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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 91/117

10:00 a.m., September 9, 1991

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
M. Al-Jasser	
G. K. Arora	
	Deng H., Temporary
	G. C. Noonan
	Q. M. Krosby
J. de Groote	
E. A. Evans	
	N. Kyriazidis
	A. F. Mohammed
	I. Fridriksson
H. Fukui	N. Tabata
B. Goos	
J. E. Ismael	T. Sirivedhin
	J. C. Jaramillo
J.-P. Landau	J.-F. Cirelli
A. Mirakhor	O. Kabbaj
	L. Mwananshiku
D. Peretz	
G. A. Posthumus	
	Y.-M. T. Koissy
A. Torres	
A. Végh	A. G. Zoccali

L. Van Houtven, Secretary and Counsellor
M. J. Miller, Assistant

Also Present

European Department: M. Guitián, Deputy Director; F. Caramazza, M. C. Deppler, V. R. Koen, K.-W. Riechel, H. Vittas. Exchange and Trade Relations Department: J. Ferrán, Deputy Director. IMF Institute: P. B. de Fontenay, Director. Legal Department: R. B. Leckow. Research Department: M. Mussa, Economic Counsellor and Director. Secretary's Department: C. Brachet, Deputy Secretary; A. Tahari. Advisors to Executive Directors: P. Bonzom, L. E. Breuer, C. D. Cuong, L. Dicks-Mireaux, B. R. Fuleihan, M. Galán, J.-L. Menda, F. A. Quirós, B. A. Sarr, S. von Stenglin. Assistants to Executive Directors: T. Berrihun, S. B. Creane, H. Dognin, T. P. Enger, S. K. Fayyad, E. Haller Pedersen, M. E. Hansen, O. A. Himani, P. Kapetanović, G. Lindsay-Nanton, I. Martel, L. J. Morelli, F. Moss, M. Mrakovcic, S. Rouai, R. Thorne.

1. FRANCE - 1991 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1991 Article IV consultation with France (SM/91/153, 8/5/91). They also had before them a background paper on recent economic developments in France (SM/91/169, 8/22/91).

Mr. Landau made the following statement:

During the past three years, France has made decisive progress toward price stability. It is now envisaged that, in 1992, it will have the lowest inflation rate inside the group of the seven biggest industrial countries. Within the European Monetary System (EMS), nominal convergence has now been achieved with Germany. This provides a strong basis on which to proceed toward European Monetary Union.

These results have been obtained at no visible cost in terms of real growth. During the period 1988-90, GDP increased annually by 3.4 percent, which is the average level of the G-7 countries and above the European Community (EC) overall performance; the current account has been kept close to balance; and export market shares have been stabilized, although at a rather low level. Finally, unemployment has been reduced. The strategy of competitive disinflation--anchored on the stability of the franc's exchange rate inside the EMS--thus seems to have produced significant benefits.

This policy is more severely tested now that growth has slowed. Most of this evolution is attributable to the international environment: indeed, in this regard, France has performed better than the industrial countries, on average, during the last ten months. Nevertheless, tensions have surfaced both in the field of public finance--with increases in the general government deficit--and in the labor market, where the rate of unemployment is again rising.

In this situation, the strategy of my authorities has been, first, to strengthen financial and monetary discipline, and, second, to pursue structural reform in a long-term perspective, so as to make the economy more responsive and less vulnerable to external or internal shocks.

The staff is right in pointing out that the Government did not display any complacency in dealing with the growing fiscal deficit. A case could have been made, in theory, for an automatic stabilization approach, according to which no action would have been taken to compensate for the shortfall in revenue stemming from slower growth. To be sure, the fiscal deficit in France stands at less than 1.5 percent of GDP, and the public debt ratio is the lowest of all the G-7 countries.

But my authorities strongly believe in the benefits to be drawn from having clear, simple, and permanent rules governing monetary and financial policy. In this framework, keeping the fiscal deficit on track appears to be the best way both to constrain expenditure and ensure the credibility of the overall strategy. This also implies that social security accounts should be kept in strict balance; hence, the recent increase in the contribution rate, which is viewed with little sympathy by the staff.

There are other, more specific, reasons for doing so: debt service accounts for a significant--and fast growing--share of budget expenditures; also, the rapid internationalization of French financial markets in the last three years means that about 18 percent of negotiable public debt is presently held by nonresidents, whose confidence in our ability to maintain control over public finances is therefore essential.

Keeping with the target of F80 billion for the general government deficit might prove impossible in 1991, however, since the shortfall of revenues has been larger than anything which could be expected. Slippages will be limited by a stringent tightening of expenditures, which was quickly decided and implemented during the year, in two packages: one in March, for F10.2 billion, and one in June, for F17 billion. The overall savings is about 0.4 percent of GDP. For 1992, the budget--currently under preparation--will be built on one main objective: no increase in taxes or social contributions. In parallel, expenditures would be kept constant in real terms and thus should decline significantly as a share of GDP. Depending on projections for next year's growth, the nominal deficit target might nevertheless exceed, by a small amount, the one originally set for 1991.

Turning to monetary policy, two main developments have marked the last year. One is of a technical nature: a new definition of the money aggregate M3 has been introduced, which now encompasses all the liabilities of money market funds. Under the previous definition, M3 would only include those liabilities which were matched, on the asset side, by short-term securities. Thus, portfolio reallocations by those money market funds--while neutral on the behavior of nonfinancial private agents--have changed the level of M3 and made its interpretation more difficult. These optical distortions will disappear. As for the past, the M3 target range was fixed in 1991 in coordination with EMS partners.

It is now closely monitored, together with the evolution of domestic credit.

The second change is more substantial: during the last 15 months, the interest rate differential between France and other members of the EMS--notably Germany--has been reduced very significantly. It has been divided by three on short-term, and by two on long-term interest rates. The staff thinks that there appears to be little room for further downward movement. They point to changes in the French franc position within its band. However, it has been possible not to follow the recent increase in German official interest rates, without visible exchange rate effects. Apart from very short-term fluctuations, market perceptions are mainly guided by the intrinsic performance of the economy, first as regards inflation, and second, on the current account. In this framework, and provided that the performance on these two fundamentals is kept satisfactory, it is both feasible and legitimate that the private sector could, in terms of interest rates, reap the benefits of lower inflation. This helps and strengthens public support for the general strategy.

Overall, it appears that, owing to the results achieved in inflation, public finance and the external balance, the franc is moving progressively to the position of a very strong currency.

The main concern, in the field of structural reforms, relates to unemployment, which is increasing again, obviously for cyclical reasons. But it is all the more worrisome that its level at the peak of expansion was still very high, and that its elasticity to growth seems, in France, rather low in comparison with that in other industrial countries. The staff sees a clear relation between this situation, on the one hand, and, on the other, the structure of the tax system and the functioning of the labor market. My authorities broadly agree with this analysis, as well as the general orientation and objectives which are outlined in the staff report. Some tactical differences remain, however.

First, the staff focuses on the tax wedge between take-home pay and the cost of labor. It is indeed significantly larger in France than in other comparable countries. Part of the gap, however, might be accounted for by statistical discrepancies: some social security taxes are levied in France on a compulsory basis, whereas they might be considered as voluntary in other countries; but the underlying reality is much the same. Furthermore, the overall cost of labor is comparable, or lower, in France than in other EC countries. So the tax wedge might certainly be a problem as much as it bears specifically on some part of the labor force--namely, less qualified workers. It is not the source of an overall deficiency in wage competitiveness.

The staff makes interesting remarks on the evolution of wages and incomes. It is very satisfactory that the increase in wages and unit labor costs is projected to be moderate in 1991, after a slight acceleration in 1990. The staff wonders whether this is a fortuitous development. On the contrary, we think that this is a direct consequence of the increase in male adult unemployment. I also believe that wage expectations are now influenced more and more by financial policies, in a framework of greater nominal stability. For the future, moderation in wage growth is a necessity, as underlined by the staff: it is a precondition for strong business investment in a world of high real interest rates.

The employment of less qualified workers is, however, penalized and handicapped both by abnormally heavy taxation and, according to the staff, the minimum wage system. My authorities share the broad line of these analyses. They see no possibility for suppressing the minimum wage or changing the rules for its determination. They have studied carefully the possibility of a differentiated minimum wage for young workers, as suggested by the staff. Foreign experience, although significant, does not seem to yield sufficient results, both in terms of its quantitative impact and considering the risk of a substitution effect to the detriment of older workers.

Nevertheless, there is obviously a need to simplify the tax structure and reduce its relative burden on low-paid workers. Much has been done already in the past years with the "déplafonnement" of social security contributions--which amounted to a transfer of more than 10 percent from low to high wage taxation--and the institution of the "contribution sociale généralisée," which is a broad-based proportional income tax. More will have to be done, but present efforts are certainly hampered by the necessity of preserving the current flow of tax revenues.

In the end, the solution to eliminating the tax burden lies, as pointed out by the staff, in the reduction of the long-term trend of expenditure growth. Present efforts focus on social expenditure, specifically in the pension system. A major reform has been prepared in the form of a White Paper. Three main measures are contemplated and are presently being submitted for public consideration; the indexation of pension increases to the cost of living, rather than to the average wage--this measure has been implemented de facto over the past three years, but would now become binding--the extension of the contribution period by at least three years; and a change in the determination of the final pension by reference to a better average of earnings during the working life. Those reforms, if implemented, are projected to ensure the financial balance of the pension system up to the year 2005, without any increase in tax contributions, notwithstanding the unfavorable evolution of the demographic structure. Similar efforts, although less elaborate, are contemplated regarding health insurance. There seems to be a limit to what can be done on the demand side, because of both its small price elasticity and the development of compensatory private insurance. But the supply of health services is to be kept more and more under monitor and control through agreements with hospital workers and the medical profession.

Much has been achieved in recent years. Public financial and monetary discipline has been a constant guide for the actions of my authorities. There are many signs that, although tensions and difficulties remain, that discipline is having more and more of an impact on the whole economy, and is changing the behavior of private agents. This Government, as its predecessor, will stay on course and certainly not lower its ambitions on inflation, whatever the evolution of the environment may be. On the real side of the economy, the last three years have demonstrated that disinflation is compatible with a good performance on growth. We still have to make sure that, through adapted structural adjustment and reform, growth will generate greater job creation, so that we can solve the unemployment problem, which is today the main concern of my authorities.

Mr. de Groote made the following statement:

It is undeniable that the shift in France's policy stance toward a medium-term strategy of disinflation paid off handsomely again in 1990. It should serve other countries as an example that sound macroeconomic and structural policies, when framed and implemented in a sufficiently long-term time perspective, bring about substantial improvements in economic fundamentals. Instead of elaborating on these outstanding results, let me focus immediately on some policy issues that will probably become more important in the near future, when France experiences the sustained and broadly based cyclical upswing that can be expected for the years ahead.

Turning first to monetary policy, it is beyond doubt that the disinflation strategy, the linchpin of which is the maintenance of the franc's parity vis-à-vis the deutsche mark, has its merits and needs to be pursued. This is demonstrated by France's inflation record in the recent past, and by the price projections for the near future compared with those for the other major countries, as highlighted in the new World Economic Outlook. The staff report nevertheless leaves an impression of slight doubt as to the credibility of the overall strategy. First, mention is made of difficulties with the setting of targets for domestic monetary aggregates: a new target aggregate had to be chosen to insulate it from portfolio shifts that were either tax induced or influenced by the complete elimination of capital controls; there was also some difficulty in keeping the new target inside its announced range; and one could wonder whether the consistency with the German broad money supply target could not cause confusion if the German money supply were to behave differently from what is expected in the aftermath of German reunification--an element mentioned in the staff report for Germany. The French authorities have responded by making it clear that, in case of a conflict between the monetary aggregate target and the exchange rate target, the latter commitment would always take precedence. Given the increased possibility for such a conflict, it is not certain, however, that the continued emphasis on domestic monetary targeting will remain indispensable to strengthen France's monetary policy credibility. The traditional Belgian opposition to monetary targeting, which used to be of relevance foremost for small countries, seems to be applicable more and more to large countries, too, when these are part of a de facto monetary union.

There is a second element in the staff's presentation of France's monetary policy in which I detect some disagreement with the authorities, and which has also to do with credibility: it relates to the sequencing of the process whereby a hard currency status is acquired in the market as evidenced by a decreasing risk premium and, therefore, a lower interest rate on assets denominated in this currency. The staff report leaves the impression that France has tried to reverse this sequencing. In order to counteract real interest rates that one regarded as abnormally high, French monetary policy would thus have caused the franc to slide downwards in the ERM band by pushing first for lower interest rates, and thereby reduced interest rate differentials with the deutsche mark before securing fully its hard currency status. Mr. Landau has in my view convincingly answered this point by pointing out that not every reduction in interest rate differentials with the deutsche mark led to a weakening of the franc's exchange rate.

However, a more general issue remains open for discussion. If France has been able to pursue a more autonomous interest rate policy during the recent past, do the findings of Appendix II of the background paper on recent economic developments tell the whole story? There it is stated that German interest rates are now also strongly affected by French rates, whereas before only the reverse was true. Could it not be that the results in Appendix II are somewhat biased, in the sense that the date chosen for the dummy variable indicating German reunification--January 1990--also happened to be the date of the complete elimination of capital controls in France, which in itself anticipated the start of the first stage of the EMU?

A second issue of importance for the French economy in the near future is that of fiscal policy. Here, I find myself in broad agreement with the staff appraisal: the authorities must see to it that public spending remains tightly controlled in order to attain the dual objectives of a lower fiscal deficit and a reduced level of taxation. Concerning the deficit, the Government has clearly shown its resolve not to ease up on fiscal adjustment in the wake of slowing economic growth. Such a resolve represents more than just a continuation of past policies. The rejection of the automatic stabilizers approach clearly goes one step further and will undoubtedly enhance France's fiscal policy credibility. Several European governments will look with envy at the determination the French Government has shown in this regard.

On the reduction of taxation levels, it is obvious that such an objective cannot be pursued vigorously at a time of economic slowdown. However, such a time offers an occasion for reflection on past strategies and for drawing lessons on how to proceed once economic activity, and thus fiscal revenues, picks up again. With regard to the Central Government, I note from Chart 6 in the staff report that France has already made a significant effort to reduce taxation levels since the middle of the 1980s. What matters most, therefore, for the period ahead--and here I fully share the staff's recommendation--is the adoption of a medium-term fiscal reform strategy that would encompass both the direct taxation system for individuals and corporations, as well as a tilt in the relative balance of taxation away from direct toward indirect taxation. When implemented, such reforms will undoubtedly contribute significantly to a better incentive structure and an increased efficiency in the French economy, by reducing tax rates while broadening the tax base to protect revenue.

The Central Government is only part of the picture, however. As appears from the same chart, as well as from Chart 7 in the background paper, the cause of the problem of high levels of taxation, both in absolute terms and relative to EC partners, is to be found in the social security sector and in the need to offset the expenditures of local authorities. With the structural imbalances in the social security system having been masked thus far by favorable economic conditions, the current slowdown should be used to instigate a political debate on the long-term future of France's system and, in particular, on the sustainable real rate of increase of certain categories of social spending.

I note that the current circumstances have already provoked some new thinking in France on the issue of private minority participation in state industries; perhaps we will witness a similar kind of evolution in the approach to the upward drift in social security outlays. Equally important for the immediate future is reflection and action on local authorities' taxing and spending behavior. Their insufficient fiscal accountability, coupled with greater spending powers as a result of decentralization, carries the potential of serious mismanagement.

At a time when Europe is trying to work out arrangements for subjecting member states to fiscal discipline in order not to endanger the future monetary union, it seems odd that several European countries encounter difficulties in tackling a similar situation at home. Much research still has to be done on the distribution of spending and taxing powers between the central and local authorities. My own country, for one, could greatly benefit from it. I would encourage the staff to contribute to this research, just as it has been contributing fruitfully to the debate on the relative merits of direct and indirect taxation in the papers before us.

These issues are not only important in themselves. They are equally of particular relevance in light of the current debate on the adequacy of world savings. As is rightly argued--again in the latest World Economic Outlook--the public sector can play a crucial role in addressing this problem. France, like other major industrial countries, has a particular responsibility in this respect. Although I concur with Mr. Landau that France has set an exemplary record in this respect over the last years, the future seems to give cause for some concern. Indeed, the background paper mentions that considerable investment efforts will be needed over the medium term, not only to replace the aging stock of productive equipment, but also to reabsorb the large pool of unemployed. Such investment needs could lead to renewed external current account pressures, if not financed out of domestic savings, and--in particular--out of public savings. These pressures could even materialize very soon, given the current account outcome obtained last year, which was less favorable than might have been expected. It is noteworthy that the import coverage in volume terms of the industrial balance deteriorated, notwithstanding the German import demand push. I would be interested to hear the staff's view on this point.

An answer to this question will, in any case, involve structural issues. Apart from tax policy, which I have already addressed, two major issues stand out: employment, and industrial policy. As to the former, France faces a general and a specific problem. The general one is that even after such an extended period of sustained economic growth, the rate of unemployment remains high and very sensitive to an economic slowdown. The specific problem is that of youth unemployment. The staff has very convincingly analyzed this latter problem and comes to conclusions similar to those of the OECD. In somewhat different words, it amounts to saying that the wedge between the minimum wage and the average wage has become too narrow over the years, at least when the skill level of new entrants into the labor market is compared with that of the insiders. As to the general problem of structural employment, the staff believes that the wedge between take-home pay and the cost of labor has become too large. Elements other than sheer price elements have to be considered for a full analysis of this issue. The fact that one of the annexes to the new World Economic Outlook specifically deals with the problem of unemployment in industrial countries indicates that the staff is also much aware of the complexity of the issue. In essence, for a strategy to be successful in solving the unemployment problem over the longer term, it will have to address both the demand and supply sides of labor, as well as the functioning of the market where demand and supply meet. Especially with regard to the functioning of the market, recent studies seem to reveal the importance of a number of issues which have not received enough attention: who really influences the rate of wage increases? And do average wage levels for a given activity allow for a sufficiently wide range to take account of differences in embodied human capital? Devising labor market policies that ultimately succeed in reducing structural unemployment requires the implementation of flexibility in the labor market, as well as sustained efforts to raise the quality of labor and keep its cost in line with the evolution of its productivity.

Another area where markets should be allowed to respond flexibly is that of product markets. Here, France has already gone quite a way in the area of financial products, where liberalization and exposure to competitive forces has brought about profound changes. Much remains to be done, however, with respect to industrial products. It is true that the European single market will bring about more competition, but regulations and government intervention still seem to be widely prevailing. A case in point are the subsidies, where the new Government has indicated its intention to strengthen industrial policy and to increase financial and tax incentives for the development of small- and medium-sized enterprises. Is it really the Government's role to be so visibly present in industrial activities, or should it not start thinking of scaling back its activity, contenting itself with setting the broad framework in which industry can compete more freely?

While I have focused in my intervention, as should be done in this kind of exercise, on certain areas of economic policy where improvements are still possible, I would like to conclude in stressing the outstanding performance the French economy has delivered over these last few years. This should be to the satisfaction of not only Mr. Landau and his authorities, but also the Chairman, who has contributed decisively in shaping some aspects of this successful outcome. France's continued adherence to a policy of sustainable growth in an environment of low inflation is not only important for the country itself, for its immediate neighbors, and for its friends, but is also crucial for the European Community at large, in which France is bound to continue to play a leading role.

Mr. Goos stated that he welcomed the comprehensive and detailed analysis in the staff report, which was also noteworthy for its conciseness. He could concur with most of the conclusions. He was particularly pleased to note that structural issues had been given more appropriate attention than in the past.

The French authorities were to be commended for their successful disinflation strategy of recent years, Mr. Goos continued. That strategy had not been without its costs, but as the post-adjustment indicators suggested, it had paid off impressively in terms of buoyant business investment and higher growth in an stable overall financial environment. In view of that enviable inflation and financial situation, France seemed to be set on the way to becoming a stability co-leader within the European Monetary System (EMS), if it had not already achieved that role. He welcomed that development, as it implied a strengthening of the stable course of the EMS and a more balanced sharing of the responsibility for the success of the system. At the same time, that responsibility clearly required maintenance of financial discipline and promotion of a flexible economic structure that was able to absorb exogenous shocks.

The staff had rightly pointed out a number of policy issues which, if left unchecked, might eventually erode France's excellent stabilization and growth record, Mr. Goos observed. With respect to fiscal policy, while he was impressed by the authorities' decision to stay the course of fiscal consolidation, even in the present situation of slower economic activity and weakening fiscal revenues, he fully shared the staff's concern that fiscal adjustment should concentrate in the first place on expenditure reduction, rather than on raising tax revenues. In that context, he took note of Mr. Landau's concern that further expenditure cuts, by raising the share of debt-service outlays in overall expenditures, might undermine confidence in the French financial markets. However, that concern should not be overemphasized; given the already high debt-service ratios in terms of overall expenditures, the longer-term effects of a credible strategy of expenditure reduction should not go unnoticed by the markets, and should therefore boost confidence instead. In that regard, he was concerned that the budgetary consolidation might be hampered by the new thrust of industrial policies--the closer cooperation between state and industry that had recently been announced by the new Prime Minister. That policy reorientation was a serious matter for concern in and of itself, and it was difficult to reconcile with the authorities' acknowledgment that the more market-oriented approach to industrial policy had served their country well.

Rather than reversing the previous successful policy stance, he therefore believed that the French authorities would be better advised if they stressed privatization, and thereby reduced the large share of the public sector in the economy, Mr. Goos commented. While he appreciated the fact that such a policy stance seemed to be under consideration in France, he wondered why private participation in public enterprise was still not allowed to exceed 49 percent of equity.

With respect to tax reform, in view of the already large share of indirect taxes in overall government revenue, and the recent decision by the European Community to harmonize that share--which was relatively high in France--he hesitated to endorse the staff's advice to further increase indirect taxes and lower direct taxes, Mr. Goos stated. Rather, the authorities should concentrate on broadening the tax base of direct taxes by abolishing the existing widespread exemptions. He believed that that was advice that the staff could also support.

Concerning monetary policy, he had read with great interest the study on the German leadership in the EMS in the background paper, but he had been somewhat surprised by its conclusions, Mr. Goos remarked. Intuitively, he would have expected a loosening of the relationship between interest rates on French franc- and deutsche mark-denominated assets to have occurred, as a result of the divergent cyclical development and the special factors arising from German unification. By loosening that relationship, a loosening of the causal relationships between movements in one country and in the other might also have been expected. He therefore wondered whether the staff could substantiate the results of the model with more economic reasoning.

He welcomed the cautious stance of France's interest rate policy, Mr. Goos went on. In that connection, he had noted the complaint about the abnormally high real interest rates, which had basically been addressed appropriately by the staff. Also, it needed to be recognized that under a quasi-fixed exchange rate system, without restrictions on the flow of capital, goods and services, the level of real interest rates was generally a function of supply and demand for savings in the whole region. By the same token, however, it might also be expected that an increased demand for savings in one part of the region would generate positive spillover effects for overall production, which indeed seemed to be borne out by the strong expansion of French exports to Germany, and the concomitant turnaround in the bilateral trade balance between the countries, which had traditionally been a deficit at the expense of France. The fact that France's membership in the EMS had served it well should not be obscured.

There was a discussion in the staff paper of the exchange rate parity with the deutsche mark and the monetary targets set by the authorities, Mr. Goos recalled. In that connection, he had also noted the concern expressed by Mr. de Groote that the relationships between monetary and real indicators might have been blurred in Germany as a result of developments in the wake of unification. He shared that concern to some extent; in particular, if a monetary growth target were set and then monetary expansion was allowed to deviate from that target even for a limited time only, the credibility of the French authorities in setting the target might be undermined. In considering the possible adverse effects coming from Germany, it needed to be borne in mind that the east German economy had a relatively small share in the overall German economy--perhaps 10 percent--and there was the same relationship between monetary aggregates held in east and west Germany. Even if there had been changes in the behavioral pattern, they should not complicate too much monetary developments in Germany. In fact, as recent developments had shown, the Bundesbank was again in firm control of the expansion of monetary aggregates, after some initial problems.

With respect to structural issues, the staff had addressed a number of pertinent points, but he had been disappointed by what appeared to be a rather unenthusiastic response of the French authorities to the various staff proposals, Mr. Goos commented. He had already referred to the structural problems within the budget, but he was also concerned about the authorities' response to minimum wages and employment policies in general.

He had been disappointed by the attitude of the authorities that emerged from the staff report regarding trade liberalization, and in particular by the Government's insistence on reciprocity, Mr. Goos stated. Such a principle was very difficult to accept in the Fund, where trade liberalization was almost a standard feature of Fund-supported adjustment programs. While he appreciated the concern of the French authorities about the need to provide for adequate transitional periods for restructuring, the deficiencies and rigidities addressed in the report had been known for a long time, and he wondered when the authorities intended to initiate specific liberalization action, to be concluded within an appropriate--and not too long--period of time. Furthermore, he hoped that the authorities would be able to overcome their resistance to trade liberalization and to play a more active role in that regard, particularly in the agricultural sector; such a role would indeed be consistent with France's special relationship with a large number of developing countries, and it would be fully in keeping with France's concern over the economic well-being of those countries. Aid was no substitute for trade liberalization, at least not in the longer run.

He had found France's economic policies over the previous few years most impressive, and he would encourage the authorities to continue their efforts, Mr. Goos concluded.

Mr. de Groote commented that the economies of the European countries were so interconnected that it was difficult to speak about one without also speaking about the others. With regard to German unification and its effect on France, the argument that unification was of little significance to France economically because of the relative size of east versus west Germany, and thus the relative size of money aggregates, was incorrect, in his view. Rather, the key element was the behavior of expectations and its influence on the velocity of money, which affected interest rates. That effect could be great, even if the relative size of the monetary aggregates was not large. When expectations and psychological reactions were taken into account, the quantitative element of money was not as important.

Mr. Goos remarked that Mr. de Groote's conclusion assumed that 90 percent of the German public would be affected significantly by what was going on in the eastern part of Germany, and that the changes in monetary behavior would be so pronounced that they could have a negative spillover effect on other countries. He had doubts about such an assumption. He was encouraged by the fact that the Bundesbank had regained after a very short period full control over the expansion of the monetary aggregates.

Mr. Evans made the following statement:

This is a particularly well written and perceptive staff report, and the research underlying it, presented in the annexes to the background paper on recent economic developments, is most impressive. I am in general agreement with the staff appraisal, as--I note--is Mr. Landau.

I do, however, have one or two significant differences with either the staff or Mr. Landau and, with an eye to ensuring that we present a clear view to the French authorities, I would like to concentrate on those differences. Like Mr. de Groote, I recognize that this risks understating the significant agreements that exist, and I would like in particular to compliment the French authorities on their recent and prospective conduct of fiscal policy and the consequent marked improvement in financial stability.

Yet deep-seated problems remain. These have many manifestations, but perhaps none is more telling than the failure of policy to achieve one of its most basic objectives--the reduction of unemployment. At the height of the most recent upswing, the unemployment rate had been reduced only to 9 percent--and this was accepted as being entirely structural. With the slowing of growth in 1990 and 1991, the unemployment rate has risen again. Eventually, as recovery proceeds--and I agree that it will--the growth of unemployment will slow. But--and this is the main point I wish to make--unless there is a marked change in the French authorities' approach to structural policies, the unemployment rate in France will never sustainably fall below the 9 percent rate reached at the height of the latest upswing--rather, and repeating the history of the last two decades, the next upswing's trough in unemployment will be higher than the last, unless there is a change in policy.

The reasons for this are well brought out in the staff documents, although more so if they are read in conjunction with those of 1989 and 1990. In exploring France's unique unemployment experience, the staff report places particular emphasis on distortions in the labor market, in taxation policy, and in industry policy.

On labor market policy, per se, the staff is clearly correct--and Mr. Landau acknowledges as much--but, in the presence of the authorities' refusal to contemplate a change in their approach to minimum wages, there is no obvious solution. I agree with Mr. Landau that establishing a separate--that is, a lower--minimum wage for youth would have little effect; it may shuffle the pack, but not much more. The problem here cannot be addressed without addressing the minimum wage: the policy issue is how to do that.

On taxation and unemployment, the staff has rightly focused on the unusually high tax burdens that apply in France on relatively low incomes and on the clear lack of progressivity in the tax system. The staff recommends two alternative solutions. Its preferred course is a switch in weight from direct to indirect tax; or, alternatively, a concentration on direct taxation, with base broadening paying for rate reduction.

While these approaches are presented as alternatives, both could, of course, be pursued in tandem, with beneficial results. If a choice had to be made between them, however, I would side with Mr. Landau on that choice. We should recognize that both approaches are based on the weaknesses of the direct--income--tax system--high rates applied to an extraordinarily narrow base. The switch option addresses this by reducing income tax rates, and hence the cost of the base distortions. The base-broadening option both reduces the rates and the extent of distortions. The welfare gains from the second approach would be much larger than from the first.

It should be recognized here that there is absolutely no economic reason why taxation reform should not be put in train immediately; there is no budget constraint. It would not be a difficult matter, for example, to design a revenue-neutral package that would reduce marginal income tax rates at all income levels, increase the progressivity of the total tax system, and provide scope for minimum wage rates to be held constant, or reduced, while the incomes of the recipients are increased.

A package of this sort has been used in several countries. It would be particularly attractive for France, because the French fiscal system has become one of competing incentives. Minimum wages are higher than elsewhere; wage subsidies are higher than elsewhere; and the taxes on low income earners are higher than elsewhere. Although the causality among those components is not certain, there is no doubt that the three are closely interrelated. It is for that reason that only a concerted approach to dealing with them is likely to overcome the political obstacles.

I notice that Mr. Landau has made no reference to industry policy or agricultural policy in his statement. I can understand that he may not wish to endorse the view attributed in the staff paper to the French authorities, that "...reform of the EC's Common Agricultural Policy...was a matter that concerned the EC members and should not be linked to the Uruguay Round of trade negotiations". Like Mr. Landau, I have spoken on this matter often in the past, and I do not wish to dwell on it today. But also like him, we should not endorse that particular view. On the contrary, I would hope that by the end of this meeting the Acting Chairman's summing up will be able to note that Directors explicitly rejected that particular view. For the rest, I agree entirely with the remarks that Mr. Goos has made on both industry and agricultural policy.

Mr. Koissy made the following statement:

The evolution of France's economic and financial situation in 1991 clearly shows how economic management can be upset by the kind of shocks that occurred in the last quarter of 1990. However, it is comforting to note, as is indicated in the staff report and Mr. Landau's statement, that the French economy has resisted these shocks. Since the start of the second half of 1991, signs of recovery are evident, in particular through the evolution of the main components of overall demand, and in the firming up of exports. Furthermore, the relatively low level of the external current account deficit, as well as the favorable inflation differential vis-à-vis France's partners in the G-7, have contributed to the strengthening of confidence in the French franc, and the narrowing of the interest rate differential vis-à-vis the German financial market. The low level of the deficit of overall government operations has also played a positive role in the favorable perception of the financial markets. The satisfactory evolution of the economic and financial situation shows the wisdom and good sense of the strategy pursued by the French authorities in recent years. In particular, fiscal and monetary policies have been appropriate, making it possible to maintain the policy of a strong franc and to pursue major structural reforms, which have contributed to improving the efficiency of the economy as a whole.

As I broadly agree with the staff appraisal and the recommendations in the report, I will limit my comments to fiscal policy, incomes and unemployment policy, and current structural reforms.

With regard to fiscal policy, the combined effects of an unfavorable economic situation and the pressures on overall expenditure--especially that related to social security and of local governments--made the task of the authorities in meeting their fiscal targets for 1990 more difficult. For 1991, thanks to the introduction of corrective measures, slippages from the initial targets will be limited. The authorities deserve congratulations for the flexibility and speed with which they have undertaken this fiscal correction during 1991. The target of maintaining the fiscal deficit in 1992 at its 1991 level in nominal terms, and the medium-term direction of fiscal policy announced in the draft fiscal law of 1992, seem appropriate. I also share the reservations expressed by the Government about the possibility of achieving the medium-term fiscal deficit target through the compression of expenditure. The margin for maneuver in this area has declined considerably because of measures taken over the past five years--and in 1991, in particular--to reduce the tax burden and contain expenditure.

Expenditure reduction measures have given rise to profound changes in the structure of central government expenditure, by continuously increasing the share in overall expenditure of public debt service and transfers--which are more difficult to cut. However, recent initiatives to contain the deficit stemming from health and pension benefits, by promoting competition in the health sector and a reform of the pension fund system, should contribute to loosening the constraints on expenditure reduction. Along with the rationalization of expenditure, those initiatives should allow the achievement of the medium-term fiscal objectives.

We agree with the staff's call for prudence in the area of local government expenditure, so as not to compromise the medium-term fiscal objective. Unfortunately, the staff report does not suggest any concrete measures in this area. Perhaps the staff representative could tell us about the prospects for containing the expenditure of local governments over the medium term.

We note with regret that unemployment is rising again, and that it is at a relatively high level despite the sustained economic growth of recent years. As Mr. Landau quite correctly emphasizes, this problem is a source of concern, calling for increased efforts by the authorities to find a lasting solution.

In this context, the multidimensional approach pursued by the authorities deserves to be supported and strengthened, as it should succeed in contributing to the reduction of the structural components of unemployment in the long run. However, given the competitiveness objectives, I agree with the staff's recommendation that the authorities should continue to rationalize the costs of employment and to pursue structural reforms so as to introduce greater flexibility into the employment market, while maintaining longer-term measures, such as retraining and the restructuring of the educational system.

With regard to incomes policy, it is reassuring to note that recent developments in wage costs have on the whole been favorable, and that the French authorities continue to place importance on the moderation of wage demands--a guarantee of employment growth--and an improvement in the competitiveness of the economy.

With respect to sectoral policies, we note that the submission to competitive bidding of companies in major sectors of the economy has been beneficial and has contributed to the improvement of the efficiency of the economy. This approach deserves to be continued.

I would like to express the appreciation of my constituency for the many forms of assistance from France from which it has benefitted. I would like to congratulate the French authorities for having increased the volume of their official development assistance contributions in 1990, at a time when they were facing considerable fiscal constraints. I would like to emphasize the important role the French authorities continue to play in the search for satisfactory solutions to the debt problems of developing countries.

Mr. Kyriazidis made the following statement:

Economic developments in France in recent years confirm the success and appropriateness of the adjustment strategy followed by the French authorities. They also confirm the significance of the consistency and continuity which have characterized these policies, and they have established the indispensable third C, credibility, as a fact of life. The strong rate of growth of GDP and the vigorous growth in employment, against the backdrop of declining inflation and external balance anchored on a stable exchange rate, would seem to indicate that the French economy is well poised for a period of solid growth and stability. This conclusion is not negated by the slowdown and the attendant tensions on the fiscal and unemployment fronts which the French economy is currently experiencing, and which are due chiefly to external factors, as indicated by the staff and Mr. Landau. The favorable prospects for the French economy in the near future are further enhanced by the reasonable expectation of a further decline in the rate of inflation in 1992 in a climate of strengthened confidence. The evidence for this is the significant reduction in the risk premium on French franc-denominated assets, which has allowed the authorities, as stated by Mr. Landau, to pass on to the private sector in terms of reduced interest rates the benefit of lower inflation, without visible exchange rate effects.

It is, however, true that although developments in the past three years have succeeded in arresting the relative decline of the French economy vis-à-vis its partners in terms of most of the relevant indicators, one cannot so far entertain the hope of a better than average performance in the near future, and this precludes any significant catchup in terms of unemployment, export market shares, or capital stock rebuilding. This appears, indeed, to be a major problem for the French authorities. Indeed, the French economy would require a substantial improvement in competitiveness if it is to reach a rate of expansion of the capital stock sufficient to reduce unemployment significantly over the medium term without serious negative effects on the balance of payments or a deterioration in price performance. It is rather disturbing to note that, despite the strong growth in investment in recent years, the rate of expansion of the capital stock is still inadequate even to stabilize the rate of unemployment. It is implied that the root cause is to be found in relative factor prices. I would welcome some more comments from the staff on this point, particularly as to the changes in relative factor prices which would be required in order to achieve a rate of growth in the capital stock that would be consistent with the desired reduction in unemployment, as well as the current account balance and declining inflation.

I find myself in agreement with Mr. Landau's arguments concerning monetary policy. The staff seems to believe--although this belief is not expressly stated--that the credibility of monetary policy might have been weakened by the reduction in interest rates led by the authorities. I find no clear evidence--as also pointed out by Mr. Landau--to this effect, at any rate if one is to judge from the apparent relationship between changes in interest rate differentials and the position of the French franc in the ERM. In fact, given the relatively steep reduction in interest rate differentials, the movement of the franc within the ERM would seem to indicate that the policy of the French authorities was not amiss. This conclusion is strengthened by the fact that the recent rise in German interest rates appears to have had no effect on the exchange rate of the French franc, despite the stability of French rates. With regard to monetary targeting, however, like Mr. de Groote, I have some doubts about its usefulness on a national scale in a liberalized financial environment. Of course, if monetary targeting is merely indicative, it might serve a useful purpose, provided that, in terms of policy decisions, the exchange rate target always takes precedence.

The authorities have been quite correct in moving vigorously to contain the increase in the fiscal deficit caused by the fall in revenues as a result of the slowdown in economic activity. Although there is some argument in favor of the automatic stabilizer policy, particularly if the cyclical downturn in activity is expected--as in this case--to be short-lived, I would agree with the French authorities that the maintenance of the credibility of their fiscal policy is a priority objective. However, as Mr. Landau acknowledges, the original fiscal target cannot be achieved either in 1991 or 1992 despite the measures taken, and thus one might say that the automatic stabilizer element has not been totally eliminated from the fiscal stance of the authorities. This might provide some consolation to any remaining Keynesians in the Board.

There seems to be some disagreement between the authorities and the staff as to the means by which the containment of the deficit has been achieved, and, more particularly, as to the wisdom of the increase in social security taxes. This is, of course, a part of the more general argument about the medium-term strategy in France, which appears to have relied more heavily on revenue increases than on expenditure reductions. In principle, I would be in agreement with the staff's view on the medium term. However, I do consider that a very considerable effort has been made by the French authorities in the direction of expenditure reduction since the mid-1980s. It is easy to see from Chart 6, however, that the effort has been mainly concentrated on the Central Government, while social security and local authority expenditures have been gaining momentum and, since 1989, have more than offset the positive results achieved in the central government accounts. In this situation, given the limited ability of the authorities to affect social security expenditures in the very short term, I would find some difficulty in criticizing them for raising social security taxes.

There can be no disagreement, of course, as to the overall objective of medium-term fiscal policy--that is, containing growth in expenditures sufficiently to allow a reduction in the tax burden, which is indeed very heavy in France. This is, as it should be, part of the structural reform program of the French authorities, as indicated both in the staff report and in Mr. Landau's statement. Priority is appropriately given by the authorities to social expenditures over the medium term. The proposed reform of the pension system is a major step in the direction of ensuring the financial balance of the system up to the year 2005 without an increase in tax contributions, notwithstanding the adverse demographic trends. Another important element in this strategy is the efforts contemplated by the authorities in the health insurance sector.

The staff provides an interesting analysis of the French tax system in support of its preference to shifting the tax burden from direct to indirect taxation. The major argument is drawn from the distortionary aspects of the existing direct tax system. The authorities, on their side, in order to support the disinflationary process, preserve the degree of progressivity in the tax system, and move toward tax harmonization with the EC, do not appear to be very favorably inclined to the staff's recommendations. Major tax reform efforts are, of course, unwise during a period of economic slowdown, since they can be very costly in terms of revenue. It would be appropriate, however, for the authorities to study measures that in the medium term would reduce the distortionary features of the income tax, expand the tax base, distribute the tax burden more evenly between wage and salary and other incomes, and raise the effective progressivity of the system, while reducing tax rates. The generalized social tax introduced this year has made a positive contribution in this respect, as also has the "deplaffonement" of health insurance contributions. A serious constraint on the authorities' possibilities, however, is the overall burden of social security expenditures, which require a form of taxation that inevitably tends to reduce significantly the progressivity of the tax system, as indicated by the staff, and recognized with some qualifications by Mr. Landau.

The arguments presented by both sides on this issue appear to stem from divergent philosophical approaches to taxation. This is not, of course, the occasion to discuss the issue in depth. I would be wary, however, of the argument that tends to relate, as the staff seems to do, welfare with the growth effects of given tax measures without reference to distributional effects. I would also be somewhat wary of arguments that appear to question the desirability of progressivity itself, because of what are called its "distortionary" effects. This approach might lead eventually to something like throwing the baby out with the bathwater.

Another aspect of the fiscal problem lies in what appears to be the lack of sufficient control and proper fiscal accountability of the local authorities. On this point, I fully agree with Mr. de Groote as to the need for serious in-depth study of this problem as a part of structural policies. It would indeed be most unfortunate if decentralization involved a shift of expenditures from the central government to the local authorities without adequate control, leading in the final analysis to a negation of the fiscal consolidation effort.

The structural reforms implemented by the authorities in their strategy have been very important and significant. The deregulation of the financial markets, the complete liberalization of capital movements, the strengthening of competition, and the reduction of subsidies to industry constitute very significant measures. Some measures have also been taken with regard to the labor markets, which have introduced a very welcome measure of flexibility with positive results. However, there remain very serious rigidities, which may well constitute major obstacles to the authorities' efforts both as regards the reduction in unemployment and the increase in the flexibility of the supply response of the French economy.

The staff focuses chiefly on the tax wedge between take-home pay and the cost of labor. I have some doubts as to whether this is such a decisive factor in determining the demand for labor. What really matters is the overall cost to the employer of hiring new labor in relation to productivity, and if this is comparable or lower in France than in other West European countries, as Mr. Landau points out, then the explanation should be sought elsewhere. Together with Mr. de Groote, I would think that structural unemployment in France cannot be explained simply in terms of prices. Further analysis is certainly required for a proper understanding of the problem, and this view is amply supported by the annex to the world economic outlook devoted to unemployment in industrial countries. With regard to low-qualified workers, I would tend to think that the minimum wage system can be a crucial factor in sustaining unemployment if it raises the cost of labor above the productivity yield. There are some indications that this may be the case in France, in view of the significant narrowing of the differential between the minimum wage and the average wage.

In a general way, the relatively low elasticity of employment to growth in France is a perplexing problem rendered even more thorny by the political difficulties involved in radical changes in the system.

One of the major positive developments in France has been the degree of wage moderation achieved, which has led to significant improvements in relative unit labor costs, business profitability, and competitiveness. Nobody can disagree that the maintenance of wage moderation in the future is a necessity as an incentive to investment in a world of high interest rates. Mr. Landau is quite optimistic about the immediate prospects. I am somewhat concerned, however, about the implications during the upturn of Mr. Landau's remark that appears to link wage movements--at least in 1991--with changes in male adult unemployment. I would welcome some elaboration on this point by Mr. Landau.

I am happy to concur with Mr. Landau that France has already achieved all the criteria of convergence set for the establishment of the European Monetary Union. The success achieved by the French authorities constitutes a major contribution to early progress in the direction that all members of the EC desire. France, in this respect, can well serve as a role model for a number of other countries, including, or should I perhaps say particularly, my own, in pointing to the proper way for the achievement of our common goals.

Mr. Peretz made the following statement:

Let me start, as Mr. Kyriazidis finished, by commending the French authorities for the determination with which they have continued to pursue firm monetary and fiscal policies over what is now an extended period, often in the face of a difficult external macroeconomic environment. The reduction in market interest rate differentials between France and Germany illustrates the degree to which the credibility of French policy is now established. In a long-term sense, I agree with Mr. Landau that the franc has made a great deal of progress towards being regarded by markets as a strong currency.

In the short term, the position is rather different, with the franc at the bottom of the ERM band, despite both a deutsche mark that is weak because of current market doubts about German policy, and a small interest rate differential in favor of the franc rather than against it. The test of when the franc's credibility has truly arrived will be when it rises to the top of the ERM and stays there even when German rates rise above French rates.

We are not quite there yet. But I do not regard such a development as necessarily impossible. But to get there I agree with the French authorities that particular caution is needed in present circumstances. A country cannot establish that degree of credibility by taking every opportunity to reduce rates within the ERM. On the contrary, France will have to be ready to increase interest rates should domestic indicators suggest such a rise is needed even if such a rise is not required to maintain the franc's position in the ERM. You will detect that my comments here are pointing in the opposite direction to Mr. de Groote's.

As I have said several times in this Board, one of the virtues of the ERM as it exists at present is that in principle different currencies could take on the role of nominal anchor. There can be beneficial competition between countries in anti-inflationary policy. But this requires that countries like France and, indeed, the United Kingdom, will make an independent assessment of domestic monetary conditions in setting interest rates--rather than blindly following every German interest rate move. I note the deutsche mark is the main anchor at the moment. It is a possibility, in principle, that other currencies can take on that role.

As to fiscal policy, here, too, the authorities face perhaps their most challenging period for some while, with the slowdown in growth that set in at the end of last year. I commend the authorities for the resolution with which they have continued to pursue the same central government deficit target for 1990/91 despite the economy's weakness. They are surely right too to see containing the deficit as one of the most important contributions the authorities can make to raising the level of national saving. Let me make a few comments, though.

First, the authorities seem to have been unwilling to address some of the largest distortions in the tax system. It is clear from the staff report that the authorities agree on the nature of the main distortions, but see severe political constraints; thus, reform of the income tax base is described as "impossible," and unification of enterprise income taxes "waiting for more propitious circumstances." There is a lot of concern about upsetting interest groups. There is never a convenient time for dealing with these kind of barriers to efficiency, but the longer they are put off the greater the economic costs will be. Indeed, I wonder whether the French authorities might not do well to heed the lesson of the Regan tax reform in the United States, namely, that it is possible to do the seemingly impossible in tax reform, in the face of the most difficult interest group pressures, so long as the reform package is comprehensive and seen to be fair. So I think the staff is correct to suggest that a medium-term fiscal reform strategy could have more chance of popular acceptance by dealing with all the major issues as a package rather than as individual issues.

On a different subject, I wonder also whether, over the medium term, it may not now be possible to make a contribution to fiscal consolidation in France--and in other industrial countries--by making reductions in defense spending. This is a subject that most countries will now be considering.

Meanwhile, the authorities should take action to avoid the tax slippage that they acknowledge as a risk for this year. I am also concerned that, while the central government deficit is projected to be close to earlier forecasts, the general government deficit has shown a significant overrun, mostly because of quickly growing local authority spending. The background paper indicates that this spending is not subject to sufficient financial controls. This is a problem that many industrial countries face. Could the staff comment on how that control would be improved?

Finally, let me make some comments on a few structural issues. First, rigidities in the labor market. I very much agree with the staff's view that the minimum wage discourages demand for unskilled labor, particularly of young people. And I agree with Mr. Evans's comments. While the minimum wage remains at its present level it is going to be a continuing drag on growth in the French economy. So I was very sorry to read that the authorities see the minimum wage law as "untouchable." My own solution would be to abolish the minimum wage law altogether; but short of that, its level certainly needs to be reduced. Otherwise, growth in the French economy is going to be inhibited for some time.

Second, I cannot resist a comment on the rather recondite subject of reserve ratios for banks, which gets a whole appendix to itself in the background paper. I have to say I did not find the appendix very convincing reading.

The only operational requirement for the exercise of effective monetary policy in a developed financial system is that the authorities should be able to influence the level of short-term interest rates in a predictable way. To do this the central bank must always be able to force commercial banks to borrow from it, at the interest rate of its choosing. There are circumstances in which the ability to increase reserve ratios may be a useful instrument to use to establish or re-establish the necessary shortages in the short-term money market. But in a modern financial system the same result can almost always be achieved by central bank open market operations--in the short- or long-term bond markets, for example, or by using foreign exchange swaps.

This, then, in my view, should leave the nonremunerated reserve ratio normally serving one purpose only--which is indeed the purpose it serves in the United Kingdom. It is a means of charging commercial banks for the services provided to them by the central bank--clearing services, for example, or banking supervision.

Finally, let me make a comment on agricultural policy. Here I thought the French authorities' suggestion that CAP reform concerns EC members only disingenuous. I agree entirely with Mr. Goos and Mr. Evans. France has an important role to play in securing a satisfactory outcome to the Uruguay Round--something from which France will benefit as well as the rest of the world. So let me take this opportunity to urge the French authorities to agree to an early and much-needed reform of the CAP, which would, I believe, be of great benefit to European Community countries, to the rest of Europe, and to the rest of the world, as well as to France.

Let me say again, in case these remarks seem somewhat critical, that I believe the overall conduct of French macroeconomic policy in recent years has been outstanding and in a sense is a lesson to us all, as Mr. Kyriazidis says. If my comments seem critical, they are made in the spirit of deep underlying friendship and close relations between our two countries for the last 900 years.

Mr. Ismael made the following statement:

I join other Directors in commending yet another year of good economic performance and admiring the authorities' continuing efforts to maintain stability while improving efficiency. French economic growth was surprisingly strong in the second quarter of this year, rising by 0.8 percent from the previous three months, and France thereby seems likely to have avoided a full recession. Under these circumstances, and coupled with the smaller than expected rise in the German Lombard rate last month, there is no need for the French authorities to reduce interest rates at this time. The deutsche marks' weakness today is not pronounced enough to allow the French authorities the extra leeway either.

I am in general agreement with the well-written, yet concise, staff report. Nonetheless, I am somewhat puzzled by the stress being placed on the need to sustain disinflation in a climate in which the inflation rate is already among the lowest in the world. While I would not by any means advocate expansionary financial policies, it seems that further lowering of the inflation rate should not be the most urgent task at hand.

In this same vein, I welcome the authorities' policy to achieve a steady reduction of the budget deficit as a means to reduce public debt-service expenditures; but even more importantly, it is a welcome vehicle for reducing the large role of the government in the economy--as can be seen from Chart 7 of the background paper--thereby increasing efficiency. Therefore, I endorse the staff's position that emphasis should be placed on expenditure cuts. In this connection, efforts should be made to contain expenditures not only when revenue shortfalls make it necessary in order to meet the budget deficit objective, but also when revenues exceed expectations. The progress made to date in restraining wage and subsidy expenditures is to be commended, but greater effort is still needed, especially as generous public wage increases can have a demonstration effect on the private sector and transfer payments still seem too high. A review of the Social Security System and the relationship between the Central Government and the local authorities would be very useful, indeed. I note from Table A26 of the background paper that "operating and other expenditures" of the Social Security System amount to almost 30 percent of total expenditures. Perhaps the staff could explain the composition of this item and the reason it is so high. I would also appreciate learning whether the law enables the Government to repay more expensive debt and replace it with cheaper debt, and if so, whether this is contemplated.

The authorities have also made notable progress in reducing labor market rigidities. Much, however, remains to be done, and I think the measures suggested by the staff are worth pursuing, including reviews of the taxation, social security, and education systems. An increase in employment would improve total welfare more than maintenance of rigid minimum wage or social security systems.

Similarly, a freer trading system would improve the welfare of the French consumer. I am disappointed that the authorities see no urgency in reforming the EC's Common Agricultural Policy in order to expedite conclusion of the Uruguay Round. With its competitive agricultural sector, France should be in a strong position to take the lead in making the EC market more open, reinforcing the role that France has played in support of developing countries in other areas, including official development assistance, where France's exemplary performance is highly appreciated.

Mrs. Krosby made the following statement:

The staff report provides some interesting food for thought about the policy predicament of a country experiencing low inflation and high unemployment in the midst of an economic downturn, and the policy stance of which is dictated largely by a neighbor faced with mounting inflationary pressures amid an economic boom.

The report emphasizes the handsome dividends that have accrued to France as a result of its strategy of competitive disinflation. Indeed, France's performance record over the last few years has generally been much better than that of a decade ago: growth is stronger; inflation is down; and the external position has strengthened. In recent months, France has even outstripped Germany on price performance, albeit with some help from the Germans themselves.

In other areas, however, the record is frankly not so good. Unemployment stands at over 10 percent. And, although the staff report touts the fact that the unemployment rate in France now matches that of its trading partners, this is hardly an achievement, since the comparison apparently is with other EC countries that, like France, have high unemployment associated with their links to the deutsche mark and/or serious structural problems in the labor market. Meanwhile, capital investment is widely acknowledged to be inadequate. The authorities themselves calculate that the capital stock would need to grow substantially faster than the current rate just to keep unemployment from rising. At the same time, the staff points to the need to replace France's aging capital stock, the legacy of poor economic performance in the 1970s and early 1980s, in order to improve competitiveness.

There is no escaping the fact that France bears a heavy cost in terms of investment, output, and employment due to the artificially high interest rates needed to maintain the franc's fixed exchange rate against the deutsche mark. Indeed, there is broad agreement that interest rates in France are higher than purely domestic economic conditions would warrant. The authorities reportedly consider interest rates abnormally high for this stage of the cycle. And the staff concedes that French policies are such that France could well have done with lower interest rates.

The staff credits the authorities for skillfully narrowing the differential between French and German interest rates, accompanied though it was by a weakening of the franc within its EMS band. There now appears to be little scope for a further narrowing of the differential, but this is hardly surprising. Although the credibility of French policy has increased in recent years, the market does not expect the franc to replace the deutsche mark as the anchor in the EMS. Hence, for the foreseeable future, however low inflation may be in France, interest rates west of the Rhine seem destined to remain higher than those to the east, and France will remain the captive of German interest rate policy. This state of affairs would be costly enough to the French economy if the two countries were at the same point in their economic cycles. But growth and employment have been markedly weaker of late in France than in Germany. When the imperative to invest that I mentioned earlier is factored in--both for employment and competitiveness--the cost of France's exchange rate policy should be clear.

Mr. Landau's statement generally ignores the complications policymakers face when they attempt to moor France in deep waters on Germany's short anchor chain. However, his statement does make quite clear--not that there has been much doubt--that the authorities are not about to add any additional scope to this short anchor line if doing so would call into question their commitment to the deutsche mark parity or their intention to continue to disinflate an already weak economy. This being the policy, France needs to compensate for weakened investment, growth, and employment prospects by embarking on a much more ambitious program of structural reform than recent performance or, indeed, this year's discussion, suggest that the authorities are willing to undertake.

Turning to structural issues, we are in substantial agreement with the staff on the priorities for structural reform. On fiscal policy, while France has been successful in reducing the size of the government budget deficit, spending, and consequently taxation, remain very high as shares of GDP. We therefore share the staff's regret that a substantial part of the fiscal adjustments being undertaken--at least at the general government level--are in the form of increased taxes, rather than reduced expenditures. We also share the staff's views on the desirability of a tax reform that would widen the tax base, reduce exemptions, and thereby permit a lowering of marginal rates and an improvement in incentives to work, save, hire and produce.

The staff report rightly draws attention to the roles of France's relatively large tax wedge between the cost of and return to labor, and the high minimum wage, in raising the unemployment rate, especially for young and unskilled workers. On the tax wedge, I confess I was not particularly convinced by Mr. Landau's suggestion that statistical discrepancies account for its significantly larger size in France. Moreover, to argue that the overall cost of labor in France is comparable to, or lower than, that in other EC countries seems to miss the point about employment. While the overall cost of labor obviously affects competitiveness, the overall return on labor determines whether employers are willing to hire additional workers, and the extent to which the workers themselves are willing to work. The staff's suggestion of a youth minimum wage is an interesting one. This may indeed be worth considering, especially since the authorities have already tried a number of other ways to reduce the cost of hiring young, unskilled labor that so far have been costly, but apparently not very effective.

With regard to agricultural policy, the French authorities assert that French agriculture is one of the most competitive in the EC. This may be true, but a better standard of comparison is the world. By this standard, French agriculture is not very competitive, as illustrated by the fact that most French farm product prices are held above world market levels by import protection, and the fact that most French agricultural products require export subsidies to be competitive in world markets. Indeed, France's very disappointing decision in recent days to block an EC initiative to give Eastern European agricultural products access to EC markets is further evidence that French agriculture is not competitive. Moreover, the authorities declare that their objective is to increase France's market share and external surplus in agriculture. This goal appears to be at odds with the goal of the Uruguay Round trade negotiations, which is to increase the world division of labor along the lines of comparative advantage. In this connection, we endorse the staff recommendation that France should play a key role in promoting reform of the Common Agricultural Policy on a basis that provides for convergence to world prices.

The staff report also draws attention to the authorities' resistance to trade liberalization in industries such as automobiles and electronics, as well as agriculture. The authorities reportedly respond by saying that the viability of domestic producers must be safeguarded to ensure that imports are not unduly concentrated in hitherto heavily protected markets. But this response seems to confirm the staff's observation. All countries have comparative disadvantages in certain industries, or are uncompetitive in particular industries for any number of reasons. As a result, imports often are concentrated in particular industries. A country committed to trade liberalization must accept this fact.

The staff report contains the authorities' claim that industrial policies have become more market-oriented in recent years. While this is generally true, the report says little about how much more remains to be done. For instance, the Government appears to be using state-owned banks to subsidize uncompetitive companies with loans and equity investments. In addition, the Government continues to subsidize Airbus Industrie. The authorities' claim of greater market orientation is closely followed by a statement of their intention to facilitate the expansion of small- and medium-size firms, with the goal of improving France's trade deficit in manufactures. This point seems inconsistent with a desire for greater use of market mechanisms.

In conclusion, we recognize and welcome the improved economic performance that France has registered in various areas under its policy of competitive disinflation. However, the authorities should not lose sight of the investment and employment costs involved, nor should they delay compensating for these costs by undertaking a much more vigorous program of structural reform.

Mr. Fukui made the following statement:

I would like to commend the authorities for their efforts to attain a relatively high rate of growth during the period 1988-90, even though growth in 1991 is expected to slow down. I also appreciate the authorities' success in restraining inflation, which has fallen from about 6 percent during the period 1983-87 to about 3 percent in recent months.

Despite these favorable outcomes, the French economy has various problems, to which serious attention should be paid. I would like to comment on four major points: first, the high rate of unemployment and inefficient labor markets; second, the implementation of monetary policy and exchange rate policy; third, the fiscal deficit; and fourth, the protective industrial policy.

The unemployment rate--at 9 percent in 1990--is expected to rise further, owing mainly to an increase in unemployment of the younger age group. It is surprising that the staff report stated that the unemployment rate of the 14-24 age group is 25 percent for females and 15 percent for males. Under these circumstances, the authorities made efforts to increase job opportunities for the young and unskilled by lowering the hiring cost and providing them with various training programs. However, the effects of these measures taken by the authorities are limited by budget constraints. In order to eliminate social instability and to establish more efficient labor markets, it is imperative that the level of the minimum wage be lowered, in particular for those of younger age, and to restore the flexibility of real wages.

With regard to price developments in 1992, Mr. Landau's statement mentions that France will have the lowest inflation among the G-7 countries in 1992. However, according to the staff's estimate in the World Economic Outlook, France will rank second in terms of the GNP deflator among G-7 countries in 1992. The authorities' clarification of this would be appreciated.

The authorities declared that the first priority for the implementation of monetary policy is to maintain the value of the franc vis-à-vis the deutsche mark. Consequently, interest rates in France have been at around 10 percent in nominal terms and 7 percent in real terms. I wonder whether these high interest rates have an adverse effect on the real economy, which has already begun to stagnate.

Regarding the intermediate target of monetary policy, I would like to ask the staff about the meaning of M3. The authorities stated that making M3 the intermediate target is the best way to attain credibility in policy implementation. However, there is ambiguity as to whether or not there has been a stable relationship between M3 and the real economy. According to the experiences in industrial countries in the 1980s, it was somewhat difficult to find a stable relation between the monetary aggregates and the real economy, owing mainly to the disintermediation caused by the liberalization of the financial system. On this point, I would like to hear clarification from the staff or the authorities.

On the fiscal front, I welcome the fact that the fiscal deficit against GNP declined from 3.3 percent in 1985 to 1.4 percent in 1990. However, this was due to an increase in the tax rate, and not to a cut in expenditure. The main reason for the difficulty in reducing expenditure is that approximately 43 percent of total expenditure is allocated to social security related items. Besides, the revenue side has the problem that the household and corporate income tax have many shortcomings because of distortions stemming from various kinds of tax exemptions. Therefore, more than half of total revenue depends upon the value-added tax. As a result, the top rate of the value-added tax was 28 percent in 1989, although it was reduced to 21 percent in 1991. However, the standard rate of the value-added tax is 3.6 percent higher than that of Germany. Further efforts are necessary to make the value-added tax rate converge with the rates of other EC members.

Regarding industrial policy, the automobile, iron and steel, electronics, computer, and aircraft industries are owned by the French Government. Therefore, the share of products and services of the state-owned industries is estimated at approximately 30 percent of GNP. This figure seems to be the highest in the industrial countries. As the staff pointed out, the high cost structure and inefficient management are deep-rooted in these state-owned industries. Under these circumstances, it is imperative that privatization policy be pursued further. In this context, I welcome the fact that the authorities allowed private participation in public enterprises up to 49 percent of equity this year. However, outright privatization still remains suspended. In order to eliminate inefficiency in public corporations, outright privatization should be permitted.

According to the EC's estimate, subsidies in the manufacturing sector were equal to approximately 3.7 percent of value added in France. These subsidies tend to be obstacles to strengthening the competitiveness of industries. It is widely acknowledged that the best way to strengthen the industries is to expose them to the front line of international competition. I hope that the authorities will take broad and courageous steps to implement open policies, including outright privatization, and to eliminate industrial subsidies.

Mr. Végh made the following statement:

Since the mid-1980s, France has embarked on a program of stability and growth. Fiscal deficits were reduced on a step by step basis, monetary discipline was pursued, and exchange rate stability achieved through the participation in the Exchange Rate Mechanism (ERM). At the same time, important structural reforms were implemented, restrictions on capital movements were eliminated, subsidies were reduced, and a more competitive environment was put in place. The more commendable aspect of recent economic developments in France is the medium- to long-term perspective from which the French authorities approach the drafting of economic policies. In reading the background material, one gets the impression, however, that the pace of economic transformation in France should be accelerated, particularly when one takes into account its growing importance in world economic affairs and the pressing needs arising from the political and economic transformations presently taking place.

The slowdown of economic activity in France, due in part to the decline of world economic activity, has been the most important factor in economic developments last year. It is under these circumstances that the weaknesses and strengths of the economy become apparent, and that the quality of the policy being implemented is tested.

The slowdown in economic activity impinges on the fiscal result through reduced revenues, which presents the dilemma of reducing expenditures or increasing taxes in order to achieve the desired fiscal results. It is commendable that the French authorities have taken measures to preserve the projected deficits in spite of reduced revenues. The deficit in the public accounts and the relatively high percentage of public debt to GDP, which have shown an increasing trend in the last years--reaching almost 39 percent of GDP in 1990--are important reasons to try to prevent increases in the budget deficit. I agree with the staff, however, that increasing taxes is not the best way to cope with reduced revenues, particularly when the taxes being increased contain distortionary elements, such as social security contributions, which affect labor markets through higher labor costs. Moreover, there is little leeway to increase taxes, as the level of taxation in France is already high. In this context, for reasons of maintaining competitiveness, coupled with the tax harmonization principles of the European Community, any increase in fiscal pressure will have to be limited. Expenditure reduction, therefore, is the only alternative open to France's authorities in order to achieve the targeted fiscal results in the short run, and internal balance in the medium term.

Also with respect to the revenue side of the budget, I note that the staff is not in favor of compensating for reductions in the value-added tax rate by increasing direct taxes, as the French authorities seem inclined to do. I believe that the authorities' arguments are sound, based as they are on European Community tax harmonization laws. The staff's concerns on the large number of exemptions in the direct tax area are also valid. The key objective appears to be how to eliminate the excessive number of exemptions or loopholes in the area of direct taxes. It is noteworthy that the apparently progressive tax structure of France becomes regressive when the burden of social security contributions and the exemptions attached to the direct income tax are considered; here, there is a clear need for reform.

There is a need to reduce public expenditures. In the labor market area, the traditionally high level of unemployment has been further affected by the slowdown of economic activity. Two permanent problems are pointed out in the staff paper: the low skill level of the unemployed, and the relatively high minimum wage. Political considerations are seen as an impediment to overcoming the latter problem. The fact is, however, that the high level of unemployment translates into a heavy fiscal burden, while the problem remains unalleviated.

Although there is no specific indication in the staff report as to the level of support in the area of agricultural products, Chart 8 of the background paper on recent economic developments shows that the level of support is close to 3 percent of GDP. For a country with an agricultural sector that represents only about 4 percent of GDP--Table A-10 of the background paper--that is a very large figure, which in turn results in a large impact on public expenditures. In this respect, I welcome the decision of the authorities to allow internal agricultural prices to reflect world market prices, even though on the condition that the process of conversion will not be swift. Given the pressing needs of developing and agricultural product exporting countries, the sooner such a convergence with world prices is achieved, the sooner will the long-sought external viability of many developing countries take place, including countries not only of my constituency, but also of Central and Eastern Europe. I therefore encourage the French authorities to make public that commitment, and to accelerate that process, which will assist a successful conclusion to the Uruguay Round.

With respect to industrial policy, I was surprised to notice in the background paper that public enterprises are increasingly burdening the budget through capital transfers--reaching F10.4 billion in 1990. An industrial policy based on financial and tax incentives for the development of small- and medium-sized enterprises is under way, which will result in an additional fiscal burden. It is equally surprising to read in the staff report that this support to small enterprises is linked to the desire of the Government to eliminate the trade deficit in manufactures. The reason for this policy goal is not clear. There is nothing wrong with having a trade deficit in some goods and a surplus in other goods or services. However, even if the concept that French industry needs to become more competitive in external markets is accepted, I doubt that the best way to go about it is by increased support to small- and medium-sized enterprises. I wonder whether a revamping of public enterprises through a full-fledged process of privatization would not have more favorable consequences, both for the external and the internal accounts.

I was particularly interested in Appendix II of the background paper, which referred to the relationship between the French and German currencies. That appendix shows that, starting with the German unification process, the franc is taking a more important role in the EMS than it had before. This supports the point I made earlier about the great responsibility of the French authorities not only with respect to the European Community, but to the entire European common house, as Mr. Gorbachev put it a few years ago, and to the world community at large.

The staff representative from the European Department stated that, with respect to the latest developments, growth in France in the second quarter of 1991 had rebounded to an annual rate of about 3 percent-3-1/2 percent. Wage developments had been somewhat less auspicious; after having risen at an actual rate of 1 percent in the first quarter, they had risen by 1-3/4 percent in the second quarter, albeit for partly structural reasons related to the reform of wage scales. The budget for 1992 was not finalized at present, but the staff expected it to be more or less consistent with what was implied in the staff report. One feature was likely to be the unification of corporate tax rates at a rate of 33-1/3 percent sought by the staff. The monetary aggregates--which had been outside the band at the time of the staff mission--had moved back within the band in recent months. Regarding France's good inflation performance compared with that of other G-7 countries, it was true that some of the difference might have been due to the choice of inflation indicator, as France's inflation performance as shown in the consumer price index was indeed better than that shown by the GNP deflators.

He welcomed Directors' support of France's stance of actively seeking to achieve the nominal fiscal deficit targets, despite the slowdown in activity, the staff representative commented. The danger associated with nominal fiscal targeting as practiced in continental Europe was the tendency to lose sight of controlling spending over the medium term. During the past economic upswing both in the Netherlands and in France, the governments had been candid about the fact that they had spent more when revenues were buoyant than they really ought to have done, and that they wished they had implemented a more cautious policy, in retrospect. In that context, it was important to be symmetrical and to observe the same rules during an economic downturn as during an economic upturn. Otherwise, notwithstanding the commitment to nominal targets, the Government would be forced to raise taxes over the cycle, to the detriment of the long-run strategy of holding down spending and taxes. A clear view of the desired level of spending over the medium term was thus necessary.

Local authority taxes were problematic in France, as they often were in other countries as well, the staff representative observed. The problem in France was twofold. First, as part of the agreements that had been made between the Central Government and the local authorities at the time of decentralization, the local authorities had been given a tax treatment which had not allowed for the fact that the Government would attempt to cut taxes over the medium term, and they had therefore started from a very high and generous tax base, which had permitted a rapid increase in expenditures. That tax treatment took various forms, including the formulas for transfers, and the exclusion of certain kinds of local taxes from income when calculating central government taxes. The second problem was the lack of financial control, as there were no controls on local authority borrowing, and very few mechanisms to make local authorities' actions transparent to the public and the electorate. The French Government had programs under way to make the local accounts more transparent, and to scrutinize local authority borrowing more closely. The Central Government had also wished to reduce the implicit or explicit transfers through the tax system to the local authorities, but that course had been very difficult politically, as representatives in the National Assembly were themselves often part of the local authority establishment.

With respect to the measurement of the monetary aggregates, the staff had not examined the question of the stability of the new definition of M3 in any detail, the staff representative stated. However, the authorities believed that M3 was sufficiently stable for their purposes, and far more stable than the old definition of M3 had been. There was always the issue of the pertinence of monetary aggregate targets under a fixed exchange rate regime, however. On purely analytical grounds, and using the small open economy model, money was endogenous and, therefore, not too much significance should be attached to deviations of the aggregates from their targeted path because of random shocks. The staff strongly supported the authorities' view that, in the final analysis, the exchange rate was the main target of monetary policy, not the growth of the aggregates. Undue importance should therefore not be attached to the monetary aggregates in themselves. That being said, however, it was clear that the French experience with the monetary aggregates would be useful background for work on the monetary unification of Europe, when control over the monetary aggregates would be different from what it was at present, although the exchange rate regime would be the same. The monetary aggregates should be viewed in that light, rather than as especially useful in the longer-term context as indicators of the present stance of French monetary policy.

When considering interest rates, it was fundamental to be clear on whether the exchange rate parity was fixed or not, and in the case of the franc, there was overwhelming evidence that it was fixed, the staff representative remarked. Given that assumption, there was the further question of the anchor currency of the system--whether it was the deutsche mark, or whether an evolution to a more shared approach had taken place. If the deutsche mark was viewed as the anchor, then, as Mrs. Krosby had said, France could not have a negative interest rate differential vis-à-vis Germany; as long as the deutsche mark was the anchor of the system, and the franc could not appreciate vis-à-vis the deutsche mark, then capital market arbitrage conditions meant that France could not have interest rates below those on German paper. Of course, that statement could be qualified to some extent--taking into account liquidity effects and taxes, as Mr. Spencer had done in relation to the recent Board discussion of the Article IV consultation with Sweden (EBM/91/115, 9/6/91), and depending upon where the franc was in the band; but in terms of basic monetary relationships, the statement would stand. In the past, there had been a large positive interest differential reflecting exchange rate uncertainties. The French Government had moved aggressively, and successfully, to reduce it--in fact, to about 30 basis points on both short- and long-term rates in March/April 1991. It was in that context that there appeared to be limited room for maneuver.

In the longer term, there was the question of the reference point of the system of whether or not the anchor was going to change, the staff representative went on. It seemed that something was indeed changing in the system, but whether that was because of an improvement in the quality of French policies or of rising uncertainties with respect to German policies could not be determined absolutely; it was probably some of both. There clearly were opportunities for France to acquire more anchor-like attributes and thereby possibly to achieve negative interest rate differentials vis-à-vis Germany; the recent evolution of inflation performance pointed in that direction. However, the management of the exchange rate within the ERM band was an important offsetting consideration. In that respect, the French policy of keeping interest rates as low as possible and the franc at the floor of the band in the short run was counterproductive to achieving the longer-term objective of achieving a greater anchor role for the franc. In that context, it needed to be remembered that success in eliminating past risk premia did not prove policy independence, as the dependence on the reference currency--in this case, on the deutsche mark--for the evolution of monetary policy still remained; the elimination of the risk premia was only a symbol of the improved confidence of the market in the policies followed.

The effect of the level of real interest rates on the French economy had been a matter of some debate between the authorities and the staff for some time, the staff representative continued. The French authorities argued, on the basis of the empirical evidence, that interest rates had no influence on the French economy. It was difficult to find empirical evidence to prove the contrary. However, the staff had always argued that relative prices and interest rates mattered, and that the position of the French authorities was too extreme. In any case, it was going too far to say that the current problems of the French economy were due to high real interest rates; although real interest rates might explain part of the problem, the most significant factors lay elsewhere, in the staff's view, notably in competitiveness and structural rigidities.

The staff and the authorities agreed that France had a competitiveness gap in terms of wages that needed to be closed, the staff representative went on. Real wages were too high, as was the real exchange rate. The spread was probably not very wide--perhaps of the order of 5 percent. The authorities' strategy was to eliminate the overvaluation of the real exchange rate through disinflation, which, given the commitment to a fixed exchange rate, would improve competitiveness over time. The statistical evidence indeed showed that the authorities had been moderately successful in terms of wage developments in that regard. The strategy was essentially that of lowering the real wages in France relative to those in partner countries, thereby increasing the return to capital, increasing investment, and increasing the supply side of the economy, thus permitting the economy eventually to move to a growth rate with an employment performance comparable to that of partner countries, without placing any strains on the external position. That strategy was basically endorsed by the staff.

Structural policies were all the more important in the context of the kind of policies the authorities were pursuing, as Mr. Evans had noted, including in the area of wages, the staff representative observed. While French labor costs, when converted simply from francs into deutsche marks, for example, appeared to be competitive, an important gap between France and Germany could be found in labor productivity, which accounted for many of the structural problems of the French economy. It was in that respect--not in direct wage costs--that the French competitiveness problem could best be understood. That consideration lay behind not only the need for wage moderation, but also the emphasis that the French authorities had placed on controlling social security expenditures, which were a component of labor costs; wage moderation was one way to improve competitiveness, but a reduction in labor costs, such as through a reduction in social security contributions, was an equally good way.

With regard to changes in the tax structure, it needed to be borne in mind that, from a purely analytical and theoretical point of view, there was no reason for choosing a value-added tax over a direct income tax, and in that respect the staff itself had no preference, the staff representative pointed out. Nevertheless, because it was politically very difficult in France to initiate a reform of the system of direct taxes, the staff had believed that the authorities should reconsider the strategy of lowering the value-added tax rate in line with those of EC partners. Moreover, the problems in France stemmed in part from past policies which had increased greatly the reliance on direct, rather than indirect, taxes, because of tax harmonization within the European Community, and that, together with the greater distortions attached to the direct income tax system, had meant that the distortions were getting worse over time. Although there was clearly the possibility of eliminating those distortions through reform, the trend had been in the opposite direction.

The staff had been mindful of the issue of progressivity in considering taxes, the staff representative from the European Department commented. In fact, the staff had analyzed the effect of a value-added tax on two different groups--low-income households, and high-income households. The staff had observed that the formally very progressive system of taxation in France was in fact not progressive.

Mr. Kyriazidis said that in the staff's argument in favor of an increase in the value-added tax rate had not considered the distributional effects of such an increase. In his view, the argument that, because the direct system of taxation was actually less progressive than it appeared at first, it could therefore be abandoned in favor of an indirect system that improved the fiscal accounts but which might not consider the issue of progressivity, was a flawed one. He agreed with Mr. Evans on that score.

The staff representative from the European Department replied that the staff took it as a premise that issues of progressivity should be decided by the authorities. After the authorities had identified those objectives, the staff would attempt to find the best set of taxes to achieve them. A detailed analysis of the French tax system would uncover many opportunities for reducing distortions and increasing progressivity through tax reform. The staff itself had no views on what the degree of progressivity should be, but it had been careful to try to isolate what the implications of its recommendations were for progressivity issues.

Mr. Kyriazidis said that he wondered whether progressivity would be improved or lessened if income tax rates were lowered by 2 percentage points and the value-added tax rate raised by 1 percentage point.

The staff representative from the European Department responded that even though there was no question that the current system of income tax rates was progressive, the answer to Mr. Kyriazidis's question would depend entirely upon what was done to the structure of exemptions. Progressivity was completely undermined by numerous exemptions; there was ample opportunity for reducing the rates and making the system more progressive by curtailing exemptions. In any case, the staff's analysis kept track of the effects on rich and poor households separately, and suggested that the kind of change in taxes that Mr. Kyriazidis had referred to would have the same impact on the welfare of both low-income and high-income households.

Mr. Landau observed that intertemporal considerations--distributional effects between generations--needed to be taken into account in any discussion on the welfare effects of various changes in the tax structure. A value-added tax was a tax only on consumption, which implied that it was more favorable to saving compared with an income tax. In a country such as France, where the savings rate of private households was rather low, such a consideration could be very important.

The staff representative from the European Department remarked that a value-added tax was in part also a tax on wealth--a point that was often forgotten in the European context, and which the European trade unions tended to ignore. Ultimately, the purpose of wealth was consumption; therefore, by extension, a tax on consumer goods amounted to a tax on wealth. Most European countries seemed to be moving toward a system under which it became increasingly difficult to tax capital, so that, in effect, the only thing left to tax would be wages, as it would be extremely difficult to catch in the tax net the nonwage part of incomes. The staff would argue that, for reasons of equity, it would be better to tax the expenditure side, which could not evade the tax net. From a wider perspective, therefore, it was probably more equitable to tax expenditures than incomes.

Mr. Peretz commented that the value-added tax might be a tax on wealth, but what was more important, it was a tax on the use of wealth. The danger of wealth taxes in themselves was that they taxed saving as well as spending. Since most European countries had problems of saving, it was a mistake to tax wealth as such. Of course, taxing expenditure had the additional virtue--that Mr. Landau had pointed to--of encouraging savings. The value-added tax was not like a traditional wealth tax, which was a tax on money that had been saved as well as on money that had been spent.

Mr. Evans stated that if an expenditure tax was a tax on wealth, it was a regressive tax on wealth. The issue of non-labor incomes and the income tax had to be addressed directly. It had been addressed by other countries with integrated economies, and it could be addressed through tax administration that moved ahead of where the European Community had gone in terms of the identification of tax payers, but it could not simply be ignored by going to a second-best solution.

Mr. Kyriazidis said that, in relation to Mr. Landau's observation about the need to take into account intertemporal considerations, the contributions to social security and the pension scheme were a form of deferred income. Those constituted another kind of intertemporal income transfer that could not be equated with normal income taxes directed toward financing government expenditure.

The staff representative from the European Department said that in the past, risk premia had applied to French interest rates relative to rates on deutsche mark instruments, and the direction of causality had clearly been one way--from the deutsche mark to the franc. That relationship was currently less precise, and the direction of causality more ambiguous. French and German interest rates had converged more, but the determinant behind that causality had become more complex, tied to uncertainties in Germany, on the one hand, and improvements in French policy, on the other hand.

Mr. de Groote observed that Mr. Ismael had questioned the need for the French authorities to continue such a strong stance of fiscal policies while inflation was low. Thus, there was no unanimity in the Board on that point.

When the staff had convinced his Belgian authorities to make a strong statement in favor of an alignment of the exchange rate with the deutsche mark, the staff's main argument had been that if the risk of exchange rate movements was eliminated, the only forces that could come into play in the determination of any interest rate premia were inflation differentials, Mr. de Groote recalled. In Belgium, the rate of inflation had fallen to below the German inflation rate, and interest rates had fallen below German interest rates. Over the long run, therefore, the main determinant of interest rates in the absence of an exchange risk was the inflation differential. He would therefore not be surprised that what had happened with regard to a small country that did not play a very important role in international payments would also apply to a larger country. Once those who invested and saved were convinced that France was not going to abandon the peg to the deutsche mark, and that the French inflation rate would remain low, or lower than the German inflation rate, then he could not see why French interest rates could not fall beneath German interest rates. The staff's assumption was that people always referred to the interest rate in the anchor currency, but they only would do so if there was a risk of a change in the exchange rate; if there was no such risk, then the anchor became only a nominal anchor, which did nothing else but allow inflation differentials to express themselves. Perhaps Mr. Posthumus could say whether or not the Netherlands had also had such an experience.

Mr. Peretz said that he agreed with Mr. de Groote. Also, the way to get French interest rates below German rates was not to take every opportunity to reduce French rates within the exchange rate mechanism (ERM), but rather to establish a degree of credibility so that the market would believe that there was a possibility that, if there ever were a realignment of the ERM, it would be in the opposite direction--that is, that the deutsche mark would be devalued against the French franc. If, in order to reduce French interest rates, the franc were to be devalued within the ERM, as one speaker had suggested, the result would very quickly be not just a devaluation of the franc, but an increase in French interest rates to a point well above where they were at present. Therefore, countries such as France and the United Kingdom were faced with only one option by which to reduce interest rates, namely, to act in a prudent fashion to improve the country's credibility in the market over the long term.

Mr. Landau stated that he was not certain as to the technicalities of the differences in comparing France's inflation performance as measured by the change in the consumer price index as against the GNP deflator, and he was not certain that France's performance would turn out to be better than Japan's in that regard. Nevertheless, it was clear that France's performance would be very close to Japan's, a fact which his authorities were proud of, given that Japan was the inflation standard against which others had to be measured in the decade of the 1980s.

There were a number of assumptions underlying the questions that had been raised on the effect of France's exchange rate strategy on growth, and on employment in particular, Mr. Landau continued. The first was that there was a link between the exchange rate strategy and the inflation and employment performance, and that a tradeoff existed between inflation and employment. The reason the authorities had embarked on the exchange rate strategy that they had was because they did not believe that there was such a tradeoff, at least in the context of the French economy. In their view, the optimal strategy for achieving long-term growth was to strive for the lowest possible rate of inflation, regardless of developments abroad. The appropriateness of that strategy had been largely proved over the preceding three years, as the firmer exchange rate policy had not led to problems with the overall growth performance. On average, growth in France had been at least equal to--and perhaps a bit greater than--that in other industrial countries over that period, and the export and trade performance had been much better than might have been expected in the light of the increase in the real effective exchange rate of the franc--by several percentage points--that had occurred over that period. Also, export market shares and export volume had generally held up well, despite the decrease that had been seen in the first half of the 1980s; in fact, the latest statistics showed that growth in the volume of French exports over 1985-91 had only been exceeded by growth in the volume of U.S. exports--which, in a way, seemed almost too good to be true. There was thus no link between the authorities' anti-inflation strategy or exchange rate policy and the growth performance. The key problem was rather the relationship between growth and unemployment, where tax policies and the structure of the labor market were the important issues, not exchange rate policy.

Another assumption behind the questions that had been raised on the exchange rate strategy was that France's interest rate policy was unduly constrained by what was happening in Germany, Mr. Landau went on. However, the real puzzle was the difference in real interest rates between Europe and the United States, which he had great difficulty in explaining in purely rational economic terms. The existence of that difference was an enigma, given that capital was as mobile between Germany and the United States as it was between France and Germany. Perhaps the difference might be due to some exchange rate uncertainty between the United States and Europe, but he would doubt that anyone would argue to reintroduce that uncertainty inside Europe; or perhaps there might be a temporary risk premium attached to German securities due to the consequences of German reunification. In any case, the interest rate differential between France and Germany had been reduced, which meant clearly that the market had perceived part of the risk premium as being German-specific and temporary. To a certain extent, risk premia in other European countries might have been affected by what was happening in Germany as well. If that was true, it would apply regardless of the exchange rate and interest rate policies France pursued. Therefore, he would subscribe fully to what Mr. Peretz had said--that, in the medium run, regardless of what was done with respect to the growth or the exchange rate strategy, the authorities would have no control over the real exchange rate or the real interest rate. The objective should therefore be to obtain the optimal fiscal policy mix in Europe. In that regard, the authorities welcomed the actions taken by the German authorities on the management of the exchange rate inside the band, and its link with interest rate policy.

The authorities' inflation objective was an absolute one, not a relative one, Mr. Landau stated. The authorities would do whatever was necessary with respect to the interest rate or the monetary aggregates to ensure that the inflation objective would be attained. With regard to whether or not interest rates should be guided by the position of the franc inside its fluctuation band, he would answer both "yes" and "no"; yes, to the extent that the authorities would do whatever was necessary on the interest rate front to keep the franc inside its band, and, therefore to a certain extent interest rate policy was constrained by that; and no, to the extent that the authorities would allow for some flexibility inside the band, so that the unpredictability in the exchange rate essential in any band system could be maintained, and in order to maintain an anchor in the European monetary system (EMS). An anchor should be a currency that was constantly at the upper end of its band. What ultimately determined an anchor was the market's perception of economic policy and economic performance, which was in turn dependent on the performance of inflation and the current account. That was part of the reason why the attainment of medium-term current account balance continued to be an objective of French economic policy. The franc could not become an anchor--or even a co-anchor, as Mr. Goos had said--in the EMS in the full meaning of the word as long as France had a current account deficit.

The issue of the investment performance of the economy and its relation to growth had been raised by a number of Directors, Mr. Landau recalled. Investment performance had caught up over the preceding three or four years, and overall investment growth had been parallel with, or even a bit better than, that in other partner countries. There was however still some way to go because of the very poor performance at the beginning of the decade, and because of the need to modernize some of the capital stock.

The prospects were for potential output growth of about 3 percent in the medium run, which was what would be needed merely to stabilize--not reduce--unemployment, Mr. Landau observed. Potential output would have to be increased if unemployment was to be reduced significantly in the medium term. Mr. de Groote was correct that there might be a dilemma posed by reducing unemployment and the current account objectives he had just described, but wage moderation was the key to resolving it. While there was no immediate competitiveness problem in France, in the medium term wage moderation would be essential to provide the room for further investment in the capital stock.

According to the French econometricians, the recent moderation in wage pressures that Mr. Kyriazidis had identified was due to the fact that unemployment was concentrated in that part of the labor market with the largest impact on wage inflation, Mr. Landau explained. He suspected that there was another aspect to that phenomenon, however, that would not appear in the equations for some time--namely, that a change in the expectations of wage earners was taking place, to the extent that they were being influenced increasingly by developments in financial policy and the exchange rate.

He was not certain that the productivity of labor in France was below that in Germany, Mr. Landau remarked. The rate of increase of labor productivity in France had been comparable with that in Germany. The key explanation was that France increased its productivity in a much less favorable way, from the perspective of employment, than did Germany--that is, by increasing the capital/labor ratio, which, ceteris paribus, suggested that the unemployment situation would not improve, rather than by raising the quality of labor through manpower training and better education. Even if the figures were the same, the economic mechanisms behind them were very different, and their impact on unemployment was very different. Thus, it was more a question of the interaction between wages, capital formation, productivity increases, and unemployment, than of direct competitiveness.

With respect to industrial policy, it needed to be borne in mind that France had a history of industrial activism, although it had declined recently, Mr. Landau commented. The agreement between a major Japanese computer firm and a major French computer firm that had been successfully concluded recently, which had been in danger at one point of being overturned, bore witness to the fact that the trend of such activism was downward. Industrial subsidies, as a percentage of GNP, had fallen in France for the previous five years, and were currently comparable with the level of such subsidies in other European countries. The Commission of the European Communities would ensure that industrial subsidies did not increase in France. The "taboos" that had existed before about private control of public companies were also finally in the process of being broken. In April, a decree was passed that allowed public companies to yield up to 49 percent of their capital stock to private partners, and discussions on the potential for further privatization were continuing. In that connection, as Mr. Ismael had noted, the issue of substituting less-costly equity for debt needed to be considered.

The introduction of specific measures to assist small- and medium-sized enterprises could indeed create distortions, but it needed to be recognized that such enterprises already confronted distortions themselves, in the form of inadequate access to capital markets and certain structural factors, Mr. Landau concluded. The measures that were being taken were intended only to eliminate those distortions. On the issue of corporate taxes, he would not rule out the possibility of a reduction in the top tax rate, but the process might be step-by-step, with a faster introduction of a reduced top rate for smaller enterprises.

Mr. Posthumus made the following statement:

> The staff rightly praises the well-balanced French macroeconomic policies. The priority given to disinflation in the past years has clearly borne fruit. France is becoming a strong pillar for stable, sustainable growth in the Common Market and, therefore, of strength to face the challenges that lie ahead for Europe. However, there must be no complacency, as there is still much to do to strengthen the economy. I will concentrate on some aspects of what has to be done regarding monetary policy, fiscal policy, and policies in agricultural and product markets.
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> In the past year, France has seized each opportunity to ease its monetary policy, succeeding in doing so until now without undermining public confidence in its disinflation objective. Recently, for the third successive time, France did not adjust its official interest rates when German rates were increased. As the staff points out, the room for maneuver appears more or less exhausted, and monetary policy should readjust to take account of the impending economic recovery--first to second quarter growth was 0.8 percent, which amounts to 3.2 percent on a annual basis. This will ensure, on the one hand, that the internal objective of price stability is achieved--inflation is still at 3.4 percent--and, on the other, that France contributes to the external objectives of avoiding strains in the EMS and of convergence within the EC. The argument of the authorities that real interest rates were considered abnormally high for this stage of the cycle, which would support a relative decline of nominal interest rates, is interesting, but not very consistent with the EMS. It is not possible to use interest rates at all times both to support economic activity and to maintain the position of the franc in the EMS. In the present situation, however, the impending recovery and the position of the franc both point to the need to be more cautious with respect to interest rate policy. The monetary easing has led to a continuously weak franc in the EMS, which in fact seems to exclude an interest rate durably lower than in the

other hard currency EMS countries. The loss of foreign exchange reserves in the first five months of this year also appears to point to a somewhat too rapid loosening of policy by the monetary authorities. According to the Bank of France's weekly report, reserves dropped by 12 percent in this period. The actual use of reserves was substantially larger, but was not fully apparent, as a result of the revaluation of reserves following the dollar appreciation, while part of the support to the franc resulted in an increase in reserves elsewhere, rather than in a loss of French reserves.

At present, there is a risk that the markets will conclude that political priorities determine interest rate policy, thus ruling out the possibility of a stronger franc within the EMS-band, because the Bank of France lacks the autonomy to establish a two-sided risk in the band. If this market perception grows, the chances of a durably relatively low interest rate will diminish.

France is one of the few countries in the EC that satisfies the budgetary criteria being considered in the framework of European monetary union (EMU). The authorities' continuous efforts to reduce the budget deficit deserve praise. I fully support the authorities' approach to fiscal policy, including the refusal to use the automatic stabilizer approach at this time.

I am concerned, however, about the combined effect of two fiscal policy guidelines that have recently been decided upon. The decision not to increase social security taxes or tax rates over the next few years will limit substantially the room for maneuver in the budget. At the same time, Mr. Landau informs us that expenditures will be kept constant in real terms. The result--the budget deficit--will then depend on nominal and real growth of the economy. The deficit would become undetermined if both guidelines or intentions become political liabilities, in particular when a "no new taxes" approach precedes rather than follows the expenditure cuts that should make this possible. The staff recommendation on taxation--to shift reliance from direct to indirect taxation--appears rather academic, and I agree with the authorities' reaction to it. More attention should have been given by the staff to recent EC agreements in this respect.

On structural policies, the staff has made recommendations regarding policies in product markets and agriculture. I fully support these recommendations. Among G-7 countries, France now is the leader not only in low inflation and in low public debt ratios, but also in preventing the reduction of protection. France should rather take initiatives to break the deadlock within the Community, and then in the Uruguay Round, and thereby complete the transformation of its own economy, and give other, weaker economies--such as those in Eastern Europe and a large part of the developing world--a chance. Continuing protection will not strengthen France's industry or agriculture; it did not do so in the past, and it will not do so in the future.

Mr. Al-Jasser made the following statement:

During the recent slowdown in economic activity, the French authorities have adhered closely to their policy strategy of gradual competitive disinflation. The authorities are to be commended for keeping their medium-term objectives at center stage, and for avoiding any marked policy deviations that may have undermined the credibility and progress achieved under the medium-term strategy. As the record of recent years shows, the medium-term orientation of policies has served France well: a low rate of inflation has been maintained, and export performance has strengthened. At the same time, the present slowdown has highlighted the urgency of making further progress in structural reforms, particularly in those that would improve the functioning of the labor market. Broadly speaking, I concur with the thrust of the staff's recommendations.

A key element in the authorities' successful implementation of their overall macroeconomic strategy has been the reduction in the central government budget deficit. However, the recent economic slowdown has raised some question as to whether the present operational framework of fiscal policy--namely, nominal deficit targets--is the best suited for the task of sustained deficit reduction. In my view, the implementation of budget deficit targets is vulnerable in the absence of supporting expenditure limits. During a cyclical upswing, the present approach is able to accommodate an expansion of expenditures alongside revenues, while still meeting deficit reduction targets. This, however, introduces some risk to the process of sustained deficit reductions. During a cyclical downturn in revenues, the required adjustment in spending to meet a deficit target may well prove to be difficult in the wake of a greater than usual increase in expenditures, as well as disruptive for longer-term spending commitments. Furthermore, the degree of expenditure restraint that is called for may not be feasible, and offsetting discretionary ad hoc revenue measures would be required to prevent any widening in the budget deficit. At worst, the deficit reduction target may not be met, thereby placing the credibility of financial policies in jeopardy. In sum, the downside risks argue strongly for the introduction of spending limits within a forward looking framework. This would also facilitate the smooth implementation of tax reductions and reforms.

With respect to the public finances of the local authorities, local government spending and revenues have been one of the fastest growing components of general government finances in recent years, and are now equal to about half of central government revenues and outlays. At the same time, we are told by the staff that the local authorities do not have adequate checks on their borrowing. In the context of the overall policy strategy of financial restraint, I wonder whether this issue warrants closer attention.

I share the authorities' concern over the persistent and high rate of unemployment in France, and I note Mr. Landau's full presentation of his authorities' views on this issue. Setting cyclical considerations aside, some reduction in the unemployment rate should be expected from a continuation of the present overall macroeconomic strategy of competitive disinflation. However, the relatively modest decline in the unemployment rate that has been achieved to date under this strategy suggests that new initiatives are required to address this problem adequately. While the authorities have a number of labor market policies in place that are targeted at the sizeable structural component of unemployment, it is time, perhaps, to reevaluate the effectiveness and design of these policies. In this respect, I find the discussion of labor market policies in the staff report and background paper helpful, and the various policy proposals persuasive. I share the staff's view on the need for an approach that emphasizes the removal of existing rigidities that drive a substantial positive wedge between the marginal cost and product of labor. Such a wedge appears to make a significant contribution to the high level of unemployment of both young and lower-skilled workers. Of course, complementary measures aimed at improving the marginal productivity of vulnerable segments of the labor force will continue to have an important role to play. Also, I wonder to what extent impediments to regional labor mobility may be an important factor in explaining the high rate of structural unemployment in France. Perhaps the staff could comment on this question.

Conspicuous by its absence from the staff report is any discussion of the energy sector in France, which is well known to be one of the most heavily taxed as well as subsidized in the world. A closer look at subsidies and taxes on the various sources of energy in France merits attention in next year's report.

Moreover, I find the authorities' views on trade liberalization disappointing. In particular, the staff's discussions offer little evidence of support by the authorities for timely or significant progress in the area of agricultural reform. The authorities' attitude would seem to be at odds with their aim of enhancing France's growth potential and welfare through improvements in efficiency and competitiveness. It also does not serve the best interest of the international economic community. I urge the authorities to assume a more constructive role on this issue and to help hasten progress in the reform of the Community's Common Agricultural Policy and the conclusion of the Uruguay Round. Last week, we discussed Sweden, which chose to put action before words in promoting trade liberalization. That is an example that merits emulation by other large countries.

I would be remiss if I did not note that, while much remains to be done on structural policies, this should not detract from the steady underlying improvement in the performance of the French economy.

Mr. Mwananshiku made the following statement:

The economic strategy pursued by the French authorities since 1983 has paid dividends in terms of growth, the moderation of inflation, a reduction in unemployment, and the restoration of cost competitiveness. However, in the course of 1990 and the first half of 1991, the economy has slowed considerably, owing largely to external factors. The slowing down of economic activity has retarded progress toward intended policy objectives, as witnessed, among other things, by the rise in the rate of unemployment and the difficulty in meeting the fiscal deficit reduction target. With the expected upturn in economic activity in the second half of 1991 and in 1992, I encourage the authorities to continue their restrained macroeconomic policy stance, and to pursue a range of structural measures with steadfast determination. In this regard, the authorities' commitment to continued firm implementation of their disinflation strategy is certainly reassuring. I believe that such a policy stance augurs well for the successful integration of the French economy into the single European market.

Given the anticipated slippages in 1991, I hope that the authorities will succeed in ensuring that the budget deficit goals for 1992 are fully met. I share the staff's view on fiscal policy that the steady reductions in the deficit should be continued largely through better containment of expenditures. In this respect, I welcome the authorities' intention, as indicated by Mr. Landau, to keep expenditures constant in real terms in 1992.

I welcome the tax burden reduction measures being carried out, in view of their impact on savings and investment, and I encourage the authorities to strengthen their effort in this direction. The recently expressed intention of the authorities to launch a far-reaching reform of the pension system will, if implemented, have a significant positive impact on budgetary outturns in the years.ahead.

I note the social and distributional concerns of the authorities. However, I encourage them to continue pursuing the policy of moderation in meeting wage demands, and to link wage adjustments to gains in productivity. I recognize that it is not easy to ensure that distribution-oriented policies are fully compatible with growth and employment objectives, as witnessed by the experience of a large number of developing countries--including many in my constituency. But I believe that this task will be relatively easy for the French authorities, as their economy is better placed to respond to changing circumstances and to absorb shocks than less developed economies. I hope that policies conducive to investment and employment creation will continue receiving due emphasis.

Further improvements in the growth of investment, efficient resource allocation, and competitiveness will have a positive global impact, in view of the relative weight of the French economy. I encourage the authorities to continue with their policy of modernization and replacement of the capital stock, given the importance of this in enhancing the pace of job creation and halting the upward trend in the unemployment rate.

With respect to the external sector, the depreciation of the dollar and the yen since the last quarter of 1990 has had a negative impact on cost competitiveness and export profitability. The authorities should continue the policy of productivity enhancement in 1991 and over the medium term to ensure the restoration of competitiveness. On trade policy, I encourage the authorities to proceed further with trade liberalization in areas such as agriculture and textiles, given their importance in contributing not only to the country's welfare, but also to the growth of trade of developing countries.

I commend the French authorities for their generous debt initiatives and the level of official development aid, and urge them to bring that aid to the internationally agreed target.

The Executive Directors agreed to resume the discussion in the afternoon.

2. ESTONIA - APPLICATION FOR MEMBERSHIP

The Managing Director informed the Board that an application for membership from Estonia had been received in the Fund on September 9, 1991 (EBD/91/267, 9/9/91).

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/91/116 (9/6/91) and EBM/91/117 (9/9/91).

3. COSTA RICA - TECHNICAL ASSISTANCE

In response to a request from the Costa Rican authorities for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/91/262 (9/3/91).

Adopted September 6, 1991

4. MONGOLIA - TECHNICAL ASSISTANCE

In response to a request from the Mongolian authorities for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/91/264 (9/3/91).

Adopted September 6, 1991

5. APPROVAL OF MINUTES

The minutes of Executive Board meetings 90/159 and 90/160 are approved.

APPROVED: February 21, 1992

JOSEPH W. LANG, JR.
Acting Secretary