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Assessment of the 2016 Stability Programme for

France

(Note prepared by DG ECFIN staff)

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1. INTRODUCTION

This document assesses France's April 2016 Stability Programme (hereafter called Stability Programme), which was submitted to the Commission on 29 April 2016 and covers the period 2016-2019. In accordance with national legal provisions, the programme was submitted to the Parliament on 13 April.

France is currently subject to the corrective arm of the Stability and Growth Pact (SGP). The Council opened the Excessive Deficit Procedure for France on 27 April 2009. The country is recommended to correct the excessive deficit by 2017. The year following the correction of the excessive deficit, France will be subject to the preventive arm of the SGP and should ensure sufficient progress towards its medium-term budgetary objective (MTO). As the debt ratio in 2017 is projected to reach 97% of GDP, exceeding the 60% of GDP reference value, France will also be subject to the transitional arrangements as regards compliance with the debt criterion during the three years following the correction of the excessive deficit, during which it should ensure sufficient progress towards compliance.

This document complements the Country Report published on 8 March 2016 and updates it with the information included in the Stability Programme.

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2016 spring forecast. The following section presents the recent and planned budgetary developments according to the Stability Programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on the Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long-term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework and the quality of public finances. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

According to the Stability Programme, the recovery of the French economy will continue in 2016 and 2017, with GDP growing by 1.5% in each year. These growth projections are identical to those underpinning the Draft Budgetary Plan (DBP).

Activity would be supported by both domestic and external factors. On the domestic side, economic policy measures supporting firms' competitiveness and households' purchasing power as well as a less restrictive fiscal stance would play a significant role. On the external side, tailwinds are expected from the low oil price environment, the improving global outlook as well as from the accommodative monetary policy. The recovery of private consumption is projected to continue in a context of improved labour market prospects. Total investment is expected to pick up gradually as difficulties in the construction sector fade out and corporate investment accelerates further, supported by improved profit margins, the over-amortization scheme, as well as the continued pick-up in economic activity. After an exceptional export performance in 2015, exports are expected to slow down in 2016, despite a projected acceleration of French export markets. Imports would continue to grow more dynamically than exports. In total, the programme expects net exports to remain a drag on growth in 2016 and 2017. Given the GDP growth projections, the output gap as recalculated by the Commission following the commonly agreed methodology, stands at -1.8% in 2015 and is expected to gradually close by 2019. The recalculated output gap is smaller than in the

Stability Programme itself, given the lower recalculated potential growth. The Stability Programme includes, in its computation of potential growth, an ad-hoc effect of structural reforms which is not in line with the commonly agreed methodology. Moreover, while the (recalculated) output gap is forecast to close by 2019, the output gap presented in the programme itself is forecast to remain negative over the programme horizon until 2019, at -2.4%.

As regards the labour market, total employment would continue its acceleration, supported by the economic recovery and the effect of the measures adopted by the government. Inflation is expected to average 0.1% in 2016 before increasing to 1.0% in 2017. Inflation for 2016 has been significantly revised downwards compared to the DBP due to the further fall in oil prices in the first months of 2016.

Table 1: Comparison of macroeconomic developments and forecasts

	2015		2016		2017		2018	2019
	COM	**SP**	**COM**	**SP**	**COM**	**SP**	**SP**	**SP**
Real GDP (% change)	1.2	1.2	1.3	1.5	1.7	1.5	1¾	1.9
Private consumption (% change)	1.4	1.4	1.5	1.6	1.4	1.6	1.8	1.9
Gross fixed capital formation (% change)	0.0	0.0	1.5	1.7	4.0	3.0	3.9	4.5
Exports of goods and services (% change)	6.0	6.1	4.1	3.9	4.8	4.8	5.5	5.5
Imports of goods and services (% change)	6.4	6.7	4.8	4.8	4.7	5.1	5.6	5.8
Contributions to real GDP growth:								
- Final domestic demand	1.2	1.1	1.4	1.5	1.8	1.6	1.8	2.0
- Change in inventories	0.2	0.4	0.2	0.4	-0.1	0.0	0.0	0.0
- Net exports	-0.2	-0.3	-0.3	-0.3	0.0	-0.1	-0.1	-0.1
Output gap[1]	-1.8	-1.8	-1.5	-1.4	-0.9	-1.1	-0.5	0.0
Employment (% change)	0.4	0.4	0.5	0.7	0.7	0.6	0.4	0.4
Unemployment rate (%)	10.4	n.a.	10.2	n.a.	10.1	n.a.	n.a.	n.a.
Labour productivity (% change)	0.8	0.8	0.8	0.8	1.0	0.9	1.4	1.4
HICP inflation (%)[2]	0.1	0.0	0.1	0.1	1.0	1.0	1.4	1¾
GDP deflator (% change)	1.2	1.1	1.0	0.9	1.0	0.9	1.3	1.7
Comp. of employees (per head, % change)	1.2	1.1	1.1	1.1	1.5	1.6	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-1.2	-1.6	-0.5	-1.4	-0.5	-1.1	-1.0	-1.0

Note:

[1] In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

[2] In the Stability Programme, the National Consumer Price Index is reported.

Source:

Commission 2016 spring forecast (COM); Stability Programme (SP).

The GDP growth forecast for 2016, although unchanged compared to the DBP, appears now on the optimistic side. In particular, the Commission spring forecast for GDP growth is lower than the programme's as the change in inventories is expected to have a lower contribution. The Commission 2016 spring forecast concerning the growth rate of employment is also lower than the programme's. In its opinion on the macroeconomic scenario underpinning the

2016 Stability Programme, the High Council of Public Finances (HCPF) also considers the government's GDP growth forecast to be on the high side for 2016, although still achievable. It is to be noted, however, that the Commission assessment does not take into account the better-than-expected outcome concerning GDP growth in the first quarter of 2016, which also represents an upside risk to the Commission GDP growth forecast for 2016. Concerning 2017, the programme's macroeconomic assumptions are plausible. The differences with respect to the Commission spring forecast can essentially be explained by the no-policy-change-assumption, which induces in particular a stronger investment growth forecast, in a context of a negative fiscal effort.

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. Deficit developments in 2015

In 2015, according to data notified to Eurostat the general government deficit reached 3.5% of GDP, after 4.0% in 2014.[1] This outturn is below the target set in the April 2015 update of the Stability Programme and the DBP for 2016 submitted on 15 October 2015, which expected the headline deficit to reach 3.8% of GDP in 2015.

Total expenditure declined from 57.3% of GDP to in 2014 to 56.8% in 2015, which is 0.1 pp. lower than expected in the 2015 Stability Programme. The growth rate of expenditure (0.9% in nominal terms excluding payable tax credits) was in line with what was expected in the 2015 Stability Programme and 0.1 pp. below the expected growth in the DBP. Both the norms on State government expenditures and on healthcare expenditures were respected. 0.1% of GDP lower-than-expected interest payments and a strong fall in local government investment (EUR -5.1 bn or 0.2 pp. of GDP) also contributed to expenditure restraint. Taking into account the cost of the tax credit for competitiveness and employment, which was EUR 7.1 bn (0.3 pp. of GDP) higher than in 2015, total public expenditures increased by 1.4% in 2015, compared to 1.8% in 2014.

Meanwhile, total revenues declined from 53.4% of GDP in 2014 to 53.2% in 2015, which is 0.1 pp. higher than expected in the 2015 Stability Programme. According to the authorities, discretionary measures reduced the tax burden by EUR 1.8 billion (0.1 pp. of GDP), slightly less than planned in the 2015 Stability Programme, while the overall elasticity of the tax burden stood at 0.8, in line with what was expected in April 2015.

[1] Following a revision of national accounts, published by INSEE on 17 May 2016, the 2015 general government deficit reached 3.6% of GDP, instead of 3.5% previously estimated. The revision is due .to a downward revision of nominal GDP.

3.2. Medium-term strategy and targets

In line with the DBP for 2016, the Stability Programme plans a headline deficit of 3.3% of GDP in 2016 − although the 2015 general government deficit turned out to be 0.3% of GDP lower than expected − and aims to improve the deficit further to 2.7% of GDP in 2017. The headline deficit targets are 0.1 pp of GDP below the recommended headline targets for these years and the excessive deficit would be corrected by 2017, in line with the deadline set by the Council. The medium-term objective (MTO), a structural deficit of 0.4% of GDP, in line with the provisions of the Stability and Growth Pact, would be reached in 2018. The Stability Programme projects that the debt ratio would reach a peak of 96.5% of GDP in 2017 before declining to 93.3% in 2019.

In the Commission spring forecast, the headline deficit is projected to reach 3.4% of GDP in 2016, 0.1% of GDP above target. The Commission spring forecast projects slightly lower social security contributions and higher unemployment due to a lower projected employment growth and does not take into account the expected savings from the forthcoming reform of the unemployment insurance scheme as negotiations between social partners are still ongoing. The recalculated structural balance would improve by 0.2 pp of GDP. The Commission spring forecast projects that the structural balance would remain unchanged as the headline deficit is 0.1 pp. higher than the 2016 headline deficit target of the authorities and, takes into account as a one-off measure the 2016 revenue of the 4G licences amounting to EUR 1.6 bn, contrary to the authorities whose definition of one-offs is not in line with the Commission classification principles in this regard.

For 2017, the Stability Programme plans that the general government deficit would reach 2.7% of GDP, slightly below the 2.8% of GDP target set by the Council recommendation of 10 March 2015. To reach this target, the Stability Programme announces additional consolidation measures to compensate the impact of lower inflation on public finances amounting to EUR 5 billion (0.2% of GDP) to be further specified in the DBP for 2017 and commits to compensate the new spending initiatives announced since the entry into force of the 2016 budget, notably related to the ‘emergency employment’ plan and the wage increase for civil servants. The Commission spring forecast projects that the general government deficit would decrease to 3.2% of GDP. Under the no-policy-change assumption, the announced reinforcement of the budgetary strategy is not taken into account as the measures have not yet been specified. As for 2016, the forecast does not incorporate the planned savings from the agreement for the unemployment insurance scheme as negotiations between social partners are ongoing. Finally, the spring forecast quantifies the budgetary cost of the new spending initiatives at ¼ % of GDP by 2017. As the Stability Programme does not identify any specific savings measures to compensate for these spending initiatives and simply indicates that they fall under the norm of the State which the authorities commit to respect in 2017, the Commission spring forecast did not consider that the norm of the State will be respected in 2017. The improvement in the recalculated structural balance would amount to 0.3% of GDP. The Commission spring forecast projects a deterioration of the structural balance by 0.2 % of GDP, the difference with the effort projected by the authorities being due to the higher headline deficit. To ensure the credibility of the adjustment planned by the government, the measures underpinning the budgetary strategy still need to be fully specified.

The trajectory has not been changed since last year's stability programme (See Figure 1). This is in contrast with past experiences of lower deficit targets for the general government deficit in successive stability programmes and is made possible by the gradual economic recovery and the better-than-expected general government deficit in 2015.

The Stability Programme plans the headline deficit to continue improving to -1.9% of GDP in 2018 and to -1.2% of GDP in 2019. The programme also confirms the MTO of a structural deficit of 0.4% of GDP set by the programming law of public finances of 29 December 2014, a value which respects the objectives of the Stability and Growth Pact. The MTO is planned to be reached already in 2018, after which the authorities plan a balanced budget in structural terms in 2019. The headline deficit targets for 2018 and 2019 of the programme are consistent with an improvement in the recalculated structural balance of 0.4% of GDP in each year.

In terms of composition of the adjustment, much of the effort planned over 2016-2019 is expected to come from the expenditure side. The share of total revenues in GDP would decline from 53.2% in 2015 to 52.3% in 2019. In line with the commitment not to increase the tax burden further, the government plans that the tax burden as a share of GDP would decline gradually from 44.5% in 2015 to 43.5% in 2019 as a result of the further roll-out of the tax cuts planned in the Responsibility and Solidarity Pact. Public expenditure growth would remain limited and the share of public expenditures in GDP would decrease from 56.8% in 2015 to 53.5% in 2019, close to its pre-2009 level.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2015	2016		2017		2018	2019	Change: 2015-2019
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	**53.2**	**52.8**	**52.8**	**52.6**	**52.7**	**52.5**	**52.3**	**-0.9**
of which:								
- Taxes on production and imports	15.9	15.8	15.8	15.7	15.7	15.8	15.8	-0.1
- Current taxes on income, wealth, etc.	12.5	12.4	12.4	12.3	12.3	12.1	11.8	-0.7
- Social contributions	18.8	18.7	18.7	18.6	18.6	18.6	18.6	-0.2
- Other (residual)	6.0	6.0	5.9	6.0	6.1	6.0	6.1	0.1
Expenditure	**56.8**	**56.2**	**56.0**	**55.9**	**55.3**	**54.4**	**53.5**	**-3.3**
of which:								
- Primary expenditure	54.8	54.3	54.1	54.0	53.4	52.4	51.4	-3.4
of which:								
Compensation of employees	12.9	12.8	12.7	12.7	12.6	12.4	12.2	-0.7
Intermediate consumption	5.1	5.0	4.9	4.9	4.8	4.6	4.4	-0.7
Social payments	25.9	25.7	25.7	25.6	25.4	25.1	24.6	-1.3
Subsidies	2.5	2.6	2.6	2.6	2.6	2.5	2.4	-0.1
Gross fixed capital formation	3.4	3.4	3.4	3.3	3.3	3.3	3.4	0.0
Other (residual)	5.0	4.7	4.8	4.8	4.8	4.6	4.4	-0.6
- Interest expenditure	2.0	1.9	1.9	1.9	1.9	2.0	2.1	0.1
General government balance (GGB)	**-3.5**	**-3.4**	**-3.3**	**-3.2**	**-2.7**	**-1.9**	**-1.2**	**2.3**
Primary balance	**-1.5**	**-1.5**	**-1.3**	**-1.3**	**-0.7**	**0.1**	**0.9**	**2.4**
One-off and other temporary measures	0.0	-0.1	-0.2	-0.1	-0.1	0.0	0.0	0.0
GGB excl. one-offs	**-3.5**	**-3.3**	**-3.1**	**-3.2**	**-2.6**	**-1.9**	**-1.2**	**2.3**
Output gap[1]	-1.8	-1.5	-1.4	-0.9	-1.1	-0.5	0.0	1.8
Cyclically-adjusted balance[1]	-2.4	-2.5	-2.5	-2.7	-2.1	-1.6	-1.2	1.2
Structural balance[2]	**-2.4**	**-2.4**	**-2.3**	**-2.7**	**-2.0**	**-1.6**	**-1.2**	**1.2**
Structural primary balance[2]	-0.4	-0.5	-0.4	-0.7	-0.1	0.4	0.9	1.3

Notes:

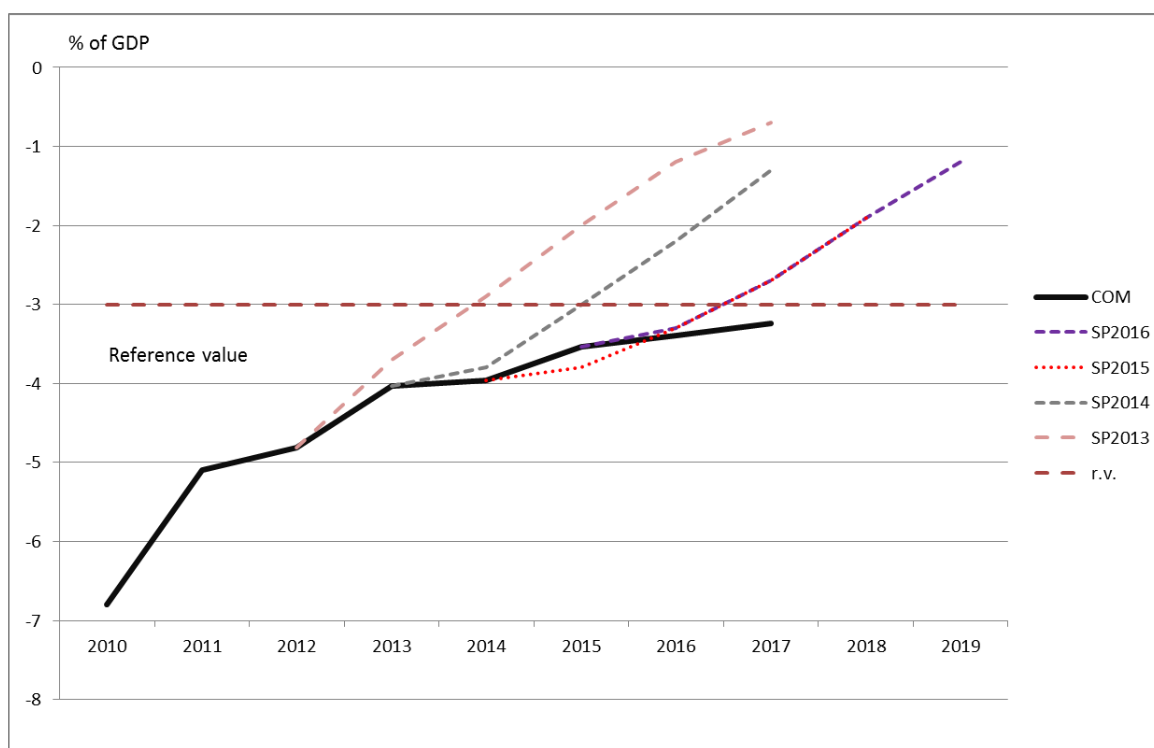
[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme (SP); Commission 2016 spring forecasts (COM); Commission calculations.

Figure 1: Government balance projections in successive programmes (% of GDP)



Source: Commission 2016 spring forecast; stability and convergence programmes

3.3. Measures underpinning the programme

On the revenue side, the measures implemented in 2016 are expected to reduce revenues by 0.2% of GDP. As in 2015, the main revenue measures derive from the implementation of the Responsibility and Solidarity Pact. In particular, the extension of the reduction in employers' social security contribution to all wages below 3.5 times the minimum wage as of 1 April 2016 is expected to reduce public revenues by 0.1 pp. of GDP in 2016. The revenues will decrease further by 0.1 pp. of GDP as the exceptional tax on large companies expires in 2016. Finally, the additional reduction in the personal income tax will reduce public revenues by another 0.1 pp. of GDP. In terms of deficit-improving measures, the carbon tax is expected to yield 0.1 pp. of GDP. In 2017, the main measures of the Stability Programme include the abolition of the tax on the company turnover known as "*Contribution sociale de solidarité des sociétés*" (C3S) for 0.2 pp. of GDP and the first step in the reduction of the corporate income tax rate from 33.3% to 28% for 0.1 pp. of GDP. Overall, the yields of the discretionary revenue measures included in the Stability Programme are plausible.

On the expenditure side, the authorities plan to further implement the EUR 50 billion savings package over 2015-2017 to reduce expenditures. However, the breakdown of the savings effort over the period has changed since its announcement, leaving a significant share of the savings to be achieved in 2017 (EUR 19 billion instead of EUR 15.4 billion initially planned). In 2016, as in 2015, the savings were revised downwards due to the lower-than-expected inflation. For 2016, the authorities also announced additional savings amounting to EUR 3.8 billion (0.2 pp. of GDP). These additional savings include a further reduction in spending by the State and its agencies (EUR 1 billion), projected lower spending on social security and healthcare (EUR 1 billion) and lower interest payments (EUR 1.8 billion). Moreover, the

Stability Programme identifies EUR 1.6 billion savings to compensate for the emergency employment plan while other new spending initiatives would be compensated via budgetary redeployments under the norm of the State. These measures are taken into account into the Commission 2016 spring forecast. Concerning 2017, the Stability Programme announced EUR 5 billion (0.2% of GDP) additional savings to offset the negative impact of lower-than-expected inflation. These additional savings, which are not yet identified, would be shared between the State and its agencies for EUR 2 billion, social security and healthcare for another EUR 2 billion and local governments for EUR 1 billion. The Stability Programme does not identify the budgetary impact for 2017 of the spending initiatives announced in the course of 2016, with the Commission spring forecast estimating this impact at ¼% of GDP. In particular, the wage increase of civil servants would increase expenditure by 0.1% of GDP and the emergency employment plan by 0.1% of GDP.

Main budgetary measures

Revenue	Expenditure
2015	
• Additional reduction in personal income tax for low-earning households (-0.1% of GDP) • Reduction in employers' social contributions for employees paid between 1 and 1.6 times the minimum wage (-0.2% of GDP) • Creation of carbon tax (+0.1% of GDP)	• Ramp-up of the tax credit on competitiveness and employment (+0.3% of GDP)
2016	
• Additional reduction in personal income tax for households (-0.1% of GDP) • Extension of the reduction in employers' social security contribution to all salaries below 3.5 times the minimum wage (-0.1% of GDP) • Expiry of the exceptional tax on large companies (-0.1% of GDP) • Carbon tax (+0.1% of GDP)	• Ramp-up of the tax credit on competitiveness and employment (+0.1% of GDP)
2017	
• Abolition of the "Contribution sociale de solidarité des sociétés" (C3S) (-0.2% of GDP) • Reduction of the corporate income tax rate from 33.3% to 28% (-0.1% of GDP)	
Note: The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.	

3.4. Debt developments

Public debt has increased at a fast pace between 2009 and 2015, from 79.0% to 95.8% of GDP.[2] This development was driven by the cumulated general government deficits recorded over the period as well as by the low GDP growth. In 2015, the headline deficit continued to contribute to the increase in public debt although it was partly offset by the particularly high stock-flow adjustment in 2015 as debt issuance premiums were favourable.

Table 3: Debt developments

(% of GDP)	Average 2010-2014	2015	2016		2017		2018	2019
			COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**88.8**	**95.8**	**96.4**	**96.2**	**97.0**	**96.5**	**95.4**	**93.3**
Change in the ratio	3.3	0.4	0.6	0.4	0.6	0.3	-1.1	-2.1
Contributions [2] :								
1. Primary balance	**2.5**	**1.5**	**1.5**	**1.3**	**1.3**	**0.7**	**-0.1**	**-0.9**
2. "Snow-ball" effect	**0.8**	**-0.2**	**-0.2**	**-0.2**	**-0.6**	**-0.2**	**-0.9**	**-1.2**
Of which:								
Interest expenditure	2.4	2.0	1.9	2.0	1.9	2.0	2.0	2.1
Growth effect	-0.8	-1.1	-1.2	-1.4	-1.6	-1.4	-1.6	-1.7
Inflation effect	-0.8	-1.1	-0.9	-0.8	-0.9	-0.8	-1.2	-1.5
3. Stock-flow adjustment	**0.0**	**-0.9**	**-0.6**	**-0.6**	**-0.1**	**-0.1**	**-0.1**	**0.0**
Of which:								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

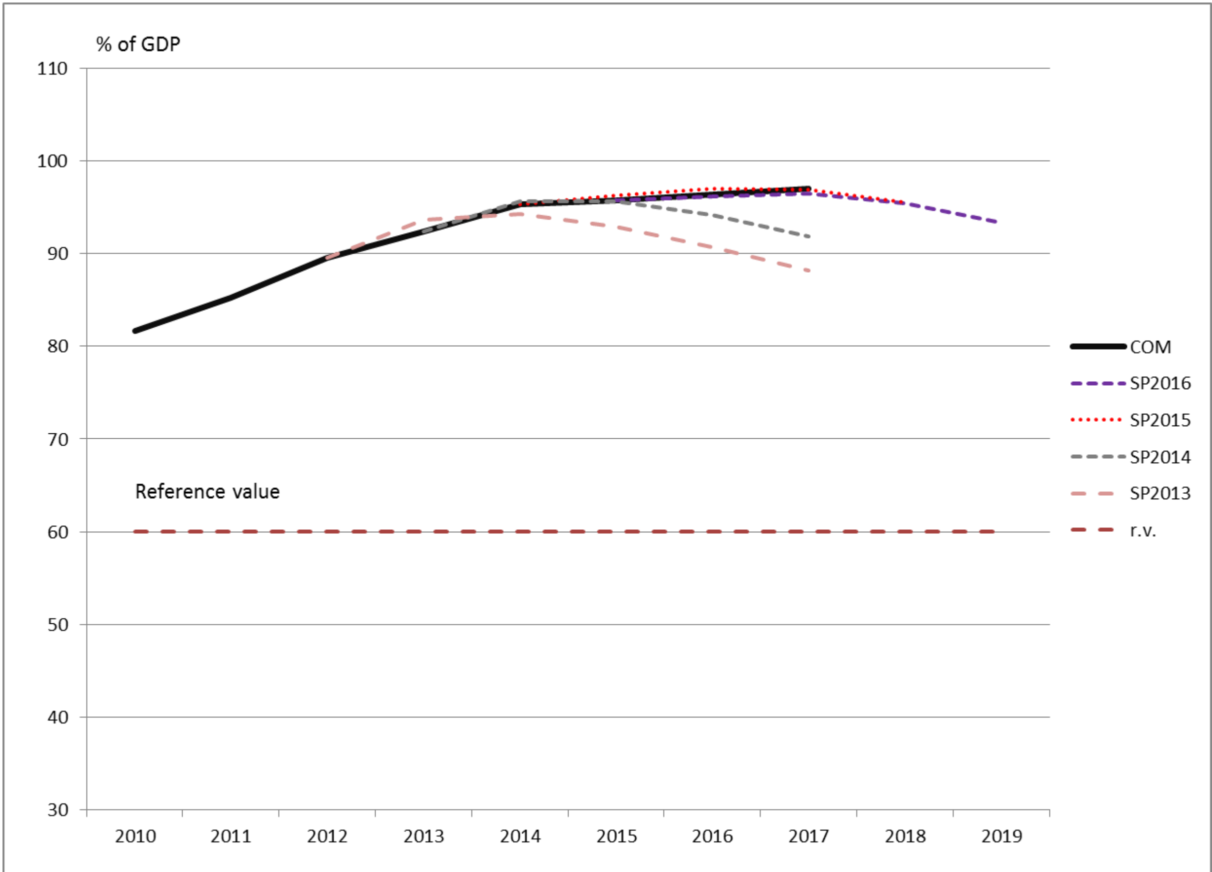
Commission 2016 spring forecast (COM); Stability Programme (SP), Comission calculations.

According to the Stability Programme, the public debt ratio would start decreasing in 2018 (see Figure 2). The primary balance would continue to improve over the period to 2019 and a surplus will be reached already in 2018. At the same time, the snow-ball effect would contribute to the decrease of public debt until the 2019 horizon as the moderate increase in interest expenditure will be outweighed by the recovery in GDP growth and inflation. The stock-flow adjustments are expected to improve the public debt ratio in 2016 thanks to a favourable change in State's cash position and to the disposal of State assets. The level of the gross debt ratio expected in the Commission spring forecast for 2016 and 2017 is slightly

[2] Based on the national accounts INSEE publication of 17 May 2016, public debt in 2015 would reach 96.1% of GDP due to a downward revision of nominal GDP.

higher than in the Stability Programme mainly due to the lower primary balance projection in both years.

Figure 2: Government debt projections in successive programmes (% of GDP)



Source: Commission 2016 spring forecast; stability and convergence programmes

3.5. Risk assessment

The budgetary strategy set forth in the Stability Programme is risky as it is based on the better-than-expected deficit outcome in 2015 and the improvement in cyclical conditions, which is outside the control of the government. Moreover, there are risks related to the implementation of the budgetary strategy pursued by the authorities.

The programme's employment growth forecast for 2016 appears on the high side with implications for the social benefits expenditures. Inflation was revised downwards significantly in 2016 to 0.1% in both the Stability Programme and the Commission spring forecast, as in 2015. Should inflation in 2017 not pick up as expected, this would reduce the yield of the savings planned by the authorities, therefore jeopardizing the achievement of the headline deficit target. This would require the adoption of further consolidation measures, after an already significant amount of additional savings announced to compensate for the lower inflation. Finally, the programme forecasts a continued increase in GDP growth over the forecast horizon, which is to reach +1.9% in 2019. This forecast relies on a further acceleration of private consumption, despite the fading tailwinds from low oil prices. Given the already low savings ratio expected in 2017, there are risks that consumption might not grow as dynamically as assumed by the programme in the medium term. Hence, while the

macroeconomic scenario from 2017 onwards appears broadly plausible, the projected path of GDP growth might prove optimistic.

In the medium term, the expected effect on potential growth of reforms implemented or initiated since 2012 appears on the high side. A recent publication by the Commission3 estimates that a selection of reforms included in the 2015 National Reform Programme would increase GDP by +0.4% in 2020. On the other hand, the government estimates that structural reforms included in the 2015 National Reform Programme would increase GDP by +4.0% in 2020, including +1.7% stemming from the tax credit on competitiveness and employment and Responsibility and Solidarity Pact. These results are, however, not directly comparable, given that the Commission estimates only the impact of a selection of these reforms, and that the government does not take into account the effect of the consolidation measures required to finance the measures. Nevertheless, this suggests that the expected +0.8% increase in potential GDP in cumulated terms by 2019 taken into account in the Stability programme might be on the high side. The High Council of Public Finances also considers the programme's potential growth to be overestimated with the continued important output gap over the forecast horizon being identified as implausible.

Beyond the impact of the macroeconomic environment, risks linked to the budgetary execution also weigh on the fiscal outlook. On the revenue side, the Stability Programme expects that the tax elasticity in 2016 would remain below 1 as inflation would stay low and compensation of employees would be less dynamic than the overall economy. Still, as the programme plans a limited reduction in the output gap (see Section 2), the return to a tax revenue elasticity of 1 in 2017 might take longer to materialize. The tax revenue developments are plausible although the labour market developments might weigh on social contributions. On the expenditure side, the main risks stem from the ambitious expenditure targets set forth by the authorities as the reduction in expenditure growth is not entirely backed up by specific savings measures. The respect of the expenditure norm of the State is one of the pillars of the authorities' consolidation strategy. However, recently the norm has only been attained due to de-budgeting operations and the postponement of payments. The tightening of this norm requires that the further redeployments of credits are supported by specific savings measures. On the other hand, interest rates could turn out to be lower than currently expected in the Stability Programme.

The debt ratio would be impacted by the various risks outlined above. A review of the debt projections made in the Stability Programmes since 2013 (see Figure 2) shows that the plans of the government to curb the growth in public debt within the next two years have so far proved ineffective. This is due to both to higher-than-expected general government deficits (see Figure 1) and lower-than-expected nominal GDP growth. This time again, should medium-term nominal GDP growth prove more modest than expected, the adjustment needed to put the debt ratio on a firmly decreasing path and to ensure the long-term sustainability of public finances could prove stronger than expected.

[3] "The Economic Impact of Selected Structural Reform Measures in Italy, France, Spain and Portugal", European Economy Institutional Papers 23. April 2016.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

On 27 April 2009, the Council opened an Excessive Deficit Procedure for France granting until 2012 for the authorities to bring the headline deficit below 3% of GDP. In the face of unforeseen economic developments with negative consequences on public finances, and as France was considered to have achieved effective action, the deadline was postponed three times. On 2 December 2009, the delay was extended to 2013. It was then extended to 2015 by the Council recommendation of 21 June 2013. Finally, on 10 March 2015, the Council decided to extend the deadline for correction of the excessive deficit until 2017 (see Box 1).

Box 1. Council recommendations addressed to France

- On 10 March 2015, the Council recommended France under Art. 126(7) of the Treaty to correct its excessive deficit by 2017. To this end, France should reach a headline deficit of 4,0 % of GDP in 2015, 3,4 % of GDP in 2016 and 2,8 % of GDP in 2017, which is consistent with delivering an improvement in the structural balance of 0,5 % of GDP in 2015, 0,8 % of GDP in 2016 and 0,9 % of GDP in 2017. This would require additional measures of 0,2 % of GDP in 2015, 1,2 % of GDP in 2016 and 1,3 % of GDP in 2017 based on the extended Commission services' 2015 winter forecast.
- On 14 July 2015, the Council also addressed recommendations to France in the context of the European Semester. In particular, in the area of public finances the Council recommended to France to ensure effective action under the excessive deficit procedure and a durable correction of the excessive deficit by 2017 by reinforcing the budgetary strategy, taking the necessary measures for all years and using all windfall gains for deficit and debt reduction. Specify the expenditure cuts planned for these years and provide an independent evaluation of the impact of key measures.

The general government deficit of 3.5% of GDP in 2015 was below the recommended target of 4.0% and the improvement in the structural balance is expected to amount to 0.3% of GDP in 2015, against the recommended 0.5% of GDP. As France is compliant with the headline deficit target but not with the underlying improvement in the structural balance, a careful analysis building on the two complementary indicators of the fiscal effort provided by the top-down and the bottom-up approaches is needed.

The two estimates of the fiscal effort send conflicting messages. Using the same potential growth as the one estimated at the time of the Council recommendation of 10 March 2015 and correcting for revenue windfalls/shortfalls, the adjusted change in the structural balance would amount to 0.7% of GDP, which is above the 0.5% of GDP recommended by the Council. The bottom-up assessment of the effort achieved in 2015 would amount to -0.1% of GDP, below the recommended 0.2% of GDP.

The gap, amounting to 0.4% of GDP in 2015, between the improvement in the adjusted structural balance and the bottom-up assessment of the fiscal effort since the initial recommendation is mainly explained by three factors. First, the lower-than-expected interest payments that are not taken into account in the bottom-up metric explain 0.1% of GDP of the difference between the two indicators. Secondly, the beta correction in the top-down assessment is based on developments in current revenues, whereas the bottom-up assessment is based on total revenues. As total revenue was more dynamic than current revenue, windfalls stemming from capital revenues were not netted out from the adjusted structural balance, pushing up the top-down estimate of the fiscal effort by 0.1% of GDP. The dynamism can be mostly explained by higher-than-expected inheritance tax revenue which is coinciding with a reform of inheritance taxes. The bottom-up indicator only partly takes into account the dynamism of the inheritance tax, as the yield of the reform as estimated by the

authorities does not explain the entire windfall gain. Finally, when the fiscal adjustment relies on expenditure cuts and the GDP deflator turns out to be higher than expected as was the case for France (1.2% versus 0.8%), the top-down assessment tends to point to a 0.2% of GDP higher effort than the bottom-up assessment.4 Nonetheless, with the GDP Deflator evolving differently than inflation, as measured by the HICP, further analysis is needed to isolate the economic reading of the impact of these price developments on the fiscal effort from the methodological aspects related to the differences in the construction of the two metrics. Overall, the top-down approach seems to be slightly overstating the fiscal effort as it is pushed up by strong capital revenues and lower than expected interest payments. Therefore, based on both metrics, the fiscal effort seems to be somewhat lower than recommended at this juncture.

According to the Stability Programme, the government plans to bring the headline deficit to 3.3% in 2016 and 2.7% in 2017. The general government deficit would thus be 0.1 pp. lower than the headline target set by the Council for both years. In terms of structural adjustment, the improvement in the recalculated structural balance according to the commonly agreed methodology, which is based on the nominal budgetary targets set by the government and thus includes the additional measures announced in the Stability Programme for 2016 and 2017, is expected to stand at 0.2% in 2016 and 0.3% in 2017. The planned adjustment in the structural balance thus falls clearly short of the level recommended by the Council in 2016 and 2017.

The Commission spring forecast projects that the general government deficit would reach 3.4% of GDP in 2016, in line with the recommended target although without margin. The spring forecast projects a stabilisation of the structural balance in 2016, below the recommended structural effort of 0.8% of GDP. Both the top-down and bottom-up metrics confirm that the structural effort would not be met with a wide margin.

In 2017, under a no-policy-change scenario, the Commission considers that the headline deficit would decrease to 3.2% of GDP, therefore remaining well above the 2.8% of GDP recommended target set by the Council as a number of measures for 2017 have not been fully specified at this stage and are not included in the Commission forecast (see above). The spring forecast projects a deterioration of the structural balance by 0.2% of GDP, which is significantly below the recommended structural effort of 0.9% of GDP. Both the top-down and bottom-up metrics confirm that the structural effort would not be met with a wide margin. In cumulated terms, the structural balance would remain unchanged over the period 2015-2017, while it was recommended to improve by 2.2% of GDP. In adjusted terms, the cumulated change of the structural balance over the same period increases to 0.7% of GDP, but remains still below the one recommended by the Council. The structural effort as measured by the bottom-up metric would stand at 0.9% of GDP over 2015-2017, which is also clearly below the cumulated recommended bottom-up effort of 2.7% of GDP.

Provided that the headline deficit is durably brought below 3% by 2017, France would be in the preventive arm of the Excessive Deficit Procedure from 2018 on. The Stability Programme expects that the structural balance would reach -0.3% of GDP in 2018 and 0% of GDP in 2019 compared to the medium-term objective (MTO) of a structural balance of -0.4%

[4] From a more technical perspective, as explained in the Vade Mecum, the top-down and the bottom-up measures are based on different benchmark growth rates for structural expenditure. Namely, the baseline scenario estimated at the time of the recommendation which serves as baseline in the bottom-up approach and the nominal potential GDP growth rate corrected by the α parameter in the top-down assessment.

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of GDP. Based on the commonly agreed methodology, the structural balance in 2018 and 2019 is, however, estimated at respectively -1.6% and -1.2% of GDP.

Table 4: Compliance with the requirements of the corrective arm

(% of GDP)	2015	2016		2017	
	COM	SP	COM	SP	COM
Headline balance					
Headline budget balance	-3.5	-3.3	-3.4	-2.7	-3.2
EDP requirement on the budget balance	-4.0	-3.4		-2.8	
Fiscal effort - change in the structural balance					
Change in the structural balance[1]	0.3	0.2	0.0	0.3	-0.2
Cumulative change[2]	0.3	0.4	0.3	0.7	0.0
Required change from the EDP recommendation	0.5	0.8		0.9	
Cumulative required change from the EDP recommendation	0.5	1.3		2.2	
Fiscal effort - adjusted change in the structural balance					
Adjusted change in the structural balance[3]	0.7	-	0.1	-	-0.1
of which: *correction due to change in potential GDP estimation (α)*	0.1	-	0.1	-	0.1
correction due to revenue windfalls/shortfalls (β)	-0.3	-	0.0	-	-0.1
Cumulative adjusted change [2]	0.7	-	0.8	-	0.7
Required change from the EDP recommendation	0.5	0.8		0.9	
Cumulative required change from the EDP recommendation	0.5	1.3		2.2	
Fiscal effort - calculated on the basis of measures (bottom-up approach)					
Fiscal effort (bottom-up)[4]	-0.1	-	0.4	-	0.6
Cumulative fiscal effort (bottom-up)[2]	-0.1	-	0.3	-	0.9
Requirement from the EDP recommendation	0.2	1.2		1.3	
Cumulative requirement from the EDP recommendation	0.2	1.4		2.7	

Notes

[1]Structural balance = cyclically-adjusted government balance excluding one-off measures. Structural balance based on programme is recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology. Change compared to *t-1* .

[2] Cumulated since the latest EDP recommendation.

3 Change in the structural balance corrected for unanticipated revenue windfalls/shortfalls and changes in potential growth compared to the scenario underpinning the EDP recommendations.

[4]The estimated budgetary impact of the additional fiscal effort delivered on the basis of the discretionary revenue measures and the expenditure developments under the control of the government between the baseline scenario underpinning the EDP recommendation and the current forecast.

Source :

Stability Programme (SP); Commission 2016 spring forecasts (COM); Commission calculations.

5. FISCAL SUSTAINABILITY

France does not appear to face fiscal sustainability risks in the short term. Nonetheless, some fiscal variables such as the primary balance and gross financing needs (14.5 % of GDP) point to possible short-term challenges.

Based on the Commission forecasts and an unchanged policy scenario beyond forecasts, government debt, at 95.8% of GDP in 2015, is expected to continuously rise over this horizon and reach 101.3% in 2026, thus remaining above the 60% of GDP Treaty threshold. This highlights high risks for the country from debt sustainability analysis in the medium term. The full implementation of the Stability programme would nonetheless put debt on a slightly decreasing path by 2026, although remaining above the 60% of GDP reference value in 2026.

The medium-term fiscal sustainability risk indicator S1 is at 4.5 pps. of GDP, primarily related to the high level of government debt and the initial budgetary position (IBP) contributing with respectively 2.9 and 1.3 pp. of GDP, also indicating high risks in the medium term. The full implementation of the Stability programme would decrease the sustainability risk indicator S1 to 3.0 pps. of GDP, leading nevertheless to a similar assessment of the medium-term risk. Overall, risks to fiscal sustainability over the medium-term are, therefore, high.

The long-term fiscal sustainability risk indicator S2 (which shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path) is at 0.7 pp of GDP. In the long-term, France therefore appears to face low fiscal sustainability risks, primarily related to the projected decrease of age-related spending (contribution of -1.0 pp. of GDP to S2), mitigated by the unfavourable initial budgetary position (1.7 pp. of GDP). Full implementation of the Stability Programme would put the S2 indicator at -0.9 pp. of GDP, leading to a similar low long-term risk.

To improve the sustainability of the complementary pensions schemes while strengthening incentives to work longer, social partners agreed on a package of measures for the complementary pension schemes (AGIRC-ARRCO) at the end of October 2015. According to social partners' estimations, the agreement should improve the financial situation of the complementary pension scheme as a slight deficit would persist in 2030 only under the two most pessimistic scenarios of the Steering Committee on Pensions (*Conseil d'Orientation des Retraites*).

Table 5: Sustainability indicators

Time horizon				No-policy Change Scenario		Stability / Convergence Programme Scenario	
Short Term				**LOW risk**			
	S0 indicator [1]			0.2			
		Fiscal subindex (2015)		0.2	LOW risk		
		Financial & competitiveness subindex (2015)		0.1	LOW risk		
Medium Term				**HIGH risk**			
	DSA [2]			HIGH risk			
	S1 indicator [3]			4.5	HIGH risk	3.0	HIGH risk
	of which						
		IBP		1.3		-0.2	
		Debt Requirement		2.9		3.0	
		CoA		0.3		0.3	
Long Term				**LOW risk**		**LOW risk**	
	S2 indicator [4]			0.7		-0.9	
	of which						
		IBP		1.7		0.1	
		CoA		-1.0		-1.0	
		of which					
			Pensions	-1.7		-1.7	
			HC	0.7		0.6	
			LTC	0.6		0.6	
			Other	-0.6		-0.5	

Source: Commission services; 2016 stability/convergence programme.

Note: the 'no-policy-change' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2016 forecast until 2017. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2015 Ageing Report.

[1] The S0 indicator reflects up to date evidence on the role played by fiscal and financial-competitiveness variables in creating potential fiscal risks. It should be stressed that the methodology for the S0 indicator is fundamentally different from the S1 and S2 indicators. S0 is not a quantification of the required fiscal adjustment effort like the S1 and S2 indicators, but a composite indicator which estimates the extent to which there might be a risk for fiscal stress in the short-term. The critical threshold for the overall S0 indicator is 0.43. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.35 and 0.45.

[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections. See Fiscal Sustainability Report 2015.

[3] The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady adjustment in the structural primary balance to be introduced over the five years after the forecast horizon, and then sustained, to bring debt ratios to 60% of GDP in 2030, including financing for any additional expenditure until the target date, arising from an ageing population. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is assigned low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 p.p. of GDP per year for five years after the last year covered by the spring 2015 forecast (year 2017) is required (indicating an cumulated adjustment of 2.5 pp.), it is assigned medium risk; and, (iii) if it is greater than 2.5 (meaning a structural adjustment of more than 0.5 p.p. of GDP per year is necessary), it is assigned high risk.

[4] The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: i) the initial budgetary position (IBP) which gives the gap to the debt stabilising primary balance; and ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that in an infinite horizon, the growth in the debt ratio is bounded by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60% debt threshold. The following thresholds for the S2 indicator were used: (i) if the value of S2 is lower than 2, the country is assigned low risk; (ii) if it is between 2 and 6, it is assigned medium risk; and, (iii) if it is greater than 6, it is assigned high risk.

6. FISCAL FRAMEWORK

The fiscal framework has been significantly reinforced over the last few years with the creation of the High Council on Public Finances (HCPF). This independent authority assesses the plausibility of the macroeconomic scenario underlying the various budgetary plans and checks that draft budgets are consistent with the structural deficit reduction path set in the current multiannual programming law for public finances. As already discussed in section 2.1, the HCPF considered in its opinion of 13 April 2016 presented to the Parliament that the macroeconomic scenario of the government for 2016 is on the high side, although still achievable. For the period 2017-2019 the scenario was considered realistic, although the projected acceleration of growth towards the end of the forecast horizon was subject to downside risks.

In order to better control developments in public expenditures, expenditure norms have been set up to for the various sub-sectors of government. Norms currently exist on State expenditures, both in volume and in nominal terms, on healthcare expenditures and, since 2015, on local government expenditures. The track record of the norms over the last few years shows that they are increasingly complied with, thanks in particular to a more effective governance framework. Nonetheless, as indicated in section 3.5, the attainment of the expenditure norm of the State is subject to risks as it is not backed up by structural measures and relies to some extent on the postponement of the payment of invoices or subsidies as also flagged by the French Court of Auditors. Moreover, the governance framework to monitor and correct the respect of the target on local government expenditures is less developed than that of the other norms. Contrary to the norms for State and healthcare expenditure, the local expenditure norm is only indicative and its execution is not monitored as closely in-year implying that possible deviations cannot be corrected in a timely manner.

The authorities indicated that the Stability Programme is to be considered the French national medium-term fiscal plan. Also, the National Reform Programme quantified the expected return on non-defence public investment projects such as the Programmes d'Investissement d'Avenir (PIA) and the activities of the Banque Publique d'Investissement, with a significant impact on public finances.

In accordance with Regulation (EU) 473/2013 and the Commission Delegated Regulation (EU) 877/2013, France needs to report twice a year on action taken to correct its excessive deficit. To this end, the French authorities have annexed to the Stability Programme an additional document on the budgetary impact of discretionary measures taken on both the expenditure and the revenue side, the targets for the government expenditure and revenues as well as information on the measures adopted and the nature of those envisaged to achieve the targets. The supplementary information provided in the annexed document enhances the transparency of the budgetary adjustment strategy as additional details are provided on the measures taken and planned as well as on the breakdown of the quarterly yields of the measures for 2016. Data on the in-year budgetary execution for the general government and its subsectors is not provided as information is not yet available at this stage of the year.

7. CONCLUSIONS

In 2015, France achieved a headline deficit of 3.5% of GDP[5], 0.5 pp. of GDP below the target under the EDP. However, the structural balance improved by 0.3% of GDP which is below the effort recommended by the Council. Following a careful analysis, the required fiscal effort appears to have been met based on the top-down approach but not based on the bottom-up approach. However, the top-down approach seems to be slightly overstating the fiscal effort as it is pushed up by strong capital revenues and lower than expected interest payments. Therefore, based on both metrics, the fiscal effort seems to be somewhat lower than recommended at this juncture.

France plans to correct its excessive deficit by the 2017 deadline set by the Council. Based on the Commission 2016 spring forecast, the headline deficit is expected to decrease to 3.4% of GDP in 2016 and further to 3.2% in 2017. The projected improvement in the structural balance falls short of the effort required by the Council in both years, regarding both the uncorrected and the corrected change in the structural balance. Based on the bottom-up method, the effort is also below the requirement in both years. Also the cumulated structural effort over the period 2015-2017 would fall short of the recommended effort according to all metrics. Overall, the budgetary strategy is based on the better-than-expected deficit outcome in 2015 and improving cyclical conditions, which carries risks to the timely and durable correction of the excessive deficit by 2017.

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[5] According to notified data. See footnote 1.

8. ANNEX

Table I. Macroeconomic indicators

	1998-2002	2003-2007	2008-2012	2013	2014	2015	2016	2017
Core indicators								
GDP growth rate	2.8	2.0	0.3	0.7	0.2	1.2	1.3	1.7
Output gap [1]	1.5	1.9	-0.8	-1.4	-2.1	-1.8	-1.5	-0.9
HICP (annual % change)	1.4	2.0	1.9	1.0	0.6	0.1	0.1	1.0
Domestic demand (annual % change) [2]	3.0	2.4	0.3	0.7	0.6	1.4	1.6	1.7
Unemployment rate (% of labour force) [3]	8.9	8.6	9.0	10.3	10.3	10.4	10.2	10.1
Gross fixed capital formation (% of GDP)	20.8	21.9	22.5	22.1	21.7	21.2	21.2	21.6
Gross national saving (% of GDP)	23.4	22.4	20.7	19.7	19.9	20.7	21.2	21.6
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-2.0**	**-3.1**	**-5.4**	**-4.0**	**-4.0**	**-3.5**	**-3.4**	**-3.2**
Gross debt	**59.6**	**65.2**	**80.7**	**92.4**	**95.4**	**95.8**	**96.4**	**97.0**
Net financial assets	**-35.3**	**-38.7**	**-54.9**	**-66.1**	**-73.7**	**n.a**	**n.a**	**n.a**
Total revenue	49.8	49.5	50.4	52.9	53.4	53.2	52.8	52.6
Total expenditure	51.8	52.6	55.8	57.0	57.3	56.8	56.2	55.9
of which: Interest	2.9	2.6	2.6	2.3	2.2	2.0	1.9	1.9
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**-0.1**	**-0.1**	**-0.4**	**-1.9**	**-2.2**	**-1.6**	**-1.3**	**-1.2**
Net financial assets; non-financial corporations	**-89.0**	**-94.9**	**-94.3**	**-101.3**	**-102.4**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**8.2**	**0.1**	**6.6**	**8.9**	**7.7**	**n.a**	**n.a**	**n.a**
Gross capital formation	11.8	12.0	12.3	12.4	12.8	13.3	13.6	14.0
Gross operating surplus	18.0	18.0	17.5	16.7	16.5	17.5	18.0	18.3
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**4.0**	**3.0**	**3.8**	**3.3**	**3.8**	**4.0**	**4.2**	**4.0**
Net financial assets	**127.2**	**132.5**	**133.7**	**148.2**	**152.2**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	37.5	37.9	38.6	38.7	39.1	38.7	38.6	38.5
Net property income	6.0	5.8	5.6	5.4	5.2	5.1	4.9	4.9
Current transfers received	23.6	24.0	25.7	26.8	27.2	27.0	26.8	26.7
Gross saving	9.6	9.6	10.0	9.3	9.6	9.5	9.6	9.4
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**1.9**	**-0.2**	**-2.0**	**-2.6**	**-2.3**	**-1.2**	**-0.5**	**-0.5**
Net financial assets	**-9.1**	**3.0**	**12.7**	**13.4**	**19.7**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	1.8	-0.2	-2.0	-1.9	-1.8	-1.1	-0.7	-0.6
Net primary income from the rest of the world	1.6	1.7	1.9	1.6	2.0	1.9	1.9	1.9
Net capital transactions	0.0	-0.1	0.0	0.0	0.0	0.2	0.6	0.5
Tradable sector	39.7	37.3	34.8	34.2	34.0	34.3	n.a	n.a
Non tradable sector	50.0	52.6	55.2	55.5	55.6	55.1	n.a	n.a
of which: Building and construction sector	4.4	5.0	5.5	5.3	5.1	4.8	n.a	n.a
Real effective exchange rate (index, 2000=100)	91.8	98.0	100.3	101.4	102.7	98.3	98.1	97.0
Terms of trade goods and services (index, 2000=100)	101.6	100.2	99.0	98.3	99.8	102.9	104.9	105.1
Market performance of exports (index, 2000=100)	116.7	106.6	102.2	105.7	104.1	104.9	104.8	104.7

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

[2] The indicator on domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source :
AMECO data, Commission 2016 spring forecast