Economic Policy and Income Distribution in France Since the 1970s

Presentation for the International Research Meeting in Business and Management 2-3 July, Nice

Luis REYES

KEDGE Business School and Université Paris 13

\[1\] luisantonio.reyesortiz@univ-paris13.fr, Luis.Reyes-Ortiz@kedgebs.com, www.luisreyesortiz.org
Outline

1. From the Bretton Woods system to the oil shocks
Outline

1. From the Bretton Woods system to the oil shocks

2. The end of stagflation, and the beginning of the calvary
   - The consequences for households
   - The consequences for firms
Outline

1. From the Bretton Woods system to the oil shocks

2. The end of stagflation, and the beginning of the calvary
   - The consequences for households
   - The consequences for firms

3. From the liquidity trap to the crisis
1. From the Bretton Woods system to the oil shocks

2. The end of stagflation, and the beginning of the calvary
   - The consequences for households
   - The consequences for firms

3. From the liquidity trap to the crisis

4. Public expenditure and income inequality
Outline

1. From the Bretton Woods system to the oil shocks

2. The end of stagflation, and the beginning of the calvary
   - The consequences for households
   - The consequences for firms

3. From the liquidity trap to the crisis

4. Public expenditure and income inequality
The Bretton Woods system (1945-1971) was characterized by (among others):
- fixed exchange rates,
- strong intervention by central banks,
- capital controls,
- high inflation,
- low unemployment rates,
- high levels of government expenditure,
- low public debt/GDP ratios,
and overall social and economic stability, despite some important movements in the sixties.
The Bretton Woods system (1945-1971) was characterized by (among others):
The Bretton Woods system (1945-1971) was characterized by (among others):

- fixed exchange rates,
From Bretton Woods to the oil shocks
Bretton Woods broad overview

The Bretton Woods system (1945-1971) was characterized by (among others):

- fixed exchange rates,
- strong intervention by central banks,
From Bretton Woods to the oil shocks
Bretton Woods broad overview

The Bretton Woods system (1945-1971) was characterized by (among others):

- fixed exchange rates,
- strong intervention by central banks,
- capital controls,
The Bretton Woods system (1945-1971) was characterized by (among others):

- fixed exchange rates,
- strong intervention by central banks,
- capital controls,
- high inflation,
The Bretton Woods system (1945-1971) was characterized by (among others):

- fixed exchange rates,
- strong intervention by central banks,
- capital controls,
- high inflation,
- low unemployment rates,
The Bretton Woods system (1945-1971) was characterized by (among others):

- fixed exchange rates,
- strong intervention by central banks,
- capital controls,
- high inflation,
- low unemployment rates,
- high levels of government expenditure,
The Bretton Woods system (1945-1971) was characterized by (among others):

- fixed exchange rates,
- strong intervention by central banks,
- capital controls,
- high inflation,
- low unemployment rates,
- high levels of government expenditure,
- low public debt/GDP ratios,
The Bretton Woods system (1945-1971) was characterized by (among others):

- fixed exchange rates,
- strong intervention by central banks,
- capital controls,
- high inflation,
- low unemployment rates,
- high levels of government expenditure,
- low public debt/GDP ratios,
- and overall social and economic stability, despite some important movements in the sixties.
"What started as a small, short-term credit facility grew to be a large, intermediate-term facility until the US gold window closed in August 1971" (Sandra Kollen, Federal Reserve of Atlanta).
"What started as a small, short-term credit facility grew to be a large, intermediate-term facility until the US gold window closed in August 1971" (Sandra Kollen, Federal Reserve of Atlanta).

"By the early 1960s, the U.S. dollar’s fixed value against gold, under the Bretton Woods system of fixed exchange rates, was seen as overvalued" (IMF).
"What started as a small, short-term credit facility grew to be a large, intermediate-term facility until the US gold window closed in August 1971" (Sandra Kollen, Federal Reserve of Atlanta).

"By the early 1960s, the U.S. dollar’s fixed value against gold, under the Bretton Woods system of fixed exchange rates, was seen as overvalued" (IMF).

"The principal causes of America’s recent trade deterioration are to be found (...) in the high value of the dollar in foreign exchange markets" (Arthur Burns; Foreign Affairs, 1984).
In 1971, Richard Nixon announced the closing of the gold window, abruptly ending the Bretton Woods system.
In 1971, Richard Nixon announced the closing of the gold window, abruptly ending the Bretton Woods system.

"In September 1971, a month after Nixon’s speech, at an OPEC meeting in Beirut, its member states increased oil prices by nearly 9 percent explicitly to compensate for the devaluation of the U.S. currency" (Graetz, 2011).
In 1971, Richard Nixon announced the closing of the gold window, abruptly ending the Bretton Woods system.

"In September 1971, a month after Nixon’s speech, at an OPEC meeting in Beirut, its member states increased oil prices by nearly 9 percent explicitly to compensate for the devaluation of the U.S. currency" (Graetz, 2011).

Despite some measures implemented to control prices, inflation aggravated.
In 1971, Richard Nixon announced the closing of the gold window, abruptly ending the Bretton Woods system.

"In September 1971, a month after Nixon’s speech, at an OPEC meeting in Beirut, its member states increased oil prices by nearly 9 percent explicitly to compensate for the devaluation of the U.S. currency" (Graetz, 2011).

Despite some measures implemented to control prices, inflation aggravated.

The second half of the seventies was characterized by what came to be known as "stagflation".
Outline

1. From the Bretton Woods system to the oil shocks
2. The end of stagflation, and the beginning of the calvary
   - The consequences for households
   - The consequences for firms
3. From the liquidity trap to the crisis
4. Public expenditure and income inequality
The end of stagflation, and the beginning of the calvary

In 1979, the Fed’s newly elected chairman Paul Volcker raised interest rates strongly.
In 1979, the Fed’s newly elected chairman Paul Volcker raised interest rates strongly. In order to avoid capital flight, France and several other (mostly western) economies were forced to follow suit.
The end of stagflation, and the beginning of the calvary

The end of stagflation

- In 1979, the Fed’s newly elected chairman Paul Volcker raised interest rates strongly.
- In order to avoid capital flight, France and several other (mostly western) economies were forced to follow suit.
- With interest rates at high levels, and despite the celebrated stabilization of inflation, three main consequences emerged:
  1. Firms shifted their capital structure in favor of equity issuing (in contrast to debt issuing, as was the norm up to then),
  2. As banks perceived this lack of demand for credit, they granted easier access of credit to households,
  3. The debt/GDP ratio of indebted economies (for the most part developing countries) increased drastically, and currency/financial crises became more frequent.

In this work, we focus exclusively on the first two.
The end of stagflation, and the beginning of the calvary

The end of stagflation

- In 1979, the Fed’s newly elected chairman Paul Volcker raised interest rates strongly.
- In order to avoid capital flight, France and several other (mostly western) economies were forced to follow suit.
- With interest rates at high levels, and despite the celebrated stabilization of inflation, three main consequences emerged:
  1. firms shifted their capital structure in favor of equity issuing (in contrast to debt issuing, as was the norm up to then),

The end of stagflation, and the beginning of the calvary
The end of stagflation

In 1979, the Fed’s newly elected chairman Paul Volcker raised interest rates strongly.

In order to avoid capital flight, France and several other (mostly western) economies were forced to follow suit.

With interest rates at high levels, and despite the celebrated stabilization of inflation, three main consequences emerged:

1. firms shifted their capital structure in favor of equity issuing (in contrast to debt issuing, as was the norm up to then),
2. as banks perceived this lack of demand for credit, they granted easier access of credit to households, and
The end of stagflation, and the beginning of the calvary

The end of stagflation

- In 1979, the Fed’s newly elected chairman Paul Volcker raised interest rates strongly.
- In order to avoid capital flight, France and several other (mostly western) economies were forced to follow suit.
- With interest rates at high levels, and despite the celebrated stabilization of inflation, three main consequences emerged:
  - firms shifted their capital structure in favor of equity issuing (in contrast to debt issuing, as was the norm up to then),
  - as banks perceived this lack of demand for credit, they granted easier access of credit to households, and
  - the debt/GDP ratio of indebted economies (for the most part developing countries) increased drastically, and currency/financial crises became more frequent.

In this work, we focus exclusively on the first two.
In 1979, the Fed’s newly elected chairman Paul Volcker raised interest rates strongly.

In order to avoid capital flight, France and several other (mostly western) economies were forced to follow suit.

With interest rates at high levels, and despite the celebrated stabilization of inflation, three main consequences emerged:

1. firms shifted their capital structure in favor of equity issuing (in contrast to debt issuing, as was the norm up to then),
2. as banks perceived this lack of demand for credit, they granted easier access of credit to households, and
3. the debt/GDP ratio of indebted economies (for the most part developing countries) increased drastically, and currency/financial crises became more frequent.

In this work, we focus exclusively on the first two.
Outline

1. From the Bretton Woods system to the oil shocks

2. The end of stagflation, and the beginning of the calvary
   - The consequences for households
   - The consequences for firms

3. From the liquidity trap to the crisis

4. Public expenditure and income inequality
The end of stagflation, and the beginning of the calvary
The consequences for households (1)

- With the strong increase of interest rates, and the corresponding fall in the demand for credit by firms, banks granted easier access of credit to households.
With the strong increase of interest rates, and the corresponding fall in the demand for credit by firms, banks granted easier access of credit to households.

With the fall of the real interest rate paid by households, their demand for credit increased strongly.
The end of stagflation, and the beginning of the calvary
The consequences for households (1)

- With the strong increase of interest rates, and the corresponding fall in the demand for credit by firms, banks granted easier access of credit to households.
- With the fall of the real interest rate paid by households, their demand for credit increased strongly.
- This in turn implied:
  1. high demand for real estate and correspondingly high property prices (i.e. two major real estate bubbles),
  2. rising shares of debt as proportion of disposable income, and all this was coupled with
  3. higher unemployment rates and greater labor market flexibility (higher profit rates at the expense of lower wage/GDP ratios, reduced benefits and higher contributions paid by workers, etc.).
With the strong increase of interest rates, and the corresponding fall in the demand for credit by firms, banks granted easier access of credit to households.

With the fall of the real interest rate paid by households, their demand for credit increased strongly.

This in turn implied:

1. high demand for real estate and correspondingly high property prices (i.e. two major real estate bubbles),
The end of stagflation, and the beginning of the calvary
The consequences for households (1)

- With the strong increase of interest rates, and the corresponding fall in the demand for credit by firms, banks granted easier access of credit to households.
- With the fall of the real interest rate paid by households, their demand for credit increased strongly.
- This in turn implied:
  1. high demand for real estate and correspondingly high property prices (i.e. two major real estate bubbles),
  2. rising shares of debt as proportion of disposable income, and all this was coupled with higher unemployment rates and greater labor market flexibility (higher profit rates at the expense of lower wage/GDP ratios, reduced benefits and higher contributions paid by workers, etc.).
The end of stagflation, and the beginning of the calvary

The consequences for households (1)

- With the strong increase of interest rates, and the corresponding fall in the demand for credit by firms, banks granted easier access of credit to households.

- With the fall of the real interest rate paid by households, their demand for credit increased strongly.

- This in turn implied:
  1. high demand for real estate and correspondingly high property prices (i.e. two major real estate bubbles),
  2. rising shares of debt as proportion of disposable income, and all this was coupled with
  3. higher unemployment rates and greater labor market flexibility (higher profit rates at the expense of lower wage/GDP ratios, reduced benefits and higher contributions paid by workers, etc.).
The end of stagflation, and the beginning of the calvary

The consequences for households (2)

- Households stock of debt as proportion of their disposable income (%)
- Real annual interest rate paid by households (%), right scale
The end of stagflation, and the beginning of the calvary

The consequences for households (3)
Outline

1 From the Bretton Woods system to the oil shocks

2 The end of stagflation, and the beginning of the calvary
   - The consequences for households
   - The consequences for firms

3 From the liquidity trap to the crisis

4 Public expenditure and income inequality
Since credit became more expensive (both because interest rates rose and inflation was controlled), firms issued more equities than debt.
Since credit became more expensive (both because interest rates rose and inflation was controlled), firms issued more equities than debt.

As a consequence, business executives became more estranged from central bank command and lobbied for deregulation in financial markets.
The end of stagflation, and the beginning of the calvary

The consequences for firms (1)

- Since credit became more expensive (both because interest rates rose and inflation was controlled), firms issued more equities than debt.
- As a consequence, business executives became more estranged from central bank command and lobbied for deregulation in financial markets.
- The economy fell into a liquidity trap.
Since credit became more expensive (both because interest rates rose and inflation was controlled), firms issued more equities than debt.

As a consequence, business executives became more estranged from central bank command and lobbied for deregulation in financial markets.

The economy fell into a liquidity trap.

With major borrowers (i.e. NFCs) demanding less credit, lenders (i.e. banks) had a strong urge in becoming market makers and find customers where there were formerly no potential gains (i.e. households and developing economies), thus creating new sources of instability.
Since firms were no longer being subject to the pressure of banks to invest in safer-though-less-profitable projects, investment tends to take place in riskier sectors, thus promoting even more risk-taking (i.e. issuing more equities at higher prices).
Since firms were no longer being subject to the pressure of banks to invest in safer-though-less-profitable projects, investment tends to take place in riskier sectors, thus promoting even more risk-taking (i.e. issuing more equities at higher prices).

As a consequence, since riskier investment projects tend to be less labor-intensive than less-risky projects, labor demand diminished, thus aggravating (and even perpetuating) the unemployment problem.
Since firms were no longer being subject to the pressure of banks to invest in safer-though-less-profitable projects, investment tends to take place in riskier sectors, thus promoting even more risk-taking (i.e. issuing more equities at higher prices).

As a consequence, since riskier investment projects tend to be less labor-intensive than less-risky projects, labor demand diminished, thus aggravating (and even perpetuating) the unemployment problem.

Given that the nature of riskier projects tends to be unproductive (for instance, advertising), new creation of wealth tends to be slower than it would otherwise be.
The end of stagflation, and the beginning of the calvary

The consequences for firms (3)

---

![Graph showing apparent real interest rate paid by firms (%) and stock of debt issued by firms, share of total stock of liabilities (%).]
The end of stagflation, and the beginning of the calvary
The consequences for firms (4)
The end of stagflation, and the beginning of the calvary

The consequences for firms (5)
Outline

1. From the Bretton Woods system to the oil shocks

2. The end of stagflation, and the beginning of the calvary
   - The consequences for households
   - The consequences for firms

3. From the liquidity trap to the crisis

4. Public expenditure and income inequality
### From the liquidity trap to the crisis

#### The liquidity trap

<table>
<thead>
<tr>
<th>Period</th>
<th>Correlation coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979q1-1981q3</td>
<td>0.66</td>
</tr>
<tr>
<td>1981q4-1986q2</td>
<td>-0.81</td>
</tr>
<tr>
<td>1986q3-1992q2</td>
<td>0.41</td>
</tr>
<tr>
<td>1992q3-2000q4</td>
<td>0.79</td>
</tr>
<tr>
<td>2001q1-2003q4</td>
<td>-0.91</td>
</tr>
<tr>
<td>2004q1-2008q3</td>
<td>0.21</td>
</tr>
<tr>
<td>2008q4-2012q4</td>
<td>-0.92</td>
</tr>
<tr>
<td>1979q1-2012q4</td>
<td>-0.45</td>
</tr>
</tbody>
</table>

**Table:** Correlation coefficient between quarterly real interest rate and capital structure of firms, several periods. Source: authors’ calculations based on data from *INSEE* and *Banque de France.*
The crisis

- The housing bubble is likely to have been fed by, at least, two major long-term trends:
The housing bubble is likely to have been fed by, at least, two major long-term trends:

1. the sharp increase in households’ indebtedness, and
The housing bubble is likely to have been fed by, at least, two major long-term trends:

1. the sharp increase in households’ indebtedness, and
2. the strong degradation in households’ living standards (wage contraction and rise in unemployment, mainly).
The crisis

- The housing bubble is likely to have been fed by, at least, two major long-term trends:
  1. the sharp increase in households’ indebtedness, and
  2. the strong degradation in households’ living standards (wage contraction and rise in unemployment, mainly).

- In turn, throughout the same period the stock-market bubble grew thanks to the bull market that accompanied the massive issuance of equities created by:
The housing bubble is likely to have been fed by, at least, two major long-term trends:

1. the sharp increase in households’ indebtedness, and
2. the strong degradation in households’ living standards (wage contraction and rise in unemployment, mainly).

In turn, throughout the same period the stock-market bubble grew thanks to the bull market that accompanied the massive issuance of equities created by:

1. movements in interest rates, and
The housing bubble is likely to have been fed by, at least, two major long-term trends:

1. The sharp increase in households’ indebtedness, and
2. The strong degradation in households’ living standards (wage contraction and rise in unemployment, mainly).

In turn, throughout the same period the stock-market bubble grew thanks to the bull market that accompanied the massive issuance of equities created by:

1. Movements in interest rates, and
2. The falling from grace of credit demand by firms (both of which were mutually reinforcing).
The crisis

The housing bubble is likely to have been fed by, at least, two major long-term trends:
1. the sharp increase in households’ indebtedness, and
2. the strong degradation in households’ living standards (wage contraction and rise in unemployment, mainly).

In turn, throughout the same period the stock-market bubble grew thanks to the bull market that accompanied the massive issuance of equities created by:
1. movements in interest rates, and
2. the falling from grace of credit demand by firms (both of which were mutually reinforcing).

With the collapse of Lehman Brothers in the U.S. came the signal of the worldwide bubble burst of both markets.
Outline

1. From the Bretton Woods system to the oil shocks

2. The end of stagflation, and the beginning of the calvary
   - The consequences for households
   - The consequences for firms

3. From the liquidity trap to the crisis

4. Public expenditure and income inequality
Public expenditure and income inequality

Public expenditure (1)

- Financing capacity/need of the government, % of GDP
- GFCF of the government % of GDP, right scale (both in volume)
Public expenditure and income inequality

Public expenditure (2)

- Apparent real interest rate paid by the government (%), annualized
- Stock of liabilities issued by the government as % of GDP, right scale
Thank you for your attention.