© 2002 International Monetary Fund

November 2002
IMF Country Report No. 02/251

France: 2002 Article IV Consultation—Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2002 Article IV consultation with France, the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **July 15, 2002,** with the officials of France on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on September 30, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff supplement of **October 22, 2002** updating information on recent developments.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its October 28, 2002 discussion** of the staff report that concluded the Article IV consultation.

The document(s) listed below have been or will be separately released.

Report on Observance of Standards and Codes—Updates
Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

FRANCE

Staff Report for the 2002 Article IV Consultation

Prepared by Staff Representatives for the 2002 Article IV Consultation with France

Approved by Michael Deppler and Leslie Lipschitz

September 30, 2002

- The Article IV consultation discussions took place in Paris from July 4-15, 2002. The team—Messrs. Leipold (Head), Everaert, Estevão, Nadal De Simone, Weisfeld, Mme. Detragiache (all EU1)—met with Mr. Mer, Minister of the Economy, Finance, and Industry, Mr. Lambert, Minister of the Budget and their staff; Governor Trichet and officials of the Banque de France; Mr. Mattei, Minister of Health, Family, and Disabled Persons; the economic advisors to the Prime Minister; members of the commissions of finance of the National Assembly and the Senate; officials of the Ministry of Social Affairs, Labor and Solidarity, the national statistical institute, the Banking Commission, the securities supervisor, the insurance regulator and supervisor; as well as market participants, academics, and representatives of labor unions and employers. Mr. Duquesne (Executive Director) or Mr. Boitreaud (Alternate Executive Director) attended the meetings.

- France is an Article VIII member, and apart from certain security restrictions (Appendix I), maintains an exchange system free of restrictions.

- France subscribes to the Fund's Special Data Dissemination Standard and comprehensive economic data are available on a timely basis (Appendix II).

Contents Page

I. Background 3
II. Policy Discussions 4
A. Economic Performance and Outlook 5
B. Tackling the Consequences of Aging 8
C. Meeting the Challenge of Fiscal Consolidation 11
D. Promoting Growth through Fiscal Reforms 14
E. Boosting Efficiency through Labor and Product Market Reforms 15
F. Containing Risks and Pursuing Deregulation in the Financial Sector 16
G. Other Issues 18
III. Staff Appraisal 19

Figures
1. Selected Components of Demand 5
2. Output and Private Consumption 5
3. Business Indicators 5
4. Real Effective Exchange Rate 6
5. Consumer Indicators 6
6. Inflation Components 7
7. Measures of Slack 7
8. Business Sector Output per Hour Worked 7
9. Share of Workers Earning the *SMIC* or Less 8
10. General Government Revenue 14
11. Public Employment as Percent of Total 14
12. Doubtful Loans and Provisioning Ratio 17

Tables
1. Main Economic Indicators 1998–2007 23
2. Vulnerability Indicators 1998–2002 24

Text Boxes
1. Policy Recommendations and Implementation 4
2. Aging and Fiscal Sustainability 9
3. Post-Assessment Developments of Compliance with the Basel Core Principles for Effective Banking Supervision 18

Appendices
I. Fund Relations 25
II. Statistical Information 27

I. Background

1. **The 2002 consultation mission took place as a new center-right government was taking office and outlining its broad economic policy orientation.** With the presidency of the Republic and the government politically aligned, a substantial majority in Parliament, and no major domestic elections for five years, a window has opened for substantive progress on outstanding economic reforms. Central to the new government's policies are the desire to refocus the role of the state, by adjusting spending priorities and decentralization, and to boost the growth potential of the economy through tax reductions and the creation of a business-friendly environment.

2. **The authorities face the imminent challenge of a key demographic turnaround—an enduring decline in the active population beginning in 2007.** Other things equal, this will reduce annual per-capita-GDP growth by about ½ of one percentage point for a few decades. Increased pension and health care costs will add over 5 percentage points of GDP to budgetary outlays by 2040—when the age structure of the population stabilizes—with much of the impact occurring within the next ten years.

3. **The French economy has notable strengths to meet this challenge, including high business sector productivity and a favorable recent performance.** As elsewhere in Europe, a deceleration in labor force and productivity growth reduced economic growth in the 1990s compared to earlier decades. Performance deteriorated at the beginning of the decade, pushing unemployment to very high levels by the mid-1990s. During the subsequent cyclical upswing, growth was rekindled by the upsurge in world trade and facilitated by supportive monetary conditions, while the benefits of earlier fiscal consolidation, wage moderation, and labor market reforms that boosted labor demand and alleviated inactivity traps also kicked in (Box 1). GDP and employment expanded rapidly during 1997–2000 and the unemployment rate fell to a fifteen-year low by early 2001, while inflation remained contained. The economy weathered the recent economic downswing relatively well, with moderate growth resuming after a shallow and brief decline in activity at end-2001.

4. **Nonetheless, important weaknesses remain—such as low activity rates and an onerous tax burden—while fiscal consolidation was reversed after 1999 and, outside the labor market, progress on structural reforms has been limited.** Taxes and social security contributions were cut—to some extent using revenue windfalls and causing the structural deficit to double to about 2 percent of GDP in 2002. Meanwhile, civil service, health care, and pension reforms—essential to curb expenditure in the medium term—remained on the drawing board. In product markets, competition was strengthened, but most network industries remain controlled by the state, and France has tended to brake further liberalization in Europe. The financial sector is sound, though it continues to be affected by administrative controls.

Box 1. France: Policy Recommendations and Implementation

Over the past five years, the Fund has advised France to strengthen public finances, with a focus on reducing government spending through pension, civil service and health care reforms, while cutting the heavy tax burden, and addressing the structural problems underlying low activity rates through labor market and entitlement reform. Promoting competition, further privatization, and the removal of administrative regulations in financial markets were also recommended.

In concluding the 2001 consultation, Directors stressed that policies should continue to be firmly geared toward raising potential growth by lifting the employment rate, reducing the tax burden in the context of medium-term fiscal consolidation (with structural balance to be achieved by 2004), and accelerating product market reforms.

Over the medium term, the direction of policies has been in line with these recommendations, but the extent of fiscal consolidation and the pace of reform have fallen short of Fund advice, which the authorities attribute to political constraints, the time needed to build consensus, France's traditional reliance on a large public sector as service provider, and the importance of equal access to basic services in product markets. In particular, needed pension, health care, and social service reforms remain to be enacted. After considerable progress, fiscal consolidation was reversed in 2000-02 as tax cuts overtook expenditure restraint. Cuts in social security contributions, active labor market policies, and more flexible labor organization in the context of the workweek reduction contributed to job-rich growth in the late 1990s and helped raise employment rates appreciably. But unemployment remains high and participation rates low, indicating a need for further action. Privatization has advanced appreciably, but product market reform has been slow.

II. Policy Discussions

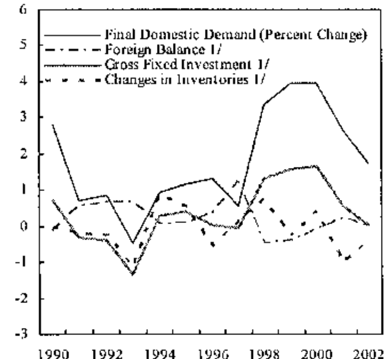
5. Against this background, **the discussions focused on the policies required to tackle the adverse consequences of aging on the economy and the budget, and in particular on the respective roles of: structural reforms to raise potential growth; pension and health care reform to generate budgetary savings; and fiscal consolidation to create room for maneuver**. With the government newly in office, specific policy measures were still being worked out, but the authorities' broad policy direction was generally in line with staff views.[1] The authorities emphasized policies to promote growth, in particular through tax cuts, consensual structural reform, and gradual fiscal consolidation accompanied by decentralization. The staff felt that fiscal consolidation deserved higher priority as a necessary ingredient of addressing the demographic shock and buttressing the credibility of any tax cuts. The staff also pressed for ambitious time tables on needed labor market and other structural reforms.

[1] A supplement to this report, including an annex on public debt sustainability and a draft PIN, will be issued before the Executive Board discussion to update policy and economic developments, including the 2003 budget and medium-term fiscal plans.

A. Economic Performance and Outlook

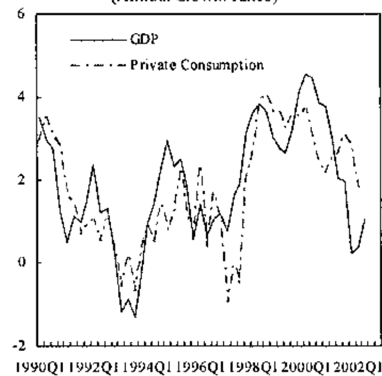
6. **During the last cycle, the appreciable increase in the employment rate boosted private consumption, but this proved insufficient to shield the economy from the global slowdown.** The 1997-2000 upswing saw buoyant investment and exports as well as strong private consumption demand—responding to employment gains and supportive policy conditions on the back of rapid growth in disposable income (Figure 1 and Table 1).[2] By the first half of 2001, however, adverse price shocks and a deteriorating external environment caused sharp declines in investment growth, exports, and inventories. Initially, resilient private consumption mitigated their impact, helped by tax relief. Nonetheless, further price shocks, a deteriorating employment outlook, and weakening confidence sapped consumption demand in late 2001, leading to a decline in output in the fourth quarter (Figure 2). Household savings remained relatively stable throughout the upswing and increased when the outlook deteriorated, suggesting that neither the equity price bubble, nor the ongoing steady rise in property prices, caused significant wealth effects for consumption.[3]

Figure 1. Selected Components of Demand



Sources: INSEE, National Accounts; and IMF, WEO.
1/ Contribution to GDP growth, in percentage points.

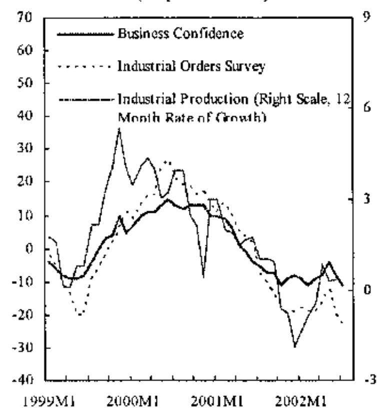
Figure 2. Output and Private Consumption (Annual Growth Rates)



Sources: INSEE, National Accounts.

7. **At the time of the mission, there were signs of a recovery gathering momentum, though with downside risk.** The staff agreed with the authorities that short-term indicators were consistent with growth picking up further through the third quarter to an annualized rate of about 2½ to 3 percent (Figure 3). It was expected that private consumption would strengthen, as tax cuts raised disposable income, and the employment outlook brightened responding to an improving external environment. This would ultimately lead to an acceleration of business investment, of which the timing was, however, uncertain. The authorities acknowledged the staff's concern about the strength of the recovery, in light of weakness in the region, in particular of Germany, uncertainty about the pace of the U.S. recovery, and

Figure 3. Business Indicators (Dispersion Index)



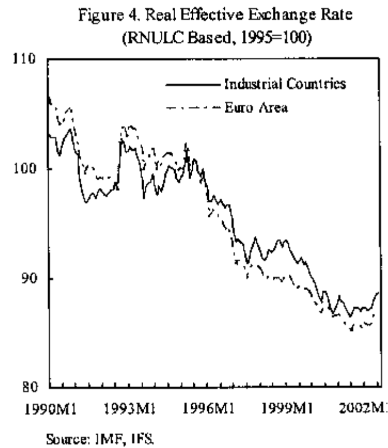
Source: WEFA Database.

[2] A background study reviews France's cyclical performance in international perspective.

[3] An INSEE study shows that private consumption is well explained by disposable income and employment expectations.

financial market turbulence. The euro appreciation was seen as a widely anticipated move toward a long-term equilibrium that would only slightly impact competitiveness and lead to a somewhat lower current account surplus, unless the appreciation accelerated. More broadly, with unit labor cost-based real effective exchange rates, including vis-à-vis the euro-area, not much off their decade lows, competitiveness remained satisfactory (Figure 4).

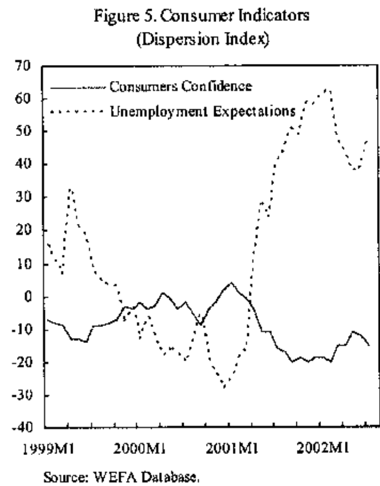
Figure 4. Real Effective Exchange Rate
(RNULC Based, 1995=100)



Source: IMF, IFS.

8. **Since the discussions, downside risks have intensified.** Data released since the mission show the economy growing at an annual rate of 2 percent in the first half of 2002, though without signs of acceleration. In the second quarter, consumption strengthened but with recent consumer confidence indicators deteriorating—reflecting a softening of the labor market—only a modest further pickup is expected (Figure 5). Business investment fell in the second quarter and is unlikely to return to strength in the near term. Consequently, the staff has lowered its GDP growth projections to 1.2 percent in 2002 and 2.3 percent in 2003; the 2003 budget preparation was initially based on 3 percent growth, but this projection is reportedly being scaled back. On the downside, equity markets remain volatile with adverse impact on financing conditions and confidence, and recent oil price pressures could also have a dampening effect.

Figure 5. Consumer Indicators
(Dispersion Index)



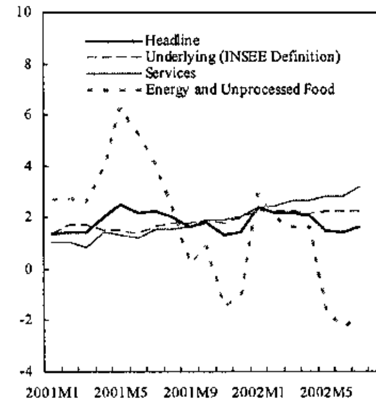
Source: WEFA Database.

9. **Policy conditions were generally seen to support a return of growth to near potential rates.** Monetary conditions were expected to remain accommodative, with weakness in other main countries of the euro-area somewhat more pronounced that in France. Automatic stabilizers would also continue to provide appreciable support, as would the overhang of budgetary stimulus in 2002. The authorities and staff agreed that fiscal discretion should not be used to address cyclical developments. At the same time, the authorities, while recognizing the need for further fiscal consolidation, were concerned that in light of a possibly weak recovery, correcting 2002 slippage (see ¶18) and proceeding with rapid fiscal consolidation posed economic risks.

10. **France has had low inflation over the past decade, but price increases accelerated in 2001 and underlying inflation remained stubbornly above 2 percent in the first half of**

2002 (Figure 6).[4] As elsewhere in the euro area, the rise of inflation can be traced to the euro depreciation, the energy price shock, the strong upsurge in unprocessed food prices, and more recently, the euro changeover. There were, however, also some idiosyncratic developments. In particular, the authorities acknowledged that the workweek reduction in the service sector had contributed to upward price pressures. More recently, some network industries raised tariffs, though the authorities postponed a requested electricity tariff increase.

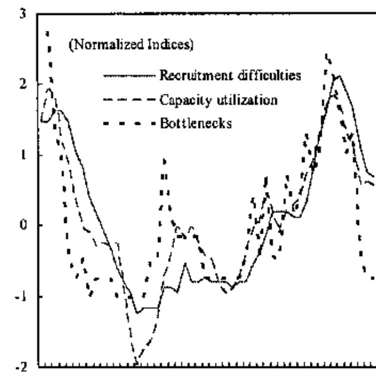
Figure 6. Inflation Components
(Annual Growth Rates)



Source: INSEE.

11. **Despite these developments, there was agreement that the outlook for inflation was benign.** Most of the factors responsible for the recent upward drift in inflation were thought to be reversing or to have constituted one-time price adjustments, though upside risk from oil prices has recently resurfaced. In addition, the customary post-election discretionary boost to the minimum wage had been foregone,[5] while the acceleration in wages observed in late 2001—a likely response to tight labor market conditions earlier in the year—had subsided. With the appreciation of the euro, high frequency indicators pointing to slack (Figure 7), and the output gap not expected to close in the near term, underlying inflation was set to ease, in the staff's projection, to below 2 percent by early 2003.

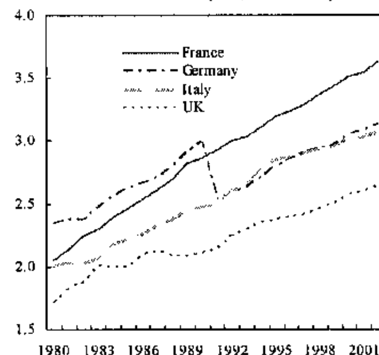
Figure 7. Measures of Slack



Sources: WEFA; INSEE; and staff calculations.

12. **Looking further ahead, the level and growth rate of potential output were seen to be crucial for the orientation of policies.** There was agreement that long-term economic performance had been favorable, with high business sector productivity (Figure 8) compensating to a large extent for structural weaknesses, such as relatively low participation rates and a high NAIRU. In addition, during the 1990s, wage moderation

Figure 8. Business Sector Output per Hour Worked (PPP, 1995 Prices)



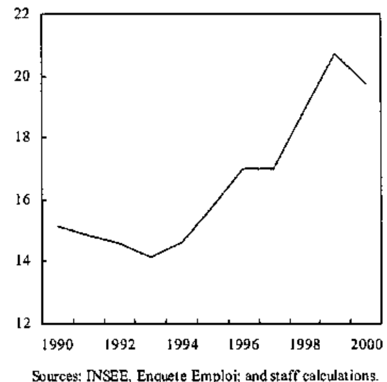
Sources: OECD, Analytical Database and staff calculations.

[4] A background study shows that inflation in France over the medium term can be relatively well described by a hybrid Neo-Keynesian Phillips curve, in which marginal costs and thus wages and productivity play a key role.

[5] On July 1, the *SMIC* was increased by 2.8 percent, reflecting only legally mandated indexation.

and cuts in social security contributions had initiated a phase of labor deepening, resulting in a sharp reversal of the decline in the share of lower-paid workers in total employment (Figure 9). These changes, together with the reduced user cost of capital in the 1990s, could permanently lower the unemployment rate as firms adjusted to a higher optimal capital stock.[6] Pointing to the beneficial effects of European integration, including the adoption of the euro, and other ongoing structural reforms, the authorities harbored confidence that the French economy could grow at 3 percent per year in the near term—reflecting a mix of stronger underlying potential growth and a cyclical recovery. Such growth rates would facilitate the fiscal consolidation needed to address the aging problem while providing scope for tax cuts—that in turn would promote growth. The staff cautioned that the achievement of higher growth rates would require tackling structural weaknesses up front. It also noted that pipeline effects of ongoing reforms were limited as the mandatory reduction in hours worked had offset much of the benefits of other recent labor market reforms.[7]

Figure 9. Share of Workers Earning the SMIC or Less (In Percent)



Sources: INSEE, Enquete Emploi; and staff calculations.

B. Tackling the Consequences of Aging

13. **It was well recognized that the adverse consequences of aging clouded the long-term outlook for the economy and the budget.** All else equal, demographics would reduce annual GDP growth appreciably starting in 2007 and raise budgetary expenditure significantly in the not too distant future. While staff and authorities agreed that there was uncertainty on key parameters underlying long-term calculations of the impact of such developments—notably regarding labor productivity—there was no doubt that the increase in expenditure would undermine fiscal sustainability (Box 2, baseline scenario).

14. **Recognizing that pension reforms were essential, the authorities had set a deadline of mid-2003 to reach consensus on reform measures.** Studies had shown that the budgetary impact of aging could be eliminated by either an increase in contribution rates by 10 percentage points, or a reduction in the replacement rate by one third, or a rise in the effective contribution period by six years. The staff concurred with the authorities that the first two solutions were not very attractive: the tax burden was already high, and replacement rates were projected to decline as pensions are indexed to consumer prices for most pensioners. Linking the contribution period to changes in life expectancy (anticipated to rise by six years by 2040) was a promising and equitable avenue, though the authorities noted that it would be

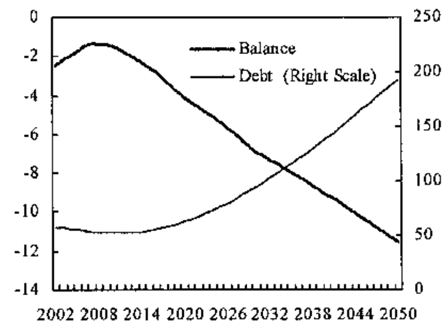
---

[6] A background study, using survey data, suggests that this process may have lowered the NAIRU considerably.

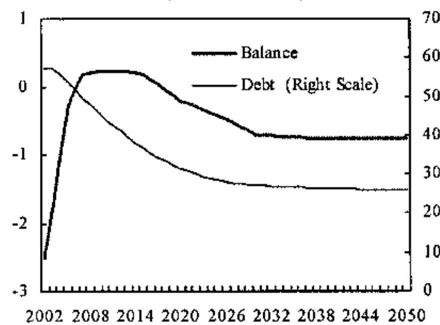
[7] See Country Report No. 01/199, Box 1.

Box 2. France: Aging and Fiscal Sustainability

The Aging Working Group of Ecofin (AWG) projects pension spending to grow by 3.7 percentage points of GDP by 2040 in France. Including health and long-term care, the incremental bill rises to 5.3 percentage points of GDP.[1] The Conseil d'Orientation des Retraites (COR) projects an increase in pension costs by 4.1 percentage points of GDP.



To gauge the long-term fiscal effects of population aging, the staff constructed a baseline scenario that illustrates the unsustainable path of the debt and deficit under unchanged policies. The scenario assumes the following: (i) aging costs as projected in the AWG baseline scenario; (ii) the macroeconomic scenario as in the Summer 2002 WEO projection through 2007 (Table 1), and thereafter, annual GDP growth of 2.3 percent minus the effect of aging as estimated by the INSEE, resulting in average annual growth of 1.9 percent over 2008-40, close to the AWG baseline scenario;[2] (iii) the real interest rate falling gradually to 4 percent from the current implicit rate on French government debt of about 5 percent; and (iv) the primary surplus as in the Summer 2002 WEO projection through 2007 and constant thereafter, except for the effects of aging. Initially the deficit improves somewhat as expenditure grows by less than GDP, but aging and debt servicing costs impart unfavorable dynamics from the middle of the next decade.



To assess how much up-front fiscal consolidation is needed to put the public finances on a sustainable path (defined as a constant public debt-to-GDP ratio in 2040 when the age structure of the population stabilizes), a scenario was constructed based on a reasonable estimate of savings from pension reform—2 percent of GDP in the long-run, with effects beginning to accrue gradually in 2010.[3] In addition, the primary balance was adjusted by ¾ of one percentage points of GDP for as long as necessary to achieve constant debt in 2040. In this scenario, the structural fiscal balance reaches close to balance beginning in 2004 and registers a small surplus during 2006-2016. In the long run, this path implies that the deficit remains around ¾ percent of GDP and the debt around 27 percent of GDP. Different adjustment paths are feasible, but the overall amount of needed savings is given, so that higher steady state debt levels require higher primary surpluses to fund a higher interest bill.

Structural reforms that lift potential growth in the medium term could greatly contribute to achieving the necessary fiscal consolidation, but only if public spending does not increase apace and revenues from higher growth are thus used to accumulate surpluses. Keeping public spending as in the baseline, achieving the Lisbon objective of an employment rate of 70 percent by 2010 would be sufficient to make aging costs sustainable.

[1] Health care cost projections assume non-age related expenditure growing at the growth rate of GDP, probably an optimistic assumption in light of recent historical experience. On the other hand, projections are not corrected by "death costs" (with longer life expectancy, more population will be concentrated in the older age cohorts, but mortality rates for each old age cohort will be lower, thus reducing age-specific health costs).

[2] Population aging reduces the labor force, and thus potential growth. The INSEE computed the effect of aging on per capita output growth. The adjustment for total GDP growth was obtained using the AWG population projections.

[3] According to the COR, savings of 2 percent of GDP can be obtained through measures that raise the average retirement age from 59 years (as in the baseline scenario, up from 58 today) to a little over 62 years in the long run.

socially difficult to increase the statutory contribution period by the same amount as life expectancy. They also hesitated to support an early phasing out of differences between public and private sector pension regimes,[8] though this would command appreciable long-term savings. Nonetheless, they intended to seek consensus on substantial pension reform, based on the principle of equity, while also promoting complementary pension regimes. They considered that pension reform was, however, likely to be able to address only part of the projected increase in pension costs.

15. **The authorities acknowledged the need to improve the control of health spending, but did not see much scope for related budgetary savings over the medium term.** It was recognized that in an aging society, used to high-quality health care and with incomes rising, pressure to provide increasingly more health care and related services would persist. Nonetheless, all agreed that budgeting of health sector expenditure had to become more realistic and its control more effective. At present, the overall annual expenditure growth norm was being routinely exceeded by a large margin in part because the aggregate ceiling did not translate into a norm for individual providers. Thus, the authorities were seeking negotiated arrangements with health care professionals and planning to curtail the currently very high use of drugs. They intended to eliminate reimbursement for drugs without proven effectiveness and promote the use of generic drugs. The staff agreed that health care was unlikely to be an area of appreciable budgetary savings—though there was scope for cutting waste—and advocated realistic budgeting, improved control mechanisms, and stronger incentives on both demand and supply sides.

16. **With savings from reform expected to be limited, policies to boost growth would be essential, though the staff noted that the size and timing of the growth dividend were uncertain and a small medium-term fiscal surplus would be required.** The staff supported the authorities' intentions to raise competitiveness and the attractiveness of France to investors through regulatory reform and a reduction in the tax burden, but argued that tax cuts should not be assumed to pay for themselves and would not be credible unless accompanied by expenditure reduction. The staff noted that lifting employment rates a considerable part of the way to the Lisbon target (70 percent) by 2010 could help ensure debt sustainability, as it boosted potential growth during the transition. Even so, expenditure growth would need to be kept well below GDP growth so as to generate a small structural

Employment Rates by Years of Age 2001 Q1

	Total	15-19	20-24	25-29	30-54	55-59	60-64
France	62.7	10.6	49.0	77.1	79.9	49.3	9.9
Euro area average	61.6	19.5	53.1	72.7	76.4	49.4	20.1
EU average	63.6	23.6	55.7	74.1	77.4	52.8	23.2
EU-Top 4[1]	72.1	43.8	69.5	81.2	81.3	65.1	35.0

Source: Eurostat and staff calculations.
[1]Population-weighted average of employment rates in Denmark, Netherlands, Sweden, and United Kingdom.

[8] Civil servants need to contribute 37½ years for a full pension, versus 40 years in the private sector, their pensions are indexed to wages rather than consumer prices, and are computed on a higher base.

surplus over the medium term. Raising employment rates would not be straightforward, however, since the employment rate for people between 25 and 54 years of age in France was already above the EU average, and efforts had already been expended on raising employment rates of the young (see text table). Moving employment rates for the young and old to a level close to top performers in Europe—with employment rates above 70 percent—would require an ambitious set of policies (see also ¶29). Recent data from the authorities indicated further progress since early 2001, but given the uncertainties involved, the staff emphasized that the prudent course would be to pursue both reforms and fiscal consolidation until there was clear evidence of an acceleration of potential growth.

C. Meeting the Challenge of Fiscal Consolidation

17. **Against the backdrop of the recent lack of fiscal consolidation and given the need to tackle aging costs, staff pressed for up-front and steady progress toward budget balance.** Indeed, after making significant inroads in the run up to EMU, fiscal consolidation was reversed at the end of the 1990s when much of the room created by expenditure restraint and the cyclical upswing was used for tax cuts.[9] Earlier consolidation had lowered the structural deficit from about 3½ percent of GDP in the mid-1990s to about 1 percent of GDP in 1999, mainly through tax increases. During the cyclical upswing in 2000, tax cuts caused the structural deficit to rise to 1½ percent of GDP, a level at which it remained in 2001.

18. **In this context, the significant slippage from the initial 2002 budget revealed by a public finance audit was a further setback, sustained by the decision to proceed with an early income tax cut and no immediate corrective action.** Compared to the initially envisaged budget deficit of 1½ percent of GDP, the audit projected the 2002 budget outcome in the range of 2.2-2.6 percent of GDP. While lower-than-expected growth contributed to the slippage, the shortfalls in non-tax revenues—including dividends from publicly controlled enterprises—and overruns in social security spending were largely unrelated to the cycle. The authorities nonetheless based their supplementary 2002 budget on the high end of the public finance audit and cut personal income taxes (equivalent to 0.15 percentage points of GDP, effective in September), while accommodating higher health care spending.

19. **The staff supported the operation of automatic stabilizers but was critical of other aspects of the supplementary budget as conveying an improper signal about budgetary discipline.** The sharp overrun of expenditures by the central government—hitherto a bastion of exemplary restraint—was of particular concern and, in the staff's view, partly related to the maturing of a host of labor market and social assistance programs. The staff estimates that the structural deficit, which was to be contained to about 1½ percent of GDP in 2002 according to the Stability Program, will exceed this level by around ½ percentage point of GDP. In response to staff calls for renewed efforts to curb expenditure, the authorities noted that some expenditure overruns were cyclical or reflected one-time

---

[9] A background study shows that buoyant labor market performance in this period did not result in a sizeable reduction of spending on labor market and income support programs.

factors. Nonetheless, they were committed to ensure that the 2002 general government deficit did not exceed 2.6 percent of GDP—thus tolerating no further slippage on the expenditure side and to this end freezing allocations worth ¼ percent of GDP, and saving any higher-than-expected revenues.

20. **Fiscal plans for 2003 and beyond, including the Stability Program update, were still under preparation, though shifts in spending priorities and the intention to reduce the tax burden during the government's mandate were not in doubt.** Law and order, justice, and defense were to receive considerably more resources, including higher staffing. While this was to be accommodated in 2003 at the central government level within an overall real expenditure growth limit of 0.2 percent, areas for cutbacks were still being specified. On the revenue side, the intention was to reduce taxes by €30 billion (about 2 percentage points of GDP) during the government's tenure (2002–07). Under the Stability and Growth Pact, France has committed itself to achieving budget balance or a small surplus over the medium-term, and allowing automatic stabilizers to operate while ensuring that deficits do not exceed 3 percent of GDP in any given year. In practice, this has translated at the Seville summit into a commitment to achieve a nominal general government deficit not exceeding ½ of one percentage point of GDP by 2004, provided real GDP grew by at least 3 percent per year during 2003–04.

21. **The discussions considered how these apparently conflicting demands on the budget could be reconciled.** There was agreement that achieving nominal budget target objectives depended on actual growth performance, and the staff noted that on current prospects and policies, the 2004 nominal objective would remain out of reach. It observed that—assuming spending growth in line with the most recent Stability Program, except for health care in 2003—proceeding with the planned tax cuts during 2004–2007 would leave the budget in a structural deficit over the medium term (see text table below). The staff emphasized that this calculation depended on potential growth rather than on the actual growth outturn. The authorities—conceding that the room for further tax relief was limited in the near term—argued that structural reforms, including tax cuts, would raise potential growth, thus allowing more consolidation for a given degree of expenditure restraint.

France: Medium-Term Fiscal Scenarios [1]

	2001	2002	2003	2004	2005	2006	2007
Staff Assessment of Policy Intentions Prior to 2003							
Budget[2]				Percent of GDP			
GDP growth in volume (in percent)	1.8	1.2	2.3	2.7	2.8	2.5	2.4
Tax revenues	45.0	44.3	44.3	43.9	43.5	43.1	42.7
Expenditures	52.8	53.2	52.9	52.2	51.5	50.9	50.4
Overall balance	-1.5	-2.5	-2.1	-1.9	-1.7	-1.5	-1.4
Structural balance	-1.6	-1.9	-1.4	-1.3	-1.4	-1.3	-1.3
Growth rate of real expenditure (in percent)	1.7	2.1	1.7	1.3	1.3	1.3	1.3
Staff Normative Scenario[3]							
GDP growth in volume (in percent)	1.8	1.2	2.2	2.4	2.7	2.7	2.6
Tax revenues	45.0	44.3	44.3	44.3	44.3	43.7	43.2
Expenditures	52.8	53.2	52.6	51.9	51.1	50.2	49.5
Overall balance	-1.5	-2.5	-1.9	-1.2	-0.5	-0.3	0.0
Structural balance	-1.5	-1.9	-1.1	-0.4	-0.2	-0.1	0.1
Growth rate of real expenditure (in percent)	1.7	2.1	1.0	1.0	1.0	1.0	1.0

Source: Data provided by the authorities and IMF staff calculations.

[1] This table will be updated in a supplement when data on the 2003 budget and the new Stability Program become available.

[2] Assumes no additional tax cuts in 2003, cuts €27 billion distributed linearly over 2004-07, and real spending growth as in the 2003-05 Stability Program (except for 2003, when overruns in health care spending are projected).

[3] Reflects growth-reducing impact of a more contractionary fiscal stance in 2003-05 compared to the baseline.

22. **As input to the elaboration of the authorities' medium-term plans, the staff recommended a path of steady underlying fiscal consolidation around which automatic stabilizers would be allowed to operate.** It advocated an adjustment of about ¾ of one percentage point of GDP per year in the structural budget balance during 2003–04, followed by a further moderate consolidation toward a small structural surplus later in the decade.[10] Such a forward-looking approach to the problem of aging would impart credibility to the new government's fiscal policy, in particular by ensuring that tax cuts were sustainable; and would allow room for automatic stabilization under the Stability and Growth Pact's deficit ceiling. The staff conceded that, as a result, growth would be somewhat lower during 2003-04, though the outlook for France was slightly better than for other large euro-area countries and consistent action among them could create scope for a mitigating monetary policy response. While the ultimate objective of lowering the debt level was not in dispute, the authorities were skeptical about the economic case for a rapid pace of adjustment, which they preferred to undertake under more buoyant growth prospects.

23. **The discussions reviewed areas of expenditure restraint that would be essential for successful fiscal consolidation.** There was agreement that sustained expenditure restraint would require structural reforms. In this context, the authorities expected that civil service reform and a refocusing of the government on core tasks could yield considerable savings. Noting that spending on public sector wages and salaries (over 13 percent of GDP) was high in France, the staff urged the authorities to work toward an early identification of specific areas for cutbacks. It also suggested to scale back some labor market and entitlement programs—as France was one of the countries with the highest social benefits.

24. **The staff advocated a further strengthening of the medium-term fiscal framework to secure effective expenditure control.** In France's Stability Programs, expenditure norms are set for a three-year period in terms of real growth rates. The implementation of this framework has however been wanting: expenditure norms are revised from one program to another; medium-term plans do not include the current budget year; and overruns are not systematically corrected. Indeed, it was unlikely that the cumulative expenditure norm for 1999–2002 contained in the first Stability Program would be respected. The authorities noted that these problems would be partly addressed, and the medium-term orientation of the budget improved, as the new law on budgetary procedures became effective.[11] In this context, the 2003 budget and corresponding Stability Program would be presented together. The authorities also took note of the suggestion to set spending norms on the level of expenditure.

---

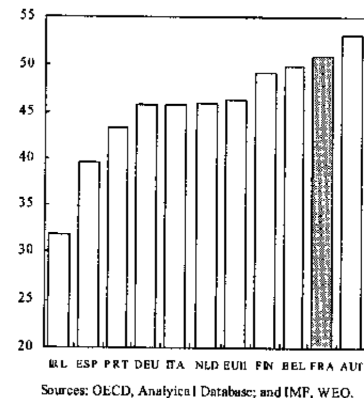
[10] This adjustment profile could be achieved by holding general government real expenditure growth to 1 percent per year (slightly below the rate envisaged in the 2003-05 Stability Program, given the overruns recorded in 2002) and deferring tax cuts to 2005-07.

[11] See ROSC on Fiscal Transparency and its 2001 and 2002 updates.

D. Promoting Growth through Fiscal Reforms

25. **The staff supported the authorities' intention to lower the tax burden, but stressed that tax cuts be earned through credible expenditure restraint and designed to promote growth.** Despite previous efforts, the government's revenue intake as a share of GDP remained one of the highest among advanced countries (Figure 10). While specifics of the planned tax reduction remained to be elaborated, initial intentions were for a combination of income tax relief, a lowering of social security contributions, a reduction in corporate taxation, and a decrease in VAT on restaurant services. The staff felt that boosting disposable income through income tax and VAT cuts would have little structural benefit. Instead, it advocated continuity of tax policy and, in that sense, saw merit in maintaining some of the announced plans of the previous government (e.g., an increase in the earned income tax credit *(PPE)*, abolition of the remaining corporate income tax surcharge, and reform of the *taxe professionnelle*). The staff supported cuts in social security contributions, while cautioning not to use them to tackle cyclical unemployment, and called for tax reform to take full account of the interaction between taxes and benefits.

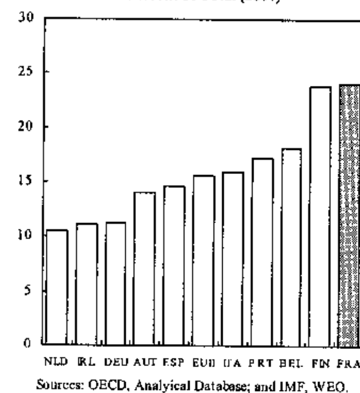
Figure 10. General Government Revenue (2001, In Percent of GDP)



Sources: OECD, Analytical Database; and IMF, WEO.

26. **Decentralization of several functions of the state—intended to reinvigorate democracy—features prominently in the government's agenda.** A draft modification of the constitution is to be presented later this year, *inter alia* to permit devolution of responsibilities and resources to the local level. The authorities saw decentralization as a lever to create a more effective and responsive government, and rather than imposing a blueprint, they planned to permit experimentation at the local level. The staff recognized the potential advantages of decentralization, but urged that it be used also as an opportunity to rationalize the various levels of government, and cautioned about possible economic and budgetary risks. In particular, devolution of fiscal autonomy should be done against clear accountability, and tax, and local labor market and transfer programs should guard against undoing efforts at the central level to improve the functioning of the labor market.

Figure 11. Public Employment as Percent of Total (2001)



Sources: OECD, Analytical Database; and IMF, WEO.

27. **The authorities saw civil service and administrative reform as key to boosting public sector productivity and efficiency.** Progress in this area was seen as both desirable and feasible: France's public sector is large, taking up nearly a quarter of total employment (Figure 11), and about half of the civil servants are to retire by 2012. The government had accordingly announced that not all retiring civil servants would be replaced. They felt that through use of information technology, simplification of administrative regulations, and application of the new law on budgetary

procedures—centered on results-oriented expenditure control—appreciable productivity gains could be achieved. The staff supported this orientation, noting also that attempting to replace all or even most civil servants at a time when the labor force was expected to fall would put undue pressure on the labor market.

E. Boosting Efficiency Through Labor and Product Market Reforms

28. **Labor market indicators have improved substantially over the last five years, but there was agreement that they remained unsatisfactory by international comparison and that recent policy initiatives had failed to fully remedy shortcomings.** Unemployment was still high and, given the strong employment growth observed over the last five years, most likely due to structural problems. Labor force participation was low for the young and the old, reflecting rigidities at the entry level and distorted incentives at the end of the working life. The incidence of unemployment among highly educated was higher in France than elsewhere and a large share of the unemployed had been so for a long time. There was agreement that cuts in social security contributions for the low skilled had improved their employment prospects. Programs specifically targeted to the young and long-term unemployed had also had moderate success in placing persons into regular jobs. However, the youth employment program (*Emploi jeunes*), had had little effect in securing private sector employment and would be phased out.

29. **Against this background, further measures that would boost employment rates and promote labor market flexibility were discussed.** The staff noted that well-targeted active labor market policies that put people into private sector jobs appeared to be effective, and could possibly have a positive long-run impact on the budget through a lower NAIRU and higher tax revenues. Nonetheless, the authorities agreed that a streamlining of the myriad of existing labor market programs would be desirable. Even so, they felt it justified to introduce a new labor market program (*contrats jeunes en entreprises*) to address a presently uncovered niche, though the staff felt that this program could generate windfall beneficiaries.[12] The authorities thought it was still early to evaluate the new unemployment regime (*PARE/PAP*),[13] while noting an increased rate of administrative removal from unemployment benefits. If necessary to balance the budget of the unemployment fund, the reintroduction of the phasing out of unemployment benefits (*dégressivité*) remained a possibility. The authorities were receptive to the suggestion to ensure actuarial fairness across all pension regimes so that labor market participants be neither induced or compelled to retire early, nor penalized for deciding to work longer, though they noted that this was a complex issue that would take time to implement. They intended to soften dismissal restrictions

---

[12] Under this program, employers receive complete exoneration of social security contributions for two years, and half for the third year, when they hire job seekers with limited education and age less than 22 on contracts of unlimited duration.

[13] The new regime aims to provide closer guidance to job seekers, administratively enforce an active job search requirement, and improve job matching.

introduced by the previous government and remove biases against part-time work, including through a modification of the *PPE*, which they recognized to be a useful tool.

30. **Since the mission, the government has presented its proposal on how to tackle two key issues in the context of the reduction of the workweek: the unification of multiple minimum wages and income guarantees and the cost pressures for small- and medium-sized enterprises.** The former will be phased in during the next three years, raising the hourly minimum wage for some groups appreciably, but the authorities intend to offset about two-thirds of its impact on labor costs through further targeted cuts in social security contributions.[14] Overtime limits will be raised from 130 to 180 hours, the transitory lowering of overtime pay will be extended, and the existing reductions in social security contributions will be applied on an hourly basis and better phased to avoid low-wage traps. While this package will burden the budget, its overall impact on unit labor costs is difficult to assess, but it would seem to entail an increase in the relative price of low-wage workers.

31. **Significant progress was in the pipeline on divestiture of commercial activities by the government, but reform of network industries would remain gradual, faced with ingrained public resistance.** The authorities intended to withdraw from all commercial activities other than those considered of strategic importance. Tenders had been invited for intermediaries to handle the sale of remaining government participations, as soon as market conditions permitted. On network industries, the government had announced its intention to allow private equity participation in electricity and gas utilities. The authorities stressed the ground-breaking nature of the decision, in particular against the deeply held public belief that basic services were best provided by national public service companies, fears by employees of loss of benefits, and perceptions of possible market failures. These concerns still stood in the way of full privatization and material progress in other areas such as the railways and postal services.

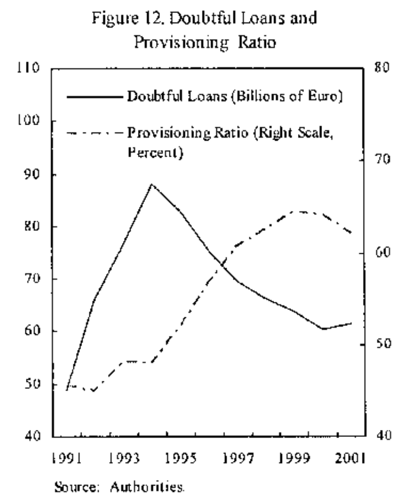
F. Containing Risks and Pursuing Deregulation in the Financial Sector

32. **The financial sector had weathered the economic slowdown well, but recent financial market turbulence was a source of concern, albeit not of a systemic nature.** By international comparison, average household and enterprise indebtedness with the financial

[14] Multiple income guarantees arise from differences in timing of the adoption of the 35-hour workweek at which a monthly income guarantee is established at 39 times the then prevailing hourly *SMIC*. This drives a wedge between workers benefitting from the reduced workweek and those continuing to work at 39 hours or subsequently hired staff, and also among different vintages of conversion since monthly guarantees are indexed to prices but the *SMIC* also partly reflects average wages. The law requires that all employees receive the same hourly minimum wage by 2005. In the authorities' proposal, the *SMIC* will be raised by 11.4 percent, though the increase in the hourly wage for employees benefitting from monthly guarantees will be less.

sector was relatively low and the quality of corporate sector credit had held up better than elsewhere, showing only a limited deterioration. Banks had broadly maintained their provisioning ratio in 2001 and doubtful loans had risen only marginally after a secular decline throughout the 1990s (Figure 12 and Table 2). The possible adverse impact of the difficulties in the telecommunication industry appeared manageable as French banks' credits to this sector were limited and well diversified within the sector. Exposure to Latin America was lower than in most other advanced countries. Nonetheless, further efforts to control costs and manage risks were necessary and declines in equity prices constituted a key risk, especially for life insurance companies. The implications for banks of highly leveraged corporate borrowers also deserved close scrutiny.

Figure 12. Doubtful Loans and Provisioning Ratio



Source: Authorities.

33. **The staff encouraged the authorities to continue updating supervisory arrangements, review corporate governance issues, and pursue further financial sector liberalization**. The authorities intended to proceed rapidly with changes in securities market regulation and supervision—*inter alia* through the merger of the three existing securities market authorities.[15] They also planned to further improve cooperation among bank, insurance and securities supervisors and strengthen the insurance supervisor. They felt that the French approach—though short of a full application of a "twin peaks" model—was working well, underpinned by cross-appointments of board members of banking and insurance supervisory agencies. The authorities had also continued to improve supervision of the banking system (Box 3) and implemented a number of measures to improve transparency in financial markets.[16] They felt that corporate governance issues in Europe were less worrisome than in some other countries, but they were nonetheless proceeding with a review of corporate governance and accounting practices, which they emphasized would need to be coordinated internationally.[17] The authorities did not share staff's views on the efficiency losses associated with continued public sector ownership of a large credit institution and some remaining administrative controls in the financial market—e.g., of interest rates on sight deposits and certain savings accounts. There were no immediate plans to modify these arrangements.

[15] For details, see Country Report No. 01/199 Box 3.

[16] See update of the ROSC on Monetary and Financial Transparency.

[17] In France, all publicly listed companies must have accounts certified by two independent auditors that are appointed for a six-year period.

Box 3. France: Post-Assessment Developments of Compliance with the Basel Core Principles for Effective Banking Supervision

This report is based on information provided by the authorities in the context of this consultation and does not constitute a reassessment.

In the original assessment (SM/01/320), France's overall degree of compliance with the Basel Core Principles was found to be very substantial, reflecting the overall high quality of bank supervision. It was judged fully compliant with 21 of the 25 core principles and largely compliant with the remaining four. In a number of areas, including where full compliance was found, Fund staff suggested further improvements.

The following actions were taken with respect to the four principles with which France was thought largely compliant:

- Core Principle 5 – Investment Criteria: a working group has been set up to prepare legal modifications required for full compliance.
- Core Principle 13 – Other Risks: the authorities believe that the Law on New Economic Regulations of May 2001 and the planned preparation of a white book on corporate governance should help improve compliance. They intend to await the outcome of ongoing reflections on how to improve corporate governance both at the national and the European levels before deciding on additional action.
- Core Principle 18 – Reporting: a regulation on consolidated surveillance came into effect in July 2001.
- Core Principle 21 – Accounting: measures to improve disclosure practices have been taken, including through the adoption of a new regulation.

Additional measures were taken in 8 out of a total of 10 other areas that were commented on in the assessment. They include the deepening of cooperation between the banking and the insurance supervisor as well as the preparation of a draft law aiming at reforming the supervisory landscape. In some areas, the authorities intend to await the outcome of ongoing debates both at the national and the European levels before selecting a course of action.

Finally, the authorities have expressed reservations with respect to the possibility of judicial contestation of supervisory authorities' decisions, which they considered an essential element of France's legal system, and the proposed strengthening of the role of certified accountants, which is important to ensure sincerity of accounts, but should be regarded with a certain prudence in light of recent experience.

G. Other Issues

34. **The authorities were strengthening ongoing efforts to combat money laundering and terrorist financing.** France has a comprehensive anti-money laundering (AML) legal framework reflecting its commitments at both the European and international levels. The response to the Fund's questionnaire on these issues shows that legal provisions criminalize money laundering and the financing of terrorism, provide for the reporting of suspicious transactions, and authorize the confiscation of the proceeds and instruments of money laundering. The authorities noted that new provisions to combat the financing of terrorism (CFT) had been implemented recently and that they intended to adopt the new EU AML directive prior to June 2003—with France having been one of its key promoters. Possible weaknesses remain as the Banking Law does not appear to list the two major money laundering offenses among those for which conviction would disqualify individuals from

serving on boards of directors or supervisory boards, and the lack of uniformity of AML-related fit-and-proper standards among the various major financial subsectors. The authorities observed that France's constitution requires a case-by-case assessment of the fit-and-proper standard, but that this did not weaken the effectiveness of its application.

35. The OECD working group on the implementation of the **anti-bribery convention** considered France's legal framework as generally conforming to the requirements of the convention. On **trade policy,** the authorities emphasized the need to continue multilateral liberalization through the WTO and improve the export capacity of developing countries through other multilateral organizations, including the World Bank. They also advocated the creation of an international organization to deal with **environmental aspects of trade,** expressing concern about the use of environmental and sanitary standards as instruments of protection. They saw no incompatibility between fostering development through trade and the **Common Agricultural Policy** (CAP) and objected to an acceleration of the CAP reform. In 2001, France is estimated to have spent 0.34 percent of GNP on **official development assistance** (ODA) and it intends to increase this slightly in 2002.

III. Staff Appraisal

36. **France's recent economic performance and near-term outlook are relatively favorable; in the longer term, demographic pressures cast a shadow over economic and budgetary prospects.** Building on strong employment gains, private consumption supported the economy for most of 2001, but was ultimately insufficient to offset adverse price shocks and the deterioration in the external environment. With the reversal of these shocks in the first half of 2002 and supportive policy conditions, the moderate growth that has emerged is projected to continue, though appreciable downside risks remain. As slack has returned to product and labor markets, there are no signs of wage pressures and the inflation outlook is benign. Starting in 2007, for the first time in recent history, the active population is set to decline which could reduce per-capita-GDP growth appreciably during the next few decades. Much of the budgetary impact of the demographic shock is set to occur already within the next decade and, if unchecked by proactive policies, the associated pressures would jeopardize fiscal sustainability.

37. **In the face of these prospects, policies will need to be geared decisively toward strengthening the public finances and boosting the growth potential of the economy.** With relatively low activity rates, there is ample scope for improving France's economic performance through comprehensive tax-benefit, pension, labor and product market reforms. Together with policies to enhance public sector efficiency, such reforms would relieve a substantial part of the budgetary burden of aging and contribute to sustainable expenditure reduction. In turn such a reduction is key to ensuring that any tax cuts—desirable as they are—are credible and will not be reversed. With the demographic shock now imminent, the design and implementation of specific reform measures will need to be ambitious both in substance and timing.

38. **Among the areas of needed action, pension reform must now be a priority.** Thus, the establishment of a firm deadline to define essential changes is highly welcome. A target

for desired budgetary savings should be set. The contribution period should be lengthened as life expectancy evolves, and differences between public and private pension systems should be phased out. Reforming pensions is also key for improving labor-market functioning and ensuring intergenerational equity.

39. **Fiscal consolidation is equally imperative, as the fiscal dividend of pension and other structural reforms is uncertain and unlikely to eliminate the adverse budgetary consequences of aging.** From this perspective, the lack of progress in fiscal consolidation during the recent cyclical upswing, and the structural deterioration expected in 2002, represent a clear setback. Of particular concern are the sharp expenditure overruns by the central government, persistent difficulties in controlling public health care spending, and the decision to proceed with tax cuts without correcting expenditure overruns. Thus, in the execution of the 2002 budget, every effort should be made to keep expenditure below the level envisaged in the supplementary budget and any better-than-expected revenue performance should not lead to a relaxation of such efforts.

40. **Beyond 2002, fiscal consolidation should proceed at a steady pace, using structural reforms to yield durable expenditure restraint—a necessary precondition for sustainable tax cuts, which will thus initially need to be put on hold.** The long-term effects of aging as well as the credibility of fiscal policy and the smooth functioning of the monetary union require that the general government balance move toward equilibrium as soon as possible. Restricting real spending growth at the level of the general government will be key. Around the path of steady fiscal consolidation, automatic stabilizers should be allowed to operate freely. Improvements in the budget balance due to above-trend growth should, however, not be seen as an underlying strengthening of the fiscal position that provides scope for maneuver.

41. **Further strengthening of the medium-term fiscal framework will be essential for successful fiscal consolidation**. The forthcoming joint presentation of the 2003 budget and the next Stability Program to Parliament is a welcome step toward an improved integration of annual budgets and the medium-term fiscal framework. To be effective and ensure that overruns are corrected, multi-year expenditure norms would be best defined in terms of the level of expenditure rather than its growth rate.

42. **A reduction in France's high tax burden made credible through contemporaneous expenditure restraint would benefit potential growth**. To this end, the reduction will have to be well designed within a broad package of tax measures aimed at raising activity rates and strengthening competitiveness, rather than directed at boosting disposable income. Reducing effective marginal tax rates for the low skilled will be essential and require coordination with social benefits reform. In this context, the earned income tax credit is a useful instrument and the planned removal of its bias against part-time work is welcome. To improve the environment for business and high-skilled labor, lowering marginal taxes on corporate and high labor income will also be pertinent.

43. **On the expenditure side, reforms to raise productivity in the public sector, stem the rapid rise in health care spending, and scale back entitlement programs are**

essential. With the new law on budget procedures—an important and welcome innovation—the authorities have the instrument at hand to meet the first challenge. Part of this process will have to consist of reforming the civil service within a broader process of redeployment and redefinition of the role of the state, already underway. Decentralization could provide such an opportunity if the devolution of responsibilities to the local level lead to more effective and leaner government, which has proven difficult in other countries. The intent not to replace all departing civil servants should be pursued boldly. The ensuing reduction in public employment will be needed to avoid crowding out the private sector as the labor force diminishes. In the health care sector, tighter controls on providers and negotiated arrangements to curtail spending growth and other proposals to reduce wasteful spending, particularly on drugs, should all be firmly implemented. In the context of tax-benefit reform, generous social entitlement programs should be trimmed to help reduce inactivity traps.

44. **In the labor market, it will be essential to preserve wage moderation and the employment prospects of the low-skilled and promote further flexibility to increase employment rates.** The government proposal to address the legally-mandated need to eliminate multiple hourly minimum wages and monthly income guarantees—the result of an ill-conceived implementation of the workweek reduction—is set to raise labor costs at the level of the *SMIC*. Other aspects of the proposal will mitigate this cost increase, but insufficiently to avoid adverse effects on the employment prospects of low-paid workers and at an appreciable cost to the budget. With a strong majority in Parliament, the authorities have scope to make real progress toward increased labor market flexibility and participation, in particular through the removal of impediments to part-time work, the simplification of dismissal restrictions and the introduction of actuarial fairness among pension schemes. Well-targeted active labor market programs continue to have a role to play, but a comprehensive cost-benefit analysis of the multitude of existing programs should provide a basis for their streamlining.

45. **More product market reform and financial sector deregulation will help foster economic efficiency.** Recent initiatives to accelerate divestiture of commercial enterprises and to allow private sector equity investment in the gas and electricity companies are welcome, though a commitment to eventually relinquishing state control would be desirable. Further, to reap substantial benefits, more rapid progress in subjecting electricity, natural gas, railways, and postal services to competition is needed. The system of administrative regulation of some interest rates, the prohibition of remuneration of sight deposits, and the requirement to provide checks free of charge should be removed as they no longer fit in the context of international financial market integration.

46. **While the financial sector appears to have weathered the economic slowdown well, recent financial market turbulence and realization of downside risks to the economic outlook will impact bank balance sheets in 2002.** They call for intensified supervision, especially of insurance companies, which are particularly sensitive to equity market valuations. It will be important to make further progress on several ongoing initiatives, including the changes in securities market regulation and supervision and a review of corporate governance and accounting practices to strengthen transparency and preempt

accounting irregularities. Exemplary efforts to combat money laundering and terrorist financing should continue to be pursued.

47. France's support for development through an appreciable level of **ODA** is welcome, as is the government's announced intention to raise this level further. The authorities are encouraged to promote **trade** liberalization and reconsider objections to an early reform of the **Common Agricultural Policy**.

48. It is proposed that the **next Article IV consultation** take place on the standard 12-month cycle.

Table 1. France: Main Economic Indicators
(Annual percentage change, unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
				Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Demand and supply in constant prices 1/										
Gross domestic product	3.5	3.2	4.2	1.8	1.2	2.3	2.7	2.8	2.5	2.4
Private consumption	3.6	3.5	2.8	2.8	1.9	2.3	2.8	2.7	2.5	2.5
Public consumption	0.0	1.5	2.9	2.4	2.8	1.9	2.0	2.1	1.4	1.0
Gross fixed investment	7.3	8.3	8.3	2.7	0.1	1.5	3.7	3.9	3.5	3.5
Business investment	10.2	9.1	9.2	3.1	-0.3	1.6	5.2	5.5	5.0	5.0
Residential investment	3.9	7.2	4.1	-0.8	0.4	0.9	1.0	1.0	1.0	1.0
Public investment	2.0	6.9	11.1	6.1	1.2	1.7	1.8	1.6	1.2	1.0
Stockbuilding 2/	0.7	-0.3	0.4	-1.0	-0.4	0.6	0.0	0.0	0.0	0.0
Total domestic demand	4.1	3.7	4.3	1.6	1.3	2.7	2.8	2.8	2.5	2.4
Foreign balance 2/	-0.5	-0.4	-0.1	0.2	0.0	-0.3	-0.1	0.0	0.0	0.0
Exports of goods and NFS	8.3	4.2	13.6	1.5	0.5	5.5	6.9	6.7	6.4	6.3
Imports of goods and NFS	11.6	6.2	15.0	0.8	0.6	7.1	7.6	6.9	6.7	6.6
Prices										
GDP deflator	0.9	0.5	0.5	1.4	1.8	1.2	1.4	1.5	1.6	1.6
Consumer prices (average) 3/	0.7	0.6	1.8	1.8	1.8	1.4	1.6	1.6	1.6	1.6
Consumer prices (end of period) 4/	0.3	1.4	1.7	1.4	1.5	...	...	...	...	...
Employment and wages										
Employment	1.5	1.9	2.4	2.1	1.0	0.8	0.8	0.7	0.6	0.4
Unemployment 5/	11.5	10.8	9.5	8.6	9.0	8.9	8.5	8.2	7.9	7.5
Productivity 6/	2.0	1.3	1.8	-0.3	0.3	1.6	1.9	2.1	1.8	2.0
Unit labor costs (whole economy)	0.0	1.3	0.7	3.1	2.2	1.8	1.6	1.4	1.7	1.5
Output in manufacturing	5.3	3.9	6.0	1.7	0.8	2.9	3.8	4.2	3.2	2.9
Hourly labor compensation in manufacturing	0.8	1.4	2.3	3.1	2.8	3.4	3.5	3.5	3.5	3.5
Unit labor costs in manufacturing	-4.5	-1.5	-4.1	2.5	2.6	1.3	0.4	-0.1	0.8	0.8
Personal sector										
Real disposable income 7/	2.9	3.1	3.1	3.5	1.7	2.0	2.8	2.8	2.3	2.4
Savings ratio 8/	15.6	15.3	15.5	16.1	15.9	15.7	15.7	15.7	15.5	15.5
Output gap 9/	-1.8	-1.1	0.6	0.0	-1.1	-1.2	-0.9	-0.6	-0.3	0.0
Rate of growth of potential output	2.1	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.3	2.1
Balance of payments										
Trade balance (billions of euros)	23.5	16.5	-0.5	4.5	3.9	-2.2	-4.6	-3.3	-2.1	0.3
(in percent of GDP)	1.8	1.2	0.0	0.3	0.3	-0.1	-0.3	-0.2	-0.1	0.0
Current account (billions of euros)	36.0	39.4	21.0	26.8	28.3	22.5	22.5	26.5	30.3	29.7
(in percent of GDP)	2.8	2.9	1.5	1.8	1.9	1.4	1.4	1.6	1.7	1.6
Terms of trade	1.4	0.2	-3.0	0.8	0.1	-0.4	-0.3	0.0	0.0	0.0
Nominal effective exchange rate 10/	97.2	95.8	92.7	93.0	93.3	...	...	...	...	...
Real effective exchange rate 10/	92.5	91.8	88.2	87.2	87.6	...	...	...	...	...
Public sector accounts 11/										
Revenue	51.2	51.8	51.4	51.1	50.6	50.7	50.3	49.8	49.4	49.0
Expenditure	53.8	53.5	52.7	52.6	53.1	52.8	52.2	51.5	50.9	50.4
General Government balance	-2.7	-1.6	-1.3	-1.5	-2.5	-2.1	-1.9	-1.7	-1.5	-1.4
Structural balance	-1.5	-0.9	-1.6	-1.6	-1.9	-1.4	-1.3	-1.4	-1.3	-1.3
Primary balance	0.9	1.7	1.9	1.7	0.6	1.0	1.1	1.4	1.5	1.5
Gross debt	59.5	58.5	57.3	56.9	57.2	57.0	56.3	55.3	54.3	53.3

Sources: Data provided by the authorities and Fund staff estimates.

1/ Data from the INSEE quarterly national accounts system.

2/ Change as percentage of previous year's GDP.

3/ Harmonized CPI.

4/ For 2002, year on year in July.

5/ In percent of labor force; harmonized index.

6/ GDP over total employment.

7/ Personal disposable income deflated by the implicit deflator for private consumption.

8/ In percent of household disposable income.

9/ In percent of potential GDP.

10/ Index; Base 1995=100. For 2002, data as of July.

11/ In percent of GDP; Data for 2001-02 exclude the proceeds from the sale of UMTS licenses, which amounts to about 0.1 percent of GDP.

Table 2. France: Vulnerability Indicators
(In percent of GDP)

	1998	1999	2000	2001	2002 Latest estimate	2002 Date
External Indicators						
Exports (annual percentage change, in U.S. dollars)	5.8	-1.4	-1.4	-1.5		
Imports (annual percentage change, in U.S. dollars)	7.0	0.2	3.0	-1.7		
Terms of trade (annual percentage change)	1.4	0.2	-3.0	0.8		
Current account balance	2.8	2.9	1.5	1.8		
Capital and financial account balance	-1.9	-2.4	-2.2	-2.4		
Of which: Inward portfolio investment (debt securities etc.)	4.1	8.1	10.2	7.4		
Inward foreign direct investment	2.0	3.2	3.3	3.9		
Other investment liabilities (net)	0.5	5.2	4.2	2.1		
Total reserves minus gold (in billions of U.S. dollars, end-of-period)	44.3	39.7	37.0	31.7	30.3	July
Euros per U.S. dollar (period average)		0.939	1.085	1.118	1.100	July
Market Indicators						
Financial Markets						
Public sector debt (Maastricht definition)	59.5	58.5	57.3	57.3		
3-month T-bill yield	3.1	3.0	4.9	3.3	4.5	July
3-month T-bill yield (real)	2.8	1.7	3.1	1.9	3.0	July
Spread of 3-month T-bill with the U.S. (percentage points, end-of-period)	-1.3	-2.2	-0.9	1.6	2.8	July
10-year government bond	4.1	5.3	5.1	5.1	5.2	June
Spread of 10-year bond with the U.S. (percentage points, end-of-period)	-0.6	-0.9	-0.1	0.0	0.3	June
Yield curve (10 year - 3 month)	0.9	2.3	0.3	1.7	0.7	June
Corporate bond yield (AAA)	...	5.9	5.6	5.6		
Corporate bond yield (BBB1)	...	6.8	6.6	6.6		
Stock market index (end-of-period)	212.5	321.1	319.4	249.2	184.1	July
Real estate prices (index, 1997=100)	103.8	113.2	124.6	127.8		
Credit markets (end-of-period growth rates)						
Credit to the private sector	2.8	5.5	8.5	5.0	5.6	April
Bank credit to households	4.1	7.8	6.8	5.8	6.3	April
Mortgages	3.7	8.2	7.1	6.3	6.6	April
Bank credit to nonfinancial enterprises	3.8	6.4	11.9	3.6	1.8	April
Sectoral risk indicators						
Household sector						
Household savings ratio	15.6	15.3	15.5	16.1		
Household financial savings ratio	6.9	6.7	6.9	7.1		
Real estate household solvency ratio (index, 1992=100) 1/	153.7	162.1	153.4	150.4		
Corporate sector						
Profitability of business sector	40.7	40.0	39.8	39.0		
Investment ratio	16.7	17.5	18.4	18.3		
Savings ratio	18.1	17.8	16.4	13.9		
Self-financing ratio	100.5	93.9	81.8	69.6		
Financial sector						
Share of mortgage credit in bank credit to the private sector	26.1	26.8	26.1	26.5	26.2	April
Share of non-performing loans in total loans	5.9	5.1	4.3	4.1		
Ratio of provisions to non-performing loans	58.5	60.7	60.8	59.9		

Sources: Banque de France; IMF, International Financial Statistics; Bloomberg; FNAIM; Commission Bancaire.
1/ This index combines the effect of real disposable income, repayment conditions for loans, real estate prices, and public incentives for the purchase of houses.

France: Fund Relations

As of August 31, 2002

I. **Membership Status**: Joined December 27, 1945; Article VIII.

II. General Resources Account:	SDR Million	Percent of Quota
Quota	10,738.50	100.00
Fund holdings of currency	6,433.93	59.91
Reserve position in Fund	4,304.62	40.09
Financial transaction plan transfers (net)	608.00	

III. SDR Department	SDR Million	Percent of Allocation
Net cumulative allocation	1,079.87	100.00
Holdings	440.40	40.78
Designation plan	0.00	

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**: None

VI. **Projected Obligations to Fund** (SDR million; based on existing use of resources and present holdings of SDRs): None

VII. **Implementation of HIPC Initiative**: Not applicable

VIII. **Safeguards Assessments:** Not applicable

IX. **Exchange Rate Arrangements**:

- Since January 1, 1999 France has participated in Stage III of the European Economic and Monetary Union (EMU).

- France continues to apply exchange restrictions vis-à-vis Iraq, the Federal Republic of Yugoslavia (Serbia and Montenegro) and the Socialist People's Libyan Arab Jamahiriya. These restrictions have been notified to the Fund under Decision No. 144-(52/51), as follows: in respect of Iraq, see EBD/90/234 (8/8/90) and EBD/93/92, Supplement 1 (1/6/94); and in respect of the Federal Republic of Yugoslavia (Serbia and Montenegro) and the Socialist People's Libyan Arab Jamahiriya, see EBD/93/92 (12/27/93) and Supplement 1 (1/6/94).

X. **Article IV Consultation**: The last article IV consultation was concluded at EBM/01/109 (10/26/01). France is on the standard 12-month consultation cycle.

XI. **FSAP Participation and ROSC**:

	Date Issued	**Document No.**
Transparency in Monetary and Financial Policies	10/17/00	SM/00/236
Fiscal Transparency Module	10/18/00	SM/00/238
Fiscal Transparency, Transparency in Monetary and Financial Policies—Update	10/18/01	SM/01/316

FRANCE: STATISTICAL INFORMATION

France's economic database is comprehensive and of high quality. The authorities regularly publish a full range of economic and financial data and calendar dates of main statistical releases are also provided. The transmission of data in electronic form from INSEE and the profusion of data from various institutions (Banque de France, INSEE, Ministry of Finance, Ministry of Labor and Solidarity) have helped to build an infrastructure in which all data can be easily accessed through the Economic Data Sharing system. As a subscriber to the Special Data Dissemination Standard (SDDS), France posts its metadata on the Fund's Dissemination Standards Bulletin Board (DSBB) on the Internet.

Since the beginning of 1999, France's monetary and banking statistics methodology has changed to reflect the standards of the European Monetary Union. Statistics for *International Financial Statistics* on banking institutions and monetary aggregates are prepared on a monthly basis and are timely.

France adopted the European System of Integrated Economic Accounts 1995 (ESA95) in 1999. Although data for GDP and its components are available since 1978, data for the household, corporate, and public administration accounts are only available since 1992. France produces annual national accounts aggregates based on two methodologically different systems of accounting: the quarterly and the annual accounts. Both systems provide valid information although estimates from the two accounts differ slightly.

Recent data issues include the need to provide monthly or quarterly developments not only in the finances of the central government, but also in the social security and local governments. These data should be presented in a comprehensive fashion and under national accounts accounting standards, to facilitate monitoring of the general government accounts.

France: Core Statistical Indicators as of Mid-September 2002

	Exchange Rates	Int'l Reserves 1/	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Central Government Balance	GDP/GNP	External Debt/Debt Service
Date of Latest Observation	Sep 14	Jul 02	Sep 14	Sep 14	Jul 02	Sep 14	Aug 02	Jul 02	May 02	Jul 02	2002 Q2	Jul 02
Date Received	Sep 14	Sep 10	Sep 19	Sep 19	Sep 10	Sep 14	Sep 12	Sep 15	Aug 8	Sep 9	Sep 11	Sep 10
Frequency of Data	Daily	Monthly	Weekly	Weekly	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly
Frequency of Reporting	Daily	Monthly	Weekly	Weekly	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly
Source of Update	Reuters	Banque de France	Banque de France	Banque de France	Banque de France	Reuters	INSEE	Reuters/ INSEE	Banque de France	MoF	INSEE	Banque de France
Mode of Reporting	Electronic	Electronic/Fax	Electronic/ Fax	Electronic/ Fax	Electronic/ Fax	Electronic	Electronic/ Fax	Electronic/ Fax	Electronic	Electronic	Electronic	Electronic/ Paper
Confidentiality	Published	Published	Published	Published	Published	Published	Published	Published	Published	Published	Published	Published
Frequency of Publication	Daily	Monthly	Weekly	Weekly	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly

1/ Includes all gross international reserves of the state; reserves at the Banque de France are reported weekly, and within a week.

INTERNATIONAL MONETARY FUND

FRANCE

Staff Report for the 2002 Article IV Consultation
Supplementary Information

Prepared by the European I Department

(In consultation with the Policy Development and Review Department)

Approved by Michael Deppler and Leslie Lipschitz

October 22, 2002

1. This supplement to the staff report for the 2002 Article IV consultation with France provides an update on recent economic and policy developments, in particular the 2003 budget proposal and the authorities' medium-term fiscal plans, and reflects discussions on these topics held during the Annual Meetings.[1] This information qualifies the staff appraisal in the sense that the near-term outlook is now somewhat weaker than expected and that the authorities' fiscal plans for 2003 and the medium term further delay fiscal consolidation with respect to earlier intentions and the staff's recommendations.

2. **Economic indicators are somewhat weaker than envisaged in the staff report, increasing downside risks to the staff's baseline projection and casting doubt on the authorities' 2003 growth assumption.** Sentiment about the growth outlook has shifted down markedly in the recent period. For 2002, official (INSEE, Banque de France) and *Consensus Forecasts* seem to be converging toward a growth rate of some 1 percent (1.2 percent in the staff report). For 2003, the draft budget anticipates growth of 2½ percent. The authorities count on an improvement in the external environment and a supportive budget to reach this objective, but recognize that recent declines in equity valuations and the absence of signs of a revival of domestic demand in Germany and Italy constitute key downside risks. The staff is less upbeat, noting that uncertainty, including on energy prices, is weighing on business investment and that short-term indicators in France and elsewhere portend moderate growth rather than a strengthening recovery. Thus, despite a more supportive budget than assumed in the staff report, the staff continues to project GDP growth of 2¼ percent in 2003, with appreciable downside risks remaining, consistent with the near-term outlook for the euro area, Germany, and Italy as reflected in their respective

[1] The supplement includes a draft Public Information Notice (PIN) and, in line with recent Executive Board guidelines, also presents a public debt sustainability analysis based on standardized tests (Annex).

supplements (Table 1). For its part, the October *Consensus Forecasts* place 2003 GDP growth at only 1.9 percent.

3. **The authorities view the 2003 budget—which postulates an unchanged deficit from 2002 (2.6 percent of GDP)—as designed to realize the government's key priorities while supporting confidence and the economic recovery.** These priorities involve: first, strengthening the state's effectiveness in the areas of security, justice, and defense (on the latter, the authorities note that benefits would accrue also outside France), and second, implementing tax cuts to rekindle employment growth and investment. The authorities view the 2003 budget as realizing these objectives. It makes some room for the expenditure increases in the above areas (as well as in official development assistance) by savings in education, research, and some labor programs.[2] The authorities also point to a reversal of the previous persistent rise in public employment. Though they acknowledge that the reversal is modest (reducing the narrowly defined civil service by 1,089 positions—against the background of more than 50,000 retiring civil servants), the authorities emphasize that this change of direction represents an important signal. All in all, real general government spending is set to rise by 1.5 percent in 2003, following an expected increase of 3.2 percent in 2002. On the tax side, the budget includes further targeted cuts in social security contributions to mitigate the cost pressures from prospective increases in the minimum wage (see ¶30 of the staff report) and support the hiring of young job-seekers (*contrats jeunes en entreprise)*, the removal of the bias of the earned income tax credit against part-time work, a slight reduction in the top marginal income tax rate (to below 50 percent), and the elimination of the wage bill and expenditure on research and development from the base of the *taxe professionelle*. It also implements a further, modest across-the-board income tax cut to support household incomes.

4. **The authorities consider the 2003 budget as braking the appreciable—and mostly inherited—deterioration of 2002, and as not inconsistent with fiscal consolidation, which they intend to undertake in earnest as from 2004.** The authorities note that, with real expenditure growth kept at 1.5 percent, the expenditure-to-GDP ratio is set to fall by ½ of one percentage point of GDP. Tax cuts absorb only 0.2 of one percentage point of GDP of this amount, with the remainder taken up by prudent budgeting of tax revenues (with an underlying GDP elasticity of 0.8) and a return to more sustainable, lower levels of non-tax revenues. All in all, the authorities view the budget as placing public finances on a more transparent and sounder footing, and preparing for measurable fiscal

---

[2] In addition, the budget includes measures to contain health spending (notably, the non-reimbursement of drugs without proven effectiveness and limits on the reimbursement of other drugs to their generic equivalent). The authorities note that the budget adopts a more realistic approach to budgeting in health care, where spending is set to rise by 5.3 percent (in nominal terms). Furthermore, to keep social security spending within the norm, the possibility of implementing a corrective supplementary social security budget in mid-year—a new procedure—is provided for.

consolidation from 2004 onwards, in a hopefully more auspicious growth environment. In the staff's calculations, the budget implies no improvement in the structural deficit in 2003, which would thus remain at some 2 percent of GDP.

5. **In the update of their medium-term fiscal plans to 2006, the authorities intend to narrow the deficit from 2004 onwards and continue reducing the tax burden, so as to create the conditions for durable growth, achieve full employment, and deal with the impending demographic pressures.**[3] Tax cuts will continue to be implemented, for a total in 2004-06 of € 9 billion (0.6 percent of GDP, under the central assumption of annual average GDP growth of 2.5 percent), while expenditure growth will be held below output

France: 2003 Budget and Medium-Term Fiscal Plans [1/]

	2001	2002	2003	2004	2005	2006
Authorities: 2.5 percent growth			Percent of GDP			
GDP growth in volume (in percent)	1.8	1.2	2.5	2.5	2.5	2.5
Tax revenues	45.0	44.6	44.3	44.3	44.2	44.1
Overall balance	-1.5	-2.6	-2.6	-2.1	-1.6	-1.0
Growth rate of real expenditure (in percent)	1.7	3.2	1.5	1.4	1.3	1.2
Structural balance (staff estimate)	-1.5	-2.0	-2.0	-1.5	-1.2	-0.7
Authorities: 3 percent growth 2004-06						
Tax revenues	45.0	44.6	44.3	44.2	44.0	43.8
Overall balance	-1.4	-2.6	-2.6	-2.0	-1.4	-0.5
Growth rate of real expenditure (in percent)	1.7	3.2	1.5	1.4	1.2	1.2
2003-05 Stability Program						
GDP growth in volume (in percent)	2.3	2.5	2.5	2.5	2.5	...
Overall balance	-1.4	-1.4	-1.3	-0.5	0.0	...
Growth rate of real expenditure (in percent)	1.7	2.3	1.3	1.3	1.3	...
Structural balance (staff estimate)	-1.4	-1.4	-1.4	-0.7	-0.3	...

Source: Data provided by the authorities and IMF staff calculations.

[1/] *Projet de loi de finances 2003,* including *Rapport Economique, Social et Financier.*

growth to create some room for fiscal consolidation.[4] Staff estimates these intentions to imply a total underlying adjustment of 1¼ percentage points of GDP over the plan's period (see text table). Even so, the general government balance is projected to remain in deficit through 2006 (-1.0 percent of GDP), reflecting the government's priorities and a gradual approach to reform on the expenditure side. The authorities note that fiscal and other structural reforms

[3] The authorities note that the medium-term fiscal plans presented at this time are in response to the requirements of the new Organic Budget Law, and that the ensuing parliamentary debate will inform the update of the Stability Program, to be presented to the EU Commission in late November.

[4] Inclusive of measures already taken in 2002 and envisaged in the 2003 budget, total tax cuts would amount to € 15 billion in the period 2002–06 (1 percent of GDP).

could boost potential growth by ½ percentage point. Under such a scenario, with annual GDP growth at 3 percent during 2004–06, the authorities would allocate about half of the growth dividend to additional tax cuts while achieving a budget close to balance (i.e., a deficit of 0.5 percent of GDP) by 2006.

6. **In the staff's assessment, the 2003 budget, while containing a number of helpful features, falls short of requirements mainly due to the absence of determined structural efforts to rein in expenditure.** The increased transparency, prudent budgeting of revenues, and the setting of realistic spending norms on health care are welcome. Some of the tax measures, in particular regarding the earned income tax credit, should improve the functioning of the labor market, but their magnitude is small, while some of the other tax reductions are not directed at strengthening the supply side of the economy. Moreover, the absence of appreciable efforts to restrain expenditure leaves the fiscal accounts ill-prepared to address cyclical and other risks: indeed with the staff's slightly weaker growth projection, the budget deficit is expected to rise to 2¾ percent of GDP in 2003, uncomfortably close to the 3 percent limit under the SGP, to which the authorities remain nonetheless firmly committed. Other factors—among which a possible call on the public purse to participate in the recapitalization of France Telecom and the return of non-tax revenues to historical, lower averages—could pose further fiscal risks. Finally, from a regional perspective, the budget's explicit departure from the fiscal consolidation guidelines agreed by the Eurogroup's majority places further strains on the fiscal framework in the euro area.[5] Staff would thus urge that every opportunity be seized to strengthen expenditure restraint, in both the finalization and execution of the 2003 budget.

7. **The staff considers the authorities' fiscal plans for 2004–06 as insufficiently ambitious to boost potential growth and address France's impending demographic shock; it encourages a stepped-up effort in the update of the Stability Program later this year.** With expenditure restraint below that envisaged in the previous 2003–05 Stability Program and back-loaded, and no correction for past overruns, there is little room for meaningful tax cuts. The consequent decline in the tax-to-GDP ratio by ½ of one percentage point between 2002 and 2006—though helpful—is modest, and unlikely to raise potential growth appreciably. Accordingly, staff would recommend that the update of the Stability Program reflect greater expenditure restraint through well-specified measures. It would also note in this connection that, without additional fiscal consolidation, appreciable long-term budgetary savings will need to be obtained from the pension reform being prepared for mid-2003.

---

[5] At its meeting in early October, the Eurogroup agreed that countries that have yet to reach the SGP close-to-balance objective "need to pursue continuous adjustment of the underlying balance by at least 0.5 percent of GDP per year", with "all Ministers but one accept[ing] this to start no later than in next year's budget." *Eurogroup—Terms of Reference on budgetary developments in the euro area*, dated October 7, 2002.

Table 1. France: Main Economic Indicators
(Annual percentage change, unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004	2005	2006
					Proj.	Proj.	Proj.	Proj.	Proj.
Demand and supply in constant prices 1/									
Gross domestic product	3.5	3.2	4.2	1.8	1.1	2.3	2.8	2.9	2.5
Private consumption	3.6	3.5	2.8	2.8	1.6	2.0	2.9	2.7	2.6
Public consumption	0.0	1.5	2.9	2.4	2.8	1.9	1.9	1.8	1.4
Gross fixed investment	7.3	8.3	8.3	2.7	0.1	0.7	3.3	3.9	3.5
Business investment	10.2	9.1	9.2	3.1	-0.3	0.3	4.6	5.5	5.0
Residential investment	3.9	7.2	4.1	-0.8	0.4	0.9	1.0	1.0	1.0
Public investment	2.0	6.9	11.1	6.1	1.2	1.8	1.9	1.6	1.2
Stockbuilding 2/	0.7	-0.3	0.4	-1.0	-0.6	0.6	0.2	0.0	0.0
Total domestic demand	4.1	3.7	4.3	1.6	1.0	2.4	2.9	2.8	2.5
Foreign balance 2/	-0.5	-0.4	-0.1	0.2	0.1	-0.1	-0.1	0.2	0.1
Exports of goods and NFS	8.3	4.2	13.6	1.5	0.5	5.2	6.9	6.9	6.6
Imports of goods and NFS	11.6	6.2	15.0	0.8	0.2	5.9	7.8	6.8	6.8
Prices									
GDP deflator	0.9	0.5	0.5	1.4	1.8	1.2	1.4	1.5	1.6
Consumer prices (average) 3/	0.7	0.6	1.8	1.8	1.9	1.6	1.6	1.6	1.6
Consumer prices (end of period) 4/	0.3	1.4	1.7	1.4	1.8	...	...	...	...
Employment and wages									
Employment	1.5	1.9	2.4	2.1	0.6	0.6	0.6	0.7	0.5
Unemployment 5/	11.8	11.2	9.6	8.5	9.0	8.7	8.5	8.2	7.8
Productivity 6/	2.0	1.3	1.8	-0.3	0.4	1.6	2.1	2.1	2.0
Unit labor costs (whole economy)	0.0	1.3	0.7	3.0	2.0	1.7	1.4	1.4	1.5
Output in manufacturing	5.3	3.9	6.0	1.7	0.6	2.7	4.0	4.3	3.4
Hourly labor compensation in manufacturing	0.8	1.4	2.3	3.0	2.8	3.4	3.5	3.5	3.5
Unit labor costs in manufacturing	-4.5	-1.5	-4.1	2.1	2.4	1.3	0.0	-0.2	0.5
Personal sector									
Real disposable income 7/	2.9	3.1	3.1	3.5	1.3	1.9	2.6	2.7	2.4
Savings ratio 8/	15.6	15.3	15.5	16.1	15.8	15.7	15.4	15.4	15.2
Output gap 9/	-1.8	-1.1	0.6	0.0	-1.3	-1.4	-1.1	-0.7	-0.4
Rate of growth of potential output	2.1	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.3
Balance of payments									
Trade balance (billions of euros)	23.5	16.5	-0.5	4.5	3.9	-0.1	-4.6	-4.4	-4.3
(in percent of GDP)	1.8	1.2	0.0	0.3	0.3	0.0	-0.3	-0.3	-0.2
Current account (billions of euros)	36.0	39.4	21.0	26.8	30.5	28.7	26.4	29.6	32.6
(in percent of GDP)	2.8	2.9	1.5	1.8	2.0	1.8	1.6	1.7	1.8
Terms of trade	1.4	0.2	-3.0	0.8	-0.1	-0.5	-0.3	0.0	0.0
Nominal effective exchange rate 10/	97.2	95.8	92.7	93.0	93.4	...	...	...	...
Real effective exchange rate 10/	92.5	91.8	88.2	87.2	87.7	...	...	...	...
Public sector accounts 11/									
Revenue	51.2	51.8	51.4	51.1	51.2	50.7	50.7	50.6	50.5
Expenditure	53.8	53.5	52.7	52.6	53.9	53.6	52.9	52.2	51.5
General Government balance	-2.7	-1.6	-1.3	-1.5	-2.6	-2.8	-2.3	-1.6	-1.0
Structural balance	-1.5	-0.9	-1.6	-1.6	-2.0	-2.0	-1.6	-1.2	-0.8
Primary balance	0.9	1.7	1.9	1.7	0.5	0.3	0.8	1.5	2.0
Gross debt	59.5	58.5	57.3	56.9	58.4	59.3	59.2	58.3	57.0

Sources: Bank of France; data provided by the authorities; and Fund staff estimates.

1/ Data from the INSEE quarterly national accounts system.

2/ Change as percentage of previous year's GDP.

3/ Harmonized CPI.

4/ For 2002, year on year in August.

5/ In percent of labor force; harmonized index.

6/ GDP over total employment.

7/ Personal disposable income deflated by the implicit deflator for private consumption.

8/ In percent of household disposable income.

9/ In percent of potential GDP.

10/ Index; Base 1995=100. For 2002, data as of August.

11/ In percent of GDP; Data for 2001-02 excludes the proceeds from the sale of UMTS licenses, which amounts to about 0.1 percent of GDP.

PUBLIC DEBT SUSTAINABILITY[6]

This annex compares the staff's baseline projection for France's public debt with scenarios based on historical averages for key underlying variables. The sensitivity of the debt dynamics to a number of shocks is also considered. The shocks are applied as temporary deviations from the baseline, without consideration of feed-back effects, and with magnitudes based on historical developments over the past 10 years. With stress tests being standardized, the scenarios considered in this annex do not address other issues relevant for debt sustainability such as the impact of population aging on public finances or the process of divestiture of the state from commercial activities.

The baseline scenario envisages a stable debt ratio through 2003, followed by a steady decline, reflecting the authorities' intentions regarding fiscal consolidation. It is based on the 2½ percent growth medium-term fiscal program presented with the 2003 budget (*Projet de loi de finances 2003*), but adjusted for the staff's macroeconomic assumptions. The latter do not differ much from the authorities, with growth being initially somewhat weaker but subsequently stronger as the recovery proceeds. In view of the need to establish the credibility of the authorities' fiscal strategy and to address imminent demographic pressures, the staff has advised a more up-front and more ambitious path for fiscal consolidation.

The shocks to the baseline scenario reveal the sensitivity of debt dynamics to the macroeconomic environment and the importance of policy action to offset their adverse consequences on fiscal sustainability. Indeed, a prolonged episode of high real interest rates combined with low real GDP growth would give rise to adverse debt dynamics (stress test 1). In such a scenario, nominal deficits would be above 4 percent of GDP starting in 2003 and rise continuously thereafter. Given the commitment of euro-area countries to fiscal sustainability—and the 3 percent deficit ceiling under the Stability and Growth Pact—such a course of events is highly unlikely. In all other scenarios, the public debt-to-GDP ratio would be on a declining path by the end of the projection period, though in most of them the level of the ratio would be appreciably higher than in the baseline.

---

[6] This Annex reports standardized stress tests for public debt sustainability (see SM/02/166, 5/28/02).

Table A1. France: Public Sector Debt Sustainability Framework, 1997-2007

	Actual					Projections					
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
I. Baseline Medium-Term Projections											
Public debt/revenues 1/	114.1	116.3	112.9	111.5	112.0	114.1	116.9	116.9	115.4	112.9	109.4
Public debt/GDP 1/	59.3	59.5	58.5	57.3	57.3	58.4	59.3	59.2	58.3	57.0	55.3
Change in public debt/GDP	2.2	0.2	-1.0	-1.2	0.0	1.1	0.9	-0.1	-0.9	-1.3	-1.7
Net debt-creating flows/GDP (5+6)	1.3	0.2	-0.5	-1.3	-0.4	1.0	0.9	-0.1	-0.9	-1.3	-1.7
Overall deficit, excluding net interest payments/GDP (=primary deficit)	-0.7	-0.9	-1.7	-1.9	-1.8	-0.5	-0.3	-0.8	-1.5	-2.0	-2.4
$((r - \pi) - g(1+\pi))/(1+g+\pi+g\pi))$debt/GDP (8/7) 2/	2.0	1.1	1.2	0.6	1.4	1.5	1.1	0.7	0.5	0.7	0.7
Adjustment factor: $1+g+\pi+g\pi$	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
$((r - \pi) - g(1+\pi))$debt/GDP (9+10)	2.0	1.1	1.2	0.6	1.4	1.6	1.2	0.7	0.6	0.7	0.7
$(r - \pi)$ times debt/GDP	3.1	3.2	3.2	3.1	2.5	2.2	2.5	2.4	2.3	2.2	2.1
minus $g(1 + \pi)$ times debt/GDP	-1.1	-2.1	-1.9	-2.4	-1.0	-0.6	-1.3	-1.7	-1.7	-1.5	-1.4
Residual, incl. asset changes, privatization receipts (negative), and valuation changes in e: exchange /GDP (3-4)	0.9	0.1	-0.5	0.1	0.4	0.1	0.0	0.0	0.0	0.0	0.0
Memorandum Items: Key macro and external assumptions											
Nominal GDP (local currency)	1251	1306	1354	1418	1464.5	1506	1559	1624	1696	1766	1838
Real GDP growth (in percent per year)	1.9	3.5	3.2	4.2	1.8	1.1	2.3	2.8	2.9	2.5	2.5
Consumer price index (change, in percent per year)	1.3	0.7	0.6	1.8	1.8	1.9	1.6	1.6	1.6	1.6	1.6
Exchange rate (LC per US dollar)	0.9	0.9	0.9	1.1	1.1	1.1	1.0	1.0	1.0	1.0	1.0
Nominal appreciation of local currency against US dollar	-12.3	-1.0	-4.2	-13.4	-3.0	4.9	4.2	0.5	0.6	0.3	0.3
GDP deflator (change, in percent per year)	1.3	0.9	0.5	0.5	1.4	1.8	1.2	1.4	1.5	1.6	1.6
Average interest rate on public debt (percent per year)	6.7	6.3	5.8	5.8	5.8	5.6	5.5	5.4	5.4	5.3	5.3
Average real interest rate (nominal rate minus change in GDP deflator, percent)	5.4	5.5	5.3	5.2	4.3	3.8	4.3	4.0	3.9	3.8	3.7
Growth of revenues (deflated by GDP deflator, in percent per year)	3.0	2.0	4.5	3.3	1.3	1.2	1.3	2.6	2.6	2.4	2.5
Growth of noninterest expenditure (deflated by GDP deflator, in percent per year)	1.4	1.5	2.9	2.9	1.5	3.8	1.8	1.5	1.3	1.3	1.5
II. Stress Tests											
1. If real interest rate, real GDP growth rate, and primary balance (in percent of GDP) in 2003-2007 are at average of past 10 years						**58.4**	**60.7**	**62.9**	**65.3**	**67.8**	**70.3**
2. If real interest rate in 2003 and 2004 is average plus two standard deviations, others at baseline						**58.4**	**61.2**	**63.2**	**62.3**	**61.0**	**59.3**
3. If real GDP growth rate in 2003 and 2004 is average minus two standard deviations, others at baseline						**58.4**	**61.2**	**63.4**	**62.6**	**61.3**	**59.6**
4. If primary balance (in percent of GDP) in 2003 and 2004 is average minus two standard deviations, others at baseline						**58.4**	**62.9**	**67.0**	**66.2**	**65.0**	**63.3**
5. Combination of 2-4 using one standard deviation shocks						**58.4**	**63.7**	**69.2**	**68.4**	**67.2**	**65.6**
6. One time 30 percent real depreciation in 2003, others at baseline 3/						**58.4**	**59.3**	**59.2**	**58.3**	**57.0**	**55.3**
7. If debt ratio in 2003 rises by (additional) 10 percent of GDP, others at baseline						**58.4**	**69.3**	**69.3**	**68.5**	**67.3**	**65.7**
Memorandum Items											
Primary deficit (percent of GDP, average of past 10 years)						0.0	0.0	0.0	0.0	0.0	0.0
Primary deficit (percent of GDP, standard deviation of past 10 years)						1.7	1.7	1.7	1.7	1.7	1.7
Real interest rate (nominal rate minus change in GDP deflator, average of past 10 years)						5.8	5.8	5.8	5.8	5.8	5.8
Real interest rate (nominal rate minus change in GDP deflator, standard deviation of past 10 years)						0.9	0.9	0.9	0.9	0.9	0.9
Nominal interest rate (average of past 10 years)						7.2	7.2	7.2	7.2	7.2	7.2
Nominal interest rate (standard deviation of past 10 years)						1.4	1.4	1.4	1.4	1.4	1.4
Real GDP growth rate (average of past 10 years)						2.0	2.0	2.0	2.0	2.0	2.0
Real GDP growth rate (standard deviation of past 10 years)						1.4	1.4	1.4	1.4	1.4	1.4
GDP deflator (average of past 10 years)						1.4	1.4	1.4	1.4	1.4	1.4
GDP deflator (standard deviation of past 10 years)						0.6	0.6	0.6	0.6	0.6	0.6

Source: Staff Calculations.

1/ General government.

2/ Defined as: r = interest rate; π = GDP deflator, growth rate; g = real GDP growth rate.

3/ Real appreciation is approximated by nominal appreciation against US dollar plus increase in domestic GDP deflator.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 02/129
November 13, 2002

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2002 Article IV Consultation with France

On October 28, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with France.[1]

Background

A new center-right government took office in July 2002 and announced as central themes of its policy orientation the desire to boost the growth potential of the economy through tax cuts and structural reforms, and to refocus the role of the state through a shift in spending priorities and decentralization. The economy is facing a fast-approaching demographic turnaround—with the active population beginning to decline in 2007 and reducing annual per-capita-GDP growth by about half a percentage point for a few decades. Furthermore, pension and health care costs are projected to add over 5 percentage points of GDP to budgetary outlays by 2040, with much of the impact occurring within the next 10 years.

During the 1997–2000 upswing, economic growth was rekindled by the upsurge in world trade, facilitated by easy monetary conditions, and supported by the benefits of wage moderation, labor market reform, and earlier fiscal consolidation. By the first half of 2001, however, adverse price shocks and a deteriorating external environment caused sharp declines in investment growth, exports, and inventories. Further shocks and weakening confidence sapped previously resilient consumption demand, leading to a decline in activity in the fourth quarter of 2001. Since then, moderate growth has resumed and the staff projects output growth to pick up from 1.1 percent in 2002 to 2.3 percent in 2003. Despite the recent increase in oil prices, the staff's outlook for inflation remains benign as the effects of adverse price shocks, the euro

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

depreciation and changeover, and cost pressures arising from the reduction of the workweek are set to wane.

In 2002, the general government budget deficit is expected to widen to 2.6 percent of GDP from 1.5 percent of GDP in 2001. The deterioration is in good part due to the cyclical downswing but also to structural factors, in particular to the trend increase in social security spending. The 2003 budget targets an unchanged deficit of 2.6 percent of GDP, reflecting further moderate cuts in taxes and social security contributions, and higher budgeting of health care expenditure. Spending priorities are being shifted toward security, justice, and defense, with some cutbacks on research and labor market programs. All in all, staff estimates that there would be virtually no structural improvement in 2003. The 2003 budget also presents an update of the authorities' medium-term plans for 2004-06, under which tax cuts would continue to be implemented, real expenditure growth kept to an annual average of 1.4 percent, and—under the central growth scenario (2.5 percent annual average)—the deficit decline to 1 percent of GDP by the end of the period. Higher growth (3 percent) is seen to create scope for greater deficit reduction but also for larger tax cuts, with a deficit of 0.5 percent of GDP thus still persisting in 2006.

On structural issues, a mid-2003 deadline has been set for pension reform, needed to mitigate the budgetary costs of ageing. In the labor market, overtime limits have been raised, the bias against part-time work of the earned income tax credit (*Prime pour l'emploi*) removed, and existing cuts in social security contributions simplified. Also, a new employment scheme targeted to young, unemployed, first-time job-seekers has been put in place. A solution has been found for the unification of the minimum wage and minimum monthly income guarantees which will result in a boost to the minimum wage and—to mitigate its impact—further targeted reductions in social security contributions. Divestiture by the state of remaining stakes in commercial enterprises is being pursued, and reform of network industries is set to continue, with the private sector gaining access to equity participation in the electricity and gas utilities. Given recent financial market turbulence, supervision in the financial sector is being intensified, in particular for insurance companies. Further streamlining of securities supervision is under way. Efforts to combat money laundering and terrorist financing are being strengthened on an ongoing basis.

Executive Board Assessment

Directors observed that recent economic performance in France has been relatively favorable, reflecting the benefits of earlier structural reforms and supportive policy conditions. In particular, labor market reforms together with wage moderation have contributed to strong employment growth over the past several years. While immediate growth prospects also appear more favorable than in other main euro area countries, the recovery is nevertheless expected to be only gradual, with tepid growth in the near term and downside risks stemming from the external environment and financial market turbulence. Directors agreed that the major challenge facing the French economy in the coming years will be the demographic change starting in 2007, which will reduce future GDP growth and threaten fiscal sustainability unless a timely, substantive set of reform measures is put in place. They noted that, while the French economy has notable strengths to meet this challenge, important remaining weaknesses—including low activity rates, an onerous tax burden, and a lack of fiscal consolidation since 1999—now need to be addressed.

Against this background, Directors urged the authorities to gear policies decisively toward strengthening the public finances and boosting the growth potential of the economy through comprehensive structural reforms. Critical elements of the reform effort will be to achieve an important relief of the budgetary burden of population aging and a substantial public expenditure reduction, which, in turn, will be key to ensuring the credibility and sustainability of needed tax cuts. Continued labor and product market reforms will also need to be given a high priority. Directors stressed that the design and implementation of fiscal consolidation and reform measures will need to be ambitious both in timing and substance, and accordingly, encouraged the new government to use the present window of opportunity to implement a well-sequenced and integrated strategy, while clearly explaining its benefits to the public at large.

Directors welcomed the authorities' re-affirmation of their commitment to the Stability and Growth Pact objective of achieving and maintaining a budgetary position close to balance or in surplus over the economic cycle, as well as their determination to hold the general government deficit below the 3 percent of GDP threshold. They noted that the 2003 budget contains a number of helpful features to enhance fiscal discipline, including improved transparency, prudent revenue budgeting and realism in health care budgeting, while tax measures should improve the functioning of the labor market and promote investment. At the same time, however, Directors observed that, following substantial spending overruns in 2002, real expenditure restraint in 2003 is set to fall short of previous intentions without achieving a significant improvement in the underlying balance.

While recognizing the challenge which the authorities are facing in pursuing fiscal consolidation in the current more difficult environment, many Directors were of the view that an early adjustment in the fiscal imbalance would be desirable. In particular, they considered that achieving sufficient expenditure restraint would enhance the scope for both deficit reduction and tax cuts that would support confidence and growth more effectively. A number of Directors also observed that the 2003 deficit is targeted to remain uncomfortably close to the 3 percent of GDP limit and thus vulnerable to cyclical risks, and that from a regional perspective, a stronger fiscal consolidation effort, starting in 2003, would help alleviate strains on the euro area's fiscal framework. These Directors therefore urged the authorities to seize every opportunity to bolster expenditure restraint in both the finalization and execution of the 2003 budget. Other Directors, however, considered that the 2003 budget is striking an appropriate balance between the need to arrest a further weakening of fiscal performance and concerns about the fragility of the recovery. They stressed the importance of a credible fiscal adjustment path over the medium term, and were reassured by the authorities' commitment to take additional corrective measures in 2003, if needed.

Regarding medium-term fiscal plans, Directors stressed that the imminent demographic shock requires the authorities to be ambitious in firmly committing to a fiscal consolidation effort that will make steady progress toward underlying fiscal balance while reducing the tax burden substantially. They looked forward, in this regard, to the early implementation of expenditure reforms supported by a strict monitoring framework, that will set the stage for an annual underlying fiscal adjustment of at least half of one percentage point of GDP until balance or even a small surplus is reached. While tax and other structural reforms will boost future growth, it will nevertheless be prudent to base future budgets on conservative growth assumptions, and to refrain from spending presumptive growth dividends prematurely on further tax cuts, or to cut taxes before spending is well under control. Directors, therefore,

urged the authorities to explore the scope for up-front expenditure restraint that would enable them to be more ambitious in reducing the tax burden and improving growth potential. They encouraged the authorities to reflect these considerations in the update of their Stability Program.

Directors saw comprehensive pension reform as a key priority area for addressing the challenges of population aging and achieving expenditure restraint essential for sustainable fiscal consolidation. They welcomed the mid-2003 deadline for submitting reform proposals to Parliament, and encouraged the authorities to design a reform that will secure substantial long-term budgetary savings. Among the reform measures to be envisaged, Directors saw particular merit in linking the contribution period to life expectancy, phasing out the differences between public and private pension regimes, and raising the effective age at which people choose to retire.

In other areas, Directors welcomed the measures announced by the authorities to contain spending growth in the health care sector, including spending on pharmaceuticals, while emphasizing the need for effective control and incentive mechanisms applying to both providers and users. To make tax reforms more effective, they underscored the need to link tax and benefit reforms and to trim back generous social entitlement programs. Directors encouraged the authorities to step up reform efforts toward a smaller, more productive civil service. While welcoming the initial steps taken toward downsizing, many Directors saw scope for more ambitious measures using the opportunity afforded by the wave of civil servant retirements. In supporting the authorities' decentralization initiative and the related aim of a more responsive civil service, several Directors cautioned that attention continue to be paid to the need for leaner government and for firm budgetary control at all levels of government.

While commending the impressive employment growth achieved over the past several years, Directors called for further labor market reforms to raise participation rates and reduce structural unemployment. They welcomed the modification to the earned income tax credit, the cuts in social security contributions targeted to the low-skilled, and measures to lower the cost of the reduction of the workweek. Directors underscored the need to preserve the benefits of past wage moderation. While recognizing the need to harmonize minimum wages, they expressed concern about the impact of the substantial increase in the minimum wage on employment prospects for the low skilled. To improve labor market flexibility, Directors welcomed the authorities' intention to make dismissal rules less burdensome, and noted the importance of removing disincentives to part-time work and introducing actuarial fairness in pension regimes. A number of Directors also encouraged the authorities to streamline the multitude of active labor market programs.

Directors welcomed the authorities' new impetus to divestiture of the state from commercial activities and the decision to allow private participation in the capital of the electricity and gas companies. They saw scope for more rapid progress in subjecting network industries to competition, underscoring the benefits that this would bring in terms of improved economic efficiency and overall productivity. Some Directors urged the authorities to proceed cautiously in participating in capital increases in the telecommunications sector.

Directors noted that France's financial sector has weathered the economic slowdown and drop in equity valuations well, and they encouraged the supervisory authorities to remain vigilant in particular with respect to exposures to equities and highly leveraged enterprises. They also

welcomed ongoing initiatives to strengthen corporate governance and accounting rules, and praised France's leading efforts to combat money laundering and terrorist financing. Many Directors encouraged the authorities to consider removing remaining administrative regulations on interest rates and checking accounts.

Directors supported the authorities' commitment to actively promote trade liberalization in a multilateral context and the emphasis on improved market access for developing countries' exports. Many Directors nevertheless called for greater readiness to accept an early reform of the Common Agricultural Policy. Directors welcomed France's commendable contribution to development assistance, and looked forward to a further increase toward the U.N. target level.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2002 Article IV Consultation with France is also available.

France: Selected Economic Indicators
(Annual percentage change, unless otherwise indicated)

	1998	1999	2000	2001	2002[1/]
Real economy (change in percent)					
Real GDP	3.5	3.2	4.2	1.8	1.1
Domestic demand	4.1	3.7	4.3	1.6	1.0
CPI (year average)	0.7	0.6	1.8	1.8	1.9
Unemployment rate (in percent)	11.8	11.2	9.6	8.5	9.0
Gross national saving (percent of GDP)	21.8	22.5	22.4	21.8	21.1
Gross capital formation (percent of GDP)	19.1	19.6	20.9	20.0	19.1
Public finance (percent of GDP)[2/]					
Central government balance	-3.0	-2.5	-2.4	-2.5	-3.4
General government balance	-2.7	-1.6	-1.3	-1.5	-2.6
Public debt	59.5	58.5	57.3	56.9	58.4
Money and interest rates					
M3 (end of year, percent change)[3/]	2.7	5.2	4.2	10.7	6.7
Money market rate (in percent)[4/]	3.4	3.0	4.4	4.3	3.4
Government bond yield (in percent)[5/]	4.7	4.7	5.5	5.0	4.7
Balance of payments (percent of GDP)					
Trade balance	1.8	1.2	0.0	0.3	0.3
Current account	2.8	2.9	1.5	1.8	2.0
Official reserves (US$ billion)[6/]	44.3	39.7	37.0	31.7	30.2
Fund position (as of August 31, 2002)					
Holdings of currency (percent of quota)					59.9
Holdings of SDRs (percent of allocation)					40.8
Quota (SDRs million)					10,738.5
Exchange rates					
Exchange rates regime		Participant in EMU			
Euro per U.S. dollar (August 21, 2002)					1.02
Nominal effective exchange rate (1995=100)[7/]	97.2	95.8	92.7	93.0	94.2
Real effective exchange rate (1995=100)[7/, 8/]	92.5	91.8	88.2	87.2	88.4

Sources: Data provided by the authorities and IMF staff estimates

[1/]Staff projections.

[2/]Data for 2001-02 excludes the proceeds fro the sale of UMTS licenses, which amounts to about 0.1 percent of GDP.

[3/]Date for France until 1998 and for the euro area from 1999 onwards. The figure for 2002 refers to the 12-month percent change as of July.

[4/]Data refer to money market call rates up to 1998, and to the interbank rate from 1999 onwards. For 2002, data are as of August.

[5/]Average yield to maturity on public sector bonds with original maturities of more than five years. The figure for 2002 refers to August.

[6/]Excluding gold, end-of-period; from 1999, eurosystem definition. The figure for 2002 refers to August. Euro is market determined. The franc will remain in circulation until end-2001, when euro banknotes and

[7/]While the franc to euro rate was irrevocably fixed on January 1, 1999, the external exchange rate of the euro is market determined. The figure for 2002 refers to August.

[8/]Based on relative normalized unit labor costs in manufacturing.