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SM/88/182

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August 15, 1988

To: Members of the Executive Board

From: The Secretary

Subject: France - Staff Report for the 1988 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1988 Article IV consultation with France, which has been tentatively scheduled for discussion on Monday, September 12, 1988.

Mr. Riechel (ext. 4548) or Mrs. Nagy (ext. 4612) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

FRANCE

Staff Report for the 1988 Article IV Consultation

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

Approved by Massimo Russo and Helen B. Junz

August 11, 1988

I. Introduction

A mission consisting of Messrs. M. Russo, M. Deppler, K.W. Riechel, and E. Gardner (EP), and Mrs. P. Nagy (all EUR), with Mrs. A. Groen (ADM) as secretary, visited Paris from June 29 to July 13 to conduct Article IV consultation discussions. The mission met with the Minister of the Economy, Finance, and the Budget, Mr. P. Beregovoy, the Governor of the Banque de France, Mr. J. de Larosière, the Director of the Treasury, Mr. J.-C. Trichet, and senior officials of various ministries and agencies and of the Banque de France. Mrs. H. Ploix, Executive Director, attended the meetings as observer. France has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement as of February 15, 1961.

At the conclusion of the last consultation, on August 5, 1987 (EBM/87/119), Directors commended the authorities for the improvements in the structure and performance of the economy, but expressed concern over the fragility of the gains achieved and over the continued high level of unemployment. Directors observed that strict financial policies and greater liberalization of markets would have to be pursued to achieve the desired adjustment. In light of the loss of competitiveness in recent years, Directors emphasized the need for a continuation of the policy of wage moderation.

The presidential and legislative elections of May and June 1988 resulted in the formation of a new government, replacing the center-right coalition that came to power in April 1986.

II. Economic Setting

1. Economic Policies

A fundamental shift in the orientation of French economic policies occurred in 1983. Prior to that time, consensus was lacking on how to deal with the shocks of the 1970s, and policies shifted between demand and supply orientations. Since then, however, a consensus has been formed, and a consistent thrust of policies--hereafter often referred to as the "strategy"--has been sustained. The main tenets of this consensus are a strong commitment to the EMS (first as an exchange rate mechanism, but mainly as a framework for policy convergence within Europe) and a commitment to achieving durable growth through structural adjustment and disinflation. Accordingly, policies have had three priorities: the reduction of inflation to a rate at least equal to the average of that of partner countries and preferably equal to that of Germany; the re-establishment of a viable and profitable business sector, which had been badly hit by the supply shocks of the 1970s and the reflationary policies of the early 1980s; and structural reform, so as to improve the allocation of resources and durably reduce unemployment. To this end, the various governments have pursued restrictive fiscal and monetary policies; relied extensively on wage restraint both to foster the disinflationary process and to enable the enterprise sector to rebuild its profitability; geared tax and social security policies so as to lower the tax liabilities of companies and shelter them from increases in social security contributions; undertaken a major, market-oriented restructuring of monetary policy away from reliance on direct credit controls to reliance on interest rates, supported by reserve requirements, as the main instrument of policy; deregulated and fostered innovation in financial markets; and sought to increase flexibility in labor markets.

This broad thrust of policies was sustained in 1987 and 1988. The central government deficit was reduced by 1/2 percentage point of GDP in 1987 to 2 1/4 percent and a further reduction to 2 percent is planned for 1988. The conduct of monetary policy remained disciplined, as evidenced in particular by the flexible adjustment of interest rates in response to developments in the foreign exchange market. Wage restraint remained primary, with the public sector setting the example with increases equal only to expected cost of living increases. Income taxes were cut by F 70 billion (1 1/4 percent of GDP) over 1987-88, with the amount split about evenly between households and enterprises. Health benefits were curtailed and, in line with the objective of strengthening the enterprise sector, a necessary increase in social security contribution rates was charged wholly to households. Controls on capital movements and prices were either relaxed further or eliminated. Regulations governing employment and dismissals were made significantly more flexible and subsidized job training programs for the unemployed were expanded, thus further reducing labor costs to employers and enhancing employability. Finally, policies sought to limit the role of government through reductions in industrial subsidies, more market-oriented setting of regulated prices, and, up to the stock market crash, the privatization of government enterprises.

As regards policy prospects, the new Government has repeatedly stressed its commitment to continue with the basic strategy and to maintain the cardinal role of disinflation in that strategy. More concretely, the new Government has set a budget deficit target for 1989 (F 100 billion or 1 3/4 percent of GDP) 1/4 percentage point below that for 1988; been unequivocal in its commitment to a stable parity for the franc within the EMS; sought to achieve reductions in interest rates, on the grounds that these are too high in relation to France's main trading partners, its inflation record, and its commitment to exchange rate stability; envisaged possible further cuts in corporate tax rates, especially insofar as funds dedicated to real investments are concerned; and eliminated all remaining capital control restrictions on enterprises' foreign exchange transactions.

While the Government's commitment to follow through on the basic strategy is clear, it has taken decisions that reveal shifts in emphasis. This is most noticeable as regards the distribution of income. The Government plans to reinstate a wealth tax at a rate of 0.9 percent per annum on holdings of certain types of assets worth more than F 4 million. It has also proposed a guaranteed minimum income plan, which is to be financed in part by the wealth tax. Finally, the personal income tax cuts that had been envisaged by the former government are no longer contemplated. Similarly, while the former government had sought to take the state out of resource allocation decisions, the new Government has discontinued the privatization program and sought to maintain a consultative role in allocation decisions. In this vein, it has rejuvenated the Commissariat au Plan, which has been asked to clarify choices looking toward the formation of the single European market.

2. Economic situation and prospects

The benefits of the policies of adjustment initiated in 1983 were relatively slow to appear. The main exception was inflation. Consumer price inflation decelerated from 9 1/2 percent in 1983 to 2 1/2 percent over the 12 months to mid-1988, i.e., from 4 1/2 percentage points above to 1/2 percentage point below the composite rate of partner countries. Moreover, while the increase in consumer prices remains 1 1/2 percentage points above that in Germany, the comparison is markedly more favorable if based on GDP deflators, unit labor costs, or prices of manufactures. On other fronts, however, achievements until 1987 were relatively disappointing both absolutely and in relation to the rest of Europe, including Germany. Real GDP growth averaged only 1 1/2 percent from 1983 to 1987, as against 3 1/2 percent and 2 1/2 percent for the industrial and European industrial countries, respectively. The performance of exports was particularly disappointing with France losing 10 percent of its market share between 1983 and 1987. Unemployment rose steadily, from 8 1/4 percent of the labor force in 1983 to 10 3/4 percent in early 1987 before receding to 10 1/2 percent in the first half of 1988 as a result of employment measures. Moreover, the balance on current account, which had at first strengthened (initially because of adjustment and later because of gains in terms of trade), deteriorated sharply back into deficit in 1987 (Charts 1 and 2 and Appendix III).

Since mid-1987, however, a considerable adjustment-induced turnaround in France's economic performance has become apparent. This is clear from the growth of real GDP, which accelerated to 3 1/2 percent over the year to the first quarter of 1988. Part of this improvement is clearly due to the worldwide pick up in activity; indeed, growth in France over the period fell short of that of the other G-7 countries, including those in Europe. Nonetheless, the much larger acceleration of output growth in France than in partner countries at a time when domestic demand growth, unlike in partner countries, tended to decelerate suggests that the improvement in France's performance also reflects a basic change in the supply performance of the economy. As shown in the accompanying table, this change is also evident in the performance of exports, where the sharp losses in market shares of 1985-87 have been replaced by at least a stabilization and quite possibly gains in shares. Finally, there has also been a significant improvement in employment, which increased by 1/2 percent from early 1987 to early 1988. While partly due to the buoyancy of output, this increase also reflected the effects of measures to increase flexibility in the labor market.

Growth of Demand and Output

(In percent)

	Annual average 1983-87	Over same period year ago		
		1987 Q1	1988 Q1	Difference
France				
Real GDP	1.6	2.0	3.5	1.5
Real total domestic demand	1.8	4.6	2.8	-1.9
Other major European countries				
Real GDP	2.7	3.1	3.9	0.8
Real total domestic demand	3.0	3.8	5.4	1.6
Memorandum item:				
France's export performance 1/	-3.4	-4.5	1.3	5.8

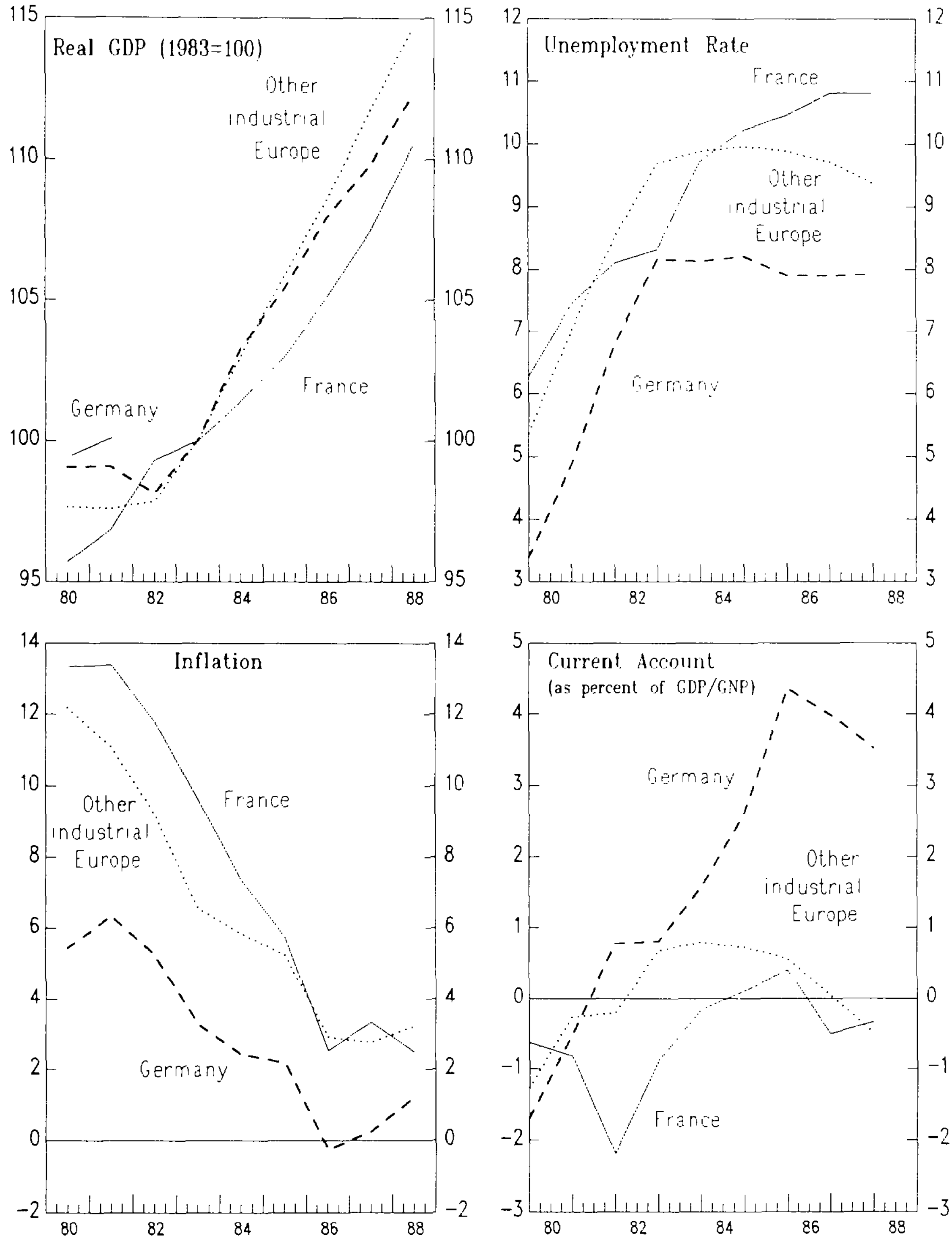
1/ In manufacturing; partly estimated.

This turnaround in the supply responsiveness of the economy is rooted in fundamental factors and should prove lasting. The main factor has been the restoration of enterprise profitability, which has returned to at least pre-second oil shock levels and, on some measures, even to pre-first oil shock levels. As a result, after an initial hiatus while firms sought to restore their balance sheets by reducing indebtedness, investment has picked up sharply. (For an analysis of investment trends, see RED, Appendix I.) Private business investment increased by 7 percent in 1986 and 1987 and is expected to rise by over 10 percent in

CHART 1

FRANCE

Selected Macroeconomic Indicators

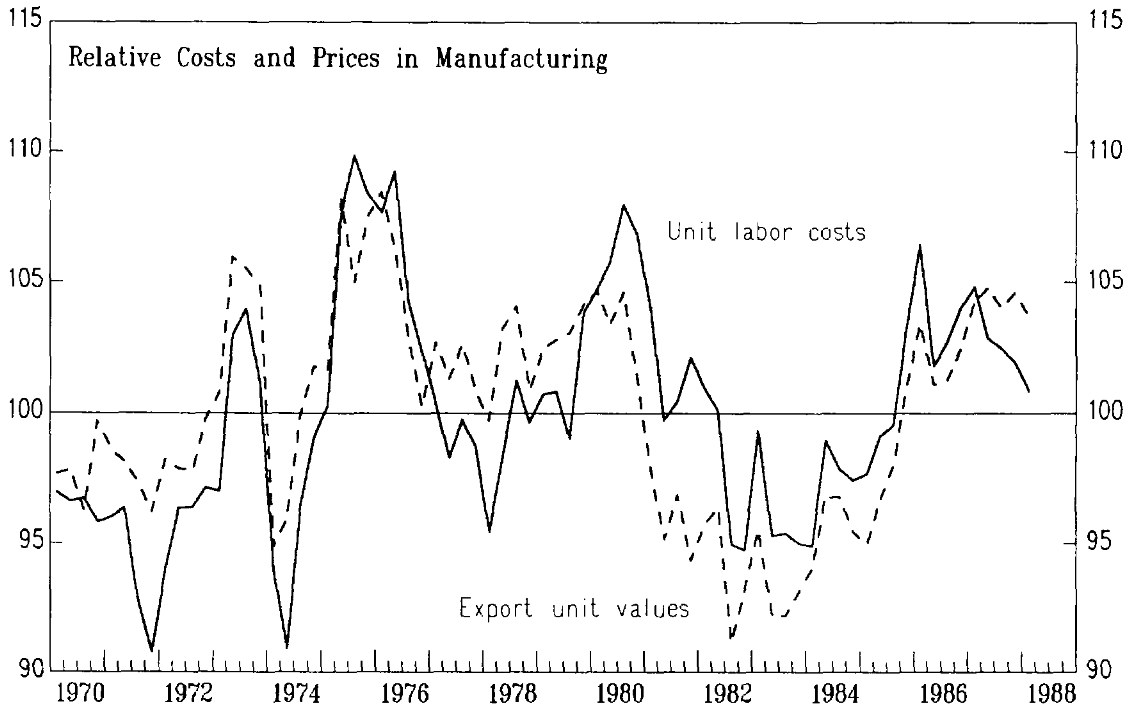


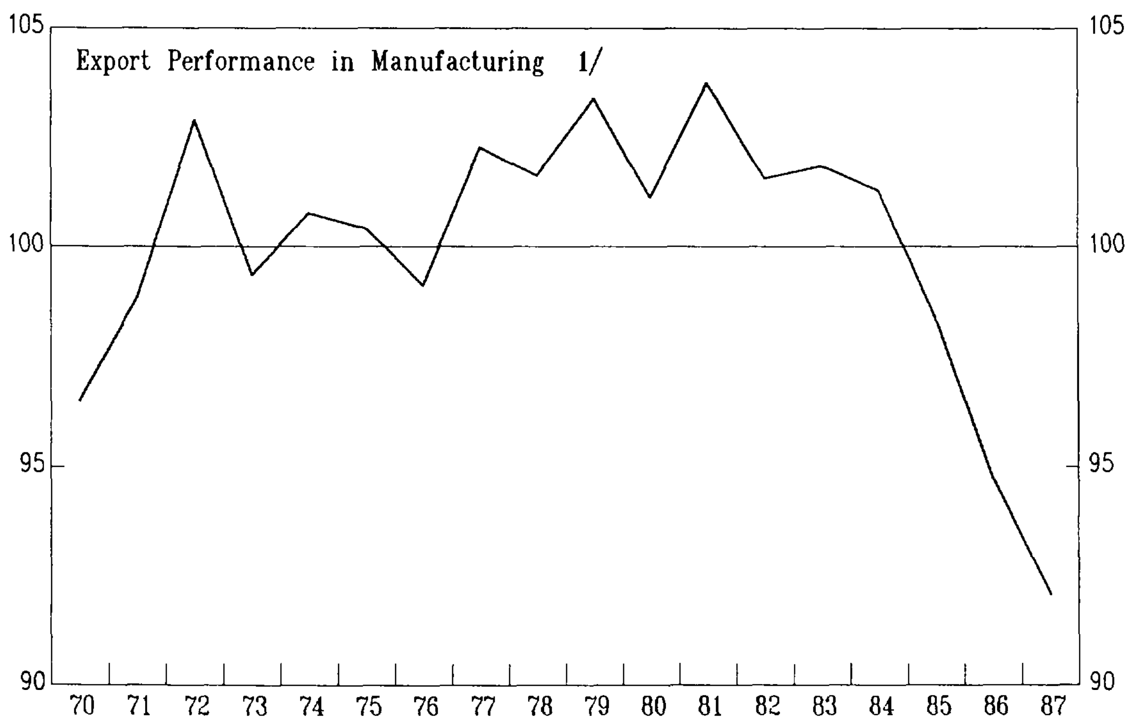
Source: International Monetary Fund, World Economic Outlook, August 1988

CHART 2

FRANCE

Selected External Indicators
(Indices, 1970-87=100)





Source: International Monetary Fund, International Financial Statistics.
1/ Ratio of France's exports of manufactures in volume to a weighted average of the imports of manufactures of France's trading partners.

1988, in part because of the high rate of capacity utilization (see RED, Section I.3). The turnaround in exports is less well understood, but also appears to reflect supply factors. While labor cost competitiveness has improved, export price competitiveness is virtually unchanged (Chart 2). It appears, however, that the increase in export profitability implied by these developments has engendered a strengthening of exports, particularly toward the European market where competitiveness has improved significantly, in part because of the EMS realignments of April 1986 and early 1987. (For an analysis of competitiveness, see RED, Appendix IV.)

Looking forward, while some slowing of growth can be anticipated as world activity reverts to a more normal pace, there is no reason to expect the better response of supply in France not to continue. In particular, the staff expects business investment to remain quite buoyant. This strength of investment as well as the improved performance of exports should offset any sluggishness in consumption (stemming from the assumption of continued wage restraint and slow recovery of employment). Overall, therefore, growth in France should, instead of lagging behind as it did in the 1983-87 period, at least keep pace with that of other major European countries over the next few years.

Despite this improvement in performance, significant imbalances remain. The unemployment rate has risen almost continuously for 15 years and would currently be at a postwar historical peak were it not for the effects of the employment measures taken in 1986-88. Similarly, the balance on current account worsened significantly from 1986 to 1987. While the deficit is modest (about 1/2 percent of GDP), it could deteriorate further if household savings--which declined from 16 percent to 12 percent of disposable income from 1983 to 1987 (see RED, Section I.2)--do not recover sufficiently to provide part of the financing required by the higher rate of investment.

The basic issue confronting the strategy over the medium term, therefore, is whether it can achieve a significant reduction in unemployment while maintaining a viable external position. In principle, of course, the answer is positive, provided global economic activity remains satisfactory. Through wage and financial restraint, the strategy engenders improvements in profitability and competitiveness that strengthen both export and investment demand and the economy's ability to supply. Given time, therefore, the strategy should be able to redress the imbalances. In practice, however, the question is whether it can do so within a reasonable period of time, say by 1992.

The answer to this question provided by standard models of the French economy is not encouraging. These models do in general bear out the main features of the strategy. In particular, they incorporate Phillips curve mechanisms which, because of the level of unemployment, imply increases in real wages significantly below those of productivity. Hence, profitability and competitiveness improve, and exports and investments are relatively buoyant. However, this buoyancy is insufficient to offset the sluggishness of consumption and to stem the rise in unemployment. As a result, model-based scenarios envisage unemployment rates of 12 to 14 1/2 percent by 1992, as compared with rates of 10 to 11 percent at the time these scenarios were prepared (see Appendix II). Achieving external balance presents less of a problem in these scenarios, but this simply reflects the authorities' objective of maintaining approximate balance on current account over the medium term in order to keep firm control over the exchange rate. In the end, therefore, tensions between external and internal balance show up in the unemployment rate rather than the current account.

The rather bleak employment prospects generated by the models also stem from the presumption that, despite the abundance of labor resources, the relatively capital intensive mode of production that prevailed in the past will continue. 1/ As a result, while the wage equations point to significant changes in relative factor prices, the factor demand equations are relatively insensitive to those changes. Not surprisingly, therefore, employment growth is projected to be relatively modest, particularly given the assumptions of unchanged trend rates of productivity growth for capital (negative) and labor (positive) resulting from the ongoing substitution of capital for labor. In conjunction with the fairly rapid growth of the labor force relative to partners because of demographic factors, these employment prospects imply a rather steep rise in unemployment.

In assessing medium-term prospects (given present policies and WEO projections for partner countries), the staff has arrived at a somewhat more optimistic view (see Appendix II). The staff's scenario presumes that capital-labor substitution in response to changes in factor prices, while admittedly conspicuous by its absence since the mid-1970s, will resurface over the medium term. In the same vein, the staff has assumed that labor productivity growth will slacken, which would be in line with experience elsewhere (e.g., Belgium and the Netherlands). Moreover, exports are expected to benefit from the sharp improvements in profitability, and consumption from the higher growth of employment. As a result, the staff does foresee a fairly sustained, employment-intensive growth path marginally above that of other European countries. However, this margin is still not sufficient to reduce the unemployment rate. 2/

1/ This feature reflects researchers' inability to detect so far a significant responsiveness of investment to relative factor prices or evidence of capital-labor substitution in production functions.

2/ It is possible, of course, that the staff has not gone far enough in making the adjustments described above. However, to go further seems unwarranted in the light of the staff's empirical work--which broadly confirms the properties of French models mentioned earlier--and the rigidities that prevail in the labor market.

III. Report on the Discussions

The discussions focused first on the origins and durability of the turnaround in performance and second, in light of global and regional policy objectives, on the policies that might strengthen this performance further over the next several years, especially as regards employment and the external balance. The first of these topics turned out to be largely common ground between the authorities and the staff. Its main elements have been incorporated into the previous section.

The authorities began by noting their continuing strong support for the strategy. The strategy was beginning to show results and there was therefore every reason to continue along the same path. Indeed, it was important not to change because of the stabilizing influence that policy continuity had on expectations. It was particularly important that the process of disinflation be brought to term. Economic agents had to learn that inflation would not be accommodated. Resort to such accommodation in the past had only led to recurrent changes in exchange rates that had laid the basis for a renewed price/cost spiral rather than a lasting improvement in competitiveness. By contrast, the present strategy was one of sustained disinflation buttressed by a high degree of exchange stability within the EMS and by supply side growth due to fundamental improvements in profitability and in the productive structure of the economy.

The staff welcomed the authorities' reaffirmation of the strategy. This strategy was indeed beginning to show results and it was important that it be carried forward so as to achieve its full benefit. In the short run, the risks seemed more on the side of demand once again getting ahead of the economy's ability to supply. Accordingly, the authorities' policy of containing increases in demand and shifting its composition toward investment seemed especially appropriate. From a medium-term perspective, however, the staff was concerned whether the strategy would achieve sufficient improvements in competitiveness to relax the external constraint and thus enable sizable reductions in unemployment.

The authorities acknowledged that past losses in competitiveness had contributed to the weak performance of exports, but they doubted that competitiveness was currently the main obstacle to exports or that it would be in the future since the strategy itself sought to strengthen competitiveness over time. It was necessary to understand, however, that for an economy undergoing as thorough a supply-side transformation as that of France, competitiveness could not be measured by a single indicator. Rather, at least three facets had to be considered.

a. As regards the standard cost and price indicators of competitiveness, the authorities viewed France's situation in early 1988 as broadly comparable to that prevailing when the EMS was established in 1979. This was especially so as regards labor cost competitiveness. Price competitiveness was somewhat less favorable, but this was a reflection of the general improvement in profit margins of enterprises and should as such be viewed as a positive element since it contributed, via increased investment, to enhancing the capacity to supply. Moreover, it had to be recognized that the dynamics of competitiveness were in France's favor. Significant gains had been achieved over the past two years and unit labor cost increases in France were projected to be significantly less than those of partner countries (including Germany) over the next several years because of the continuing restraint of wage claims and the relatively rapid growth of productivity. In their view, therefore, competitiveness narrowly defined ought not to present difficulties.

b. A large part of the losses in export market shares and in the deterioration of the balance of trade in manufactures stemmed less from past losses in competitiveness than from the relatively better sustained pace of demand in France than in partner countries and from the deficiencies in the product and geographic structure of French exports. Looking forward, some of these factors were likely to reverse themselves. Thus, partly because of an increased ability to shift toward faster growing markets, France had experienced gains in market shares over the past year or so. Moreover, prospects were that the traditional French export markets (Europe and parts of the developing world), which had been relatively slow-growing over the past five years, would be relatively better sustained in the period ahead.

c. More fundamentally, the objective of the strategy was not to turn France into a low cost producer, but to re-establish France's productive base as a supplier of a wide range of competitive high technology goods and services. Such a transformation of the structure of output was at the core of the strategy and was underway. Therefore, in evaluating competitiveness in the broad sense of the term, the authorities placed greater credence in the fact that enterprises generally judged themselves to be competitive than they did in cost and price indicators that did not capture the changes in the nonprice elements of competitiveness.

The staff agreed that capacity limits rather than competitiveness appeared to be the more proximate constraint on exports at the present juncture. Over the medium term, however, the staff remained concerned that, as buoyant investment eased capacity constraints, competitiveness would resurface as a constraint on exports and employment. In part because France had initiated adjustment later than other European countries, it had over the past few years lost market shares and lagged significantly behind other European countries in terms of employment growth--losses that would need to be made up. Moreover, looking forward, demographic factors pointed to much stronger labor force growth in France than in other European countries over the next five to ten years. It was important therefore that competitiveness improve at a fairly rapid pace. In this context, was there a danger that wage restraint would ease in the face of rising corporate profits and what would be the implications for competitiveness and the growth of investment?

The authorities agreed that a delicate balance needed to be struck between continued wage restraint in order to strengthen competitiveness, profitability, and investment, on the one hand, and measures to maintain equity and the social consensus needed to continue the strategy, on the other. On the technical level, the robustness of Phillips-type relationships for the French economy suggested that wage restraint would continue and indeed result in considerable gains in competitiveness. It could also be argued, however, that a large part of the wage restraint of the past five years had reflected the political consensus behind the strategy rather than the high level of unemployment. If so, some firming of wage claims might be expected now that the profitability of the enterprise sector had been restored to more nearly appropriate levels. In any case, it would from now on be necessary on equity grounds to at least maintain the purchasing power of wages. In addition, the Government had supported the extension of profit sharing arrangements and bonuses since these enabled employees in competitive and profitable sectors to reap some of the gains in productivity without undermining competitiveness. These adaptations were still fairly minor in macroeconomic terms, however, and the Government's general policy remained one of wage restraint, notably for civil servants. Indeed, it was partly out of concern for maintaining the social consensus behind such a strict general policy that the Government had reintroduced the wealth tax and agreed to increase minimum wages (the SMIC) by 0.4 percent more than the legally required amount. Overall, they expected wage increases to remain quite moderate, particularly insofar as the social consensus behind the strategy strengthened as a result of increased buoyancy in employment.

The staff agreed that success on employment seemed essential for the continuing viability of the strategy. The upturn in investment was likely to entail a significant growth of employment, partly because an increasing share of this investment was for capacity expansion, but mainly because it would through capacity effects strengthen exports, thus alleviating the external constraint and permitting a faster growth of the labor intensive service sector. However, the combination of high unemployment and high capacity utilization and the concentration of the unemployed in low paying categories (the young and the unskilled) suggested a need to supplement the strategy with additional structural measures, e.g., to increase labor market flexibility and to reduce the effective cost of labor, especially for the relatively unskilled. From this perspective, the recent decision to raise the SMIC by more than legally required seemed unfortunate, especially since minimum wages had historically increased more rapidly than average wages (Chart 3).

The authorities agreed that while the strategy could be expected to lead to a strengthening of employment, it was less clear--in light of the structural nature of unemployment and the rapid growth of the labor force--whether this would be sufficient to achieve significant reductions in unemployment. Structural measures would thus be necessary. However, these could not be of a very general character. In the first place, there were wide differences of view at the technical level on the net employment-creating effects of greater wage differentiation. Beyond these technical debates, there remained the fact that the SMIC--including the mechanism for increasing it in step with other wages--enjoyed broad political support and could not be challenged. Policies had, therefore, focused on job training programs. These provided training to those who needed it; reduced labor costs to the employer (since the remuneration was set well below that of the SMIC and the employer was partly or wholly exempted from paying social security contributions); and resulted in significantly lower unemployment rates. These programs had proven reasonably successful. So far, about 40 percent of those enrolled had been hired on a full-time basis at the end of their training. The authorities therefore expected to expand such programs in the future. In the same vein, the legal restrictions on dismissal and on the use of labor (e.g., regarding overtime, night work, etc.) had been significantly eased over the past year, thus further reducing the effective cost of labor to enterprises. Similar actions had been taken with regard to social security (see below).

Turning to the role of fiscal policy, the authorities emphasized its dual function of solidifying expectations about the permanence of disinflation and guarding against any incipient weakness of the current account. To that end, the central government deficit would continue to be gradually reduced, notwithstanding the loss of privatization receipts (which had substituted for capital transfers in the 1987-88 budgets) and the Government's priorities for education, training, research and development, and a guaranteed minimum income. As regards revenues, the Government was considering further cuts in corporate tax rates. This was in line with the strategy and the need to ensure the competitiveness of the enterprise sector by 1992. Nothing, however, had as yet been decided. With respect to personal income taxes, the harmonization of VAT and excise tax rates across the EC implied such a loss in fiscal revenues for France as to preclude further cuts in personal income taxes.

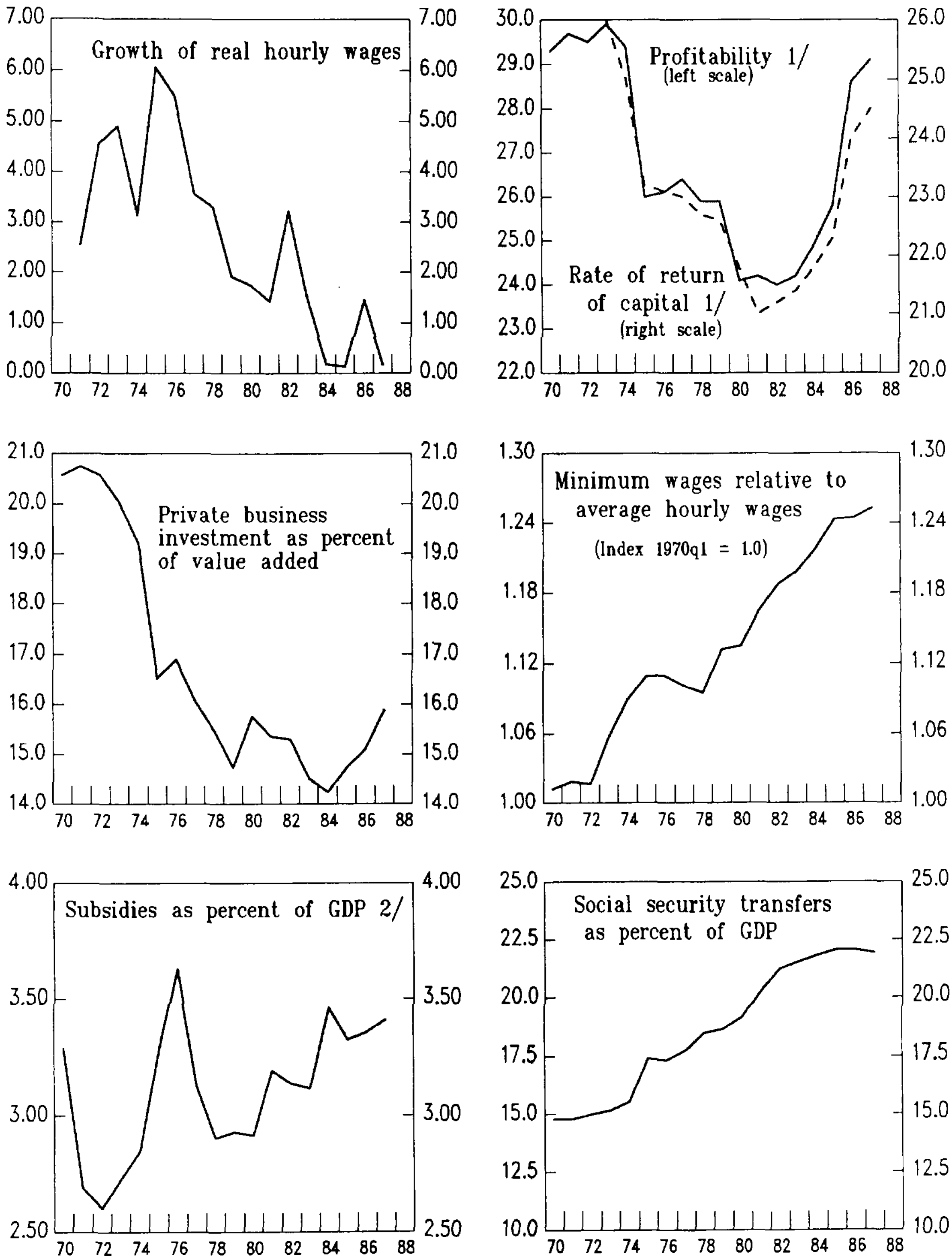
Prospects for the social security funds were not favorable. In the absence of offsetting policy action, the health and pension systems in particular faced ever-widening deficits. In the case of health, the drift was fairly moderate and could be addressed by gradually limiting benefits rather than through increases in contributions. As regards pensions, however, the situation was much more serious. It had been estimated that contribution rates would have to be raised by 1 percentage point of the wage bill per year until the mid-1990s in order to maintain the financial integrity of the system.

The staff expressed concern about these trends. France's social expenditures in relation to GDP (34 percent) were already in 1985 second only to Belgium's among the OECD countries, had risen further since then, and seemed likely to rise still further in the future. The result was that social security contributions in France were among the highest in industrial countries and constituted a significant deterrent to employment. (See RED, Appendix II for an analysis of the social

CHART 3

FRANCE

Selected Structural Indicators



Sources: Les Comptes de la Nation 1987; OECD, Detailed National Accounts; Government Outlays by Function and Type and data provided by authorities.

1/ Private business sector.

2/ Include exemptions from social security contributions associated with manpower training programs. These, together with agricultural subsidies, account for recent increases.

security system and its implications). More generally, France had been much less successful than other industrial countries in controlling public sector expenditures. For instance, whereas expenditures by General Government had amounted to 49 1/2 percent of GDP in both France and Germany in 1981, by 1987 this ratio had fallen to 47 percent for Germany, but risen to 52 1/2 percent for France. Thus, while France had an enviable record as regards fiscal deficits (the debt to GDP ratio is the lowest among G-7 countries), this was less apparent as regards efforts to contain the size of the public sector.

The authorities agreed that further efforts needed to be made in controlling expenditures, especially in the social security sphere. Indeed, a commission had been asked to make medium-term recommendations for the social security system. However, with respect to the broader question of the implications of social security for employment, certain qualifying considerations needed to be kept in mind. First, all increases in social security contribution rates (other than for unemployment) had, as a matter of policy, been borne by employees rather than employers. Second, the seemingly high proportion of social expenditures in GDP reflected not higher benefit levels in France than elsewhere, but rather the higher proportion that was financed via the public rather than the private sector. If one abstracted from this distinction, health and retirement expenditures in France were not out of line with those elsewhere. And third, while social security contributions tended to be higher in France than elsewhere, net take home pay was lower, in part because of the lesser need to make supplementary contributions to private health and retirement plans. In the end, what mattered for employment was the overall level of labor costs rather than its composition, and this was competitive.

On monetary policy, the authorities felt that the moderately restrictive stance of the past several years was beginning to yield the desired results. Interest rates were coming down in both real and nominal terms from the high levels prevailing last year; the franc had weathered the elections without difficulties and indeed was relatively strong vis-à-vis the deutsche mark despite a marked narrowing of the interest differentials; and the growth of the monetary aggregates had decelerated sharply during the first half of 1988. In their view, these results reflected three principal factors. First, the Government's consistent pursuit of disinflation and the associated commitment to stable exchange rates. Second, the adoption of a more flexible and effective mechanism of monetary management based on money market interventions rather than direct credit controls. In tandem with financial innovation, the liberalization of capital controls, and the growth of Paris as a financial center, this had contributed to the structural enhancement of the economy as well as to the effectiveness of policy. And third, the marked increase in the degree of cooperation and coordination among EMS central banks that had resulted from the Basle-Nyborg agreement. This change was best illustrated by the coordinated interest rate changes of early November 1987, but also (and more lastingly) in the more sustained exchange of views among participating central banks that had prevailed since then. The agreement had resulted in a more flexible approach to foreign exchange management, with interest rate changes, intervention, and movements in exchange rates within the margin being used much more interchangeably than heretofore depending upon the requirements of the moment. These developments had had a stabilizing influence on the market and further facilitated the conduct of policy.

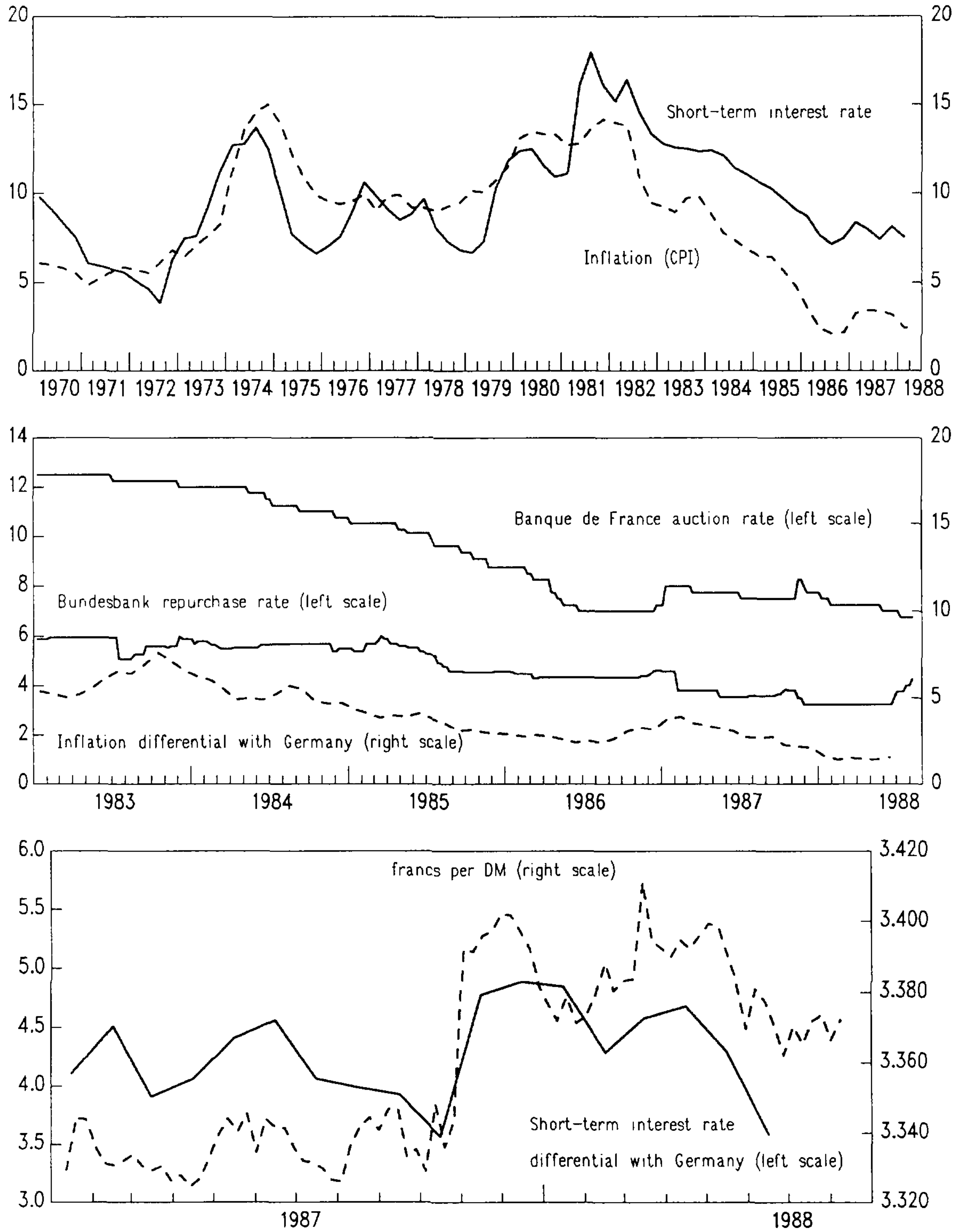
The staff agreed and thought that the authorities' disciplined approach to monetary management--to wit, the willingness to adjust interest rates by the amounts required to clear the foreign exchange market--had contributed significantly to the improved tenor of financial developments. Such a policy was clear and unambiguous and could not fail but be stabilizing in its effect on market participants. It was less clear, however, how the recent emphasis on the need to lower interest rates and on monetary targets could be reconciled with such a policy approach. Was there not a risk of ambiguity regarding the core of monetary management--the maintenance of the exchange rate parity between the franc and the deutsche mark?

The authorities thought not, since there could be no doubt about the priority assigned to the stability of the exchange rate in the conduct of monetary policy. However, the authorities felt that interest rates had not adjusted fully to the strength of that commitment or to the improvement on inflation, and that there was therefore a role for policy in fostering this adjustment. (See Chart 4 and, for an analysis of the factors contributing to the high level of real interest rates, RED, Appendix III). Similarly, the specification of the monetary targets, which had been decided in full cognizance of the objectives of other ERM central banks, was also seen as helpful in fostering the adjustment of expectations to the much lower inflation rates that were now durably in prospect for France. In this respect the authorities were pleased to note that the rate of credit expansion, although still high, had eased recently and that the growth of M2 at end-May 1988 was somewhat below the target range.

The recent strength of the French franc in the EMS, despite a reduction in interest rate differentials vis-à-vis Germany, was considered by the authorities a clear sign of the increasing recognition by the market of the improvement in France's relative economic performance and prospects. It was therefore not seen as simply a reflection of the usual weakness of the deutsche mark in the EMS in the face of a strengthening of the U.S. dollar. In this context, while welcoming the stability of exchange rates brought about by the increased coordination among G-7 countries, the French authorities remained concerned by the implication of a sudden fall in the U.S. dollar for intra-EMS stability and beyond a certain point for the competitiveness of French industrial exports.

Turning to industrial policies, the authorities stressed the significant change in orientation that had taken place. Ailing industries

CHART 4
FRANCE
Short-term Interest Rates, Inflation and the Exchange Rate



Sources: Banque de France, Bulletin Trimestriel; Monthly Report of the Deutsche Bundesbank; and International Monetary Fund, Datafund.

were increasingly being either closed down or restructured to put them on a viable basis. These policies were proving successful, with virtually all public enterprises showing significant improvements in their balance sheets. Moreover, subsidies to industry had been reduced from 1.1 percent of GDP in 1984 to 0.9 percent in 1987 (see RED, Section IV.4). As regards trade policy, the authorities had made a start toward extending to imports the liberalizations they espoused domestically. In this vein, they had supported efforts to place the EC's common agricultural policy on a more price-oriented basis; the measures adopted earlier in the year by the EC were a step in the right direction, but the French authorities would have preferred even stronger price adjustments and lesser reliance on production quotas. Similarly, the Government had come out strongly in favor of multilateral negotiations on services. By the same token, the authorities found it difficult to accept that, whereas the GATT made provision for protection against unfair prices, the issue of the damaging effects of exchange rate fluctuations on trade remained to be dealt with. These fluctuations induced large capital losses that, not surprisingly, generated protectionist pressures from capital intensive sectors, including agriculture. The authorities agreed, however, that it was difficult to distinguish fluctuations from underlying changes in exchange rates and that resistance to the latter could have the effect of exacerbating exchange rate fluctuations. (See RED, Section IV.4, and, for a multilateral perspective, SM/88/166, Supplement 1).

On foreign exchange controls, the authorities noted that new measures had been taken in the progressive liberalization of the system. Most notably, the forward exchange market and the operation of foreign exchange accounts by enterprises had been fully liberalized and the limit on tourist foreign exchange allowances had been lifted. The only remaining substantial restrictions are those on French franc loans to nonresidents and a ban on nonenterprises' foreign exchange accounts.

Finally, the authorities were pleased to report that France had increased its ODA from 0.48 percent of GDP in 1986 to 0.51 percent. Moreover, the new Government had reaffirmed its commitment to gradually increase ODA to 0.7 percent of GDP.

IV. Staff Appraisal

The results of the authorities' steadfast implementation of the supply-oriented strategy initiated in 1983 are now becoming apparent. This is true not only for inflation, where progress has been sustained, but also for output growth, investment and, most recently, export performance and employment. The clearest signs of improvement are the strength of productive investment and the unusually good response of domestic production to the strong growth in internal and external demand since mid-1987. Several years of wage moderation, increased labor market flexibility, liberalization of prices and financial markets, and disinflationary fiscal and monetary policies have markedly strengthened the position of enterprises. There is no reason to suppose that the attendant improvements in performance should not continue in the period ahead.

The emerging pay-offs of the strategy should not, however, mask the imbalances or difficulties that remain. Unemployment is very high and, given demographic trends, unlikely to improve--even though the medium-term sustainability of adjustment is likely to depend on favorable results on this front. Although stabilized, the external position remains vulnerable, particularly in light of existing imbalances within both the EMS and OECD countries. Competitiveness, while steadily improving, needs further strengthening. Profitability has been broadly restored, but the rate of return on capital is still short of the levels required to sustain the needed growth of the capital stock. The external environment, while currently quite favorable, may become less so if and when significant correction of external imbalances among the three major industrial countries takes place. Finally, capacity utilization is already high, which requires both that demand expansion be contained and that productive investment continue to grow at a rapid rate for several years to come if the external environment remains reasonably favorable.

Against this background of promise and challenge, it is clear that the first requirement of policy must be continuity in the implementation of the strategy. This strategy has begun to redress the rigidities that have affected France's performance in the past, but it is only in mid-course and must be brought to term. Moreover, attainment of the strategy's objectives hinges in part on a reassessment by the private sector of the Government's willingness to accommodate inflationary behavior. These changes in perception take a long time to take hold and are susceptible to reversals unless confronted by continued steadfastness of policy. The staff thus welcomes the new Government's endorsement and strong support for the basic thrust of the strategy.

The strategy does, however, confront several risks--of excess demand in the near term, and of excess unemployment in the medium term. In assessing policy requirements within the framework of the strategy, therefore, it is useful to distinguish near-term policy priorities from those that emanate from more medium-term perspectives.

a. As regards the near-term requirements, the salient fact is that the strength of activity over the past year has brought the economy within striking distance of capacity constraints. While this augurs well for a continued buoyancy of investment, it also presents immediate risks of a further worsening of the external accounts and of a firming of inflation, particularly against the background of rapidly rising commodity prices. Given this near-term outlook, the emphasis placed by the new Government on disinflation--as epitomized by their commitment to exchange rate stability--is appropriate. In particular, three long-standing aspects of the strategy deserve special emphasis.

(i) Wage restraint. This remains necessary in order to mitigate any risks on inflation and to contain the growth of consumption, but also to complete the process of re-establishing enterprise profitability and to promote employment. The public sector should continue to set the example by limiting wage increases to that of prices.

(ii) Fiscal consolidation. In a context of high capacity utilization, this is the most effective means of containing current expenditures (and thereby of containing any slippage on the external front) while at the same time fostering reductions in real interest rates and consolidating expectations of disinflation. In this context, the staff supports the authorities' plans for further reducing the central government deficit in 1988 and 1989.

(iii) Monetary discipline. This is essential. The staff would credit the disciplined character of monetary policy over the past year--as evidenced in particular by the greater willingness to adjust interest rates in line with the needs of the foreign exchange market--as being an essential element of policy credibility and confidence in the franc. The increase in intra-EMS coordination that followed the Basle-Nyborg agreement has contributed significantly to this evolution. In particular, it has led in the management of the exchange rate to the use of a flexible mix of interest rate changes, exchange rate changes within the margins, and intervention, thus enhancing the effectiveness and credibility of policy. In this connection, the authorities should take care that the attention given in recent months to the level of real interest rates not be misinterpreted by markets as a change in the orientation of policy. It is therefore important to continue to adjust interest rates flexibly in both directions in response to developments in the foreign exchange market. Such a policy, together with sustained coordination within the EMS, is essential if the EMS is to withstand the pressures that will doubtless arise in an era of free capital movements and is to achieve greater financial and monetary integration.

b. Turning to the policy requirements emanating out of medium-term considerations, the key questions are whether the strategy will generate a sufficient increase in exports to sustain the growth of investment and permit GDP growth rates high enough to lower unemployment; and whether the emphasis on investment should not be supplemented through structural measures aimed at increasing the employment intensity of output. While the strategy should result in improvements in both competitiveness and in employment, the staff is concerned that these will accrue at too gradual a pace, and that, unless visible and early progress in these areas is made, the momentum that is now behind the economy may slow down and impair the pursuit of the strategy itself. Policies should therefore--within the framework of the EMS--seek ways to hasten the strengthening of competitiveness and employment, while, however, avoiding rekindling inflation expectations that would once again endanger convergence toward the lowest inflation performance in the EMS. In any case, a strengthening of the strategy in the following areas would seem necessary.

(i) Wage differentiation. In addition to the need noted earlier to continue the policy of wage restraint, policies should strive to ease impediments to greater wage differentiation in order to improve incentives and promote employment. Thus, sectors that are competitive should in time be able to grant wage increases or other forms of remuneration (such as *interessement*) in line with productivity gains. By the same token, wage increases among uncompetitive sectors or for those types of labor that confront high unemployment rates (e.g., the young and the unskilled) need to be kept to a minimum. If wages (and particularly the SMIC) as well as other aspects of labor costs such as social security contributions are not made increasingly attractive to the employment-intensive service sector, it is difficult to see how major reductions in unemployment could be achieved. While a delicate balance must be struck between social consensus and labor market flexibility in its widest sense, measures that increase or perpetuate existing rigidities should be avoided and, at a minimum, their impact lessened through special programs geared toward enhancing employability.

(ii) Tax and social security policies. The tax burden is high in France and its distribution is not wholly geared toward a strengthening of productive potential and competitiveness. In the context of the single market and the attendant capital liberalization, company tax rates should be cut to assure adequate profitability and avoid discouraging investments in France. The tax system must, moreover, not be biased toward capital intensive forms of production, as is the result of the various taxes on employment, e.g., the *taxe professionelle* and the social security contributions. In addressing the impending imbalances in the social security system, the authorities should take full account of the burden that contributions already represent to competitiveness and incentives to employ and to work. Equilibrium in the social security finances should therefore be maintained by controlling costs and reviewing entitlements as part of an integrated approach with income policies.

(iii) Structural policies. The French authorities have successfully made a major, market-oriented transformation of their financial system. In the staff's view, this transformation made possible the strengthening of monetary management and of EMS coordination observed over the past year. Consistent with the need to strengthen competitiveness, the same fundamental, forward-looking approach to structural reforms needs to be diligently applied to industrial and trade policies. Although on a declining trend, subsidies to industry remain high and are particularly onerous at this stage of the strategy when the resources could be much better used elsewhere; and restrictions on trade, while comparable to those in other countries, remain considerable. In line with the disinflation and competitiveness tenets of the strategy, the authorities should refrain from actions such as the recent restrictions on television imports and are encouraged to initiate and support within the EC measures to further open markets and reduce subsidies, particularly in agriculture where subsidies have increased significantly over the past year.

It is recommended that the next Article IV consultation discussion with France be held on the standard 12-month cycle.

France - Basic Data

Area	549,200 square kilometers
Total population (January 1987):	55.5 million
GDP per capita (1987):	US$15,830

	1965	1985
Life expectancy		
Male	68	75
Female	75	81
Infant mortality rate	22	8
Population per physician	830	460
Higher education rate	18	27

	1987 Percent of GDP	1985	1986	1987	1988	1989
		(Volume changes; in percent)				
Demand and supply						
Household consumption	60.7	2.3	3.4	2.5	2.2	1.8
Public consumption	19.3	2.3	2.6	2.3	2.2	2.2
Gross fixed investment	19.3	2.8	2.9	3.7	6.8	5.4
Public	3.1	8.7	6.1	4.2	4.0	3.5
Residential construction	5.2	-2.4	-1.0	1.3	4.0	3.0
Other private	11.0	4.1	4.0	4.8	9.0	7.0
Stockbuilding 1/	0.5	-0.2	0.8	0.6	-0.1	-0.2
Total domestic demand	99.8	2.2	3.9	3.3	3.0	2.4
Exports of goods and services	21.9	1.7	-0.7	2.6	6.0	4.6
Imports of goods and services	21.7	4.3	7.4	7.5	6.1	4.3
Foreign balance 1/	0.2	-0.6	-1.8	-1.2	-0.2	-0.0
GDP	100.0	1.7	2.1	2.2	2.9	2.4
Value added in manufacturing	...	-1.6	0.0	1.3	2.2	2.2
Memorandum item:						
GDP in current francs	...	4,694.9	5,034.9	5,288.7	5,585.2	5,847.3

	1985	1986	1987	1988	1989
	(In millions; annual averages)				
Employment and unemployment					
Labor force	23.9	24.0	24.1	24.2	24.3
Unemployed	2.4	2.5	2.5	2.6	2.6
(In percent of total labor force)	10.2	10.4	10.6	10.6	10.8

France - Basic Data

	1985	1986	1987	1988	1989
	(Annual changes in percent)				
Prices and incomes					
GDP deflator	5.9	5.1	2.8	2.6	2.2
Consumer price index					
Average	5.8	2.5	3.3	2.5	2.5
Through the year	4.7	2.1	3.1	...	...
Terms of trade	2.6	10.5	1.0	1.3	-0.6
Import unit values	2.2	-12.9	-0.5	3.1	4.2
Average hourly compensation	8.5	4.8	4.8	3.8	3.9
Unit labor costs (in manufacturing)	6.6	2.0	0.7	0.8	0.9
Real disposable income of households	1.5	2.8	0.9	2.0	1.9
Savings ratio (in percent)	13.8	13.3	12.0	11.8	11.9
	(In billions of francs)				
Public finances 2/					
General Government					
Expenditure	2,488.3	2,648.2	2,784.0	2,938.0	3,079.0
Revenue	2,356.6	2,503.3	2,655.5	2,812.0	2,953.0
Financial balance	-131.7	-144.9	-128.5	-126.0	-126.0
(In percent of GDP)	(-2.8)	(-2.9)	(-2.4)	(-2.3)	(-2.2)
Central Government					
Financial balance	-153.3	-141.1	-120.0	-110.0	-106.0
(In percent of GDP)	(-3.3)	(-2.8)	(-2.3)	(-2.0)	(-1.8)
Outstanding state debt					
Total debt	1,067.7	1,194.6	1,272.0	...	...
(In percent of GDP)	(22.7)	(23.7)	(24.0)	(...)	(...)
Foreign debt	44.0	7.0	3.6	...	...
(In percent of GDP)	(0.9)	(0.1)	(0.1)	(...)	(...)
	(In billions of francs)				
Balance of payments					
Trade balance	-48.2	-16.9	-55.7	-38.8	-38.7
Services and private transfers (net)	59.1	56.8	49.5	49.2	52.9
Official transfers	-12.0	-19.7	-18.3	-29.0	-31.0
Current account	-3.1	20.5	-24.5	-18.6	-16.8
(As a percent of GDP)	(-0.1)	(-0.4)	(-0.4)	(-0.3)	(-0.3)
Autonomous long-term capital	29.4	-51.7	11.7	...	...
Short-term capital 3/	-5.8	42.9	-44.4	...	...
Net change in official reserves	20.4	11.7	-57.1	...	...

France - Basic Data (Concluded)

	1985	1986	1987	1988	1989
	(Annual changes in percent, except where otherwise noted)				
Exchange rates					
French franc per U.S. dollar (period average)	8.99	6.93	6.01	5.93	6.06
French franc per deutsche mark (period average)	3.05	3.19	3.34	3.37	3.37
Effective rate (MERM)	0.9	6.1	2.4	-1.5	-0.3
Relative unit labor costs (In manufacturing)	4.6	3.3	-0.9	-4.6	-3.1
	(Through-the-year changes in percent)				
Monetary data					
Money and quasi-money (M2)	6.0	4.1	4.3	4.0-6.0 5/	...
Domestic credit 4/	10.4	7.7	9.7	...	...
Claims on the Government	13.8	5.4	-4.4	...	...
Claims on the economy	9.7	8.1	12.2	...	...
	(Period averages; in percent)				
Interest rates					
Three-month interbank money rate	10.08	7.79	8.22	7.34 6/	...
Government bond yield	10.94	8.44	9.43	9.22 6/	...
	(Period average; in percent)				
Differentials with Germany					
CPI inflation rate	3.6	2.7	2.9	1.3	0.2
Unit labor costs (in common currency) 7/	6.3	-2.2	-2.3	-0.9	-1.2
FF/DM rate (percent change)	-0.6	4.8	4.6	0.9	-0.1
Three-month money rate	4.7	3.2	4.2	4.0 6/	...
Government bond yield	4.0	2.5	3.6	3.1 6/	...
Total domestic demand	1.2	0.1	0.4	0.1	0.5
	(Changes in percent)				
Partner country data					
Non-oil imports in volume (market growth)	3.3	3.3	5.1	5.9	4.3
ULCs in manufacturing in francs	1.9	-0.1	1.6	5.7	3.9

Sources: Data provided by the French authorities; and staff estimates.

1/ Changes expressed as a percent of previous year's GDP.

2/ National income accounts basis for General Government, administrative basis for Central Government.

3/ Including errors and omissions, and short-term bank capital.

4/ Counterparts to M3.

5/ Official monetary target.

6/ May 1988.

7/ In manufacturing.

Medium-Term Scenarios

In assessing medium-term prospects, the staff has examined the properties of several models of the French economy and the medium-term scenarios to 1992 that have been put together based on these models. Since a broad characterization of these models and scenarios has been given in the text, the purpose of this appendix is to identify these models and scenarios and to mention pertinent differences among them. The main results of these scenarios are given in Table 1. They are identified by their respective institutional affiliations, namely the Institut National de la Statistique et des Etudes Economiques (INSEE); Observatoire Français des Conjonctures Economiques (OFCE); and the Institut de Prévisions Economiques et Financieres pour le Developement des Entreprises (IPECODE). It should be understood that none of the scenarios can be considered official, including the one by the government agency (INSEE). Table 1 also presents the staff's medium-term estimates.

The INSEE scenario 1/ is based on the DMS model, 2/ a large-scale macroeconomic model that has been a workhorse of policy analysis in France for well over a decade. While the model would "spontaneously" generate real wage restraint if allowed to run unconstrained (because of the presence of Phillips curve mechanisms), this was overridden in the simulation to constrain real wages to increase in step with productivity. While this assumption has beneficial effects on output in the short run, it has adverse effects in the medium term since the faster growth of consumption is at the expense of exports and investment. Exports (and thereby, via the external constraint, the overall growth of the economy) end up being constrained by insufficient capacity.

The OFCE scenario, 3/ which is based on their quarterly model of the economy, foresees wages rising by only 3/4 percent per annum in real terms, or by about 1 1/2 percent less than productivity. However, the effect of the resulting increase in profitability on investment is attenuated by the efforts of firms to reduce indebtedness and by the weakness of consumption. The consequential effects on unemployment were limited by assuming that labor productivity growth would slow as a result of structural shifts. The scenario foresees a significant improvement in competitiveness, but most of this is due to the assumption of a depreciation of the franc vis-à-vis the deutsche mark

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1/ Equipe DMS, "Une Exigence de competitivité pour l'economie française," Economie et Statistique, December 1987, pp. 5-15.

2/ Equipe DMS, DMS-4--Modele Dynamique Multi-Sectoriel, (INSEE: Collections de l'Insee, series C, No. 139, July 1987).

3/ Monique Fouet, Alain Fonteneau, and Eric Bleuze, "Perspectives de l'Economie Française a l'horizon 1992," Observations et Diagnostics Economiques, January 1988, pp. 13-52.

early in 1989. Abstracting from the effects of this assumption, the improvement in export price competitiveness due to wage restraint is under 1 percent per annum. On the other hand, the scenario also assumes a fairly rapid, sustained rise in oil prices (to $31 a barrel in 1992). This weakens the effects of the policy of wage restraint since the oil price rise is mainly absorbed by enterprises. Nonetheless, the essential workings of the policy strategy remain in place since corporate profits and competitiveness improve throughout the period to 1992.

The IPECODE scenario 1/ is based on the ICARE model. Insofar as its internal dynamics are concerned, this scenario is broadly along the lines described in the text. On the external side, the scenario assumes a modest appreciation of the U.S. dollar, and a growth recession in 1989 followed by a fairly marked pick up in activity in 1990-92, notably as regards world trade. Hence, France's exports are quite buoyant, which permits a relatively faster growth of demand and output and, thereby, a stabilization of the unemployment rate around 12 percent in the early 1990s.

1/ Dominique Dumazet, "L'Economie Française Jusqu'en 1992," Revue de l'IPECODE, No. 19, April 1988, pp. 43-73.

Table 1. France: Medium-Term Scenarios to 1992

	Baseline Scenario Estimates of			
	INSEE 1/	OFCE	IPECODE	IMF Staff
	(Average changes in percent, 1988-92)			
Growth, in volume of:				
GDP	2.1	2.3	2.9	2.8
Relative to partners 2/	-0.2	...	0.4	0.1
Consumption	1.9	1.4	2.5	2.2
Fixed investment--Total	...	...	4.2	5.1
Enterprises	4.7	5.1	6.4	6.5
Exports of goods and services	4.1	4.9	6.0	5.6
Inflation (CPI)	3.2	3.2	2.4	2.5
Relative to partners 2/	0.3	+	--	-0.6
	(Levels in 1992)			
Unemployment rate	14.6	14.0	12.2	11.2
Balance on current account (in percent of GDP)	--	0.4	--	--
Assumptions on:				
Oil prices, per barrel	...	$31	$18	$17.4
Exchange rates	Constant real	3/	4/	Constant real

Sources: See text.

1/ Growth rates refer to 1987-92.
2/ The concept of "partners" varies across the simulations as regards coverage and weights so that the estimates are not strictly comparable.
3/ 5 percent depreciation vis-à-vis deutsche mark in 1989 together with a small appreciation of U.S. dollar.
4/ Small appreciation of U.S. dollar.

Table 2. Seven Major Industrial Countries: Indicators of Economic Performance, 1983-89

(Changes in percent, except where otherwise indicated)

	Average 1983-85	1986	1987	1988 1/	1989 1/
Canada					
Real GDP	4.7	3.2	4.0	4.0	3.1
(Q4 over Q4)	...	1.2	6.1	2.8	2.8
Real total domestic demand	4.8	3.9	4.7	5.4	3.9
Unemployment rate 2/	11.2	9.6	8.9	7.7	7.6
Consumer prices	4.7	4.2	4.4	3.9	3.5
GDP deflator	3.7	2.5	4.3	3.8	3.6
Gross private investment (in percent of GDP)	17.3	18.2	21.2	22.4	22.8
General government financial balance (in percent of GDP; national accounts basis)	-6.8	-5.5	-4.6	-3.5	-3.5
Private saving (in percent of GDP) 3/	24.5	21.7	23.8	23.9	23.8
Current account balance (in percent of GDP)	0.4	-2.1	-1.9	-2.0	-2.5
United States					
Real GNP	4.4	2.9	3.4	3.9	2.7
(Q4 over Q4)	...	2.0	5.0	2.8	2.7
Real total domestic demand	5.8	3.7	3.0	2.8	2.5
Unemployment rate 2/	8.1	7.0	6.2	5.4	5.3
Consumer prices	3.7	1.9	3.7	4.1	4.5
GNP deflator	3.6	2.7	3.3	3.0	4.1
Gross private investment (in percent of GNP)	16.1	16.3	15.8	16.0	16.0
General government financial balance (in percent of GNP; national accounts basis)	-3.3	-3.4	-2.3	-2.2	-1.9
Private saving (in percent of GNP) 3/	17.0	16.4	14.7	15.2	15.2
Current account balance (in percent of GNP)	-2.4	-3.3	-3.4	-2.9	-2.6
Japan					
Real GNP	4.4	2.5	4.2	5.8	4.2
(Q4 over Q4)	...	2.0	5.5	4.5	5.1
Real total domestic demand	3.2	4.0	5.1	7.4	4.9
Unemployment rate 2/	2.7	2.8	2.8	2.6	2.5
Consumer prices	2.1	0.6	0.1	1.1	1.6
GNP deflator	1.2	1.8	-0.2	0.9	1.4
Gross private investment (in percent of GNP)	23.2	23.0	24.0	25.3	26.1
General government financial balance (in percent of GNP; national accounts basis)	-2.2	-1.1	-0.4	0.1	0.3
Private saving (in percent of GNP) 3/	28.1	28.4	28.0	28.0	28.5
Current account balance (in percent of GNP)	2.7	4.3	3.6	2.8	2.7
France					
Real GDP	1.2	2.1	2.2	2.9	2.4
(Q4 over Q4)	...	2.0	2.1	2.3	2.1
Real total domestic demand	0.6	3.9	3.3	3.0	2.4
Unemployment rate 2/	9.4	10.4	10.6	10.6	10.8
Consumer prices	7.6	2.5	3.3	2.5	2.5
GDP deflator	7.7	5.1	2.8	2.6	2.2
Gross private investment (in percent of GDP)	16.4	16.1	16.5	16.9	17.1
General government financial balance (in percent of GDP; national accounts basis)	-2.9	-2.9	-2.4	-2.3	-2.2
Private saving (in percent of GDP) 3/	19.0	19.2	18.4	18.9	19.0
Current account balance (in percent of GDP)	-0.3	0.4	-0.5	-0.3	-0.3
Germany					
Real GNP	2.4	2.5	1.7	2.3	1.8
(Q4 over Q4)	...	2.4	2.3	1.1	2.4
Real total domestic demand	1.8	3.8	2.9	2.9	1.9
Unemployment rate 2/	8.1	7.9	7.9	7.9	8.1
Consumer prices	2.6	-0.2	0.2	1.2	2.3
GNP deflator	2.5	3.1	2.1	1.8	2.0
Gross private investment (in percent of GNP)	17.7	16.8	17.3	17.7	17.6
General government financial balance (in percent of GNP; national accounts basis)	-1.9	-1.2	-1.7	-2.3	-2.0
Private saving (in percent of GNP) 3/	21.2	22.4	23.0	23.5	22.8
Current acount balance (in percent of GNP)	1.7	4.4	4.0	3.5	3.2
Italy					
Real GDP	2.4	2.9	3.1	3.0	2.4
(Q4 over Q4)	...	3.0	2.8	2.9	2.4
Real total domestic demand	2.4	3.2	4.7	3.8	2.9
Unemployment rate 2/	10.1	11.1	12.0	12.0	12.1
Consumer prices	11.6	5.9	4.7	4.9	5.0
GDP deflator	11.7	7.5	5.6	5.1	5.0
Gross private investment (in percent of GDP)	18.8	17.7	17.5	17.6	17.5
General government financial balance (in percent of GDP; national accounts basis)	-11.5	-11.4	-10.5	-9.9	-10.0
Private saving (in percent of GDP) 3/	29.9	29.5	27.9	27.2	27.0
Current account balance (in percent of GDP)	-0.4	0.4	-0.1	-0.3	-0.5
United Kingdom					
Real GDP	3.2	3.2	4.6	3.2	2.2
(Q4 over Q4)	...	4.5	4.6	2.9	1.7
Real total domestic demand	3.5	3.8	4.2	4.5	2.3
Unemployment rate 2/	11.0	11.4	10.3	8.9	8.7
Consumer prices	5.2	3.4	4.2	4.6	4.4
GDP deflator	5.1	3.6	4.4	4.9	4.5
Gross private investment (in percent of GDP)	15.7	15.3	17.3	17.8	17.6
General government financial balance (in percent of GDP; national accounts basis)	-3.4	-2.7	-1.4	-0.9	-1.0
Private saving (in percent of GDP) 3/	20.0	18.0	18.3	16.7	16.5
Current account balance (in percent of GDP)	0.9	--	-0.4	-2.0	-2.1

Sources: World Economic Outlook (WEO) and staff projections.
1/ Staff projections; second round of the current WEO exercise.
2/ In percent of the labor force.
3/ Including statistical discrepancy. Calculated as a residual: private saving = gross private investment - general government financial balance + current account balance.

France - Fund Relations

(As of July 28, 1988; in millions of SDRs)

I. Membership Status

France is one of the original members of the Fund. France accepted the obligations of Article VIII, Sections 2, 3, and 4, of the Fund agreement as of February 15, 1961.

A. Financial Relations

II. General Department

(a) Quota: SDR 4,482.8 million.

(b) Total Fund holdings of French francs:
SDR 3,261.0 million (72.74 percent of quota).

(c) Fund credit:
None.

(d) Reserve tranche position:
SDR 1,222.1 million.

(e) Current operational budget:
The French franc is included in the current budget.

(f) Lending to the Fund (SDR millions):

	Limits	Outstanding	Uncalled
CAB	1,700.0	--	1,700.0
SFF	--	--	--
Enlarged access	--	--	--

III. Current Stand-By or Extended Arrangement and Special Facilities

No use of Fund credit during the last 10 years.

IV. SDR Department

(a) Net cumulative allocation: SDR 1,079.9 million.

(b) Holdings: SDR 1,081.0 million, or 100.1 percent of net cumulative allocation.

(c) Current Designation Plan: France is included in the current plan.

V. Enhanced Structural Adjustment Facility (SDR millions)

	Limit	Outstanding	Uncalled
Loan contribution by Caisse Centrale de Cooperation Economique	800	--	800

VI. Administered Accounts

Not applicable.

VII. Overdue Obligations to the Fund

None.

B. Nonfinancial Relations

VIII. Exchange Rate Arrangements

Since March 13, 1979, France has participated together with Belgium, Denmark, Germany, Ireland, Italy, Luxembourg, and The Netherlands in the exchange rate mechanism of the European Monetary System (EMS). Under this agreement, France maintains spot exchange rates of the currencies of the other participants within margins of 2.25 percent (in the case of the Italian lira, 6 percent) above and below cross rates derived from central rates expressed in ECUs.

IX. The last Article IV consultation was concluded at EBM/87/119 (8/5/87). France is on a 12-month consultation cycle.

France--Statistical Issues

1. Outstanding Statistical Issues

a. Monetary accounts

Monetary aggregates are now regularly updated in IFS with data provided by the Bank of France. In addition, the Bank of France recently provided the Bureau of Statistics with a revised set of quarterly data for the deposit money banks and other banking institutions covering the period March 1978-December 1987, which will be incorporated in an early issue of IFS. These revised data reflect the culmination of discussions between the Bank of France and the Bureau which commenced in 1983. The revisions result from a major expansion in banks' reporting systems. The authorities have also revised their own presentations of money and banking data in national sources; as a result of the above-mentioned discussions, these sources can in the future be used to update the IFS page without recourse to unpublished balance sheet data.

b. Government finance

The annual data on government finance published in IFS are as reported in the GFS Yearbook and include social security and extra-budgetary operations through 1986; monthly and quarterly data cover only Treasury operations. The debt data published in IFS cover only the outstanding debt of the Treasury and are not published in the GFS Yearbook due to differences in coverage of other government finance data and to the lack of breakdowns by type of debt holder and type of debt instrument. The GFS Yearbook also publishes data on local and consolidated general government through 1985.

2. Coverage, Currentness, and Reporting of Data in IFS

The table below shows the currentness and coverage of data published in the country page for France in the August 1988 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Bank of France which during the past year have been provided on a timely basis.

Status of IFS Data

		Latest Data in August 1988 IFS
Real Sector	- National Accounts	1987
	- Prices: CPI	May 1988
	- Production:	April 1988
	- Employment:	Q4 1987
	- Earnings:	March 1988
Government Finance	- Deficit/Surplus	November 1987
	- Financing	November 1987
	- Debt	November 1987
Monetary Accounts	- Monetary Authorities	June 1988
	- Deposit Money Banks	April 1988 (partial)
	- Other Banking Institutions	1984
Interest Rates	- Discount Rate	June 1988
	- Bank Lending/Deposit Rates	May 1988
	- Bond Yields	May 1988
External Sector	- Merchandise Trade: Values:	May 1988
	Prices:	Q3 1986
	- Balance of Payments	Q2 1987
	- International Reserves	May 1988
	- Exchange Rates	June 1988

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