

The French System of Monetary and Credit Controls*

The purpose of this article is to present French monetary and credit controls as a coherent system, to display the inner logic of this system, and to evaluate its implications for such policy objectives as economic growth, a stable price level, and a sustainable balance-of-payments situation. Despite its many elements in common with monetary and credit systems in other countries the French system is sufficiently different in the degree of "socialization" of credit and direct administrative intervention by the authorities into credit affairs that any simple interpretation of policy actions by French authorities that relies on direct parallels to practice in other countries is likely to prove misleading. The effects of even such traditional central banking techniques as open market purchases and sales and alterations in the central bank rediscount rate cannot be understood in the French environment without a grasp of certain general features of French financial institutions. Moreover, in assessing the actions of the monetary authorities it is important to appreciate the priority that French authorities assign to selective credit policy as distinct from general monetary policy and the extent to which their system permits them to intervene by administrative measures into the free play of financial market forces.

The French approach to national monetary and credit policy is based upon a political consensus that asserts the need to control the financial system in the service of national economic goals. This consensus was formed during the years of occupation and resistance in the second world war and appears to rest upon both a positive commitment to national economic planning and upon a critical view

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of the performance of banks and other financial institutions during certain episodes of pre-war French history.¹

By way of orientation a brief and thus oversimplified statement of certain key features of the French system is helpful. First from 1945 to date the French system of monetary and credit controls has assigned a higher priority to the allocation of credit than to control of the money supply. Second, to encourage investment and to assist French export industries in meeting foreign competition the level of French interest rates has been deliberately kept at a level below that of market equilibrium throughout this period.² Third, speaking broadly, the *Banque de France* (central bank) has the responsibility for controlling the money supply and short term credit; the Ministry of Economics and Finance exercises primary authority in the allocation of medium and long term credit.³ The institutional base for control of the money supply and short term credit is the banking system; that for control of medium and long term credit is the postal checking system, the network of Treasury local offices, the government budget, and the capital market, all of which are subject to control or influence by the Ministry of Economics and Finance either directly or via various intermediaries.

In the discussion that follows we develop these views in greater detail, examine the functioning and interaction of the systems for controlling money supply, short term and longer-term credit and consider their implications for objectives of French national economic policy.

I. Money Supply and Short Term Credit: The Institutional Base

In 1945 in a major step to establish government control over the financial system the French Parliament nationalized the *Banque de France* and the then four principal commercial (or deposit) banks

1 See P. BERGER, "Le Contrôle du Crédit en France", *Revue Politique et Parlementaire*, December 1962, pp. 36-39; P. BESSE, "Le Conseil National du Crédit", *Revue Economique*, No. 5, September 1951, pp. 578-80.

2 See P. BERGER, "Les Taux d'Intérêt en France", *Moneta e Credito*, Banca Nazionale del Lavoro, December 1964, p. 8.

3 F. BLOCH-LAINÉ, "Pour une Réforme de l'Administration Economique", *Revue Economique*, November 1962, p. 877; P. BERGER, *Monnaie et Marchés de Capitaux a Court Terme*, Centre d'Etudes Supérieures de Banque, Les Cours de Droit, Paris, 1965, pp. 104-09, 129-34.

with nation-wide branch systems. The same legislation established the National Credit Council (*Conseil National du Cr dit*) as the focal point for formulation of national policy for monetary and short-term credit affairs and provided for broad representation of diverse economic interests among its membership now 44 persons.⁴ The chairman of the National Credit Council is the Minister of Economics and Finance and the vice chairman and customary acting chairman is the Governor of the *Banque de France*. Other members represent the interests of labor, management, agriculture and certain government ministries and departments concerned with economic affairs. The Director of the Treasury is a non-voting member but functions as the principal representative of the government in the deliberations of the Council.

The line of policy implementation passes from the Council through the *Banque de France* and the Banking Control Commission to the Professional Association for Banks (*Association Professionnelle des Banques*) or alternatively to the Association of Financial Enterprises and Institutions (*Association Professionnelle des  tablissements Financiers*) for certain non-bank financial firms. It is the responsibility of these professional associations to see to it that their members are informed of the decisions of the National Credit Council as well as all banking regulations and mutual agreements concerning professional practice.

In French law "All enterprises or institutions whose customary business is to accept from the public, in the form of deposits or otherwise, funds which they use for their own account in discount, credit or financial transactions shall be regarded as banks".⁵ All such banks must be registered with the National Credit Council under one of three categories depending on their type of banking business. The categories are deposit banks (*banques de d p ts*), business banks (*banques d'affaires*) and banks for medium and long term credit (*banques de cr dit   moyen et   long terme*). Certain

⁴ See "Law of December 2, 1945 Regarding the Nationalization of the Bank of France and the Large Banks and Regarding the Organization of Credit", in *Central Banking Legislation, A Collection of Central Bank, Monetary and Banking Laws*, Vol. II, Europe, Ed. by Hans Aufrecht, International Monetary Fund, 1967, pp. 199-211, and D cret No. 67-748 du 30 Aout 1967 in CONSEIL NATIONAL DU CR DIT, *Vingt-Deuxi me Rapport Annuel*, Ann e 1967, Annexe A, p. 17.

⁵ See "The Law of June 13, 1941 Relative to Regulation of the Banking Profession", Article 1, in *Central Banking Legislation, op. cit.* p. 211.

banks with special legal status are not required to register since they are controlled under other legislation. These include the popular banks, savings banks, agricultural and professional credit associations.

The deposit banks accept sight and time deposits, make short and medium term loans (mostly by discounting bills), underwrite and deal in securities, and carry on a general banking business. Until January 1966 the deposit banks were prohibited from accepting savings deposits with terms above two years while the business banks could accept deposits with terms under two years only from a very limited clientele. The deposit banks can now accept deposits of any maturity while the business banks can accept deposits at sight or short term from anyone, but still serve a limited and traditional clientele of large firms and old families. The banks for medium and long term investment make investments whose maturity must exceed two years and in practice typically exceeds five years.

At the end of 1969 there were 191 deposit banks of various descriptions (including seven discount houses), 18 business banks, and 28 banks for medium and long-term investments.⁶ At year end 1969 total credit outstanding by these registered banks was F162.36 billion, of which the three nationalized deposit banks accounted for about F91 billion or 56 percent as shown in Table 1.

Regulatory decisions of the authorities (in this case the National Credit Council, the *Banque de France*, and the Banking Control Commission) reach the registered banks through the Professional Association of Banks in which membership is obligatory for each registered bank. Government authority over the nationalized banks is also expressed in the form of government ownership of their shares and appointment of their Boards of Directors. These Boards must represent a broad range of economic interests. Appointment to the Board is by or with the approval of the Minister of Economics and Finance. He must also approve the selection of the chairman and the general manager. Operating officers of these banks hold their appointments on indefinite tenure and may be removed by the authorities for cause, including failure to implement directives from the authorities. In addition, the Banking Control Commission appoints a permanent government auditor (*censeur*) for each of the nationalized banks with access to all meetings and records of these

⁶ See CONSEIL NATIONAL DU CR DIT, *Vingt-Quatri me Rapport Annuel*, Ann e 1969, p. 120.

TABLE I

CREDITS AND LOANS TO THE FRENCH ECONOMY FROM VARIOUS SOURCES¹
(end of 1969 in billion francs)

I. Bank Credit		F 213.07 ²
Registered banks	(162.36) ³	
Of which nationalized banks (91.0) ⁵		
Popular banks	(11.16) ³	
Agricultural Credit Intermediaries .	(37.85) ³	
Banque Française du Commerce Ext.	(1.70) ³	
II. Specialized Financial Intermediaries and the Treasury		165.74 ²
III. Financial Establishments		18.55 ²
(a) Based on bank credit	(11.49) ³	
(b) Capital and reserves	(6.43) ⁴	
(c) Discrepancy	(0.63)	
IV. Banque de France (includes only direct loans)		0.15 ²
Total		F 397.51 ²

¹ Excludes loans to regional and local public collectivities.

² CONSEIL NATIONAL DU CRÉDIT, *Vingt-Quatrième Rapport Annuel, Année 1969*, Annexes., Annexe 78, p. 214.

³ *Op. cit.*, Annexe 1, p. 55.

⁴ CONSEIL NATIONAL DU CRÉDIT, *Vingt-Quatrième Rapport Annuel, Année 1969*, p. 124.

⁵ Estimated from diverse balance sheet data for Crédit Lyonnais, Banque Nationale de Paris and Société Générale, in *Polks World Bank Directory*, 152nd edition, September 1970.

banks and the duty to report to the Commission. The Law of 1945 provides for nationalization of additional deposit banks should their characteristics (*e.g.* size and branch structure) become similar to the existing nationalized banks.

Operating control over those business banks whose balance-sheet together with off-balance-sheet liabilities exceed F20 million takes the form of a Government Commissioner appointed by the Minister of Economics and Finance and assisted by a Control Committee of three members chosen to represent labor, business and government interests. The Government Commissioner attends all meetings of the bank's board of directors and has a "veto over any

decision contrary to the national interest which is taken by the board of directors, by one of its committees, or by the general meeting [of stockholders]. ... He may present to the board of directors any measures which seem to him to be in the general interest and, in particular, those which conform to the wishes or decisions of the National Credit Council".⁷ A commissioner can also be named to those banks or financial establishments over which these business banks may possess or acquire control.

The authority of the National Credit Council extends also to firms and individuals whose financial business does not fit the category of registered banks but which are engaged in brokerage, short- or medium-term credit transactions and exchange transactions, or discounting, accepting as collateral, or cashing commercial paper, checks or government securities.⁸ At the end of 1969 there were 446 such firms⁹ with only F18.55 billion in credit extended of which almost two thirds or F11.49 billion represented credit they had received in turn from banks as shown in Table I. Decisions of the National Credit Council concerning the activities of these firms and individuals are transmitted via the Banking Control Commission and the Professional Association of Financial Enterprises and Institutions.

The *Banque de France* has the key functional position in this entire regulatory structure for money and short term credit.¹⁰ This is evident from the role of the Governor of the *Banque de France* as vice chairman and customary acting chairman of the National Credit Council and as permanent Chairman of the Banking Control Commission. Moreover the technical and professional skills he brings to these positions assure that his advice and recommendations will be accorded special weight in the decisions of these bodies.

A variety of establishments of semi-public character engage in banking and credit of a kind not dissimilar to that of the registered banks. These include popular banks specializing in banking for individuals and smaller enterprises, institutions for agricultural credit (*caisses de crédit agricole*) and for mutual credit, and the French Bank for Foreign Commerce (*Banque Française du Commerce*

⁷ See "Law of December 2, 1945", Title IV, Art. 11 in *Central Banking Legislation*, *op. cit.*, p. 203.

⁸ See "The Law of June 13, 1941 Relative to Regulation of the Banking Profession", Article 27 (2) in *Central Banking Legislation*, *op. cit.*, p. 218.

⁹ CONSEIL NATIONAL DU CRÉDIT, *Vingt-Quatrième Rapport Annuel, Année 1969*, p. 123.

¹⁰ P. BERGER, *Monnaie et Marchés de Capitaux à Court Terme*, *op.cit.*, pp. 104-09.

Extérieur). All these are under the direct control of government authority and are generally required by their respective authorities to observe the regulations and instructions ordered for the registered banks. Their contribution to credit outstanding at the end of 1969 also can be seen in Table 1.

II. Medium and Long Term Credit: Allocation and Control

The French government has the dominant voice in the allocation and control of medium and long term credit.¹¹ The primary locus of government authority over such credit is the Ministry of Economics and Finance, but policy is strongly influenced by the *Commissariat Général du Plan* and to a lesser degree by discretion left to various public and semi-public financial intermediaries with assigned roles in credit allocation. The means available to the government to control the allocation of medium and longer term credit include the tax, subsidy and loan program of the government budget, obligatory redeposit with the Treasury of the liquid resources of the organs of local and regional government and the postal checking system, policy control over the investment-allocation of savings that flow to savings banks via centralization of such funds in the public *Caisse de Dépôts et Consignations*, and control of access to the capital market. These domestic controls have been supplemented by exchange controls over capital movements between France and foreign countries that have varied in intensity in recent years and are currently (Fall 1971) both comprehensive and rigorous.

Direct investment aid from the state Treasury is channeled through the Fund for Economic and Social Development (*Fonds de Développement Economique et Social*) and may be in the form of grants or loans.¹² The FESD was created from the fusion of diverse state funds and stands at the center of financial procedures for granting state aid. Its Board of Directors unites the highest officials of the administration and of the various specialized financial establishments. The Board approves annually the investment program of nationalized industries (e.g. gas, electricity, coal, aircraft, railroad) which are financed by a combination of state and private capital.

11 J. DONY, A. GIOVINETTI, B. TIBI, *L'Etat et le Financement des Investissements Privés*, Editions Berger-Levrault, Paris, 1969, pp. 90-99.

12 J. DONY, A. GIOVINETTI, B. TIBI, *op. cit.*, pp. 95-102.

The Board also coordinates and encourages investment in other industries in accordance with the national development plan.

State intervention in the allocation of investment funds occurs at a level once-removed from the direct procedures of FESD via a variety of public and semi-public institutions chief among which are the *Caisse de Dépôts et Consignations*, the *Crédit National* (long term credits to private industry and commerce), the *Crédit Foncier* (war damage, construction, mortgage credit), and the *Caisse Nationale des Marchés de l'État* (mutual credit for professions, medium term credit for public enterprises). The *Crédit National* and *Crédit Foncier* operate either by granting loans or by signing their approval of medium term loans granted by the banking system thus making these bank loans eligible for rediscount at the *Banque de France*. They obtain funds for direct loans by issuing their bonds on the capital market or by rediscounting with the *Caisse de Dépôts*.

As the major channel through which private savings reach the money and capital markets the *Caisse de Dépôts et Consignations* is the dominant financial intermediary in the French financial system.¹³ Its resources come primarily from the network of public and mutual savings banks which are legally obligated to redeposit their funds with it.¹⁴ In addition it holds the liquid funds of the social security system. Prior to 1945 the resources of the CDC were largely absorbed in financing long term government debt. Inflation since 1945 has greatly reduced the share of such debt in the assets of CDC. Currently its major lending commitments are to finance housing construction and the construction needs of local governments. It also lends to public and mixed ownership industrial firms and purchases their bonds or, occasionally, stocks. Another major role of the CDC is loans to and rediscounting for financial institutions such as the *Crédit National* and the *Crédit Foncier*. Until recently the approval of the CDC has been required on all bank-initiated medium term loans eligible for rediscount at the *Banque de France*.

Neither the Treasury nor any of its so-called "correspondants" just discussed maintains deposits in the deposit banks. Instead deposits of liquid funds are made with the *Banque de France* either

13 *Ibidem*, pp. 95-102.

14 Until 1967 insurance companies and pension funds were required to deposit their liquid funds with the CDC. Since 1967 they may place them in the money market. This is a change from the closed Treasury circuit in favor of the banking system.

directly by the institution (Treasury or CDC) or indirectly through prior deposit with the Treasury (as in the case of local authorities and of the giro payments system operated by the Post and Telegraph System). This fact together with the guidance of credit flows moving through the system according to criteria derivative from national economic policy gives rise to the phenomenon of the "Treasury circuit" with implications both for monetary policy and for credit policy.¹⁵

Net drains from the commercial banking system into the Treasury circuit occur whenever depositors in banks make payments into accounts in the postal giro system, pay taxes, purchase newly issued government debt, or place savings in savings banks. Most such funds are promptly returned to circulation by government disbursements, investment expenditures by loan recipients and in other ways. But the banking system can lose liquidity on balance owing to timing lags, a decision by Treasury *correspondants* to increase their liquid balances, or a permanent shift in savings or payments habits of the population toward the Treasury circuit. Any net drain on banking liquidity into the Treasury circuit must be settled in the form of a transfer of deposit claims on the books of the *Banque de France*, i.e. in central bank money. This, then, is an aspect of the Treasury circuit with implications for monetary policy.

Implications of the Treasury circuit for credit policy and for the interaction of credit policy with monetary policy (e.g. rediscounting of medium term loans by the central bank) are far more profound. Provisions for the rediscounting of medium term loans by registered banks at the CDC, *Crédit Foncier*, the *Crédit National* and at the *Banque de France* are among the major gaps in the central bank's controls over the money supply and will be discussed below.

Allocation of credit to the economy by the Treasury and other institutions constituting the Treasury circuit is intended to serve national goals as defined in French national economic plans. The volume of such credit outstanding at the end of 1969 is shown in Table 1 as F165.74 billion. This sum, which exceeds that of the registered banks, is understated by the omission from the table of

¹⁵ F. BLOCH-LAINÉ, P. DE VOGÜE, "Le phénomène du circuit", in *Le Trésor Public et le Mouvement Général des Fonds*, Presses Universitaires de France, Paris, 1960, pp. 271-83; P. BERGER, *Monnaie et Marchés de Capitaux à Court Terme*, op. cit., pp. 129-34; M. WALTER, "Problèmes de Trésorerie Rencontrés par les Banques Françaises", *Revue de Science Financière*, April-June 1965, pp. 244-45.

loans to local public collectivities. A balance sheet for the CDC shows these in the amount of F37 billion as of September 30, 1969.¹⁶

Credit through the Treasury circuit customarily is offered to eligible borrowers at interest rates below those prevailing in the banking circuit. Moreover, the interest rates as well as the volume of funds allocated through the Treasury circuit are less variable in response to credit and business conditions than through the banking circuit.¹⁷ The supply of funds through the Treasury circuit has been guaranteed in part by the government's administrative controls over savings flows, in part through the use of tax differentials to favor deposits and debt sales by the Treasury and its *correspondants*, and in part by enlisting monetary expansion via rediscounting with the *Banque de France* as an ultimate source of funds for the Treasury circuit and its clients should other sources prove inadequate.

It is these two forms of interlock between monetary and credit policy and between the banking system and the Treasury circuit that make it impossible to understand French monetary and central banking policy without attention to credit policy, the role of the Treasury and its *correspondants*, and of the responsibilities of the central bank in the realm of credit policy. The implications of these interrelationships will be developed more fully in the discussion that follows of the central bank's responsibility for monetary policy.

III. General Instruments of Monetary and Credit Policy

In France as in other countries the money supply may be defined as currency in circulation plus demand deposits and, according to one's purpose, time and savings deposits. In any such system the ultimate reserves of the banking system are currency and claims against the central bank. By regulating the terms of access by the banking system to claims against the central bank the latter influences commercial bank behavior and thus the money supply.

In the French system as elsewhere the supply of claims against the central bank that is available to the banking system depends

¹⁶ *Journal Officiel de la République Française*, January 8, 1970, p. 352.

¹⁷ S. GUILLAUMONT-JEANNENEY, *Politique Monétaire et Croissance Économique en France, 1950-1966*, Librairie Armand Colin et Fondation Nationale des Sciences Politiques, 1969, pp. 118-121.

not only on actions by the monetary authorities but also upon the demand of the public for currency, the condition of the government budget with respect to balance or imbalance between revenues and expenditures, the implications of this for government finance and debt management, and upon the balance of payments as this gives rise to a net inflow or outflow of foreign exchange. The following discussion focuses on the instruments and policies of the central bank but will refer briefly on occasion to these other influences when they are particularly relevant.

The general (i.e. non-selective) instruments of central bank policy usually are taken to be rediscounting, open market operations, and minimum reserve requirements. This general usage is followed here. However, as will become clear, both rediscounting and minimum (asset) reserve requirements have been and are used by the *Banque de France* for selective ends.

One fact is central to an understanding of the varied approaches of the *Banque de France* to the regulation of the French money supply. At no time since the end of the second world war has the rediscount rate (or more properly, the array of rediscount rates) charged by the *Banque de France* been high enough to prevent the demand for credit in the economy from causing too rapid an expansion in the money supply for reasonable stability in the general price level.¹⁸ Deprived of the interest rate as an adequate price-rationing device for control of the money supply, the *Banque de France* has had to rely on a variety of expedients such as asset reserve ratios, ceilings on primary rediscount lines, changed definitions and procedures for prior approval of paper eligible for rediscount, and imposition of ceilings on the granting of credit by banks and other financial institutions. Moreover, the existence of privileged categories of paper eligible for rediscount "above ceiling" ("hors plafond"), such as credits for medium term equipment loans and export credit, has always provided the banking system and the economy with channels by which to vitiate measures by the *Banque de France* to restrict monetary expansion. Only credit ceilings are free of this defect. But they have other severe disadvantages.

¹⁸ On this point see R. MARJOLIN, J. SADRIN, O. WORMSER, *Rapport Demandé, par Décision en Date du 6 Décembre, 1968*, Paris, April 6, 1969, pp. 4, 9; P. BERGER, "Les Taux d'Intérêt en France", *loc. cit.*, p. 8; *Les Instruments de la Politique Monétaire en France* (Document rédigé à l'intention du Comité Monétaire de la Communauté Economique Européenne), Banque de France, October 1968, p. 30.

*Rediscount Policy.*¹⁹ Rediscounting has been the principal channel through which the *Banque de France* regulates bank liquidity, although recent reforms have increased the relative importance of open market purchases and sales in making short-term adjustments in bank liquidity. Discount facilities at the *Banque de France* are available by law to "any member of the public" but in practice only discounts for registered banks and the public- and semi-public financial institutions mentioned above are quantitatively important. Each bank is assigned individually a discount limit (its *plafond de réescompte*) up to which it may discount at the *Banque de France* at the basic discount rate. On occasion the authorities have reduced these rediscount ceilings across the board, for example in 1951 and 1956 and most recently in October, 1970. Supplementary and temporary accommodation has been available under various arrangements at rates above the basic discount rate. Following the disorders of May-June 1968 these ceilings were temporarily raised by 20 per cent across the board to aid in the economic recovery. At the end of October 1968 they reverted to their previous level.

Since 1951 supplementary and temporary accommodation ("en pension" or "under repurchase agreement") has been available at rates above the basic rediscount rate. Until December 1967 this was largely through the rediscount channel in two steps: the so-called "hell" and "super-hell" rates. Since December 1967 the *Banque de France* has made such credit available only through open market purchases on repurchase agreements (en pension) and at a rate of interest 2½ per cent above the basic rediscount rate. This "super-enfer" channel has been used very little because the central bank prefers the open market channel at variable rates close to the rediscount rate.

Properly drawn commercial bills are eligible for rediscount. In addition a variety of credit instruments are accorded the privilege of being discountable at the basic rate but in excess of a bank's discount ceiling ("hors plafond"). These include medium term loans to finance housing, industrial equipment and exports, and grain storage bills. To be discountable the medium term credits require the endorsement of one of the specialized financial institutions (e.g. *Crédit National, Crédit Foncier, Caisse des Dépôts*) and the prior approval of the *Banque de France*. Most medium term credits that

¹⁹ *Les Instruments de la Politique Monétaire en France, op. cit.*, pp. 32-35, 44-46.

are discounted at the Banque de France have first been discounted at one of the public institutions such as the *Crédit National*, *Crédit Foncier*, or the *Caisse des Dépôts*. For tap Treasury bills (*bons du Trésor sur formule*) there has been a privileged discount rate below even the basic discount rate.

The privilege accorded to banks of rediscounting medium term credits for housing and industrial equipment, export credits, and grain storage bills above the banks' individually assigned discount ceilings has its rationale in credit policy considerations. These are preferred credit categories which the government wishes to encourage the banks to support. In practice these privileged categories have become the avenues for bank rediscounting that has been excessive in its effect on the liquidity of the banking system and on the money supply within the limits of interest rate policy that the authorities have been willing to enforce. In short, the authorities have been unwilling to rely sufficiently on price rationing of central bank credit to check the inflationary expansion of commercial banks' loans and deposits supported by rediscount credit at the central bank. To restrict the volume of such credit-instruments eligible for rediscount the authorities have resorted to two additional types of non-price rationing. They have limited the central bank's obligation to accept Treasury debt instruments and medium term credits for rediscount except by prior agreement; and they have introduced asset-reserve requirements to freeze bank holdings of both government and private paper that would otherwise have been eligible for rediscount.

Under present policy *medium term credits* are eligible for discount when they carry three signatures and are presented to the central bank by the intermediary of one of the specialized public or semi-public institutions. In practice one of these institutions provides the third signature. Their approval is given only if the basic credit meets criteria of national policy with respect to facilitating purchase of industrial equipment or a program of modernization. Note that eligibility for rediscount is determined on a case-by-case basis, normally by review at the time the commercial bank is making the basic loan.²⁰ Although the criteria by which a credit may be endorsed for rediscount have varied from time to time to allow for changing credit conditions, the overall volume of such paper presented for

²⁰ *Ibidem*, pp. 54-55.

discount has remained excessive from the viewpoint of monetary stability.

Prior to 1958 the Banque de France had to accept Treasury bills and notes under three months maturity for discount at a fixed rate without discretion. From 1958 it was relieved of this obligation and from December 1960 the discounting of such short term public bills was made subject to prior agreement. By this time, however, the low rate of interest on such bills sold to the banks on tap, the freezing of banks into holdings of such bills by means of the Treasury floor (see below), and the more balanced state of the national budget had greatly reduced the significance of Treasury bills held by the banks as rediscountable paper. Since 1969 the *Banque de France* acquires these Treasury obligations through open market channels and at variable interest charges of its own selection depending on policy considerations. Treasury obligations may also be used by banks to collateralize "advances" from the *Banque de France* at a rate $1\frac{1}{2}\%$ above the basic rediscount rate.

Reserve ratios: Since 1945 French banks have been subject to three different reserve requirements in the form of required minimum ratios between specified assets and specified liabilities. The first of these, the Treasury "floor" (*plancher*) came into existence on October 1, 1948 and required the banks to retain at least 95 per cent of their portfolios of government obligations on hand as of September 30, 1948 and to invest in such obligations 20 per cent of any increase in deposits above their level on that benchmark date.²¹ The purpose of the "floor" was to prevent the monetization of government debt at a time when the government budget still was running substantial deficits, a monetization the banks had been able to cause by discounting Treasury notes and bills at the central bank or letting them mature without renewal. The "floor" also provided funds for the Treasury at rates some 2% below prevailing market rates of interest. In more recent years following the introduction of the bank liquidity coefficient ("coefficient de trésorerie") and the improvement of government finances with more balanced budgets, the Treasury floor has been progressively reduced until removed altogether in 1967.

²¹ P. BERGER, "Le Contrôle du Crédit en France", *loc. cit.*, pp. 43-44.

A second liquid asset ratio or bank liquidity coefficient ("coefficient de trésorerie") was introduced in October 1960 with effect from January 1961.²² The primary purpose of this coefficient was to reduce the volume of medium term credits eligible for rediscount that the banks could actually use to borrow at the central bank. The bank liquidity coefficient specified a minimum ratio between certain of the banks' liquid assets and their deposit liabilities. The liquid assets eligible to satisfy the requirement were of two kinds: (1) cash assets including vault cash, demand claims against the Treasury, the postal checking system and the Banque de France; and (2) a second category composed of rediscountable medium term credits, grain storage bills, and rediscountable export credits. Treasury notes and bills held to satisfy the Treasury "floor" requirement also counted toward the bank liquidity requirement. Thus the coefficient acted to freeze the banks into a portion of their stock of liquid assets that they might otherwise have presented for rediscount.

Introduced at 30 per cent of deposits in January 1961, the bank liquidity coefficient was progressively raised until it reached 36 per cent in May 1963 at which level it remained until January 1966 when it was reduced to 35 per cent. On occasion it was also varied downward to aid the Banque de France in relieving month-end tightness in the money market.

In January 1967 the French monetary authorities introduced for the first time a system of required minimum reserves in the form of non-interest bearing deposits at the Banque de France.²³ On this occasion both the Treasury "floor" and the bank liquidity coefficient were canceled and their place taken by a so-called "coefficient of retention" ("coefficient de retenue") which specifies a "minimum portfolio of rediscountable bills representing medium term credit" fixed as a percentage of banks' deposits.²⁴ Once again the purpose has been to freeze in bank portfolios a portion of existing bills eligible for rediscount and thus to limit rediscounting above ceilings for discounts at the basic discount rate. The definition of the new coefficient is such that two categories of bills formerly covered by the bank liquidity coefficient ("coefficient de trésorerie") have regained unrestricted rediscountability above discount ceilings. These are short term export credits (under two years, or more recently

²² *Les Instruments de la Politique Monétaire en France, op. cit.*, pp. 38-39.

²³ *Ibidem*, pp. 38-43.

²⁴ *Ibidem*, pp. 46-48.

under 18 months) and grain storage bills guaranteed by the Office of Cereals.

When introduced the "coefficient of retention" was regarded as transitional between the asset-reserve requirement of the "coefficient de trésorerie" and the newly established system of minimum required reserves in the form of deposits with the Banque de France. Apparently the authorities expected the latter reserve requirement to be so effective as to make the asset-reserve requirement redundant. Experience has demonstrated otherwise.²⁵ After lowering the "coefficient of retention" successively from 20 per cent in January, 1967 at time of introduction to 13 per cent in July, 1968, the authorities have had to raise the coefficient on three occasions, most recently in April, 1970 at which time it was set at 16 per cent.

The shortcomings of the system of minimum cash reserves (deposits at the *Banque de France*) are inherent in the French system of monetary and credit controls. Such reserves, like open market operations, are effective restraints on bank-credit expansion only if the banks are prevented by cost considerations or administrative denial from offsetting an increase in minimum required reserves or open market sales by recourse to further rediscounting of eligible paper. In the French system the rediscount rate is maintained at too low a level to have this effect and privileged channels for rediscounting remain open in the service of national priority uses of credit. Thus an increase in required reserves simply results in an offsetting increase in rediscounting so long as the banks have eligible paper to spare. The role of the coefficient of retention is to freeze the excess stock of such paper into bank portfolios while permitting *currently created*, discount-eligible credits to enjoy their privileged status. The objective is to allocate credit to priority uses at favorable interest rates.

Effective April 1, 1971 French banks are required to hold minimum obligatory cash reserves defined as a percentage of their credits as well as of their deposits. The stated rationale for a separate reserve requirement against bank credit is that this will give the authorities more direct influence on credit expansion regarded as a process responsible for money creation.²⁶

²⁵ BANQUE DE FRANCE, *Compte Rendu des Opérations*, Exercice 1969, Edition Provisoire, Paris, June 1970, p. 33.

²⁶ CONSEIL NATIONAL DU CRÉDIT, *Vingt-Cinquième Rapport Annuel*, Année 1970, Edition Provisoire, pp. 1-14.

Open market policy: In France the short-term money market in which the *Banque de France* intervenes with open market operations is restricted to banks, financial establishments, public and semi-public financial intermediaries and certain insurance companies and pension funds.²⁷ Thus it is nearly analogous to the federal funds market in the United States. Operations of the *Banque de France* in the money market are limited by decision of the Banque's General Council to Treasury notes, "mobilization bills" (i.e., a short term bill drawn in favor of a banker and secured by other liquid bills) that the *Banque de France* has approved for rediscounting at time of issue, bills guaranteed unconditionally by the *Caisse National des Marchés de l'Etat*, and sight bills issued by the National Society for Railroads. When the supply of such bills is inadequate for open market operations the *Banque de France* on its own initiative will accept commercial bills at a higher rate of discount. Thus, during 1968 and 1969 when bank liquidity was drained both by a massive outflow of foreign exchange and by a substantial increase in the public's demand for currency, open market purchases ("en pension") were broadened to include both commercial bills and even some paper technically ineligible for rediscount. Since 1968 the *Banque de France* has sought successfully to enlarge the role of open market operations in extending credit to the banking system. A principal reason for this emphasis has been the desire of the *Banque de France* to achieve greater interest-rate flexibility in its credit operations than rediscounting practice (with its privileged categories) makes possible. The *Banque de France* intervenes in the market at rates set by the Governor in the light of policy considerations. These rates may vary from day to day. The influence of the Euro-currency market on short term international capital flows has been a principal force stimulating the adoption of more flexible rate policy in the French money market.

IV. Direct and Selective Instruments of Monetary and Credit Policy

The monetary and credit authorities in France have utilized in recent years a variety of direct and selective policy instruments to supplement the more general instruments just discussed. These

²⁷ *Les Instruments de la Politique Monétaire en France*, op. cit., pp. 48-52; R. MARJOLIN, J. SADRIN, O. WORMSER, op. cit., pp. 79-80.

include control of deposit and lending rates set by banks and other financial firms, regulation of interest rates on government securities, annual and month-by-month controls on the maximum permissible rate of expansion in bank credit, direct administrative review of bank discounts and loans for larger borrowers, control of security issues of borrowers in the capital market, control of instalment credit terms and of maximum loan-to-capital ratios for instalment lenders, a variety of controls on international capital movements, and general price controls. In addition, the public and semi-public financial intermediaries such as the *Caisse des Dépôts et Consignations*, the *Crédit Foncier*, the *Crédit National* are subject to direct administrative control with respect to their lending, discounting, and endorsement policies.

Perhaps the most precise of these direct controls is that exercised by the *Banque de France* over bank credits whose eligibility for subsequent rediscounting the bank wishes to establish.²⁸ To establish such eligibility the lending bank must submit full credit information on the loan and borrower to the *Banque de France* for review and approval at the time the loan is made. If the *Banque de France* does not find these aspects of the loan in conformity with its established policies it will refuse its approval for rediscount. Ordinarily the lending bank will not make a loan to which the central bank has taken exception. In addition to such review until June 1969 any bank credit extended to a firm that brought the total such credit by one or several banks beyond F10 million could not be granted without the prior approval of the *Banque de France*.²⁹ In June 1970 the requirement of prior approval was suspended and replaced by a system of ex post reporting for loans to enterprises that bring the total credit to the enterprise to an amount in excess of 25 million francs. These measures permit the *Banque de France* to exercise a rather detailed direct supervision over the amount and terms for bank credit to major borrowers and to enforce its conformity to national policy. As a further control the banks are required to report monthly to the central bank's *Service Central des Risques* total short term credits outstanding to a firm or individual in excess of F100,000.³⁰ Banks are still required to be able to justify on

²⁸ *Les Instruments de la Politique Monétaire en France*, op. cit., pp. 52-55.

²⁹ *Ibid.*

³⁰ *Ibid.*, pp. 52-55; CONSEIL NATIONAL DU CRÉDIT, *Vingt et Unième Rapport Annuel*, Année 1966, pp. 34-36.

request of the *Banque de France* any credit subject to this reporting. Such a census is very helpful to the National Credit Council in observing the responsiveness of credit flows to national policy objectives. Eighty-five per cent of bank credit is subject to reporting and review at the present time.

A second important direct control is regulation of the maximum rate of bank credit expansion.³¹ This measure was first introduced in February 1958 and later suspended. It was reactivated in September 1963 and remained in force until June 1965 when it was again suspended. Reactivated again in November 1968 credit ceilings remained in force until late October 1970 when they were suspended once again. In setting ceiling rates for bank credit expansion the *Banque de France* has sometimes exempted the high priority categories of export, medium term investment, and construction credits from the ceilings and on other occasion has permitted these categories to expand at higher rates than bank credit generally.³²

Regulation of lending and borrowing rates of interest is another direct control actively employed by the authorities. Virtually all key interest rates on bank deposits and loans, on short and medium term credit through banks and other financial institutions, in the money and government securities markets, rates paid on various forms of saving, and interest rates on loans to priority national uses of credit made by the public and semi-public financial intermediaries are subject to regulation either formally or informally. The only major exception to such control is occasioned by the need to pay interest on large savings deposit balances (over F100,000) which are sufficiently competitive with Euro-dollar rates to prevent the outflow of foreign exchange to the international money market through commercial leads and lags and other loopholes in exchange controls. Interest rates on time deposits and non-negotiable certificates of deposit for maturities in excess of one year also have been exempted from ceilings in an effort to entice savers to make longer-term commitments.

Interest rates on bank credit are not formally controlled but the nationalized banks receive administrative guidance in setting rates and all three nationalized banks use an identical and mutually

³¹ *Les Instruments de la Politique Monétaire en France, op. cit.*, pp. 56-57. A decree of the Ministry of Economics and Finance dated 5 February 1970 formally extended to the specialized banks the authority of the *Banque de France* in regulating credit expansion previously limited to the "registered banks".

³² BANQUE DE FRANCE, *Compte Rendu des Opérations, op. cit.*, p. 35.

agreed rate schedule. To influence bank lending terms the *Banque de France* has provided rediscounts at more than a dozen different rates when the basic, privileged, and penalty rates are counted. Schedules of various allowable bank fees and charges are set by the National Credit Council. Changes in the *basic* rediscount rate have been accompanied by suggestions to the nationalized banks that they alter their customer rates by lesser or greater amounts. These suggestions are always followed. The *Banque de France* with the aid of the public and semi-public financial intermediaries reviews lending terms on all credits whose eligibility for rediscount depends on their prior approval and will refuse this approval if the *terms* are not to its liking.

The money market is a kind of annex to rediscounting, and its rate is determined by the rate at which the *Banque de France* participates in the market. But here interaction with the Euro-dollar market limits the full freedom of action of the French authorities. Interest rates on Treasury bills, notes and bonds are set by the Treasury at time of issue. Tap Treasury obligations, regardless of maturity, are redeemable at the central bank beginning three months after issue at a slight penalty in realized interest. Registered banks are forbidden to discount Treasury notes for their customers at other than authorized rates specified in a maturity schedule. Thus the rates on government debt are regulated.

The lending and deposit rates of savings banks, popular banks, agricultural banks and mutual credit associations are subject to control by appropriate authorities such as the Ministry of Economics and Finance, and the Ministry of Agriculture and are ordinarily adjusted in conformity with policy action by the National Credit Council and the *Banque de France*.

On the basis of this review one may conclude that every important interest rate in France is subject to a very substantial measure of direct government influence or even outright control. Clearly this is only possible because of the comprehensive breadth of the system of credit controls as outlined in the foregoing discussion. This system includes control of access to the capital market and, since September 1968, comprehensive foreign exchange controls.

V. Evaluation and Commentary

The French system of monetary controls is contained within a broader framework of credit controls operated in the service of national economic goals. The system of credit controls is comprehensive. Flows of credit through the commercial, savings, agricultural, and popular banks, the postal checking system, financial intermediaries, the money and capital markets and the government budget are regulated as to terms, conditions, purpose and, in certain instances, even specific borrower, in the service of national goals. A succession of national economic plans has expressed these goals which have included the modernization of the technical and organizational structure of industry, further industrialization, modernization of agriculture, construction of housing, expansion and modernization of transportation and public utilities, and encouragement of exports to achieve a favorable current-account balance in international transactions.

Throughout the years since 1945 successive French governments have been strongly committed to a low interest rate policy. The rationale for this policy is that it encourages investment required for the success of the national economic plans and, by keeping interest costs low, contributes to the price competitiveness of French exports in international markets.³³ To safeguard the benefits of a steady supply of credit at low interest rates to high priority uses the Ministry of Economics and Finance has supervised a "Treasury circuit" to gather and disburse funds and the *Banque de France* has provided privileged access to rediscount facilities for paper related to export financing, construction, and medium term business investment.

These features of the French system of monetary and credit controls have modified substantially the significance of traditional instruments of central bank policy: changes in rediscount rate and reserve requirements, and the use of open market policy. The rediscount channel normally accounts for the major portion of central bank credit to the French banking system. Moreover the banks are permanently indebted to the central bank and this indebtedness has increased steadily year after year. Potentially, there-

³³ J. DONY, A. GIOVINETTI, B. TIBI, *op. cit.*, pp. 297-298; P. BERGER, "Les Taux d'Intérêt en France", *loc. cit.*, p. 8.

fore, a rise in the rediscount rate could exert a potent force on the cost of bank credit. But this force has been blunted in its impact on the banks and on the cost of credit in the economy by the existence of the privileged categories for rediscounting and the "Treasury circuit".

On occasion a rise in the basic discount rate has not been accompanied by a change in the lower rates for privileged categories. Even when these special rates were changed they remained below the basic rate. As a result a rise in the basic rediscount rate typically has had only a very attenuated effect on the actual cost of rediscounting subsequent to the rise.³⁴ Open market operations traditionally have been of very limited importance in the French system and have accounted for an almost insignificant portion of total central bank credit. Thus a rise in the *Banque de France's* intervention rate on the money market has affected a minor portion of central bank credit and, moreover, has tended to divert borrowing to the privileged rediscount categories. A similar difficulty has hampered the effectiveness of reserve requirements in that an increase in reserve requirements has tended to be offset by an increase in rediscounting.

The essential difficulty with all three of these traditional instruments of central banking policy has been the opposition to their effectiveness posed by the government's commitment to low interest rates and preferred credit categories as a means for allocating real resources to priority uses. Not only have the traditional instruments of monetary policy been restrained in application by considerations of credit policy, but a substantial portion of the total flow of credit in the economy has been sheltered from their influence by the operation of the privileged "Treasury circuit" to be discussed below.

Recourse by banks to the privileged rediscount categories has prevented the *Banque de France* from controlling the money supply. Regardless of efforts by the *Banque de France* to control the money supply by traditional instruments the privileged rediscount channels have allowed the money supply to expand in response to the presentation for rediscount of the privileged types of credit paper.³⁵ There is no necessary relationship between the volume of such paper created and presented to the central bank which leads to growth in the money supply and the needs of the growing French economy for additional money. The situation is analogous to that under the

³⁴ R. MARJOLIN, J. SADRIN, O. WORMSER, *op. cit.*, p. 69.

commercial bills doctrine adopted as a guide to discounting by other central banks at an earlier time.

Most of the non-traditional instruments employed by the *Banque de France* have had their origin in attempts to control the expansion of bank credit and money supply without resort to adequate increases in the level of interest rates. The three successive asset reserve requirements imposed on banks namely the floor (*plancher*) for holdings of Treasury notes, the bank liquidity coefficient (*coefficient de trésorerie*) and the current coefficient for retention of medium term rediscountable paper (*portefeuille minimum d'effets représentatifs de crédits à moyen terme*) have aimed at freezing a portion of the existing stock of rediscountable assets in bank portfolios so as to slow down monetary expansion. So long as credit policy dominates monetary policy, application of such asset reserves will almost certainly be among the improvisations needed by the *Banque de France* in its attempts to fulfill its assigned tasks.

In a system of comparatively free credit markets all interest rates move upward when the central bank slows the rate of growth in the money supply relative to that in the real magnitudes of the economy. This response is muted in the French economy owing to restraints exerted through administrative controls rather than through market processes. A prime example of this is the use of ceilings on the rate of bank credit expansion. Such ceilings restrain both the supply of bank credit and the demand by banks for central bank credit. In a free market situation such ceilings on bank credit would be accompanied by a rise in interest rates charged by banks to their customers. In the French system this is prevented by administrative suggestions and informal but powerful understandings among officials of the appropriate government ministries, the National Credit Council, the *Banque de France*, the financial intermediaries and secondary discount institutions, bank officials and others.

Since 1945 the government has had all the legal authority it needs over the banking and credit establishments and institutions to make its suggestions and directives prevail: witness the nationalized status of the principal branch banks. The stock in these banks is held by the government so that within reason their profits are no constraint on national credit policy. Moreover their managers and directors hold office at the pleasure of the government and can be

³⁵ *Ibid.*, pp. 70-71.

removed for failing to follow directives from the authorities. These and other sanctions guarantee their compliance with national policy. Thus, credit ceilings and interest rate controls have been combined to restrain credit while maintaining a relatively low level of interest rates. Here again these devices are likely to remain as persistent features of the French monetary and credit system so long as credit policy continues to dominate monetary policy. Of course, the credit ceilings may be suspended from time to time when conditions permit and interest controls can be latent when relaxed credit conditions are possible.

International capital flows have posed problems for the French system of monetary and credit controls as they do for most countries. But the implications for France are different from those for a country which has no carefully formulated national policy for credit allocation. For France a major capital inflow may pose problems not only because it expands the money supply and thus may add to domestic inflation, but also because it may bypass the carefully designed system of credit controls. Thus money obtained from a capital inflow may be spent for investment purposes other than those of high national priority since it is not subject to initial credit review. Moreover, if the authorities find it necessary to offset the inflationary thrust of capital imports by tightening credit at home, they may actually have to reduce the flow of credit to categories which they would prefer to the use made of the capital import.

Given the credit allocation and real investment objectives of the French authorities one can imagine that they would prefer comprehensive foreign exchange controls to an open frontier were it not for the substantial reciprocal benefits of the latter. Indeed, a recent careful review of the legislation and regulations which replaced long-standing exchange controls in 1966 concludes:

Reaction to these new regulations was enthusiastic: government officials announced that a new era of economic freedom in international relations had begun, and various commentators concurred. But while it is true that the new regulations largely abolish control of foreign exchange as such, there has been no substantial liberalization of governmental control over investments by foreigners in France. Indeed, under the new regulations investments are submitted to control procedures which in certain circumstances, are more rigorous than antecedent measures.³⁶

³⁶ CHARLES TOREM and W.L. CRAIG, "Control of Foreign Investment in France", *Michigan Law Review*, Vol. 66, No. 4, February 1968, p. 670.

Thus, practice with respect to foreign investments appears to follow the logic of the system of credit controls whether a system of foreign exchange controls is officially operative or not.

Existence of the "Treasury circuit" poses problems for monetary policy. These are not separate from but an expression of the problem posed by general credit policy. Substantial resources flow into this circuit by virtue of administrative decision rather than market forces. Among these resources are savings collected by savings banks, liquid funds of the postal checking system, proceeds of bonds and notes sold by certain public and semi-public financial institutions, and an allocation from the government budget. Typically the interest rates charged on loans or credits made through the "Treasury circuit" are set by law or by the decision of a government ministry, or the government-appointed governing board of one of the financial intermediaries and do not vary flexibly with central bank policy. Moreover the flow of resources into the "Treasury circuit" has been in the past, and to some extent still is, encouraged by favorable tax treatment of interest paid on liabilities issued by members of the circuit, their favored access to the capital market, and by restricting competition for savings by the banking system. Changes introduced in 1967 and subsequently with a view to encouraging a higher level of aggregate saving in the economy have reduced though not removed these differential advantages of the Treasury circuit.

Thus far we have described the French system of monetary and credit controls and considered some of its more important implications, particularly for the interpretation of French monetary policy. Now we shall discuss its major defects. The most obvious defect is that the system is biased towards inflation. Under this system it has been impossible for the *Banque de France* to control the money supply. For the actual growth in the money supply to be so adjusted to growth in real economic magnitudes as to achieve price stability would be purely fortuitous and is most unlikely. This prospect of continuous inflation carries implications for the rate of voluntary saving in the French economy and for the persistent reappearance of balance-of-payments deficits leading to the need for periodic devaluations. Only if the outside world inflates at an equal or faster rate will periodic devaluations prove unnecessary.

The problem of inadequate aggregate saving in the French economy is recognized as a central one by French officials and economists. To speak of inadequate saving implies some stipulated invest-

ment goals and a desire to avoid or at least restrain inflation. The French economic plans confirm both objectives. French economic analysis, both official and private, views both business and household saving as inadequate. The French have business saving in mind when they refer to the low proportion of firms' capital investment programs contributed by their retained earnings. This problem is partly a matter of tax policy but more importantly of cost inflation pressing against price controls and squeezing business profits.³⁷ There is a tendency among French authors to look toward foreign competition as an explanation for low profit margins, but this neglects the contribution of domestic cost inflation and price controls.³⁸

The detrimental influence of inflation on the amount of saving done by households and on their choice of assets is recognized to the point of lamentation in French official and private writings. After fifty years of almost uninterrupted inflation household savings habits have become adjusted to the shrinking value of fixed income assets so that long term bonds whether state or private are regarded as unattractive unless indexed. Since 1958 issue of indexed bonds has been forbidden. Stocks are not very attractive given the narrow profit margins of firms, the paucity of information made available to the public by French firms, and the high cost of capital market transactions. Interest paid on savings deposits, even though accorded favorable tax treatment, often has been set so low as to imply a zero or negative real yield after allowance for price inflation. For all these reasons household savings have been low in proportion to income, have normally not been invested in longer term financial assets but have sought out short term liquid forms that could be quickly converted into land, consumers goods, precious metals, and similar real assets should inflation appear to be getting out of hand.

Savings habits of this kind formed over half a century do not alter quickly during short episodes of price stability. Neither do they respond readily to the enticement of moderate increases in interest rates paid to savers. Despite this fact an effort has been made since 1967 to encourage increased saving by households and to allocate a larger share of such saving to the banking system. Steps have included permitting deposit banks to compete for savings deposits, higher interest ceilings on savings and time deposits and

37 R. MARJOLIN, J. SADRIN, O. WORMSER, *op. cit.*, p. 9.

38 S. GUILLAUMONT-JEANNENEY, *op. cit.*, p. 151.

more even tax treatment among the various forms of deposit-savings and between these and Treasury notes and bills.

In view of the attention accorded to the problem of increasing saving and the recent measures intended to stimulate such increase, it is ironic that the monetary and credit system contains a built-in inflationary mechanism which constantly reinforces the seasoned skepticism of savers by generating further inflation. To seek a solution to the problem of inflation by trying to encourage saving without first putting an end to excessive monetary expansion is a strategy that appears certain to fail.

Another defect of the present system is the damage it does to the flexibility and efficiency of financial institutions. Required asset ratios reduce the flexibility of bank portfolio management. Ceiling rates of credit expansion freeze the relative size of financial firms, and protect inefficient firms from the competition of more efficient firms thus tending to prevent cost reduction in the financial industry. Administrative controls on the volume of credit coupled with interest rate ceilings force lenders to choose among borrowers on grounds other than price and usually result in discrimination against smaller and newer customers. All these are commonly recognized and regretted evils of the present French system.³⁹

There can be little doubt that the French system of monetary and credit controls succeeds in allocating credit approximately as the authorities intend. But does this allocation of credit have a similar effect on real resource allocation? Explicit quantitative evidence on this point is almost impossible to obtain. Reasoning from the nature of the system of credit controls, however, one can say that it is so comprehensive as to leave no important gaps through which credit may flow to enable borrowers to acquire money to frustrate the will of the authorities. Only retained earnings might do this, but they are so low that the authorities seek ways to increase them. Thus the substitution of alternative channels for those regulated or blocked by the authorities, which is a common defect of less comprehensive systems of credit control, does not seem to be a shortcoming chargeable to the French system.

A major theme of this discussion has been the French dilemma of reconciling the requirements of non-inflationary monetary policy with those of a comprehensive system for credit allocation in the

³⁹ BANQUE DE FRANCE, *Compte Rendu des Opérations*, *op. cit.*, pp. 33-34, 68.

service of high priority national economic goals. It is our view that these goals are incompatible under the present French system.

This dilemma is emphasized in the report of a recent high-level Commission appointed by the Council of Ministers to study the money market and recommend reforms.⁴⁰ There is no space here to consider this interesting report in detail. But we shall mention several of its key recommendations. First, it seeks an end to the system of preferential discount rates as soon as alternative arrangements can be worked out. Second, it recommends replacement of rediscounting by open market operations as the major channel for providing central bank credit to the banking system. Third, it calls for opening of the closed [Treasury] financial circuit to the forces of market competition accompanied by a greater role for the registered banks as intermediaries between savings and longer term investments. This last pair of recommendations has the dual objective of replacing administrative with market decisions and of reducing the banks' motivation for rediscounting at the central bank.

If implemented these recommendations would free the *Banque de France* to control the money supply and conduct a non-inflationary monetary policy. But success in such a policy would almost certainly require a substantial increase in the interest rate charged by the *Banque de France* for its credit whether made available through rediscount or open market channel. This would raise the general level of interest rates throughout the economy. The monetary and price level effects of this increase in interest levels would be entirely salutary. It is a gross fallacy to regard a low level of interest rates as desirable to keep down costs and prices. Just the opposite is true, if at the low interest level excessive monetary expansion produces price inflation as in the French case. Thus the basic rationale for the French policy of low interest rates i.e. to avoid cost increases that contribute to domestic inflation and thus to aid the competitiveness of French goods in international markets, is seriously in error.⁴¹

The report is much less satisfactory in its implications for credit allocation to high priority national objectives. Its basic recommenda-

⁴⁰ R. MARJOLIN, J. SADRIN, O. WORMSER, *op. cit.*, *passim*.

⁴¹ The *Report* acknowledges that low interest rates on export credit have not played a decisive role as concerns the price-competitiveness of French exports and have impaired the effectiveness of measures intended to stabilize credit and prices. R. MARJOLIN, J. SADRIN, O. WORMSER, *op. cit.*, p. 104.

tion in this area amounts to the suspension of administrative intervention so that decentralized (though guided) market processes may undertake the task. It recognizes that under these circumstances different borrowers would be accommodated at different rates of interest than under the present system.⁴² This result is not likely to appeal to that substantial segment of public and official opinion that distrusts the power and influence of private financial institutions and private financial markets in national economic affairs.⁴⁵

In the two and one-half years since the publication of this report in 1968 the *Banque de France* has made progress in modifying the French system in the directions that the report recommends. The number of privileged rediscount categories has been reduced and their rates of interest moved closer to the basic rate of rediscount. The role of the open market in the extension of central bank credit has been increased relative to that of rediscounting. The share of the open market channel rose from 15 per cent in 1967 to 38 per cent at the end of 1970. In July of 1971 this share soared to 81 per cent.⁴⁴ Moreover during 1969 under the influence of high rates of interest in the Euro-currency market the discount rate of the *Banque de France* reached 8 per cent and its money market intervention rate rose at one point to 10 5/8 per cent. There has also been some relaxation in the closed Treasury circuit. Credit ceilings have been suspended.

It is not clear how far these changes in the system will go nor to what degree they are permanent. For example, the sharp rise in the role of the open market channel for central bank credit during 1971 is due in large part to temporary measures to reduce the attraction of the French money market for non-resident short term capital. Despite exchange controls, funds move between the Euro-currency market and the French money market when the interest rate differential becomes sufficiently attractive. To discourage the inflow of these funds the *Banque de France* has set its money market intervention rate below its discount rate thus abandoning the traditional relationship between these two rates. Since bank rates on customer loans conventionally move with the discount rate

⁴² *Ibid.*, p. 14.

⁴³ For an example see J. DONY, A. GIOVINETTI, B. TIBI, *op. cit.*, pp. 129-31.

⁴⁴ CONSEIL NATIONAL DU CRÉDIT, *Vingt Cinquième Rapport Annuel*, Année 1970, Edition Provisoire, Annexe 3, p. 14 and *Statistiques Mensuelles Provisoires, Mois de Juin*, 1971, p. 3.

rather than the open market rate, the *Banque de France* by moving these rates differently, has partly insulated the domestic credit markets from its policy in the money market. Thus, current reliance on the open market channel cannot be taken as unambiguous evidence of a basic change in policy toward reliance on price rationing of central bank credit. Moreover, authority to reimpose credit ceilings remains in reserve. The authorities continue to influence the cost and availability of credit by administrative and selective means. The Treasury circuit continues to function. Finally, the tradition of credit control by qualitative and selective measures still has strong support in some official quarters.

Whether the job of real resource allocation would be better done by simply allowing private credit markets to work is debatable under present French circumstances. This does not mean that the present system should be retained. If national policy calls for official intervention in the economy to secure an allocation of real resources different from what would emerge from the play of private market forces, a system of credit controls is not an optimum way to intervene. Rather the task should be assigned to the budgetary system with an appropriate set of taxes and subsidies to redistribute purchasing power from low to high priority economic purposes. This would free credit policy from the task of altering real resource allocation for which the credit system is ill suited and would free monetary policy from the restraints imposed upon it by credit policy.

Whether the French electorate would support a government that openly adopted such a budgetary policy is not clear. Moreover, there is the possibility that an increased rate of taxation would be offset by a reduction in saving and thus not achieve its objective of restricting consumption. There may also be some problems concerning the use of subsidies from the perspective of the international agreements to which France is a party.⁴⁵ But only greater reliance on budgetary policy to reallocate real resources in line with official priorities will remove the inconsistency between the requirements of monetary and credit policy that is the dilemma of the present French system.

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⁴⁵ BANQUE DE FRANCE, *Compte Rendu des Opérations*, *op. cit.*, p. 28; J. DONY, A. GIOVINETTI, B. TIBI, *op. cit.*, p. 22.