

SAVING TELFGRAM

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SAVING TELEGRAM NO 2 TO PARIS OF 28 JUNE 1984

AND SAVING TO ALL OECD POSTS

OECD: EDRC MEETING ON THE FRENCH ECONOMY

1. The annual examination of the French economy in the Economic and Development Review Committee of OECD was held on 25 June 1984. The examining countries were the UK and Italy. The French team was led by Milleron and Samuel-Lajeunesse (Ministère de l'Economie, des Finances et du Budget) with Ullmo (Plan) and Raymond (Banque de France).

2. The OECD Secretariat report suggests that short-term prospects for 1984 and 1985 are for only modest recovery and stresses the need for longer-term improvements in trend competitiveness and industrial structure. The French were broadly content with its overall tone, which they clearly see as providing support for the continuation of strict policies.

Current Policy and Short-Term Outlook

3. Milleron described the broad thrust of French economic policy as being to improve the external balance by reducing inflation and slowing the growth of internal demand. Several other statements by Milleron during the course of the meeting illustrate how far French policy has apparently shifted since 1981/82:

- the rejection of 'simpliste' Keynesian formulae: the government can do less on transfers (balanced reduction in revenue and spending) without necessarily having a deflationary effect;

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/- the need

- the need for strict control of government spending and, in particular, a rigorous policy to contain growth in public sector employment and pay;
- the need to reduce the financial burden on enterprises in order to improve profits and hence investment;
- the need for industry to meet foreign competition; and
- the need for a greater role for market forces generally, with hints of possible further relaxation of industrial price controls and exchange controls and talks of a 'growing awareness' of the rigidities minimum wage legislation may cause.

At the same time Milleron was at pains to stress the 'original' features of the French approach, for example the use of wages policy and measures such as youth schemes and encouragement of reduced working hours aimed at reducing unemployment, though it was conceded that even the direct effect of these measures had been small.

4. The Secretariat's forecasts (see table below) were in fact little discussed. For 1984 there was general agreement that French targets for monetary growth, inflation and the trade balance were ambitious. Raymond responded that monetary growth, after over-shooting for technical reasons in late 1983, had grown very slowly in the first months of 1984 and was expected to average 6% for the year as a whole. Milleron conceded that inflation would probably only fall to 6-7% by the end of 1984, but adherence to the 5% target was essential for the operation of wages policy. On the trade balance the French

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argued that despite the poor performance in the first quarter of 1984, the balance on manufacturing trade was still improving and preliminary balance of payments figures for the second quarter suggest a return to balance or at least only a small deficit.

|                            | <u>1983</u> | <u>1984</u> | <u>1985</u> |
|----------------------------|-------------|-------------|-------------|
| Growth of Real GDP (%)     | 0.7         | 1.2         | 1.8         |
| Trade Balance (FFr B)      | -61         | -42         | -36         |
| Consumer Prices (% change) | 9.6         | 7.6         | 5.7         |

5. For 1985, there was even less discussion though the UK commented that the forecast looked a little pessimistic, given that falling inflation and improved competitiveness might be expected to give a boost to domestic and external demand.

Medium-Term Prospects

6. The argument in the Secretariat's paper is that despite recent improvements the French foreign trade position remains fragile because of:

- (i) increasing import penetration, particularly in the capital goods sector;
- (ii) a tendency for the main export industries to be those in which large industrial groups dominate and for which home demand is growing slowly; and
- (iii) less favourable trends in the balance of trade in services.

These factors, coupled with the fact that much of the recent improvement may be attributable to past currency realignments and to France being cyclically out-of-phase with other economies,

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give rise to concern that the current account surplus necessary to meet debt repayments may not be achievable. The Secretariat's paper ascribes these structural problems in the balance of payments to weaknesses in the industrial system, in particular the need for modernisation of the obsolescent capital stock.

7. The French, while again questioning some of the figures and saying, with some justification, that they did not find some parts of the OECD analysis very convincing, did accept that there were grounds for concern. Indeed, the IXth Plan stresses the need for industrial modernisation and restructuring. Milleron also stressed the recent improvements in companies' financial positions, due to falling real wages and productivity gains, which, if continued, should encourage the investment needed to modernise the capital stock. The UK and other delegations asked whether investment and expansion could be further promoted by liberalisation measures such as de-control of industrial prices, dismantling of the 'encadrement' system of credit control and increased flexibility in the labour market. The French indicated willingness to go some but not all of the way along this path. Milleron emphasised the need for gradual change and for flexibility in policy.

8. On competitiveness and the external balance, Samuel-Lajeunesse indicated that the current exchange rate would provide sufficient competitiveness to meet their objective of a slight surplus on the current account over the next few years. Their calculations suggested that an improvement in the current account balance of only 0.5% of GNP would be sufficient to enable reductions in the

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debt/GNP ratio in 1986/87 and actual reductions in debt by 1988. In reply to a question from the US, Samuel-Lajeunesse said that he did not foresee any special problems for the franc within EMS from a fall in the dollar, particularly if it was gradual. The dollar fall in early 1984 had not led to difficulties.

9. Summing up, the Chairman concluded that there was general agreement that the thrust of the report was right and that the objectives of French policy - both short and medium-term - were ambitious. The main problem for the French economy was the external constraint and this was related to fundamental problems of wage trends, budget discipline, rigidities arising from regulation, and obsolescence of the capital stock. To correct these at a time of international uncertainty would require sacrifices - particularly regarding employment - but there was no alternative to the continuation of present austere policies. The French were keen for this to be stressed more in the report and this would be pursued in the bilateral meeting, along with other queries over statistical detail.

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