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The Economic Policies of the New French Government:
Moving Cautiously with an Aura of Haste*

Conservative French Prime Minister Chirac, who took office in mid-March, has moved quickly to implement the first stages of right's economic program, the focal point of the election campaign. Although the new measures announced so far have been designed to convey the impression that the right is moving forcefully, we believe that Chirac is also acting prudently to try to avoid the potential political and economic dangers the conservatives would face from an abrupt change in French economic policy. In our view, Chirac's program basically extends the pragmatic and market-oriented policies adopted by the Socialists after their initial flirtation with a more traditional leftist approach. Chirac has already outlined steps to lift many of the remaining French foreign exchange and price controls, and proposed a supplementary 1986 budget to begin reorienting government spending and reducing the budget deficit. The right's main break with the Socialist program is in its emphasis on denationalization; Chirac has pledged to privatize a wide range of French banks and industrial firms worth between \$21 and \$28 billion over the next five years. We do not expect that the right's economic policies will lead to serious conflicts with US interests, except possibly in the area of agricultural trade. In fact, renewed French emphasis on market forces should complement US efforts in this area and may allow American firms better access to some French markets.

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Cohabitation: The Political Backdrop to the Right's Program

After less than two months of France's novel experiment in powersharing between a Socialist President and a conservative government, the French political situation remains volatile, and

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this has at times overshadowed Chirac's attempts to push through economic reforms. The first weeks of "cohabitation" have progressed more smoothly than many predicted, however, which suggests that both Chirac and Mitterrand are--for the time being, at least--behaving with some deference toward each other. Nevertheless, both Mitterrand and Chirac have their eyes fixed on the 1988 French Presidential election. Chirac has made no secret of his Presidential ambitions, and Mitterrand clearly wants to pave the way for a Socialist successor with a popular mandate to dissolve the National Assembly and call new parliamentary elections. In the meantime, Chirac and Mitterrand will be trying to outflank each other whenever possible, while trying not to appear to threaten France's political stability in pursuit of personal or partisan interests. Mitterrand and Chirac will continually probe and test each other's wills and powers, and much of the sparring will be over economic policy. [REDACTED]

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Cohabitation opens new political horizons for Chirac, but he almost certainly realizes that it creates perils as well, especially with regard to his performance on economic issues. Chirac lacks the consistent popularity of other Presidential aspirants on the right, notably former Prime Minister Raymond Barre. He probably calculates that cohabitation is a make-or-break opportunity for him, and that he must use his tenure as Prime Minister to build popular support and pave the way for a Presidential campaign. Chirac must do this without seriously blundering, however, since a precipitous erosion of public support for the government might tempt Mitterrand to resign and dissolve the National Assembly, forcing early elections. The Socialists would almost certainly stress economic issues in such a campaign, pointing to their ability to turn the French economy around in recent years, and holding Chirac accountable for any negative economic results. For Chirac, therefore, cohabitation will be a political tightrope, and we believe that it will force him to act prudently on economic policy and avoid risky experimentation as much as possible. [REDACTED]

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One indication of the importance Chirac attaches to the political dimensions of his economic program is his decision to name Edouard Balladur, his top political strategist, as economics "Czar." As Minister of the Economy, Finances, and Privatization, Balladur will oversee not only the traditional areas of monetary and fiscal policy, but also the politically sensitive issue of denationalization. By temperament a behind-the-scenes technocrat, Balladur's pragmatic, cautious approach and concern for Chirac's public image are likely to have a moderating

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influence on economic policy. We believe that under his guidance, the government will be less likely to adopt some of the more far-reaching--and risky--economic reforms outlined in the right's campaign platform. [redacted]

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The Economic Setting: Welcome Breathing Room for the Government

If the political imperatives of cohabitation force moderation on the government, France's brightening economic picture affords it welcome room for maneuver. Although Chirac has lambasted the Socialist's economic record, they in fact managed to turn the French economy around in the past three years: French inflation fell from 13.3 percent in 1981 to 5.8 last year and is probably heading to below 3 percent in 1986. French GDP growth, while still lackluster by international standards, picked up last year to 1.3 percent, and is likely to exceed 2 percent this year. The French current account balance, moreover, registered a surplus of more than \$300 million in 1985, and this year Paris is likely to run a trade surplus, the first since 1978. [redacted]

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Apart from inheriting a relatively robust economy, the conservatives will also reap the benefits of the decline in oil prices and the cheaper dollar, which further cuts Paris' import bill. France imports virtually all its oil, and an average 1986 oil price of \$16 a barrel will, according to one recent independent French forecast, boost GDP growth by an additional 0.6 percent. This bonanza, coupled with the dampening effect lower energy and imported commodity prices will have on inflation, probably assures the government of positive short term economic results. Chirac will therefore have more room to experiment, and perhaps even stumble, without having to worry unduly about re-igniting inflation or weakening growth. [redacted]

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The recent favorable economic news improves Chirac's chances of implementing the right's program and convincing the French people that he can do better than the Socialists. Nevertheless, the government is displaying considerable caution in formulating and announcing its economic program. Chirac's strategy to date appears to focus on two goals:

--Giving the impression of moving forcefully on high visibility programs, especially denationalization;

--Focusing on unemployment--currently hovering near 10.5 percent--as the nagging problem that the Socialists aggravated but the right can cure. [redacted]

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Measures Announced Thus Far

Privatization

The government is pressing ahead with its much ballyhooed program of denationalization, but we believe that Socialist delaying tactics and market constraints will force the government to move more slowly than its public posturing suggests. Chirac initially sought to privatize by decree--a procedure whereby the government is granted extensive powers by the National Assembly, which ratifies the actions after the fact. But Mitterrand, whose signature is necessary before decrees take effect, announced in early April that that he would not permit the use of decrees to privatize firms nationalized before 1982. The President also said that he will oppose a cut-rate sell off of French industry and will only sign decrees that give the state the same generous terms the Socialists gave share holders when they nationalized firms in 1982. Finally, Mitterrand extended his "no signature" warning to any privatization decrees that threaten the existing rights of public sector workers.

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Mitterrand's groundrules by no means block the conservative's privatization program but make it more difficult for the government by forcing the right to push individual denationalization measures through the National Assembly where it has but a razor thin majority. Nevertheless, Chirac is pressing ahead, and has adopted a conciliatory tone toward Mitterrand by signalling his willingness to send contentious denationalization measures to the National Assembly as regular bills. In a speech before the National Assembly in mid-April, Chirac outlined his plans to sell off a wide range of nationalized firms, worth from \$21 to \$28 billion, over the next five years. These include:

- The 36 banks, five major industrial groups (Thomson, Pechiney, Saint Gobain, Rhone Poulenc, CGE) and two financial holding companies (Suez and Paribas) nationalized by the Socialists in 1982.
- The aerospace and armaments firms Matra and Dassault, which the state also took control of under the Socialists.
- The three large banks (Banque Nationale de Paris, Societe Generale, Credit Lyonnais) and three large insurance firms (UAP, GAN, AGF) nationalized after World War II.

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--The Havas advertising group and the oil giant Elf Aquitaine, France's largest concern, also nationalized after the war.

Notably absent from the government's privatization list are the automaker Renault and steel manufacturers Sacilor and Usinor, the three state-owned heavy industrial firms that perennially lose money. [REDACTED]

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Although the government has yet to specify many of the details of privatization and the timetable, Chirac is unlikely to opt for a simple, wholesale sell-off of public holdings. The total value of French equities is now only about \$70 billion, and massive government sales could depress and destabilize what has otherwise been a bull market. Instead, the government is likely to convert some of the many types of non-voting equities outstanding into voting shares, thus transferring the control of companies into private hands. Alternatively, it may gradually expand stock offering to dilute public holdings. In any case, the government is likely to retain substantial holdings in many companies, figuring that by possessing large blocks of equity it will maintain a strong voice in the company's affairs. The privatization program is also likely to include incentives for employees to purchase shares. It will probably also specify a limit--probably on the order of 25 percent--on total foreign holdings to blunt Socialist charges that the right is selling control of the French economy to foreigners. [REDACTED]

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The government probably recognizes the constraints it faces but will nevertheless move ahead as quickly as possible to privatize some highly visible firms to demonstrate Chirac's ability to implement the program and underscore the dynamism of the right's economic program. The Paribas and Suez groups and one of the more profitable industrial firms nationalized in 1982--perhaps Rhone Poulenc--are the best candidates for early divestiture. According to press reports, Chirac's advisers are privately expressing confidence that the first firms could be ready for launching by autumn, although most in the financial markets are looking forward to early next year. [REDACTED]

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Budget Policy and Measures to Boost Employment

The conservative's full fiscal program--which promises to include tax cuts, further spending reductions, and a reexamination of the social security system--will be introduced in the fall when the government announces the 1987 budget. In mid-April, however, Chirac announced a supplementary 1986 budget

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aimed at bringing government spending into line, gradually introducing new priorities, and correcting what the conservatives argue are the traps in the Socialist's 1986 budget. The supplementary budget increases the government's receipts by some \$3.2 billion, largely through about \$1.4 billion in expenditure cuts and \$1.1 billion in sales of assets of state-owned firms that are permitted under existing legislation. State-sponsored research, the area hardest hit, is cut by over \$200 million, or nearly 4 percent of the government's total civil research budget. The additional revenue to be raised is to be used to boost spending by almost \$3 billion on the following: about \$1.1 billion is to be spent on additional subsidies for Renault, Sacilor, and Usinor, and nearly \$600 million for a youth employment program. Finally, in a largely political gesture, the supplementary budget legislation provides for the elimination next year of the much-maligned wealth tax imposed by the Socialists. [redacted]

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The government's next step in dealing with unemployment will likely be legislation to give more flexibility to the labor market. Chirac has already sought power to issue decrees permitting more part-time and temporary employment, providing further youth training schemes, and cutting companies' mandatory social security contributions to encourage them to hire more young employees. Mitterrand balked, however, at Chirac's attempt to seek decrees making layoffs easier, and Chirac is likely to try to move on this issue. [redacted]

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Price and Exchange Controls and other Financial Measures

In these areas the conservatives have moved cautiously to extend the liberalization begun by the Socialists. - In mid-April, the government fulfilled a campaign promise to ease foreign exchange controls, but important limitations remain in effect. French companies are now allowed to buy forward foreign exchange contracts for up to three months, as opposed to the previous rules allowing only a limited number of firms importing essential products to purchase contracts for one month's forward cover. In addition, exporters are no longer required to convert their foreign currency earnings into francs within 15 days, as had been the case previously, but can now hold foreign currency for 90 days. The government, however, stopped short of permitting French nationals to hold foreign exchange indefinitely, continuing a tradition in place in France since the 1930s. The other financial reforms the government has adopted include restoring anonymity to gold transactions in hopes that citizens holding gold illegally will decide to sell it for more productive

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investments and declaring a tax amnesty to encourage Frenchmen to repatriate capital illegally held out of the country. [redacted]

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The government has also sought the power to legislate by decree in removing price controls. This process was well under way under the Socialists, however, who claim that by early this year over 85 percent of French industrial prices were decontrolled. We believe that the right is likely to extend this liberalization, but maintain price controls in several key areas, especially services and books and pharmaceutical products, which are politically popular. [redacted]

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Chirac's most dramatic move in the monetary area was his instigation of the early April EMS realignment. Contrary to some press reporting, the realignment did not surprise the market, but was widely assumed to be inevitable because of price differentials between France and West Germany. Chirac probably also figured that by initiating an early realignment he would be able to blame Socialist economic policies for the franc devaluation. Balladur, who negotiated on behalf of France, was nevertheless quick to put the best face on the realignment by stressing the salutary effect it would have on French export competitiveness and employment. In trying to neutralize its inflationary impact, Balladur also announced simultaneously that Paris will try to hold money supply growth this year to 5 percent, compared with last year's 7-8 percent figure. This tactic of counterbalancing policies to minimize their possible ill-effects was followed in mid-April when the Bank of France--which is less independent than the US Federal Reserve--cut its intervention rate, the key French money market rate, by one half a point, to seven and three-quarters percent. At the same time, the bank tightened another aspect of credit policy by increasing the amount of reserves commercial banks are required to deposit with the central bank. [redacted]

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International Economic Policy and Implications for the United States

Thus far, Mitterrand and Chirac have shown little inclination to clash on international economic affairs. Right and left in France share a general consensus on most international economic issues, especially the need for more concerted international action to stabilize exchange rates. Both the Socialists and the right, moreover, are dogged champions of French interests in international trade. Thus, while the conservatives generally favor economic liberalization, we believe that the government will continue to adopt protectionist measures when they appear necessary for safeguarding French markets. [redacted]

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The United States is likely to find the new French government a tougher adversary in one trade area, agriculture. Chirac made the plight of French farmers an important theme in his election campaign. He attacked the agricultural policy of the Socialists, charging that it had sacrificed French farm interests by accepting reform of the European Community's Common Agricultural Policy. One of Chirac's campaign promises was to raise farm incomes, through increased export subsidies if necessary. Chirac almost certainly intends to protect the EC's agricultural policy from any outside attacks, and last year he told US diplomats that he was opposed to entering into a new round of multilateral trade negotiations unless the United States and the EC settled the agricultural issue ahead of time. Chirac has apparently decided to stick to his tough agricultural line now that he is in office and has named Francois Guillaume, head of the largest farmers' union and one of the most militant champions of French farmers, Minister of Agriculture. Soon after taking office Guillaume said that the EC must be prepared to enter into a trade war with the US if it is necessary to protect Europe's agricultural markets.

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The new government's desire to liberate the French economy by reducing public ownership, cutting government subsidies, and lifting administrative controls will give more play to market forces, although the French tradition of heavy state economic intervention will die slowly. From a US perspective, one of the most promising aspects of the new government's economic approach is that the right may be more amenable than past French governments to opening some markets to US firms. This may be evident first in telecommunications, where some US companies have already begun probing the government to see if new opportunities are emerging. In a mid-April meeting with US officials, Gerard Longuet, the new PTT Minister, spoke of his "dedication" to the liberalization of French telecommunications markets, although he acknowledged the difficulties the government will face in this complex area. Longuet said that the government was nevertheless committed to finding a middle course between the traditional French approach of central planning in telecommunications and a reliance on free markets. He noted, however, that successive French governments have poured immense amounts of money into the protected French telecommunications industry, and that there is public resistance to seeing it "go down the drain" due to an onslaught of imports. Longuet's implication, which has been echoed by other French officials, was that despite the right's market-oriented convictions, progress will be slow.

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