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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/81

10:00 a.m., June 3, 1983

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Alfidja	W. B. Tshishimbi
J. de Groote	H. G. Schneider
B. de Maulde	
	M. Teijeiro
R. D. Erb	
M. Finaish	T. Alhaimus
	Jaafar A.
T. Hirao	T. Yamashita
R. K. Joyce	
	C. Robalino
	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	
	J. E. Suraisry
	T. de Vries
A. R. G. Prowse	
	O. Kabbaj
F. Sangare	E. I. M. Mtei
M. A. Senior	
J. Tvedt	A. Lindø
N. Wicks	
Zhang Z.	Wang E.

L. Van Houtven, Secretary
S. J. Fennell, Assistant

Also Present:
African Department: M. Sidibe. Asian Department: J.-P. C. Golle, S. M. Schadler. Central Banking Department: P. Ewenczyk. European Department: L. A. Whittome, Counsellor and Director; P. B. de Fontenay, B. de Schaetzen, P. Dhonte, H. B. Junz, A. Leipold, V. Marie, B. J. Nivollet, J. S. Van't dack, M. Xafa. Exchange and Trade Relations Department: C. D. Finch, Director; S. J. Anjaria, P. J. Quirk. Fiscal Affairs Department: M. Katz. IMF Institute: G. M. Teyssier, Director; P. H. D. Jaillet, C. Vie, Participants. Legal Department: W. E. Holder. Research Department: J. H. Felman. Treasurer's Department: D. Berthet. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, J. R. N. Almeida, C. J. Batliwalla, J. Delgadillo, L. Doe, S. M. Hassan, L. Ionescu, P. D. Péroz. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, L. Barbone, L. E. J. Coene, T. A. Connors, G. Ercel, C. Flamant, I. Fridriksson, G. Gomel, M. J. Kooymans, W. Moerke, V. K. S. Nair, Y. Okubo, J. G. Pedersen, G. W. K. Pickering, E. Portas, J. Reddy, J. Schuijer, M. Toro, Wang C.-Y.

1. FRANCE - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with France (SM/83/69, 5/6/83; Sup. 1, 5/23/83; and Sup. 2, 6/1/83). They also had before them a report on recent economic developments in France (SM/83/84, 5/18/83; and Cor. 1, 6/1/83).

The Director of the European Department noted that the tightening of credit control norms reported in the supplementary staff paper issued on June 2, 1983, as well as the recently announced measure to limit to 90 percent the amount of bank lending from long-term resources not subject to the controls, seemed to imply a noticeable reduction in the rate of credit expansion for the second half of 1983.

Mr. de Maulde made the following statement:

Being an industrial country with a wide open economy, France plays an important role in world economic developments. What happens in France with respect to production, prices, and money has an impact on the rest of the world. Conversely, the French economy is heavily dependent on economic developments elsewhere.

In 1982, and in early 1983 as well, the worldwide depression has persisted, and even become more severe in certain respects. During this period France, like its major partners, has had to adapt its economic policy to this situation in order to be in a position to participate in the recovery of the Western economies, when it materializes.

The excellent staff report on the Article IV consultation describes this adjustment effort, which France undertook in 1982 and strengthened in 1983.

Regarding economic developments in 1982, I will only comment on the following three ideas. Activity and employment, although depressed, have remained higher in France than abroad, thereby providing support to the economies of France's major partners. This cyclical lag, rather than a relative decline in industry, accounts for the deterioration in France's external balance. In 1982, the French Government implemented fundamental policies aimed at reinforcing the traditional instruments of economic management and at introducing a comprehensive and credible incomes policy.

As noted in the staff report, while the growth of GDP slowed down during the year, in overall terms it remained higher than in the other major industrial countries at +1.7 per cent. The Government has taken steps to limit the deterioration of employment. Given demographic trends, which I had the occasion to comment upon in this Board last year, and the rate of economic growth, the number of unemployed should have increased by 307,000, according to our economic models. The actual increase in unemployment was only 117,000 due to the introduction of a package of measures aimed at helping businesses that were creating or maintaining jobs, at facilitating early retirement, and at redistributing working time. At the end of the year, there was even a slight drop in unemployment.

Domestic demand within our major trading partners was even weaker than our own, and consequently foreign firms increased their sales on the French market while French businesses saw their sales on foreign markets decline. Our own estimates indicate that nearly half the deterioration in our trade balance is due to this cyclical phenomenon. Approximately one third of the same decline reflects the extra costs generated by the appreciation of the U.S. dollar, especially for our oil imports, while the balance stems from incidental causes, namely the poor performance of the food and agricultural sector, and, early in the year, labor disputes in the automotive industry.

Clearly, the competitiveness of French industry in some products is lagging behind that of neighboring countries. Such is the case, for example, for consumer durables, which France imported in large quantities last year. Does this, however, justify a blanket condemnation of the entire industrial sector, such as the one contained in the report where it reads: "Over the last three years, disposable corporate income has increasingly fallen short of compensating for the economic depreciation..." and "Low investment has caused equipment to age, has hampered the adjustment to new products and markets, and undercut growth and employment"?

I, for one, believe that the analysis should be more subtle. Statistical series do not enable us accurately to measure economic depreciation. Similarly, existing ratios between disposable income of firms and their added value, and between investment and added value, are not comparable between countries. There is no scientific basis for the view that these two ratios would be lower in France than in other major industrial countries. It may even be presumed that, because of the greater role played by the public sector, investment in France has shown better resilience to reduced profit margins.

The only general observation supported by the various national statistics is that in the last four years as activity has weakened, profits have tended to decline, and the investment effort has tended to slow down; this is true in all industrial countries and France, like its partners, aims at reversing that trend. Its industrial capacities apparently have not become more obsolete or modern than those of other countries.

The primary objective of the economic policy implemented by the French Government in 1982 was to reduce the rate of inflation to below 10 percent for the year as a whole and this has been achieved. To this end the authorities introduced one dramatic, short-term measure prefaced by two substantive, long-term measures.

The short-term measure introduced by the Government was a four-month freeze on prices and wages, the aim of which was to "break" inflationary expectations and make it possible to set up policy instruments for the following period.

The two long-term measures that were introduced dealt with government finance and incomes policy. The staff report provides detailed information on fiscal policy: overall, public spending has been rigorously controlled, and the limit on the budget deficit of 3 percent of GNP has been strictly observed. I shall return shortly to the issue of the incomes policy, which was successfully introduced in 1982 and has now become a key element of the 1983 program.

At the end of 1982, the French economy was following the path to disinflation: in prices, wages, overall demand, and government finance, all indicators pointed in this direction. However, since our major partners were achieving rapid progress along the same lines, the cyclical gap remained sizable; in particular, the foreign trade performance, which continued to be quite poor, could not fail to unsettle exchange markets.

The realignment of exchange rates in March 1983, which has been extensively discussed in this Board, came as a consequence of this gap. This adjustment--intended only to correct for past imbalances--has been one basic element in a comprehensive plan to restore lasting external equilibrium to the French economy.

This comprehensive plan was adopted on March 24, 1983 and the various measures necessary for its implementation were rapidly taken in the following weeks. The fundamental and unequivocal choice of the Government is to maintain France's open trading system within the context of our international commitments, in particular within the European economic and monetary arrangements. To this end, two targets were set: to restore within two years the equilibrium of the balance of payments on current account, and, within the same time frame to bring the inflation rate down to 5 percent. Since the half-way mark of these two targets is to be reached in the first 12 months, it has been decided to reduce overall domestic demand by F 65 billion in 1983--or roughly 2 percent of French GDP--to enforce strict restraints on wages, to limit the growth of monetary aggregates, and to promote savings.

The staff report before us does not challenge the principle, the nature, or the scope of these measures. In order to maintain the critical stance which is the regular feature of such literary exercises, the Fund staff brings forward the rhetorical question of whether these measures will be fully implemented, noting that if they were not fully implemented, the targets would not be reached.

I wish to assure my colleagues that the French Government will do all that it has decided to do. In government finance, as the Board is aware, the Central Government's budget deficit is comparatively lower in France than in other major industrial countries. The policy instruments in the hands of the Minister of Finance are effective, as was once again demonstrated in 1982. Since the end of March, expenditures have been cut by the planned amount. The increases in taxes on petroleum products, in transportation fares, in electricity charges, and in post and telecommunications fees have been carried out. Taxpayers are at this very moment receiving official notices to make payments under the compulsory loan scheme. There has been no delay in following the announced schedule, nor is any foreseen.

The staff report rightly emphasizes that the implementation of the policy on preannounced wage settlements is of fundamental importance to the success of the French program. My authorities fully share this view. In their mind, holding down business costs should not be left to unemployment. They will act as firmly as required to prevent the 8 percent standard, set for 1983, from being exceeded; they have good reason to believe that the social climate will be helpful to this end. Indeed when the temporary freeze on prices and wages was lifted in late 1982, a large number of wage negotiations took place. At that time, all the labor unions agreed with the principle of the Government's wage policy; this constitutes, in France, a new development of great significance. At present, under various forms--industry-wide agreements, specific agreements in individual firms, recommendations by employers' associations--the so-called "Delors system" applies to virtually all French wage earners. The success of this policy is a genuine national challenge, involving the whole of French society.

As to monetary policy, my colleagues will recall perhaps, with some amusement, the old quarrel of the Fund staff with regard to credit controls; for obscure ideological reasons, it continues to prefer quantitative rather than monetary base controls, which financial innovations have made costly and erratic. To be sure, the French system of "encadrement" is not flawless; after a time exceptions tend to proliferate making the system increasingly difficult to manage. Not unlike any mechanical device, it then needs to be cleaned and tuned up. The French monetary authorities are now completing such a revision, in order to ensure that the new monetary target, adjusted downward, will not be exceeded.

In line with previous policies, the authorities attach considerable importance to the promotion of long-term savings. Given the difficult economic and financial environment, the performance of public issues of long-term bonds in 1982 was remarkable, thanks to a systematic policy of high long-term real interest rates. This policy, which has been carried over into the first few months of 1983 with the same results, will be continued. Furthermore, financial and tax measures have been taken to promote the issue of corporate shares, to improve the operation of the financial markets, and to protect the savings of lower-income households. The results of these measures are quite encouraging.

In sum, my own assessment is that the adjustment of the French economy might well be achieved over a shorter time span than presently forecast. The Government's plan has been developed on the assumption of continued weakness of the international economic environment. Should the recovery currently envisaged in our latest world economic outlook materialize, the French external balance would move into equilibrium faster. In any case, the French Government will continue to implement the policy that it has set until such time as this result has been achieved.

Mr. Grosche indicated his support for the staff appraisal. At the time of the Executive Board's discussion of the 1982 Article IV consultation with France, a number of Executive Directors had expressed doubts about the success of the French approach to strengthening public and private demand, which was different from that of other industrial countries. Recent economic developments, in addition to the shift in emphasis in economic policies in France, had shown that those concerns had been justified. Clearly, France's trading partners had benefited from the expansionary policies pursued during part of 1981 and 1982. However, from a medium-term perspective, the divergence in economic strategy might not have been beneficial for either the French economy or for those countries having close economic ties with France. Now that the implementation of less restrictive financial policies had become possible in industrial countries that had successfully contained inflation, France would have to pursue a more restrictive stance.

There was no alternative to adjustment, Mr. Grosche considered, and the French Government should be commended for implementating a strong program in the middle of 1982. The further strengthening of policies in March 1983 provided clear evidence of the authorities' intention to tackle the problems with determination. A full and rapid implementation of measures appropriate to meet the 1983 and 1984 objectives of the stabilization program would help to achieve greater convergence of economic policies and economic developments among industrial countries. As the fundamental shift in economic policy had not taken place until mid-1982, it would obviously take some time to reach the desired objectives.

The reduction in inflation in 1982 was commendable, Mr. Grosche went on; however, inflationary expectations still seemed to persist. Furthermore, three months had passed since the 1983 target for inflation had been set, and there was still a risk that the inflation differential between France and its major trading partners would not be reduced as planned.

With respect to the balance of payments, Mr. Grosche said that he was not sure that the 1982 current account deficit could be halved by the end of 1983, given structural weaknesses in the competitive position of French industry in some products and the J-curve effect following the March 1983 depreciation. Additional information provided in Supplement 2 had shown that some skepticism was justified; the revised target called for a reduction in the trade deficit to F 45 billion in the 12 months to April 1984, as against F 92 billion in the previous 12 months. Although the trade balance deficit had remained relatively high in the first three months of 1983--F 24 billion compared with a total of F 93 billion in 1982--the latest data on foreign trade indicated that it had narrowed substantially in April to F 1.5 billion after F 6.5 billion in March. However, it was not unlikely that at least part of that improvement was due to higher imports in the months preceding the March devaluation. He was in full agreement with the staff in its appraisal of both the competitiveness of the French industry and the exchange rate.

The present level of France's external debt was moderate relative to that of other OECD countries, and there was no need for any concern, Mr. Grosche continued. However, the speed with which foreign debt had increased in recent years was disturbing, and the revised objective of halving the current account deficit in 1983 would make the necessary deceleration of the growth of external debt more difficult. Nevertheless, he was confident that the French Government would hold its external debt at manageable levels.

The stabilization of public finances had been a major objective of the policy packages of mid 1982 and March 1983, Mr. Grosche noted, and he welcomed a shift toward a more sustainable fiscal policy. The latest information in Supplement 2 confirmed Mr. de Maulde's assurances that the policy instruments in the hands of the Minister of Finance were effective. It seemed likely that the projected budget deficit of 3 percent of GDP would be achieved. That target was still low by international standards, but the fiscal deficit, which had been growing rapidly in recent years, demonstrated a rather expansionary policy. He, therefore, shared the staff views that such a deficit might prove to be excessive and that the expression of the budget target in nominal terms might be helpful. In any case, that target was the minimum that should be achieved, and the authorities should consider implementing additional measures if necessary.

With regard to monetary policy, the credit expansion planned under the revised monetary target for 1983 should be regarded as an upper limit, Mr. Grosche commented. That was particularly necessary considering the excessive liquidity position that had arisen as a result of previous policies. Concerning the "old quarrel" between the authorities and the staff on the question of quantitative credit control versus monetary base control, the staff could have given a more detailed explanation of the particular institutional setting that was necessary for success within a monetary base policy. In addition, a discussion of the role of the exchange system as well as the influence of interest rate developments abroad on domestic rates would have been useful. However, the experience of other industrial countries that had used some form of monetary base controls had not been unsatisfactory. In the medium term, there seemed to be a case for the authorities to give up the bias against more market-oriented techniques of monetary policy. However, in the short run, it was crucial to ensure that the present system of "encadrement" was working effectively; he hoped that the review being completed by the French monetary authorities would lead to an improvement of that system.

There could be no doubt, Mr. Grosche observed, that incomes policy would have to play a key role for the 1983 adjustment program to be successful. After extensive negotiations in late 1982, the social partners had broken with the tradition of automatic adjustments of wages for past price increases, and had introduced a much-improved system of preannouncing wage increases according to the targeted rate of inflation. Assuming that the targeted inflation level was achieved, incomes policy would keep real wages more or less at present levels. An adjustment of the French economy without cutting real wages would be a remarkable achievement, and France would have escaped the social costs experienced in many other industrial countries. Like the staff, he was concerned whether the preannounced wage settlements would hold, given the fact that a number of wage agreements allowed for the possibility of an automatic catch-up at the end of the year should the inflation target be overshot. Mr. de Maulde's optimism that such a catch-up was not going to materialize appeared to be based primarily on the favorable social climate. Nevertheless, the recent outcry by different groups against the incomes policy should keep the Government on the alert.

In conclusion, Mr. Grosche said that he welcomed the fact that the March 1983 package did not include new protectionist measures and he was confident that the French Government would continue to maintain an open trading system. In addition, the proposal to eliminate the exchange restrictions by the end of 1983 was welcome.

Mr. Lovato noted that the authorities had shown a remarkable ability to adapt their economic policies to the continued depressed state of the world economy, while at the same time trying to minimize the negative effects that policies of restraint had brought about in other industrial countries. The macroeconomic indicators of performance showed that France had a higher level of activity than its trading partners, that the inflation rate had shown a marked deceleration, and that the budget deficit had been contained within the set limits. In many other industrial countries, the effects of the recession on public finances had been felt much more deeply than in France. However, poor performance, particularly in the external sector and in the accumulation of external debt, gave cause for some concern.

He shared Mr. de Maulde's view that the staff had been too harsh in explaining that the large trade deficit in 1982 had been due to the decline in the French industrial sector, which was becoming rapidly obsolete, Mr. Lovato continued. The arguments in favor of that hypothesis seemed to be rather casual and there was a need for more data and studies to substantiate that judgment. The loss of export market shares that France had been experiencing since 1980 was cause for concern, but it could hardly be explained purely in terms of movements in overall competitiveness. Imports had increased in recent years at a faster rate than domestic demand, indicating a growing import penetration in French markets; and yet in 1981 and in most of 1982 as well, aggregate measures of competitiveness had recorded sizable gains for France. A disaggregated analysis of export performance indicated, inter alia, that problems had been particularly severe in sectors such as automobiles and home furnishings, where it was most likely that nonprice factors, in addition to buoyant domestic demand, had been at the root of the surge in imports and the sluggish behavior of exports. Furthermore, the increasing proportion of exports of capital equipment and means of transportation, which would most likely give France a secure trading position in the medium term, had not helped to reduce the trade deficit in the short term due to the depressed state of world demand for those goods. The March realignment of the European Monetary System (EMS) had put the French export sector on a very competitive footing.

The staff observations concerning the profit and savings performance of enterprises, if supplemented both by a more accurate study of the behavior of profit margins and their links with employment and investment, and by a comparison with other industrial countries' performances, might provide the basis for useful advice on industrial policy, Mr. Lovato considered. However, sketchy allusions did not constitute an explanation for the alleged process of deindustrialization in France, and he hoped that by the time of the 1984 Article IV consultation the staff would have completed more extensive studies.

He was puzzled that the staff suspected that a budget deficit of the order of 3 percent of GDP was excessive for France, Mr. Lovato continued. Could the staff substantiate those allegations, and did the staff not think it was natural for a budget deficit to rise under conditions of global recession?

The authorities should be commended for their ability to implement an incomes policy that had contributed to reducing inflation and inflationary expectations, Mr. Lovato went on. Had an agreement between the interested parties already been reached with regard to the avoidance of a catching up of wages and salaries at the end of the year, should the inflation rate turn out to be higher than forecast? That was a critical problem since the year-end increase in wages might have the effect of refueling the inflationary process and of undermining confidence in the anti-inflationary strategy.

With regard to commercial policy, Mr. Lovato concluded, the authorities' emphasis on countering "unfair" competition and encouraging bilateral trade agreements was misplaced and could have wider international repercussions. The recently introduced exchange restrictions were of a protectionist character, should be recognized as such, and should be reversed as shortly as possible.

Mr. Senior remarked that it was clear from the staff report that the range of economic policy options available to the French authorities had been limited by the difficult world economic situation. The lack of synchronization between developments in the French economy and in the economies of the other major industrial countries during the previous years had had both positive and negative results. The deterioration in the external position had been the result, in part, of the different stance of French economic policy vis-à-vis that of major industrial countries and, in part, the result of structural weaknesses, some of which the current government had inherited. Those weaknesses included the indexation of incomes, which increased real income even in the face of declining terms of trade; the geographical distribution of French exports, which had been highly concentrated in countries seriously affected by the world recession; and the restructuring of certain industries with the aim of recapturing domestic markets.

The French authorities had acted promptly to ease the deterioration of the balance of payments by establishing a comprehensive plan that included important fiscal, monetary, and incomes policy measures, Mr. Senior continued. The pace of the contemplated adjustment program, which aimed to achieve the desired targets for the balance of payments and the inflation rate, seemed appropriate since action had already been taken in several areas. In that respect, it was encouraging to note the positive impact that the exchange action had had on the trade balance in April 1983. Similarly, the recent decisions of the authorities to reduce the growth target for M-2, to tighten credit control, and to remove some import restrictions, were favorable developments that demonstrated the determination of the authorities to achieve the planned objectives. The authorities had recognized the importance of incomes policy for the success of the adjustment program and had rightly emphasized the implementation of a policy of preannounced wage settlements with due consideration to avoiding any further increase in unemployment.

With respect to monetary policy, Mr. Senior noted that it was important to control the rate of domestic credit growth, particularly to the public sector, which in the past had been growing rapidly. Because the improvement of the external position was one of the main objectives of the authorities' economic policy, and considering that the exchange regime was not a freely floating one, the control of domestic credit growth was the basic variable.

Mr. Joyce indicated his agreement with the staff appraisal. The French authorities had found it necessary to adapt their economic policies considerably in light of developments in France and in other countries.

There had been some improvements in the economy during 1982; the growth in GDP had been greater in France than in most, if not all, of its major trading partners; the increase in the level of unemployment had been lower than estimated; and the authorities had had some success in reducing inflationary pressures through the implementation of price controls. In addition, a series of comprehensive measures had been introduced to balance the financial position of the social security fund and the unemployment insurance fund. Those were not inconsequential achievements.

Developments in 1982 had not all been positive, Mr. Joyce observed. First, experience in a number of countries had shown that attempts to pursue policies that were out of step with those of their neighbors did not work. At best, such policies were likely to be only partially successful in the short term, and they were almost certainly counterproductive in the medium or long term. In France--a country with a large and open economy--the increase in private demand had been absorbed by the external sector. That was particularly true of consumer durables, in which French industry had proved to be insufficiently competitive.

Second, progress on prices and incomes had been uneven and inflationary expectations continued to persist, Mr. Joyce remarked. The freeze of prices from June to October 1982, which had been introduced in conjunction with the June 12 EMS realignment, did not appear to have met the objective of breaking inflationary expectations. Inflation in 1982 had been less than the authorities' 10 percent target; however, with the ending of price controls in October 1982, there had been rapid price increases, and the annual rate of inflation from November 1982 to April 1983 had exceeded 10 percent. Indeed, in the first four months of 1983, consumer prices had risen at an annual rate of 12.5 percent, considerably above the 8 percent target for 1983. The fight against inflationary expectations was likely to prove long and difficult. Although a significant change in wage setting had been introduced in 1982, with the de facto indexation of wages being replaced by a system of preannounced wage norms, the rise of real disposable income of 3.5 percent did not appear to have been truly justified by economic developments in France.

Concerning more recent economic developments and the prospects for 1983, Mr. Joyce said that the French authorities were to be commended for the introduction of strong measures that had required considerable political courage. Those measures aimed at reducing both inflation and external imbalances were clearly steps in the right direction. The new fiscal measures that had been introduced were much more restrictive, but the staff believed that they might not be restrictive enough to achieve the target for a central government deficit of 3 percent of GDP. While the deficit relative to GDP was smaller in France than in many other industrial countries, it was interesting to note that according to the OECD, the share of new sources of finance taken up by the Central Government had increased from 12 percent to 21 percent between 1980 and 1981, and that it stood at close to 30 percent in 1982. To some extent, the development reflected the overall thrust of the economic policies and, indeed, the philosophy of the French authorities. The 3 percent target might be particularly hard to achieve if real growth in 1983 were negative.

While he agreed with Mr. de Maulde that a monetary base policy might not necessarily be the most appropriate course for France to follow, Mr. Joyce stated, the current practice of depending heavily on quantitative ceilings on credit to the private sector did seem unsatisfactory. The resulting widespread swings in monetary aggregates during 1982 had done little to inspire confidence in the anti-inflationary effort, and while the official monetary targets for the year as a whole had been met, monetary policy in 1982 might not have been as tight as intended since the growth in GDP had been significantly lower than projected. Furthermore, if it had not been for an unexpectedly large decline in net foreign assets, which had offset the expansion of net domestic credit, the money supply targets might not have been met. In the long term, he was concerned about the extensive use of subsidized credits in the system and the possible adverse effects on resource allocation, more particularly on access to credit by smaller firms.

He was concerned that the inflation targets of 8 percent in 1983 and 5 percent in 1984 might prove to be somewhat optimistic, Mr. Joyce went on, particularly in view of the actual and planned increase in public tariffs and excise taxes, and a possible further depreciation in the franc. However, the new credit measures announced in the latest staff paper could have a significant bearing on the outcome. Moreover, the wage and income policies could be effective if the institutional setting provided a genuine social consensus, and if such policies were effectively underpinned by appropriate fiscal and monetary policies. He was still somewhat concerned about the outlook for wages; at the end of 1982 only 40 percent of signed wage agreements had been consistent with the official target for 1982/83, and it still remained to be seen whether the policies aimed at permanently abolishing indexation would be successful. The 2 percent increase in real hourly wages in 1982 might have encouraged less militancy on the part of labor in recent months, but he did not know how durable that result would prove to be. Furthermore, earlier government statements concerning catch-ups if inflation targets were overshot might make it difficult for the authorities to contain the wage increases, even if the so-called "automatic" adjustments were avoided. The recent report from the Labor Ministry stating that wages in the first quarter of 1983 had increased at a 12 percent annual rate reinforced his concern.

On the external side, there appeared to be some grounds for optimism, Mr. Joyce remarked. While the Government had recently revised upward its current account deficit targets for 1983, the improvement recorded in April was promising and suggested that the realignment of the franc was bearing fruit. He welcomed the authorities decision to eliminate the recently introduced restrictions on foreign exchange for tourism by the end of the year.

In conclusion, Mr. Joyce stated that he shared the concerns expressed by the staff that the measures taken by the authorities were not likely to correct deeper weaknesses in the economy. The most important structural problem facing France was the continuous decline in investment over the previous ten years. The French authorities attached considerable importance to raising investment and ensuring that it was directed to the most profitable and promising sectors. Recent measures, such as the reduction in the business tax and the freezing of business contributions to social security, should help to improve profitability. Continuing low levels of investment could only perpetuate France's balance of payments problems, with French industry finding itself unable to respond to increased foreign and domestic demand, resulting all too often in increased imports. Finally, the French authorities were to be commended for the many steps that they had taken, and for their willingness to strengthen those measures although a number of the objectives would not be met. He hoped that the measures would prove successful and that the French economy might once again find itself in step with its partners in Europe. With those problems behind them, the authorities might be able to address more serious medium-term problems.

Mr. Suraisry said that he was in general agreement with the staff appraisal and could support the proposed decision. The French economy was going through a testing period. Deliberately expansionary policies followed in 1981 and the first half of 1982 had not yet led to the hoped-for recovery. Although real growth had been higher, and unemployment had risen relatively less than in other major industrial countries, industrial output and investment had remained depressed. The rate of inflation was well above that of France's main trading partners; the current account deficit had widened significantly; and the franc had come under periodic pressure in the exchange markets. In light of those developments, the shift to more restrictive policies in the second half of 1982 and the early part of 1983 had been appropriate and commendable. The comprehensive package of measures, introduced in support of the devaluation of the franc in March 1983, provided convincing evidence of the authorities' determination to stabilize the economy. The objectives of reducing inflation to 5 percent and eliminating the current account deficit in less than two years were ambitious, but if they could be achieved the stage should be set for resumed growth in the medium term.

There were some encouraging signs that the adjustment efforts were having their intended effects, Mr. Suraisry continued. The authorities had had success in devising and implementing a credible incomes policy with the full support of business and the trade unions; it was essential that there should be no slippages in the 1983 wage settlements, and Mr. de Maulde's assurance on that point was welcome. However, it might be difficult to prevent "catching up" awards in 1984, particularly if the rate of inflation exceeded the official targets. Recent data indicated that both wages and consumer prices were rising faster than the authorities had projected, and developments in those areas would have to be watched closely.

The authorities had acted firmly to contain the fiscal deficit, Mr. Suraisry noted; government spending had been cut back, and wide-ranging tax increases had been implemented as planned. The moves to restore financial balance to the social security funds and to improve the efficiency of the public sector enterprises were appropriate, but he noted the staff concern that the degree of fiscal restraint might be insufficient and that the authorities would have to be prepared to take additional steps if they proved necessary. He shared the staff view that credit and monetary policies should play a fully supportive role in the adjustment efforts. The recent decision to lower the target growth rate for M-2 to 9 percent in 1983 was welcome. While he could understand the staff concern about the effectiveness of quantitative credit controls as an instrument for controlling domestic credit expansion, it was reassuring to learn from Mr. de Maulde that those controls were being revised and strengthened. The revival of activity in the long-term bond market should assist the authorities in meeting their monetary target by providing an important source of nonmonetary financing for the public sector.

On the external side, Mr. Suraisry remarked that the current account should benefit from the improved competitive position of French industry and from the expected world recovery. He welcomed the authorities' commitment to maintaining an open trading system, particularly given the impact that France's trade policy had on the rest of the world. The restrictions on the provision of foreign exchange for tourists were costly and inefficient, and he hoped that they would be eliminated as soon as possible.

In conclusion, Mr. Suraisry said that he encouraged the authorities to hold firmly to their present strategy despite the inevitable sacrifices that would be involved. If they could succeed in controlling inflation and restoring external equilibrium, the economy should be in a much stronger position to benefit from the hoped-for recovery in the world economy.

Mr. de Groote stated that he generally agreed with the staff appraisal. Nevertheless, he would make three general observations that applied to the present French situation and might also be relevant for a number of other industrial countries. First, the French experience had demonstrated the limitations of pursuing an independent economic policy regardless of developments abroad. The lessons from that experience could perhaps have been drawn more clearly in the staff paper. If recovery efforts in the major industrial countries were not sufficiently coordinated, there was the obvious risk that when recovery developed faster in one country than in the others, the one country pursuing a more expansionary policy might be forced to restrict its recovery and apply stricter policies from those that had been evisaged in order to avoid unfavorable effects on its balance of payments. Economic growth in the world as a whole would have been much larger if the recovery efforts of the major European industrial countries had been better coordinated. The authorities' strict deflationary efforts would not have been so necessary if French policies had been better coordinated with the policies of neighboring countries, in particular those of Germany.

The deterioration in economic conditions in France always seemed to be dramatized more than was necessary, Mr. de Groote remarked; although there had been an important deterioration in the external balance in relation to the initial position, the situation was certainly not as alarming as had been perceived. While the economic situation was not fully satisfactory, it was not bad relative to the situation in other countries, particularly in terms of unemployment, growth, and fiscal and external balance. It appeared that the French Minister of Finance was expected to perform much better than his counterparts in the EC countries, a factor that should be taken into account when considering the French economic situation.

Second, the OECD study on France and the staff report both indicated that the deterioration in the external position had been more pronounced than was warranted by past historic relationships between domestic demand and the external balance, Mr. de Groote noted. Apparently, French industry had not reacted sufficiently to the expansion of domestic demand, which had had to be met by imports. In fact, rates of capacity utilization had hardly changed since the end of 1980 because it was not economically viable to produce at full capacity. Therefore, in the short run, fuller utilization of the existing capital stock would only be achieved by changing the capital/labor ratio, and that would require wage restraint and rationalizing investments. A reduction of the share of wages in value added was essential in order to reduce both domestic demand and the costs of production and to return the external balance to equilibrium. The present policy of wage moderation should be sufficient to allow the restoration of profitability, and the French authorities should be commended for having already made substantial essential efforts in that regard. The abolition of the de facto indexation was a critical element in that issue. In the short run, any expansion that would not deteriorate the balance of payments position would have to come from the export sector and would therefore have to be supported by an appropriate relationship between cost and profit.

Third, the long-term restructuring of the economy could be achieved only through a major investment effort, Mr. de Groote considered. In order to reverse the trend of industrial stagnation, it was essential to ensure that wage restraint was maintained. Only when wage moderation was perceived as more permanent could a positive influence on investment be expected. New investment would also help to increase levels of employment. In that respect, it would have been useful if the staff had included a fuller analysis of the scenarios elaborated by the Commissariat Général du Plan for the period of the Ninth Plan, 1984-88. Most scenarios foresaw strong investment trends, but those might be difficult to achieve without substantial improvements in profitability and without favorable expectations in the long-term evolution of wage costs. Perhaps the staff could comment on those issues.

The report contained limited information on France's external debt distribution, Mr. de Groote continued. More information in the staff paper on France's short-term debt position would have been welcome. In addition, he was surprised that the staff had not discussed in more detail the foreign exchange restrictions on tourism expenditure. Those measures seemed likely to be ineffective, and it was doubtful whether they would improve the balance of payments situation. It was possible that black market operations could develop along the French borders, and eventually the French authorities would find it necessary either to intervene or to let a parallel exchange rate develop.

In conclusion, Mr. de Groote stated, it was quite remarkable that in spite of France's economic difficulties, development aid to the third world continued to be seen as a priority objective. The authorities were to be greatly commended for that stance.

Mr. Wicks stated that he was in broad agreement with the comments of Mr. Joyce and Mr. de Groote. The lack of convergence of France's economic policies with those of its major trading partners might have had positive features for France in the short term, but it had certainly brought about medium-term problems. The action taken by the authorities to bring the French economy more into line with the economies of its major partners was welcome, and he hoped that some stability in the external position could be achieved. It was a question of whether that action would be sufficient, and he noticed that the staff had expressed certain qualifications in that regard.

The French authorities should be commended for the adoption of stringent inflation and current account objectives, Mr. Wicks considered, but he shared the staff view that it was unlikely that either objective would be met in 1983. The circumstances were somewhat different from those of 1982 when the inflation target had been achieved through the strict enforcement of the wage freeze. With inflation running at an annual rate of about 12.5 percent in the first four months of 1983, higher public sector tariffs, and the exchange rate devaluation that had offset the beneficial effects of lower oil prices, the achievement of the 8 percent target would be difficult. France's large debt service burden suggested that a trade surplus would be necessary to balance the current account, although some further improvement in the trade accounts could be expected after the full benefits of the devaluation had worked through the system. The timing of that improvement would be rather uncertain, and he noted that the target date for halving the deficit had been pushed back to April 1984.

Turning to the policies for achieving the inflation and current account objectives, Mr. Wicks went on, the measures introduced in March 1983 were a move in the right direction, but there should be a more positive role for monetary policy in achieving the inflation objective. In 1982, it had been possible to accommodate a rapid expansion of domestic credit within the M-2 target by tolerating a large current account deficit. The present objective was to halve the deficit, and there was thus much less scope for credit expansion to be offset by current account flows; that being so, the achievement of the 9 percent M-2 target for 1983 implied a sharp fall in domestic credit expansion. He fully endorsed the staff view that the credit expansion that was planned under the revised monetary target must be regarded as an upper limit and should be rigorously and continuously monitored. With regard to the "old quarrel" concerning monetary controls, for many years the United Kingdom had used the direct quantitative approach but had found it completely unworkable and had had to abandon it. He hoped that if the revision of the present system was not successful, the authorities would consider using another approach to monetary control. In the meantime, the authorities could give greater weight to reducing bank lending to the public sector in order to offset a potentially excessive demand for credit.

With regard to fiscal policy, Mr. Wicks stated that he supported the March 1983 austerity package that aimed to reduce the public sector deficit, and in particular to control the central government deficit. It was encouraging to note that, according to Mr. de Maulde's statement, expenditures had been cut by the planned amount since the end of March. The proposed administrative saving was substantial, amounting to some F 16 billion from the Central Government, nationalized industries, local authorities, and the social security budget. Did Mr. de Maulde or the staff see any problems in securing those savings? It would be helpful if the target for the central government deficit were expressed in nominal terms rather than as a percentage of GDP.

The information contained in Table 1 of the staff report on the profitability of the nonfinancial corporate sector underlined the need to increase the profitability of industry, both in France and in neighboring economies, Mr. Wicks commented. Until industry was more profitable, there would not be a full recovery or full prosperity. Some adjustment of the level of real wages would be necessary if corporate profitability was to be restored. The staff paper had noted the escalation of nonwage labor costs, which also needed to be kept under strict control. Mr. de Maulde's reassurances that there would be no provision for "catching up" with inflation under the new system of preannounced wage settlements was welcome, but he noted with concern that the growth of earnings had bounced back in the first quarter since the end of the wage freeze. In addition, the industrial minimum wage had been raised by 3.5 percent in March. Clearly, the implications of those developments upon the industrial profits would have to be watched carefully.

With regard to the external policy, Mr. Wicks stated that the recent restrictions imposed on the provision of foreign exchange to residents for tourism were of doubtful benefit. He could speak with experience of such restrictions since they had been used in the United Kingdom for a long time. It was with some reluctance that he could agree to approve those exchange restrictions until the end of the year.

Finally, Mr. Wicks remarked that it would have been useful if the staff could have covered in more detail the evolution of the external indebtedness of France. In addition, the French exchange arrangements and the impact of France's membership in the EMS upon the adjustment effort might have been dealt with in greater detail. Since the EMS realignment of March 21, 1983, the franc had weakened steadily against the U.S. dollar. Although there had been some mention in the external policy section of the staff paper of the authorities' attitude toward overseas development assistance and protection, it was disappointing that the paper had not discussed the degree of openness of the French capital markets. Article IV consultations should examine the external sector in a comprehensive way, particularly in the case of major industrial countries.

Mr. Hirao indicated his agreement with the staff appraisal. He recalled that at the time of the 1982 Article IV consultation with France, the French economic strategy had been markedly different from that of most other industrial countries, which believed that the restoration of price stability was a necessary precondition for the resumption of sustainable growth. France's economic policy during 1982 and early 1983 had sought to reconcile the seemingly conflicting goals of financing increased government spending, improving business profitability, and containing inflationary pressures. Initially, emphasis had been placed on the expansion of demand, but it had subsequently been shifted to the improvement of industrial profitability. However, in the face of a deteriorating external position and continuing high levels of inflation, the authorities had shifted their economic policy and measures had been introduced to curb inflation and improve the fiscal position. It appeared that the difference between the economic policy of France and that of the other industrial countries had been narrowed. The primary concern of the French authorities was to control inflation with a view to reducing the current account deficit. The authorities had firmly restated their intention to limit consumer price increases to 8 percent through 1983 and 5 percent through 1984, but there remained a risk that the 1983 target might not be achieved.

The new measures introduced in March 1983 were appropriate, Mr. Hirao considered, and while the total effect of those measures was not yet evident, a marked improvement in the trade account had already been observed in April. The package aimed at achieving a 1983 budget deficit target of F 118 billion, or 3 percent of GDP. That figure had been viewed by the staff as excessive, given the financing requirements of the business sector. He shared the staff view that effective control over expenditures would be easier if the budget target had been expressed in nominal terms.

With regard to monetary policy, Mr. Hirao said that he agreed with the staff that the authorities would have to be prepared to reduce the public sector's demand for credit and to allow a rise in interest rates if it appeared that credit expansion would be excessive. In that respect, the authorities' recent announcement of a further tightening of credit controls was welcome.

Commenting on industrial policy, Mr. Hirao noted that while the rate of growth of gross savings had been sustained, the self-financing ratio had reached a historical low in 1981 and had declined further in 1982. The strong rise in fiscal pressure in both 1981 and 1982 had accounted for the weakness in corporate savings. In his statement, Mr. de Maulde challenged the staff view that over the previous three years, disposable corporate income had not compensated for economic depreciation; could the staff comment on that point?

The fact that the economic package introduced in March 1983 avoided the introduction of new protectionist measures was welcome, Mr. Hirao commented. France, as a key trading nation, should play a leading role in the achievement of a broader-based trade liberalization, and the authorities' determination to secure the benefits of the open trading system was welcome. Finally, he welcomed the French authorities' decision to terminate the restrictions on foreign exchange for tourism by December 31, 1983.

Mr. Erb stated that he was in general agreement with the staff appraisal and supported the proposed decision relating to the recently imposed exchange restrictions. Since he had made a long statement during the 1982 Article IV consultation with France, and since many of the concerns expressed at that time still applied, he would make his discussion brief. France had begun to take steps to deal with inflation and its balance of payments problem, but the action taken should be viewed as the minimum that was required; appropriate measures should be swiftly and vigorously implemented and should be fully supported by monetary, fiscal, and wage policies.

The policies announced in March 1983 did not deal with the deeper weaknesses in the economy, Mr. Erb noted, but were related to the problems of the industrial sector, in particular the low levels of investment and competitiveness. There had been an excessive allocation of resources to the agricultural sector, parts of which required high levels of protection to survive.

Regarding the external sector, Mr. Erb continued, the authorities were only being prudent in placing great importance on reducing the current account deficit. It would be undesirable--and probably unsustainable--to continue to let external debt grow for any length of time at the rate experienced in 1982. The EMS realignment, in conjunction with the supporting financial policies, would be helpful in reducing the external imbalance. The fact that the March 1983 program avoided new protectionist measures was welcome, but it was unfortunate that the authorities had felt the need to impose exchange restrictions on foreign travel, even if they were only temporary. He trusted that those temporary exchange restrictions would be applied in a nondiscriminatory way. France, like many other industrial and developing countries, had increased trade restraints over the previous few years. In looking more carefully at trade policies in the context of Article IV consultations, the staff should not shy away from examining trade restraints or production policies in industry or agriculture that were under the umbrella of a group of countries such as the EC. In conclusion, he hoped that Mr. de Maulde's more optimistic view about future prospects for the French economy would become a reality.

Mr. Malhotra indicated his agreement with the staff appraisal and his support for the proposed decision. The point had been made by several Executive Directors that if a country introduced economic policies that were at variance with policies of its major trading partners, it was likely to face difficulties. Some of the measures taken by the authorities to protect employment and to increase minimum wages had achieved a measure of success. However, it had proved difficult to sustain them, partly because of the policies being pursued in several other countries. The new policies adopted in March 1983 were appropriate, although the staff appeared to be somewhat skeptical as to whether they would be adequate to achieve the authorities' objectives, particularly with regard to the inflation in 1983. Further, considerable effort would be necessary to achieve a halving of the current account deficit by April 1984.

Discussing the staff paper, Mr. Malhotra said first, that in examining profitability of industry, the staff had a tendency to concentrate almost exclusively on the wage side of the equation. There was a feeling outside the Fund that it put too much emphasis on wage restraint. It would be useful if a more comprehensive assessment of efficiency and profitability in the industrial sector could be made. He was however not suggesting that wages were not important; it was well known that in some countries strong trade unions had made excessive demands.

Second, it would have been useful if the staff could have dealt in a more comprehensive manner with the proportion of the overall available credit absorbed by the public sector, Mr. Malhotra continued. Due consideration had to be given to the requirement of industries in the public sector. When talking of the public sector deficit, and sometimes of the budgetary deficit, the staff might have a tendency to forget that some countries had a larger public sector than others and therefore had to provide it with more money, either from the budget or from the banks.

It was clear that if inflation rates in France continued to be higher than in other industrial countries, France's balance of payments problems were likely to become more acute, Mr. Malhotra went on. It was therefore essential for the authorities effectively to implement policies that would reduce the rate of inflation. Furthermore, the recent rate of increase in indebtedness did not appear to be sustainable in the medium-term and would need to be moderated. The French authorities had shown great political courage in recognizing the evolving situation and working out a new set of policies that were going in the right direction.

Mr. de Vries recalled that many of the Executive Directors had had some doubts about the original French policy stance; unfortunately, events had shown that those doubts had been well founded. Developments in France provided a clear example of how the benefits of demand expansion were short lived, and how the medium-term costs far outweighed the short-term benefits. The change in French policy and the consequential effects on both the internal economy and the economy of France's partners was welcome. The benefits in employment that Mr. de Maulde claimed had been achieved by the policy of demand expansion were due, at least in part, to measures such as early retirement and work sharing, and they did not appear to be of a fundamental nature. Mr. de Maulde's assurance that the French authorities would implement the new measures was welcome.

The large capital outflow from France was some indication of a lack of confidence in the stability of France's economy, Mr. de Vries considered. Given that capital outflow, an improvement in the current account position was even more necessary. It was the hope of the Netherlands authorities that the French Government would protect its credibility by promptly taking additional measures to achieve its objectives, if at some point they seemed to be in jeopardy.

A number of Executive Directors had noted that the budget deficit of 3 percent of GDP was small in comparison with the deficit of a number of other countries, Mr. de Vries remarked. It was a rather fruitless point to discuss, since cross-country comparisons of budget deficits in percentages of GNP were misleading. It would be more helpful to compare budget deficits in one country over a period of time; although the 3 percent target was small by international standards, given the French situation it was on the high side, and its reduction as a medium-term objective was greatly welcomed. Like other Directors, he would prefer the budget deficit objective to be given as an absolute amount rather than a percentage of GDP, which was vague and too flexible. If there were any danger of overshooting that target, the French authorities should introduce stricter controls, particularly on government expenditures and international transfers.

Between September 1981 and March 1983, domestic liquidity had increased by 28 percent and nominal GNP by 17 percent, Mr. de Vries continued, and the difference had largely been used to finance speculation against the franc. Perhaps the French authorities were not fully aware of how closely some authorities monitored French monetary policy when the franc was under pressure. The Netherlands authorities had been alarmed at the large outflow of money from France earlier in 1983; while the rate for Eurofranc deposits had been high, the rate on domestic deposits had remained low, and the outflows that had occurred had been compensated to a large extent by new liquidity creation. The authorities would have to adopt a target for domestic liquidity creation that was much lower than the target in 1982 and took into account the objective of an improved current account position. Domestic monetary policy could play a role in limiting the effects of a deterioration in the current account position, but the consequences of such a policy on domestic interest rates would have to be accepted.

He was somewhat puzzled by Mr. de Maulde's comments on the negative effects of the appreciation of the U.S. dollar on the French balance of payments, Mr. de Vries went on. Whether justified or not, the appreciation of the dollar had led to an increase in the U.S. deficit and therefore increased export opportunities for other countries; but somehow French industry had been unable to take advantage of the situation. In that regard, there seemed to be great structural problems in the French economy that were related particularly to the profitability of industry, and it was an important medium-term objective to reverse that situation. Like other Executive Dirctors, he did not welcome the restrictions on the provision to residents of foreign exchange for tourism, and he would have to abstain on that decision. Finally, the measures that had been taken by France in March 1983, and the courage of the authorities and of the Finance Minister, were to be commended. Achievement of the objectives set would help to restore the traditional role of France in the EC and in the world.

Mr. Zhang commented that the basic objective of the economic policy adopted by the French Government in May 1981, to reduce unemployment and to initiate of economic recovery, contrasted with the policies being pursued by other industrial countries, which were generally aimed at reducing inflation at the cost of employment and growth. The Government had envisaged that recovery would take place in three stages; first, private consumption would be supported by raising low wages and increasing government transfers. Second, an increase in exports had been expected to result from the broad and steady world economic recovery forecast for 1982. Third, the subsequent increase of French industrial production and profitability would have led to an expansion of private investment, and thus to a recovery and sustained growth. Various measures had been implemented to promote that course of development. At the same time, the Government had taken steps to combat inflation by restraining the size of the budget deficit and by adopting an incomes policy to control the rates of increase in prices, wages, and income. Monetary policy had also been directed to that end, although it seemed to have been somewhat less restrictive and different in concept from the policies implemented in other industrial countries. Furthermore, in contrast to most other industrial countries, the authorities had adopted a policy aimed at structural reform and modernization of the industrial sector over the medium term.

There had been a clear and carefully thought-out program to promote economic recovery and growth, Mr. Zhang considered; however, that program had been predicated on the widely held expectation of a recovery of activity outside France in 1982. Almost two years had elapsed and the Executive Board was perhaps in a position to evaluate the first effects of that program. There had been positive achievements in many areas in France between mid-1981 and mid-1982: domestic demand and GDP had increased significantly compared with the limited growth of other OECD countries, the trend of rising unemployment had been checked, and the raising of low wages and transfers appeared to have had a beneficial impact on the distribution of income--although there was no precise published data to confirm that impact. There had also been unfavorable developments that had necessitated some reversal of the original policy measures after mid-1982. Inflation had continued at double-digit rates, and the budget deficit had widened substantially since the beginning of 1982. However, the most crucial difficulty was the rapid deterioration in the current account that had been accompanied by a continued outflow of capital. That had led to two realignments of the French franc in the EMS since mid-1982.

There were two clear lessons to be learned from recent French experience, Mr. Zhang remarked. First, to ensure world economic recovery, the major industrial countries would have to implement economic policies in a coordinated manner; otherwise, any country that resorted to faster expansion would have serious balance of payments difficulties. Second, the historically high interest rates had had serious implications for international capital movements, exchange rate changes, and the debt burden, even for a developed industrial debtor like France.

Judging by developments during the first half of 1983, Mr. Zhang continued, the trend of wage and price increases would continue to ease, the budget deficit would be maintained at a reasonable level, and monetary policies would become more restrictive through the remainder of 1983. On the other hand, the outlook for production and employment was not so encouraging, neither were the prospects for an expansion of investment.

The major uncertainty continued to concern the external balance, Mr. Zhang went on. The leveling of private consumption and the effective depreciation of the franc could be expected to have a favorable impact on the current account, but the extent of the improvement would still depend largely upon the level of economic activity in major OECD countries, and also upon the cost of imported materials, particularly those purchased in dollars, such as oil. Given the present levels of international interest rates, the direction and magnitude of capital movements were not likely to change. A package of restrictive measures had already been introduced at the time of the second exchange rate realignment in March 1983. If the balance of payments position did not improve during the remainder of 1983, would the authorities make their short-term policy even more restrictive? The external balance could undoubtedly thereby be improved in the near term, and the inflationary repercussions of a future change in the exchange rate would be avoided. At present, it was a question whether, provided there was some further improvement in inflation during 1983, the authorities should contemplate a further restriction of demand or whether they should be considering means by which such an eventuality could be avoided. To what extent would the recent developments affect the implementation of the medium-term industrial policy measures intended to introduce further structural reform and modernization?

He would like to raise some more specific points relating to the staff report, Mr. Zhang said. First, to what extent had the low level of agricultural production, resulting from unfavorable conditions in 1982, held down export performance in that year?

Second, the staff had suggested on page 4 of SM/83/69 that "lack of competitiveness" had been the main, if not the only, reason for poor profitability in 1982, Mr. Zhang remarked. Had other factors, such as weak external demand and the price freeze, had any impact? Third, why had the staff placed such emphasis on the fact that gross operating surplus of the corporate sector had remained below 24 percent of value added? Was that benchmark low by comparison with other countries, and was that ratio really meaningful? Fourth, did the last sentence of the first paragraph on page 4 mean that total self-financing of companies--after allowing for interest payments--fell short of calculated depreciation allowances in the previous three years by about F 210 billion, resulting in cumulative net dissaving of that amount? Did it imply that there would be a cumulative net dissaving if businesses financed an expansion of capacity by borrowing, and if so, was that economically meaningful? On page 17, the staff had mentioned that "disposable corporate income" had fallen short of compensating for "economic depreciation." What was the economic depreciation? From that statement it appeared that the shortfall was responsible for low investment, and that that had caused the equipment to age. It was worth noting that a similar shortfall might be observed in the opposite situation when capital equipment was being modernized.

Finally, there were repeated references in the staff appraisal to "the deeper weaknesses of the French economy" Mr. Zhang concluded. He would welcome a brief account of their nature.

Mr. Alhaimus noted that France had been facing the basic problems associated with high inflation, slow growth, and domestic and external imbalances. The new administration had initially attempted to deal with those problems through a set of policies that placed emphasis on improving employment.

Commenting on the lag of France's adjustment in real incomes to the structural changes in terms of trade that had emerged ten years previously, Mr. Alhaimus observed that while several of France's trading partners had initiated that adjustment at a relatively early stage, in France the process had been much slower. The associated burden had been shifted partly to the Government and in part to enterprises, thereby weakening the former's financial position and affecting profitability, investment, employment, and growth. It was against that background that the policies pursued by the new administration up until mid-1982 should be assessed. Those policies had had some positive results in terms of real growth, reducing the rate of increase of unemployment, and containing inflationary pressures through a gradual tightening of incomes policy. However, the failure of the world economic recovery to materialize had had adverse implications in France, particularly for the external sector; namely, the deterioration in the current account and foreign exchange pressures. It was tempting to pose the question of what the outturn of the external sector could possibly have been in the absence of the stimulative impulse stemming from the policies pursued during the relevant period, given the various constraints and structural rigidities in the domestic sector.

An important feature of the new package adopted in March 1983 was the emphasis placed on incomes policy, Mr. Alhaimus considered. He hoped that close adherence to the strategy of preannounced wage settlements would act as a check to increases in unit labor costs, enhancing competitiveness and slowing down inflation, while reducing the cost of financial stabilization in terms of unemployment. It was necessary to take account of economic developments in France's major trading partners when assessing whether the authorities' adjustment effort would be successful and whether the balance of payments objectives would be attained. In that connection, how would the expected improvement in France's competitiveness be affected by similar and simultaneous improvements in major trading partners?

It was reassuring to note Mr. de Maulde's statement that "the fundamental and unequivocal choice of the Government is to maintain France's open trading system," Mr. Alhaimus remarked. That statement was particularly welcome given the misunderstanding over a reference made in a recent official statement about "the conquering of the domestic market," and given the mounting protectionist pressures in France and the restrictions governing imports into EC members from developing countries. Finally, the commitment of the French authorities to increase official development assistance to a level closer to the internationally agreed target of 1 percent of GNP was noteworthy and should encourage other industrial countries facing lesser financial difficulties to take a similar step.

Mr. Tvedt commented that in the face of adversities and unfavorable external conditions, the French authorities had demonstrated bold policy initiatives, flexibility, and pragmatism. At the time of the 1982 Article IV consultation with France, his chair had expressed interest in the policy course chosen by the authorities. The countries in his constituency had consistently attached the highest priority to the maintenance of employment, and so he had great sympathy with the authorities in their efforts to break out of the serious state of stagflation through expansionary policies. However, it had been extremely difficult for France to pursue that policy while most neighboring countries had adopted a different, more restrictive policy approach. Furthermore, the cyclical upturn in the world economy had not materialized as expected, and it had become clear to the authorities that, in the circumstances, their policy could not succeed. They were to be commended for their courage and promptness in adjusting their policy in response to different external conditions.

It was understandable that the authorities had adopted, as their principal policy objective, a reduction in the rate of inflation, Mr. Tvedt considered, since differentials in inflation rates between France and its European neighbors had, at times, created serious problems for the external sector, in particular the exchange rate and external reserves. It was, therefore, of vital importance for the authorities to discontinue the de facto indexation of incomes and to reduce inflationary expectations. The consensus that had been reached on wage policy and wage increases in the period ahead deserved high praise, although it should be underlined that an incomes policy alone did not perform magic; it must be supplemented by effective policies in other areas. That had been realized by the French authorities, as was reflected in their determined efforts to contain the fiscal deficit and balance the external current account. The staff paper had indicated that the four-month wage and price freeze in 1982 had been partly successful in breaking inflationary expectations, and it was interesting to note that a freeze of such short duration could have a lasting impact. Would not the broad-based consensus over incomes policy be just as effective, if not more so, in influencing inflationary expectations?

Economic difficulties in France were by no means solely cyclical, Mr. Tvedt went on, and the response of the domestic manufacturing sector to the expansionary policy of 1982 had been disappointing. In 1983, most growth had occurred in services, and manufacturing production had remained stagnant. Furthermore, the low rate of investment was of some concern. Industrial profitability had been limited, but the latest realignment within the EMS had provided an urgently needed adjustment of the French franc that should improve competitiveness of French manufacturing and enhance profitability. In that connection, it was also important to rebuild and maintain adequate profitability in nonfinancial public enterprises.

The authorities were to be commended for their efforts to limit the increase in unemployment, Mr. Tvedt said. Unemployment was still high, and its reduction should continue to figure prominently among French policy objectives.

Turning to monetary and fiscal policies, Mr. Tvedt stated that, taken in isolation, the fiscal deficit was not large; however, its financing was difficult and had important effects on monetary developments. He could accept the authorities' view on the role of monetary policy, but he was slightly troubled by the apparently excessive growth of credit that was not subject to controls, since the expansion might pose problems for the implementation of monetary policy in the medium and long term.

In conclusion, Mr. Tvedt noted that the French authorities had taken courageous steps to arrest the unfavorable developments within the French economy. The results would not be achieved quickly, but through the combination of an incomes policy and strong monetary and fiscal policies, the stage had been set for a healthy recovery. An important segment of French industry was involved in production that was likely to rebound strongly with the recovery of world economic activity. The external position of France had come under strong pressure in the past few years and was rather weak; restoring the extenal position was a vital element in rebuilding confidence in the French economy. He welcomed the authorities' commitment to maintaining an open trading system. Finally, the authorities had reacted pragmatically and boldly to the difficulties facing them, and he was encouraged by Mr. de Maulde's assurances that the French Government would continue to implement the policy that it had set until the desired results had been achieved.

Mr. Robalino stated that he admired the courage and the persistence of the authorities, as well as the understanding of the social partners over the new wage setting procedures adopted in France in 1982. He could appreciate the difficulties faced by the French authorities in changing their incomes policy, because several countries in his constituency were making the same change.

The substantial decline in corporate savings since 1980 was a serious problem, Mr. Robalino considered, but overall savings had declined only marginally because of a rapid growth in the personal savings ratio. It was important to note that residential construction as a percentage of GDP had not increased and that the increase in personal savings had been channeled to productive investment.

He was conscious of the difficulties that would be created if excessive reliance were placed on quantitative credit restrictions rather than restrictions on the monetary base, Mr. Robalino went on. Quantitative credit restrictions had advantages if employed in combination with an adequate policy regarding the monetary base; a quicker impact could be achieved in that way.

The record of the French economy was mixed, Mr. Robalino concluded. There had been moderate growth and a moderate public sector deficit; however, the rate of inflation was higher than in neighboring countries, and the deficit on current account was too high for a wealthy country such as France. Unemployment had been controlled, but the external difficulties, caused by losses in market share and cyclical factors, could not be minimized. The authorities had adopted appropriate policies, and had shown tremendous determination in implementing them. Finally, France had one of the best records in development aid of all the industrial countries, and the authorities were aiming to increase that aid in 1983. Could the staff provide a more detailed breakdown?

Mr. Alfidja stated that the French authorities had taken a series of measures intended to solve some of their economic problems, but the economic recovery would undoubtedly be painful and would not take place rapidly, in view of the magnitude of the imbalances in the real and financial sectors. As Mr. de Maulde had stressed, there was no reason to doubt the Government's intention to attain the targets it had set.

In 1982, the Government had attempted to reduce the unemployment rate by adopting a shorter work week, introducing early retirement schemes, and reducing social security contributions from employers that took certain job-creating steps, Mr. Alfidja noted. Enterprises that made an additional effort to increase employment might also be granted preferential access to bank credit at subsidized rates. The staff report had mentioned that those stimulating measures had begun to bear fruit and that the unemployment rate had been reduced by about 1 percentage point in 1982. It was to be hoped that in the long term the fiscal benefits--including tax collections from new employees and reduced unemployment compensation payments--would exceed government outlays for social security payments and interest rate subsidies.

The primary objective of French economic policy, namely, to reduce the inflation rate to below 10 percent in 1982, had been attained, Mr. Alfidja noted. Although price developments had not been very favorable in the recent few months, the Government's target of 8 percent inflation in 1983 did not seem out of reach. To that end, the adoption and implementation of a suitable incomes policy would help to moderate inflationary expectations. Furthermore, it would be desirable to ensure that real wage increases were not greater than the rise in productivity, in order to enhance the competitiveness of French exports.

In industrial and public enterprise policy, Mr. Alfidja remarked that higher wages and other personnel costs, together with a higher rate of value-added tax, had reduced the profit margin of certain producers.

But it should also be noted that, in addition to the fiscal and monetary measures that had been taken by the Government to cut costs in some of those enterprises, the worldwide recession had also contributed to an export slowdown and to lower profits.

In contrast to the 1982 budget, which had sought to stimulate domestic demand, Mr. Alfidja commented, the 1983 budget reflected the authorities' desire to reconcile the level of domestic demand with the goal of reducing the burdensome external deficit. As Mr. de Maulde had pointed out, the goal of holding the budgetary deficit to 3 percent of GDP was more ambitious than the objectives adopted by several other industrial countries. If those countries were to follow the French example, internal and external equilibrium might be re-established in several other countries at a lower cost. He noted with special interest the measures taken by the French Government in March 1983 with a view to reducing the budget deficit, such as the decision to defray the expenditure of F 15 billion included in the budget, the reduction of F 12 billion in budgetary transfers to public enterprises, and the imposition of a surtax on fuel. In addition, several measures, including the forthcoming imposition of an income tax surcharge and high taxes on cigarettes and alcohol, had been taken in order to reduce the deficit of the social security fund.

Turning to the external sector, Mr. Alfidja said that France seemed to have been less successful in its effort to reduce imbalances in the current account and the overall account of the balance of payments. Over the previous three years, the current account deficit had widened; however, more recent data suggested some improvement in April, reflecting in part the decline in imports of oil products. The appreciation of the dollar had contributed substantially to increasing the burden of imports and certain other flows. That was true not only for France but also for many other countries, in particular those who chose to link the evolution of their economies to that of the French economy. In addition, the lack of competitiveness of French products in the world market was a major obstacle to sustained growth of French exports. Thus, structural measures would be desirable to improve the competitiveness of French goods, and he welcomed the efforts being made by the French Government in that regard as well as its desire to support the value of the French franc. The cooperation of certain industrial countries would be useful in assuring that support. In conclusion, he supported the proposed decision regarding exchange restrictions.

Mr. Prowse stated that, in general, he supported the staff appraisal, in particular its discussion of the importance of real wage levels and industrial competitiveness. He was not sure whether the new policy on preannounced wage settlements would be successful, but there was no reason to argue that it should not be attempted. On another matter, the growth of external debt was surprising given the fact that France had a mature industrial economy.

Mr. de Maulde's statement was instructive and, in some respects, reassuring, Mr. Prowse continued, but it was either more defensive or more aggressive than he had expected. The action that had been taken since

March 1983 in cutting expenditure by the planned amounts was reassuring, and the revenue raising achievements--including increases in taxes on petroleum products, in transportation fares, in electricity charges, and in post and telecommunication fees--were quite outstanding. In addition, the performance of the French Government in the matter of development assistance was particularly commendable.

Two points in Mr. de Maulde's statement were particularly interesting, Mr. Prowse considered. First, Mr. de Maulde had questioned the staff on their methodology for determining indicators of profitability in the nonfinancial corporate sector. He had felt that there was no scientific basis to the view that the two ratios--between disposable income of firms and their added value and between investment and added value--would be lower in France than in other major industrial countries. Could the staff comment on their methodology and on the question of international comparisons of industrial efficiency and competitiveness? It should be recognized, however, that Mr. de Maulde had admitted that the competitiveness of French industry in some products was lagging behind that of neighboring countries.

Second, with regard to the "old quarrel" about techniques of monetary policy, Mr. Prowse commented that, as Mr. de Vries had explained, the stance of policy and its effectiveness was more important than the method by which it was achieved. Personally, he believed that the monetary base was probably a more efficient system. Mr. de Maulde's suggestion that the staff view on monetary policy rested on "obscure ideological reasons" did not give the staff due justice.

In the light of recent discussions in Executive Board meetings, Mr. Prowse stated, he was disappointed that the staff report had not included a more detailed discussion on the matter of external debt and of commercial policy. It had been recognized by Executive Directors that the inclusion of projections and profiles of external debt in the staff paper was not so significant for countries that were not major debtors; however, for the consultation with France such quantitative information would have been useful. More important, the staff paper had failed to consider the effects of French commercial and trade policy on the domestic and international economy. The extent of staff consideration of that important matter had been constrained to a brief statement of the views of the French authorities in the last paragraph on page 11 and the top of page 12 of the staff paper (SM/83/69). He was most concerned about the reference to the agricultural sector in which the staff had stated "in the view of the authorities, arrangements to organize international markets in agriculture and possibly other sectors should on balance benefit all countries, given that the alternative seemed to be that of unilateral import restrictions." If those were also the views of the staff, the assertion that the alternatives seemed to be unilateral import restrictions warranted some elaboration.

In Supplement 1 to the staff report, the Executive Board had been asked to approve the exchange restrictions associated with the provision of currency for tourism, since the authorities had agreed to terminate those restrictions by the end of 1983, Mr. Prowse continued. Tourism could be considered an import, and it was therefore proper to treat those restrictions as restrictions on imports. Like the United Kingdom, New Zealand had used similar restrictions in the past and had found them to be ineffective; funds had been held abroad, and parallel markets had developed. The restrictive action taken by the French authorities was probably symbolic in that it reinforced the significance of the policy adjustment that the Government had made; on that basis, it might be acceptable. However, given the French external situation, the use of exchange restrictions, even if only as a symbolic gesture, was not justified, and he could not support the proposed decision approving them.

Mr. Sangare stated that the French authorities had faced a complex and difficult situation in 1982 and during the first quarter of 1983. Table 1 in the report on recent economic developments indicated that real GDP had increased by 1.7 percent in 1982, a relative improvement compared with the performance in 1980 and compared with the performance of other industrialized countries. The improvement in growth had been due to the stimulation of overall demand as a result of various measures initiated by the authorities in 1981 and 1982. In view of the growth of global demand of 3.8 percent, an increase in investment and a higher level of production would be expected. However, the rate of growth of capital formation in investment enterprises had been at negative rates in France.

It appeared that the service sector had accounted for a large proportion of the growth of GDP, Mr. Sangare remarked. The industrial sector had reacted only marginally. There were perhaps major structural problems in that sector: the level of investment had not been maintained, production costs had risen, and industrial production had not been sufficiently competitive. The decline in external demand for French exports of highly technological industrial products, provoked by the world recession, had perhaps had more of an impact on French industrial productivity than the staff had indicated. It would be useful if the staff could provide more information on that issue since it might have an important effect on future policy. Could the staff also explain its view on the evolution of demand in those highly technological industries? Furthermore, the staff had not covered in enough detail the effect on public financing of subsidies granted to public enterprises. On a related point, he believed that the major industrial countries should direct their activities more toward high-technology industries, which for France would be the aerospace industry, and that the developing countries should concentrate on highly labor-intensive industry.

It was with satisfaction that he noted both the slowdown in growth of unemployment and the efforts undertaken by the authorities to reach the difficult equilibrium between unemployment, inflation, and growth, Mr. Sangare went on. Did the staff believe that the support measures that had been introduced to maintain employment levels could be sustained in the medium term?

The authorities had reduced the level of inflation to 10 percent a year, Mr. Sangare noted. That encouraging result was partly due to wages and incomes agreements. The staff paper did not discuss whether the measures introduced by the authorities would have the effect of closing the gap between the inflation rate in France and the rate in other members of the EC in the long term. It might be that a number of monetary and budgetary austerity measures would need to be taken on a consistent basis, to ensure a lasting reponse.

Public financing in France best demonstrated the authorities' flexibility, Mr. Sangare considered. Their adaptation of budget policy in light of recent developments, and the courageous decision to limit the budget deficit to 3 percent of GDP, seemed reasonable, given the present level of employment and output. Indeed, it would be difficult to reduce the deficit below the target level, because the authorities should also encourage investment. The measures already taken by the authorities to slow down expenditure and to improve the profitability of the public sector were acceptable.

The current account deficit had arisen as a result of poor export performance, which had declined by 3.7 percent, and by the considerable expansion of imports, which had increased by 4.8 percent, Mr. Sangare went on. Variations in demand and prices at the international level, as well as speculative pressures on the franc, had immediate and disequilibrating consequences on the external payments situation. Without any doubt, those factors explained part of the deterioration of France's external balance. In the austerity plan, the authorities had included, as one of their objectives, the reduction of the deficit by half by the end of 1983 and the elimination of the deficit in 1984. Monetary policy supported that objective; measures had been taken to ensure strict control of domestic credit and public expenditure, in particular for defense and the social security system.

The realignment of exchange rates on March 21, 1983 was proof of the authorities' wish to have an open foreign exchange system, Mr. Sangare continued. Protectionism distorted the international trade system and was economically inefficient, and he therefore welcomed the authorities' proposal to abolish protectionist practices and to maintain an open trading system. Finally, the authorities' intention to continue increasing official development aid was commendable and he hoped that other countries would follow the same line; developing countries had considerable need for such aid, and it would also help to revive the world economy.

Mr. Teijeiro indicated his agreement with the staff appraisal and his support for the proposed decision. He would first like to comment on the consistency of the present policy position. The recent realignments of the franc within the EMS and the growing foreign indebtedness of France reflected a degree of inconsistency between exchange rate policy, incomes policy, and monetary policy. Some of those policies would have to be altered if foreign indebtedness and losses of reserves were to be reduced. Given the political circumstances, it seemed unrealistic to tighten incomes policy further; indeed, it would be a major success if wages were not adjusted by the beginning of 1984 for past price increases. On the other hand, a more flexible exchange rate policy would reduce the chances of reaching the inflation objective. Therefore, it would be necessary to adjust monetary policy to bring consistency into France's economic system, and it was in the monetary field that policies seemed to be particularly out of line.

Domestic credit had increased at an annual rate of 18 percent between September 1981 and March 1983, Mr. Teijeiro noted; that rate of expansion would more than double the inflation target. Credit to the private sector had been growing at even higher rates than to the public sector. In addition, government support of the productive sectors could explain a large part of the government deficit; that kind of support was conceptually equivalent to credit to the private sector. In sum, monetary figures indicated that the expansion of domestic credit was proceeding at rates that were inconsistent with the exchange rate policy, the incomes policy, and the inflationary target.

The present level of French foreign indebtedness was not as worrisome as the level of the current account deficit, Mr. Teijeiro went on. The deterioration in the balance of payments position had prompted the authorities to introduce capital controls, followed by the introduction of foreign exchange restrictions. It was a question of whether increased barriers to trade would be introduced next. A reversal of protectionism was essential for the recovery of the world economy, and France's behavior was crucial. What was the likelihood that the current protectionist tendencies--in particular, the growing discrimination against suppliers outside the EC--were going to be reversed? He noticed that the authorities had proposed at the EC level the creation of a new commercial policy instrument that was designed to discourage unfair import competition from non-EC suppliers. Finally, he wondered whether the staff could include an evaluation of the major trade restrictions and government subsidies in terms of effective rates of protection to the different sectors in the next report on France.

The Director of the European Department stated that the latest wage agreements did not provide for an automatic catch-up at the end of the year. There would be a review of the evolution of real wages in the public sector in early 1984, but the private sector arrangements did not specifically provide for such a formal review. However, if price increases were to be significantly more than 8 percent through 1983, there would undoubtedly be pressure for such reviews.

A great number of Executive Directors had been concerned with the profitability and competitiveness of French industry as compared with other countries, the Director noted. Intercountry comparisons posed particular difficulties. There was no single explanation for the failure of French industry to respond to the increase in domestic demand that had occurred in 1982 or for the loss of export market shares. However, there was a widespread feeling that lack of competitiveness due to an aging capital stock, low investment, and the resulting supply constraints in part explained the poor performance of the French industry. Indeed, a recent report from the Institut National de la Statistique et des Etudes Economiques (INSEE) had come to a similar conclusion, and was indeed somewhat more pessimistic in that it suspected that import penetration might in some areas be irreversible. National accounts data indicated an overall 4 percent fall in export volume in the first quarter of 1983.

The staff had carried out a number of comparisons of profitability between countries, the Director continued, and in most of them France came out relatively unfavorably, but he would be the first to admit that there were serious questions about the exact comparability of data. However, there was little question that over the years the profitability of French industry had deteriorated and that the deterioration had resulted in a sharp weakening of the financial position of enterprises. The profit position of manufacturing companies in France was weak and appeared likely to remain weak in the immediate future.

In the French national accounts, "economic depreciation" was interpreted as replacement on a current cost basis and was unaffected by changes in tax law, the Director explained. A straight-line method of depreciation was used. Over recent years, the ratio of gross corporate savings to corporate value added had deteriorated, and if the French position was measured against the U.S. position--two countries in which the figures seemed broadly comparable--then despite its recent weakness the profitability of U.S. enterprises was significantly better than that of French enterprises.

The "old quarrel" over monetary policy was concerned with effectiveness rather than technique, the Director went on. The present system of quantitative controls, incorporating a great number of exceptions, was not an instrument that could be made easily effective. A large number of semiofficial or wholly official financial intermediaries had been built up in France over the past several years; they could be numbered in the hundreds.

The authorities' fiscal policy had contributed to excessive money creation, the Director considered. With regard to the control of expenditure, experience seemed to indicate that the authorities would be able to implement and to sustain budget cuts.

Like several Executive Directors, he was doubtful about how effective the new restrictions on foreign exchange for tourism would be, the Director stated. Certainly, the example of other countries demonstrated that such devices were less effective, for a variety of reasons, than might be supposed. The staff had recommended Executive Board approval of the exchange restrictions once the French authorities had decided to put a firm terminal date to those restrictions; in doing so, the staff was acting in accordance with normal procedures.

With regard to the Ninth Plan, the staff had had only preliminary discussions with the authorities in Paris, the Director continued, and at that stage the Plan had not been a formal document. The general theme of the Plan seemed to be that France could sustain a somewhat higher rate of growth than its partners, and yet maintain balance of payments equilibrium, as long as investment increased at 6 percent a year over the whole planned period. This seemed to imply that the rate of growth of private sector consumption had to be held down to 1 percent a year. Given those figures, it was questionable whether the authorities would be able to achieve such an outcome.

Commenting on the external debt situation, the Director said that, in stock terms, France's external debt was not a cause for concern. However, the rate of increase in debt, if prolonged, would be. The debt service ratio in 1981 had been 2.7 percent; in 1982, it had been 3.8 percent; and in 1983 the staff projected it at 4.3 percent, with a small reduction foreseen for 1984. The stock of debt at year-end as a percentage of GNP had risen from 6 percent in 1981 to 8 percent in 1982, 9.5 percent in 1983, and possibly 10 percent in 1984. Using available sources of information, he would estimate short-term debt at about F 8-9 billion. In order to ensure consistency with other staff papers and with the French presentation, the staff had referred only to authorized debt; that excluded certain other forms of debt, most of which was unimportant except for borrowing by authorized banks that acted as intermediaries and re-lent to nonresidents. In addition, other minor categories--such as borrowing by firms to finance work abroad and borrowing by nonbank firms of an amount that did not exceed F 10 million--were also excluded from the figuring.

The effect of the poor harvest in 1982 on the balance of payments was estimated to have been about F 5-6 billion, the Director of the European Department continued. The measures introduced to reduce the level of unemployment could be sustained over the medium term, but they would inevitably result in an increase in nonlabor costs, which would in turn require strong wage restraint. Finally, inflation targets were not fully consistent with the aim of convergence within the EC.

Mr. de Maulde stated that the tone of his statement had been intended to be firm, since he wished to dissipate any suspicions that the staff might have had. In its appraisal, the staff had used the verb "suspects" five times.

In response to points raised by Executive Directors, Mr. de Maulde said, first, that the incomes policy set up by the French authorities did not include any clauses for automatic review at the end of 1983 or the beginning of 1984. It referred to the possibility of a review of wages at the beginning of 1984, but would take into account on the one hand the effective movement of prices, and on the other hand the economic possibilities of each sector. He shared Executive Directors' views that those agreements were important, and he assured them that the French authorities intended to conduct incomes policy with all necessary strictness.

Second, with regard to trade, Mr. de Maulde remarked that the consultation had included some original features, since it was rare that staff representatives of the Exchange and Trade Relations Department took part in consultations with an industrial country; as a result, the French authorities had been subjected to numerous and precise questions on trade policy issues. Full and detailed answers had been provided, and his authorities intended to support the Fund in its efforts to expand work in that area. It would have been absurd for the authorities to adopt politically difficult economic policies, only to introduce trade restriction measures later. The authorities intended to restore equilibrium within the framework of an open economy.

Third, Mr. de Maulde thanked the Director of the European Department for having confirmed that international statistics were difficult to compare, and that he like others was unable to throw full light on the question of profitability. The French authorities were concerned with the need to restore profits of enterprises, especially in the productive sector--be it private or public. A number of measures had been taken, and others would follow in that area. Present profit levels were not sufficiently high to enable the necessary resumption of investment, and one of the aims was to restore margins of profitability.

Fourth, Mr. de Maulde said that he agreed that the monetary figures for 1982 were not good, probably because the authorities had concentrated more on budgetary and income policies than on monetary matters. Measures had been taken on May 30, 1983 to reduce domestic credit expansion to 11 percent by the end of 1983. The figure was fully in line with other parameters mentioned in his statement. Concerning the monetary instruments, the French institutional structure was not directly comparable with that of the United Kingdom or the United States; not all of the instruments used in those countries could necessarily be adapted to the French situation.

Fifth, with regard to inflation, Mr. de Maulde remarked that in the first quarter of 1983, prices had increased partly because of the aftermath of the price and wage blockage, and partly because of the significant tariff increases. It was quite impossible to raise the prices of gasoline, electricity, and transportation without affecting price indices. That combination of price increases together with a careful monitoring of income levels had dampened domestic demand and would contribute to the stabilization of prices in the medium term. It was the aim of the authorities to reduce the level of inflation to 8 percent in 1983, and to 5 percent at the end of 1984.

In conclusion, Mr. de Maulde assured the Executive Board that the exchange restrictions would be lifted by the end of the year. If the Executive Board did not approve the decision, it would be adopting a different attitude toward France than toward the other two European countries that had taken the same kind of measures in similar circumstances. It was the authorities' objective to reduce the current balance deficit by half by the beginning of April 1984 and to eliminate the deficit in the following 12 months. He was aware that unforeseen developments--both favorable and unfavorable--could occur; the authorities would be prepared to take all necessary steps to reach the targets that had been set.

The Chairman made the following summing up:

Executive Directors stressed that France's experience in 1982 demonstrated the limitations on the pursuit by one country of economic policies at variance with those followed in the main trading partners. They welcomed the shift of policy and strongly supported France's recently announced program, which was designed to improve the external position and so avoid excessive reliance on foreign borrowing. They felt that a full and speedy implementation of the courageous measures announced in March would be necessary to achieve progress toward the Government's objectives.

Many Directors thought that too rapid stimulation of demand at a time of international stagnation had led to excessive increases in domestic costs and had been a major cause of the balance of payments difficulties in the past year. However, there were also structural weaknesses in the French economy which were unlikely to be overcome through a cyclical recovery alone. The fact that the French manufacturing sector had failed to respond fully to the stimulatory policies of 1981-82 might reflect the underlying and increasing weakness of the profit position of nonfinancial corporations. A strengthening of the financial position of enterprises was seen as an essential element for a resumption in productive investment that would strengthen the structure of the economy and lay the basis for noninflationary growth. Several Directors thought that additional measures to alleviate charges on businesses and to improve their competitiveness were required and mentioned in this respect the relatively high level of social security charges that had to be borne by French industry.

Directors strongly welcomed the introduction of the new system of wage settlements, which by suppressing de facto wage indexation addressed one of the main structural causes of inflation. They observed that although the recent effective depreciation of the franc had considerably improved competitiveness, there were still prospects of a continued significant inflation differential with France's main trading partners. They stressed, therefore, that it was essential to hold strictly to the wage objectives set by the Government for 1983, and those envisaged for 1984, and they hoped that the existing social consensus would facilitate that task.

Directors emphasized that monetary and credit policies would have to play a stronger role in the adjustment process if the official objectives were to be achieved, and they noted with regret the excessive credit expansion in the 18 months to March 1983. They agreed that, both to break inflationary expectations and to restore the balance in external accounts, it was essential that the growth of domestic credit be firmly restrained. The measures announced at the end of May appeared to imply a significant tightening of credit for the remainder of 1983, which was welcomed. Some Directors felt that, in view of the difficulties encountered in controlling credit expansion in the past year, a reform of the financial system and of monetary policy instruments needed to be considered.

Many Directors thought that, whereas the fiscal deficit did not appear high by international standards, there was evidence that it had favored excessive money creation. Directors therefore supported the authorities' intention to limit the deficit to a level that could be financed without undue recourse to monetary financing and regarded this as an indispensable step for the curbing of domestic credit. They welcomed the determination of the French authorities to stick to their fiscal target, but several Directors added that it would be more appropriate in their view to formulate that target in nominal terms rather than as a percentage of GDP.

The rapid pace of increase in France's external debt was noted with some concern. Directors noted that a protectionist approach could only retard the necessary strengthening of the productive sector, while impeding the recovery of the world trade. They expressed the strong hope that France would remain determined to avoid the introduction of further protectionist measures and noted with satisfaction that the March 1983 program did not include measures of that type. The imposition of the exchange restrictions on foreign exchange for travel purposes was regretted, and its effectiveness was put in doubt. Directors welcomed the undertaking of the French authorities to abolish these restrictions by the end of 1983.

Finally, Directors commended France for maintaining its high level of official development assistance despite difficult circumstances. It is expected that the next Article IV consultation with France will be held on the standard 12-month cycle.

Mr. de Vries stated that, in view of Mr. de Maulde's statement, he could support the proposed decision on the exchange system.

The Executive Board then turned to the proposed decision on the exchange system, which it approved with one objection.

The decision was:

The Fund welcomes the decision of the French authorities to eliminate, by December 31, 1983, the exchange restriction arising from limits on the provision of foreign exchange for tourism, as described in SM/83/69, and, accordingly, grants approval of the restriction until December 31, 1983.

Decision No. 7417-(83/81), adopted
June 3, 1983

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/83/80 (6/2/83) and EBM/83/81 (6/3/83).

2. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/83/146 (6/1/83) is approved.

APPROVED: October 20, 1983

LEO VAN HOUTVEN
Secretary