‘Riding out the recession’ from the Financial Times (18 April 1978)

Caption: On 18 April 1978, the British daily newspaper Financial Times remarks that Luxembourg is less affected than its neighbours by the prevailing economic recession.

Source: Dans l'article "Riding out the recession" publié dans son édition du 18 avril 1978, le journal britannique Financial Times remarque qu'à l'opposé de ses voisins, le Luxembourg est moins affecté par la récession économique de l'époque.

URL:
http://www.cvce.eu/obj/riding_out_the_recession_from_the_financial_times_18_april_1978-en-104bb398-9594-4353-aa87-8f4ea2d23685.html

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Riding out the recession

LITTLE LUXEMBOURG has so far ridden out the recession with less apparent discomfort than many of its bigger neighbours. That does not necessarily say much. More cars, bigger houses, and still one of the highest living standards in Europe help conceal stagnation in manufacturing output and a gross domestic product growth of barely 2 per cent. last year and perhaps less this year. Prime Minister Gaston Thorn in his more old Testament moods likes to remind his electorate of the dangers of whoring after false economic indicators and ignoring the country's basic structural problems.

But there are certain simple equations operating in the Duchy's favour. Low or falling inflation in its main trading partner countries has brought Luxembourg's own rate down. A strong currency, inside the "snake" joint float, keeps the import bill from soaring. A booming banking sector has offset its sick steel industry, both in covering the balance of payments and in taxes paid to the state. Moderate borrowings by the state has kept interest rates low.

The main impulse to the economy is from private consumption these days, not from industrial production which last year only increased 0.6 per cent. in volume while construction fell 1.2 per cent. This was mainly due to companies refusing to put any more money into fixed assets, because the residential housing sector is still doing quite well. In fact since 1975/6 the government has taken off the clamps which it had previously applied to housing and consumer credit. The latter has soared, increasing by 24.5 per cent. over 1977. The fact that nonetheless the inflation rate was down to 3.3 per cent. on an annual basis by February 1978 shows how little of Luxembourg's inflation is domestically generated.

"But for historical reasons, there is no reason why with this level of inflation we could not be directly linked with West Germany," says M. Pierre Jaans, the Commissaire Bancaire, and Luxembourg's nearest equivalent to a central bank governor. The actual monetary link is indirect but strong. The Luxembourg franc is tied at parity with the Belgian franc, and both are in the snake tied to the mighty D-Mark. The Belgian national bank, which manages the Belgo-Luxembourg currency, seems determined to keep inside the snake, and Luxembourg, which has three seats on the 10-man Belgo-Luxembourg Exchange Institute has absolutely no quarrel with this. Luxembourg has now followed Belgium in passing legislation to strengthen its armoury against speculators. The powers, which M. Jaans stresses are to be kept in reserve to prevent unwelcome inflows into the Belgian and Luxembourg franc, include suspension of interest on and blocking of accounts. But the powers are double edged, and could equally be used to discourage outflows.

Snake

The Luxembourg case for staying in the snake is in fact stronger than the Belgian. Last year 71 per cent. of its imports came from just two snake countries, Germany and Belgium, which also took 48.5 per cent. of Luxembourg exports. The Duchy no longer has trade surpluses, but at least its deficit seems to have stabilised, staying at between Lux.Frs. 8-9bn. both in 1977 and 1976 (Luxembourg trade statistics are frequently difficult to disentangle from Belgium, with whom it forms a complete customs and currency union). The price performance of Luxembourg exports is hardly sensational (rising 0.6 per cent. in value last year to Lux.Frs. 66.4bn., though 2 per cent. in volume). This reflects very slack demand not only for steel, 54 per cent. of total exports, but to a lesser degree for plastics and rubber (10.7 per cent. of exports) and textiles (9.2 per cent.). Prices of the much wider range of goods that the Duchy imports have of course risen faster, though feeble internal demand and the strength of the franc have kept their volume and cost within reasonable bounds.

More crucially, invisible receipts earned by the financial sector, which now includes some 90 banks, are enough to cover the trade and put the overall balance of payments into the black (by Lux.Frs.10bn. last year). This sector is now very much the golden egg of the Luxembourg economy. Grand Ducal governments have to tread a narrow path between maintaining the informal system of controls that attracts banks to Luxembourg, and making sure that slipshod banking does not undermine confidence in the Luxembourg market place. Initial fears that Finance Minister Jacques Poos, a former editor of Luxembourg's Socialist paper Tageblatt, might take a more doctrinaire line with the banks have now dissipated. On the other hand, here were unwelcome rumours at the start of the year that some of the German banks in Luxembourg had made considerable foreign exchange losses with the abrupt fall of the dollar. Official checks and published bank results now prove these rumours to be without serious foundation.

Nevertheless, M. Jaans has discreetly been persuading Luxembourg banks to improve the solidity of their operations and management, with the result that over the last year while total banking business grew by 16 per cent., banks' capital and reserve backing rose by 23 per cent. Banks have been encouraged temporarily to forego some dividend payments to their parent banks outside Luxembourg, so that their average ratio of paid up capital to third party debt rose from 3.5 per cent. in 1976 to 3.8 per cent. last year (the legal minimum is 3 per cent.). Parent banks have also been encouraged to make the manager of their Luxembough subsidiaries a member of the local board, a move which increases the Luxembourg authorities' legal hold over him, and also to make more use of external auditors (in addition to the normal controls from the Banking Commission).

Luxembourg finance ministers have made the happy error in recent years of consistently underestimating the amount of taxes brought in by the financial sector of the state. This windfall has come in very handy to finance increased public works, Lux.Frs.2bn. in 1974 to an estimated Lux.Frs.3.3bn. this year, needed to provide employment and counteract layoffs or short-time working in the private sector. Unemployment, at about 1,000 workers or less than 1 per cent. of the active workforce, is nonetheless at an historic high for the Duchy, and is bound to increase not only because the steel industry has considerably more people to shed but also because of the number of young people coming on to the labour market up to 1984-85. Only after that date will the post-1966 plummet in the Luxembourger birthrate contract the labour market. But despite this counter-cyclical spending, state finances are pretty healthy. For this year, some two thirds of the public capital spending programme will be covered by the surplus on current account, leaving only 3.8 per cent. of the total budget to be financed out of borrowing. This would seem to refute the argument by some members of the Christian Social opposition that the Thorn Government has let state finances go all to hell, though it equally bears out their boast that M. Thorn took over in 1974 from an exceptionally sound base.

It is only partly true to say that Luxembourg labour law makes legal strikes so complicated to arrange that the unions do not bother. Traditional Luxembourger phlegm even among the unions, coupled with the Thorn Coalition's close links with the union leadership, are the other factors making for social peace even during this troubled recession. Wages rises, too, have moderated, rising 9.6 per cent. last year (12.7 per cent. in 1976), and of that 7.2 per cent. was due to the automatic link with the cost of living index.

But the close working relationship with the unions bore its most spectacular result in the so-called "tripartite agreement" made between government, unions and employers last summer and now, to the dismay of the political opposition, passed into law. The basic premise is that the government will continue to use public money to stimulate and diversify the economy, the unions will not strike or block necessary plant closures, and the employers will do their best to keep on investing. It is mainly aimed at the steel industry. But the most interesting feature is the series of measures to be triggered off automatically by set levels of unemployment. For instance, once the level of 1,500 unemployed is passed, then the government is to introduce and pay for a compulsory early retirement scheme (not just for the steel industry as at present). If the threshold of 2,500 jobless is reached, the government is to further increase tax breaks for investors, and in the vaguely worded event of a "manifest crisis," the government has the power to juggle the index to keep wage rises down, block all prices and rents, and prevent any further redundancies.

Planning

Most of this is happily hypothetical as yet, but it is a far reaching kind of advance planning, perhaps only possible in a small and tightly knit community. Certain measures under the tripartite agreement have been taken already, notably a flexible ban on overtime and a temporary ban on any new immigrant labour coming to the duchy, and the creation of the Societe Nationale de Credit et d'Investissement. The SNCI, formed in January with a start up capital of Lux.Frs.1bn. and some private participation, has three roles. First, it will state participations in certain companies, and already has done so in the "lame duck" case of the Rodange steel company to the tune of Lux.Frs.200m. M. Raymond Kirsch, the top finance ministry official who now heads the SNCI, says the approach here will be "empirical, not ideological." The SNCI has no aims, nor indeed resources, to take over the commanding heights of the Luxembourg economy, and is already turning away more requests for intervention than it is granting.

Second, the SNCI will loan cheap investment credit by financing part of new projects at 4.5 per cent. (some four points below prevailing market rates). This, Mr. Kirsch says, will be channelled particularly to small and medium sized businesses, and he point out that the SNCI will be "sharing some of the risk, by putting up some of the principal, as well as subsidising the interest." So far some 20 credits of this type have been granted to a total value of Lux.Frs.80m. Last, though the SNCI has not yet started business in this field, it will provide export credit—within the new OECD guidelines on export credit, Mr. Kirsch assures. All of which is designed to put Luxembourg companies on something of an equal footing with their foreign counterparts.

D.B.