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INFORMATION

April 5, 1982

To: Members of the Executive Board
From: The Secretary
Subject: France - Staff Report for the 1982 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1982 Article IV consultation with France.

This subject has been tentatively scheduled for discussion on Monday, May 3, 1982.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

FRANCE

Staff Report for the 1982 Article IV Consultation

Prepared by the Staff Representatives for the
1982 Article IV Consultation with France

Approved by L. A. Whittome and C. David Finch

April 2, 1982

Article IV consultation discussions were held in Paris February 3-15, 1982. The French authorities were represented by officials of the Ministry of the Economy and Finance, the Ministry of the Budget, the Bank of France, and other government agencies. The staff mission consisted of Messrs. L. A. Whittome, P. Dhonte, L. DeMilner, J. Somogyi, B. de Schaetzen, Ms. M. Xafa, and as secretary, Mrs. L. Girvan (all EUR). Mr. B. de Maulde, Executive Director for France, attended the meetings as an observer. France accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund Agreement as from February 15, 1961.

I. The Economic Background

For some time it has become increasingly difficult in France, as in other industrial countries, to reconcile high rates of growth and employment with external balance and price stability. An earlier approach sought a strong currency, backed by firm financial policies and an easing of controls, in the hope that it would force greater attention to costs on the part of enterprises and thereby safeguard their competitiveness. However, in depressed world trade conditions the cost had been a sharp increase in unemployment. By the middle of 1981 the earlier conflict between economic growth and external balance appeared to have re-asserted itself, and inflation remained intractable.

1. The level of activity

The French economy experienced a mild recession over the twelve months starting with April 1980. Private consumer demand was sluggish, real fixed investment declined, and the volume of exports of goods and services stagnated. There was an involuntary accumulation of inventories, and industrial output fell. With the rapid growth of the labor force unemployment increased to about 7 per cent in the early months of 1981.

By mid-1981 signs of recovery had begun to appear. An upturn in private consumption was brought about by increases in social transfers and in the minimum wage, by the expiration of a surcharge on employees'

social security contributions, and by a renewed decline in the savings ratio. The recovery of demand was reinforced in the spring by a surge of exports, mainly of manufactures to the oil producing countries. Investment was slow to follow, however, reflecting continued excess capacity, tight financial conditions, and uncertain prospects (Table 1).

By the end of 1981 investment too began to pick up: domestic sales and imports of machinery and equipment increased strongly. Stockbuilding recovered as the improvement in the outlook began to be reflected in business surveys. Industrial production rose by 1 per cent in the last quarter of 1981 over the fourth quarter of 1980, and real GDP by 1.5 per cent. The decline in unfilled vacancies since early 1980 was halted, though unemployment continued to rise. The unemployment rate in the opening months of 1982 was about 1 1/2 percentage points higher than it had been a year earlier.

2. Costs and prices

The inflation rate in France exceeded the industrial country average throughout the 1970s. Although the rate of increase in consumer prices dropped from 13.6 per cent in 1980 to 13.1 per cent in 1981, the inflation differential with respect to the other industrial countries widened from 1 3/4 percentage points. Consumer prices rose more than the GDP deflator in both years, reflecting the sharp increase in oil prices in 1980, the effects of currency depreciation on the local currency cost of imported goods in 1981 (Table 2). After the franc was devalued within the EMS in October 1981, a freeze was imposed on certain prices and others were made subject to guidelines, with the intent of holding inflation below 13 per cent through 1982. Public utility charges, which account for 14 per cent of the CPI, were also kept unchanged during the fourth quarter of 1981.

With indexation of minimum wages and (de facto) of all labor income, the terms of trade losses of 1980 and 1981 were not translated into a decline in real wage rates. These continued to rise in spite of the high and growing rate of unemployment, though at a reduced pace. On the other hand, take home pay showed no gain in 1979 and 1980 for the first time in twenty years, due largely to an increase in social security contributions paid by the employees. In 1981 it rose again as social security taxes were reduced and discretionary increases in the minimum wage were granted beyond the regular cost of living adjustments.

The continued rise in wage rates at a time when the recession had an adverse cyclical effect on productivity caused a deterioration in the profit position of enterprises in 1980 and 1981. The squeeze on profits was compounded in both years by a rise in real interest rates.

3. The external balance

The external deficit on current account continued to widen in 1981 to the equivalent of 1.4 per cent of GDP (Table 3). To be sure, there was a noticeable improvement in the energy trade balance as both

agricultural and manufactured exports regained some of the market shares they had lost in the previous year. The gains in competitiveness resulting from an 11 per cent effective depreciation of the franc were the principal factor explaining the buoyancy of exports. At the same time, the recession contributed to a slower growth in imports, particularly of intermediate products and equipment goods.

However, mainly because of the appreciation of the dollar, the energy import bill in 1981 rose by 20 per cent despite a large drop in volume. There was a large decline in the surplus on invisibles reflecting a lower surplus on services and higher net transfers abroad. Increased shipment costs in dollars, a drop in net investment income, and a decline in net travel and tourist earnings brought down the service balance.

Capital inflows had amply covered the current account deficit in 1980 leaving the balance of payments in overall surplus. Relatively volatile short-term monetary capital was attracted by positive interest differentials, and by the strength of the franc in the EMS. However, the elections in May 1981 and uncertainties concerning the new Government's policies contributed to massive capital outflows. In response domestic interest rates were increased, reserve requirements were removed on nonresidents' deposits, and exchange controls were tightened. Capital outflows eased but short-term inflows resumed only after the October currency realignment.

The authorities also stepped up external borrowing by state enterprises. Net inflows on this account nearly doubled in 1981. Nevertheless, the balance of payments in 1981 registered a deficit equivalent to the gain in reserves in 1980.

II. The Policy Discussions

The French authorities are currently embarked on an effort to expand demand and output, in order to reduce unemployment, while avoiding an acceleration of price inflation. The nationalization of major industrial groups and financial institutions provides some assurance that the economy will respond in the desired fashion. The authorities are very aware of the immediate need to safeguard competitiveness by containing costs and improving profit margins if a reasonable external balance is to be maintained. But in their view the overriding emphasis given to inflation control elsewhere has led to excessive increases in interest rates and to excessive demand restraint.

1. The exchange rate

Because of the openness of the French economy large exchange rate changes continue to be seen as unsettling for prices and business expectations, especially in the presence of widespread indexation. Accordingly, the authorities aim at maintaining nominal exchange rates as stable as possible though this does not preclude occasional adjustments when these become necessary.

The main purpose of exchange market intervention has been to maintain the prescribed margins of the European Monetary System (EMS). Interest rate policy and capital controls have also been used to influence the exchange markets. Intensifying capital controls was one of the first measures applied in May 1981 to underscore the new administration's determination to maintain a stable franc.

Renewed pressure on the franc in August and September of 1981 highlighted the conflict between exchange rate stability and lower interest rates. In October 1981 the franc was devalued in the EMS. The realignment was accompanied by a freeze on some government investment outlays for 1982 and temporary selective price controls. In the months that followed, the franc's position strengthened within its EMS margins, and as official reserves recovered, interest rates were eased. In March of 1982, however, renewed pressures forced a resumption of heavy intervention, a sizable increase in interest rates, and a further tightening of capital controls.

2. Monetary policy

Monetary policy was eased in early 1981 but became more restrictive in the latter part of the year. The annual average increase in M_2 came to 12.5 per cent (Table 4). Financing of the budget deficit was the most significant expansionary factor, while the loss of net foreign reserves served as a partial offset. Bank lending to the private sector expanded less rapidly than credit to the Government. In particular bank credit to private residents grew only moderately faster than the money supply itself.

Monetary growth slowed down significantly in the last four months of 1981. The demand for liquid assets moderated when the authorities placed restraints on the yields on time deposits and certificates of deposit. As the franc moved up within its EMS margins after early October, a general easing of short-term interest rates was implemented. In consequence the bond market experienced a marked recovery and new issues rose close to the record level of 1980.

The authorities intend to pursue a policy of monetary restraint in 1982. Against a 17 per cent projected growth in nominal GDP, they have targeted a monetary expansion of 12.5 to 13.5 per cent. The monetary growth target for 1982 is for the first time expressed in terms of a range because of uncertainties not only with respect to prices, but also to the extent of the expected recovery and the precise size of the budget deficit.

Ceilings on credit expansion continue to be the major instrument for controlling monetary expansion. Credit ceilings are considered to provide some room for bank lending and interest rates to be determined separately. Interest rate policy for its part is determined by exchange rate considerations and by the objective of shifting financial resources

out of short-term assets into the bond market. Positive bond yields are to be maintained in real terms, while money market rates are just to match the rate of inflation, so as to ensure a further growth in the securities market.

3. Fiscal policy

The initial state budget for 1981 introduced an expansionary fiscal policy which was reinforced by the new administration that came into office at mid-year, as fiscal policy was to provide the initial stimulus for the desired economic recovery.

In 1981 the deficit of the state budget (on an administrative basis) is estimated to have reached F 76 billion or 2.5 per cent of GDP compared with a deficit equivalent to 1.1 per cent of GDP the year before. Improvements in social benefits, support for employment and investment, and assistance to ailing industries were introduced in the second half of 1981. They added some F 24.5 billion to total outlays of which only about F 7.5 billion were offset by discretionary revenue increases. The slack in the economy, rising health costs, the lapsing in February 1981 of a temporary surcharge on employees' health insurance contributions, and discretionary increases in benefits led to a deterioration in the balance of the social security funds, which was offset by increases in contributions and other measures taken late in the year. On balance, the general government deficit on a national accounts basis is estimated to have reached 2.4 per cent of GDP in 1981, and to have provided, on the basis of one calculation (see Table 5), an impulse to economic activity equivalent to 1.6 per cent of GDP.

The state budget for 1982 foresees a deficit of F 95.5 billion or 2.6 per cent of GDP; the corresponding figure for the general government is 2.3 per cent of GDP. This is in line with the estimated outturn for 1981 and implies no new stimulus to economic activity. Outlays are to increase (as in 1981) mainly because of a sharp rise in interest payments and a 20 per cent increase in social transfers. In addition increases in public sector employment are to contribute to a rise in the wage bill of 17 per cent. Given the weakness of the base for direct taxes and the full indexation of income tax brackets, tax revenues are projected to grow at a rate slightly lower than nominal GDP notwithstanding discretionary increases, which include a surtax on higher incomes to help finance unemployment compensation, a new wealth tax, and a further increase in the tax on petroleum products. Social security contributions will rise by 24 per cent as a result of the rate increases that became effective in November 1981.

The budget forecasts for 1982 are thought to be consistent with just over 3 per cent growth in real GDP and a 13.5 per cent rise in the deflator. There is some concern that the deficit for 1982 might not be held within the budgeted amount, particularly if GDP growth falls short of the projected rate. The principal uncertainties relate to the unemployment

benefits; the deficit of the other social security funds that may be affected by measures to stimulate employment; and the financing requirements of public enterprises, including those of some newly nationalized firms. Some of the increases in Departmental appropriations were so large that it was thought unlikely that the amounts projected could be wholly spent during 1982. On balance, however, the projected deficit was more likely to be exceeded, though no estimate of any excess could be made. The French representatives agreed that an excessive budgetary stimulus would undermine confidence, and probably translate into higher prices and imports rather than growth and employment.

The authorities considered that it was too early to assess the possible financial implications of the policy of decentralization. Major decisions had yet to be taken in this area. However, they underlined the importance of ensuring that the local authorities balance their current expenditures and receipts.

4. Industrial policies

Industrial policy under the new Government will continue to promote research and innovation, to support investment in energy-saving equipment, to provide adjustment assistance to help restructure ailing industries and diversify economic activity in depressed regions, and to develop the export potential of small and medium enterprises. Progress toward these objectives was viewed as particularly urgent in view of the commitment to strengthen investment and to "recapture the domestic market."

A major effort is to be launched to raise the share of research and development expenditure in GDP. Part of this effort would fall directly on the public sector, but private investment also would receive financial assistance. The 1982 budget provides for a rise in industrial assistance of over 50 per cent.

The textile and industrial equipment sectors, where import penetration had increased sharply over the past few years, would have a priority access to state assistance. A three-year plan was announced in December 1981 to reduce import penetration in capital goods industries, and to secure a higher share of exports in value added by restructuring and introducing new processes. Social security charges of textile firms that increased their investment without reducing employment, were also reduced.

The nationalization program became effective on February 13, 1982. It involves, besides the ailing steel industry, five major industrial groups, two financial groups, and most of the incorporated private banks. The State has also secured majority participations in two additional industrial groups and a blocking minority in the shares of a foreign affiliate operating in France. Beyond prospective agreements with two other affiliates of foreign companies, no further nationalizations are envisaged. Shareholders will receive 15-year government-guaranteed variable rate bonds in exchange for their shares.

Nationalization has raised the share of industrial value added under state control from 10 to about 30 per cent. The French representatives stressed that the nationalized groups, although expected to take account of the priorities set in the Government's development plans, would retain full autonomy of management. They distinguished companies which competed on the same basis as private firms from the so-called "large public enterprises" which were regulated industries. The newly nationalized industries would clearly belong in the former group.

A number of the newly nationalized firms had suffered heavy losses in 1980-81, and provision would have to be made to strengthen their capital base. However, budgetary constraints imposed strict limits in this respect.

Finally, considerable progress toward energy independence has already been achieved through both conservation and the development of domestic energy sources. The rise in domestic energy prices in line with imported energy costs, combined with fiscal and financial incentives promoting conservation, has held the increase in energy consumption to an average of 0.7 per cent per year over the period 1973-81, down from 7.2 per cent in the previous decade. This can be compared with a 2.5 per cent average GDP growth rate, down from 5.6 per cent in the previous ten years. The share of oil in total primary energy consumption declined from 66 per cent in 1973 to 49 per cent in 1981. The counterpart of this reduction has been a massive nuclear power program that has raised the share of nuclear energy in total energy consumption to 10.3 per cent in 1981, as well as a rise in the share of natural gas.

Continued progress toward energy independence remains a priority. A small scaling down of the nuclear power program is contemplated, reflecting partly a previous overestimation of energy consumption. A stronger effort to develop domestic coal resources is also to be undertaken, leaving the 1990 target share of oil in total energy consumption virtually unchanged in the 30-32 per cent range, while reducing the share of nuclear power to 26-28 per cent from the previously targeted 30 per cent.

5. Incomes policy

A deceleration of prices and wage costs is regarded as an essential prerequisite for the desired expansion of investment and output. The need is all the greater in that, although the effective depreciation of the franc since August 1980 has restored price competitiveness, the financial condition of enterprises weakened seriously in 1980 and 1981.

The French representatives thought that the prospects for a moderation of price increases were favorable. Import price increases are expected to drop to less than 10 per cent in 1982. Other factors include the influence of economic conditions, particularly on employment, and

the anticipatory price increases that have occurred in certain sectors in 1981. Moderation will be furthered by monetary policy, by limiting public service price increases to 10 per cent during 1982, and by the introduction of price agreements in the services sector as price controls were phased out.

Wage moderation is all the more important as discretionary increases in minimum wages will in future have more extensive spillover effects than before. Initially, wage settlements in the public sector were to be negotiated on the basis of a 10.5 per cent guideline. This involved setting the precedent of indexing wages on the target rate of inflation rather than on past inflation, with provisions for catch up adjustments in mid-year and year-end. Introduction of the new system has, however, been delayed until the second half of 1982, and its extension to the private sector is uncertain. Nevertheless, the authorities hope that their policy of social reforms will induce trade unions to temper their demands. The French representatives also expected that productivity gains in the upswing stage of the cycle would curb the rise of labor costs. The November 1981 rise in social security tax rates and the prospective recovery of profit margins in industry would foster some upward adjustment of prices, but the former had been necessary to contain the public sector deficit and the latter was a prerequisite to a recovery of investment.

6. Employment policy

The French authorities did not expect output expansion alone to absorb the prospective increase in the labor force. To maintain unemployment at its 1981 rate of 7.6 per cent, an average of 230,000 new jobs would have to be created annually, compared with the 90,000 per year achieved on average in the 1976-80 period. To increase the absorption of job seekers, the authorities have turned to specific measures.

Decrees taken in January 1982 have generalized a fifth week of paid annual leave, and reduced the statutory weekly working hours from 40 to 39, as a first step toward a target of 35 hours by 1985. Contractual agreements are under negotiation to limit recourse to overtime and to discontinue the past practice of making up for certain national holidays. The effects of these measures are still very uncertain. The authorities expect that they will result in a 2.5 per cent effective reduction in hours worked per year, while productivity gains generated in the process would amount to 1.5 per cent, implying some increase in labor costs. However, the effects both on employment and on productivity are likely to show large sectoral variation.

Work sharing is also to be promoted through a reduction in the retirement age. Legislative proposals provide for a reduction in the retirement age to 60 by 1983. The proposals would replace existing early retirement schemes but would also entail a net cost to the social security system.

Finally, fiscal incentives are to be provided under so-called "solidarity agreements." Such agreements provide for staged reductions in social security contributions of employers creating new employment through additional reductions in the workweek. Employee pensions are also to be subsidized for firms that allow workers to take early retirement between the ages of 55 and 60, provided they are replaced by new personnel.

Youth training programs and job creation in the public sector would also contribute to employment creation. Finally, public employment is to increase by a total of 125,000 or 3 per cent in the 18 months to the end of 1982. An additional 85,000 new jobs are targeted for 1983.

7. Trade and aid policy

Under present policies, the external current account deficit is expected to widen moderately in 1982. The authorities felt that a moderately higher deficit was acceptable but expressed concern about the rise in import penetration over the last three years. A particular effort has been undertaken to identify sectors with high import penetration, and to help domestic producers in those sectors to meet foreign competition. The two main sectors presently involved are the capital goods and textile industries. A three-year plan aimed at reducing import penetration has been adopted. It features reorganization and modernization efforts supplemented by subsidized loans and grants, and by reductions in social security contributions.

The French authorities have decided to increase ODA contributions to independent countries, from the equivalent of 0.34 per cent of GDP in 1979 and 0.32 per cent in 1980, to the equivalent of 0.7 per cent in 1988.

III. The Economic Outlook

When the new Government presented the 1982 budget to the National Assembly in October 1981, the official forecast projected that the real rate of growth would accelerate to 3.1 per cent in 1982 and inflation (as measured by the consumer price index) would slow down to slightly below 13 per cent during the year. It was assumed that by early 1982 activity would begin to strengthen in France's main trading partners and that international interest rates would ease. A pickup in demand, lower interest rates, and cyclical productivity gains would improve the profit position of firms and stimulate investment. In the first half of 1982, therefore, exports and investment would take over from private consumption as the main driving force of the recovery.

Since then it has become clear that the initial view of the international environment had been unduly optimistic. International demand continues to remain weak and there is no sign of an imminent upturn. The French representatives felt that prospects of a high U.S. budget

deficit would continue to exert upward pressures on U.S. interest rates and this made it difficult to expect a weakening of the dollar, but the slowdown in imported input prices, particularly of crude oil, appeared to be more pronounced than expected. In any event the French official forecast remained cautiously optimistic, for it was thought that a moderately lower growth of 2.5-3 per cent was still within reach. Consumption would rise at a rate of 2.5 per cent and stocks would contribute about 1 percentage point to GDP growth in 1982.

This forecast, however, depended crucially on investment, the outlook for which remained uncertain. In particular, prospects of an early pickup have been dampened by continued high interest rates, and business surveys of investment intentions remain very pessimistic, pointing toward a continued decline in 1982. On the other hand, after the squeeze of 1980 and early 1981 profits have stabilized since mid-1981, and subsequently have, perhaps, risen. Furthermore, preliminary data showed a discernible improvement of investment in the fourth quarter of 1981. Taking into account a 3 to 5 per cent increase in investment of large public enterprises, French officials expected total investment to increase by about 2.3 per cent in 1982.

The relative cyclical position of the French economy--growth in France would be about 2 percentage points higher than in partner countries--implied some worsening of the foreign trade balance. The main uncertainty concerned the extent to which the projected gain in the terms of trade, and structural improvements in foreign trade such as the expansion of export capacity in agriculture and food processing and the development of domestic nuclear energy, would be sufficient to compensate for the cyclical imbalance. The official view was that the trade deficit would widen, but that the surplus on invisibles should increase enough to stabilize the ratio of the current account deficit to GDP at 1.4 per cent. No difficulty was expected in financing this deficit, which was modest by international standards, and the authorities planned to continue their policy of encouraging large public enterprises to borrow abroad.

The French representatives expected the rate of inflation to decelerate in 1982. Following the October 1981 currency realignment, increased emphasis had been placed on controlling inflation (see Chapter II, Section 5). Wage restraint is also counted on to slow the wage price spiral. Some slowdown in nominal wages was expected to result from the new forward-looking indexation system. The continued rise in the number of unemployed should also cause some downward pressure on wages. On the other hand discretionary increases in minimum wages could have some spillover effects.

Unemployment remains the authorities' major concern. By the summer of 1982 the projected upturn in activity should have halted the decline in private sector employment. At constant participation rates, however, the supply of labor is still projected to grow by about 200,000 persons this year. Even taking into account the creation of 70,000 new public

sector jobs, the number of unemployed may, therefore, increase by at least 100,000 persons in 1982. Some amelioration was expected to result from new employment measures including direct employment incentives and the reduction in the workweek, but significant results would have to wait until the last months of 1982 or later.

IV. Staff Appraisal

Since 1975 France, in common with many other countries, has faced an external constraint and a persistent high rate of inflation which have prevented the rates of growth previously achieved being again reached and sustained. The effect of the slowdown in activity has been the more significant in that from 1975 until 1985 the rate of increase in the labor force will have been unusually high by French experience and high, also, relative to most major countries. The number of registered unemployed reached 2 million in October 1981.

France has suffered also from many of the other imbalances which have affected other countries. The external deficit on current account, though large, has been kept under control by restraint on domestic demand, export promotion, and by a sustained drive to reduce drastically the dependence of the French economy on oil, in particular through the development of a nuclear power industry. Other areas of difficulty have been tackled with less conspicuous success. In particular nominal wages have over the past nine years persistently risen at annual rates of over 12 per cent and real wages have risen also despite some reduction in the rate of rise over the past three years. In a period of substantial deterioration of the terms of trade and decline in productivity, profits have come under strong pressure. The financial position of enterprises has been made worse by rises in costs resulting from the need to keep the deterioration in the public sector accounts (especially the social security funds) in bounds at a time when the reduction in the rate of growth was putting pressure on the finances of the public sector.

These weaknesses have contributed to a stubbornly persistent rate of inflation which has over the past eight years never fallen below 9 per cent. The de facto full indexation of incomes has helped perpetuate this high rate of price increase. Given that the franc is tied to the currencies of several of France's main trading partners, the disparity in price performance has led over time, to strain.

The Government that came to power in 1981 is determined to explore the extent of the room for maneuver available to reduce the present rate of unemployment. It believes that overcautious economic policies are likely to prove self-defeating for they will perpetuate low gains in productivity. They will lead also to fiscal pressures that will have to be met either by reductions in expenditures and transfers, which will always be extremely difficult to bring about, or by rises in revenues which are likely in turn to add to labor costs and thus help perpetuate

slow growth. The French authorities are in no doubt that the rate of inflation must be reduced but they believe that sustained success in reducing inflation can only be achieved under conditions in which demand is allowed to grow so as to avoid a continued deterioration in the labor market and in public finance.

The staff are sympathetic to the Government's intention to limit, to the extent possible, the growth of unemployment and the wastefulness and risk of social strain associated with it. Given the continuing external constraint, the evolution of costs is crucial to the success of such an approach. A sustainable increase in employment cannot be expected unless productive investment revives from its current low levels and this is unlikely to happen unless the profit position of firms improves. An improvement in profitability adequate to set the scene for a significant increase in investment can in present circumstances only come about as a result of a marked deceleration in labor costs. At the same time the fiscal burden falling on firms, including their social security contributions, must not be allowed to increase, and credit to the private sector must not be squeezed out by the demands of the public sector.

These are important provisos and the main question to be asked at this stage is whether or not the policies presently in force are such as to hold out a reasonable hope that the Government's aims can be fulfilled in the external environment that faces the French economy.

Some encouragement can be derived from the fact that inflation now seems to be leveling off. The dangerous trend in financial policies that developed during 1981 has been recognized and a general government deficit no larger in terms of GDP than that recorded in 1981 is now being sought in 1982 at the same time as monetary policy aims at achieving a rate of growth in M_2 lower in 1982 than the expected increase in nominal GDP.

There are, however, in the view of the staff a number of serious and unresolved questions. The first is that, as argued earlier, the successful implementation of the Government's objectives depends crucially on the stimulation of investment which in turn will depend upon an improvement in the profit position of enterprises. If this is to be significant it would require a temporary fall in real wages. The various social measures that have been introduced to date or are about to be introduced shortly (including the 39-hour workweek, the fifth week of paid holiday, inducements to earlier retirement, improved family allowances) are, in the opinion of the staff, likely to increase labor costs.

Second, it seems to the staff that largely because some of the assumptions underlying the original budget estimates now appear unduly optimistic, the budget deficit is likely to be considerably larger than had been foreseen. Unless the rise in the public sector deficit is stringently controlled it could lead to doubts as to the coherence of fiscal and monetary policies. Indeed it now seems questionable whether

the growth of M₂ can be held within the target range; if this were to be so, it could throw doubt on the maintenance of exchange rate stability in the EMS. Capital controls are unlikely to be of much help in such a situation.

In 1981 the general government deficit absorbed about one third of net domestic saving compared with about 10 per cent in 1977-79 and a surplus of nearly 4 per cent in 1980. A firm control over financial policies remains essential to control inflation and to set a scene in which a fall in real wages could allow a growth of total output without endangering the balance of payments.

The French authorities are making an ambitious attempt to move away from the practice of giving the main priority to the reduction of inflation, a policy which governs, in their view, the actions of several industrial countries. A reduction in inflation is necessary, however, to bear out the reaffirmation of France's continued membership in the EMS and in that framework to sustain sufficient competitiveness to raise employment. In this respect, the gains in competitiveness achieved in the past year from the appreciation of the dollar and the October 1981 EMS realignment are in danger of being rapidly eroded by the widening differential in inflation rates between France and its trading partners. Tight financial policies will be essential both to contribute to the desired deceleration of inflation and to guard against weaknesses in the balance of payments. Insofar as costs are not controlled to the extent necessary, the financial policies will need to be that much tighter, but then such a development is unlikely to be compatible with the achievement of the Government's employment objective.

There remain two major new initiatives that could have significant economic effects, namely the nationalization program and the drive toward decentralization of decisionmaking. It is too early to come to any judgment. So long as the newly nationalized industries, including the banks, are run as profit-oriented enterprises then the sole fact that their ownership has changed need not lead to significant changes in the way they operate. Many commentators have long taken the view that the unusual degree of centralization in France had become a source of weakness as too many decisions of detail needed to be referred to Paris. So long as the policy of decentralization can ensure that local bodies continue to follow careful financial policies, then the economic risks entailed in the policy of decentralization should be minimized.

Lastly, it is hardly necessary to emphasize the crucial role that France can play in seeking to avoid any general trend toward a revival of protectionism. In the staff's view, an undue importance can be given to the rise in import penetration. Sharp increases in import penetration in narrow sectors can certainly cause difficulties for individual industries, but from an analytical point of view, the ratio of imports to domestic consumption is not in itself meaningful, as it varies depending on factors such as the degree of international specialization. The staff

are also concerned lest excessive emphasis be placed on assistance programs to ailing industries. In other industrial countries, such programs have often proved costly and resulted in serious misallocation of resources. The staff welcome the French authorities' statements that the attempt "to reconquer domestic markets" will not involve the introduction of measures of a protectionist nature, that a general return to protectionism could not be in the interests of the world economy, and that France would resist any such tendency. The staff also welcome the determined effort being made to ensure that French foreign aid remains at high levels, and the commitment to raise development assistance to independent countries from the equivalent of 0.32 per cent of GDP in 1980 to the equivalent of 0.7 per cent by 1988.

Table 1. France: Components of Aggregate Demand

(Volume changes in per cent, 1970 prices)

	1978	1979	1980	1981	1982 1/
Private consumption	4.7	3.5	2.2	2.3	2.5
Public consumption	4.3	1.6	2.7	1.8	3.0
Gross fixed investment	1.2	3.7	2.6	-1.1	0.4
Public	-0.9	1.5	1.6	-2.6	3.1
Residential	-0.1	5.0	-4.4	-2.8	-0.6
Business	2.1	3.6	5.6	-0.3	--
Final domestic demand	3.9	3.3	2.3	1.5	2.1
Stockbuilding 2/	-0.3	1.0	0.4	-1.7	0.5
Total domestic demand	3.6	4.4	2.7	-0.2	2.6
Exports of goods and services	6.6	6.8	3.4	4.9	3.7
Imports of goods and services	6.1	11.3	8.6	0.7	6.0
Foreign balance 2/	0.2	-0.8	-0.8	0.9	-0.5
GDP	3.7	3.5	1.6	0.7	2.1
Memorandum items:					
Industrial production	2.4	4.1	-0.4	-2.4	4.5
Unemployment rate	5.2	5.9	6.3	7.6	8.3

Sources: INSEE, Rapport sur les Comptes de la Nation (1981); Informations Rapides, Série F, No. 148 (March 5, 1982); and staff estimates.

1/ Staff estimates.

2/ Change from previous year as a per cent of previous year's GDP.

Table 2. France - Labor Costs and Profitability Indicators
for Nonfinancial Enterprises

(Changes in per cent; period averages)

	1978	1979	1980	1981 <u>1/</u>
Hourly labor costs				
Nominal	13.7	13.6	14.8	14.8
Real <u>2/</u>	3.8	3.2	2.9	3.4
Hourly net real wages <u>3/</u>	3.6	--	-0.2	2.3
Consumer price index	9.1	10.7	13.6	13.1
GDP deflator <u>4/</u>	9.5	10.1	11.6	11.0
Real interest rate <u>5/</u>	-0.4	-0.2	0.8	3.0
Apparent labor productivity	3.0	3.3	0.9	1.7
Operating surplus ratio <u>6/</u>	25.3	25.7	24.5	23.7
Savings ratio <u>6/</u>	12.5	13.2	11.8	10.9

Sources: Collections de l'INSEE, C 94-95; Assemblée Nationale, Projet de Loi de Finances pour 1982, Rapport Economique et Financier; and staff estimates.

1/ Preliminary.

2/ Deflated by the GDP deflator.

3/ Deflated by the CPI.

4/ Marketed GDP.

5/ Base lending rate deflated by the GDP deflator.

6/ Level of the ratio to value added for nonfinancial corporations.

Table 3. France: Balance of Payments, 1977-82

(In billions of francs, unless otherwise indicated)

	1977	1978	1979	1980	1981 Est.	1982 Proj.
Trade balance <u>1/</u>	-11.9	5.1	-5.0	-50.8	-49.5	-58.4
Service balance	10.6	24.5	27.4	35.2	30.2	32.9
Transfers	-13.9	-14.8	-17.1	-17.6	-23.2	-24.2
Current balance	-15.2	14.8	5.3	-33.2	-42.6	-49.7
Long-term capital <u>2/</u>	0.6	-8.6	-14.8	-4.5	-7.7	...
Short-term nonmonetary capital	6.5	5.7	8.1	15.5)		
Leads and lags, unallocated and errors and omissions	18.0	14.8	7.5	21.3)	-11.7	...
Monetary capital <u>2/</u>	-6.6	-14.6	1.8	29.0	34.0	...
Net changes in official reserves	3.2	12.2	7.9	28.2	-28.0	...
Current account as a per cent of GDP	(-0.8)	(0.7)	(0.2)	(-1.2)	(-1.4)	(-1.4)

Sources: Ministère de l'Economie et des Finances and Banque de France: Balance des Paiements entre la France et l'Extérieur 1980; data provided by the French authorities; and staff estimates and projections.

1/ Balance of payments basis, includes Negoce International.

2/ Adjusted for intermediation by the banking sector.

Table 4. France: Monetary Survey

(National definitions; percentage changes on a year earlier; end of period)

	1978	1979	1980	1981 1/	1982 2/
Monetary aggregates					
Money supply (M ₂) 3/	12.2	14.4	9.7	12.0	12.5-13.5
Of which:					
Narrow money (M ₁)	11.1	12.2	6.8	14.7 4/	...
Quasi money	13.5	16.8	12.6	9.6 4/	...
Broad money (M ₂) 5/	13.5	14.5	10.4	11.9 4/	...
Counterparts to M ₂					
Foreign assets (net) 6/	20.3	13.1	40.0	-7.1	...
Domestic claims, net	10.0	15.2	11.1	18.4	...
Treasury	2.8	9.9	-5.3	27.6	...
Economy 7/	11.0	15.9	13.0	17.4	...
Less: other items (net)	13.2	27.2	55.8	71.4	...

Sources: Banque de France, Bulletin Trimestriel; Conseil National du Cr dit, Statistiques Mensuelles; and data provided by the French authorities.

1/ Preliminary data.

2/ Monetary target.

3/ Aggregate in terms of which the annual target for the growth in money supply during the year is expressed. This target rate was set at 12.5 per cent for 1977, 12 per cent for 1978, 11 per cent for 1979 and 1980, and 10 per cent for 1981. The data include deposits by nonbank nonresidents.

4/ November data.

5/ M₃ differs from M₂ mainly in institutional coverage, by including also savings banks and the National Energy Fund. In addition, M₃ includes Treasury bills held by the nonfinancial sector.

6/ Net assets held by the Banque de France only; excluding changes in the valuation of gold and ECUs, and SDR allocations.

7/ Including claims on nonbank nonresidents and excluding lending from nonmonetary sources.

Table 5. France: General Government Financial Balance

(National accounts basis)

	1979	1980		1981		1982
	Outturn	Preliminary outturn ^{1/}	Revised outturn ^{2/}	Initial estimate ^{1/}	Preliminary outturn ^{2/}	Initial estimate ^{2/}
Billions of francs	-15.8	-17.0	10.4	-52.7	-74.3	-83.0
Per cent of GDP						
1. Actual balance	-0.7	-0.6	0.4	-1.7	-2.4	-2.3
2. Cyclically neutral balance	-0.8	-1.3	-1.5	-1.8	-2.4	-2.3
3. Cyclical effect (2-1) ^{3/}	-0.2	-0.7	-1.9	-0.1	--	--
4. Change in cyclical effect ^{3/}	-1.2	-0.5	-1.7	0.7	1.6	--

Sources: Assemblée Nationale, Projets de Loi de Finances, Rapports Economiques et Financiers; and staff estimates.

^{1/} Estimates underlying the budget law for 1981.

^{2/} Estimates underlying the budget law for 1982.

^{3/} Data may not add up due to rounding.

France - Fund Relations

Status: France formally accepted the obligations of Article VIII, Sections 2, 3, and 4, of the Fund Agreement as from February 15, 1961.

Quota: SDR 2,878.5 million.

Fund holdings of French francs: SDR 2,008.8 million or 69.8 per cent of (measured in SDRs) quota as of February 28, 1982.

France's holdings of SDRs: SDR 954.4 million or 88.4 per cent of net cumulative allocation, as of February 28, 1982.

Gold distribution: 1,283,718 fine ounces.

General Arrangements to Borrow: The maximum commitment of France is F 2,715.4 million (SDR 398.9 million); as of February 28, 1982, F 2,715.4 million remained available.

Last consultation: The staff report for the 1980 Article IV consultation with France (SM/81/29, 2/4/81) was considered by the Executive Board at EBM 81/27 (2/25/81).

Exchange system: Since March 13, 1979, France has participated together with Belgium, Denmark, Germany, Ireland, Italy, Luxembourg, and the Netherlands in the exchange rate mechanism of the European Monetary System (EMS). Under this agreement, France maintains spot exchange rates of the currencies of the other participants within margins of 2.25 per cent (in the case of the Italian lira, 6 per cent) above and below cross rates derived from central rates expressed in ECUs. On January 31, 1982 the exchange rate of the French franc against the SDR under Rule 0-3 was F 6.7436 = SDR 1.

Basic Data

Population (1980 annual average) 53.7 million
 GDP per capita (1980) SDR 9,327

National accounts 1980 (at current prices):	<u>In billions of SDRs</u>	<u>Per cent of GDP</u>
Private consumption	318.9	63.7
Public consumption	76.6	15.3
Gross fixed investment	108.0	21.6
Change in stocks	7.6	1.5
Exports of goods and services	105.6	21.1
Imports of goods and services	<u>115.7</u>	<u>23.1</u>
GDP	500.8	100.0

Selected economic data (changes in per cent):	<u>1979</u>	<u>1980</u>	<u>1981</u> <u>1/</u>
GNP <u>2/</u>	3.5	1.6	0.7
Private consumption <u>2/</u>	3.5	2.2	2.3
Gross fixed investment <u>2/</u>	3.7	2.6	-1.1
Exports of goods and services <u>2/</u>	6.8	3.4	4.9
Imports of goods and services <u>2/</u>	11.3	8.6	0.7
GNP deflator	10.1	11.6	11.0
Consumer price index (end of year)	11.8	13.6	14.0
Money plus quasi-money (end of year)	14.4	9.7	12.0
Domestic credit (end of year)	15.2	11.1	18.4

Balance of payments (in millions of SDRS;
 on a transactions basis)

Trade balance	-912	-9,236	-7,724
Net services	4,992	6,400	4,713
Private transfers	-1,779	-1,920	-2,509
Official transfers	-1,335	-1,280	-1,127
Current balance	966	-6,018	-6,648
Long-term capital	-2,694	-818	-1,202
Basic balance	-1,728	-6,836	-7,849
Short-term capital	3,168	11,945	3,480
Changes in official reserves (increase = -)	-1,440	-5,109	4,369

1/ Staff estimates.

2/ In volume terms.