MASTER FILES

ROOM C-120 04

NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/92

3:00 p.m., June 13, 1984

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Alfidja	
J. de Groote	H. G. Schneider
B. de Maulde	X. Blandin
	M. A. Weitz, Temporary
	M. K. Bush
	S. R. Abiad, Temporary
	T. Yamashita
J. E. Ismael	
R. K. Joyce	
A. Kafka	C. Robalino
	G. Grosche
G. Lovato	N. Coumbis
	A. S. Jayawardena
	J. E. Suraisry
J. J. Polak	
	R. L. Bernardo, Temporary
	H. Alaoui-Abdallaoui, Temporary
	E. I. M. Mtei
	J. L. Feito
J. Tvedt	
	T. A. Clark
Zhang Z.	Wang E.

J. W. Lang, Jr., Acting Secretary
C. J. Fairbairn, Assistant

Also Present

Asian Department: L. Mendras, J. Thornton. European Department: L. A. Whittome, Counsellor and Director; T. R. Boote, P. Dhonte, D. Gros, A. Leipold, G. A. Mackenzie, V. Marie, K.-W. Riechel, H. O. Schmitt, M. Xafa. Exchange and Trade Relations Department: C. D. Finch, Director; G. G. Johnson, N. Kirmani. Legal Department: S. A. Silard. Secretary's Department: B. J. Owen, P. D. Péroz. Treasurer's Department: D. Berthet. Bureau of Statistics: K. W. Nahr. Advisors to Executive Directors: K. A. Hansen, G. E. L. Nguyen, P. Péterfalvy, D. I. S. Shaw. Assistants to Executive Directors: J. R. N. Almeida, L. E. J. M. Coene, C. Flamant, V. Govindarajan, D. Hammann,, H. Kobayashi, J. A. K. Munthali, G. W. K. Pickering, T. Ramtoolah, D. J. Robinson, A. A. Scholten, Wang C. Y.

1. FRANCE - 1984 ARTICLE IV CONSULTATION

The Executive Directors resumed from the previous meeting (EBM/84/91, 6/13/84) their consideration of the staff report for the 1984 Article IV consultation with France (SM/84/109, 5/15/84; and Sup. 1, 6/11/84). They also had before them a report on recent economic developments in France (SM/84/123, 5/29/84).

The Director of the European Department, in response to a question concerning the profitability of replacement investment, explained that the staff, in investigating the determinants of investment, had used a modified investment equation calculated by the official French forecasting body. They had found that high expected profitability was an important cause of replacement investment, while investment for the purpose of expanding capacity was more demand related.

There had been some questions on the efficacy of capital controls, the Director said. The differential between the Eurofranc interest rate and domestic interest rates indicated that capital controls had caused a considerable market segmentation. The French authorities were considering some gradual dismantling of capital controls, but plannned to proceed slowly to avoid destabilizing capital flows and disturbing domestic interest rates.

One speaker had requested further information on French industrial policy, the Director said. The emphasis was on industrial modernization, rather than on the short-term preservation of employment, although exceptions to that generalization could probably be found.

There had been a question from Mr. Polak concerning the need for a real wage cut, the Director recalled. The French authorities were fully aware of the need for cutting costs, but wished to do so by preserving the level of purchasing power while allowing productivity gains to accrue entirely to enterprises.

It would be difficult to quantify the costs of protectionism on the more efficient and unprotected sectors of the economy, the Director said, but the view that protectionism involved misallocation of resources was widely accepted. The staff had been in contact with a number of outside bodies in an attempt to construct a satisfactory quantitative measure, but as yet without success.

As to whether the French authorities would return to a free wage bargaining system, the Director commented that their view was that the present incomes policy had become a permanent feature of the French economy and that it should be made flexible enough to resolve any further conflicts that might arise, particularly with respect to differentials between sectors and professions. However, the longevity of the present approach to incomes policy would obviously rest on the extent of the continued political support, on the evolving role of the unions, and on expectations about the future rate of inflation.

Mr. de Groote asked whether crowding out of the private sector could occur while interest rates were falling.

The Director of the European Department replied that interest rates in France were set by the authorities to maintain the exchange rate. Thus, crowding out would not be evident in the normal market interest rates, but in credit rationing or in secondary market interest rates about which information was limited. However, it should be emphasized that the credit ceilings had not been reached in 1983 and crowding out was not a current problem.

Mr. de Maulde said that he agreed that interest rates, in view of their crucial role in the French economy, should be set more freely, through the gradual dismantling of credit ceilings and the gradual phasing out of subsidization in the financial sector. Interest rates performed a dual role; first, they stimulated long-term capital investment, particularly through the broad market, and second, they played a role in moderating the demand for credit. However, the conditions necessary for the establishment of a purely market-driven system were lacking. For historical and administrative reasons, a highly complex network of credit distribution had developed, but steps were now being taken to simplify it. The subsidization through lower interest rates of economic activities such as agriculture and housing was a deeply ingrained feature of the French economic tradition; subsidies for small firms or new investment were equally difficult to abandon. A more fundamental reason for maintaining an administered credit system was related to the evolution of the economy since 1970. The external oil shocks had been absorbed, not through a reduction in disposable income, but through diminished industrial profitability, hence a demand for credit by firms structurally much stronger than in other industrial countries, which called for an equally strong restraint mechanism. Clearly, if profits were to continue to rise, the need for credit regulation and subsidized interest would lessen as self-financing became a viable option, with the additional help of an invigorated securities market. In such a framework, a progressive removal of the credit restrictions would help to create the conditions conducive to a more flexible money market system.

The delay in the release of French monetary statistics had been noted by Mr. Polak, Mr. de Maulde recalled. The problem was a psychological one, since the French authorities demanded perfect accuracy in their statistics, unlike other countries, although they were perhaps excessively pedantic on the issue.

On industrial policy, Mr. de Maulde agreed very much with the Director of the European Department who had said that the general objective of French policy was to create productive employment, rather than to maintain short-term employment. Concerning management, both public and private, emphasis was put on managerial autonomy in order to stimulate responsibility, a prime goal of the French authorities. His reference to Colbert was directed to that great man's public investment policy, and not to his external policy.

Concerning protectionism, Mr. de Maulde said that he had discovered during the course of the staff's discussions with the French authorities that France differed from other countries not in the degree of its protection, the intensity of which could not be measured, but in the public announcement of its protectionist measures; other countries executed protectionist measures far more secretly. In terms of image, France would have been better advised to adopt a more clandestine approach, although the Fund could rest assured that France did intend to continue to remove protectionist barriers at the same rate as other countries.

An interesting question had been asked by Mr. Wicks concerning the withdrawal of the incomes policy which, he felt, would cause short-term distortions and insurmountable problems in the medium term, Mr. de Maulde remarked. The answer was that the question should not yet be considered. The current problem was to reduce inflation under a strict incomes policy; only after its resolution could the problem of transition to a market system be confronted.

Concerning the credibility of the 1984 objectives for inflation and external balance, Mr. de Maulde said that the French authorities intended to pursue the same policy as in 1983, in that corrective measures would be taken in the fiscal sphere should any deviation from the objectives become evident. Of highest priority was the reduction of inflation to the same rate as France's main trading partners, while simultaneously achieving external balance. The French authorities believed in convergence of inflation rates, and would continue to pursue a basic policy of raising industrial profitability and ensuring structural adjustment.

The Chairman made the following summing up:

> Executive Directors commended the French authorities for the implementation of the comprehensive set of adjustment measures which had been adopted last year. While avoiding a fall in activity, these measures had led to a remarkable reduction of France's external deficit in 1983, and to an improvement in the as yet weak profit position of industry; they therefore welcomed the firm implementation of the Government's incomes policy.
>
> Executive Directors thought, however, that the results, either achieved or in immediate prospect, had to be consolidated and reinforced in order to ensure a satisfactory position. They stressed that the progress in lowering the rate of inflation in 1983 had been disappointing. They noted that the rise in unemployment could not be arrested by stopgap measures, but that it underlined the urgent need to strengthen the profit position of enterprises, which, despite some recovery in 1983, remained weak, and a continued shift from personal incomes to profits was necessary. It was also necessary to reduce the rigidities arising from price controls and from labor regulations which hampered the activities of enterprises. They considered that the need to reverse the rapid buildup of external debt required the

restoration of a current account surplus. The combination of relative demand restraint and improved competitiveness suggested that further improvement in the current account in 1984 was possible, but, especially in view of the trade deficit for the early months of the year, the situation had to be monitored closely over the year as a whole. They considered it an important minimum requirement that the current account should be in balance in the last months of 1984.

Directors noted the emphasis of the authorities on the stability of the exchange rate in the European Monetary System. They observed, however, that price increases in France were still running well ahead of the rates experienced in other major industrial countries and well ahead of the authorities' own target. They considered it very important that the price target set for 1984 should be achieved in order to break inflationary expectations. The situation of enterprises left no room for any reduction in competitiveness. It was essential, therefore, that a strong further deceleration of domestic costs be achieved, and they noted that, in addition to and in conjunction with incomes policy, a reduction in tax pressure could be instrumental for the purpose.

Executive Directors therefore strongly supported the authorities' intention to implement their financial policies with great determination in 1984 and emphasized the need to sustain the course in 1985 and 1986. They warned that the continued success of incomes policy required the full support of adequately constraining financial policies. They noted that, in view of the external constraint, it was of primary importance to implement fully the restraint on domestic credit that was associated with the target for the money supply. They considered that the expansion of M-2R should be kept well within the range announced by the authorities, which would require greater flexibility in interest rate policy, and that the authorities should move firmly if carefully away from a system of monetary control based on administrative credit ceilings to one giving more prominence to market-determined interest rates. Directors noted with some concern that the target for the budget deficit had been overshot in 1983. The financing of deficits of the current magnitude would contribute to an excessive expansion of the monetary aggregates, with adverse implications for prices and the external current account, or would require higher real interest rates. They considered, therefore, that despite the difficulty of containing the deficit in a period of low growth, a target of a deficit equivalent to 3 percent of GDP might well be too high in that a deficit at that level could endanger the achievement of the Government's essential objectives. They considered it preferable to establish a target of not more than 2.5 percent of GDP. They supported the Government's intention to reduce the burden of taxation in 1985, so long as progress was made in reducing the budget deficit and advised that some of the necessary cuts in expenditures should be advanced to 1984. They noted with concern that the ratio of public expenditure to GDP was still rising and would be close to 50 percent in 1984.

Directors strongly supported the authorities' emphasis on the modernization of the industrial structure. While welcoming the authorities' commitment to avoid trade restrictions, they stressed the need for France, together with other industrial countries and members of the European Communities to work actively to reduce existing barriers to trade. They warmly commended the authorities for the increase in official development assistance.

It is expected that the next Article IV consultation with France will be held on the 12-month cycle.

2. PEOPLE'S REPUBLIC OF MOZAMBIQUE - MEMBERSHIP - COMMITTEE

The Executive Directors recalled that on May 3, 1984 the Fund had received an application for membership from the People's Republic of Mozambique (EBD/84/133, 5/4/84).

The Chairman proposed that a committee should be established to proceed with the formal investigation and report to the Executive Board.

The Executive Board agreed to the proposal by the Chairman and took the following decision:

A reasonable time for discussion and preliminary investigation having elapsed, under Rule D-1 the Executive Board decides to establish a committee to proceed with the formal investigation, to obtain all relevant information, and to discuss with the Government of the People's Republic of Mozambique any matters relating to its application for membership in the Fund.

The committee shall consist of Mr. de Maulde (Chairman), Mr. Alfidja, Ms. Bush, Mr. Finaish, Mr. Kafka, Mr. Lovato, Mr. Sangare, and Mr. Zhang.

Adopted June 13, 1984

3. ARGENTINA - REPORT BY MANAGING DIRECTOR

Mr. Polak said that he would be interested in learning more about the state of negotiations with Argentina, especially in light of recent press reports, and about the special meeting called by the Chairman for Friday.

The Chairman responded that there was of course general interest in how the discussions with Argentina were developing. A Fund mission had been in Buenos Aires for five or six weeks--joined recently by the Director of the Western Hemisphere Department--which had discussed intensively a possible adjustment program with the authorities. However, before full agreement had been reached on the policies to be incorporated in the letter of intent, and even though the authorities had been informed that the customary course of action was for the two parties to reach agreement in principle before the substance of the proposed policy was formulated in a letter of intent, the Cabinet had met in Buenos Aires on June 9 to discuss the letter of intent, which had been communicated first to Congress and then submitted to the mission on June 11.

Early drafts of the letter of intent had been communicated to the mission, the Chairman continued, but the authorities had at a later date modified some of their initial formulations. The first task was therefore to examine the letter carefully, and to assess the adequacy of the proposed policies in terms of a viable Fund program.

The Ambassador of Argentina to the United States had been received at the Fund on June 12, the Chairman said. The Ambassador had been eager to dispel the impression left by some press reports to the effect that further discussions on the substance of the letter of intent were precluded. He had indicated clearly that the Argentine authorities wished to continue the discussions with the Fund, a wish that had also been conveyed to the mission.

He would be in a better position once the staff mission returned to headquarters on the following day, June 14, to give Executive Directors an informal indication of management's first analysis of the letter of intent, the Chairman remarked. The special meeting had been called for that purpose, in accordance with the usual practice when negotiations took longer than expected.

The Executive Directors took note of the Chairman's comments.

APPROVED: January 28, 1985

LEO VAN HOUTVEN
Secretary