

Post-war Monetary Policy in France

I.

When France was liberated from German occupation in 1944, economic activity was at a low ebb. War damage was considerable and, over a period of years, French production and manpower had been drained off to be fed into the German war machine. The bulk of these « unrequited exports » was paid for in occupation currency and the volume of notes issued increased steadily. After liberation, the introduction of Allied currency further inflated the supply of money. There was also the legacy of the 1930's when — apart from a partial recovery in 1937 — production had been stagnant and the capital resources of the country had been allowed to run down to danger levels. Moreover, the whole nation was now in revolt against all types of restrictions associated with the occupation and therefore in no mood to accept a policy of austerity and self-discipline. Evasion of control had almost become a patriotic duty. Yet the situation clearly demanded strong action. Production, including the provision of the plain necessities of life, had to be raised rapidly. The reconstruction and re-equipment of the economy was a matter of great urgency. Some attempt to halt the rise in prices was imperative and the deficit in the balance of payments had to be bridged.

In the early stages, the main emphasis of postwar economic policy was on nationalisation, which was applied to the basic industries and to the more important banks, including the Bank of France. The legislative basis for the latter part of the government's programme was completed by December 1945, though it is difficult to see what major contribution nationalisation was of itself expected to make. Much more important were the wide powers of control and regulation accorded to the National Credit Council, acting in co-

operation with the Bank of France and the Banking Control Commission. Of this trio, the Council was the policy-making arm of authority. Its members represented a wide range of economic, financial and government interests and included officials from the Treasury, the Ministry of Economic Affairs and the Economic Planning Commission. Its role was primarily consultative, though it was also responsible for the registration of banks and of financial houses, the opening and closing of branches and the determination of rates and commissions to be charged by commercial banks. It might also act as a tribunal of appeal (e.g. against the classification of a bank in one or other of the specified categories by the Banking Control Commission and against decisions of the Government commissioners attached to the *banques d'affaires*). The Bank of France, through its specialised services, also helped to form policy, but its more obvious functions were executive. Its task was to implement credit policy. It did this both by influencing the cash base of the commercial banks and by variation of its rediscount and advances rates. Finally, there was the Banking Control Commission, with a heavy weighting of official representatives, whose job it was to « police » the banking system by supervising its operations and by requiring the observance of certain ratios. It also served as an appeal tribunal (against certain types of decisions of the National Credit Council). It was sometimes difficult to be sure where the frontiers of responsibility of the several authorities began and ended, but an effective liaison was assured by the strategic positions held by the Governor of the Bank of France, who was *ex officio* Vice-President of the National Credit Council (and its effective chairman since its political head was rarely present) and President of the Banking Control Commission. In addition, there were

the personal contacts between the officers of each of these bodies and there was frequent consultation. Subject only to the ultimate authority of the Government, these three bodies had full power to regulate and to control credit conditions and the terms of banking business throughout France, as well as to determine within wide limits the overall character of the banking structure.

The early postwar years in France were characterised by poverty and inflation. Foods and other consumer goods were in short supply and housing constituted a major problem. Harvests were poor and prices continued to rise. Increased wage rates were granted to offset the impact of the rising cost of living, but, by pushing up costs, higher wages only added to the upward pressures on prices. The inflation was further intensified by the scale of government expenditure on reconstruction. It was obviously necessary both to raise production levels and to rebuild the capital resources of the economy as rapidly as possible. Nevertheless, the pace at which governments attempted to achieve these targets imposed severe strains on the economy. The resources available for the reconstruction of industry and the rehabilitation of agriculture were distinctly limited and there was little inclination to accept a reduction in consumption standards to make more capital available. The Government itself had therefore to find the resources, the necessary planning and co-ordination being carried out by the *Commissariat Général du Plan de Modernisation et d'Équipement* under the direction of M. Jean Monnet. Successive governments incurred recurrent budget deficits and the finance for these and for the current demands of industry was found by resorting both to the Bank of France and to the commercial banks, which provided credits both at short- and medium-term for the purpose. As judged by the growth in industrial production, the results of this policy were impressive. The index of production (including building) for December 1945 (base 1938 = 100) was only 62. By March 1947, industrial production was back to 1938 levels, though the prewar peak of 1929 was not to be approached until the end of 1950. Yet such progress, impressive though it was,

must not be allowed to obscure the very high price that had to be paid in terms of rising costs, inflated further by upward adjustments to wages in a vain effort to absorb the impact of higher prices on the cost of living. Inflationary pressures of this kind could only be cumulative and, at some stage, it was clear that a halt would have to be called. Business was booming, but the driving force was inflationary and American aid could only provide a partial offset. Meanwhile, the banks had allowed their holdings of Treasury bills to run off in order to grant credits freely to finance both current production and the re-equipment of industry. It was not long before they were lent up and since their deposits increased rather less rapidly than their loans, resort to central bank accommodation became increasingly frequent and, indeed, after a time almost continuous. Technically, therefore, the Bank of France was in a strong position to take restrictive action, but in the early years the authorities responsible for credit policy were still feeling their way and positive measures were rather long delayed.

II.

The National Credit Council held its first meeting on February 1, 1946. The problem with which the authorities were then faced was how best to finance the recovery of the country and the very considerable demands both of the State and of private enterprise, while at the same time avoiding an expansion of credit of such a magnitude as to threaten the stability of the franc. Somehow, a proper relation had to be maintained between the current volume of production and available liquid resources. In addition, it was necessary to restrict the granting of credit for consumption purposes and to divert the resources of the banking system to projects which ranked high in the overall economic plan, such as those concerned with the production of plant and equipment basic to the reconstruction of the country. The granting of credits was to be judged not merely on the basis of accepted banking criteria, but mainly in relation to the national interest and the relevance of a

particular credit to the Government's investment and reconstruction programme.

In attempting to achieve these objectives, chief emphasis was laid initially on qualitative controls. It was also hoped that the selection of credits would of itself limit the growth in the total volume. As the basis of selection, the Government believed it would be sufficient to follow the requirements laid down in its overall economic plan, but in the early stages this plan scarcely existed in any concrete form, as the planners were themselves feeling their way. As a result, the guidance which the National Credit Council might reasonably have expected was at first only made available to them in the very vaguest terms. In these circumstances, all that the Council could do was to request the banks to avoid granting credits for purposes which were obviously inappropriate or, indeed, actively detrimental to the healthy development of the economy. Credits were not to be made available to facilitate the building up of stocks of finished goods in excess of normal levels. By financial pressure, stocks were to be forced on to the markets, thus pushing down retail prices, though this policy was not, in fact, markedly successful. Gradually, the controls became more specific and this process was materially assisted by the collection of information through the *Service Central des Risques* (1) (first set up in March 1946), supplemented where necessary by special enquiries. Subsequently, in October 1947, more detailed guidance was provided with a view to « stabilising » the volume of credit granted. This was to be achieved whenever possible by reductions in the amount of accommodation granted and by more rigorous selection. On several occasions (more especially during 1948 and 1949), individual commodities or industries were singled out for particular attention. Thus, the banks were urged to exercise great care in granting credit to finance the holding of stocks of butter, wines and alcohol, rum, wool and sheepskins, cotton, leather and leather goods. During this same period, credits

(1) The functions of this service were described in some detail in the author's earlier article on « The French Deposit Banks and the *Banques d'Affaires* » in this Review, December 1954, pp. 194-195.

used to finance the fattening of cattle were completely prohibited. Where a proportion of the production in question was normally exported (e.g. wines), special arrangements were made to ensure that adequate finance was made available for the purpose. Imported raw materials (e.g. wool and cotton) were similarly treated. Not only was there an attempt to meet the special characteristics of particular industries, but when the restrictions ceased to be necessary, they were relaxed or lifted. Meanwhile, the essential industries — those basic to the economy and all the export industries — were actively encouraged. Even so, the guidance offered within the framework of this control remained rather general in character. The qualitative controls were probably responsible for some slowing down in the growth of bank credit, but not very much more than that can be claimed for them.

Supplementing the qualitative control proper was the « prior authorisation » procedure, which was introduced by the Bank of France in January 1947. In the first instance, applications for accommodation in excess of Frs. 30 million (2) were to be submitted, together with a « dossier », for vetting by the central bank. There were two obvious weaknesses in the operation of this control. First, not all forms of bank accommodation were included. « Prior authorisation » did not apply to bank guarantees (*cautions* and *avals*), to State paper (*effets publics*), nor to commercial bills and documentary credits. The last category was excluded on the grounds that such paper was « self-liquidating ». In fact, it constituted a major loophole. Second, the Bank of France at that time lacked both the experience and the staff to provide more than a cursory supervision. Preparation of a « dossier » was supposed to provide the basis for determining the extent to which the credit was « necessary ». Thorough vetting would inevitably have entailed protracted delays and possibly because of the need for a speedy decision, very few submissions for « prior authorisation » by the Bank of France seem to have been refused. From a disciplinary point of view, the actual

(2) This figure was raised to Frs. 50 million in February 1948 and to Frs. 100 million in April 1950.

preparation and submission of a « dossier » in support of a credit application was doubtless a much more potent check on excessive borrowing than the actual vetting by the Bank.

There can be little doubt that during the early postwar years far too much was expected of these qualitative controls. It may be conceded that the authorities required time to formulate a comprehensive system of quantitative controls with which to reinforce the selective techniques initially employed, but without firm action of a quantitative character it proved difficult to restrain the increasing dependence on bank credit and to ensure strict economy in the use of scarce resources. Moreover, the Bank of France was in a strong position to exercise restriction, since the commercial banks were soon lent up and were forced to rediscount with, or to borrow from, the central bank. In these circumstances, it was likely that a sharp rise in Bank rate would have forced on the banks some degree of discipline and, by requiring that higher rates be charged to bank customers, the latter would have been obliged to keep their stocks at minimum levels and to employ their own resources more economically. In addition, they would have been compelled to reconsider their more marginal applications for assistance. It is true that Bank rate was raised slightly on January 9, 1947 from 1⁵/₈% to 1³/₄% for Government paper and commercial bills and to 2¹/₄% on all other eligible paper. Rates were further increased to 2¹/₂% and 3% respectively on October 9, 1947, but in view of the degree of developing inflationary pressure, such revisions appear to have been much too limited and there was no clear break with the established policy of « cheap money ». It was the view of the authorities that no resources should be left unemployed for lack of credit. In theory, only the production of essential goods was to be encouraged, but in practice and because of the looseness of the controls, a proportion of bank lending was used to finance speculative activity, or was fed into industries catering directly for increased consumption. Some of this increase in consumption was « essential », given the low standards that had prevailed for much

of the economy during the war and immediate postwar years, but, obviously, both a high rate of investment and higher levels of consumption were bound to produce bottlenecks. The achievement of higher production levels in basic industries could only be retarded and an all-round rise in prices — and wages — was inevitable. Poor harvests only accentuated strains already apparent. These were the bases of the inflation which developed steadily in France throughout 1947 and 1948 and which prompted the sterner measures of September, 1948.

III.

Meanwhile, France had made some progress towards the achievement of relative stability. To a major extent, this was a consequence of her own hard work. The level of production had increased steadily and this offset in part the growth in the monetary supply associated with the authorities' desire to maintain employment at the highest possible levels. The good harvests of wheat and potatoes in 1948 were also of great assistance, since they eased some of the upward pressure on prices and indirectly on wages (which tended to be adjusted in sympathy with the increased cost of living). In addition, vital help was provided in the form of Marshall Aid, which began to flow in April 1948. In September, a new Government under M. Queuille set about « restoring the national finances », a task attempted by so many postwar governments in France. By means of a combination of taxation measures, credit restriction and administrative economies, the Government was able to more than cover ordinary expenditure by revenue and for a full year the Treasury avoided any increase in its debt to the Bank of France. A measure of price stabilisation was also achieved, though this was by no means complete. Production continued to increase and the economy appeared to be in an advanced stage of convalescence. With more plentiful supplies of goods coming forward, it became less necessary to hedge against inflation and free market quotations for the

gold bar fell from Frs. 800,000 per kilo to round about Frs. 600,000.

As a means of maintaining relative stability, a new quantitative credit control was introduced on September 30, 1948. Indeed, some twelve months earlier, active consideration had been given to the possibility of imposing a quantitative control based either on a global credit ceiling or on a system of compulsory ratios, but it was then felt that effective measures would be difficult to implement during a period of rapidly rising prices and that the effects were likely to be too drastic. In fact, a liquid assets ratio was instituted in February 1948, but it was not intended as a credit control and was imposed by the Banking Control Commission as a means of ensuring bank solvency and as a protection to depositors. The banks were required to hold 60% of their short-term liabilities in the form of liquid assets and, for certain banks, the ratio might be raised to 70%, but liquid assets were defined most liberally and maintenance of the ratio was not particularly onerous. Much firmer action was now to be taken. The banks were « invited » as from October 1, 1948 to restrict any increase in lending to part only of the growth in new deposits, not to increase the percentage of their deposits currently being employed in loans, and not to have recourse to rediscounts at the Bank of France except within the ceilings fixed by the central bank for each institution. There was also an intensified application of selective controls, but these were no longer required to take the main burden.

The new quantitative controls took two main forms — the requirement that the banks should hold a certain amount of their resources in short-dated Government paper and the imposition of credit ceilings.

As from October 1, 1948, all banks were required to hold in Treasury paper a minimum equal to 95% of their holdings on September 30, 1948. This was the so-called *plancher* (or « floor »). In the event of any increase in deposit liabilities beyond the level as at that date, holdings of Treasury paper were to be increased to the extent of 20% of the rise in these liabilities. If there were a fall in deposits, holdings of Treasury paper might be

reduced in sympathy to the extent of 80%. These arrangements were introduced in order to prevent the banks from selling government securities for the purpose of obtaining resources with which to expand credit to commerce and industry. The practice of unloading government securities had occasioned considerable anxiety during 1946 and 1947, when the reduction in commercial bank accommodation to the State had had to be offset by direct advances from the Bank of France to the Treasury, thus involving a net increase in the supply of credit to the economy. The Bank of France had then obtained a series of « gentlemen's agreements » with the commercial banks whereby they undertook to maintain their existing holdings of Treasury paper, which might be reduced only if there was a net withdrawal of deposits. These arrangements had already proved to be reasonably effective and the new regulation was therefore to a large extent a formalisation of the earlier agreements and, in fact, there was no radical change in the use made of bank funds. Furthermore, as a quantitative control, these requirements would effect no net reduction in bank credit, unless the funds transferred to the Treasury in this way were used to repay its advances from the Bank of France, or were applied in some other way in reduction of State debt. To the extent that the funds were spent by the Treasury, there could only be a reduced and lagged rate of expansion in credits granted to commerce and industry. Nor was there any provision in the regulations requiring that additional holdings of government paper, in consequence of a rise in deposits, should be acquired from the Treasury direct and it was therefore possible to obtain such paper from non-bank investors, thus releasing funds for expenditure in the private sector.

The authorities also sought to limit the growth in bank credit granted to commerce and industry by imposing *plafonds* (or « ceilings ») on commercial bank rediscounts at the Bank of France. This was not an entirely new technique in the Paris Money Market. In common with other central banks, the Bank of France had resorted from time to time to the rationing of rediscounts during periods of

THE COMPOSITION OF THE MONETARY SUPPLY.
Frs Billiards

TABLE I

| | Notes in Circulation | Deposits | Total Supply of Money | Gold & Foreign Exchange | Advances by Bank of France to State | Bank Credits (inc. Bank of France) | |
|---------------------------|----------------------|----------|-----------------------|-------------------------|-------------------------------------|------------------------------------|------------------------|
| | | | | | | to State | to Commerce & Industry |
| 1946 - December | 732 | 625 | 1,357 | 144 | 517 | 304 | 308 |
| 1947 - March | 761 | 645 | 1,406 | 144 | 529 | 317 | 328 |
| June | 832 | 687 | 1,519 | 144 | 399 | 299 | 375 |
| September | 871 | 710 | 1,581 | 144 | 627 | 296 | 406 |
| December | 921 | 758 | 1,679 | 152 | 633 | 295 | 490 |
| 1948 - March | 779 | 1,050 | 1,829 | 152 | 656 | 297 | 587 |
| June | 823 | 1,050 | 1,873 | 152 | 616 | 297 | 675 |
| September | 911 | 1,151 | 2,062 | 152 | 666 | 345 | 742 |
| December | 993 | 1,175 | 2,168 | 65 | 763 | 354 | 870 |
| 1949 - March | 1,045 | 1,107 | 2,152 | 65 | 757 | 368 | 901 |
| June | 1,116 | 1,116 | 2,282 | 73 | 773 | 375 | 976 |
| September | 1,225 | 1,304 | 2,529 | 115 | 785 | 432 | 1,083 |
| December | 1,301 | 1,403 | 2,704 | 154 | 768 | 420 | 1,219 |
| 1950 - March | 1,337 | 1,355 | 2,692 | 172 | 796 | 406 | 1,191 |
| June | 1,400 | 1,429 | 2,829 | 226 | 770 | 432 | 1,266 |
| September | 1,496 | 1,444 | 2,940 | 426 | 718 | 424 | 1,348 |
| December | 1,590 | 1,530 | 3,120 | 467 | 705 | 431 | 1,355 |
| 1951 - March | 1,607 | 1,578 | 3,185 | 515 | 716 | 442 | 1,383 |
| June | 1,699 | 1,622 | 3,321 | 493 | 666 | 462 | 1,517 |
| September | 1,819 | 1,672 | 3,491 | 463 | 730 | 499 | 1,609 |
| December | 1,883 | 1,795 | 3,678 | 279 | 742 | 513 | 1,905 |
| 1952 - March | 1,920 | 1,838 | 3,758 | 212 | 803 | 571 | 2,002 |
| June | 1,948 | 1,898 | 3,846 | 216 | 805 | 587 | 2,025 |
| September | 2,035 | 1,926 | 3,961 | 283 | 773 | 638 | 2,095 |
| December | 2,124 | 2,035 | 4,159 | 236 | 802 | 626 | 2,271 |
| 1953 - March | 2,128 | 2,084 | 4,212 | 216 | 940 | 649 | 2,183 |
| June | 2,142 | 2,146 | 4,288 | 210 | 953 | 654 | 2,273 |
| September | 2,227 | 2,172 | 4,399 | 206 | 935 | 659 | 2,328 |
| December | 2,310 | 2,320 | 4,630 | 225 | 931 | 702 | 2,518 |
| 1954 - March | 2,327 | 2,337 | 4,664 | 259 | 989 | 697 | 2,459 |
| June | 2,374 | 2,384 | 4,758 | 282 | 960 | 704 | 2,542 |
| September | 2,444 | 2,468 | 4,912 | 308 | 892 | 737 | 2,677 |
| December | 2,551 | 2,704 | 5,255 | 394 | 947 | 768 | 2,880 |

excessive demand for credit and, prior to World War II, it had been its practice to apply such ceilings to the smaller banks operating in the Paris market in order to prevent their over-reaching themselves. Now the ceiling technique was to be used for a rather different purpose — the prevention of a general expansion in bank credit. Rediscount ceilings were fixed for each bank and the details are not known, only the totals being published from time to time. Initially, the total of these ceilings amounted to Frs. 186 milliards. The large banks with a network of branches were accorded a ceiling for their institution as a whole and they then allotted internal ceilings for each of their branches or, where branches were grouped, to each of their larger offices. The ceilings for banks with a localised business were determined by the respective managers of the Bank of France's own branches in the provinces, in view of the necessity to take into account the precise character of local conditions. At times when the ceilings became fully effective, it was usual for the commercial banks to establish firm ceilings for each of their customers and the latter were then obliged to operate within the ceiling assigned to them.

During the early postwar years, the use of commercial bills as a medium of finance had been completely uncontrolled and, indeed, actively encouraged by way of rediscount concessions. This policy had been favoured in the rather naive belief that being « self-liquidating » paper such bills could scarcely be inflationary. During the first nine months of 1948, the rapid increase in the discount of commercial bills at last convinced the authorities that the gap must be closed and, although such paper continued to be excluded from submissions for « prior authorisation », it was incorporated from the very first in the rediscount ceilings. Moreover, once a bank reached its rediscount ceiling, even a commercial bill carrying the very best of signatures, with a maturity of three months or less and specifically drawn to finance the movement of goods would now be refused for rediscount at the Bank of France. This represented a truly radical break with established tradition.

Although it was intended that the control should be comprehensive, not all types of paper were in fact subject to restriction within the ceiling and three categories were specifically excluded. These were the medium-term *effets de mobilisation* discounted by the *Crédit National* for the purpose of financing the re-equipment of industry; bills drawn on member institutions of the *crédit agricole* in connection with the movement of the wheat harvest; and bills drawn by the Treasury on importers (e.g. in respect of liability for customs duties). At the time, none of these items was really very large, but latterly resort to medium-term paper for re-equipment purposes was to increase quite sharply and its exemption from the ceilings was to become something of an embarrassment to the authorities.

When the ceilings were originally fixed, they were set close to the actual level of rediscounts outstanding on September 30, 1948, but where rediscounts were considered to be low for seasonal or other special reasons, allowance was made for a limited amount of expansion. It was hoped that by this means bank lending would be greatly restricted, since even a bank in receipt of new deposits would be forced to lend cautiously once its total rediscounts approached the ceiling. There was no prohibition on further lending, but as additional discounts would not now be eligible for « mobilisation » at the Bank of France such paper would become relatively illiquid and funds would be tied up until it matured. As the banks were then obliged to borrow almost continuously from the Bank of France, the dangers of illiquidity were considerable.

From the authorities' point of view, the chief difficulty in operating this control was the persistent building up of pressure against the ceilings. This was met partly by revising the ceilings upwards and partly by instituting a number of « safety valves ». Thus, from the original level of Frs. 186 milliards, the ceilings were raised to a total of about Frs. 200 milliards by the end of 1949 and further increased to approximately Frs. 250 milliards by September 1950. In October 1951, they aggregated Frs. 285 milliards, rising to almost Frs. 500 milliards by the end of that year.

The degree of elasticity required, particularly during a period of rapidly rising prices, constituted the chief weakness of the ceiling technique. Some upward revision was unavoidable under these circumstances, but which claims were legitimate and which were not? The central bank was constantly under pressure to adjust the ceilings upwards and much bilateral bargaining took place between the Bank of France and individual commercial banks. Yet the commercial banks continued to complain that the strictness of the limitations was excessive and that this form of control lacked flexibility. To a disinterested observer, there seemed to be far too much flexibility, especially in view of the number of safety valves that had been built into the mechanism. Quite apart from the upward revisions of the ceilings and the exemption of medium-term paper, there was the additional accommodation which might be made available at the discretion of the Bank of France through the open market, as well as the *avances à 30 jours* to approved banks which provided further supplementary assistance.

Bank of France intervention in the open market dates only from June, 1938, when the Bank was empowered to buy and to resell (without endorsement) short-dated government securities and such other paper as was eligible for rediscount at the Bank. As in London, it was found convenient to operate mainly through a « special buyer » and, although it does deal through other houses from time to time, the bulk of the Bank's business is put through the *Compagnie Parisienne de Rées-compte*, which is virtually the official broker in the market. In this way, more or less accidental distortions of the flow of funds either in to or out of the money market can be « smoothed out », the bulk of such transactions being in Treasury bills and « acceptances » of the *Crédit National* (3). At times when the accumulated pressure of the demand for funds began to threaten the maintenance

(3) Drafts accepted by the *Crédit National* are drawn on it by parties to whom the State owes money (e.g. public works contractors), the Treasury having made appropriate provision for payment of the drafts at maturity. These transactions are not to be confused with the medium-term *effets de mobilisation*.

of credit ceilings, open market purchases were employed as a safety valve. Frequently, the stringency would only be temporary and there would have been no point in outright discount, which involves an irrevocable purchase and sale. Hence, the more general use of *en pension* facilities, whereby securities are sold to the Bank of France under an arrangement which permits their repurchase within 15 days, the cost to the borrower being the difference between the prices of sale and repurchase (4).

In the open market, the Bank of France can operate at its own discretion, but in securing short-term accommodation by way of *avances à 30 jours* the initiative rests with the banks. These advances are for a period of from 5 to 30 days against short-term government paper and may not exceed ceilings agreed upon between the more important banks and the Bank of France. Not all banks may claim this privilege and the agreements are restricted to about fifty banks throughout the country, including all the big Paris banks, the regional banks, and even some of the local banks. There is no formal deposit of security. When such a loan is required, a letter of request is addressed to the Bank and, if the amount required together with loans outstanding is within the agreed ceiling, the loan will be made, subject only to its full repayment on or before the expiry of the 30-day term. Within the prescribed limits, these advances, too, could be used as a « safety valve », when pressure developed against the primary credit ceilings.

Meanwhile, Bank rate, after a temporary rise on September 4 from 2½% to 3% (depending on the type of eligible paper) to 3½% and 4% respectively, had been consolidated at 3% as from September 30, 1948. This rate was to be maintained without change until June 8, 1950, when it was dropped to 2½% because of the fear of incipient depression. Yet much more potent than the actual level of Bank rate was the determination to make it effective by means of quantitative action. The major limitation was effected

(4) Open market operations appear in the Bank of France Return under the heading *effets négociables achetés en France*.

through the agency of the rediscount ceilings, operated in conjunction with the several « safety valves » to relieve pressure on occasions when this built up to uncomfortable levels.

IV.

In the early stages of quantitative control and prior to the outbreak of the Korean war in June 1950, the combined action of the *plafond* (or « ceiling ») and the *plancher* (or « floor ») worked fairly well, but as soon as prices began to rise rapidly the mechanism gave evidence of strain and the « safety valves » had to be brought increasingly into play. Although world prices had already begun to move upwards before Korea, internal price stability had for the most part been maintained during the first six months of 1950, but after June the influence of the increased war demand for raw materials was quickly transmitted to domestic prices. Those sectors of the French economy dependent on imported raw materials (e.g. textiles) were obviously sensitive to movements in world prices and the impact of changes in external conditions was both immediate and direct. It was nevertheless hoped that, when lower import prices returned, the internal price structure would again move downwards in sympathy. What was less easy to foresee were the ultimate effects of large-scale rearmament expenditure, which became necessary in consequence of France's share in Western defence, to which had to be added the persistent drain on resources occasioned by the war in Indo-China. Budgetary equilibrium on current account and some progress towards covering government capital expenditure had scarcely been achieved when this new burden appeared.

Although to some extent due to the rise in import prices, much of the responsibility for the subsequent resurgence of inflation in the domestic economy must be laid at the door of weak government. The growth in the money supply was considerable. Between June 1950 and March 1952, the note issue rose by over Frs. 500 milliards and total monetary resources by over Frs. 900 milliards, the bulk

of this — Frs. 875 milliards — representing an increase in bank credit. While it is true that the cost of carrying stocks, particularly of imported goods, was rising, the upward pressures were considerably reinforced by a budget deficit which was to climb to no less than Frs. 725 milliards in 1952. Moreover, with a persistent rise in the cost of living, there had been a developing pressure for higher wages. These were increased twice during 1951 and, with a lag, this also pushed up costs. Despite good harvests, farmers, too, were able to bargain for higher prices for their cereal crops and food prices rose further. The single major achievement, though it should not be dismissed lightly, was the success in raising the index of industrial production by March 1952 to 50% above 1938 levels. But whether the industrial boom was worth the price of inflation, driving the cost structure of France more and more out of alignment with those of its competitors, was very much an open question.

To what extent could credit controls assist in containing these pressures? During the months immediately following Korea, the authorities were somewhat handicapped by recent action taken to ward off recession. It may nevertheless be argued that they were rather slow to go into reverse. Indeed, by the time really drastic measures had been invoked in October 1951, the worst was almost over. There was a further upsurge of import prices towards the end of the year and this carried over into 1952, but the damage had already been done. Domestic prices had by now clearly shifted permanently to a higher level and all that could be hoped for was achievement of some degree of stability on the new basis. The global ceilings which had been imposed as from September 1948 had gradually been lifted from their original level of Frs. 186 milliards to about Frs. 285 milliards by October 1951, but it was still thought that the setting of a ceiling to rediscounts at the central bank would be sufficient to prevent the situation from getting out of hand. Policy appears to have been based on the assumption that when the rise in import prices was reversed, a disinflationary effect would be transmitted quickly to internal pri-

ces. In fact, the upward pressure on domestic prices seems to have acquired a momentum of its own and, in consequence, it proved difficult to bring them under effective control.

TABLE II
BANK OF FRANCE - WEEKLY RETURNS
(Frs. Milliards)

| Last Balancing Date in | Discount Portfolio (Banks & Other Customers) | Open Market Purchases. | Advances at 5 to 30 days to approved banks |
|------------------------|--|------------------------|--|
| December, 1945 | 25.9 | 18.0 | 0.7 |
| June, 1946 | 46.2 | 25.0 | 1.7 |
| December | 79.4 | 37.6 | 3.5 |
| June, 1947 | 87.2 | 43.0 | 9.1 |
| December | 117.9 | 67.4 | 15.7 |
| June, 1948 | 166.1 | 71.3 | 2.1 |
| December | 247.2 | 97.4 | 10.3 |
| June, 1949 | 259.3 | 156.2 | 15.8 |
| December | 364.3 | 137.7 | 11.3 |
| June, 1950 | 387.3 | 128.9 | 8.8 |
| December | 427.2 | 136.9 | 11.3 |
| June, 1951 | 470.8 | 196.4 | 18.0 |
| December | 832.1 | 223.2 | 20.1 |
| June, 1952 | 853.1 | 254.3 | 21.4 |
| December | 994.7 | 274.0 | 25.2 |
| June, 1953 | 947.0 | 281.4 | 20.7 |
| December | 952.9 | 292.5 | 19.8 |
| June, 1954 | 964.6 | 217.4 | 12.7 |
| December | 1,179.3 | 236.8 | 18.6 |

Following the fall of the second Queuille Government on July 10, 1951, there had been a long period of political uncertainty, only resolved by the installation of M. Pleven's Government on August 11. Inevitably, there was a hold-up in the formulation of policy. The new Government was plagued with difficulties. Agricultural prices had risen sharply. Over the course of the year, there had been a recurrence of the deficit in the balance of payments and the franc was weakening. Pressure developed for higher wages. The framing of the budget was more difficult than usual and it was realised that there would be a heavy deficit in 1952. Bank credits to commerce and industry were still increasing — they were to jump by nearly Frs. 300 milliards during the last quarter of 1951. Clearly, the existing credit controls required to be strengthened.

In the early days of October, the authorities went into action. Bank rate, which had been

reduced to 2½% in June 1950 in order to ward off the recession that then threatened the economy was raised first to 3% on October 11, 1951 and then to 4% on November 8. But this upward revision of interest rates could not be expected to take the whole strain and the discipline imposed by means of credit ceilings and the *plancher* relating to holdings of government paper was also tightened up. Initially, it had only been necessary to bring rediscounts within the ceilings and to achieve the *plancher* at the end of each month, but when the demand for credit began to increase progressively the banks experienced great difficulty in observing both the ceiling and the *plancher* requirements, even at month-ends. Technically, the ceilings remained unbroken, but they had to be raised on several occasions in order to accommodate the increasing pressure for funds and the Bank of France was also obliged to offer additional assistance through the open market and by means of *avances à 30 jours*. During the second half of 1951, the position had begun to get out of hand. Rediscounts frequently exceeded the ceilings during the course of a month, but with assistance through the open market the banks had been able to bring their rediscounts within the ceilings at month-ends and to observe the *plancher*. With the agreement of the Treasury, the Bank of France was now obliged temporarily to relax the *plancher* requirements in order to facilitate the compression of rediscounts within the ceilings stipulated. At the same time, it continued to be necessary to make funds available, through the open market, and, by October 1951, the « tolerance » allowed in excess of the ceilings amounted to Frs. 150 milliards. It is against this background that one must view the drastic overhaul of the mechanism which then took place.

The arrangements introduced in October 1951 required, first, that the *plancher* should now be observed not merely at month-ends but also on a daily basis. In this way, the lag between the growth of deposits and their absorption in holdings of Treasury paper would be eliminated. Any bank which was not at that time meeting its *plancher* requirements was to take appropriate action to do so. New

rediscount ceilings *en principe infranchissable* and totalling approximately Frs. 500 milliards were fixed to take into account the increased demand for bank credit by commerce and industry occasioned by higher price and wage levels and in order to permit the banks to regularise their position in meeting the *plancher* requirements. Rediscount ceilings might not now be exceeded during the course of the month and the Bank of France announced that it would also limit the extent of its intervention in the money market, which was to be restricted to meeting exceptional needs. Applications for supplementary finance must be moderate in amount and would be accorded against commercial paper on an *en pension* basis only and for a limited term. Such additional borrowing was also to be restricted to 10% of the primary ceiling and accommodation granted within this secondary ceiling was subject to a penalty in the form of a rate which at that time exceeded Bank rate by 1½%. The more important banks might still borrow from the Bank of France by way of *avances à 30 jours* against Treasury bills and « acceptances » of the *Crédit National*, but these advances were already subject to ceilings, in this case as fixed by agreements between the institutions concerned and the Bank of France. The only rediscounts *sans limitation globale* now permitted were the medium-term credits issued to finance the re-equipment of industry, since this remained a leading priority. In addition, from the beginning of 1952, it was decided that credits to finance exports (initially for a term of no more than 90 days, but subsequently extended to 180 days) might be « mobilised » at the Bank of France outside the ceilings either by outright sale or *en pension*. The subsequent growth in medium-term credits suggests that this particular concession may have been used by some banks as a partial evasion of the full rigour of the controls, but no doubt the authorities scrutinised developments very closely and, on balance, felt that the encouragement thus given to priority activities was justified.

Certain changes were also made in the operation of the qualitative controls. The « prior authorisation » procedure was now extended to include the commercial bill, which

had previously been exempted, but only the larger credits — in excess of Frs. 500 million in total instead of Frs. 100 million — had to be submitted to the Bank of France for its approval. In part, the upward revision of the qualifying limit for « prior authorisation » reflected the inclusion of the commercial bill, but it was also probable that with the more complete coverage given by alternative methods of credit control, « prior authorisation » by the Bank of France was now regarded as less necessary. In addition, by giving closer and more individual attention to the larger credit applications, the efficiency of the control was doubtless much improved and there was likely to be less delay in advising the Bank's decision. Credits below the limit for « prior authorisation » continued to be vetted by the banks themselves consistent with instructions issued from time to time by the Governor of the Bank of France as to the economic activities which should be encouraged or discouraged as the case might be. Thus, on December 21, 1951, the banks were advised that, from a study of the returns furnished to the Bank of France, it was clear that certain industries were still being given too much credit and that bank finance was being employed for the purpose of building up excessive stocks, often as a speculation against further rises in price. Every effort had to be made to reduce outstanding credits to these industries and applications for further accommodation must be refused. Credits to finance hire purchase were also to be reduced and a close watch was to be kept on those concerns which sought to secure additional liquid resources by requesting usances longer than were really necessary for the finance of the transactions specified in their applications.

As a result of these several modifications, the controls were now sufficiently strengthened to contain the inflationary pressure which had developed, though in the early months of 1952 the banks undoubtedly experienced some difficulty in adapting themselves to the new situation and applications for supplementary assistance were heavy. The tightening up of credit control came too late to moderate the exaggerated rise in domestic prices which followed Korea, but the intensi-

fication of control did materially assist in the achievement of relative stability at the new level.

V.

In March 1952, a new Government headed by M. Pinay came to power. Two governments had fallen in rapid succession and there was little to suggest that M. Pinay would be any more successful than his predecessors. The Treasury was faced with a heavy budget deficit and the country's foreign exchange position was serious. There was further pressure for increases in wages and the only really encouraging signs were the steady rise in industrial production and the falling trend in world prices for raw materials. On this slender basis, reinforced by a more determined credit policy, the Pinay Government proceeded to fight what might be termed a psychological battle for price stability. For a time, M. Pinay had public opinion on his side and this materially assisted him in managing a difficult Parliament. A fresh attempt was made to secure a more balanced position by reducing capital expenditure and by floating a national loan « in defence of the franc ». Despite provision for repayment on the basis of the market price for gold, this loan had only a limited success and the Government had to fall back on short-term borrowing from the banks. Drastic import restrictions were imposed and measures introduced to stimulate exports. However, the aspect of M. Pinay's policy which seized the public imagination was his attempt to reduce prices largely by Government precept and public exhortation. It may seem surprising, but to a certain extent this policy worked. As was only to be expected, its success was greatest during the first few months. Prices may not have been reduced very much but they were prevented from rising and, with the help of a good wheat harvest, the Government also managed to avoid a general wage increase.

M. Pinay was noticeably less successful in solving the balance of payments crisis. Tax relief and other measures to stimulate exports clearly failed and chief reliance had to be placed on an intensification of import restric-

tions. Unfortunately, the inflation of costs which had already taken place stifled exports more effectively than imports could be cut by administrative action. Pressure against the franc mounted and M. Pinay had to marshal all his resources of persuasion by continuing to emphasise that no devaluation was contemplated. Nevertheless, the deficit on the balance of payments continued to increase. For visible trade, it was Frs. 173.8 milliards in 1952 compared with Frs. 128.6 milliards in 1951.

It is something of a paradox that the fall of M. Pinay in December 1952 was in large measure due to the degree of his success. Any attempt to stabilise a price level after a long period of inflation is bound to be painful. The initial emphasis on disinflation and the prospect of lower prices brought with it a tendency to avoid commitments and to postpone purchases as long as possible. Bankruptcies and liquidations increased, though for the most part it was only certain sectors — textiles, leather goods and building — which suffered badly. Nevertheless, even a moderate amount of hardship, and in these sectors it was more than moderate, involved the Premier in a loss of prestige. He was faced with a dilemma. A really successful attack on prices required more disinflation and greater credit stringency, but this was bound to hurt and to breed opposition. A less restrictive credit policy would stimulate flagging production and employment, but the downward pressure on prices would have to be relaxed. M. Pinay decided to compromise and the credit restrictions were gently relaxed. In fact, he had very little choice. His policy depended on the support of public opinion and he was bound to fail as soon as his actions became sufficiently unpopular with a large enough section of the population.

Throughout the Pinay period, Bank rate was held at 4% and penalty rates could be applied to borrowing from the central bank beyond the ceilings. In a technical sense, the primary ceiling was held, though during the early months of 1952, the « safety valves » had had to be brought into play on a number of occasions. Latterly, credit restriction became less onerous because of the decline in prices

which diminished the necessity to seek accommodation to finance the holding of stocks. After April, there was some slackening in economic activity and there were also sectors of the economy — e.g. textiles and leather — which were depressed. The authorities felt that some relaxation was justified, in order to sustain production and employment. The ceilings themselves were maintained without revision, but there were other ways of supplementing the flow of money. There was, for example, quite a noticeable growth in medium-term loans to industry and this paper was not subject to rediscount ceilings. In addition, the State was obliged to borrow heavily from the banking system and 40% of the increase in the money supply was accounted for in this way. Further assistance could be given to the economy without breaching the primary credit ceilings by resort to open market operations and these facilities were in fact widened in order to assist the export trades. Yet the rate of increase in total money supplies had moderated. Between March and December 1952, these rose by some Frs. 400 milliards, but of this increase about Frs. 200 milliards related only to the last quarter of the year, when the hold of the Government was already weakening.

There have been several changes of government since that of M. Pinay, but over much of the period — until he succeeded M. Mendès-France as Premier — M. Faure remained Minister of Finance and this provided some continuity in policy. Initially, further advances had to be sought from the Bank of France, but as the fiscal position improved these special advances were progressively reduced. The budget deficit for 1953 was Frs. 637 milliards compared with Frs. 725 milliards for the previous year. Although government expenditure continued to exceed revenue, certain sections of the community were noticeably short of cash. These included both farmers and traders. There was a slump in the gold market — to the advantage of the Bank of France. More stable prices also forced down gold values and helped to restore a greater degree of confidence in the value of money. In September, 1953, Bank rate had been reduced from 4% to 3½% and, although the penalty rate

which was applied to borrowings beyond the primary ceilings was maintained at 5½% (i.e. the penalty itself had been raised from 1½% to 2%), the Government was clearly moving away from credit restriction as a major basis of policy. Bank rate was further reduced to 3¼% in February 1954 and again to 3% in December. In addition, there was an increase both in the amount and term of credits granted by the *Crédit National* for purposes of investment. Further encouragement to investment was given when government control over the capital issues of existing companies was removed in October 1954. There had already been a considerable revival of savings and greater activity in the capital market was the result.

There can be little doubt that the economic position in France has greatly improved. Prices have remained relatively stable. Budget deficits have been progressively reduced from the post-war peak of 1952. For 1953, the deficit was Frs. 637 milliards and for 1954 Frs. 287 milliards. The index of industrial production (including building) at end-1954 was over 65% higher than for 1938. The export position is much sounder, though much of this has only been achieved by means of substantial subsidies. Because of improved export receipts and some fall in the prices of imports and industrial raw materials, the economy is much more liquid. Gold and foreign exchange balances rose to Frs. 394 milliards by the end of 1954 as compared with Frs. 225 milliards a year earlier and, over the twelve months to December 1954, total money supplies increased by Frs. 625 milliards, the larger part — Frs. 384 milliards — being contributed by the growth in deposits. Much of the overall increase — over Frs. 340 milliards — occurred in the last quarter, as a result of which the expansion in money supplies began to outrun the rate of increase in industrial production. The apparatus of credit control was little used during 1954, though it remained in readiness. Commercial bank rediscounts had been well within the primary ceiling and the penalty rate — Bank rate + 2% — ceased to be operative. Nevertheless, much of the overall improvement was illusory. Balance of payments difficulties ceased to be acute, but only

because of the scale of direct aid from the United States. It was true that the terms of trade had improved and the export position was much better, but there was no escaping the fact that the relaxation of import restrictions was greatly assisted by the extent of external assistance. The position might best be described as one of unstable equilibrium, the economy being underpinned by American aid and favourable trading conditions. If France is to be truly restored to economic health, there is much yet to be done. Fiscal reform is urgent, so that a more equitable sharing of the tax burden can be achieved. The country must learn to live within its means and to balance its budgets. Above all, there must be continued price-wage stability, combined with a determination to reduce costs through improved productive efficiency.

VI.

Finally, we must attempt an evaluation of the techniques of credit control adopted in postwar France. In the judgment of the writer, most of our attention should be focussed on the use made of rediscount ceilings, since this was the means of making Bank rate effective and thus providing the controls with some sort of bite. Nevertheless, the ceiling technique was soon found to have its limitations. So long as the pressure against the ceiling was moderate, inflation could be contained and repressed. With the assistance of built-in safety valves, it was possible to accommodate a certain amount of additional strain. Beyond this point, however, the ceiling was likely to crack and, unless the authorities were prepared

to apply a positive discount policy, the only alternative was to raise the ceiling and to attempt to maintain it at its new and higher level. Once the banks began to anticipate such upward revisions, the position of the authorities became virtually untenable. For really effective action within ceilings which it was intended to hold, it therefore became imperative to penalise heavily any excess borrowing from the central bank. In the interests of « flexibility », supplementary assistance might be made available from time to time at the discretion of the authorities, but it was important that it should be limited in amount and strictly short-term in character. These were the lessons that the authorities learnt in the hard school of experience and the October 1951 arrangements represented the application of the knowledge so gained. There can be little doubt that their success in holding the ceilings thereafter owed much to the discriminating use made of interest rate policy. For full efficiency, therefore, the credit controls had to be comprehensive and complementary. Qualitative control was largely ineffective prior to the introduction of quantitative measures and the efficiency of the latter was greatly increased when combined with the vigorous application of penalty rates on excess borrowing. At the same time, no economy can be kept on an even keel by central bank action alone. A maximum contribution depends on the implementation of an appropriate and consistent fiscal and economic programme. Effective central bank action necessarily depends on the maintenance of a favourable environment and for this the government itself must accept the major responsibility.

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