Click here for Full Issue of EIR Volume 7, Number 46, November 25, 1980

France can cure inflation

Laurent Murawiec's survey of the economy's dirigist strengths, and the remedies for its weaknesses.

French output levels broke into a sharp downturn during the second quarter of 1980, with a 13 percent annualized rate of decline of manufacturing output, and the consensus forecast for 1981 sees a year of little or no economic growth. The short-run behavior of the French economy has largely to do with the effects of the 1979 doubling in oil prices, and consequent tighter interest rates at home and constricted markets abroad.

But the near-term behavior of the output indices is less important as a measure of French economic success than the French government's willingness, and ability, to take on two basic structural problems that have chronically weakened French economic growth: the low rate of depreciation of capital stock, and the parasitical, inflationary growth of the real-estate sector. Both add up to unacceptable susceptibility to inflation, now running at an annual rate of almost 14 percent.

Foreign constraints, including the slowing of international trade and the Federal Reserve's "interest-rate war," might be blamed by French officials for the immediate recession problem. But the domestic crisis-management policy of Premier Raymond Barre has actually worsened the French economy's biggest structural problem: France's inability to turn its spectacular success in a handful of state-sponsored industries into a general renewal of production methods in stagnant sectors.

The first circle of industry

The secret of the French economy lies in the extremely high concentration of available means, in both physical and financial terms, in a few select high-technology, capital-intensive sectors which are generally state-owned or steered. The two principal poles are the energy sector with its nuclear spearhead, and the defense/aerospace, transportation, telecommunications, and electronics that provide the complement.

Nothing better than the nuclear program shows the inner workings of the "French System." Initiated in 1974 by then-President Georges Pompidou, and amplified by his successor, the program calls for lifting the share of nuclear-generated energy from a few percentage points in 1974 to 40 percent of total energy consumption by 1990. A total of about 65 gigawatts will have come on line by then—one nuclear power plant will start operating every second month between this year and 1988, including the world's first large-scale commercial fast breeder, the Super-Phénix.

This investment of more than $60 billion (the Eighth National Five-Year Plan calls for an annual investment of $19 billion in the energy sector at large, $12 billion of which will be government outlay) has only been made possible by a mobilization of the nation's credit and productive powers. Those state corporations at the center of the nuclear program and the other "first circle" industries—the national utility, EDF; the atomic energy commission, CEA; the aerospace's SNIAS; the national railway corporation, SNCF; the coal board, CDF; and even the postal administration—have *doubled their productive investment* since 1973 in constant prices, while real GDP only grew by 21 percent.

Those public corporations, plus the dense industrial network of subcontractors and private-sector corporations associated with one or the other aspect of the industrial programs—companies such as Creusot-Loire, Jeumont-Schneider, and Saint-Gobain-Pont-à-Mousson—are reaping the benefits of the French conception of *dirigisme*. The national five-year plan is "indicative," that is, it does not imply a bureaucratic type of planning, but a concerted programming of major national economic development objectives, and the concentration of budgetary, fiscal, and credit policies in the service of such aims.

The top priority has been capital goods with high technological content. The defense/aerospace sector sells about $6 billion a year abroad, 8 percent of the country's exports, and 10 percent of the world's arms trade. (France ranks third in international military materiel exports.) Aircraft represents two-thirds of this. If Concorde, a technical success, was a commercial flop, Airbus, the Dassault Corporation's Mirage, the Alpha-

© 1980 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

Jet, and others are all the results of this deliberate focusing of national credit on high-powered investment. More recently, France has joined the international space club Eurosat, with launchers and satellites, and a promising commercial future.

Export promotion system

The other pillar of the mechanism is export financing, which invariably provokes spasms of hysteria among British and American officials, insofar as it represents to them the very conception of "excess industrialization and export" which the Council on Foreign Relations and the City of London so badly want to suppress. Its central aim is to maximize the export of high-value capital goods, including military hardware.

The Banque de France has a window open for the Banque Française du Commerce Extérieur, the French foreign trade bank, and lends it at a rate of 4.5 percent, which BFCE makes available to the commercial banks for financing exports. This subsidized credit is then mixed with market-rate credits to obtain an interest in conformity with the OECD's export-credit, gentleman's agreement floor-rate of 7.75 percent. France is the only national party to this agreement to lend at the floor-rate. In 1979, about $16.5 billion of purchaser credit was extended in this way (and as much went to French industrialists as supplier credit). Coface, the Compagnie Française pour l'Aide au Commerce Extérieur, organizes every credit package for the private or public sector corporations involved. It is not an accident that the growth rate of export credit (29.3 percent in 1976, 25.6 percent in 1977, 12 percent in 1978, and 19 percent in 1979) has been one of the fastest of all categories of credit, with purchasers' credit alone growing even faster. This has been the principal cause of a return to the black in trade figures prior to the second oil shock.

The second oil shock has increased the imported energy bill from FF 84 to FF 146 billion; the 1980 trade deficit will amount to FF 60 billion, and the current account deficit to FF 30 billion. It will take the traditionally large surplus on invisibles, large inflows of foreign, especially OPEC, capital, and fairly large borrowings by the public sector corporations to balance the account.

In the first half of 1980, in spite of successful forays into relatively new markets such as Brazil or English-speaking Africa, a worrisome trend has decreased the surplus on capital goods account, and sales to the LDC's show a similar trend. The sales deficit with OECD countries has doubled, reflecting traditionally high imports of capital goods from that sector, and a tendency for imports to grow faster than exports.

The French government has had to sharply increase the level of interest to respond to Paul Volcker's upward manipulation of U.S. interest rates, in order to prevent an outflow of funds. Three-month money, which yielded 6.44 percent in December 1979, now fetches 13 percent, and long-term government bonds, which carried 9.94 percent, now carry 13.44 percent. The effects on the productive economy, and especially on those sectors highly dependent on nonsubsidized credit, are obvious.

Meanwhile, the rate of inflation has stubbornly refused to abate, for reasons examined later, and remains in the range of 12 to 14 percent per annum in the upper tier of the OECD countries, which strengthens the case for expensive credit. The currency, thanks to such measures, has remained at the top of the EMS parity grid with great stability.

In global terms, the 1980 budget is a deflationary exercise, with a small deficit of FF 31 billion—France has one of the OECD's lowest national debts in absolute and relative terms—which includes significant fiscal stimulus for investment, and, for the first time after years of neglect of this sector, a big boost for the research and development effort of the state.

A piecemeal approach

This budget typifies the policy pursued by Mr. Barre ever since he became premier in the fall of 1976: while it allocates sizable resources to the development of the "first circle" sector, those situated outside that tier are simply left to the play of "market forces."

The crisis-ridden steel industry was ruthlessly restructured two years ago at great loss of labor, capacity, and productive power. About $1 billion was expended on both restructuring and the sprinkling of investments over the regions hit by closings and layoffs. That money was not channeled into creating new, growth-oriented industrial facilities, but simply used to cool down local unrest, ridiculously. Auto components plants replaced steel, at least to some extent, but are also facing escalating troubles, now that the cheap-credit-dependent automobile sector sales are on a downward slope.

But there is worse than this piecemeal approach in Mr. Barre's book. (This may bear some partial resemblance to Mrs. Thatcher's shock therapy, but ill-educated individuals in the Anglo-American press who present both as cothinkers simply fail to understand that the export orientation and reindustrialization which otherwise characterize French policy are nowhere to be seen on the other side of the Channel). Barre's liberal dogma led last year to the lifting of price controls, which sparked off a new round of inflation, far less short-lived than the premier expected. As a result of the spate of price increases that exploded, and to which public prices contributed noticeably, the government amplified the policy of budgetary and fiscal austerity followed since 1976, and its companion, enforced wage austerity. The rationale behind the new "freedom of prices"

(prices were under state control since 1939) is that this freedom will force the "truth of prices" to the fore and effect a "sanitization of the industrial fabric," in Mr. Barre's own words.

The resulting anarchic "cutting the fat" in the nonpriority sectors has meant a very large increase in industrial bankruptcies and layoffs. If many corporations have been able to use the new leeway to increase prices to reconstitute their war chests, they have not necessarily used their added cash to invest. Little rational effort has been made to generate durable industrial employment, in spite of countless "plans" and "miniplans" and spates of measures trumpeted by the premier's office.

This year, the private sector is expected to increase its investment by 4.5 percent, and the public-owned corporations by 10 percent. Still, industrial output is already down 3.5 percent over the year before, and the alarm signals are blinking in many branches, especially steel, chemicals, textiles, shipyards (in spite of the just announced $3.5 billion Saudi order), while auto stagnates at a still-high level. Engineering expects only very mild growth. Only electronics and pharmaceuticals are unequivocally up among the nonpriority sectors.

A regional review reveals several extremely sensitive hotspots, especially in the crisis-wracked regions of old industry, the north, Lorraine, and a more general nibbling away of small chunks of the industrial fabric throughout the country, which add up to increasingly significant results. As mentioned above, official unemployment figures are above 1.5 million, and moving fast to the 2 million mark.

Against that background, and that of the upcoming presidential election, a major debate has erupted around the soon-to-be-released Eighth Five-Year Plan. Premier Barre's version of it calls for an average annual real growth of no more than 2.5 percent, which he claims would permit a balancing of the domestic and external accounts and preserve the parity of the franc—his stated priorities. Barre also acknowledges that this would add between one-half and a full million new unemployed to the current figures. Hardly an appealing election program.

Planning Commissioner Michel Albert has associated with Giscard's likely presidential challenger, Socialist Michel Rocard, the Council on Foreign Relations' French pet, to push a counterproposal aimed at gaining 300,000 to 1 million jobs over the same five-year period—at the price of zero growth in the workers' purchasing power, a 35-hour work week, a strong budget deficit, and large increase in foreign indebtedness, with labor-intensive "soft energies" and "soft technologies" content.

This counterproposal is designed more for the electorate than the economy. Still, Barre's stubborn "fiscal conservatism" threatens Giscard's second mandate, by creating a larger and increasingly desperate pool of unemployed, underemployed, and soon-to-be-laid-off labor, prone to be organized against the president.

The domestic constraints

Contrary to liberal dogma and Keynesian environmentalist delusions, there is a way to solve the paradox without unleashing either inflation or unemployment. That solution, however, requires extremely bold political and economic steps to finally remove the built-in, quasi-feudal interests that parasitize the French economy and continuously burden its growth.

First, the historical fact of a lack of "in-breadth" industrialization. Only 38 percent of the population is employed in industry, as compared to 45 percent in neighboring Germany. The domestic market, as a consequence, is fairly small, especially with a total population of only 53 million. While the agricultural population, contrary to a widespread belief, amounts to only 9 percent of the total, the service sector now accounts for nearly 53 percent of the active population, and the latter's entirely parasitical (as opposed to socially necessary) component, retail trade, and office employment in banking, insurance, and other bureaucracies, represents an increasingly unbearable toll.

It is fortunate that the agricultural sector has been able, in spite of intense speculation on the value of land, to progress at unprecedented rates since the early 1960s, and evolve into a highly capitalized, relatively concentrated, and high-yield sector. This has generated a very healthy export surplus, and partially offset the extreme weakness of the downstream food industry.

While those parts of industry defined here as the "first circle" rank among the world's leaders in their domain, other branches, such as textiles and, worst of all, construction, are large-scale employers, and extremely backward and labor intensive.

Employment in industry, including construction, peaked in 1974, and lost 8 percent last year, down to 7 million, while service employment grew 1.5 million, or 15 percent, now totaling more than 11 million.

Low depreciation

An economy can offset the cost of taking goods out of the process of productive circulation only by increasing productivity. If the services and government sectors of employment grow faster than the rate of productivity, inflation will ensue.

It is elementary financial management that additional expenditures on pure economic overhead will cause inflation in the price of tangible goods, because such expenditures put additional money supply in circulation faster than the economy produces tangible wealth. What is less obvious is the way capital investment

contributes to this process. The new fixed investment in capital goods each year also removes a portion of tangible goods from circulation. If the cost of fixed investment is not offset by increasing productivity, investment will appear as inflationary.

Undepreciated new investment and overhead (services and government) expenditures are the precise equivalent of waste heat in thermodynamic process, i.e., the amount of energy lost to the process. Tangible goods that are recirculated back into the production process, such as raw and intermediate goods and consumption of goods-producing workers, are "recaptured" as thermodynamic work. So is the *depreciation* of the fixed capital stock, the portion of capital stock "absorbed" into the production process in each cycle.

France's major problem is a low rate of depreciation, or a high rate of entropy associated with capital investment. The state-backed investment policy in nuclear energy, aerospace, transportation has produced spectacular gains in productivity in those sectors. But the spinoff productivity of these investments with respect to the rest of the economy has been low. Measurement of the actual rate of turnover of capital stock in France is difficult. But we can take, for purposes of rough estimate, France's capital goods import dependency as a rough measure of the depreciation problem. The high import dependency shows that economic growth led by state investments did not "resonate" through the rest of the economy, and that the discrepancy in growth rates had to be made up through imports.

Figure 1 compares the rate of industrial production change with change in imports from the United States, a major source of French capital goods imports.

The data for 1978 and 1979 are striking; they show a huge increase in the real volume of capital goods imports needed to maintain the investment program backed by the state. This discrepancy in rates of increase of output and of capital-goods imports measures the *narrowness of base* of the French economy's productivity advances, i.e. the low rate of depreciation in the LaRouche-Riemann model's terms.

Figure 1

French industrial and import trends, 1974-79

	Percentage change industrial output	Percentage change imports from U.S.
1974	+2.9%	+2.4 %
1975	−7.9	−6.5
1976	−9.8	+8.0
1977	+1.9	−2.3
1978	+0.9	+11.2
1979	+4.5	+14.1

This is one of the two decisive factors in France's inflation problem. We see from Figure 2 (at right) that between 1970 and 1978, employment in the private services sector rose by 21 percent, employment in the government sector was virtually unchanged, and industrial employment was virtually unchanged. At the same time, the index of French manufacturing productivity rose by 32 percent.

This tells us that the rate of productivity growth was sufficient to contain the expansion of overhead costs. But we have already seen that this productivity growth was not translated into a sufficient rate of renewal of the capital stock. In addition, the French economy began to suffer from a form of *fictitious* overhead cost in the form of uncontrolled real-estate speculation, which made up the biggest portion of monetary inflation during the past decade.

High real-estate speculation

The high cost of housing, adding up to more than a third of national credit, is the second home-grown ingredient of inflation.

"Monetary" inflation primarily (if not exclusively) originates in real-estate speculation. The history of the problem starts with the enormous housing shortage that emerged in the postwar period.

To face this explosive problem, a franchise was given to the banking sector, in the form of lavish and cheap credit, so that it could finance, *at any price,* a real-estate boom and somehow settle the problem. (An important political compromise was also involved in allowing monetarist sectors of the financial structure to acquire this looting license in return for their neutrality on other policies.) A construction boom did start in the 1958-60 period. Still, as late as 1977, almost 60 percent of housing was over 35 years of age, with 21 percent over a century old. This, then, explains why households were compelled to devote upward of 30 percent of their income to housing costs.

In 1973, one square meter of a newly built apartment in Paris (one Frenchman in five lives in the Paris region) was on average worth 3,500 francs. By 1978, this had become 7,400 francs, and today 11,000 francs. This trebling of the cost, which gallops far above and beyond the average rate of inflation, represents all the more a cancerous development. In one "real-estate franc," only slightly more than 30 percent represents effective physical and other necessary costs (design, construction, necessary overhead, and financial costs), while the state pockets 15 percent of the final value in the form of value-added tax (VAT). The rest, a mind-boggling 55 percent of the sales price, goes to pure speculation—the capitalization of fictitious values as represented by

Figure 2
The French labor force, 1970-78

Sector (in millions)	1970	1978	Percentage change*	Absolute change**
Total active resident population	21.37	22.67	+6.1%	1.30
Employed	20.86	21.48	+2.9	.62
Unemployed	.51	1.20	+135.3	.68
Manufacturing	5.84	5.79	−0.9	.32
Civil engineering, construction	1.99	1.84	−7.9	.16
Transportation, communications	1.20	1.32	+9.7	.12
Private sector	5.60	6.78	+21.1	1.18
Public sector	3.43	3.76	+9.5	.33

*Based on non-rounded figures
**Rounded separately

ground rent.

At the national level, in addition, out of FF 511 billion of total medium and long-term credit distributed, e.g. in 1977, to the economy as a whole (corporate sector, households, budget, etc.), no less than FF 178 billion—35 percent—went to the combined construction/real estate sector. Gridding the "real cost of construction" factor against total credit expansion, what emerges is that on the chosen example of 1977, 19 percent of all credit extended to the economy, both medium- and long-term, went into capitalizing entirely speculative ground rent values! Compared with the more than 10 percent rates of inflation painstakingly attained through Mr. Barre's policy, it becomes obvious that only massive transfers of value from the productive sector into this speculative bubble can feed it by preserving the "value" of this financial paper, and conversely, that all the inflation generated by the bubble must be mopped up by slashing the expenditure of other sectors—hence, budget and wage austerity.

"Structural" inflation, on the other hand, has continuously been worsened by the tax levied against real estate. As the tax works its way throughout the economic pyramid, consumption, investment, and the internal and external value of the currency suffer, with the result that the *dirigiste* policy described above has to concentrate relatively scarce means (the "free energy" that remains after monetarist speculation has exacted its toll) on relatively limited sectors of the economy, those defined here as the "first circle" industries.

This goes a long way toward explaining why only 38 percent of the active population as of 1980 is employed in industry, as opposed to 45 percent in Germany, even though the per capita productivity of a French worker is 20 percent higher than that of his German counterpart.

Service sector expansion

The relatively smaller share of industry in total employment has worsened in the last years. Manufacturing employment has dropped from 27.3 percent of the labor force total in 1970 to 24.3 percent in 1978. Industry—manufacturing plus construction, civil engineering, transportation, and telecommunications—has seen its share drop from 42.2 percent to 39.4 percent in the same period.

On the other hand, the service sector alone absorbed more than the total increase in the labor force, and created close to 1.5 million jobs in that period, an increase of more than 14 percent. And, while it represented 42.2 percent of the active population in 1970, it now amounts to more than 46 percent. The rest went to the dole.

Of the 1.5 million jobs created in the service sector, a full 1 million were created in retail trade, general commerce, distribution, and clerical employment in banking and insurance, generating burgeoning overhead costs that would increasingly offset whatever profit margins were being generated in the productive areas.

Freezing the real-estate bubble in its present state would free national credit for the tasks of financing the needed reindustrialization. This makes it a national priority—with far-reaching political implications: the speculative portion of the financial sector, which is primarily based in real estate, is the premier power base of monetarist forces in France,while the relative backwardness of much of the economy provides these forces with their crucial margin of social control.