition? To answer these questions, this paper examines both the market structure and market behavior (in terms of loan rates) of French short-term business loan markets. Part I analyses the market structure of loan markets in France both before and after two recent major reforms of the banking structure. Part II examines market behavior under the minimum loan rate and shows the relation of minimum loan rates to actual loan rates, to competitive loan rates, and to the rates that probably would have prevailed if there had been no official loan rate controls.

(1) I am indebted to the Ford Foundation for financial support and to a number of individuals in French banks, Association Professionnelle des Banques, and the Bank of France for extensive discussions about French banking.

(2) Cf. Banque de France, *Compte Rendu des Opérations*, 1965, p. 31.

### I. Market Structure of Loan Markets

#### *Before the reforms of the banking structure*

The market boundaries of short-term business loan markets are determined by the mobility of bankers and borrowers. A bank's geographical mobility is generally confined to the area (or areas) in which it is located. In France, the large nationalized banks, with their nationwide branch systems, are located in virtually all parts of the country whereas the Regional Banks and Local Banks are located (as their category names suggest) in particular regional or local areas. Moreover, the Regional Banks generally operate in non-overlapping areas. Borrower mobility also affects the market boundaries of the short-term business loan markets. As borrower mobility is strongly associated with borrower size, large and small borrower markets are discussed separately.

*Loan market for large borrowers.* Because the largest business firms typically have very high credit ratings which are usually widely known, they have access to banks in any part of the country. However, the large business firms do not have to go all over the country for their funds because the major banks (which are their natural suppliers) are mostly located in Paris or have a Paris office. Hence, it is sufficient for large borrowers to exercise their mobility primarily among the banks with Paris offices.

The commercial bank alternatives available to large borrowers are the *établissements de crédit*, Paris Deposit Banks, Foreign Banks, and Regional Banks. The nationalized *établissements de crédit* are the dominant suppliers in this group. In 1964, a typical year in terms of the pre-reform banking structure, they supplied 51.5 billion F of short-term credits out of a total of 75.2 billion F for the entire group (3). This high level of concentration was modified by the addition of the short-term credit facilities supplied by the *Banques d'Affaires*. The 46 *Banques d'Affaires* significantly increased not only the number of alternative sources in Paris, but also the total supply of short-term credit. In 1964, they supplied 9.3 billion F, or

(3) Computed from *Bilans des Banques*, 1964. These figures (and those cited in Table 1) can only suggest the extent of concentration in the large borrower short-term loan market. These figures are not limited to business short-term credits but include total short-term credit; and they are not restricted to credits to large business firms.

18 per cent as much as the large nationalized banks (4). On the other hand, the *Banques d'Affaires* did not dilute market concentration for all large borrowers since they were inclined to reserve their short-term credit facilities for customers to whom they also provided long-term investment financing. In fact, a good deal of their short-term lending was extended in connection with longer-term financing. However, even if all large borrowers had access to the resources of the *Banques d'Affaires*, market concentration in the large borrower market would have been high because of the vast size differences among the bank suppliers. In 1964, almost half (49 per cent) of the major suppliers of short-term business credit to large borrowers held slightly more than 2 per cent of the resources of the entire group whereas 2½ per cent of the banks (consisting of four giant banks, each with more than 5 billion F resources) held 56 per cent of the group's resources (Table 1).

The significance of this comparatively high level of concentration is enhanced by the fact that self-financing (which was an important source of funds for large firms before the war) has sharply declined. On the other hand, the market concentration in terms of domestic suppliers of short-term business credit is moderated for some large borrowers by their access to sources of loan supply outside of France. However, this moderating influence is contingent upon the absence of official restrictions on borrowing abroad and upon the borrower's ability to tap foreign suppliers directly instead of through the intermediation of either domestic banks or foreign-owned banks or branches that are located in France. In practice, this moderating influence has not been fully effective because French companies could not borrow foreign currencies except by permission of the authorities — and this permission was granted only to a restricted class of companies (e.g., major importing companies, oil companies, and some companies engaged in exporting) (5).

(4) Cf. *ibid.* For reasons explained in the preceding footnote, these figures, too, are mostly suggestive. They do not refer exclusively to short-term *business* lending as they are the sum of *portefeuille effets* (which includes short-term lending to the Treasury as well as "*aures effets*"), *avances, garanties, and comptes courants*.

(5) Cf. OSCAR L. ALTMAN, "Recent Developments in Foreign Markets for Dollars and Other Currencies", in Joint Economic Committee, *Factors Affecting the United States Balance of Payments* (Washington, 1962), p. 507. The Government exercises this control under Decree 47-1337 of July 15, 1947, which provided that "Any natural person having his usual residence in France, any French juridical person or any foreign juridical person insofar as its agencies in France are concerned, shall be forbidden, except upon authorization of the Minister

TABLE I

CONCENTRATION OF RESOURCES AMONG SUPPLIERS OF SHORT-TERM BUSINESS CREDIT TO LARGE BORROWERS, END OF 1964 \*

Size Class (Resources) (million F)	B a n k s		Banking Resources	
	Number	Per cent	Amount (million F)	Per cent
Under 20 . . . . .	34	19.4	340	0.3
20-50 . . . . .	34	19.4	1,155	1.0
50-100 . . . . .	26	14.8	1,719	1.5
100-200 . . . . .	25	14.3	3,740	3.3
200-300 . . . . .	17	9.7	4,170	3.6
300-500 . . . . .	13	7.4	5,145	4.5
500-1,000 . . . . .	8	4.6	5,391	4.7
1,000-2,000 . . . . .	9	5.1	12,470	10.9
2,000-5,000 . . . . .	5	2.9	15,823	13.8
5,000-16,000 . . . . .	2	1.1	23,937	20.9
over 16,000 . . . . .	2	1.1	40,487	35.4
Total . . . . .	175	99.8	114,377	99.9

\* Source: Compiled from data in *Bilans des Banques, 1964*. The Banks included in this table are the Etablissements de Crédit, Paris Deposit Banks, Regional Banks, Foreign Banks, and Banques d'Affaires. (The private Banques d'Affaires were not included because individual bank figures are not available. However, the combined resources of the entire group were only 1.5 billion F).

The effective level of market concentration among the domestic suppliers of short-term business credit has been raised by institutional arrangements in connection with syndicated loans (*crédits consortiaux*; also known as *crédits syndicaux* or *crédits collectifs*). Syndicated loans in France seem to have originated during the depression years of the thirties. The banks were disturbed by the fact that a business firm which needed large amounts of credit could (and commonly did) borrow from several banks but without necessarily notifying each bank lender about its indebtedness to other banks. In many cases, bankers did not find out about these other debts until they were called to a creditors' meeting after a customer had asked for a debt moratorium (6). To avoid these difficulties, bankers got together

of Finance, to enter into a contract with a party... when the obligations originating from said contract would be stipulated in terms of a currency other than the franc", (Art. 59). Cited in *idem.* Cf. also OECD, *European Monetary Agreement, 1963*, p. 77.

(6) Cf. GEORGES PETIT-DUTAILLIS, *Le Crédit et les Banques* (Paris, 1964), p. 134.

on syndicated loans in which the number of participating banks and the amount of each bank's loan were arranged in advance.

In one of its first acts, the *Conseil National de Crédit* (CNC) established a *Service Central des Risques* (7), and required the banks to inform the central risk bureau of the amount of all loans above a certain size together with the borrower's name. With this information, the risk bureau was able to tell prospective bank lenders how much a prospective borrower already owed to other banks. The CNC hoped this would eliminate the difficulties that had arisen in the past from inadequate banker information, and that it would also curb the temptation of borrowers to spread their borrowing among a large number of banks (8). Although the establishment of the *Service Central des Risques* removed the original reason which led banks to make syndicated loans, they continued to do so for other reasons. First, syndication provided a banker with risk diversification on large loans. Secondly, many bankers felt that it would be more efficient to have a single bank (known as the *chef de file*) handle a large loan for an entire group of participating banks (9). Thirdly, the CNC had ruled that all bank loans above a certain size to a single borrower could be granted only with the prior authorization of the Bank of France (10). Since the decree specifically stated that it made no difference whether the minimum credit was granted by one or several banks, it behoved the banks to syndicate large loans not only to facilitate the procedure of securing the "prior authorization" but also to protect themselves against inadvertent violations of the decree.

Loans to the nationalized enterprises, the metallurgical firms, and the large public works firms are almost always syndicated (11). The nationalized enterprises do not restrict their bank dealings to

(7) Cf. CNC, *Rapport Annuel*, 1946, p. 167.

(8) This practice disturbed the CNC which feared that such dispersion could be dangerous in a crisis. Cf. CNC, *Rapport Annuel*, 1947, p. 22.

(9) However, the participating bankers must "tell all" to the *chef de file*, and some bankers consider this a severe disadvantage of syndicated lending, especially since the *chef de file* often does not reciprocate and give full information about the operation of the account to the participating banks. Cf. JACQUES FERRONIERE, *Les Opérations de Banque* (Paris, 1954), p. 227.

(10) Cf. CNC, *Annexes au Rapport Annuel*, 1947, p. 21. Under this requirement (originally promulgated as a *décision de caractère général*, January 9, 1947), credits of at least 30 million francs to a single borrower, whether made by one or several banks, required the prior approval of the Bank of France. (Cf. Article 4).

(11) Cf. FERRONIERE, *op. cit.*, p. 227.

the nationalized banks, and the principal non-nationalized banks often join the nationalized banks in arranging syndicated loans to the nationalized enterprises (12). Since syndicated credits (13) are particularly common for medium-term credits, commercial banks also join with *Banques d'Affaires* to make such loans (14). Syndicated credits are also employed for short-term credits (15) but less than for medium-term credits.

In a market analysis, it is useful to distinguish two variations of the syndicated loan. In the *crédits consortiaux* proper, all arrangements and negotiations with the borrowers are handled by a *chef de file* on behalf of the *pool bancaire*. In a *crédit concerté* (also called *crédit global*), each bank is allotted a participation in the loan but, within that limit, the borrower can negotiate other details with each banker (16). In the case of a large firm which is controlled by a bank (usually a *Banque d'Affaire*) which directly or indirectly owns or controls its shares, the controlling bank is automatically the *chef de file* and handles all financial arrangements for the firm. In other cases, bank control is not involved. However, once a large firm has established a relationship with a particular bank as its *chef de file*, the relationship tends to be perpetuated by a tacit understanding among the other banks in the syndicate. If a large firm (other than a firm that had been taken over by a bank which purchased its shares) tried to change its *chef de file*, it would be difficult and perhaps impossible to find another bank to assume the role. If by some chance the firm did find another *chef de file*, the other banks in the syndicate would express their solidarity by refusing to remain in the pool (17). This extremely powerful banker-customer relationship operates in both directions, and a bank *chef de file* is stuck with its borrowing customer just as much as the reverse. Moreover, the bankers' sense of obligation to accommodate old customers appears to extend even to the member banks of a pool, and they

(12) Cf. J. S. G. WILSON, *French Banking Structure and Credit Policy* (London, 1957), p. 29, note 11.

(13) Syndicated credits can be granted in any of the technical forms used for bank lending, but the *avance* form (an overdraft which is granted at one time and which is due on a given maturity date) is particularly common. Cf. FERRONIERE, *op. cit.*, p. 227.

(14) Cf. PHILIPPE AYMARD, *La Banque et l'Etat* (Paris, 1960), p. 109. They are also common among *Banques d'Affaires* for investment financing. (Cf. WILSON, *op. cit.*, p. 118).

(15) PETIT-DUTAILLIS, *op. cit.*, p. 134, and PIERRE CAUBOUÉ, *Monnaie, Crédit, Banque* (Paris, 1959), p. 104.

(16) Cf. *ibid.*, p. 227, or PETIT-DUTAILLIS, *op. cit.*, p. 134.

(17) Cf. PIERRE CAUBOUÉ, *Le Chef d'Entreprise et ses Banquiers* (Paris), p. 45.

will take a share (but perhaps a reduced share) in the pool even when they prefer to be left out entirely (18).

It follows from what has been said above that the practice of loan syndication can increase the effective concentration in the large borrower loan market. Loan syndication in the form of a *crédit consortial* drastically impairs, if it does not completely eliminate, large borrower mobility among the bank suppliers in the large loan market; loan syndication in the form of a *crédit global* does not. In short, there is a comparatively high level of concentration in the non-syndicated sector of the large borrower market and an exceptionally high concentration in the syndicated sector (especially for *crédits consortiaux*).

*Loan market for small borrowers.* An excellent credit rating can assure wide-ranging mobility for the large but not for the small borrowers. In the usual case, a small borrower, even if he is an excellent credit risk, is not known beyond his local area of operations, and it is difficult for a banker in a distant area, unfamiliar with the relevant local circumstances, to appraise the small borrower's situation. For these and related reasons, a small borrower (including one with an excellent credit rating) is typically restricted to alternatives in his local (or nearby) area where he and his operations are known to local lenders.

In each local area, the number of banks which supply short-term business credit is not always equal to the number of effective alternative suppliers for the small business borrowers in that area. In the Paris small borrower market, the 71 Paris Deposit Banks would have to be excluded for they tended to concentrate their loan operations on large customers with whom they had long-standing relationships. By and large, the Foreign Banks would also have to be excluded for they tended to concentrate on financing the trade relations of their own nationals with their home countries. For the most part, the *Banques d'Affaires* also were not important suppliers of short-term credit to small business firms.

It is doubtful whether the *établissements de crédit* ought to be included among the suppliers of short-term business credit to small business either in Paris or in other towns and cities, because it is doubtful whether the large banks were very interested in serving the credit needs of small business. Before the Second World War

(18) Cf. *idem*.

they paid little attention to small customers (19); in the postwar years, they exhibited a much greater interest. This change was motivated by a number of considerations (20). First, it was difficult (for reasons explained earlier) for large banks to attract large customers away from their existing banking connections. Secondly, small (and medium-size) borrowers typically paid higher loan rates than large borrowers even when their credit risk was equal (and sometimes superior). Thirdly, lending to small business provided risk diversification in the large banks' portfolios. Notwithstanding these considerations, there remains a real question about how far the large banks had altered their historic attitudes about lending to small business. Accordingly, the inclusion of the *établissements de crédit* among the possible suppliers for the tabulation in Table 2 (21) errs on the side of overstating rather than understating the alternatives in the small borrower markets.

The Regional Banks were included as prospective suppliers and, of course, the numerous Local Banks (with their particular concentration on the business of small, local customers) were also included. The Agricultural Banks were excluded because this paper is concerned with short-term business loans, not agricultural loans. Finally, the Popular Banks were included in the list of prospective suppliers because, in keeping with the purpose for which they were originally established, they concentrate on loans to small- and medium-size firms (22).

It is important to stress that the list of banks included in Table 2 describes the maximum number of (bank) alternatives available to small borrowers as a group. Due to inherent limitations on small borrower mobility (sometimes supplemented by self-imposed restrictions on lender mobility), some small borrowers do not have full mobility among all of the suppliers even in this selected list of small borrower suppliers.

(19) Cf. statement of Christian Pineau at the October, 1937 *VI<sup>e</sup> Congrès International de Science et de Technique Bancaires* in Paris. (Cf. *ibid.*, p. 12).

(20) Cf. *ibid.*, -pp. 52-53.

(21) The tabulation in Table 2 contains an overstatement in terms of present alternatives because the BNP merger was not included in the count (which was based on 1961 figures).

(22) As the authorities do not get full information about smaller loans from the Service Central des Risques, they have on occasion regarded the volume of loans granted by the Popular Banks as an important clue to the total amount of credit granted to small- and medium-size business firms. (Cf. CNC, *Annexes au Rapport Annuel*, 1949, p. 108).

In 1961, 1,348 towns and cities in France had one banking office or more of one or more of the banks included above as suppliers of short-term credit to small business. Table 2 shows how the number of "banks" (23) was distributed in cities and towns other than Paris. Almost 42 per cent of those local areas had only one

TABLE 2  
NUMBER OF SUPPLIERS OF SHORT-TERM BUSINESS CREDIT  
TO SMALL BORROWERS, FRANCE, 1961 \*

Number of "Banks" in Town or City	Number of Towns or Cities	Per cent of all Towns or Cities with a "Bank"
1	556	41.2
2	308	22.8
3	166	12.3
4	109	8.1
5	69	5.1
6	63	4.7
7	40	3.0
8	20	1.5
9	9	**
10	1	**
11	1	**
13	1	**
16	2	**
19	1	**
Total	1,346***	98.7

\* Source: Association Professionnelle des Banques, *Répertoire Par Localités* (des guichets permanents en France métropolitaine), 1961. Multiple offices of the same bank were not counted as separate "banks" if they were in the same town or city. The banks included in this table are the *établissements de crédit*, Regional Banks, Local Banks, and Popular Banks.

\*\* Less than 1 percent.

\*\*\* Excludes Paris.

"bank"; almost 23 per cent had only two "banks"; almost 85 per cent had four or fewer "banks"; almost 95 per cent had six or fewer "banks"; and almost 99 per cent of the localities had eight or fewer "banks". Only four cities (excluding Paris) have a somewhat larger number of "banks" and, in those cities, the range is

(23) The term "bank" as used in connection with Table 2 refers to independent alternatives only. Thus, multiple branches of the same bank in a town or city were counted as one "bank".

only from 13 to 19. Thus, the overwhelming majority of French towns and cities which have banks are at best oligopolistically structured.

The extent of small borrower market concentration in most of those cities is probably not fully suggested by the limited number of alternatives available since banking resources (in the towns with more than one "bank") are not equally distributed among a bank population that may consist of tiny Local Banks, small Popular Banks, and branches of giant national or large Regional Banks. In addition, as noted above, the large branch banks have not been fully interested in cultivating their small business loans. In short, in 99 per cent of the towns and cities with banks, the market structures of the small business loan markets have been too concentrated to ensure competitive behavior in small business loan markets — and the market position of most of those banks was not seriously threatened by potential entry. For similar reasons, it is doubtful whether market structures have been sufficiently unconcentrated to ensure competitive behavior even in the large cities where there are a large number of "banks". However, in the absence of figures on loan volume to small borrowers by different banks in each city, the point is moot.

#### *After the reforms of the banking structure*

The two major reforms of the banking structure that could (directly) affect the market structure of loan markets were the Banque Nationale de Paris (BNP) merger in 1966, and the liberalization of entry restrictions in 1967. The BNP merger unambiguously increased market concentration in the large borrower market. As shown earlier (Table 1), before the BNP merger almost half of the major suppliers of short-term business credit to large borrowers held slightly more than 2 per cent of the resources of the entire group, and 2½ per cent of the banks (the four giant banks, each with more than 5 billion F resources) held 56 per cent of the group's resources. The BNP merger raised this comparatively high level of bank concentration among the suppliers of short-term business credit to large borrowers because the new Banque Nationale de Paris was formed by a merger of two banks that had been in the top group of banks, viz., Banque Nationale pour le Commerce et l'Industrie (BNCI) and Comptoir National d'Escompte de Paris (CNEP).

By eliminating an independent source of supply, the BNP merger also raised concentration in numerous local (i.e., small borrower) markets where the BNCI and CNEP both had offices. However, the full effect of the nominal reduction depends on the extent to which the merged banks had cultivated their small borrower business and how much interest will be shown in small borrowers by the BNP. At present, there is no information on the former (i.e., no public figures on loan volume to small borrowers by different banks in each city) and it is too soon to have reliable information on the latter.

On January 10, 1967, the CNC removed the restrictions on branch entry by existing banks. This has no direct effect on the market structure of the large borrower market: it may lead to a larger number of banking offices; but, as large borrowers have access to suppliers all over the country, it will not increase the number of independent bank alternatives available to large borrowers. The new entry policy could conceivably have an indirect effect on the market structure of the large borrower loan market if it led to a change in the concentration of banking resources among the major lenders in the short-term business loan market.

In the small borrower markets, the effect of the more liberal entry provisions will depend upon the resulting amount of actual (or potential) *effective* entry into those markets. It is important to stress that free branching for existing banks is by no means the equivalent of the theoretical concept of free entry. Thus, in any given small borrower market, additional entry by banks already represented in that market would increase the number of banking offices, but it would not increase the number of effective alternatives available to small borrowers in that market. The latter would require entry by banks which are not already represented in that local market.

The possible entrants into small borrower markets are *établissements de crédit*, regional banks, small unit banks from nearby localities, Popular Banks, and *Banques d'Affaires*. There is very little scope left for the nationalized *établissements de crédit* to increase the number of effective alternatives in local markets because the three banking giants already have nationwide networks of branches. It is also doubtful whether the non-nationalized *établissements de crédit* — there are only four of them — will add to the number of effective alternatives in a significant number of local areas because

of their concern about growing too large and becoming candidates for nationalization.

As for the Regional Banks, they have traditionally maintained a strong identification with their respective regions and have generally confined their operations to non-overlapping areas. Moreover, there are only 22 Regional Banks in the entire country. Thus, if they are to make a significant impact in local markets in all parts of the country, the majority of those banks would have to abandon their traditional regional character and consciously embark on a policy of nationwide branch banking with the attendant risk of growing too large and being nationalized.

It is also unlikely that there will be much effective entry by the small unit banks in each locality because any branch expansion by Local Banks is likely to be confined to the same (or a nearby) locality. The Popular Banks, too, are not a likely source of a significant amount of effective entry into local markets for they are already widely distributed throughout the country.

Finally, while there will doubtless be some branch expansion by the *Banques d'Affaires*, there is not likely to be a significant amount of effective entry in a large number of local markets. In part, this is because most investment banks are small and are neither able to undertake nor are interested in undertaking widespread branch expansion. Moreover, they are virtually all located in Paris and any branch expansion is more likely to mean a duplication of existing facilities within the Paris region than a branching into distant parts of the country. In addition, the principal investment banks (i.e., the most likely prospects for extensive branch expansion into more distant areas) have established closer links with the commercial banks (24) (e.g., loan agreements, reciprocal exchange of shares and directors, etc.) and this (together with their fear of nationalization if they become too large) (25) may impair their incentive to seek additional funds by opening new branches.

In sum, it is most likely that any additional entry under the 1967 entry liberalization (i.e., entry in excess of the amount that would have been authorized even before the 1967 reforms) will take

(24) For example, the Banque de Paris et des Pays-Bas with the Crédit Industriel et Commercial, and the Banque de l'Union Parisienne with the Compagnie Française. Cf. *Le Monde*, January 5, 1967, p. 16. Cf. also R. J. TRUPPIE and H. VIAUX, "Changes in French Banking", *The Banker*, April, 1967, p. 317.

(25) Cf. "De Gaulle Tackles the Banks", *Economist*, November 26, 1966, p. xix.

place primarily in areas that already have banks (especially Paris) (26) and will be undertaken by banks that are already represented in those local markets. Thus, as far as most small borrowers are concerned, the possible increase in branch entry will not increase effective entry by a corresponding amount.

## II. Market Behavior in Loan Markets

### *Relation between minimum rates and actual loan rates*

From the inception of the CNC in 1945 and until (the effective date of) April 1, 1966, French banks operated subject to a CNC-imposed minimum loan rate. Although there are no published statistics about the rates paid by borrowers for short-term business credit from banks, informed observers of French banking agree that banks used to charge their large prime borrowers the minimum rate permitted by the CNC on short-term credits (27). Moreover, this was as true of syndicated as of non-syndicated loans (28).

It is implicit in the banking literature (and it was also the view of the French bankers and officials interviewed by the author) that this behavior was due to the "keen competition among the banks". There is an initial plausibility to this view for it is consistent with the fact that the CNC set the minimum loan rates but permitted competition to determine actual loan rates. Since large borrowers typically paid the minimum rate, the action of interbank competition would appear to be confirmed.

In spite of its widespread acceptance, the "keen competition" hypothesis is very doubtful for it rests on the twin assumptions that the "keen competition" was due to the large number of banks (almost 359 *Banques Inscrites*) and to their strong competitive spirit. Neither assumption is convincing. First, the large number of banks in France does not mean that the large borrower short-term loan market is atomistic. As shown earlier, the non-syndicated sector of this market is concentrated in a few very large banks, and the

(26) Cf. *Le Monde*, January 5, 1967, p. 16.

(27) For a typical expression of this view, cf. PIERRE CAUBOUÉ, "Competition among Banks in France and the Fixing of their Rates", *Banca Nazionale del Lavoro Quarterly Review*, June, 1955, p. 95; or CAUBOUÉ, *Le Chef d'Entreprise et ses Banquiers*, op. cit., p. 54.

(28) CAUBOUÉ, *Le Chef d'Entreprise et ses Banquiers*, op. cit., p. 47.

syndicated sector (especially for *crédits consortiaux*) is even more highly concentrated. Indeed, the syndicated sector borders upon the monopolistic for some borrowers because bank understandings seriously impair their mobility in seeking alternative syndicate suppliers or a different *chef de file*. Secondly, in spite of the alleged strength of their competitive spirit, the bankers have often restrained their competitive inclinations. Thus, even before the CNC existed, the large banks had organized the *Union Syndicale des Banques* to restrain bank competition. Similarly, the banks' competitive spirit did not deter them from coming to understandings and gentlemen's agreements about dividing areas for new branches or about refusing to deal with a borrower who wanted to change his *chef de file*, etc. Moreover, in spite of their opposition to some of the CNC's rate actions, the banks generally accepted and supported the CNC regulations aimed at curbing bank competition.

The history of competition curbs in French banking suggests that rate rivalry in the large borrower market, sufficient to bring rates down to their legal minimum levels, was not due to the fact that large banks were unaware of or indifferent to their oligopolistic interdependence. On the contrary, it is clear that the oligopolists behaved in a "competitive" manner (in the prime loan market) in spite of their recognized mutual dependence. Indeed, they offered the minimum rates to their best borrowers even when they believed that the CNC minimum rates were too low to meet the banks' legitimate earnings needs. A hypothesis which fits these facts is not that the banks were blinded by their competitive spirit from recognizing their mutual dependence but that they were motivated by the psychological prod of the overhanging authority of the Government. The weight of this authority is very great in a country where the largest banks have been nationalized, where the CNC has been authorized to recommend further nationalization if desirable, and where the Government has left no doubt about its determination to harness the credit mechanism to accomplish its economic goals (29). Under these circumstances, a reduction in the official

(29) The weight of Government controls led Aymard to question whether French banking would "remain a commercial profession operating within a capitalist structure and governed by the law of profit? Or is it gradually being transformed into a *banking function*, exercised in the superior interest of the collectivity, subordinated to the demands ever more precise of economic policy and in which the spirit of public service prevails over the driving power of individual profit?". Cf. AYMARD, op. cit., p. 282.

minimum loan rate would not be interpreted simply as permission for lower rates but as an indication of the rate levels desired by an organ of great actual (and even greater potential) authority to enforce its views. As a result, even when they bitterly opposed the necessity to do so, the oligopolists granted the official minimum rate to the largest borrowers of highest credit standing.

A number of considerations reinforce the credibility of the preceding hypothesis. First, the banks' bitter opposition to certain reductions in the official minimum rates (30) is better understood, given the oligopolistic structure of the large borrower market, if the minimum is interpreted as tantamount to a mandatory rather than a limit rate. Secondly, until the CNC reversed its policy in 1966, its actions were consistent with the interpretation that it would have been willing, insofar as it was feasible, to fix loan rates much as it fixed certain commissions. Its efforts to set the minimum loan rates at certain levels in spite of vigorous bank opposition appear to have been aimed at this goal at least as far as prime borrowers are concerned. The matter is more complicated for the other borrowers because loan risk must be evaluated on a case-by-case basis. Presumably, that is why the CNC in effect stipulated only a prime rate and then added that "the rates and conditions applicable to credit operations... can be increased by the banks *as a function of risks incurred*" (31). Thirdly, it would not have been possible for the banks to ignore the minimum rate for large prime borrowers and escape CNC notice. Although loan terms are negotiated privately between banker and borrower, they could not be kept secret from the CNC which keeps under surveillance the effective minimum rates applied to bank customers. Fourthly, the banks could not have taken refuge in the risk estimate to deny the minimum rate to a large prime customer. Reasonable men may differ about how much risk is involved in a non-prime loan, but there is far less scope for disagreement about the credit risk (or the identification) of a prime loan to a large firm. Finally, the banks were aware that the authorities had great power to enforce their views about interest rates without having to ask Parliament for additional support. If necessary, the Bank of France could have enforced the CNC's official minimum rates by using its authority to discount directly for private customers.

(30) For example, cf. AYMARD, *op. cit.*, pp. 107-108.

(31) *Décision de Caractère Général*, No. 56-11, December 17, 1959, Article 4.

This has declined to very small amounts but there is nothing to prevent the central bank from reactivating this enforcement device (32).

It is more difficult to analyze the rate behavior in the small borrower markets than in the large borrower market. In the small as in the large borrower market, there are no official statistics published about rates paid by borrowers. In the small as in the large borrower markets, the rate behavior cannot be deduced from a knowledge of the market structure because the market structures are not sufficiently unconcentrated to ensure competitive behavior (within the limits set by the CNC's minimum loan rate). On the other hand, in neither case can competitive behavior be ruled out on market structure ground for, while competitive behavior in a concentrated market is less likely than non-competitive behavior, it is not impossible.

It was possible to get round these difficulties in the case of the large borrower market because it is common knowledge (among informed observers) that the typical large borrower paid the minimum rate permitted by the CNC — and that fact is presumptive evidence that the large borrower market behaved as competitively as CNC rules then permitted. Among informed observers, there is also a consensus that the typical small borrower did *not* borrow at the minimum rate permitted by the CNC, but that he paid something more to cover (alleged) higher risks (and costs). The critical question, of course, is *how much* more. The prevalence of a rate above the CNC minimum is not presumptive evidence of non-competitive behavior in the small borrower market. Most small borrowers do not have credit ratings of the highest order and, to cover their higher risks and costs, they might have to pay more than the prime borrowers (i.e., more than the CNC minimum) even in a competitive market (33).

The question that needs to be answered is whether the excess (over the official minimum rate) paid by small borrowers was just sufficient or more than sufficient to cover their (alleged) higher risks and costs, i.e., was the excess due solely to bona fide risk and

(32) Simon states that business firms would turn to the Bank of France for direct loans if the banks became too exacting in their rates. Cf. PHILIPPE SIMON, *Le Financement des Entreprises* (Paris, 1961), p. 134.

(33) The base rate for small borrowers is typically increased by various additional charges which are not asked from or are much less important in the full rate of the large customer. Cf. LAUFENBURGER, cited in PATRICE GRIVET, *La Mobilisation des Crédits Bancaires in France* (Paris, 1962), p. 200, note 9.



cost differences or also to the effects of a non-competitive market structure. In the absence of the necessary statistics, it is not possible to answer the question directly but it may be possible to do so indirectly. Whatever the level of the small borrower rate, if the excess above the CNC minimum had been due solely to a risk (and cost) difference, a reduction in the official minimum rate (*ceteris paribus*) would have been associated with a comparable reduction in the new rate paid by small borrowers.

This last point is not clearly dealt with in the banking literature. My impression (based on interviews with bankers and banking officials) is that there was a tendency for the small borrower rate to fall by the same absolute amount as the change in the official minimum rate but that this was by no means invariably true. The issue seemed to hinge on the credit-standing of the borrower. According to one loan officer, "A full reduction was automatic in the case of short-term credits for the high-grade borrowers but it was neither automatic nor obligatory for borrowers of lesser standing". In other words, high-grade small borrowers tended to this extent to be treated like large borrowers (34); others were not. However, according to another informant, even a very highly-rated small borrower did not always get a rate reduction equal to the full reduction in the official minimum rate unless he protested to his banker. Indeed, even with a protest, he could not be sure that he would get the full reduction unless his case was very strong (i.e., an excellent credit risk) and unless he pressed the point with sufficient vigor and determination.

A hypothesis similar to that advanced for the large borrower market can also account for the behavior in the small borrower market. According to the earlier hypothesis, any tendency towards competitive behavior (within CNC-authorized limits) in the large borrower market was not due to a competitive market structure but to the psychological prod of the overhanging authority of the Government. It seems likely that this prod also operated in the small borrower market but with much less force than in the large borrower market. It was probably most effective for small borrowers of excellent credit standing (especially if they were sufficiently aggressive) and least effective for small borrowers of lesser credit standing.

(34) Even with identical credit ratings, small borrowers might have had to pay higher rates to cover the banks' higher costs (per dollar of loan) of negotiating small loans.

As the prime rate was normally equal to the CNC minimum rate, a change in the latter was a clear signal for a corresponding change in the prime rate. However, the loan rate for small borrowers (especially those of lesser credit standing) did not bear a precise relationship to the CNC minimum rate because it contains a risk premium which (however legitimate in principle) is in practice amorphous, ill-defined, and hard to measure. As a result, a change in the CNC minimum rate did not signal the need for a corresponding change in the small borrower rate as clearly as it did for the large borrower rate, and a banker who failed to cut the small borrower rate by the full amount of a reduction in the CNC minimum rate would not have been as clearly vulnerable to the charge of opposing the CNC's wishes for lower loan rates as if he had failed to reduce the rates to borrowers of higher credit standing (for whom the risk premium was a less important part of the total loan rate) (35).

It seems probable, too, that bankers were under less (and perhaps no) pressure from their small borrowers (especially those of lesser credit standing). Those borrowers do not consider themselves to be in the same orbit of comparison as the prime borrowers and probably would not have expected their loan rates to be cut by the same amount as the official minimum rate which (as the CNC often stated) was intended to apply only to the best (riskless) borrowers. Moreover, they certainly do not have the same market mobility as the customers of higher credit standing and this, too, probably held down small borrower protests (or made them less successful).

#### *Minimum rates and competitive loan rate levels*

Since the CNC minimum loan rate was also the actual loan rate for prime borrowers, the next question to consider is whether the minimum loan rate (before it was abolished) was set at the level

(35) It is interesting in this connection to note the following observation, made in 1950 by the CNC, after it had taken a number of steps designed to reduce the level of bank charges to customers: "It is difficult to evaluate the exact measure in which the decisions taken in 1950 in the matter of bank rates have lightened the charges of firms having recourse to credit. One remembers, in effect, that the conditions decided by the CNC are minimum conditions below which the banks are forbidden to descend. The banking charges vary as a function of particular situations, and notably according to the value of the signature and of the risks run by the bank with respect to the operations they finance". (CNC, *Rapport Annuel*, 1950, p. 17).

that would have prevailed in a purely competitive market. Clearly, if the minimum loan rate was already at a competitive level, prime loan rates (and, a fortiori, non-prime loan rates) could not be expected to fall below that level solely as a result of abolishing the minimum loan rate.

It is not possible to match the CNC minimum rate directly against a competitive rate because there has been no fully competitive loan market in France to serve as a standard of comparison. However, for the reasons set forth below, it is doubtful that the prime rate in France was always (if ever) equal to a purely competitive loan rate (taking as given all the other operating conditions of French banks and especially of the deposit rate controls) during the years of the CNC minimum loan rate. In other words, it is doubtful that the minimum loan rate at all times (if ever) covered nothing more than the actual costs and actual risks of prime borrower loans (36) plus a markup for "normal" (competitive) profits.

First, there is evidence that, at least at the outset, the CNC did not establish floor rates geared to prime borrower risks. In one of its earliest actions, the CNC homologated the existing interbank agreements that had been formulated under the aegis of the Association Professionnelle des Banques. However, the base level of the *conditions de banque* in those agreements was set to cover (at least) the normal (i.e., average) risk which banks assumed. Thus, the *conditions de banque* which the CNC took over and homologated subjected borrowers with very little risk to a base rate that was geared to the banks' average risk (37). In later years, the banks sometimes violated the official minimum loan rate for their prime borrowers (38), and this, too, casts doubt on the probability of a purely competitive relation between the banks' risks (and costs) on prime loans and the CNC's minimum loan rate.

Secondly, there is not enough information available about bank costs — either variable costs or the allocation of fixed costs — to permit bank charges to be related to bank costs with precision (39). Moreover, it appears that at least one important bank cost, the

(36) This analysis is expressed in terms of the prime loan rate because the prime rate was in fact equal to the CNC minimum rate and because the CNC intended the minimum rate to apply only to the best (least risk) customers and expected others to pay higher rates commensurate with their higher risks and higher costs.

(37) Cf. AYMARD, *op. cit.*, p. 105.

(38) Cf. CAUBOUR, *Le Chef d'Entreprise et ses Banquiers, op. cit.*, p. 54.

(39) Cf. FERRONIERE, *op. cit.*, p. 204.

money cost, has been overstated. This is implicit in the widely-held view that, as the banks no longer have access to the *marché hors banque*, they can no longer lend to their best customers at Bank Rate, much less below Bank Rate (as they sometimes used to do). Specifically it has been argued that a prime rate equal to Bank Rate would leave *nothing* over to compensate the bank for its operating costs and risks (40). The pertinent question in the present context is not whether a prime rate equal to Bank Rate would cover *all* of a bank's cost but whether it could cover *any* of the bank's operating costs and risks. In other words, is Bank Rate an appropriate measure of a bank's money costs, as implied in the preceding view? The answer depends on the amount and cost of bank borrowing at the Bank of France as compared with other sources of funds. While central bank discounts are unquestionably important as a source of funds for French banks (especially in tight money periods), they are far less important than customer deposits (41). Under the circumstances, it is particularly pertinent to note that the CNC's official ceiling rates on deposits have normally been below Bank Rate. Indeed, on sight deposits, the most important deposit category, the ½ per cent ceiling rate (in first category Paris banks) was far below Bank Rate (42). As the average money costs of banks (especially the large banks that are the natural suppliers of prime borrowers) have been below Bank Rate, a prime loan rate equal to Bank Rate could cover the banks' money costs and make some contribution towards covering other bank costs as well. In this connection, it is pertinent to note that in January, 1965 the base rate used to determine the minimum loan rate was cut from 3.75 to 3.60 per cent (as a result of a modification in the manner of figuring the rate rather than as a result of a change in Bank Rate) with the result that the minimum loan rate (including the 40 per cent *commission d'endos*) on a commercial paper discount fell to 4 per cent, i.e., exactly equal to Bank Rate on that date (43).

(40) For a typical statement of this position, cf. *ibid.*, p. 248.

(41) For example, at the end of 1964 the volume of Bank of France rediscounts for the banks was approximately 12 billion F, but the total deposits of the banks were more than 76 billion F. Cf. Banque de France, *Compte Rendu des Opérations*, 1965, p. 42, and CNC, *Annexes au Rapport Annuel*, 1964, p. 148.

(42) At its meeting of June 28, 1967, the CNC reduced the ceiling rate on sight deposits to zero.

(43) Cf. Banque de France, *Compte Rendu des Opérations*, 1965, p. 30, and CNC, *Rapport Annuel*, 1965, p. 120.

Thirdly, the CNC sometimes miscalculated the minimum loan rates which were necessary to cover the costs and risks of prime borrowers. For example, in January, 1948, the CNC authorized the banks to raise their tariffs to cover their costs (including risks). However, two years later, the Minister of Finance acknowledged that the increases had been predicated on expectations that were too pessimistic. In particular, he recommended a reduction on the rates on *engagements par signature* because they were "often too high in view of the risks run by the banks" (44). He also recommended a revision of the increase that had been granted on the *commission d'endos* and, following upon his letter, the *commission d'endos* was reduced from  $\frac{1}{4}$  per cent per quarter (1 per cent per annum) to  $\frac{1}{20}$  per cent per month (0.60 per cent per annum). However, since the *commission d'endos* had been compulsory even for prime borrowers, it is apparent that, before the reduction, the official minimum loan rate (including the compulsory commission) must have been more than adequate to cover the minimum risk of prime borrowers.

Finally, it is doubtful whether the CNC would have wanted to push the minimum loan rate to a purely competitive level for fear of jeopardizing bank solvency. It is true that the CNC generally exerted pressure on the banks to reduce their charges to customers, but this program was presumably carried out in conformity with the view that, "If it is undeniable that they [French banks] ought to grant business reasonable terms, it is also clear that the economy of our country would have nothing to gain from a deficit administration of the banking apparatus." (45)

#### *Minimum rates and unregulated loan rate levels.*

For the abolition of the minimum loan rate *per se* to have the desired effect of leading to lower (prime) rates, it is necessary but not sufficient for the minimum loan rates to have been above competitive levels. In addition, the minimum loan rates had to be above the rates that would have prevailed in an unregulated loan market. Since the original purpose of rate regulation was to protect bank solvency by placing a floor under loan rates, it might appear that

(44) Cf. Letter of December 6, 1949, from Minister of Finance to Governor of Bank of France and Vice-President of CNC, in CNC, *Annexes au Rapport Annuel*, 1949, p. 39.

(45) Cf. CNC, *Rapport Annuel*, 1950, p. 18.

the regulated (minimum) loan rate was invariably above the level that would have prevailed in an unregulated market. However, there are a number of reasons for believing that, in the absence of the CNC's minimum loan rate, the unregulated market rate would not have fallen below and might even have been above the official minimum loan rate.

First, in order to protect depositors and bank solvency, the minimum rate had to be above a purely competitive level, but there is no necessary implication that it also had to be above an unregulated market rate level. Indeed, while minimum loan rates may have originated in a desire to protect depositors, they were subsequently employed by the authorities as an instrument of monetary and economic policy and, during most of the postwar period, the CNC sought to reduce loan rates when possible.

Secondly, in pursuing its general policy of cutting the cost of bank services to business firms, the CNC was not always constrained by the banks' views about the appropriateness of proposed reductions and, on various occasions, the authorities pressed for rate reductions against vigorous bank opposition. The last occasion was in 1965 (the last full year of the minimum loan rate) when the banks strongly objected to the action of the Bank of France in reducing "T" because of the adverse effect on bank earnings and profits (46). Those experiences undoubtedly contributed to the growing sentiment among realistic bankers that they might be better off under a regime of unregulated loan rates than under the "false protection" of the CNC's minimum loan rates (47).

Thirdly, the existence of an officially sanctioned minimum loan rate provided bank borrowers with a psychological weapon of considerable persuasive power in their dealings with bankers. As a result, many (including both large and small) borrowers were almost certainly enabled to negotiate lower loan rates with the banks than would otherwise have been possible (48).

Fourthly, it is unlikely that an unregulated market rate would have been a competitive rate for, as noted above, the market structure in the large as well as in the small borrower markets is too concentrated to ensure competitive behavior. Indeed, the CNC ap-

(46) Cf. *Le Monde*, February 18, 1966, p. 2.

(47) Cf. *Economist*, November 20, 1965, pp. XXXII and XXXV.

(48) Cf. PIERRE BERGER, "Interest Rates in France", *Banca Nazionale del Lavoro Quarterly Review*, September, 1964, p. 278.

pears to have been concerned that, in the absence of regulation, the loan rate levels would have been higher than the authorities desired in terms of economic policy. According to Berger, one of the dual objectives in regulating the banking profession was "to prevent the banks from coming to understandings which would completely nullify any attempt by the Government to control the formation of the rates of interest on the short term money market" (49). In Berger's opinion, "... it may be asserted that such understandings, if not controlled, would undoubtedly have led to higher terms being charged" (50).

### III. Concluding Observations

The analysis of this paper has shown that, contrary to widely-held expectations, the abolition of the official minimum loan rate in France is not likely to reduce loan rates significantly, if at all (51). During the years when it was in force, the official minimum loan rate on discounts and advances was also the actual loan rate for prime borrowers and, while this rate was probably above a competitive loan rate level, it was probably below the level that would have prevailed in an unregulated market. Given the oligopolistic concentration in the short-term business loan markets in France and the history of competitive curbs in French banking, it is not likely that the abolition of the minimum loan rate will lead the oligopolists to ignore their mutual dependence and engage in unbridled rate rivalry. While they can no longer resort freely to the prewar type of cartel arrangement to regulate interbank competi-

(49) *Ibid.*, p. 277. In this connection, cf. the CNC's 1952 statement that the official measures (which the CNC had taken to reduce bank charges) "would have no real effect except in the measure where the banks assure their loyal application without looking for ways to paralyze their effect or to reduce their impact by the play of private ententes". (CNC, *Rapport Annuel*, 1952, p. 13).

(50) BERGER, *op. cit.*, p. 278. Berger concluded that "It seems certain, therefore, that, all things considered, the effect of regulation by the National Credit Council has been to lower the cost of credit". His view is based in part on the fact that deposit rates have been limited.

(51) It is pertinent to note that some French experts do not expect more than a symbolic reduction of loan rates as a result of the "return to competition". (Cf. *Le Monde*, February 18, 1966, p. 2). The CNC has also stated that it does not expect this reform to lead "automatically and in all cases" to lower loan rates. (Cf. CNC, *Rapport Annuel*, 1965, p. 21).

tion (52), they could approximate the effects of overt collusion by means of tacit collusion based on an oligopolistic rationale. The latter kind of behavior is not a necessary result in an oligopoly market, but the authorities have made it more likely by authorizing the BNP merger and thereby raising the concentration in business loan markets (53).

Finally, it is clear from this discussion of the probable market effects of abolishing the minimum loan rate that an *assurance* of competitive behavior requires more than a release of artificial restraints on bank rivalry; it requires also a competitive market structure.

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(52) There now exists a legal ban on consultation between bankers. Cf. *Economist*, November 20, 1965, p. xxxii.

(53) For an example of bank action, taken after the abolition of the minimum loan rate, but "which looks uncommonly like a cartel arrangement", cf. *Economist*, December 3, 1966, p. 1063.