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Foreign and Commonwealth Office

London SW1A 2AH

7 January 1986

N L Wicks Esq
No 10 Downing Street

Dear Nigel,

FRENCH INDUSTRIAL POLICY

NO TRACE

Following our recent exchange about Concorde I think that you might be interested to see the enclosed copies of two letters from Roger Garside, our Financial Counsellor in Paris.

2. Although as you know I have a certain prejudice in favour of the French approach, Roger's letters bring out very strongly that not all systems work well all the time, and that at the moment the French system is functioning somewhat less well than it used to in the 1950s and 1960s. Certainly under Mitterrand the grip has relaxed: one sees that in the lack of coordination of the French performance in the Community as well as elsewhere.

Yours ever,
Rodric

R Q Braithwaite

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BRITISH EMBASSY
PARIS

2 December 1985

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H. Healey
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Mr. H.
4/12.

Dear Healey,

HOUSE OF LORDS SELECT COMMITTEE ON OVERSEAS TRADE : FRANCE'S
TRADE IN MANUFACTURES : PART II

1. In my letter to you on this subject on 28 November, I assessed France's current performance in trade in manufactures. This letter looks at the explanation which the Select Committee gave for French superiority over the UK in this field, and gives my own view of the question.

2. The Committee argued that France along with Germany and Japan displays most, if not all, of the eight characteristics which the Committee regards as essential to success in industrial development and trade in manufactures. These, as you will recall, are :

- (i) A sense of national purpose
- (ii) Close links between different groups in society
- (iii) A long term view of the economy
- (iv) Good education and training
- (v) An active industrial policy
- (vi) Financial institutions that take a long view of their relationship with industry
- (vii) A readiness to erect barriers to trade
- (viii) Good operating characteristics of firms.

THE COMMITTEE'S EXPLANATION OF FRENCH SUCCESS

3. Since the Committee's explanation embraces three very different societies, it is not surprising that the description of their qualities remains at a high level of generality. But these are generalities which, at least in the case of France, have featured

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prominently in public debate on this subject, and, given their intrinsic importance, are likely to continue to do so for as long as public attention focuses on the state of our industry. They therefore deserve scrutiny.

4. First, the Committee writes of «the way in which all main economic agents - government, employers, unions and banks - were united in their determination to advance the industrial success of their country despite what could be strong divergences of political opinion and diverging sectional interests». Few would question that for a long period from about 1950 and particularly after de Gaulle came to power in 1958, Frenchmen showed remarkable unity on the essentials of national life, in many ways displaying greater zeal for the national cause than the British, and that this often worked to their advantage. Nevertheless the Committee's Panglossian description needs qualification. First it was truer ten and twenty years ago than it is now. Today close examination shows some important conflicts of sectional interest. The financial sector provides examples : if French banks really put the success of French industry above their own interests they would long ago have achieved those great improvements in efficiency for which the Minister of Finance is now campaigning. The fact is that the larger French banks, particularly those which have been nationalised for forty years, are comfortable, swollen bureaucracies of a most unadventurous and conservative disposition whose service both to French industry and to private clients falls short of that offered by British counterparts. M. Bérégovoy has had to take the bankers by the scruff of their neck and drag them into creating financial products which have been available to industry elsewhere for a decade or more. Then again French «agents de change» (stockbrokers/jobbers) are today engaged in a rearguard action to defend their monopoly of dealing in securities against the ambition of the banks to enter the market. The result is that the Paris Bourse is falling further behind London; it is cramped, compartmentalised and provincial. If the health of French industry was the over-riding priority of the agents de change, they would by now have joined with banks to create security houses capable of channelling the vast sums required (and available) for industrial investment, at the lowest possible cost. They have done nothing of the kind.

5. «In France», the Committee also observed, «prosperity was recognised to be inextricably connected with manufacturing and the export of manufactured goods». This comment would surprise some Frenchmen. I have grown used to hearing prominent men as different as Michel Rocard and the Governor of the Bank of France say «les français n'aiment pas leur industrie». They will tell you that while their fellow countrymen are glad that Rita beat Ptarmigan and wanted the Mirage to keep the Tornado out of the Arabian Sky, that indeed they care intensely that France, in any manifestation from footballers to rockets, should beat the foreign competition,

/they



they are much more attached to, have greater confidence in, the land and its produce than the nation's manufactured goods: that the Frenchman believes in the superiority of a Camembert in a way that he does not believe in a Renault. It is a fact that the myth of France as an agricultural country enables farmers even today to pre-empt vast sums of public money that could earn a higher rate of return in industry. Nevertheless, industry enjoys a higher standing in France than in the UK. Products like the TGV and nuclear power stations are sources of pride and symbols of national prowess. The post-war rise of French industry is seen as largely responsible for the great increase in national wealth. When a Frenchman thinks of exports he thinks of the products of industry and agriculture, not services, even though the country earns about as much from services as the UK does. The Ecole Polytechnique, which is a technical school, enjoys a prestige that is only matched by two other Grandes Ecoles; one has the impression that a higher proportion of intellectual talent is attracted to engineering in France than in the UK.

6. In the Committee's view, France, like Japan, benefits from the close links established between people in their student days (at the Grandes Ecoles in France) and maintained when some enter the civil service and others manufacturing industry. The practice of people moving from the civil service into industry is thought to be a strength of the French system. No-one would deny that close personal links between civil servants and industrialists, however formed, can be exploited for the common good. My impression is that they have been put to good use in France in many fields since World War II. The existence of a tight-knit, self-confident elite, selected on grounds of intelligence, and of capacity for hard-work and clarity of expression, was surely a powerful factor for success in big projects with clear-cut goals: the modernisation of the telephone system, the building of motorways, the construction of nuclear power-stations (of essentially American design) and aerospace projects. This was «dirigisme» and «étatisme» at their best. But moving people from the civil service into the top levels of industry (and finance) can bring an administrative cast of mind into places where it does not belong, and old-boy networks can be used to make cosy arrangements that work against the public interest. Big firms in the private and public sectors whose financial performance is poor have found it easier to put off the evil day of adjusting to market realities because their top management knows how to persuade a civil servant or a minister, who was in their class as ENA, to grant them a subsidy or a tax relief. The US or British stock markets, for whom the Committee have only hard words, would have been much less indulgent - and French industry would be more competitive with the Germans now.

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7. The close personal links forged at the Grandes Ecoles have indeed been an integral part of the dirigiste, étatiste and centralist system, and have contributed to its successes. But the failures of this system have been as spectacular as its successes. They have been less publicised because France does not have a strong tradition of independent, investigative journalism. These failures include computers - the building of a national computer industry was one of the highest priorities of industrial policy for two decades and huge resources were allocated to the Plan Calcul. Wrong choices in the chemical industry in the 1970's wasted billions of pounds. Two comments suggest themselves. First, in complex markets where the customers are many and their requirements fast-changing, dirigiste and étatiste systems are at a disadvantage; and second, in France as elsewhere, the centralisation of decision-making magnifies mistakes as well as successes.

8. The Committee pays tribute to the system of five-year plans as one way in which France, like West Germany and Japan, takes a long term view of economic development. France pioneered indicative planning, and in the 1950's and 1960's the plans were very important. They were the product of broad consultation as well as intensive cerebation by planning experts. They gave expression to the intelligent sense of national purpose then felt so strongly. They certainly stimulated leaders in many fields to form a view on what would and should be done, and how. The process continues today, and is still of considerable value. But the Plan is much less influential and less quantitative now. It is no longer the «ardent obligation» that de Gaulle called it. The most interesting documents published by the Commissariat-Général du Plan these days are perhaps not the five-year plans but papers on specific problems. The Commissariat would like to play a direct role in the allocation of state funds, but has been consistently excluded. No official document in France remotely matches the detail of the British government's White Paper on Public Expenditure, and some say that one reason why the Ministry of Finance does not publish such a document is that the Commissariat would insist on being allowed a voice in the forward planning of expenditure.

9. The Committee judged France to have an exemplary industrial policy, and praised French financial institutions for their contribution to industrial development; in particular the provision of loans to French industry at rates of interest subsidised by the government was thought to stand as a lesson for the UK. The remark about industrial policy is curious, because the whole notion of industrial policy has been downgraded in the past two years and has, over a much longer period, gone through an evolution that parallels that of planning. Neither «picking winners» nor the drawing up of masterplans for industry, both of which have been

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fashionable at different times in the past, are in favour today. Instead, since M. Fabius became Minister of Industry in March 1963, emphasis has been on creating a climate in which industry can flourish. The stress is on three fundamentals : investment, research and training. Investment implies profits and the socialist government is not shy of publicising the recovery in the general level of profitability. Policy specifics are not all the same as in the UK but the philosophy is remarkably similar.

10. As to the subsidisation of loans to industry, both the government and the employers' federation now argue that the right strategy is to reduce subsidies and lighten the fiscal burden on companies. The amount of money being made available by government to subsidise interest rates has been reduced in nominal terms and will be reduced further. With numerous large employers in difficulties, the government has leant on the banks to finance their restructuring, but the banks dislike it and government hopes it will not last long.

11. Moving from broad questions of strategy to institutional specifics, the Committee were particularly struck by the speed and flexibility of French institutions engaged in support for exports. This is right. It is our impression that the French official machinery for the financial support of exports is unusually rapid and dynamic. COFACE, the export credit guarantee agency, appears to have a smaller, more highly paid staff than ECGD, and to process applications more quickly. (Two years ago ECGD were hoping to make an organizational study of COFACE on the spot in Paris; if that has not been done, it deserves to be.) The way the French developed the «crédite mixte» demonstrates both the political priority given to exporting in France and the capacity of the civil service to translate that will into action. Another manifestation of the same political will was the way French political leaders were among the first in the industrialised democracies to act as salesmen for their national products, at a time when others considered it beneath their dignity.

12. It is clear that in the mid-70's the French government moved quickly and effectively to play its part in the drive to increase exports, including manufactures, to pay for the rapidly increasing energy import bill. Confident that the economy would continue to grow rapidly and that the state could easily find the money to «support» (ie subsidise) the export drive, the machinery to do so was put in place and run at full throttle. The combination of political salesmanship and crédit mixte worked very well in the Third World and Eastern Europe. It is irrelevant in OECD countries. France is painfully conscious that she must look to the latter, because they are now the more dynamic markets.

13. From the above it should be apparent that the Committee's explanation of France's surplus in manufactures is incomplete and not wholly accurate. It is incomplete in three respects. First it fails to make clear that while France has in the past enjoyed



very high rates of growth in industry and agriculture, its cost structure is such today that - as I argued in Part I of this letter - the profitability of many French exports is today highly questionable; and the low competitiveness of French products now condemn the country to a rate of growth below that of her major partners. Secondly, it makes no mention of some very important factors which contributed to the great expansion of industry. Thirdly, it does not point out that some of those very factors which made for success in earlier decades have become handicaps today, either through exaggeration or because they are no longer adapted to the tasks of today. The Committee could not be expected to cover all these because they were not writing the history of the French economy since World War II. Nor am I! But my meaning should become clearer if I list what I see as some of the decisive features and developments of that history.

14. The essential fact is that the thirty years from 1945 to 1975, «les trente glorieuses» as they are now known, brought France's first full industrial revolution. In 1945 about 30% of the labour force was still in agriculture, compared with 8% today. France emerged from World War II without great damage to her economy or loss of manpower, but with a burning resolve to efface through economic success the humiliation of June 1940. The «French miracle» gave her an industrial structure and plant which are still relatively modern.

15. The miracle was not worked through protectionism, subsidies to industry and its exports, and deficit-financing of a high-spending government. Although dirigisme and étatism set the framework of society, three of the most decisive economic acts of the period were liberal in character: de Gaulle's 1958 decisions to commit France to honour her Common Market obligations, to impose on her a rigorous fiscal strategy of balanced budgets and to make the franc convertible. The idea of state leadership was not associated with egalitarianism: in the thirty years of high growth, economic agents enjoyed the lightest direct taxation in Western Europe, and senior and middle management progressively developed the highest salary differentials. Inheritance taxes were low, and the wealth tax did not yet exist. A premium was placed on strong, even authoritarian leadership, civil servants were heirs to a tradition of respected and dedicated servants of the State. The high-flyers among them were given maximum responsibility and fast promotion; they were expected to display imagination as well as mastery of bureaucratic technique. Health care was financed on the insurance principle. Public housing was very limited and mainly provided to the poor. There was no comprehensive safety net for those who failed or suffered ill-fortune in the economy. Union membership was low and union power fragmented. Society placed a high value on learning and the schools turned out people who were relatively literate, numerate and motivated to make a place for themselves in the rather well-ordered society that was France.

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16. This orderly society was shaken in 1968, but rapidly resumed normal working with some fairly unprofound «New Frontier»-type reforms. Things started to go wrong in the mid 1970's just when the Hudson Institute was forecasting that France would soon overtake Germany. The response to the first oil-shock was crucial. In some ways it was magnificent : the nuclear power programme to cut energy imports was boldly conceived and brilliantly executed. In other ways there was a refusal to pay the price : Chirac tried to relaunch growth through deficit-financed reflation, and companies drastically increased the share of their value added which they paid out as salaries, reducing proportionally their investments over the next ten years. The courage, dynamism and hard work were adulterated by illusion and self-indulgence. A situation emerged in which the big companies most closely linked to the State became vulnerable giants, living high on the hog with too little care for the cost.

17. By the time the Socialists came to power in 1981, the economy was less strong than they, and many others, realized. The over-confident policies of their first twelve months exposed its shortcomings. But the period of socialist government has also occasioned an ideological change of importance : for the first time since Colbert people are turning against étatism and dirigisme.

18. Any attempt in a couple of paragraphs to draw lessons for the UK from the performance of French industry and from French industrial policy would sound as platitudinous as the advice of Polonius to Laertes. This letter will therefore end with just one (unexciting) conclusion : French performance in trade in manufactures cannot be explained in terms of particular mechanics, institutions or even policies which would transform our performance if copied piece-meal : good and bad choices on all of these made a contribution, but the very choices were an expression of much larger trends in French society.

Yours sincerely,
 Roger Garside.

cc :

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e.g. UK
 post 1945?

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W.P.H. 29/11.

BRITISH EMBASSY
PARIS

28 November 1985

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*It is interesting that this
letter is from the Financial
Counsellor, not the Commercial
Counsellor!*
W.P.H. 29/11.

SELECT COMMITTEE ON OVERSEAS TRADE : FRANCE'S TRADE IN
MANUFACTURES : PART I

1. The House of Lords Select Committee on Overseas Trade points to France as a country which is successful in its trade in manufactures, and you told me that a letter on this subject could prove useful to officials supporting Lord Young in the debate, if any of their Lordships raise this aspect of their report.
2. By comparison with the UK, France is in the enviable position of enjoying a surplus on trade in manufactures. In 1984, this was almost £9 billion (CIF/FOB) when arms sales are included.
3. For two reasons, it would, however, be unwise to conclude from this bare fact that the UK should remodel its policies and institutions on those of France. First because the differences of history between our two societies and the differences of character and temperament between our two peoples caution against a facile belief that what works for the French will work for the British. As we all know France is deeply imbued with the dirigiste, étatiste tradition that dates back to Colbert and his King Louis XIV. Secondly because while in the first thirty years after World War II France achieved very high rates of industrial growth and is now enjoying considerable success in the export of manufactures, on neither count is her current performance so brilliant as to prove the superiority of the French way of doing things. Indeed there is a radical rethink underway in France about the relationship between the State and industry.
4. The French have not been noticeably more successful than the British in preserving or transforming their older industries such as steel, coal, shipbuilding and textiles. Indeed the restructuring of the French steel industry lags behind our own. Where newer industries are concerned they have had some successes and some disappointments. The successes have included the nuclear power programme, telecommunications and aerospace; there have been disappointments in, for example, computers, machine tools and chemicals.



5. The French performance in trade in manufactures needs to be assessed with care. For a start, France, like the UK, has a very large structural deficit on trade in manufactures with the European Community, compared with a German surplus of US\$ 20 billion in 1983. Indeed, France has an overall trade deficit with all OECD countries except Switzerland. She achieves her surplus in manufactures by her exports to Less Developed Countries and Eastern Europe. The National Statistical Institute (INSEE) calculates that in constant prices the surplus in manufactures has not increased over the past ten years, and that France has lost and is still losing world market share in this field (1-2% in 1984). The French Government is concerned at this and is urging industry to make greater effort to develop more products better adapted for sale in industrial countries.

6. The history of the past four years shows this will not be easy. Since 1981 the franc has been devalued three times against the deutschmark in the EMS, and, like other major currencies, has depreciated heavily against the US dollar. The improvement in price competitiveness obtained by this currency depreciation has produced only one marked change in French performance : exports of goods to the United States have increased by 9% in volume. French trade with Germany is perhaps the best single point of observation for the overall competitiveness of French manufactured goods, since barriers to trade are at a minimum and Germany is France's largest trading partner. Here we observe that there has been no fundamental improvement in French performance despite the three devaluations : France remains heavily in deficit. French experts suggest that the root problem is that few French manufactures are outright winners in quality and design terms in the open competition of industrialised markets.

7. Employment and profit figures also caution against too readily accepting French industry and industrial policy as models for the UK. Employment in French manufacturing industry declined in 1984 by 144,000, and in the years 1980-1984 inclusive it declined on average each year by 123,400. In 1983 (the last year for which full figures are available), 101 out of the 450 largest French industrial companies recorded a pre-tax loss, compared to 2 of the 450 largest UK companies (in all categories) in the 1983-4 financial year. The 100 largest French companies registered a combined deficit of 700 million pounds. Of the top 30 French exporters only 2 recorded a profit in 1983 of more than 40 million pounds.

HOW PROFITABLE ARE FRENCH EXPORTS?

8. Important question marks hang over the profitability of French exports. This is an area shrouded in uncertainty but the question marks cannot be ignored, since they concern the sectors and companies

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which contribute most to the surplus in manufactures. Arms sales are the largest contributor, but how far is the arms industry dependent for its profits on the generosity of the French taxpayer expressed through the prices set for public procurement? The second largest contribution comes from the motor industry, ie Renault and the PSA group (Peugeot, Citroen and Talbot). Last year Renault recorded a loss of over a billion pounds; this was the company's fourth successive year in the red. The third largest comes from the agri-food industry. In 1984 French agriculture received 10 billion pounds of public money, which heavily subsidised the price of raw materials to the agri-food industry. Agricultural exports benefitted from subsidies from the European Community which ran to several billion pounds and part of this money directly subsidised the export of manufactures such as flour, dried milk and sugar. The fourth largest contribution to the surplus came from the steel sector, which consists largely of the companies which recorded a combined loss in 1983 of one billion pounds, almost equal to the sector's trade surplus. Until the EC Commission took action, the textile industry, which is in substantial surplus also, was the beneficiary of social security rebates.

9. French exports whose profitability seems to owe little or nothing to public subsidy, public procurement or fiscal privilege include pharmaceuticals, clothing, wines and spirits, household equipment, substantial branches of engineering and, more generally, the products of small and medium-sized manufacturing firms.

10. A second part of this letter will follow by a later bag since it is not suitable for use in the debate. It examines the Committee's explanation of the performance of French industry and French trade in manufactures.

Handwritten signature
Handwritten signature
R R Garside

cc :

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