

The contents of this document are preliminary and subject to change.

GRAY/23/3599

January 23, 2023

**Statement by Mr. Zhang and Ms. Yang on France  
(Preliminary)  
Executive Board Meeting  
January 25, 2023**

We thank staff for the insightful set of reports and the relevance of the selected issue and Mr. Buissé, Mr. Grossmann-Wirth, Mr. Benac, and Ms. de Waziers for the helpful Buff statement. We broadly agree with the staff appraisal and would like to offer the following comments.

**It is encouraging that France has recorded a solid rebound**, with output returning to pre-crisis levels and recovery being broad-based and faster than in most other European countries. However, the growth prospects are dampened by the energy crisis. We agree with staff that a prolonged war, escalation of sanctions, and additional inflation pressure represent the primary downside risks to economic outlook. The mid-term scarring effects from the crisis will depend on the progress of structural reforms, which could support sustainable and inclusive growth if successfully implemented.

**Fiscal stance in 2023 should start to normalize, supporting monetary policy efforts to control inflation.** While the fiscal responses to the energy price shock have cushioned the economic impact, they have been expensive, poorly targeted, and distortionary. The significant fiscal cost of the tariff shield, suggesting the large gap between market price and regulated energy prices, makes up the majority of the costs associated with purchasing power measures. To lower fiscal costs and encourage energy conservation, a faster phase-out of energy price caps and more targeted support are required. In the case where a swift phase-out is unfeasible, we concur with staff that a tiered pricing mechanism, with the tariff shield only covering basic energy needs, could be considered.

**We take note of the renationalization of EDF and see a reasonable argument for the government to take it under state control.** The poor performance of EDF's existing

reactors and a government-imposed electricity price cap have made EDF's debt burden appear increasingly unsustainable. As pointed out in the staff report, returning to full state ownership could facilitate the government to implement its energy policy, protect households, and reduce the country's dependence on imported fossil fuels. However, this acquisition may not have much opportunity for a financial return due to its high cost, which represents a 25 percent premium over its five-year average share price. *Staff pointed out that renationalization risks exposing the state to further losses; could staff elaboration on the risks to public finances with quantitative analysis.*

**Medium-term fiscal consolidation should focus on rationalizing current spending while protecting investment.** The fiscal deficit in France is well above that of its peers, and the elevated debt and gross financing needs pose increasing challenges to debt sustainability. To reverse the deficit and debt divergence from peers, a sustained fiscal adjustment with an emphasis on current spending rationalization is warranted. We appreciate staff's comprehensive analysis in the SIP and share staff's recommendations to improve spending efficiencies. Given the large size of social protection spending in the spending gap with peers, reforms on the pension system and unemployment benefits are imperative. Additional reforms in the areas of health, education, and tax expenditure, could also yield substantial savings. While acknowledging the strong public opposition, we support the government's plan for pension reform. We stress the significance of the buy-in for this ambitious transformation and call for the authorities to take effective mitigation to reduce the risk and impact of social unrest. Meanwhile, preserving investment is critical to boost the growth potential and facilitate green and digital transformations; *France 2030* is in the right direction of boosting critical investments and innovation.

**While the banking sector fared well during the crisis, further vigilance is needed to mitigate financial stability risks amid the tightening of financial conditions.** We take positive note that banks and insurers are in a solid financial and prudential standing. However, the economic slowdown and volatile energy prices may add pressure to the soundness of the banking sector. It is reassuring that the housing market is beginning to cool down, but the narrowing gap between the usury rate and the effective interest rates suggests increasing constraints on banks, which could adversely impact financial stability. Therefore, we see merits in allowing a complete pass-through of monetary policy.

**Efforts to accelerate green transformation is commendable.** The rise in energy prices could be utilized to encourage energy conservation and increase the usage of renewable energy sources. *France Relance* and *France 2030* would facilitate the decarbonization process, the development of infrastructures, and advancement of low-carbon energies and technologies. For reasons of efficiency and acceptability, we agree that the increases in carbon pricing should be reflected in a medium-term manner, incorporated in a planned strategy of decarbonization, and be part of a broader package of climate measures. Non-

pricing measures, like regulations and feebates, could also contribute to the transition to a low-carbon economy.

With these remarks, we wish the authorities every success in their policy endeavors.