**FOR AGENDA**



SM/86/196

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INFORMATION

August 8, 1986

To: Members of the Executive Board

From: The Secretary

Subject: France - Staff Report for the 1986 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1986 Article IV consultation with France, which has been tentatively scheduled for Executive Board discussion on Friday, September 5, 1986.

Mr. Bennett (ext. 4544) or Mr. Mackenzie (ext. 4546) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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Department Heads

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INTERNATIONAL MONETARY FUND

# FRANCE

## Staff Report for the 1986 Article IV Consultation

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

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

August 8, 1986

## I. Introduction

Article IV consultation discussions were held in Paris from June 10 to June 18, 1986. The staff team consisted of Messrs. L. A. Whittome, P. Dhonte, A. Bennett, G. A. Mackenzie, S. Powell and Miss S. Durand-Jansiac as secretary (all EUR). It met with the Minister of State responsible for the Economy, Finance and Privatization, Mr. E. Balladur; the Governor of the Banque de France, Mr. M. Camdessus; and officials of the Administration and the Banque de France. Mr. P. de Fontenay (EUR) joined the mission during the first week. The Executive Director for France, Mrs. H. Ploix, attended the meetings as an observer. France has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund agreement as of February 15, 1961.

## II. Background to the Discussions

### 1. Introduction

In the early 1980s the French Government sought to stimulate the economy by means of an increase in public sector expenditures accompanied by a sizable increase in the budget deficit. At the same time an effort was made to work more directly on the problem of unemployment through legislation which reduced the length of the working week.

Total domestic demand grew by 4 percent in 1982. But domestic supply failed to expand to the same extent so that the current account deficit rose sharply, reaching almost F 80 billion in that year. Prices, as measured by the CPI, rose by nearly 12 percent. The Government reacted and in 1983 changed the stance of fiscal policy and successfully induced a marked change in wage behavior. Because of this, and helped by a favorable cyclical position as the rest of the world came out of recession, considerable progress had been made by the time of the discussions in correcting the imbalances which had emerged so rapidly and so strikingly.

Nevertheless, despite the improvement recorded most notably in price behavior and the current account of the balance of payments in 1983 and 1984, the mere elimination in the second half of 1985 of the cyclical differential which had favored France led rapidly to a weakening in the trade balance in volume terms and to a deceleration of inflation that was less marked than could have been expected. This experience underlined the fact that the continued pursuit of corrective measures was needed. This indeed had been the view expressed by Executive Directors at the conclusion of the last Article IV consultation discussion with France in July 1985. On that occasion Executive Directors stressed that a further strengthening of financial policies remained essential and that increased attention needed to be paid to the removal of the rigidities which continued to affect many aspects of French economic life. The Government that took office in March 1986 was of the same opinion. It announced that it would both seek an improved fiscal balance and introduce a series of measures which would liberalize the economy and thus facilitate a return to stronger economic growth.

In considering the present position of the French economy it is useful to recall at the outset that the reasons why domestic supply failed to respond to the stimulus provided in 1981 remain a subject of debate. Clearly the timing of the experiment was unfortunate in that the anticipated increase in world trade failed to materialize. In particular domestic demand rose significantly more rapidly in 1982 in France than in partner countries, notably Germany. The deterioration in the French terms of trade, largely associated with an unforeseen rise in the value of the U.S. dollar, was also unhelpful. However, most analysts have concluded on the basis of a number of recent studies that a major reason for the failure of French industry to respond lay in a lack of competitiveness centered around a compression of profits. The need to improve the competitiveness of the French economy has been pursued through various instruments since 1983 and it remains a central preoccupation of the French authorities.

## 2. Activity and prices

Growth of real GDP in 1985 (1 1/4 percent) remained low by comparison with France's historical standards and the contemporary performance of its main trading partners (Chart 1). While it picked up during the year, it was outpaced by the expansion of demand, which was notably strong in the second half of the year. The resulting deterioration of the trade balance in volume terms, though offset by terms of trade gains, prompted renewed concern about the competitiveness of the economy, especially in the industrial sector. Looking at the cumulative change since 1980, 1/ the growth of domestic demand has been

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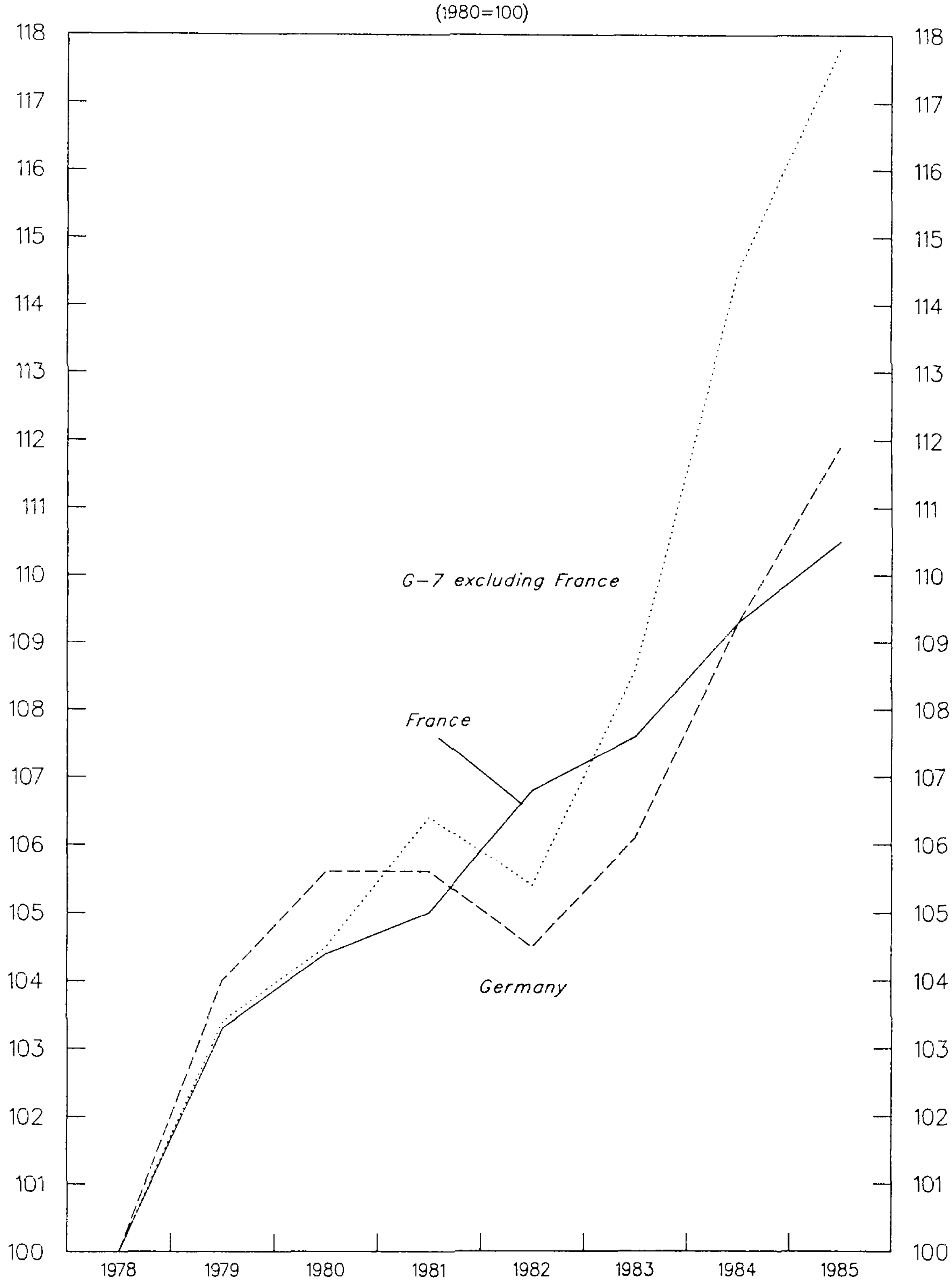
1/ A period chosen to embrace both 1981 and 1982, when demand was being stimulated, and the subsequent years, when corrective measures were in effect.

CHART 1
FRANCE AND G-7
REAL GDP
(1980=100)




Source: IMF, Datafund.

stronger in France than in other industrial countries (Table 1). But, in contrast to most other industrial countries the growth of output, particularly industrial production, has lagged demand. These trends continued in early 1986, when GDP increased at an annual rate of only 1/2 to 1 percent, and domestic demand continued to expand at a rate approaching that seen in the second half of 1985. As a result, the contribution of the trade balance was again contractionary.

Table 1. France and Other Industrial Countries:
Demand and Output

(Percentage growth rates, cumulative 1980-85)

| | France | Other industrial countries 1/ |
|---|---|---|
| Real GDP | 5.7 | 7.0 |
| Industrial production | 0.7 | 3.0 |
| Total domestic demand | 5.8 | 3.1 |

Source: World Economic Outlook.
1/ Weighted by the structure of France's exports.

The deceleration of inflation that had begun in 1982 continued into 1985 and the first half of 1986 (Chart 2). By June 1986 the year-on-year increase in consumer prices had fallen to 2.3 percent, and the gap between inflation (CPI) in France and that in her main trading partners had virtually been eliminated, although that with Germany was still about 2 1/2 percent.

The fall in inflation in 1985 was mainly the result of a sharp decline in import prices, especially those of energy and raw materials, but wage moderation continued to play a part. Wage settlements were based on a price target, set by the authorities at 4.5 percent through the year, which was slightly lower than that of the previous year (5.5 percent). In the event, average hourly wage and salary rates in the whole economy rose by 5.4 percent through the year. Although the growth of productivity fell slightly, both in the whole economy and in manufacturing, a further deceleration in unit labor costs was recorded.

Producer price increases decelerated by rather less than costs in 1985, with the result that producers' profit margins were further rebuilt. Gross operating profit margins have now recovered from the low point of the early 1980s but remain below the levels of the early 1970s. As in many other countries, however, the relative attractiveness of investing in real rather than financial assets has declined considerably (Chart 3). Real long-term interest rates in 1985 were at their highest level in over 30 years (Chart 4). 1/ It has been calculated that to establish the profitability conditions of the early 1970s at the current level of real interest rates, the gross profit margin would have to be approximately double its present level of 24 percent. 2/

The improvement in gross profit margins was one factor behind the rise in 1985 of 5 percent in private nonresidential fixed capital formation in the enterprise sector--the first substantial increase since 1980. Investment by private industrial enterprises 3/ has been buoyant since 1983. Nevertheless, at 11.7 percent of GNP, non-financial business fixed investment in 1985 was still 1.5 percentage points below the 1970-75 average, and, over the period 1980-85, the growth rate of the French capital stock has fallen to 2 percent a year (Chart 5). It is estimated that a growth rate of investment of about 8 percent a year would be required over the next five years to achieve a 4 percent growth rate of the capital stock (i.e., at about its rate of growth through the 1970s) given the fall in the share of investment in GDP in recent years and an apparent decline in capital productivity. 4/

Total employment rose by 135,000 between December 1984 and December 1985. The increase is more than accounted for by the growth of part-time public sector jobs--mainly under the travaux d'utilité collective (TUC) program--which increased by some 190,000. However, even after the

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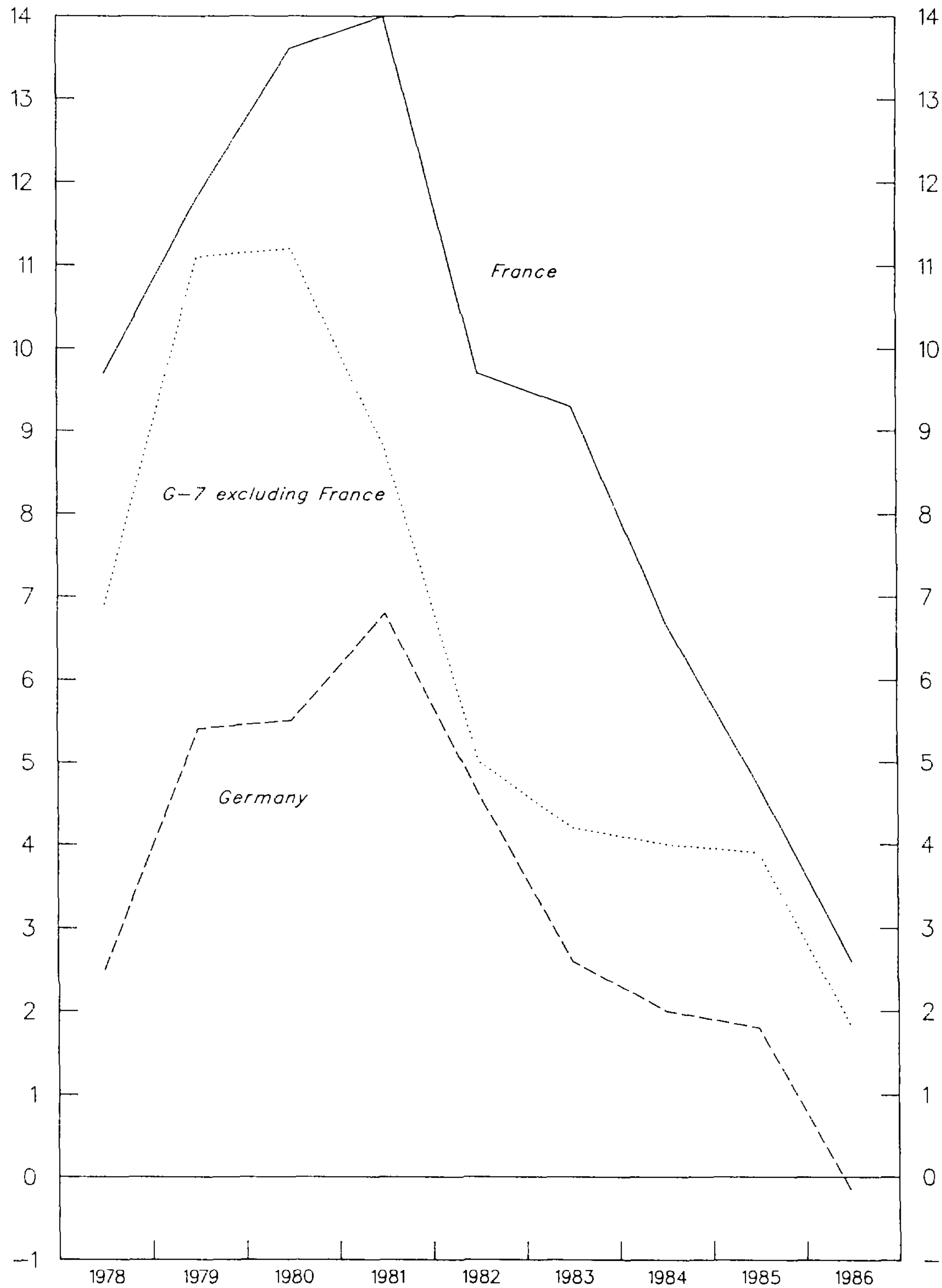
1/ Throughout this report, the real interest rate is measured as the relevant interest rate less the change in the consumer price index (CPI). At a time when the terms of trade are improving, the CPI may be biased downward as an indicator of the underlying rate of inflation. But this bias was insignificant in 1985 when the CPI and other measures of inflation (e.g., the GDP deflator) rose at almost exactly the same rates. Using this definition should also not materially affect cross-country comparisons, as are made elsewhere in this report.

2/ Appendix III to Recent Economic Developments discusses the profitability of the enterprise sector at greater length.

3/ Nonresidential investment in the enterprise sector excluding that in the public utilities (GEN), agriculture, construction and services.

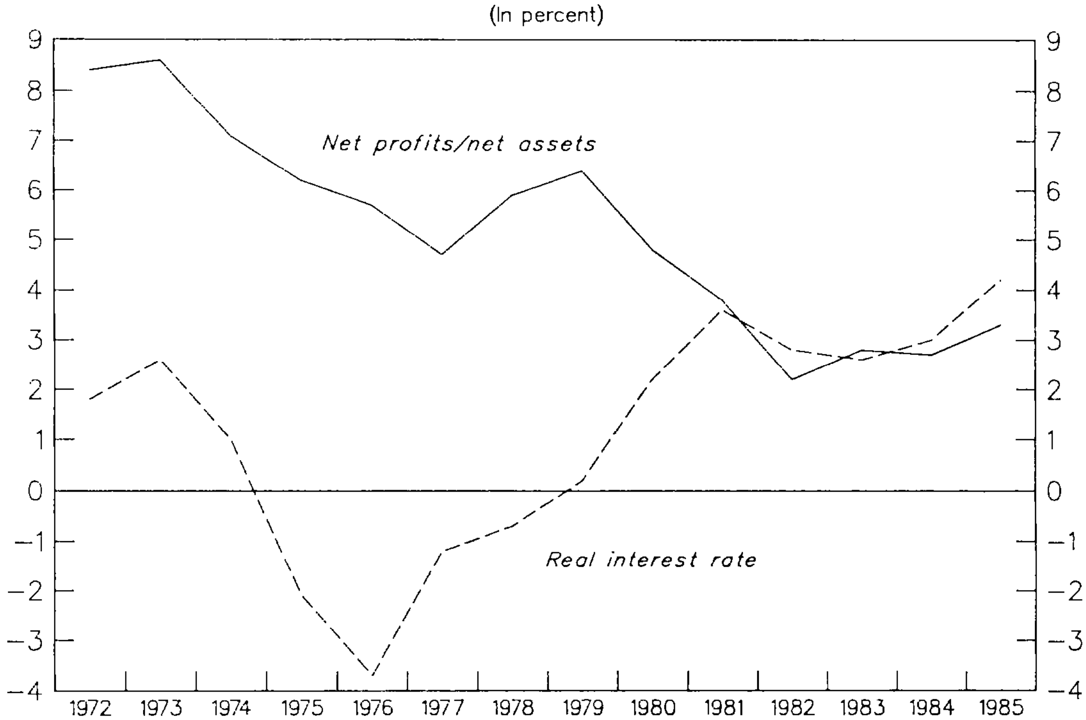
4/ The relationship between the rate of growth of investment and that of the capital stock depends on the rate of depreciation and the ratio of the level of investment to that of the capital stock. The latter can, in turn, be expressed in terms of the product of the ratio of investment to GDP and that of GDP to the capital stock (i.e., capital productivity).

CHART 2
FRANCE AND G-7
CONSUMER PRICES
(Through the year percent change)

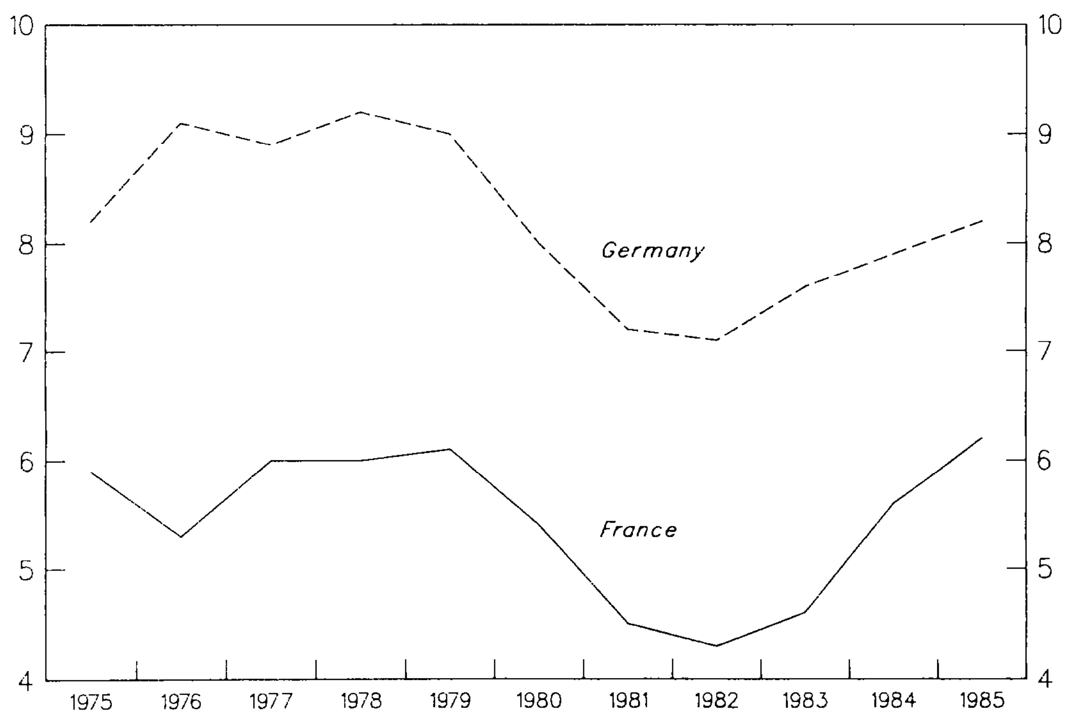



Source: IMF, Datafund.
[1] April 1985/April 1986.

CHART 3
FRANCE
RATE OF RETURN
(In percent)

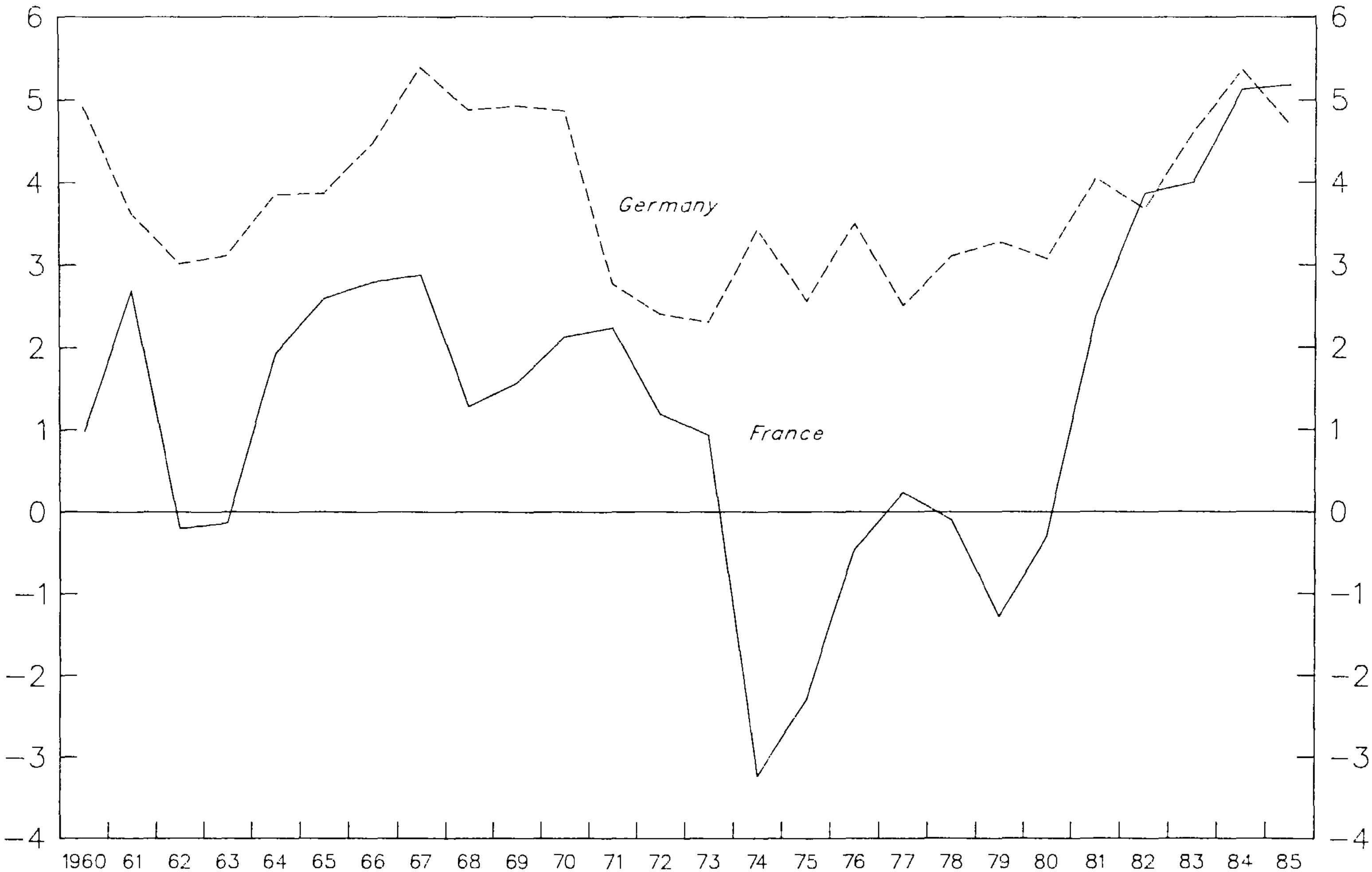



FRANCE AND GERMANY: PROFITABILITY



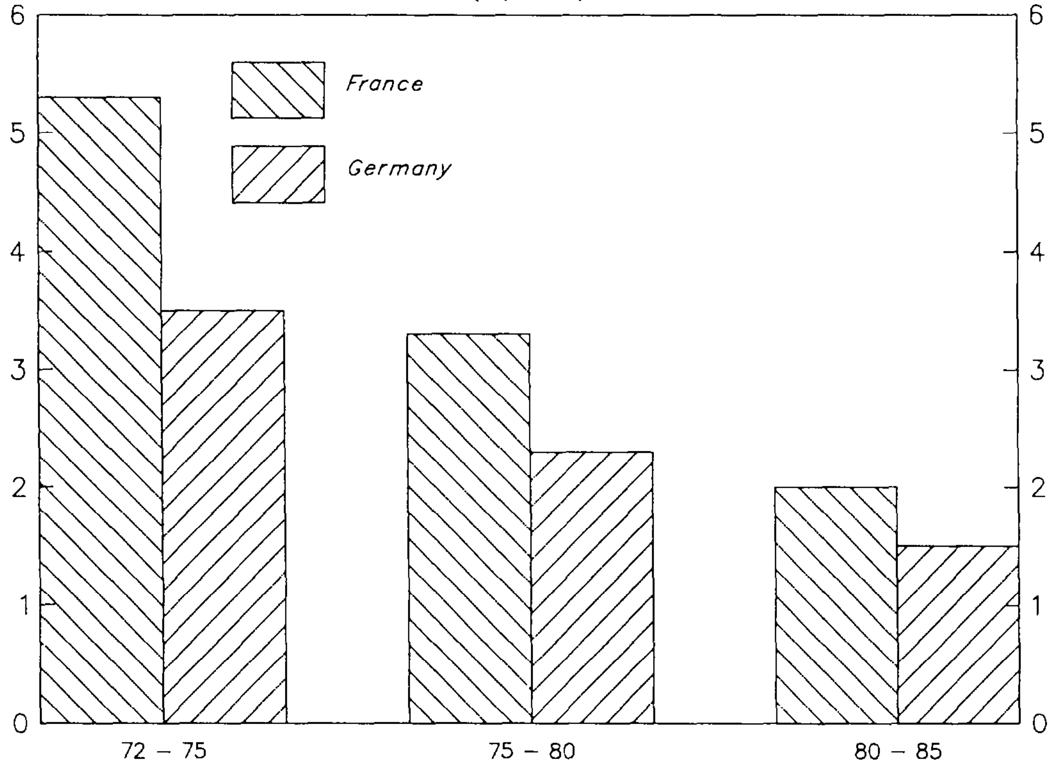

Sources: INSEE; and Statistisches Bundesamt, Volkswirtschaftliche Gesamtrechnungen.

CHART 4
FRANCE AND GERMANY
REAL LONG-TERM INTEREST RATE[1]



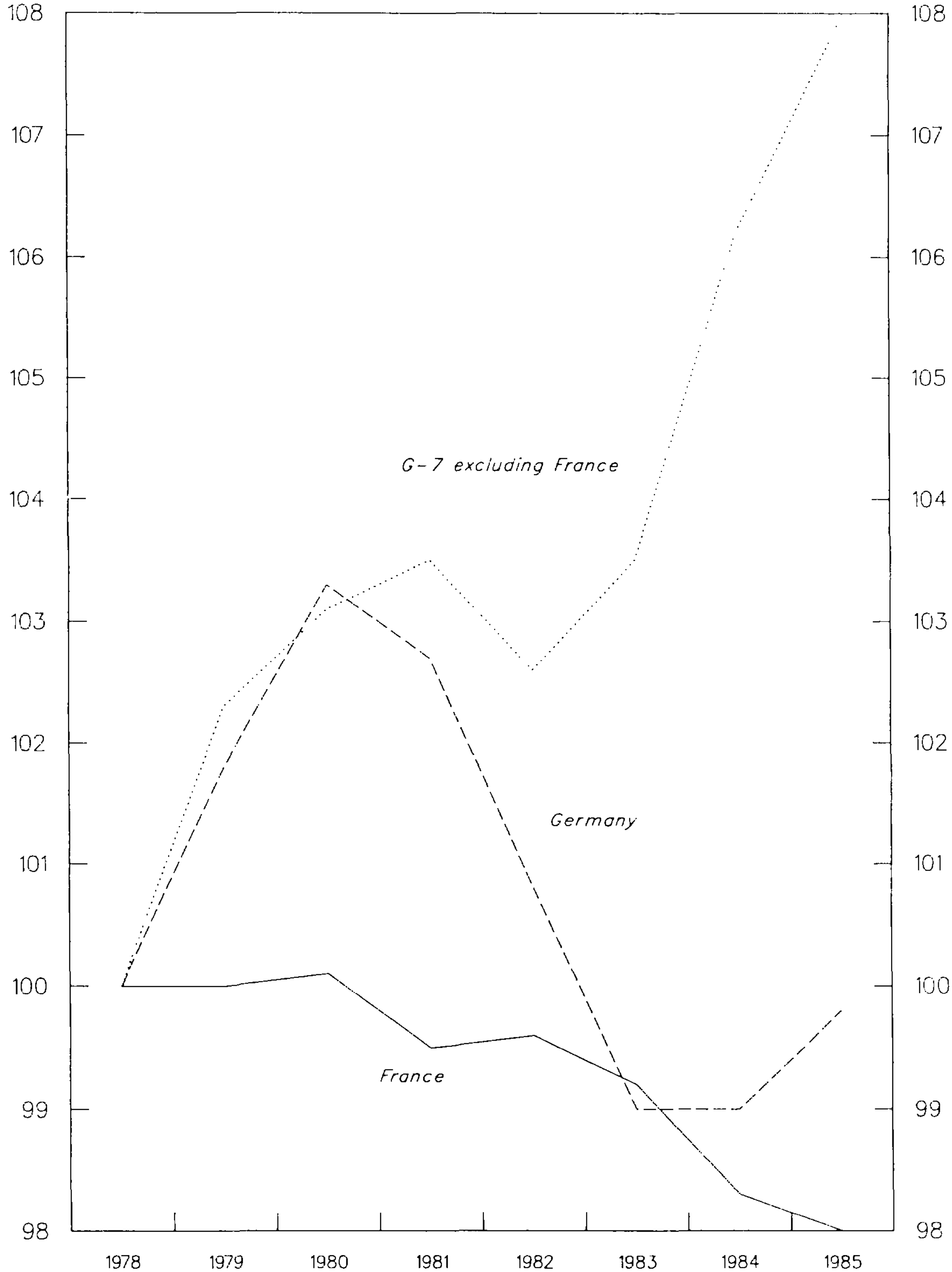

Source: IMF: *International Financial Statistics.*
[1] Government bond yield deflated by the CPI.

CHART 5
FRANCE and GERMANY
CAPITAL STOCK GROWTH
(In percent)




Source: Commission of the European Communities.

CHART 6
FRANCE AND G-7
EMPLOYMENT
(1978=100)




Source: IMF, Datafund.

figures are adjusted to exclude the impact of this program, the trend to decline in employment slowed in 1985. The success of the TUC program mitigated unemployment among young persons, which rose by less than the average. The unemployment rate averaged 10.4 percent of the labor force in 1985.

### 3. Financial developments

The 1985 budget aimed to reduce the central government deficit on a cash basis to the equivalent of 3 percent of GDP from 3.4 percent in 1984 and to lower the overall tax burden (total tax revenues and compulsory social security contributions, at general government level) by 1 percentage point of GDP. The central government deficit (on an administrative basis) turned out at 3.3 percent of GDP, while the overall tax burden, at 45.6 percent of GDP, was slightly above the 1984 outturn. Continued buoyancy of local authority taxes as well as a better than expected result for the social security accounts helped bring about an improvement in the general government deficit, which fell from 2.9 percent of GDP in 1984 to 2.6 percent in 1985 (Table 2).

Table 2. France: Public Sector Financial Balances, 1980-85

(National accounts basis; as a percent of GDP)

| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|---|
| 1. General Government | 0.2 | -1.8 | -2.7 | -3.1 | -2.9 | -2.6 |
| Of which: | | | | | | |
| Central Government | -0.2 | -1.2 | -1.9 | -3.3 | -3.2 | -2.9 |
| Local authorities | -0.5 | -0.6 | -0.8 | -0.6 | -0.4 | -0.3 |
| Social security funds | 0.9 | -0.1 | 0.1 | 0.8 | 0.6 | 0.5 |
| 2. Large public utilities (GEN) | -1.5 | -1.6 | -1.6 | -1.5 | -0.7 | -0.5 |
| 3. Total public sector (1+2) | -1.3 | -3.4 | -4.3 | -4.6 | -3.6 | -3.1 |

Source: INSEE, Rapport sur les comptes de la nation, 1985.

The financing requirement of the public utilities fell again in 1985. There are no aggregate data on the financial position of the nationalized enterprises in the competitive sector. All six of the big industrial concerns nationalized in 1982 made profits in 1985, and, taken as a whole, the group showed a profit net of central government grants. The steel producers continued to make losses, though on a significantly reduced scale. Renault's losses, however, at more than F 11 billion, were about the same as in 1984.

Monetary policy in 1985 was set in terms of a target rate of growth of 4 to 6 percent in M2 held by residents (M2R), somewhat below an assumed 1985 growth in nominal GDP of 7 1/2 percent. In the event, the target range was overshot, with M2R growing by 6.9 percent over the period, 1/ despite policy adjustments in July to slow credit expansion and to offset the unexpectedly positive external contribution to monetary growth.

## 4. External developments

*The improvement in the external current account--of F 5 billion* compared with 1984--was considerably less than that recorded in 1983 and 1984 but was sufficient to bring the current account into approximate balance. As in 1984, however, net outflows for trade credits declined considerably and there was a substantial positive swing in private short-term capital flows. As a result, the net deficit on current and autonomous capital transactions fell sharply to about F 9 billion, and was broadly matched by authorized long-term borrowing. However, because of valuation effects, French external debt fell during 1985 to F 469 billion (about 10 1/2 percent of GDP), from F 530 billion (12 1/2 percent of GDP) at the end of 1984. Official development assistance (ODA) (excluding transfers to France's overseas departments and territories, equivalent to 0.25 percent of GDP), amounted to the equivalent of 0.54 percent of GDP in 1985, slightly higher than in 1984.

Over most of the year, the franc remained relatively strong within the EMS, as it had done in 1984, again partly because of a large positive short-term interest rate differential vis-à-vis the deutsche mark. At the end of the year, speculation about an impending realignment grew and the approach of the March 1986 elections provoked further speculation in February. In the April 1986 realignment, the franc was devalued by 6.0 percent against the deutsche mark (central rates) offsetting much of the cumulative inflation differential between the two countries (Chart 2). But, since the franc had been near the floor of the EMS grid prior to the realignment and moved to the top afterwards, the actual devaluation against the deutsche mark was only 3.5 percent.

In support of the realignment, the Government confirmed a target for monetary growth of 3 to 5 percent in 1986, a halving of the monetary financing of the Treasury in 1986 relative to previous plans and its elimination in 1987; and announced cuts in public expenditure of F 10 billion in 1986 and F 40 billion in 1987. It also announced the

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1/ These growth rates refer to quarterly averages, centered on December.

following objectives: to eliminate within three years the central government deficit, excluding debt interest payments; no general increase in public sector wages and salaries in 1986; the immediate abolition of exchange controls imposed after 1981, and virtually all controls on industrial prices (together with the announcement that all price controls in the service sector would be removed by the beginning of 1987); the removal of administrative constraints on the laying off of labor from the beginning of 1987; and a substantial program of privatization.

## III. Discussions on Policy

The central topic of the discussions concerned the stance of policy that might hold out the best chance of improving the prospects for the future growth of the economy and of a reduction in unemployment without jeopardizing the external position or the further deceleration of inflation. The authorities argued that these aims could best be secured by taking measures to improve competitiveness and to increase the share of investment in GDP. Investment, which was still significantly below the levels reached in the early 1970s, would need to be both of a capital-deepening nature so as to contribute to an improvement in competitiveness and of a capital-widening kind so as to create additional employment. It was recognized that an increased rate of investment would be needed in both the manufacturing and service sectors, for future employment prospects might well be increasingly found in the latter.

In considering how best to facilitate an increase in investment the authorities stressed their view that a further shift in the distribution of income in favor of profits was essential. They discussed also the probable role of interest rates in stimulating investment and the economic effects of the series of measures that had been and would be taken to liberalize the economy.

### 1. Price and incomes policies

The French representatives said that a necessary condition for fostering the competitiveness of the economy was an improved inflation performance. The aim was to limit the rise in consumer prices through 1986 to 2.3 percent. Price convergence with Germany remained the Government's target and further progress could be expected in 1987, when they were anticipating an increase in consumer prices of 1.7 percent through the year, principally in response to a further deceleration in wages.

The basic objective of the Government's incomes policy 1/ was to maintain average per capita wages and salaries unchanged in real terms. Salary increases in the public sector were based on the consumer price inflation target in through-the-year terms. If the strict application of this rule resulted in a fall in average real earnings in the public sector, then a safeguard provision would allow a catchup in the following year. The Government's target for wages for 1986 was very tight given the goal of no real increases in wages and catchup effects from 1985. It left no room in the civil service for general salary increases during the year. It would, however, be important to achieve the target both for wages and for prices in 1986 since this would avoid further carryover effects in 1987. Otherwise the 1987 price target would be in jeopardy. The 1987 target, which implied an increase in the whole economy of about 1 percent in real wages per capita, assumed a further deceleration in average annual nominal increases in wages to 3 percent from 4.5 percent in 1986 and about 6 percent in 1985. The maintenance of a tight approach to incomes into 1987 was seen as the major macroeconomic problem facing the Government, given that almost all price controls would by then have been lifted. The coming into line of wage behavior in France and in Germany offered a unique opportunity to wipe out the inflation differential between the two countries.

The authorities confirmed that items with a weight of about 50 percent in the CPI remained under some kind of control, and that, of these, items (such as utility prices) with a weight of about 30 percent would continue to be administered in much the same way as in other industrial countries. Most prices of personal services (e.g., those for auto repairs, hotel rooms) as well as certain basic food prices remained controlled, although the Government had just announced some further liberalization of price controls covering, for example, the prices of fruits and vegetables. There was a risk that complete liberalization would be perceived as a signal that would trigger price increases and would compromise the price and incomes policy targets for 1987. Nevertheless, the authorities intended to lift all controls on the prices of services by the end of 1986.

Under the system of wage negotiations introduced in late-1982, an annual norm for wage and salary increases had been set, based on the official target for future consumer price inflation. This approach has been enforced in the public sector and had gained widespread acceptance in the private sector. This "deindexation" of wages was considered by

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1/ The Government's policy on incomes combines limits on wage and salary increases in the public sector with an exhortation that increases in private sector be equally restrained. Since this policy cannot be enforced in the private sector, it is something of a misnomer to call it an incomes policy. Nonetheless, this term is used here as a convenient shorthand expression to describe the Government's policies, including the abolition of backward-looking indexation and the encouragement of decentralized wage-bargaining.

the authorities to be a major breakthrough. Although mechanistic calculations show that more than half of the 9 percentage point decline in the rate of inflation between 1981 and 1985 can be attributed to the decline in import prices, mainly of oil, and a further third to the fall in agricultural prices and the influence of labor market slack, the authorities argued that the inflation performance would have been noticeably worse had it not been for the success achieved in moderating wage behavior.

The authorities also thought that the decentralization of wage negotiations that had occurred represented a sea-change in the determination of wages in France. In 1983 only about 7 1/2 percent of unionized enterprises in France had individual wage agreements. By 1986, this proportion was expected to have risen to 50 percent. This change meant that employees took greater account of the viability of their enterprise when entering into wage negotiations and wage demands were more realistic. Indeed, about a third of all wage agreements now used indicators of viability (production, turnover, productivity) in the determination of wages. This, and the increasing importance of individual merit pay increases within a given increase in average wages, meant that another important objective of Government policy--an increase in wage differentials--was now being achieved.

Incomes policy in France has long favored the lower paid. For example, between 1980 and 1985 the minimum wage (SMIC) increased by 17 percent in real terms, compared with a real increase in hourly wages (whole economy) of just 8 percent which, the staff thought, could have contributed to the relatively high rate of youth unemployment in France (Chart 7). The authorities contested this view. They said that a number of studies had failed to uncover any such link, and they emphasized that a majority of those employed at the SMIC tended to be unskilled, manual laborers and that the productivity of those engaged in that form of work might well vary inversely with age. The SMIC could not therefore explain a significant part of youth unemployment. Moreover, it would be socially difficult to discriminate among people doing the same work on the basis of age. They also argued that some differentiation already effectively existed because the SMIC was reduced for 16-18 year olds and for young apprentices. The authorities believed that the major reason for relatively high youth unemployment in France was instead to be found in the lack of emphasis on vocational training and practical experience in the French educational system. The contrast with Germany in this area was judged to be marked. The decline in construction activity in recent years was another reason, both because construction was labor-intensive and a relatively important employer of the young.

## 2. Public finance policies

The authorities intended to pursue a balanced approach to fiscal management. Restraint in government expenditure would create room for reductions in the tax burden and for the elimination, over a three-year period, of the noninterest component of the central government deficit. 1/ In the staff's view, it could be held that the envisaged cuts in expenditures from the levels they would otherwise have reached should not be considered particularly ambitious, given the results achieved in, for example, the United Kingdom and Germany in recent years. However, the authorities argued that, taking into account the cuts that had already been made in the three years up to and including 1986, the targets represented the very most that was feasible.

For 1986, the supplementary budget which was introduced in April confirmed the objective in the initial budget of reducing the deficit of the Central Government to 3 percent of GNP. For 1987, they intended to cut public expenditure by F 40 billion, by comparison with a baseline projection, equivalent to slightly less than 1 percent of GDP. The authorities intended to abolish about 20,000 posts in the public sector (equivalent to a 1 1/2 percent cut in such employment); to use a zero based budgeting approach to public sector investment expenditure; and to make further cuts in subsidies to industry. The authorities also pointed to the progress made recently in reducing the cost of interest rate subsidies which would have an increasing effect in coming years.

The cut in expenditures would be used partly to cut taxes and partly to reduce the deficit. Given the relatively modest growth prospects, it was not advisable to seek a faster rate of reduction of the deficit. However, it was necessary to make a start in this direction. The cuts in taxation were seen as part of the general effort to liberalize the economy and, although no decisions had yet been made as to the form of the 1987 tax cuts, some measures (a cut in the corporate tax rate, the abolition of the wealth tax) had already been announced and public references to a reduction in the taxe professionelle (a local payroll- and property-based corporate tax) have since been made. The authorities intimated that there would be further cuts in personal taxation. The burden of personal income taxation in France was not particularly high by international standards and it could be said that the disincentive effects were not very powerful. However, the marginal rate of tax for individuals (upper bracket of 65 percent of taxable income) could well be a disincentive for those affected, even though, because of generous tax allowances, relatively few taxpayers fall into this category.

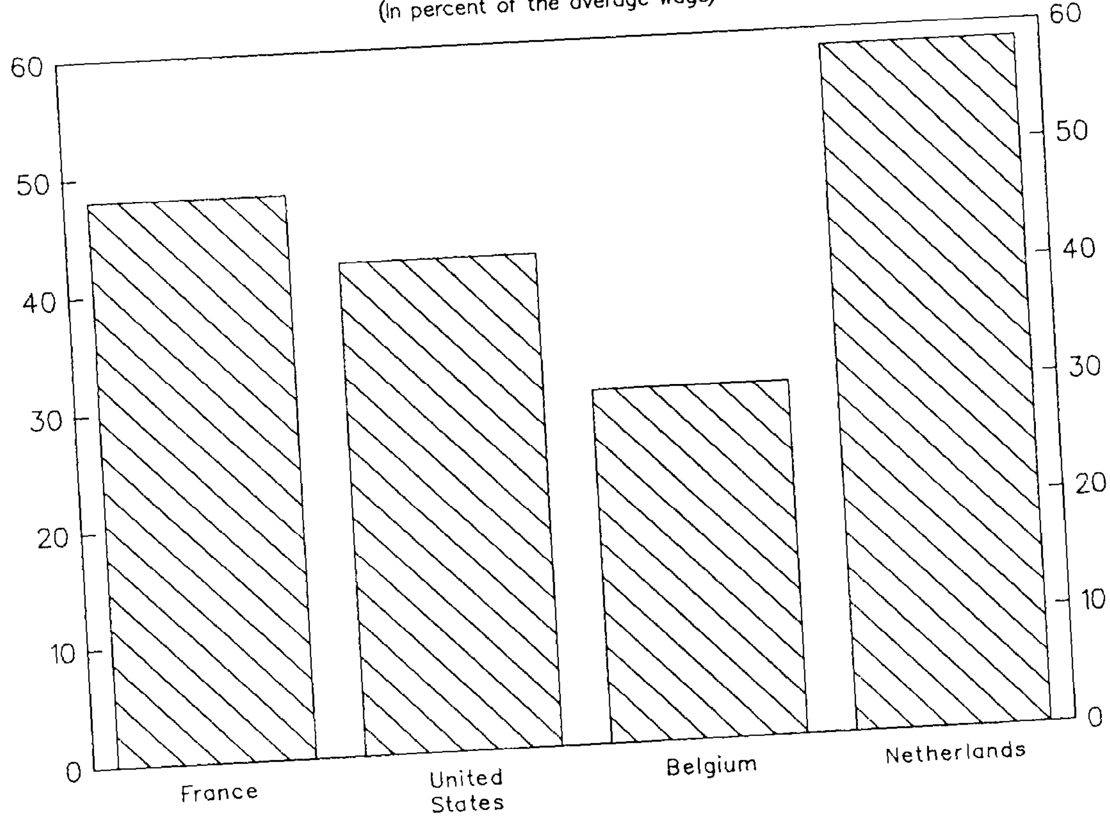
About half of the rise in the tax burden in recent years was the result of rising social security contributions and, of the G-5 countries, France had much the highest share of social security

1/ This definition had been adopted for presentational ease. It implies that the deficit would be reduced to about F 100 billion in 1989 (equivalent to 1 1/2 to 2 percent of 1989 GDP).

CHART 7

MINIMUM RELATIVE TO AVERAGE WAGES

(In percent of the average wage)




Source: National authorities.

contributions in total tax revenues. The staff inquired about the prospects for the social security system, stressing that it had been conceived at a time when the underlying rate of GDP growth promised to remain more rapid than now seemed likely. The authorities argued that this was a very difficult area to reform. There was a wide social consensus that the social security system was central to the country's well being. Over the next two or three years, however, the outlook for the social security funds was a source of concern. The general social security regime was expected, on the basis of 2 percent real economic growth, to show a growing gap between the growth of receipts and expenditure, of some F 20 billion a year. Although 1986 would not present a problem, since the regime had ample cash holdings available, later years were in question. 1/ All in all, the discussion suggested that some new approaches would have to be tried if the regimes were to remain financially viable, especially in the important area of pensions.

Local authority tax revenue continued to grow faster than national income in 1985. This was chiefly the result of lagged revenue indexation. As a result, the financial deficit of the local authorities narrowed in 1985, despite a slight acceleration in spending. The authorities had implemented measures which should correct for lagged indexation, and hoped thereby to slow the rise in the tax burden from this source. By this means they also hoped to restrain the rate of growth of local authority expenditure. The decentralization program, involving the transfer of responsibilities from the State to the local authorities, with compensatory finance in the form of earmarked tax revenues and grants, would be virtually completed by the end of 1986.

A recent Government report estimated that the practice of debudgetization had reduced the Central Government's deficit by about F 4 billion in 1985 (compared with 1984) and would reduce it by a further F 3.5 billion in 1986 (equivalent to about 2 1/2 percent of the central government deficit).

The proceeds from privatization, the authorities said, would most likely be used both to redeem outstanding government debt, including that created in 1982 to meet the cost of the previous Government's nationalization program, and to finance the capital restructuring of those enterprises that would remain for the time being in the public sector (i.e., Renault and the steel industry). They saw the latter as no more than the exchange of one asset (shares in a publicly-owned enterprise) for another (increased equity in another public sector enterprise).

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1/ The Government announced at the beginning of July an increase of 0.7 percentage points in social security contributions for old age pensions from the beginning of August 1986 and a surcharge of 0.4 percent on income tax rates. The two together were expected to yield F 20 billion in 1987.

### 3. Monetary policy

The discussions on monetary policy generally concerned the appropriateness of the stance of monetary policy. Two other specific issues were also discussed: the scope for reducing interest rates and the implications of the planned shift from credit controls to interest rate management as the main instrument of monetary policy.

The monetary target for 1986 had been set in terms of a range of 3 to 5 percent growth for M3. This compared with a projection of nominal GDP growth of about 6 percent over the same period. These targets and assumptions were not changed after the April realignment. Net domestic credit expansion over the year as a whole was expected to be somewhat smaller than the change in the money supply. The Treasury itself would be responsible for some 16 percent of monetary creation, half of what had been assumed before the realignment. Given the prevailing weakness of private sector credit demand, the authorities did not view the target for domestic credit expansion as particularly constraining.

Following the EMS realignment in April, the official French intervention rate in the domestic market had been cut in several stages to stand at 7 percent at the end of June. This represented a significant narrowing of the differential vis-à-vis Germany, and the authorities thought this differential was now about as small as was prudent given the relative inflation rates in the two countries. Both nominal short-term interest rate and inflation differentials were now of the order of 2.5 percent, implying real interest rate parity (Table 3).

Table 3. France: Real Interest Rates 1/

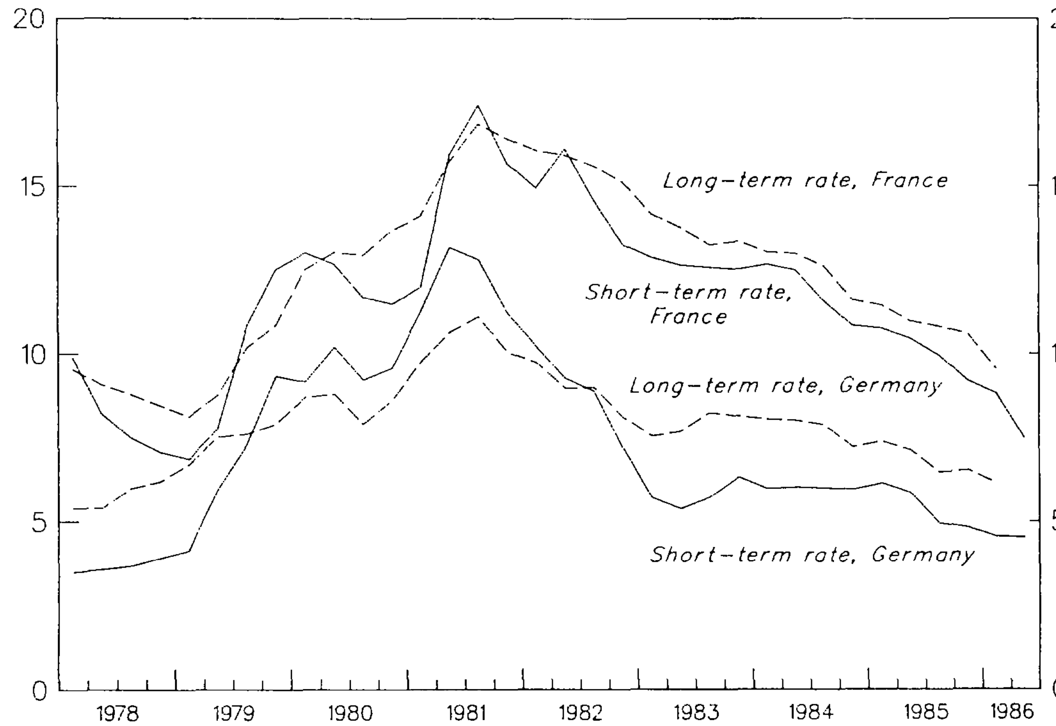
(In percent)

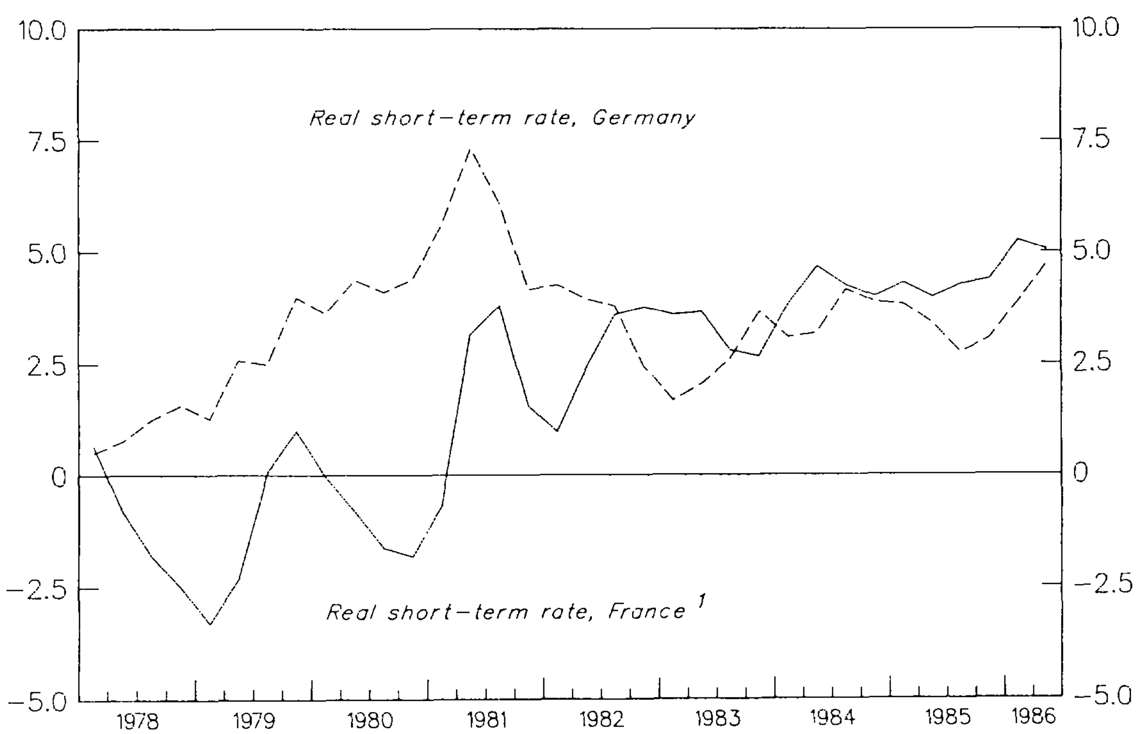
| | France | Germany | Japan | United States |
|---|---|---|---|---|
| Short term | 4.9 | 4.8 | 3.5 | 5.1 |
| Long term | 5.6 | 6.0 | 4.0 | 6.2 |

Source: OECD Monthly Financial Statistics and IFS.

1/ Calculated as the average three-month money market rate (short term) or government bond yield (long term) in May 1986, less year-on-year consumer price increase in May 1986.

CHART 8
FRANCE and GERMANY
INTEREST RATE DEVELOPMENTS, 1978–86
(In percent per annum)




Source: International Monetary Fund, *International Financial Statistics.*

[1] Nominal rates converted for changes in consumer prices.

The authorities argued that the scope for further unilateral reductions in interest rates was severely limited. The large scale capital inflows which had followed the realignment had ceased in May. That, and the desire on the part of the authorities to have more time to judge the effects of the liberalization of exchange controls, were further reasons for caution. Available empirical evidence--though necessarily based on past relationships--suggested that the response of investment to a cut in interest rates would not be large. While the authorities would clearly be happy to see further falls in French interest rates, they believed there was room to act only in the context of a multilateral decision. This position, however, had not gone unchallenged, as some had argued that, given the stability of exchange rate expectations that followed the realignment, interest rate parity should, at the extreme, be sought on a nominal, not a real, basis. By that criterion, there would still be substantial scope for nominal interest rate reductions in France. Advantage should now be taken of this, given the extraordinarily high level of current real rates. The staff observed that a reduction in interest rates that led to any destabilization of expectations would be counterproductive and argued that the degree of caution that was currently being observed was in their opinion justified.

For 1987, the authorities intended to abandon the practice of setting credit ceilings, and to rely on interest rate management to achieve their external objectives and to prevent an excessive growth in the money supply. The abandonment of credit ceilings was seen as the logical consequence of the process of unification of the financial markets which had developed over several years, and which had been characterized by a major expansion of the bond market. The objectives of monetary policy were to assure the stability of the currency in the short and medium term. In the short term, this implied paying close attention to the stability of the exchange rate within the EMS; in addition, the requirement of stability over the medium term implied that the growth of the money supply must be consistent with the targets for inflation and real GDP.

The staff argued that there could always be a possibility of conflict between the exchange rate target and the monetary target; thus, raising interest rates to slow down credit expansion could also increase capital inflows in the balance of payments and thereby stimulate monetary expansion. More generally, given the openness of the economy and membership of the EMS, the growth of the money supply must be considered to be largely endogenous.

At present, the existence of credit ceilings provided a separate instrument with which to try to influence the growth of the money supply. With their abolition in 1987, the authorities argued that a new instrument would be needed. The authorities confirmed that they had deliberately sought to increase the size of the reserve base so as to facilitate the policy of controlling the money supply by influencing bank liquidity. They believed that the existence of a large reserve base would mean that the banks were more sensitive to the Central Bank's signals and would reduce the movement in interest rates required to engineer a given change in the money supply. As an indicator, they believed that base money would be better related to M3 with a higher reserve ratio. Required reserves were currently about F 40 billion (compared with a stock of M3 of about F 3,000 billion). The authorities indicated that the desirable level was about F 60 billion. Even then it would be relatively small by comparison with the United States or Germany. The authorities acknowledged that the rise in reserve requirements would lead to some disintermediation from the banking sector.

The staff welcomed the abrogation of the credit control system, which had become a source of distortions and inefficiencies, but cautioned that the conduct of monetary policy could be particularly delicate in 1987. While the authorities would wish to announce a tight monetary target in support of their inflation objective, there was a risk that the process of financial innovation and deregulation would raise the demand for money and result in an overshooting of the monetary target, even though the stance of policy might be appropriately tight. The staff therefore suggested the use of a rather broad range of indicators when the time came to formulate the target for 1987. 1/ Such indicators should include developments in the credit aggregates and the balance of payments as well as those of the main monetary aggregates.

4. Structural policies

The French representatives said that, given their determination to maintain cautious financial policies, improved growth performance in the short to medium term would depend on the Government's success in pushing through a wide series of structural changes which, taken together, would represent a significant liberalization of the economy.

In the financial markets, the process of liberalization had been developing for several years and had recently been given major impetus with the removal of most exchange controls and the announcement of a large program of privatization of public enterprises. In the labor markets, the change in procedures of wage negotiations would be consolidated and greater flexibility would be introduced.

The pace of change in the French financial system had accelerated in the past year. The reform process has had three main features:

1/ Appendix V to Recent Economic Developments discusses problems other industrial countries have experienced during periods of financial innovation and deregulation.

a. Financial innovation. New financial instruments such as certificates of deposit (CDs) and commercial paper had been introduced. In early 1986 a financial futures market (MATIF) started operation in the Paris Stock Exchange, and a secondary market for mortgages had been established.

b. Decompartmentalization of the financial system. Since last year, negotiable financial instruments across the whole maturity spectrum had been available to investors and borrowers. In addition, there had been a shift away from specialized credit channels and institutions toward a common regime for all financial intermediaries. This had come in part through a reduction of interest rate subsidies on credit to industry, exports, and local authorities. The remaining areas where interest rate subsidies are of practical (but significant) importance were housing and agriculture.

c. Development of capital markets. Since 1981 the bond market had expanded rapidly in response to both an increase in the State's borrowing needs--together with a deliberate reduction in the monetary financing of the budget deficit--and positive real rates of interest. The bond market (in stock terms) was now comparable in relative size to those of the other main industrial countries. The stock market had also developed in recent years, with the help of fiscal incentives (Loi Monory) and the proliferation of mutual funds, but it was still relatively small compared with the United States, Japan and the United Kingdom. Various reforms had recently been introduced to help the Paris Bourse compete with foreign stock markets: commissions on large trades were now freely determined; the market-making ability of brokers has been enhanced; the procedures of the Bourse have been modernized (a number of shares are now continuously traded during business hours), and stock options and foreign exchange futures markets were in preparation. The planned privatization of 65 public corporations should also lead to a further expansion in the size of the stock market.

As discussed above, the authorities considered that the reform of the French financial system had set the stage for a change in the instruments of monetary policy; this had been signaled in 1986 by a new classification of the monetary aggregates, and would be completed in 1987 by the abrogation of the credit control system.

The French representatives noted that the reform of the financial system had taken place in a favorable environment with declining interest rates and rising bond and share prices. Lower interest rates had also facilitated the phasing out of interest rate subsidies. Any upturn in interest rates would put to the test recent financial innovations, as well as the determination to further reduce interest rate subsidies. The French representatives believed that the financial reform would prove resilient: it had been prudent--thus, money market funds were still not allowed--and it was inherently flexible. The reform also presented a challenge to the banking system which would have to find new sources of income to replace those lost as a result of disintermediation and of the reduced borrowing needs of enterprises. For their part the authorities would need to review the fiscal regime governing various types of investments. Investment in bonds currently received a favorable tax treatment and recent housing legislation provided fiscal incentives for investment in rental property. The tax treatment of investment in shares was being reviewed and might be brought into line with that of the more favored investments. This would represent progress toward a more uniform tax regime for investment income and would have the added advantage of facilitating the privatization program.

In the wake of the April 1986 realignment the authorities had removed the exchange restrictions on personal transfers and relaxed those on forward cover purchases of foreign securities. They had also abolished the investment currency (devise-titre) system. 1/ Almost all exchange restrictions imposed since 1981 had now been removed and France was in full conformity with the Treaty of Rome. The staff observed, however, that the administrative framework of controls remained in place and that personal travel allowances, in particular, remained restrictive.

The authorities thought that the abolition of the devise-titre would not lead to significant portfolio outflows. The premium on the devise-titre rate had dropped to zero well before the announcement of its abolition and the regime had not, in any case, been watertight. While they acknowledged that there was in theory some pent-up diversification demand for foreign securities, they argued that there were a number of factors currently making for increased interest in domestic securities. The present uncertainty over the U.S. dollar, the French privatization program and relatively attractive French interest rates were cited as examples.

The main exchange controls that now remained were those forbidding the opening of bank accounts abroad by residents and lending in francs to nonresidents. 2/ However, these remaining controls could easily be circumvented, given the degree of relaxation already announced, and complete liberalization was a logical complement of the steps already taken. It was their intention to abolish the remaining controls in time, but the Government wanted to proceed cautiously and evaluate the consequences of what had already been done. There was concern, in particular, about the impact on confidence of a complete and sudden relaxation of controls.

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1/ This is the system under which investors wishing to purchase foreign securities needed to buy foreign exchange from a fixed pool.

2/ The authorities announced further minor relaxations in the controls at the beginning of July. Companies can now make forward purchases of foreign exchange as far ahead as they want (the previous limit was six months); and exporters can hold on to foreign exchange for three months rather than one month.

The broad lines of the Government's privatization program had been approved by Parliament and the Constitutional Council. 1/ They called for the sale of 65 public enterprises by 1991, including not only those nationalized in 1982, but also the large banks and insurance companies nationalized after World War II, and the oil companies. The only public enterprises not included in the privatization program were the public utilities (GEN), Renault, the steel companies and "prestige" enterprises such as Air France. The Government believed that there was no justification for industrial or financial enterprises in the competitive sector to be a part of the public sector and that their efficiency would be greater in the private sector. Another advantage of privatization would be the spread of share-ownership among households.

The pace of the privatization program would be dictated mainly by the absorptive capacity of the market. The French representatives believed that an annual sale program of about F 40 billion was feasible. The program would proceed on a case by case basis. The State would not retain any residual ownership, though it might for some time retain a veto right on certain transactions (along the lines of the "golden share" used in the United Kingdom). 2/

Commenting on recent measures taken to increase the flexibility of the labor markets, the authorities explained that the law requiring employers to seek administrative authorization before making workers redundant would be abrogated with effect from January 1, 1987. It was up to the unions and the employers' organization to agree on new procedures before then. In the meantime, the Government had eased the requirements to a small extent. The authorities argued that other regulations, e.g., on fixed contract working and part-time working, were not restrictive, as shown by the high and rising rate of turnover in the labor markets. They merely gave such workers the same contract rights as full-time workers. There were, however, still some important obstacles to flexibility, notably in the area of working hours and the employment of women in shift work.

The Government had announced their intention to liberalize the existing system of rent controls. 3/ With some exceptions, principally in Paris, all dwellings would be gradually decontrolled over a period of eight years. Fiscal incentives to encourage the supply of new rented accommodation had also been announced.

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1/ However more recently the President of the Republic has insisted that the legislative authority take the form of an enactment by Parliament rather than a decree.

2/ Appendix I gives more detail on the Government's privatization program.

3/ Details are given in Recent Economic Developments, Chapter I.

## 5. External policies

Import penetration has increased substantially in recent years and France has lost export market shares even when account is taken of the geographic structure of exports. The combination of relatively low market growth--French trade is concentrated in relatively slow growing markets--and loss of market shares has meant a decline in the share of French exports in the total exports of industrial countries (Table 4).

Table 4. France and Other Industrial Countries: Share of Total Industrial Country Exports, 1981-85

(In percent)

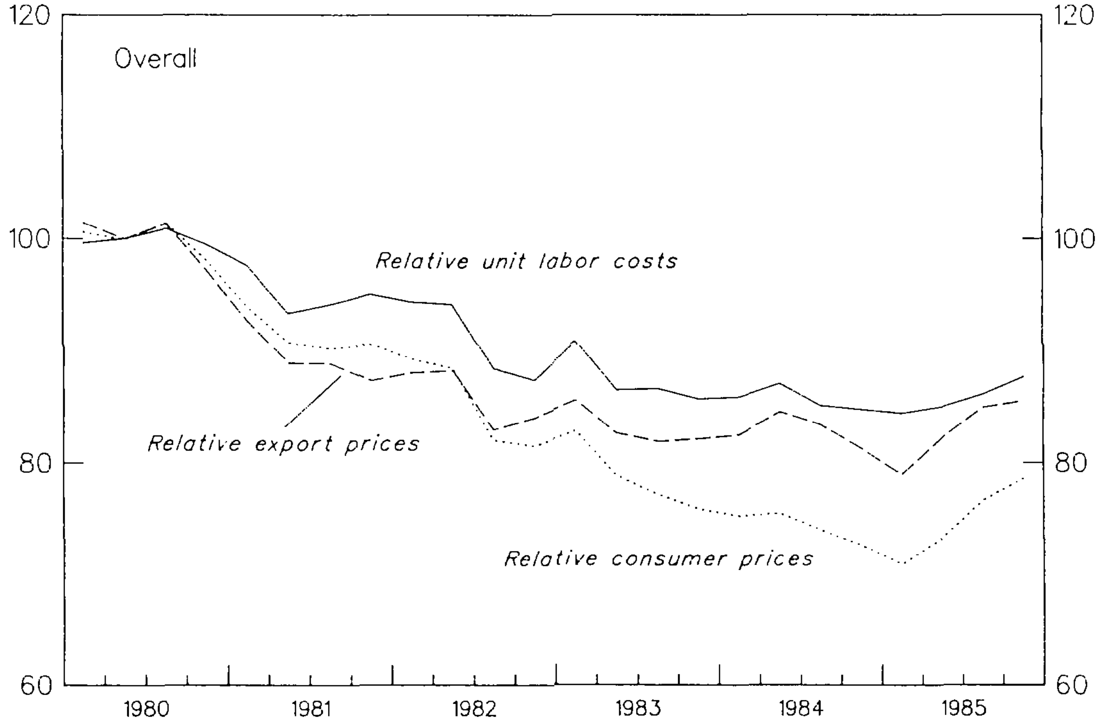
| | 1981 | 1985 |
|---|---|---|
| France | 9.6 | 9.0 |
| Belgium | 5.1 | 5.2 |
| Netherlands | 5.9 | 6.0 |
| Germany | 16.3 | 17.1 |
| Italy | 6.5 | 6.6 |
| United Kingdom | 8.6 | 8.8 |
| United States | 16.9 | 13.1 |
| Japan | 11.3 | 12.7 |

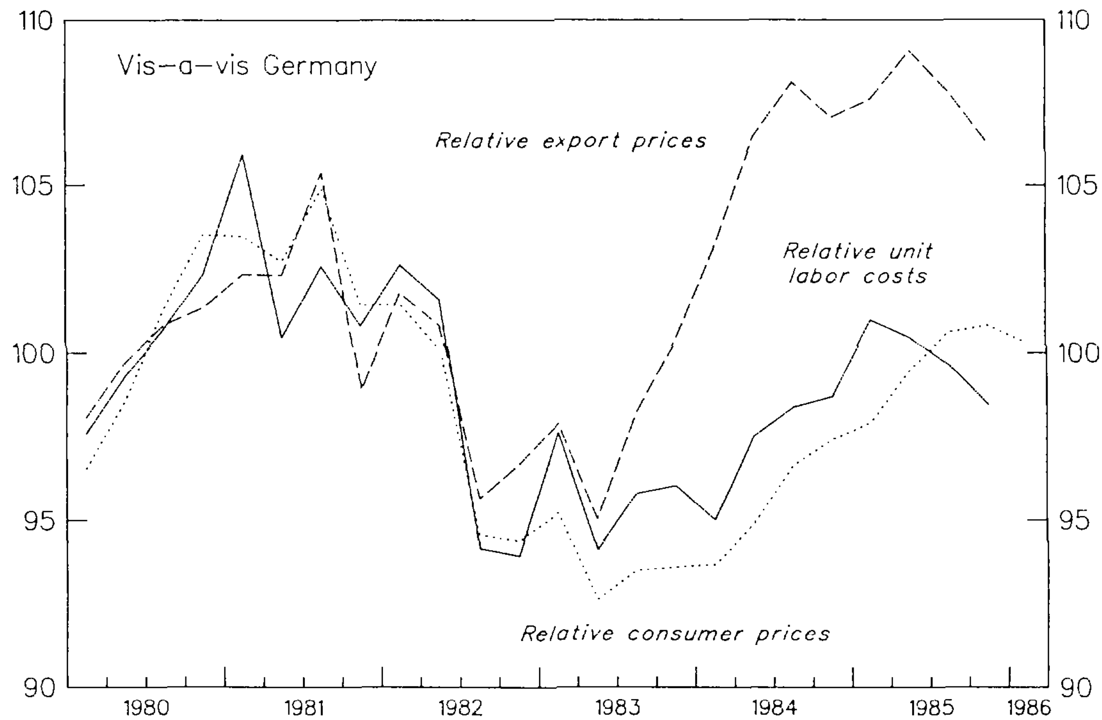
Source: IMF Datafund.

The situation in 1985 had been worrying. An acceleration from 1/2 to 2 percent a year in the growth of domestic demand, which admittedly had meant the virtual elimination of the favorable cyclical position for the first time in three years, had been associated with a significant increase in the volume of manufactured imports and an even greater decline in export volume growth. The reasons for the deterioration could not yet be fully explained but it was clear that the competitiveness of the economy had yet to be adequately restored.

It was with these considerations in mind that the authorities sought a devaluation of the franc in April 1986. The French representatives explained that they had had three objectives: first, all the usual indicators of competitiveness, and in particular relative consumer prices, had shown that a substantial gap had developed with Germany since March 1983 (Chart 9). The devaluation was necessary to restore competitiveness. Secondly, it was clear that the market was expecting a realignment. To have held out would have meant substantial (and possibly increasing) premiums on French interest rates. The devaluation had not only calmed the markets but had also allowed a significant fall in French interest rates. Capital inflows in the weeks immediately following the realignment had run at a high rate. Finally, by

CHART 9
FRANCE
INDICATORS OF COMPETITIVENESS
(1980=100)




Source: IMF, Datafund.

increasing the attractiveness of franc-denominated assets, the devaluation had facilitated the liberalization of exchange controls, which was an integral part of the Government's policies to reinvigorate the economy. The devaluation was expected to have little impact on the current account in 1986 but to improve it by about F 15 billion in 1987, when the stimulus to the external sector would reach its height.

The French representatives summarized their policy on external debt. The Government planned to reduce the level of its direct external debt as circumstances permitted and were seeking to take advantage of every possibility for early repayment. The authorities' projections for 1986 included a decline in total external debt of some F 40 billion. Scenarios prepared by the staff, consistent with the forecasts for 1986 and 1987 prepared for the forthcoming World Economic Outlook, and assuming a current account surplus equivalent to 1 percent of GDP thereafter and net autonomous long-term capital outflows ranging between 0.7 percent and 0.3 percent of GNP, showed a trend decline in gross external debt broadly in line with existing amortization schedules.

## 6. Trade policy

The French representatives noted that France approved the Community's decision to reduce average agricultural support prices in the current crop year, and in particular the decision to reduce feed grain prices by 5 percent. France also supported the various measures taken to limit overproduction. The French representatives noted that since 1984/85 production of dairy products in excess of quota had been subject to penalties of up to 100 percent of price, and that the levy on sugar had also been increased. These measures constituted a considerable effort to rationalize European agriculture, and had caused hardship to certain sectors in France, notably dairy producers. The enlargement of the Community would create difficulties for vintners and fruitgrowers in the original members because of the increased competition from producers in Spain and Portugal, but these pressures would be cushioned during a transitional period during which the degree of protection would gradually be reduced.

The Community's efforts at rationalization and the working of demographic factors had resulted in a decline of more than 20 percent in the number of farms in France in the past six years. This had led to an increase in the average area under cultivation per farm and, as a result, an increasingly efficient agricultural sector. The staff observed that in spite of the Community's measures the Common Agricultural Policy still afforded very substantial protection to the agricultural sector, and that domestic prices remained well above their international level.

The French representatives stated that only 1.8 percent of imports were subject to nationally imposed quotas. However, the staff observed that there had been no evidence in 1985 to suggest that protectionist pressures had subsided; quotas and other nontariff measures introduced at the community or national level to restrict imports of steel, textiles, autos, and electronic products remained in force in 1985. Moreover, reversing the declining trend in recent years, the number of derogations under Article 115 of the Treaty of Rome increased from 39 in 1984 to 66 in 1985.

In December 1985 the EC reached agreement to achieve free trade in services by 1992, although the agreement had thus far been ratified only by Denmark. Liberalization in this area would require the harmonization of national regulations governing the service sector. More importantly, it would entail the end of national monopolies in such sectors as road and coastal transport.

The French representatives expressed their support for a new round of trade negotiations, and stated that France was prepared to endorse their extension to encompass both trade in agricultural products and trade in services. However, they would not agree to proposals to give agricultural products special priority by putting them first on the agenda.

## IV. Outlook

The assumptions underlying the official forecast for 1986 and 1987 are that French export markets will grow by 4 percent in 1986 and rather more in 1987, and that, though there will be a continuing loss in market shares in 1986, this will not be repeated in 1987. Import growth in both years is expected to be relatively strong, both because of relatively buoyant consumers' expenditure and because of a strong growth in investment, particularly in the enterprise sector. As a result, the external sector's contribution to growth would be negative in 1986, but neutral in 1987 as a consequence of a strong recovery in exports. The trade balance is forecast to be in surplus by F 19 billion in 1986 and almost F 25 billion in 1987.

The improvement in the terms of trade in 1986 (of about 8 1/2 percent) is expected to accrue mainly to the enterprise sector, whose profit margins are projected to rise from 24 percent in 1985 to 27 percent in 1986. Because wage behavior is forecast to be in line with the officially expected future growth of prices, the household sector can only gain from an improvement in the terms of trade if either it is larger than expected or if wage drift occurs because of it. Real disposable income of the household sector is projected to grow by almost 3 percent in 1986, but this partly reflects tax cuts and the repayment in January 1986 of the compulsory loan made to the Government in June 1983. Nominal wage increases are forecast to continue to decelerate to 4 1/2 percent in 1986 and still further in 1987. With only a small further fall in the rate of price inflation in 1987, real disposable income growth would fall in that year. Since little change is forecast in the personal savings rate, private consumption growth would also fall slightly.

Investment, particularly in the enterprise sector, is projected to grow strongly, partly in response to a further increase in 1986 and 1987 in gross operating profit margins; and partly because of the pickup in the growth of output. The improvement in profit margins reflects the improvement in the terms of trade and the continued moderation in wage behavior, with real per capita increases in wages projected to rise at a rate well below that of the growth of productivity (put at 2 1/2 to 3 percent a year over the whole economy). GDP is forecast to grow by 2 1/2 percent in 1985 and by 3 percent in 1986.

The staff's forecasts for 1986 are broadly in line with those of the authorities. But in 1987 the staff sees no increase in the rate of growth, in contrast to the official projections, partly because of less buoyant assumptions on consumers' expenditure and exports. The latter reflects a more pessimistic view of French export market growth than that assumed by the authorities and shows up in a considerably smaller projected trade surplus. The staff also expect less of a deceleration in wages and salaries in 1987 and little or no decline in the rate of consumer price inflation (projected unchanged at a little under 3 percent in both 1986 and 1987).

## V. Staff Appraisal

The recent fall in oil prices has helped the French authorities reduce inflation, restore external balance and improve the supply performance of the productive sector. Significant progress will be recorded on all three fronts in 1986 and the Government's policies are generally designed to consolidate and extend it. The staff welcomes the stance of policies. It is important that financial policies be kept prudent with the fiscal deficit being gradually reduced and monetary policy kept fully supportive of price and exchange rate objectives. This will provide a foundation that can allow the many-faceted program of liberalization to bring about greater economic efficiency.

The continued emphasis put on wage moderation is well justified. Although the profitability of enterprises has already improved markedly and is expected to be strengthened again in 1986, with the terms of trade gains accruing largely to the enterprise sector, it remains below the level recorded in the early 1970s. More needs to be done to shift the distribution of income in favor of profits in order to allow a reduction in the heavy indebtedness of the enterprise sector and to create a necessary condition for a growth in investment that can lead to a long-term decline in unemployment. Wages must continue to be held to a rate of increase below that of productivity. Even when the position has been further consolidated, care will be needed--against the background of a satisfactory level of profits--to avoid the risk of substantial rises in nominal wages.

It is also important to couple wage restraint with steps to improve the flexibility of the labor market and, in this regard, the introduction of increased flexibility in dimissal procedures is to be welcome.

More emphasis could be given to vocational training; obstacles to labor mobility could be further reduced; and full flexibility in working hours could be encouraged. The staff recognizes the importance that the Government attaches for social policy reasons to the minimum wage but in economic terms there can be no doubt that it worsens the employment position in general and discriminates against the use of unskilled labor in particular. For this reason, it would be useful to take further measures to alleviate its effects on young workers and on workers in regions of high unemployment.

The staff supports the authorities' program of reducing both the budget deficit and the tax burden. This should promote efficiency and give the private sector more room to expand. Only a gradual reduction in the nominal deficit of the Central Government is envisaged but its effects should be enhanced by the determination to exert a greater control over the deficit of the General Government. If there were to be signs of a significantly greater-than-expected increase in domestic spending by the private sector, then the staff believes that it would be necessary to consider a more rapid rate of reduction of the deficit. It is also becoming urgent to reassess the long-term position of the social security system. The coverage of the pensions system, in particular, as well as its financing and the contribution that might be made by encouraging a greater development of private pension schemes are issues that need to be considered.

The staff endorses the present stance of monetary policy. The projected rate of growth of nominal GDP and the money supply, together with the reduction in the monetary financing of the Treasury should be compatible with a reasonable growth in private credit and the absence of undue pressure on the external account. Although the Bank of France has reduced the intervention rate by 1.25 percentage points since the realignment, external considerations will warrant continued caution in the authorities' attitude to further reductions.

The decision to eliminate the system of credit ceilings, which has led to rigidities in the French financial system, is welcome. Indeed, it could be advantageous to move more rapidly than currently planned. As a result of the abolition of credit ceilings, it would be inadvisable to set too precise a single target for the growth of money for 1987, not only because a fixed exchange rate system limits the freedom to control the growth of money but also because it will be difficult to judge the effects of banking sector deregulation and disintermediation on the velocity of money.

Significant progress has been made in reducing interest rate subsidies on the many types of loans made for special purposes. The remaining areas of subsidy should be quickly eliminated. The removal of these subsidies will bring to an end an important allocative distortion in the capital market, which has impaired the overall efficiency of investment in the French economy. The complicated system that has grown up is also a barrier to a simple and effective system of monetary control and has impeded the correction of the fiscal imbalance.

The external position, though improved, is still less strong than could have been expected in view of a number of favorable international developments. The decision to devalue the franc in April was fully justified and it has allowed an important liberalization of exchange controls. The additional risk involved in now abolishing the remaining controls is in the view of the staff quite minor and such a step could strengthen the growth of confidence.

The Government's intentions to privatize almost all publicly-owned enterprises in the competitive sector should result in an improvement in economic performance as long as the companies that are privatized are subjected to effective competition. The act of privatization will of itself contribute to the deepening of financial markets. For this reason, the capacity of the market to absorb share issues may very well be underestimated. It is important that the proceeds of asset sales are not used to finance government spending. Consequently, the staff is concerned by the Government's intention to use part of the proceeds of asset sales to strengthen the financial position of enterprises that will remain under public control. The State as a shareholder ought to make as critical an assessment as any private investor of the future economic viability of an enterprise which is requesting financial assistance.

Lastly, the staff, while noting the absence of significant new protectionist measures at the national level in France since last year, regrets that, in common with other EC members, many sectors of trade remain subject to subsidies and trade restrictions. The staff believes that France should play an active role in promoting the evolution of EC trade policy in ways that avoid increased discrimination against third country suppliers. In the international context, France should use available opportunities to press for liberalization and elimination of trade restrictions, such as those under the Multifiber Arrangement. These various restrictions taken together have a substantial economic cost for they impose impediments to the efficient use of human, capital and financial resources. Given the substantial progress that has been made in improving the position of enterprises in a number of sectors subject to strong foreign competition, as well as the improved profitability of the enterprise sector in general, stronger efforts could now be made to reduce tariff and nontariff barriers to imports. This would also contribute to the achievement of the Government's price objectives.

The staff welcomes the maintenance of official development assistance at a relatively high level.

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

## The Privatization Program in France

With the passing of the loi d'habilitation the French Government commits itself to the privatization of 65 publicly owned enterprises within the lifetime of this Parliament. These 65 concerns include the big three banks nationalized in 1945, the investment banks and other banking institutions nationalized in 1982, the various industrial enterprises nationalized in 1982 and large state shareholdings in insurance companies, oil corporations and diverse other companies. In preparation for this the Government recently announced some changes in the chairmen of 24 public enterprises.

The projet d'ordonnance sets out the details of the procedures. A privatization commission will be set up with members chosen according to their experience in finance, economics or the law. This commission, which will be completely independent, will assess the value of each enterprise by the same methods as used by other private enterprises wishing to raise equity capital on the Bourse. The price set for the sale of the enterprise must not be inferior to that chosen by the commission. State bonds or bonds whose service has been taken in charge by the State may be surrendered to the authorities in payment for the shares of privatized companies. The value of the bond will be calculated for this purpose according to the average price quoted in the 20 days preceding the privatization. Shares without voting rights (certificats d'investissements) currently held by the private sector as claims on enterprises about to be privatized may also be converted into voting equity at a rate of exchange which takes into account the value of this right.

Ten percent of the equity will be reserved for employee demand. Employee subscriptions may be made on preferential terms either by a discount on the price (which must not be 80 percent below the market price) or by delayed payment (which cannot be longer than three years). If the discount is more than 5 percent the shares cannot be sold within one year of purchase. The State reserves the right to prevent any one person from acquiring more than 5 percent of the equity of a privatized company. 1/ Moreover, no more than 15 percent of the issue may be acquired by foreign interests. This ruling will be supported by the creation of "golden shares." According to the Law of 24 July 1966, relating to commercial enterprises and where the protection of the national interest justifies it, an action specifique may be created and held by the State. The rights associated with the single share will be spelled out in the statutes of the company. In particular, the State will be able to veto any equity participation, subsequent to the issue, which gives more than 15 percent control to

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1/ This would not necessarily rule out the setting up of a "noyau dur," a hard core of investors approved of by the authorities.

foreign interests. This share can be cancelled at any moment at the will of the State, and in any case will lapse five years after the privatization.

The collectif budgetaire which modified the 1986 budget, foresaw that F 8 billion would be raised through privatization this year. A reduction in the State's share of the three insurance companies and in Elf-Aquitaine could be arranged at relatively short notice and would not require separate legislation. Certain of the major banks may require some capital augmentation before being privatized.

The consensus global valuation of the 65 enterprises is of the order of F 200 billion. This figure must be regarded as highly uncertain at this stage; it would be compatible with a privatization program at an annual rate of F 40 billion. While this might seem large in relation to a market whose total quoted capitalization was only F 600 billion 1/ it is not an unattainable objective. New quoted equity issues are accelerating rapidly: F 18.8 billion were issued in 1985, and a further F 15 billion have been issued in the first three months of 1986. Certain measures have been taken to improve the efficiency and thereby the capacity of the Bourse. The collectif budgetaire contained a number of changes designed to help equalize the fiscal treatment of equities vis-à-vis bonds, the former having been previously discriminated against.

The authorities have indicated that the proceeds of the privatization program will be used to redeem debt incurred for compensation following the 1982 nationalizations. Another part will be used to redeem government debt more generally defined. Finally, a third part will be used to finance the capital restructuring of the nationalized concerns remaining under state control, in particular Renault. Only the latter would feature in the conventional calculations of the Government's fiscal balance.

1/ Paris Bourse at end-1985.

## France - Fund Relations

(As of end-June 1986; 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 3,188.2 million (71.1 percent of quota).

(c) Fund credit:
None.

(d) Reserve tranche position:
SDR 1,295.0 million.

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

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

| | Limits | Outstanding | Uncalled |
|---|---|---|---|
| GAB | 1,700.0 | -- | 1,700.0 |
| SFF | -- | -- | -- |
| Enlarged access | -- | -- | 1,700.0 |

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 830.1 million, or 76.9 percent of net cumulative allocation.

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

V. Administered Accounts

Not applicable.

VI. Overdue Obligations to the Fund

None.

B. Nonfinancial Relations

VII. 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.

VIII. The last Article IV consultation was concluded at EBM/85/115 (7/29/85). France is on a 12-month consultation cycle.

France - Basic Data

| | 1985 | 1982 | 1983 | 1984 | 1985 | 1986 1/ | 1987 1/ |
|---|---|---|---|---|---|---|---|
| | In percent of GDP | | | (Volume changes; in percent) | | | |
| Demand and supply (volume) | | | | | | | |
| Household consumption | 66.2 | 3.4 | 1.0 | 1.1 | 2.5 | 2.5 | 1.9 |
| Public consumption | 13.3 | 2.5 | 1.4 | 1.1 | 1.0 | 0.5 | 1.0 |
| Gross fixed investment | 20.4 | 0.8 | -2.3 | -1.3 | 3.1 | 5.0 | 5.4 |
| Public | 2.7 | 9.2 | -2.9 | 2.2 | 2.3 | 0.5 | 0.5 |
| Residential construction | 4.0 | -7.0 | -1.8 | -4.6 | -2.3 | 1.7 | 4.0 |
| Other private | 13.6 | 1.9 | -2.4 | -1.0 | 5.0 | 6.9 | 6.7 |
| Stockbuilding 2/ | 0.3 | 1.4 | -0.8 | 0.1 | -0.3 | 0.1 | 0.1 |
| Total domestic demand | 100.2 | 4.1 | -0.4 | 0.6 | 2.0 | 2.8 | 2.6 |
| Exports of goods and services | 25.8 | -2.6 | 4.4 | 7.2 | 2.4 | 3.7 | 4.0 |
| Imports of goods and services | 26.0 | 6.8 | -0.6 | 3.6 | 5.2 | 5.8 | 5.4 |
| Foreign balance 2/ | -0.2 | -2.2 | 1.2 | 0.9 | -0.7 | -0.6 | -0.4 |
| GDP | 100.0 | 1.8 | 0.7 | 1.5 | 1.3 | 2.3 | 2.2 |
| Value-added in manufacturing | 22.1 | 0.1 | 1.3 | 1.3 | 0.3 | ... | ... |
| Memorandum item: | | | | | | | |
| GDP in current francs | ... | 3,567.0 | 3,935.0 | 4,283.0 | 4,596.8 | 4,904.0 | 5,172.0 |
| | | | | (In millions; annual averages) | | | |
| Employment and unemployment | | | | | | | |
| Labor force | ... | 23.8 | 23.7 | 23.9 | 23.9 | 24.0 | 24.1 |
| Unemployed | ... | 2.0 | 2.0 | 2.4 | 2.5 | 2.6 | 2.6 |
| (In percent of total labor force) | ... | 8.4 | 8.6 | 10.0 | 10.4 | 10.7 | 10.7 |
| | | | | (Annual changes in percent) | | | |
| Prices and income | | | | | | | |
| GNP deflator | ... | 12.6 | 9.5 | 7.2 | 5.9 | 4.3 | 3.2 |
| Consumer price index | | | | | | | |
| Average | ... | 11.8 | 9.6 | 7.4 | 5.8 | 2.8 | 2.7 |
| Through the year | ... | 9.7 | 9.3 | 6.7 | 4.7 | 2.8 | 2.3 |
| Terms of trade | ... | 1.9 | 2.6 | 0.9 | 2.6 | 8.6 | 2.2 |
| Import unit values | ... | 12.0 | 7.7 | 10.3 | 2.1 | -13.0 | 2.3 |
| Average hourly compensation | ... | 18.2 | 12.2 | 8.7 | 6.1 | 4.4 | 3.7 |
| Unit labor costs (in manufacturing) | ... | 11.1 | 7.6 | 3.6 | 2.2 | 0.7 | 0.2 |
| Real disposable income of households | ... | 2.4 | -0.7 | -0.4 | 0.8 | 2.9 | 2.2 |
| Personal savings ratio (in percent) | ... | 15.7 | 14.4 | 13.5 | 12.3 | 12.7 | 12.8 |
| | | | | (In billions of francs) | | | |
| Central Government 3/ | | | | | | | |
| Expenditure | ... | 826.4 | 918.3 | 993.1 | 1,055.8 | 1,096.3 | 1,089.0 |
| Revenue | ... | 737.9 | 783.3 | 846.0 | 901.5 | 934.1 | 954.0 |
| Loans and advances (net) | ... | -3.4 | -2.8 | -10.3 | -5.2 | 18.3 | — |
| Financial balance | ... | -99.0 | -129.6 | 146.2 | -153.3 | -144.0 | -135.0 |
| (In percent of GDP) | ... | (-2.8) | (-3.3) | (-3.4) | (-3.3) | (-2.9) | (-2.6) |
| Balance of payments | | | | | | | |
| Trade balance | ... | -103.8 | -63.9 | -39.7 | -48.4 | 7.6 | 5.9 |
| Services and private transfers (net) | ... | 46.2 | 46.2 | 49.5 | 59.1 | 59.8 | 61.1 |
| Official transfers | ... | -17.4 | -16.0 | -16.4 | -12.0 | -17.7 | -20.0 |
| Current account | ... | -79.3 | -33.8 | -6.6 | -1.3 | 49.7 | 46.9 |
| As a percent of GDP | ... | (-2.2) | (-0.9) | (-0.2) | (1.1) | (1.1) | (0.9) |
| Autonomous long-term capital | ... | -53.3 | -46.7 | -23.8 | -21.8 | ... | ... |
| Authorized borrowings | ... | 78.1 | 88.0 | 36.1 | 16.3 | ... | ... |
| Short-term capital 4/ | ... | 21.4 | 37.6 | 21.3 | 27.3 | ... | ... |
| Net change in official reserves | ... | -33.1 | 45.0 | 27.0 | 20.5 | ... | ... |

France Basic - Data (Concluded)

| | 1982 | 1983 | 1984 | 1985 | 1986 1/ | 1987 1/ |
|---|---|---|---|---|---|---|
| | | | (Annual changes in percent, except where otherwise noted) | | | |
| Exchange rates | | | | | | |
| French franc per U.S. dollar (average) | 6.57 | 7.62 | 8.74 | 8.99 | ... | ... |
| French franc per deutsche mark (average) | 2.71 | 2.98 | 3.07 | 3.05 | ... | ... |
| Effective rate (period average) | -9.2 | -8.7 | -6.0 | 0.9 | ... | ... |
| Relative unit labor costs (period average) | -3.2 | -1.6 | -0.3 | 1.0 | ... | ... |
| | | | (Annual changes in percent) | | | |
| Monetary data | | | | | | |
| Money and quasi-money 5/ | 11.5 | 10.3 | 7.6 | 6.9 | 5.0 | 5.0 |
| Domestic credit (net of non-monetary resources) | 15.6 | 12.2 | 7.4 | 3.1 | 5.0 | 5.0 |
| Claims on the Treasury | 19.7 | 29.0 | 7.3 | 6.5 | ... | ... |
| Claims on the economy | 15.7 | 11.9 | 10.3 | 9.0 | ... | ... |
| | | | (Period averages; in percent) | | | |
| Interest rates | | | | | | |
| Three-month money market rate | 14.87 | 12.53 | 11.74 | 9.95 | ... | ... |
| Prime lending rate | 12.75 | 12.25 | 12.16 | 11.09 | ... | ... |
| Government bond yield | 15.69 | 13.63 | 12.54 | 10.94 | ... | ... |
| | | | (In percent of GDP) | | | |
| Basic economic ratios | | | | | | |
| General government revenues 6/ | 45.4 | 46.1 | 47.1 | 47.2 | 46.0 | 45.6 |
| General government expenditures 6/ | 48.1 | 49.2 | 50.0 | 49.8 | 48.5 | 48.1 |
| Balance (- deficit) 6/ | -2.7 | -3.1 | -2.9 | -2.6 | -2.5 | -2.5 |
| External debt (end of year) | 8.3 | 11.4 | 12.3 | 10.2 | ... | ... |
| Debt service payments 7/ | 3.7 | 4.7 | 6.5 | 6.4 | ... | ... |
| Money and quasi-money (M2R end of year) | 46.3 | 46.7 | 46.5 | 45.7 | 45.0 | 44.8 |
| Exports of goods and services 6/ | 21.6 | 22.2 | 23.8 | 23.5 | 21.5 | 22.1 |
| Imports of goods and services 6/ | 24.5 | 23.5 | 24.3 | 24.0 | 20.7 | 21.3 |
| | | | (Period average; in percent) | | | |
| Differentials with Germany | | | | | | |
| CPI | 6.5 | 6.3 | 5.0 | 3.6 | 2.8 | 1.4 |
| Unit labor costs (national currency) | 7.1 | 8.5 | 4.7 | 2.3 | -1.2 | -1.0 |
| FF/DM rate (percent change) | 12.6 | 10.0 | 3.0 | -0.6 | ... | ... |
| Total domestic demand | 6.1 | -2.4 | -1.4 | 0.6 | -1.0 | -1.2 |
| | | | (Changes in percent) | | | |
| Partner country data | | | | | | |
| Non-oil imports in volume | 1.1 | 1.8 | 6.8 | 3.4 | 3.9 | 3.1 |
| ULCs in manufacturing in francs | 15.6 | 9.3 | 4.8 | 1.4 | ... | ... |

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

1/ Staff estimates and projections unless otherwise stated.
2/ Changes as a percent of previous year's GDP.
3/ Outturn, administrative basis for 1981-83; estimated outturn of supplementary budget law for 1984; and staff projections for 1985-86. Excluding FSC operations.
4/ Including errors and omissions.
5/ M2 (old definition) upto 1983, M2R (old definition) up to 1985, M3 (new definition) 1986 and 1987.
6/ National income accounts basis.
7/ In percent of exports of goods and nonfactor services.

# France - Statistical Issues

## 1. Outstanding Statistical Issues

### a. Monetary accounts

In May 1986 the Bank of France introduced a new definition of the main monetary aggregates; data compiled in accordance with the new definition will be published in the August 1986 issue of IFS. Some problems related to the coverage of financial data remain. In particular, the Fund does not receive information in sufficient detail to calculate data for deposit money banks; such data are at present derived as the difference between the monetary survey data supplied by the Bank of France and the monetary authorities' accounts derived from the balance sheet of the Bank of France. Data on other banking institutions have not been received since December 1984.

### b. Government finance

Monthly data for inclusion in IFS are available through November 1985.

The latest year for which complete data are published in the Government Finance Statistics Yearbook is 1982; partial data are available for 1983 and 1984. There are no tables published on lending minus repayments by function, outstanding debt by type of debt holder and by type of debt instrument, as well as supranational authorities expenditure by function. Data showing the derivation of major government finance aggregates from national sources are not available.

## 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 July 1986 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 an irregular basis.

## Status of IFS Data

| | | Latest Data in July 1986 IFS |
|---|---|---|
| Real Sector | - National Accounts | Q3 1985 |
| | - Prices: CPI | May 1986 |
| | Industrial goods | December 1985 1/ |
| | - Production: | March 1986 |
| | - Employment: | 1985 Q2 |
| | - Earnings: Labor costs | March 1986 |
| Government Finance | - Deficit/Surplus | November 1985 |
| | - Financing | November 1985 |
| | - Debt | November 1985 |
| Monetary Accounts | - Monetary Authorities | February 1986 |
| | - Deposit Money Banks | November 1985 |
| | - Other Financial Institutions | December 1984 |
| | - Insurance Companies | n.a. |
| Interest Rates | - Discount Rate | April 1986 |
| | Bank Lending/Deposit Rates | April 1986 |
| | Bond Yield | April 1986 |
| External Sector | - Merchandise Trade: Values | April 1986 |
| | Unit values | February 1986 |
| | - Balance of Payments | Q3 1985 |
| | - International Reserves | May 1986 |
| | - Exchange Rates | May 1986 |

1/ This index has been discontinued and is replaced by a quarterly index; the latest available data of the new index refer to Q1 1986 and will be published in the August 1986 IFS.