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Prime Minister

You might just read the summary

CDP 22/2

ECONOMIC LIBERALISM: WHERE DO THE FRENCH STAND?

Summary

1. The French used to be archetypal interventionists and protectionists (and at one time were admired as such by some in Britain). They have, however, come a long way since a change of course in 1983. Central planning has been abandoned; subsidised credit has dwindled to a trickle; state aids have been cut; capital movements have been liberalised; the financial market has been modernised and liberalised; restrictions on foreign investments have been eased; stock market takeovers have been made easier; prior approval for redundancies is no longer necessary; competition policy has been sharpened up. Public sector managers now have more autonomy than in the past (paras 1-5). MT

2. There are several reasons for this trend towards greater economic freedom; budgetary pressures, the Single Market programme, EC competition policy, economic self-interest. Above all, underlying attitudes are evolving, a process underpinned by social change and an upsurge of interest in overseas markets (paras 6-11).

3. This is not to say that French policy has become completely liberal. Examples of old style interventionism and protectionism can still be found. Sizeable chunks of the industrial, banking and insurance sectors remain under public control; ministers and officials still think in nationalistic terms and like to direct; French vehicles, textiles, steel, television, footwear and agricultural producers benefit from import restrictions; some of the service sectors and professions are being opened up only slowly and reluctantly (para 12).

4. Many of these remaining restrictions will disappear with the completion of the Single Market, and privatisation will be resumed one day; but mainstream attitudes look unlikely ever to evolve beyond the soft end of liberalism. On the other hand a return to dirigisme looks unlikely (paras 13-17).

5. These changes do not mean France will necessarily seem an easy or congenial place to British businessmen. Yet British exports have a larger share of the French market than of the FRG or US markets, and recently France has been the second largest recipient of British corporate investment after the US (para 18).

6. Conclusions: we should keep in mind how far the French have moved and see EC trade and industrial policy differences in perspective. The rhetoric of a Socialist government will not be liberal, but we may find them ready to work with us against protectionism elsewhere in the EC. We should react to specific examples of anti-competitive practice but avoid throwing stones (para 19).

The Rt Hon Douglas Hurd CBE MP
Secretary of State for Foreign
and Commonwealth Affairs
LONDON

21 February 1990

Sir

ECONOMIC LIBERALISM: WHERE DO THE FRENCH STAND?

> "France's reputation for interventionism is centuries old but now unjustified" - Roger Fauroux, French Minister for Industry, June 1989

1. Not long ago, a Minister in the Foreign Office spoke to me with some envy of the Ecole Nationale d'Administration, the mobility of whose former students helped to bridge the gap between government service and business. In the 1970's many of those who were dismayed by Britain's relatively poor post-War industrial performance, were attracted by the French paradigm. French success in building up their industry after the War suggested that there must be useful lessons from the French industrial policy model, characterised by indicative planning of investment in major industries, the centralisation of credit control and a broad range of support programmes. The Government prompted businessmen (often ex-ENA-trained civil servants) to start up new industries, ensured that capital was available, subsidised

credit, contributed to R&D, subsidised exports, and erected barriers against unwelcome foreign competition. The French concept of "The Plan" carried widespread prestige.

2. Even under Labour governments, and despite the intellectual attraction to many of the French model, there remained a wide gap between British and French approaches. After the May 1979 elections, which moved British policy in a different direction, the gap between our practices and those of the French widened. Monsieur Mitterrand's election in 1981, the Mauroy government's commitment to a strong public sector and the nationalisation programme of 1982 contributed to this.

3. It was only in 1983 that France came to a turning point. Socialist policies, applied to a production system that had been weakened by the oil shocks of 1973 and 1979, unexpected changes in demand for industrial products and the emergence of new industrial nations, had brought on a crisis. Government spending had risen to 48% of GDP, the trade deficit had sunk to FF 90 billion, the Franc had been twice devalued within the European Monetary System in two years. A change of course was decided.

4. This new course has brought France much greater economic freedom. Among the landmarks that have been passed:

- Old-style central planning and indictive targetting have been abandoned. The Ninth Plan (1984-88) prepared by the Socialists in 1983 was short on specifics and was put to one side by the Chirac government in 1986. The tenth Plan (1989-1992), prepared after the Socialists' return to power in May 1988, is little more than a statement of government economic policy. It is not a working document, either for officials or for business.

- Subsidised credit to the corporate sector has dwindled to a trickle. Leaving aside export credits (where subsidies are governed by OECD consensus rules) the cost to government of subsidising interest payments on loans taken out by French industrial companies has shrunk from FF 36 billion in 1984 to FF 2.5 billion in 1989. The only beneficiaries now are small and medium sized companies, many of them in Corsica and France's overseas territories. The government's aim is to eliminate all credit subsidies.

- State aids to the corporate sector have also been cut back, from a high-point in 1984-85 (the result of commitments made in the 1981-83 period). Some British industrialists seem convinced that their French competitors get a much better deal than themselves (eg Sir Robert Haslam of British Coal who has recently talked about "huge subsidies" to the French nuclear industry). Seen from here there is not much evidence of this. The only industries now in receipt of operating subsidies are the coal industry (FF 3 billion approximately in 1989) and the shipbuilding industry (just over FF 1 billion in 1989). The main emphasis is on support for civil R&D (FF 17 billion in 1989) as opposed to equity injections into public sector industrial groups (FF 4.1 billion in 1989) or regional and small and medium sized business support (FF 4 billion approximately in 1989). Total spending last year, excluding aids to exporters, was probably not very different from that of the United Kingdom where in 1988-89 central government spent over £ 2 billion on sectoral, regional and general industrial support and around £ 1 billion on the advancement of technology.

- Capital movements have been liberalised progressively. The process began in 1986. The last remaining exchange controls were lifted on 1 January 1990.

- The French financial market has been modernised and liberalised. Investment banking has boomed thanks to the lifting of credit controls in 1984, the 1986-88 privatisation programme, and a surge in mergers and acquisitions activity. Foreign owned banks have been able to win a good share of this business. French stockbroking firms have now been opened up to foreign capital, fixed commissions have been abolished and limited market-making has been introduced. Futures and options markets have been established and are flourishing.

- Restrictions on foreign investments in France have been progressively eased, most recently in September 1988 and January 1990. No prior authorisation is required for green-field investments, and apart from three reserved sectors (defence, public order and public health) established European Community companies can now acquire French companies without obtaining prior authorisation from the Ministry of Finance, while for non-European Community companies the Ministry has only one month to withhold authorisation. In 1988 United Kingdom acquisitions in France were worth £ 934 million and involved 56 different deals. From mid-1987 to end 1988, 3000 non-European Community companies sought permission to acquire French companies: fewer than a dozen were refused. Even the Japanese are generally welcome. More than 60 Japanese companies now have industrial plants in France and an effort is being made to attract more. The public attacks on the Japanese by the Minister for European Affairs, Madame Edith Cresson, give a false impression of government policy, though her main target, the vehicles sector, is a special case (see below).

- Stock market rules on takeovers have been clarified, some barriers have been removed, and hostile takeovers have become a feature of the French market. Various barriers remain, eg golden shares in comapnies privatised between 1986-88, defensive cross-shareholdings and double voting rights. But a study of European Community markets commissioned from Coopers and Lybrand showed that France was at the more open end of the spectrum, well ahead of the Germans and Dutch.

- A requirement that employers seek prior authorisation for redundancies was scrapped by the Chirac government and has not been reintroduced by the Rocard government.

- A new competition law was enacted at the end of 1986 and competition policy has been sharpened up. A Competition Council imposed fines of FF 358 million in 1989. In recent months, two cartels involving companies bidding for public interest contracts have been exposed and heavy fines imposed. It has been made clear that action against anti-competitive agreements and abuses of monopoly power is regarded as an essential feature of economic policy.

5. The nature of government's relations with public sector managers has changed too. Public sector managers now have greater autonomy than they did in the past. The government's policy is to encourage them to run their companies as though they were commercial enterprises. They are required to agree general strategies with Ministers and to operate on the basis of a corporate plan which includes manning, financial and investment targets. Government does not, however, interfere in day-to-day management. Monsieur Alan Gomez of Thomson has made this point forcibly to me (though "he would, wouldn't he"). A strong and confident personality at the head of a public

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sector group, as most of them are, can set the pace in his dealings with Ministers, in the knowledge that a good case will generally find acceptance. Moreover political affiliations have ceased to count for much; only two of the Chairmen appointed by the Chirac government have been ousted since the Socialists returned to power; several others have been reappointed. That said, there is little doubt that public sector companies do not have quite the same freedom of action as those in the private sector, notably in the area of fund-raising or where rapid decision-making may be desirable.

6. What lies behind this trend towards greater economic freedom? One important factor has been the pressure to cut back government spending to which government has felt subject. Since 1983 reducing the burden of taxation, particularly on the corporate sector, and settling the PSBR at non-inflationary levels, have been cardinal objectives of French macroeconomic policy, the aim being to keep the Franc pegged to the DM and to improve the competitiveness of French producers.

7. More recently, the pressure exerted by the liberal Single Market programme, and by the more vigorous competition policy which the Commission has pursued, has been important. Though French Ministers and officials may fight hard in individual instances to adulterate or delay the coming

into effect of new proposals, they do so in the knowledge that in the last analysis President Mitterrand requires the political commitments made in the Single European Act to be honoured. The French record on implementation, nearly as good as our own, bears this out. In the field of state aids, a ruling made by Monsieur Rocard in the autumn of 1988 requires a 'transparency' in dealings with the Commission that was not always a feature of the French approach.

8. Economic self-interest is a third factor. The liberalisation of the French financial market is the prime example. The aim has been to improve the terms on which French business can gain access to capital and to turn Paris into a major (invisibles earning) financial centre. The logic of the easing of restrictions on foreign investments is to create new employment and to compensate for possible outflows of French capital following capital movement liberalisation. The sharpening up of competition policy reflects an awareness that liberalised markets require tough and attentive regulation (cf our own monopolies and mergers policy).

9. Beyond all this, underlying attitudes are evolving. Leaving aside the Left of the Socialist Party and the Communists, where thinking continues to be influenced by Hegelian and Marxist ideas, there is now a greater

readiness among politicians, senior officials and leading businessmen to believe that it is in French interests for economic policy to be based on more liberal principles than in the post-War period. Doubts about interventionism were sown by the failure of French policy between 1973 and 1983. The impact of liberal policies on the United States and United Kingdom economies has been noted. Above all, it is increasingly recognised that opening up the French economy to outside forces is essential to its health and dynamism. The broad political base of this emerging orthodoxy helps explain why the trend towards liberalism began and has continued under Socialist governments, notwithstanding that it gathered pace between 1986 and 1988 when Monsieur Chirac was Prime Minister and several members of the radically free-market Parti Republicain were in his government.

10. The process is underpinned by social change. Among the under-40s esteem for the entrepreneur has grown at the expense of the civil servant. Many of the young flyers who join the Civil Service after graduating from ENA or the Ecole Polytechnique now do so only to qualify for membership of a useful club (which is what the elite 'corps d'Etat' are). They often leave for the private sector once this aim has been achieved. There they find a new type of French businessman who has been to business school, studied in the United States and travelled the

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world, who is less wary of foreign competition than preceding generations, more confident of his ability to handle the consequences of liberalism. Indeed to this younger generation liberal economic policies seem the natural order of things in a way that they did not to the post-War generations. They have acquired a taste for business. Moreover the prestige of the ENArque in industry is in decline. Those moulded in a pattern evolved for the purpose of centralised government direction have the reputation, whatever their intellectual abilities, of being slow to adapt to modern entrepreneurial skills, marketing, risk-taking and the competitive instincts likely to be at a premium in the Single Market after 1993.

11. Further underpinning is provided by an upsurge in interest in overseas markets on the part of French industrialists. A recent survey of thinking in the board-rooms of 300 major French companies revealed that 95% of them believed that their main strategic objective must be to develop their activities outside France. The net figure of direct overseas investments in 1988 was FF 76.1 billion. Between January and June 1989 French acquisitions in other European Community states were worth more than any other single country's acquisitions in those states. French industrial and service sector acquisitions in the United States in 1989 are thought to have been worth US$ 6 billion, 50% up on 1988, and only 4 billion below the corresponding Japanese figure.

12. It is time to look at the other side of the picture. To say that the French economic policy has become more liberal is not to say that it has become completely liberal. Examples of old style interventionism and protectionism can still be found:

- sizeable chunks of the industrial, banking and insurance sectors remain under public control. The privatisation programme launched by Monsieur Chirac and his Finance Minister, Monsieur Balladur, was abandoned in May 1988. President Mitterrand's by now famous ruling that there were to be no further privatisations or re-nationalisations until the completion of the Single Market (ie before 1993) was designed to limit the risk of damaging doctrinal squabbles within the Socialist camp. However, it has had the effect of ensuring that a significant part of the French economy remains off limits to foreigners, and gives the companies concerned the benefit of an implicit state guarantee.

- Though the national plan has become a dead letter, Ministers and officials still like to think in terms of market share goals for specific industrial and service sectors and of national champions. They have proprietorial feelings towards large French companies, private as well as public sector, that are generally absent in the United States or the United Kingdom. Their instinct if a company

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like CGE or Peugeot-Citroen were to be the object of a hostile takeover would be to attempt to block it, though it is not to be excluded that liberal principles would end up dominant (once the EC Merger Control Regulation is in force there should be little they can do). They have close links with the business community that can compensate for the absence of formal powers. Even now most leading bankers and industrialists were once civil servants, went to the same schools as Ministers and officials, especially the Ecole Nationale d'Administration, and share their values and outlook. They seem to me to be more responsive to direction than their Anglo-Saxon counterparts; and it occurs to the French Government to direct in a way that would not seem easily thinkable to British Ministers. When Monsieur Chirac was Prime Minister and British Airways' purchase of a new generation of aircraft was at issue, he found it impossible to understand that Lord King, at the head of a recently privatised company, could not be "influenced" by the Prime Minister to buy Airbus. If she did not pick up the telephone, it could only be because she lacked the political will.

- There are still a number of sectors in which French producers are protected from non-European Community competition by import restrictions and local content requirements for inward investments. The instinct to protect the producer rather than the consumer remains strong. The vehicles sector is the prime example. Japanese car producers are allowed only 3% of the French market, and have been told that they must achieve a local content of 80% at or shortly after start-up if they want to build plants in France. Even the Minister for Industry, Monsieur Fauroux, one of the most liberal members of the present government, considers the vehicles industry a special case. For the best part of a year the French tried to enforce a ruling that UK-made Nissan Bluebirds should count as Japanese until a European Community content of 80% was achieved. They are arguing for continuing restrictions on Japanese imports into the European Community well beyond the date when we are content to abandon our own Voluntary Restraint Agreement with the Japanese producers. The other economically important sectors where French producers continue to benefit from import restrictions are textiles (under the Multi-Fibre Arrangement), steel (under a European Commission-administered VRA system), television (specific QR's) and footwear (specific QR's) and agriculture (under the Common Agricultural Policy).

- As in every other major economy, government authorities and publicly owned service providers have tended to discriminate against foreign suppliers in their purchasing practice. Transport, power, telecoms and defence equipment are the principle sectors concerned. At the sub-assembly and component level, however, British companies have been able to supply without restriction.

- In some of the service sectors and the professions there has been little evidence of readiness to open up the domestic market to foreign competition any faster than necessary under the Single Market programme. Some notable rear-guard battles against liberalisation in the transport and telecommunications sectors have been fought in Brussels. Our auctioneers have so far found themselves banned from holding public auctions in France by a provision in French law which reserves this activity for members of an official corps, the commissaires-priseurs. Our ski instructors have recently encountered a reluctance to recognise the qualifications issued by the Ski Club of Great Britain. Our estate agents can only go into business in France if they have acquired certain French academic qualifications or worked for a certain period for their French counterparts. British lawyers in Paris are currently threatened by a reform of the French legal profession that would require them to qualify for entry into the French profession even if they are intended only to advise on English or EC law.

13. Many of these remaining restrictions will disappear with the completion of the Single Market (eg through mutual recognition of qualifications and public purchasing directives). A resumption of the privatisation programme seems a certainty as and when the Right next forms a government (but "when" could be some time away) and may even happen on an ad hoc

basis under a Centre-Left government after 1993. There is undoubtedly a limit to how far attitudes will evolve. It is hard to see a majority of French politicians and officials ever abandoning a nationalistic way of thinking about the French economy: it is a habit of thought that is deeply ingrained, part of their mental tradition. They will retain protectionist instincts - and will find it difficult to accept the logic of extending free access to European Community markets so long as their major competitors include those who restrict access to their own markets.

14. Not only Socialists but also many reared in the Catholic tradition in the Centre and on the Right will remain uneasy about the central position of the profit motive in economic liberalism and doubtful whether there is anything intrinsically fair about the market-place. There is a centuries-old mistrust for capitalism ("usury" or "money which corrupts" to quote President Mitterrand). They will see a greater need for interference and regulation than would be acceptable to the free-marketeer. French theoreticians point out that the most successful economies of the post-War period, Japan and the FRG, have been run on anything but free-market principles: they suggest that France should seek to steer a middle-course between the Japanese and Anglo-Saxon models. Businessmen continue to be susceptible to the charms of collaboration in preference to competition. Monsieur Beffa of St Gobain once spent an evening arguing with me about

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the way the British Government tolerated takeover bids. In short, the soft end of liberalism is probably about as far as mainstream opinion in France will get.

15. On the other hand a return to dirigisme looks equally unlikely. Even were opinion to swing back in favour of it, policy makers would find themselves subject to a number of constraints. It must be doubtful, for instance, whether the civil service is still capable of playing the role it did in the post-War period. It has 'een weakened by the decline in prestige referred to above. Key posts continue to be filled by top quality people but most Ministries now lack strength in depth and there are some signs of demoralisation. Secondly the decentralisation process that began in 1982 has reduced central government's right to intervene. Regional and local governments are jealous of their new-found powers. Dependent for their own careers on local power bases national politicians will be reluctant to take them on.

16. Thirdly, many of the traditional weapons in the armoury of the interventionist are no longer available to French policy-makers or will shortly become unuseable. Controls on capital, state aids, the blocking of takeovers, quantitative restrictions, the reserving of professions for nationals: the Single Market programme is rendering these instruments of policy obsolete or handing control over their use to

the Commission - which, since the appointments of Herr Bangemann and Sir Leon Brittan, they no longer perceive as an ally. There has certainly been more to French liberalism since 1983 than simply putting a good face on changes rendered inevitable by their political commitment to the Single Market; but undoubtedly European Community obligations would limit their options if ever they were tempted to go into reverse.

17. Finally, French indus rialists and service providers, as they expand overseas, have an increasing stake in ensuring that foreigners can enjoy access to the French market. They know that the sword of reciprocity which they brandish so frequently in their dealings with the Japanese and others could be turned against them if the barriers were to go up again.

18. None of this means that British businessmen will necessarily find France an easy or congenial place to do business. For the time being, employer social benefits contributions and corporate tax rates look set to remain higher than in the United Kingdom. The French place less of a premium on good humour and friendliness in business contacts. Fewer French businessmen speak English than an English businessman might wish, though more and more are doing so better and better. The retail distribution system is more fragmented than in the United Kingdom. It will take a long time for liberalism to permeate the thinking of many of the minor officials with whom foreigners

have to deal. These difficulties will no doubt continue to make many feel that they are unwelcome here and will fuel a belief that little has changed. But impressions can be misleading. British non-oil exports to France grew by over 20% in 1989, and from an already strong base. British exports to France in 1987 and 1988 represented 1.44% and 1.55% respectively of French GDP. Measured in these terms the French market is more open to our goods than either the German (1.37% and 1.41%) or the American (0.4% and 0.39%) markets. And in recert years France has been the second largest recipient of British fixed corporate investment after the United States.

Conclusions

19. Few French are radical free-marketeers, and there are still many examples of interventionism and protectionism in France. But there has been a pronounced trend towards liberalism in recent French policy, and France is now relatively open to foreigners wishing to sell, invest or practise here, probably more open than several other members states of the European Community, and certainly more open than Japan and most of the Newly Industrialising Economies. When we differ on trade or industrial policy issues in brussels, as we shall undoubtedly continue to do in the period ahead (for instance on policy towards Japanese car imports, air services liberalisation and the role of central authorities in ensuring the development

of pan-European infrastructure networks) these differences should be seen in perspective. We should continue to apply pressure for the removal of the restrictions that remain, and we need never hesitate to take up with the Commission or bilaterally examples of anti-competitive practice. Nevertheless, we need also to keep in mind how far the French have moved in recent years. It would be surprising if a predominantly Socialist government, relying as it dos for its political support on the Civil Service and the public sector were to make public professions of faith in the virtues of economic liberalism. Yet they are not at the opposite end of the spectrum from us and we are likely to find that they are increasingly ready to work with us against protectionism elsewhere in the Community, eg barriers to takeovers in the FRG and state aids in Italy. Nor are they always the obvious target for our attacks. Above all, we should not throw stones if we ourselves are vulnerable.

20. I am sending copies of this despatch to the Chancellor of the Exchequer, the Secretary of State for Trade and Industry, Her Majesty's Ambassadors at Washington, Tokyo, Bonn, Rome, Madrid, Brussels and The Hague, to the United Kingdom Permanent Representatives to the EC and OECD, to Charles Powell at No 10 and to the Governor of the Bank of England.

I remain, Sir
Yours faithfully

Ewen Fergusson

Ewen Fergusson

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