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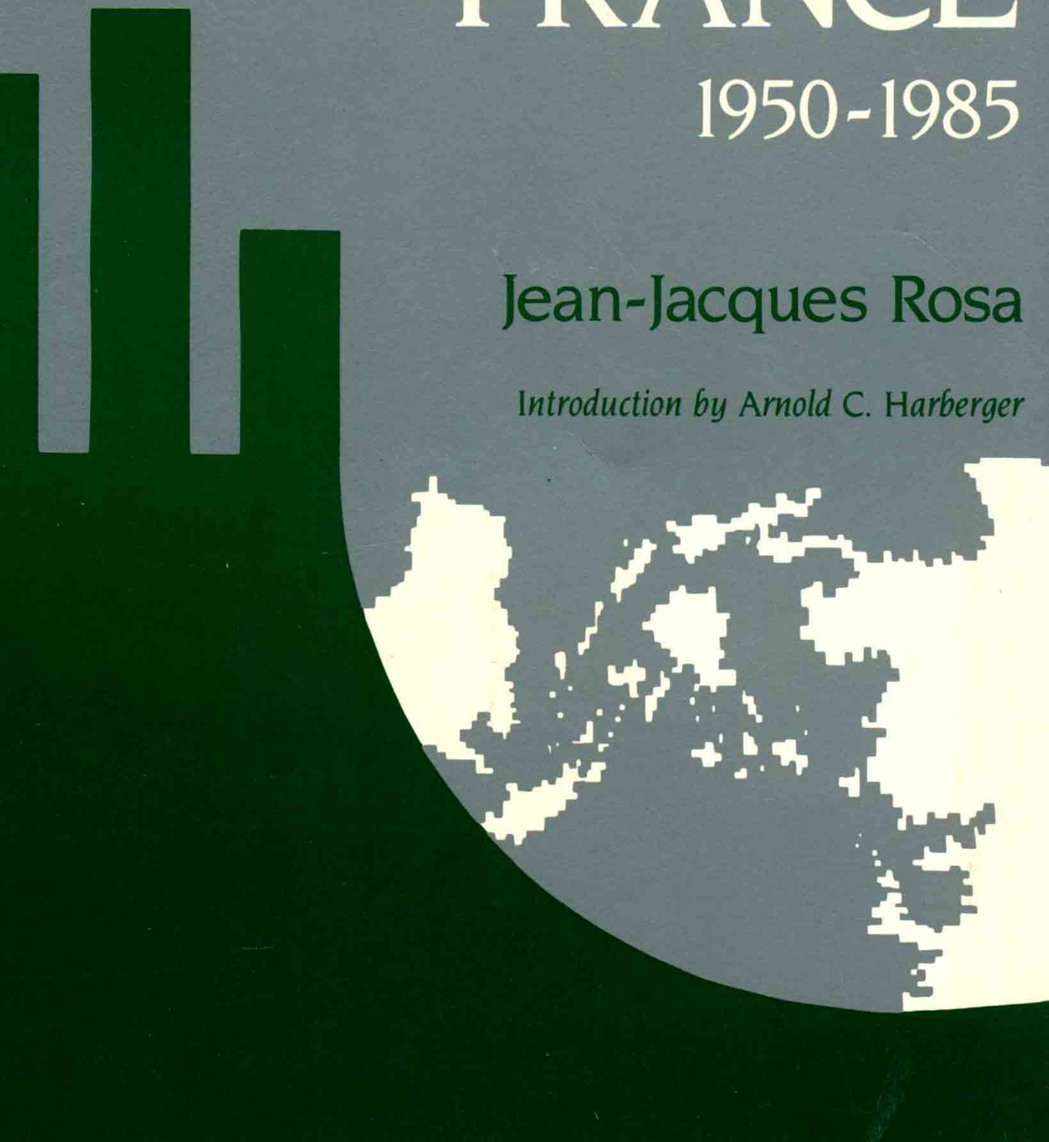
Introduction by Arnold C. Harberger



International Center for Economic Growth

France 1950–1985: Policy and Growth

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for Economic Growth

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PREFACE

This study of the French economy, by Jean-Jacques Rosa, is part of a special series of country studies that Arnold Harberger is editing in the Center's Country Studies series. This new series follows a 1983 conference in Mexico City and subsequent publication of *World Economic Growth: Case Studies of Developed and Developing Nations,* which he edited for the Institute for Contemporary Studies, with which ICEG continues to be affiliated. The earlier book featured twelve country studies, of five developed and seven developing countries. Other studies in this twelve-part series will look at Argentina, Bolivia, Burma, India, the Ivory Coast, Spain, Turkey, and other countries; and they will provide the basis for a second conference and ultimately a second volume of *World Economic Growth.*

In addition to this special series, the Center is this year publishing a number of other country studies, including a revised edition of *Models of Development: A Comparative Study of Economic Growth in South Korea and Taiwan,* edited by Lawrence Lau, and a study of the economic liberalization in the Peoples' Republic of China.

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ARNOLD C. HARBERGER

Introduction

France's economic history since the Second World War has been a story of several decades of notable (if not spectacular) success, followed by a period in which the forces of growth seemed to weaken. As the country faced the second half of the 1980s, signs of rejuvenation were present, but elements of rigidity and resistance to change also were evident. The big question was whether the future would be dominated by forces working for a flexible structure capable of continued adaptation to a changing world economy, or whether signs pointing to a growing economic "sclerosis" would be ratified by future developments.

France has been a somewhat better-than-average performer among the countries listed by the World Bank as industrial market economies. Her growth rate of per capita GNP averaged 3 percent per year over the period 1965–84, compared with 2.4 percent for the overall group. Her average inflation rate of 8 percent was only slightly higher than the average 6.5 percent per annum.

This relatively bright picture becomes somewhat muted when one examines separate periods within that time frame. Thus, GNP per capita grew at 4.3 percent per year in 1950–65, 3.9 percent per year in 1965–75, and only 1.8 percent per year in 1975–85. Over the same three spans, the rate of price inflation grew from 4.9 percent in the first period to 6.6 percent in the second and to 10 percent per year in the third.

Jean-Jacques Rosa traces this history perceptively. He notes that France shared with Japan and most other European countries the institutional shock of the Second World War. The postwar boom of these countries is explained partially by the fact that old institutional rigidities and entrenched interest groups were dislodged. Flexibility and adaptation to a changing economic environment became new watchwords. In France, the economic picture was brightened further by a stable monetary policy, at least until the mid-1970s.

Rosa attributes the declining fortunes of the French economy to "Eurosclerosis," an accumulation of rigidities and resistances to adaptation, an experience shared by several Western European countries. Policies favoring already entrenched labor groups imposed the burden of added unemployment on the young and the unskilled. Most industries in France were connected with the highly centralized banking system, which was controlled by a bureaucracy tied together by an "old boys" network of corporate managers. Rigidities in the industrial structure were exacerbated by widespread state ownership.

France passed through a watershed with the Mitterrand government's shift in policy from an ideological socialist stance in 1981 and 1982 to a more moderate, pragmatic, even traditional posture since 1983. This shift was, of course, enhanced by the right-wing victory in the elections of March 1986, leading to promises of liberalization, deregulation, and privatization in many segments of the French economy. Rosa welcomes this change, but he also expresses skepticism. He is certain that the entrenched interest groups formed by the existing (and rigid) structure of the economy will not yield their positions willingly or lightly. The question is whether the forces favoring flexibility, modernization, and change will prove strong enough to dislodge them.

JEAN-JACQUES ROSA

French Policy and Growth

The French economic system ranks as one of the most centralized among industrialized countries and is in many respects similar to the Japanese system. The French growth rate, mediocre between the two world wars, has been high since 1945, despite (or perhaps because of) pervasive government intervention in the economy.

In part, the developments of the last fifteen years have discredited traditional corporatist economic policies and induced wider swings in policy design. Beginning in the mid-1970s with the first oil shock, successive governments experimented, on the one hand, with more market-oriented policies—for instance, those of Raymond Barre between 1976 and 1981 and of Jacques Chirac from spring 1986 until the present. On the other hand, there were increasingly *dirigiste* and statist strategies—as in the case of the Pierre Mauroy government between 1981 and 1983. The Laurent Fabius government from 1983 to 1986 was a rather ambiguous mix of *dirigisme* and partial liberalization of financial markets where, nevertheless, the state still retained ownership of more than 95 percent of the financial sector.

At the same time, such a specific political and economic system did not seem to perform very differently from other, more market-oriented, industrialized economies. French postwar economic performance, although remarkable, was not significantly different from that of Germany, Italy, or Japan. And the troubled period since 1973 still has not produced substantial distinction: the French economic performance in times of crises has been average by European standards. The present problems of investment sluggishness, a historically high rate of unemployment, and stagnating overall employment are shared by all European countries and have been dubbed "Eurosclerosis" by some analysts.[1]

Meanwhile, the policy debate took a new turn during the 1970s and by the early 1980s. Global demand policy went out of fashion as the necessity of supply-side considerations and neoclassical interpretations of macroeconomics gained prominence. A strong resurgence of economic liberalism (in the European sense of basic faith in the market mechanism and efficiency) paved the way for new reflections on the virtues of deregulation and privatization. The intellectual climate and political debate were changed radically in only ten years.

But in that respect too, France has not been exceptional. That mutation can be understood as a result of the increased openness of the French economy and society. As a consequence, an evaluation of growth policies should at the very least try to disentangle the influence of domestic policies from those of international economic conditions or basic national trends.

This paper begins with a discussion of the secular growth performance of the French economy since the beginning of the century. It then cites the causes of postwar growth and describes traditional economic policies as well as their reversal in early 1980s. Finally, it presents the current policy dilemmas of French government, in macro as well as micro terms.

In this paper, the approach to government policy will not be exclusively normative—concerned with what a government *ought* to do according to considerations of economic efficiency. Rather, it also discuss the more positive, public choice approach, which deals with what a government *can* do when confronted with both economic contingencies and the interplay of political forces.

I. French Growth in the Twentieth Century

Overtaken by England and Germany in the nineteenth century race for economic power, France managed to stay in the leading group of countries undergoing a rapid industrialization process, despite a prolonged slowdown during the years 1866–1896. The retardation of growth during this episode explains in large part the image—perhaps the dominant view between the wars—of France as a stagnant economy of small firms and shopkeepers.[2]

This traditional picture does not fit the twentieth century data particularly well, as shown by secular growth figures in Table 1. But the average performance of the French economy, compared to that of other high-growth, developed countries, yields two exceptions. One, covering the Great Depression years and the Second World War (1929–1950), was a time of economic underachievement. In this period, France ranked last among the leading industrial economies. The other exception appears during the period from the early 1960s to the early 1970s, when France's economic growth ranked second only to Japan's.

Overall, these data give some support to the interpretation of postwar growth as an exceptional phenomenon; growth rates since the first oil shock have returned more to secular norms or trends. The economic "miracle" of the 1960s probably is due to the increased openness and intensification of international trade starting in the early 1950s, in complete contrast with the fragmentation and protectionism of the 1930s. According to Abramovitz, the high growth of the 1960s and early 1970s also is due to other industrial countries, which had accumulated a significant technological lag during the 1930s and 1940s, "catching up" to U.S. rates of growth.[3] (See Table 1.)

Accordingly, an explanation of French postwar growth should make a distinction between three components: (a) a general international trend due to *Pax Americana* and free trade after the war, (b) a general and international trend of other countries catching up to the United States after falling behind between 1920 and 1945, and (c) a catching up from a specific French lag accumulated in the 1930s and 1940s.

Some evidence of a the laggard position assumed by other industrial countries vis-à-vis the U.S. economy, after each of the two

Table 1
Secular Growth, 1900–1986

	Japan	FRG	Italy	France	UK	USA
1900, 1925–29[a]	1.6	0.7	1.6	1.5	0.5	1.5
1925–29, 1950–54[b]	1.4	1.2	1.3	1.0	1.1	1.3
1950–54, 1963–67[c]	8.4	5.0	4.8	3.7	2.5	1.9
1963–67, 1974[d]	10.35	4.52	5.44	5.7	3.0	2.58
1974, 1986[e]	3.72	2.28	1.68	1.86	1.35	1.79

Sources: For [a, b, c] see Simon Kuznets, *Economic Growth of Nations* (Cambridge: Harvard University Press, 1972); for notes [d, e] see Les Notes Bleues, No. 251, "Les comptes previsionnels de la Nation pour 1985 et principales hypotheses economiques pour 1986," Table 3, 1985, and OCDE, 1985.

world wars, is apparent in Abramovitz's data, here reproduced as Table 2.

That thesis implies that France's economic performance, as well as that of other developed countries, should converge in the future to approximate that of the U.S. economy since the war. In other words, the goals of growth policy probably should be revised downward when two phenomena are present—when there is no further prospect of catching up and when the liberal international regime is less secure, due to a protectionist revival and the relative decline of American power as measured by the share of U.S. GNP in world GNP. As Great Britain had been a century earlier, after the war the United States was committed firmly to free trade, indeed, to imposing a liberal economic order on the world. In present circumstances where they cannot—or will not—impose a free trade regime on their allies and partners, the international open economy is in jeopardy.

II. The Role of Policy in Postwar Growth

The above stylized facts and analysis lead us to a striking conclusion regarding the role of policy in French economic growth. Contrary to the view frequently held among bureaucrats and politicians, there is no convincing evidence that the original institution of indicative planning created after the war played a significant

Table 2
Comparative Levels of Productivity, 1870–1979
Means and Relative Variance of the Relatives of
15 Countries Compared with the USA
(US GDP per Manhour = 100)[1]

	(1) Mean	(2) Relative Variance[2]
1870	77 (66)	.51 (.51)
1890	68 (68)	.48 (.48)
1913	61	.33
1929	57	.29
1938	61	.22
1950	46	.36
1960	52	.29
1973	69	.14
1979	75	.15

[1]1870 and 1890. Figures in parentheses are based on relatives with UK = 100
[2]Standard deviation ÷ mean
Source: Moses Abramovitz, "Catching Up and Falling Behind," paper presented to the Economic History Association, New York, September 20, 1985.

role in fostering economic performance. At the very best, its usefulness came from avoiding major policy errors in managing the economy, but it could well be that a similar result would have occurred without a planning authority. Thus, we find ourselves in agreement with the earlier skeptical views of Carre, Dubois, and Malinvaud.[4]

But this conclusion also should be true in the opposite direction: the French politico-bureaucratic system did not prove to be too serious a hindrance to the forces of economic growth. Indeed, France's performance has been equal to or better than that of freer market economies, such as those in Germany or even Italy, while it fell short of that of more "corporatist," if not statist, countries such as Japan. This evidence suggests that economic performance can be divorced from the structure of political systems or (as an alternative but weaker hypothesis) that fundamentally similar growth policies can be implemented by dissimilar systems of governance.

Some recent work has been directed at estimating separately the impact of various factors on economic growth, including the analysis of different policy variables. Such research is especially relevant for an assessment of growth policy because it provides for the first time an overall coherent framework including theoretically warranted causal factors of economic growth. An example of this work is a study by Kormendi and Meguire, which covers forty-seven countries, developed and underdeveloped, located on various continents, during the period 1950–1977.[5] The basic model is derived from neoclassical growth theory in which GNP growth is linked to the accumulation of capital, labor supply, and technical progress.

If the world economy is conceived in such a model as a homogeneous space where factor mobility and diffusion of techniques prevail, the sources of growth differentials can be found only in the initial levels of income per capita and in different rates of population growth.

On this firm and now standard theoretical basis the authors of that study add some current theories of policy influences on growth. First, they address monetarist theory, as developed by Robert Barro and according to which increased variability in money creation should reduce the average growth rate of the economy.[6] Indeed, money supply variability is supposed to distort price signals and induce erroneous allocations of resources. Second, they incorporate the theory of Fischer Black, which derives directly from modern financial economics and posits a trade-off between stability of growth and the average rate of growth.[7] According to this theory, increased variability should, on average, increase the pace of economic growth, just as increased risk in investment yields on average a higher return. A third theory, that of public finance theorists and, recently, the so-called "supply-siders", suggests that higher taxes distort individual incentives and lead to reduced growth through misallocation of resources.[8] A number of authors now emphasize the disincentive effect of inflation on economic growth. And last but not least, many economists think of foreign trade as a "handmaiden of growth."

All these theories lend themselves to empirical testing on the common ground of the two growth-theory "causes," demographic expansion and catching up from an initially low GNP per capita.

Let us review briefly the main determinants of economic growth as tested by Kormendi and Meguire. We shall then analyze the consequences of those policies on growth, especially in the case of France.

Initial (1950) per capita income. If one thinks of the world economy as a single unit, within which production possibilities are developed by the "state of the arts," an initially low income reveals either an under-accumulation of capital, or a suboptimal supply of labor, or a lag of techniques behind the frontier of technology. Movement toward the equilibrium combination of factors should entail higher than normal growth, until the "world" income per capita prevails.

Average demographic growth. According to the same theory, this aspect should increase one for one GNP growth, at least in the case of a stable structure of the active population.

Growth variability. As measured by the standard deviation of growth rates in the period under consideration, growth variability should contribute to an above average growth rate.

Money growth variability. According to monetarists and new classical economists, this determinant should reduce the growth rate of the economy through false price signals and erroneous private decisions.

The average rate of money creation. According to some, it could either increase the rate of growth of the economy (as a factor facilitating production) or exercise no influence whatsoever (money being a simple "veil").

A higher average inflation rate. It should reduce the growth rate by blurring perceptions of relative prices and diverting the energies of economic agents toward "inflation-defensive" activities.

A higher ratio of exports in GNP. It should also contribute to accelerated growth, mainly through increased productivity resulting from specialization.

Higher taxes. They should slow economic growth. As a proxy of higher taxes, the authors use the rate of growth of the ratio of public spending to GNP.

France's growth performance is strictly average relative to the other forty-six countries in the Kormendi-Meguire study. The study interprets this as the outcome of opposite influences: on the one hand, monetary growth was more stable than average (explaining 1.0 percent more growth than average) and inflation was moderate (explaining another 0.3 percent excess growth). On the other hand, factors such as high initial per capita income, slow population growth, and a very unstable rate of GNP growth helped to depress French growth.

Overall, the positive effects of a conservative monetary policy seem to have been offset by a rather inefficient stabilization policy. On the first point, France did nearly as well as the United States, while on the second, her macroeconomic policy has been as ill-conceived as Great Britain's.

However interesting, the tests of Kormendi and Meguire did omit an influential theory of economic growth (or more precisely a theory of non-growth)—that of Mancur Olson, expounded in *The Rise and Decline of Nations*.[9] According to Olson, economic growth (implicitly supposed to be spontaneous and unbridled) is choked down progressively through time by the development of various interest groups, which generate a condition of "institutional sclerosis." But the development of private interest groups takes time, and national traumas such as revolution, war, or civil strife operate to impede pressure-group formation and development. Thus, countries such as France, Germany, and Japan, whose social structures were at least partially destroyed by World War II and its aftermath, should be less prone to this sclerosis.

It seems especially appropriate that a test of the Olson hypothesis should be included in this assessment of French growth policy. A convenient measure of institutional sclerosis has been constructed by Kwang Choi for eighteen countries, including thirteen European countries plus Canada, the United States, Australia, and New Zealand.[10]

According to this index, the less sclerotic countries are Austria, Finland, France, Germany, Ireland, Italy, and Japan (all having been battlefields and occupied by foreign armies during the war, with the sole exception of Ireland). On the contrary, the United States appears to be especially sclerotic. It should be noted that the hypothesis of a "European sclerosis" does not seem to be warranted by the data.

This index was used in our own modified version of the Kormendi-Meguire test for eighteen developed countries (OECD), along with initial income per capita, the rate of growth of populations, and a measure of the variability of monetary policy, to explain the rate of growth of GNP during 1950−77. Results are presented in Table 3. In that framework, a U.S. growth rate that was 0.8 percent below average is explained by a higher initial per capita income ("costing" a net effect of −1.7 percent in growth) and by a higher level of institutional sclerosis ("costing" a net effect of −0.61 percent in growth).

France, on the other hand, did extremely well compared to other highly developed countries, with a rate of growth of some 0.6 percent above average. Only Japan (3.7 percent excess growth), Germany (0.9 percent), and Italy (0.7 percent) did better.

France's performance is explained by three factors:

1) A below average initial per capita income, giving a net positive effect on growth of 0.26 percent;

2) A quite stable monetary policy, giving an additional 0.36 percent on growth;

3) A below average index of institutional sclerosis, boosting growth by 0.23 percent.

In conclusion, it appears that growth policy and the political system are not really indispensable to an explanation of the economic evolution of France during the last thirty years. France matched the growth of the average of developed and underdeveloped countries. It did, nevertheless, slightly better than other highly developed countries. This relatively better performance is explained primarily by an initially lagging economy and lower institutional sclerosis due to the circumstances of the Second World War.

Against this background we should now examine the performance of the economy during the very different period beginning with the oil crises of the early 1970s.

Table 3

Causes of Growth
18 Countries, 1950–1977
(Percent)

	Italy	Japan	Netherlands	New Zealand	Norway	Sweden	Switzerland	UK	USA
Growth rate differentials to average (to be explained)	0.7	3.7	0.4	−0.9	0	−0.9	−0.9	−1.7	−0.8
Effect of initial per capita income	0.91	1.39	0.16	−0.49	0.07	−0.67	−0.58	−0.11	−1.7
Effect of population growth	−0.38	0.21	0.35	1.1	−0.24	−0.53	0.21	−0.82	0.65
Effect of money growth instability	0.15	−0.21	0.02	−0.56	0.45	−0.07	0.06	0.06	0.47
Effect of institutinal sclerosis	0.23	0.86	−0.23	0.03	−0.06	−0.12	−0.21	−0.97	−0.61
Unexplained residual	−0.2	1.45	0.1	−0.82	−0.22	0.49	−0.38	+0.14	0.39

	Australia	Austria	Belgium	Canada	Denmark	Finland	France	FRG	Ireland
Growth rate differentials to average (to be explained)	0.1	0.3	−0.4	0.5	−0.7	0	0.6	0.9	−1.0
Effect of initial per capita income	−0.67	0.7	−0.11	−0.76	−0.39	0.44	0.26	0.54	1.0
Effect of population growth	1.7	−1.0	−0.68	1.47	−0.38	−0.53	−0.09	−0.24	−1.0
Effect of money growth instability	−0.43	−0.2	0.39	−0.13	−0.13	−0.50	0.36	0.13	0.15
Effect of institutinal sclerosis	−0.2	0.49	−0.2	−0.27	−0.08	0.13	0.23	0.17	0.51
Unexplained residual	−0.31	0.31	0.2	0.19	0.28	0.16	−0.16	0.3	−1.66

Source: Author's calculations.