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COMMISSION STAFF WORKING DOCUMENT

Analysis of the draft budgetary plan of France

Accompanying the document

COMMISSION OPINION

on the draft budgetary plan of France

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1. INTRODUCTION

France submitted its Draft Budgetary Plan for 2018 on 16 October 2017 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. France is currently subject to the corrective arm of the Pact. The Council opened the Excessive Deficit Procedure (EDP) for France on 27 April 2009. On 10 March 2015 the Council adopted a revised recommendation, asking France to correct its excessive deficit by 2017. In order to bring the headline government deficit below the 3% of GDP reference value by 2017, France was recommended to reach a headline deficit target of 4.0 % of GDP in 2015, 3.4 % of GDP in 2016 and 2.8 % of GDP in 2017, which was at that time deemed 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, requiring 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 2015 winter forecast.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2017 autumn forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission 2017 autumn forecast. In particular, it also includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2017-2018 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis on the composition of public finances and on fiscal-structural issues including reducing the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underlying the 2018 Draft Budgetary Plan (DBP) forecasts GDP growth at 1.7% in both 2017 and 2018, after 1.1% in 2016 (calendar-adjusted). Compared to the 2017 Stability Programme, the growth projections have been revised up by 0.2 percentage point in both years. Economic activity would be mainly driven by a gradual recovery in exports in a context of accelerating foreign demand and following weak growth in 2016. As imports would decelerate to 3.6% in both 2017 and 2018 (after 4.2% in 2016), the contribution of net exports to growth would become neutral by 2018 (after -0.8 percentage point in 2016). Final domestic demand would decelerate to 1.4% in both 2017 and 2018 (after 2.1% in 2016). Private consumption growth would decline to 1.3% in both 2017 and 2018 (after 2.2% in 2016), due to weak growth in the first quarter of 2017 and in line with household purchasing power in 2018. However, investment would accelerate further, in

particular driven by a sharp rebound in public investment in 2018. Employment growth would decline from 1.0% in 2017 to 0.5% in 2018, as public employment would contract due to the planned decrease in subsidised non-market employment. As a result, the apparent productivity of labour is forecast to accelerate sharply in 2018. Finally, inflation would increase from 0.3% in 2016 to 1.1% in 2017 and to 1.2% in 2018.

Given the GDP growth projections, the output gap as recalculated by the Commission following the commonly agreed methodology stands at -1.2% in 2016 and is expected to gradually close, reaching -0.2% in 2018. The recalculated output gap is smaller than at face value (-0.7% in 2018), given the smaller recalculated estimates for 2016 and the slightly lower potential growth estimated under the commonly agreed methodology in both 2017 and 2018.

Table 1. Comparison of macroeconomic developments and forecasts

	2016	2017			2018		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	1.2	1.5	1.7	1.6	1.5	1.7	1.7
Private consumption (% change)	2.2	1.2	1.3	1.1	1.4	1.3	1.4
Gross fixed capital formation (% change)	2.8	2.7	3.0	3.2	2.7	3.9	3.6
Exports of goods and services (% change)	1.8	3.4	2.5	3.1	3.7	3.9	4.0
Imports of goods and services (% change)	4.2	3.6	3.6	3.9	3.6	3.6	4.0
<i>Contributions to real GDP growth:</i>							
- Final domestic demand	2.1	1.4	1.6	1.6	1.4	1.6	2.0
- Change in inventories	-0.2	0.1	0.4	0.3	0.0	0.1	-0.1
- Net exports	-0.8	-0.1	-0.4	-0.3	0.0	0.0	-0.1
Output gap ¹	-1.2	-1.0	-0.7	-0.8	-0.8	-0.2	-0.2
Employment (% change)	0.6	0.7	1.0	1.0	0.3	0.5	0.9
Unemployment rate (%)	10.1			9.5			9.3
Labour productivity (% change)	0.7	0.7	0.7	0.6	1.1	1.2	0.8
HICP inflation (%)	0.3	1.2	1.1	1.1	1.1	1.2	1.2
GDP deflator (% change)	0.4	0.9	0.8	0.9	1.0	1.1	1.4
Comp. of employees (per head, % change)	1.0	2.0	2.1	1.7	2.2	2.3	2.0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-2.5	-2.5	-2.9	-3.1	-2.5	-2.9	-2.8
Note:							
¹ In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.							
Source:							
<i>Stability Programme 2017 (SP); Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations</i>							

The Commission 2017 autumn forecast projects GDP growth at 1.6% in 2017. However, the Commission forecast is non-calendar adjusted. Calendar adjusted GDP growth is forecast at 1.8% in 2017, according to the autumn forecast, thus slightly higher than in the DBP (by

0.1 percentage point). In 2018, the Commission's GDP forecast is identical to the authorities'. However, the forecast growth in compensation per employee is lower in both 2017 (by 0.4 percentage point) and in 2018 (by 0.3 percentage point).

Overall, the macroeconomic scenario underlying the 2018 Draft Budgetary Plan is cautious in 2017 and plausible in 2018. In its opinion, the High Council of Public Finances (HCFP) considers the government's GDP growth forecast as prudent for 2017 and plausible for 2018. Moreover, the HCFP welcomes the downward revision in the potential growth estimates, compared to the 2017 Stability Programme. However, the HCFP notes that the long term GDP growth forecast are on the high side, as they lead to a positive output gap in 2022 (+1.1% of potential GDP).

Box 1: The macro economic forecast underpinning the budget in France

The High Council for Public Finances (HCPF), the independent monitoring body attached to the French Court of Auditors, adopted on 24 September an opinion on the macroeconomic forecasts underlying the DBP as well as on the underlying budgetary strategy. This opinion is attached to the DBP submitted to the National Assembly, and was made public by the HCFP on its website at the same time. In its opinion¹, the HCPF considers that the macroeconomic scenario underpinning the DBP is prudent for 2017 and reasonable for 2018 regarding the projections for GDP growth, inflation, employment and salary mass. The HCFP nevertheless flagged that the long term GDP growth forecast is on the high side, as it leads to a positive output gap in 2022. Moreover, the HCPF assesses the public finances scenario, pointing to the low level of the adjustment in both 2017 and 2018.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The DBP projects a deficit of 2.9% of GDP for 2017, above the 2.8% of GDP deficit target set forth in the Stability Programme. The revenue-to-GDP ratio is planned to increase by 0.1 percentage point due to higher VAT collection supported by stronger private consumption and higher social security contributions driven by the dynamic wage growth. The expenditure-to-GDP ratio would post a decline of 0.3 percentage point, 0.1 percentage point of which is explained by the decline in the interest burden. Expenditure net of tax credits is projected to grow by 1.8% in nominal terms compared with an average of 1.1% over the period 2013-2016. Lower interest payments would continue to have a dampening effect on expenditure growth and therefore facilitate the achievement of the budgetary objectives. The DBP plans a higher deficit for 2017 compared to the Stability Programme which partly explains why the authorities took EUR 4.2 billion complementary measures after the publication of the June public finances audit report² by the French Court of Auditors. Specifically, the revenues-to-GDP ratio was revised upwards by 0.2 percentage point while the expenditure-to-GDP was increased by 0.4 percentage point to reflect under-budgeting and expenditure slippages as well as the recapitalisation of AREVA for 0.1% of GDP. Pending a decision of Eurostat on the

¹ Cour des Comptes (2017), Avis n° HCFP-2017-4 relatif aux projets de finances et de financement de la sécurité sociale pour l'année 2018.

² Cour des Comptes, La situation et les perspectives des finances publiques, June 2017

accounting treatment of the recapitalisation of AREVA, the operation is highlighted as a risk but not included in the 2017 deficit projection. The Commission 2017 autumn forecast also projects a deficit of 2.9% of GDP in 2017 but the underlying trends are slightly different, namely on local investment, where the Commission sees a stronger public investment in relation to the municipal electoral cycle.

For 2018, the DBP expects the deficit to fall to 2.6% of GDP, 0.3 percentage point above the target of the Stability Programme. The reduction in the deficit would be achieved by further reducing the expenditure-to-GDP ratio by 0.6 percentage point. The overall revenue ratio is set to decrease marginally compared to 2017. The elasticity of the tax burden net of tax measures would be equal to 1. The increase of environmental taxation, the public health taxes on tobacco and the switch from unemployment and health social contributions to the Generalized Social Contribution (CSG) would partially compensate the tax cuts announced by the authorities. Expenditure net of tax credits is set to grow by 1.5% in nominal terms compared to 1.3% growth planned in the Stability Programme. The expenditure to GDP ratio is 0.2 percentage point higher than in the Stability Programme and is mainly due to (i) the adjustments made to reflect higher State spending and stronger investment by local as flagged in the audit report of the French Court of Auditors and to (ii) the measures announced by the new government (see section 3.3). The interest burden was revised downwards by 0.1 percentage point to 1.7% of GDP between the Stability Programme and the 2018 DBP.

The 2017 Commission autumn forecast projects a deficit of 2.9% of GDP in 2018, which is 0.3 percentage point higher than the deficit planned in the DBP. This is due to differences in the discretionary measures that have been taken into account for 0.3% of GDP (see section 3.3). On the revenue side, overall revenues are expected to be broadly in line with the DBP. The most notable difference is on the expected dividend from the central bank of France for 2018 which is EUR 1.1 billion lower in the Commission projections. The dividend from the central bank of France for 2017 has been revised upwards on two occasions, in the 2017 DBP by EUR 0.6 billion and in the 2017 Stability Programme by EUR 0.5 billion. The historical average of the dividend being lower in the years preceding this increase, the Commission considers this upward revision to be of temporary nature. Table 2 presents the composition of the budgetary adjustment. Overall, public expenditure net of tax credits is expected to grow by 1.4% in real terms in the Commission forecast versus 0.5% in the DBP. The difference with the growth rate planned in the DBP is mostly due to more dynamic spending by central and local authorities and stronger social spending in the Commission forecast, which is largely explained by differences in the discretionary measures that have been taken into account (see section 3.3).

In its September opinion, the HCFP flags an upside risk related to stronger than anticipated government revenues in 2017. On the other hand, the HCFP identifies the achievement of the ambitious savings planned at all levels of public administrations as a downside risk for the deficit in 2018. Furthermore, the HCFP stresses the need to respect the expenditure targets in 2018 even if windfall revenues occurred in 2018, given the high structural balance and its slow improvement. While the projections for the revenues are in line with the GDP growth rate, the expenditure growth rates are stricter in 2018 compared to 2017. In the DBP, public expenditure is expected to grow by 0.5% in 2018 in real terms compared to 0.8% in 2017 and respectively by 1.6% in 2018 versus 1.8% in 2017 in nominal terms. The draft finance law for 2018 created a new ceiling for State expenditure, the so-called spending norm for the State, covering a narrower field of expenditure that can be more easily controlled. However,

compared to the previous expenditure ceiling, this norm excludes transfers to the EU budget which are projected to increase in the future. To ensure the respect of this ceiling, the authorities have announced EUR 3.2 billion savings measures on State subsidised contracts and housing allowances, the indexation of pensions and the revalorisation of certain social benefits were delayed, as well as the underfinancing of some of its missions was rectified. The authorities have already lowered the objective to reduce the expenditure to GDP ratio since July as taxes proved to be more dynamic than initially anticipated. Indeed, the preparatory document for the public finance debate published in July put forth a 1 percentage point reduction of the ratio which was later revised to 0.6 percentage point in the 2018 DBP in light of a more positive macroeconomic projection. The ONDAM, the French healthcare spending norm, was revised from 2.1% in 2017 to 2.3% in 2018 and translates into higher savings in absolute terms compared to previous years. The spending norm for local authorities (ODEDEL) is expected to decelerate to 1.2% in 2018 after 1.8% in 2017. From 2018 onwards the authorities seek to implement a new contractual approach to their relation with local authorities whereby the State transfers would be maintained. This is opposed to the years 2014-2017 when the State cut its transfers to local authorities leading the latter to reduce their spending. No correction mechanism in case of expenditure slippages at this government level has been specified so far.

Finally, two major risks weigh on the achievement of the deficit targets for 2017 and 2018. First, there is a risk that the recapitalisation of AREVA will increase the deficit by a higher amount than what the authorities currently envisage in their projection for 2017 (0.1% of GDP). Compared to the DBP, the risk to the Commission 2017 forecast is even greater to the extent that this operation is not included at all. This will depend on whether the operation would show as a one-off measure and also on the assessment made by the national statistics institute and by the decision of Eurostat on the accounting treatment thereof. Second, the total repeal by the French Constitutional Court on 6 October 2017 of the 3% tax on dividends paid by companies subject to the French corporate income tax could have a budgetary impact in the range of EUR 8-10 billion (up to 0.45% of GDP) as soon as 2017 but could also be spread over several years. In line with the DBP, the Commission does not factor the repeal of the tax into its headline forecast, due to the substantial uncertainty regarding the timing and size of the impact, but includes it as a risk to the projection. On 2 November, the amended finance bill for 2017 introduced a new exceptional tax on companies with a turnover above EUR 1 billion which is expected to increase revenues by around EUR 5 billion in 2017. This tax is meant to offset what the authorities estimate would be the budgetary impact in 2017 of the decision of the Constitutional Court on the 3% tax on dividends.

According to the Commission 2017 autumn forecast, under the no-policy change assumption, the deficit is projected to increase to 3.0% of GDP in 2019, just in line with the Treaty reference value.

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in France currently standing at 0.73%³. As a consequence, total interest payments by general government have continued to decrease as a share of GDP. Based on the information included in the DBP, interest expenditure in France is expected to fall from 1.9% of GDP in 2016 to 1.8% in 2017 and projected to reach 1.7% of GDP in 2018, well below the 2.6% recorded back in 2012 at the peak of the euro area sovereign debt crisis. The picture stemming from France's plans is broadly confirmed by the Commission forecast.

³ 10-year bond yields as of November 6 2017. Source: Bloomberg.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2016	2017			2018			Change: 2016-2018
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	53.0	52.9	53.1	53.1	53.0	53.0	53.0	0.0
<i>of which:</i>								
- Taxes on production and imports	16.0	16.1	16.2	16.2	16.1	16.3	16.3	0.3
- Current taxes on income, wealth, etc.	12.5	12.3	12.4	12.4	12.2	12.9	12.8	0.4
- Capital taxes	0.6	0.6	0.6	0.6	0.6	0.5	0.5	-0.1
- Social contributions	18.8	18.8	18.9	18.9	18.8	18.2	18.2	-0.6
- Other (residual)	5.2	5.1	5.0	5.1	5.3	5.1	5.1	-0.1
Expenditure	56.4	55.7	56.1	56.0	55.3	55.5	55.9	-0.9
<i>of which:</i>								
- Primary expenditure	54.5	53.9	54.3	54.2	53.5	53.8	54.2	-0.7
<i>of which:</i>								
Compensation of employees	12.7	12.7	12.7	12.7	12.5	12.5	12.5	-0.2
Intermediate consumption	5.0	4.9	5.0	4.9	4.7	4.9	5.1	-0.1
Social payments	25.9	25.6	25.7	25.7	25.5	25.4	25.4	-0.5
Subsidies	2.6	2.6	2.6	2.6	2.7	2.8	2.8	0.2
Gross fixed capital formation	3.4	3.4	3.3	3.3	3.3	3.5	3.5	0.1
Other (residual)	5.0	4.7	5.0	5.0	4.8	4.7	4.9	-0.3
- Interest expenditure	1.9	1.8	1.8	1.8	1.8	1.7	1.7	-0.2
General government balance (GGB)	-3.4	-2.8	-2.9	-2.9	-2.3	-2.6	-2.9	0.8
Primary balance	-1.5	-1.0	-1.1	-1.1	-0.5	-0.8	-1.2	0.7
One-off and other temporary measures	-0.1	-0.1	-0.1	0.0	-0.1	-0.1	-0.1	0.0
GGB excl. one-offs	-3.3	-2.7	-2.8	-2.8	-2.2	-2.5	-2.9	0.8
Output gap ¹	-1.2	-1.0	-0.7	-0.8	-0.8	-0.2	-0.2	1.0
Cyclically-adjusted balance ¹	-2.7	-2.2	-2.5	-2.4	-1.8	-2.5	-2.8	0.2
Structural balance (SB)²	-2.6	-2.1	-2.4	-2.4	-1.7	-2.4	-2.7	0.2
Structural primary balance ²	-0.7	-0.3	-0.6	-0.6	0.1	-0.7	-1.0	0.0
Notes:								
¹ Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/programme as recalculated by Commission on the basis of the DBP/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 2017 (SP); Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations								

The structural adjustment is set to be small in 2017 and in 2018. The DBP plans an improvement in the (recalculated) structural balance of 0.2% of GDP in 2017 and of 0.0% of

GDP in 2018⁴. In 2017, the change in the structural balance would be below the improvement of 0.9% of GDP required by the EDP recommendation. Concerning 2018, should France be subject to the preventive arm, the fiscal effort is significantly below the required effort of 0.6% of GDP. The change in the structural balance has been revised since the Stability Programme when it was foreseen to improve by 0.4% of GDP in both 2017 and 2018. Against the background of falling interest expenditure, the projected change in the structural balance in 2017 and 2018 (0.2% of GDP in 2017 and -0.4% of GDP in 2018, respectively) is accompanied by a marginally less pronounced improvement in the structural primary balance in 2017 and by a marginally more pronounced deterioration in 2018 (0.2% and -0.4%, respectively).

3.2. Debt developments

The DBP envisages a different trend of the debt-to-GDP ratio vis-à-vis the one included in the 2017 Stability Programme, the latter projecting a decrease already in 2018. Instead the DBP forecasts an increasing debt ratio in 2017, up to 96.8% of GDP which then stabilises the following year. The difference is explained by a higher debt-increasing impact of the primary balance in the DBP as well as by a less favourable contribution of the stock-flow adjustment, despite a higher nominal GDP growth forecast in both years.

Compared to the DBP, also the Commission projects an increasing debt-to-GDP ratio in 2017, although up to a slightly higher level (96.9%), then stabilising in 2018.

In the DBP the debt-to-GDP ratio stabilises between 2017 and 2018 due to a less deteriorating impact of the primary balance and a higher nominal GDP growth which offset a higher debt-increasing contribution of the stock-flow adjustment. The stability of the debt ratio in the Commission forecast stems instead from the compensation in 2018 between a less favourable impact of the primary balance and of the stock-flow adjustment on the one hand and a higher nominal GDP growth rate and lower interest expenditure on the other hand.

The DBP does not provide a breakdown of the various components of the stock-flow adjustment.

⁴ Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

Table 3. Debt developments

(% of GDP)	2016	2017			2018		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio¹	96.5	96.0	96.8	96.9	95.9	96.8	96.9
Change in the ratio	0.7	-0.5	0.3	0.4	-0.1	0.0	0.0
<i>Contributions² :</i>							
1. Primary balance	1.5	1.0	1.1	1.1	0.5	0.8	1.2
2. “Snow-ball” effect	0.4	-0.4	-0.5	-0.6	-0.5	-0.9	-1.2
<i>Of which:</i>							
Interest expenditure	1.9	1.8	1.8	1.8	1.8	1.8	1.7
Growth effect	-1.1	-1.4	-1.6	-1.5	-1.4	-1.6	-1.6
Inflation effect	-0.4	-0.8	-0.7	-0.9	-0.9	-1.1	-1.3
3. Stock-flow adjustment	-1.2	-1.0	-0.3	-0.1	-0.1	0.1	0.1

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

Source:
Stability Programme 2017 (SP); Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the draft budgetary plan

Compared to 2017, the consolidation strategy in the 2018 DBP is more expenditure-based, as the announced tax cuts will be partly compensated by increases in environmental taxation and public expenditure will be reduced by means of targeted savings.

On the revenue side, the main measures are the residence tax relief for the 80% most vulnerable households for EUR 3.0 billion, replacing the wealth tax with a real estate wealth tax for EUR 3.2 billion and the introduction of a single flat-rate levy of 30% on interest income for EUR 1.3 billion. The non-recurring revenue measures introduced in 2017 classified as one-offs in the Commission forecast deteriorate the effort on the revenue side by around EUR 1 billion. Compared to the 2017 DBP, the dividend for 2018 of the French Central Bank has been revised up by EUR 1.1 billion to EUR 2.4 billion, which is significantly above the average dividend in the past years. Finally, the environmental taxation and public health taxes on tobacco have been increased by EUR 2.5 billion in 2018 and the switch from social contributions to the CSG in two stages would increase revenues by EUR 3.5 billion.

On the expenditure side, expenditure growth in 2018 is planned to decrease to 0.5% in real terms from 0.8% in 2017, which is a very ambitious target as also pointed by the HCFP in its opinion on the DBP. The authorities aim now to reduce the expenditure-to-GDP ratio in 2018 by 0.6 percentage point and by a total of 3 percentage points until 2021. The 2018 expenditure target would translate into a decrease of public expenditure by EUR 15 billion at all levels of public administration. The new State expenditure norm covering the overall State spending

was increased by EUR 7.3 billion between 2017 and 2018 to reflect additional spending on priority areas such as security, defence and education and an upward revision of transfers to the EU budget. The DBP revised the healthcare spending norm (ONDAM) from 2.1% to 2.3% which implies EUR 0.4 billion additional expenditure. Finally, the authorities abandon the cut in transfers from the State to local authorities as of 2018, leaving their operational expenditure growth target of 1.2% unanchored by any incentivising mechanism.

The DBP also announces consolidation measures on the State, on healthcare expenditure and on local authorities. The number of State subsidised contracts would be significantly reduced, implying savings of around EUR 1.5 billion, and a significant cut in housing allowances would lead to EUR 2.1 billion additional savings. On the State wage bill, savings of around EUR 2 billion would be facilitated by the reintroduction of one unpaid day in case of illness and by the wage freeze of civil servants together with a reduction in the number of public sector employees. The healthcare spending norm (ONDAM) was increased in 2018 to 2.3% with the underpinning savings reaching EUR 4.2 billion. Nonetheless, as flagged by the *Comité d'alerte de l'ONDAM*, despite allowing for a stronger growth in healthcare spending and including funding measures for EUR 0.5 billion, the dynamism spending for innovating medical treatments and the uncertain nature of some savings call for additional buffers to accommodate in-year expenditure slippages.⁵ The Commission autumn forecast reflects only the above mentioned savings as they were specified in enough detail. Finally, in line with the treatment of savings at the local administration level, the Commission only takes into account EUR 1 billion out of the expected reduction of EUR 3 billion in operational spending. The contractual approach between the State and local representatives has not been defined yet and in case of spending slippages there is no correction mechanism in place.

⁵ *Comité d'alerte de l'ONDAM (2017) Avis du Comité d'alerte n° 2017-3 sur le respect de l'objectif national de dépenses d'assurance maladie*

Table 4. Main discretionary measures reported in the DBP⁶**A. Discretionary measures taken by General Government - revenue side**

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2017	2018	2019
Taxes on production and	0.2	0.2	0.0
Current taxes on income,	-0.3	0.2	0.0
Capital taxes	0.0	0.0	0.0
Social contributions	0.0	-0.7	0.0
Property Income			
Other			
Total	-0.1	-0.3	0.0

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.
Source: Draft Budgetary Plan for 2018

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

France is currently subject to the corrective arm of the Pact. Box 2 recalls the main features of the Excessive Deficit Procedure opened by the Council on 10 March 2015 and the latest country-specific recommendations in the area of public finances.

Box 2. Council Recommendations addressed to France

On 12 June 2017, the Council addressed recommendations to France in the context of the European Semester. In particular, in the area of public finances the Council recommended to ensure compliance with the Council Recommendation of 10 March 2015 under the excessive deficit procedure. The Council also recommended pursuing a substantial fiscal effort in 2018 in line with the requirements of the preventive arm of the Stability and Growth Pact, taking into account the need to strengthen the ongoing recovery and to ensure the sustainability of France's public finances.

The Council recalled that for 2018, should a timely and durable correction be achieved, France would become subject to the preventive arm of the Stability and Growth Pact and to the transitional debt rule. In the light of its fiscal situation and in particular of its debt level, France is expected to further adjust towards its medium-term budgetary objective of a structural deficit of 0.4 % of GDP. According to the commonly agreed adjustment matrix

⁶ Discretionary expenditure measures taken by general Government could not be compiled because the information was not submitted in accordance with the Code of Conduct.

under the Stability and Growth Pact, that adjustment translates into a requirement of a nominal growth rate of net primary government expenditure which does not exceed 1.2 % in 2018. It would correspond to an annual structural adjustment of 0.6 % of GDP.

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 of 2.8% of GDP in 2017. Based on the macroeconomic forecast underlying the Council Recommendation, this was considered consistent with an improvement of the structural balance of 0.5% of GDP in 2015, 0.8% for 2016 and 0.9% in 2017 and would require additional measures of 0.2% of GDP in 2015, 1.2% in 2016 and 1.3% in 2017.

4.1. Compliance with EDP recommendations

Table 5. Compliance with the EDP recommendation

(% of GDP)	2016	2017	
	COM	DBP	COM
Headline balance			
Headline budget balance	-3.4	-2.9	-2.9
EDP requirement on the budget balance	-3.4	-2.8	
Fiscal effort - change in the structural balance			
Change in the structural balance ¹	0.1	0.2	0.2
Cumulative change ²	0.4	0.6	0.6
Required change from the EDP recommendation	0.8	0.9	
Cumulative required change from the EDP recommendation	1.3	2.2	
Fiscal effort - adjusted change in the structural balance			
Adjusted change in the structural balance ³	-0.1	-	0.2
of which:			
<i>correction due to change in potential GDP estimation (α)</i>	0.1	-	0.1
<i>correction due to revenue windfalls/shortfalls (β)</i>	0.3	-	0.1
Cumulative adjusted change ²	0.3	-	0.6
Required change from the EDP recommendation	0.8	0.9	
Cumulative required change from the EDP recommendation	1.3	2.2	
Fiscal effort - calculated on the basis of measures (bottom-up approach)			
Fiscal effort (bottom-up) ⁴	0.5	-	0.7
Cumulative fiscal effort (bottom-up) ²	0.3	-	1.1
Requirement from the EDP recommendation	1.2	1.3	
Cumulative requirement from the EDP recommendation	1.4	2.7	
<i>Notes</i>			
¹ Structural balance = cyclically-adjusted general government balance excluding one-off measures. Structural balance based on DBP is recalculated by the Commission on the basis of the Draft Budgetary Plan scenario using the commonly agreed methodology. Change compared to t-1.			
² Cumulated since the first year for correction in 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 recommendation.			
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.			
<i>Source:</i>			
<i>Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations.</i>			

The DBP plans to bring the headline deficit from 3.4% of GDP in 2016 to 2.9% in 2017, slightly above the general government deficit of 2.8% of GDP recommended by the Council.

Based on the information in the DBP, the Commission autumn forecast expects the headline deficit to be at 2.9% of GDP, slightly above the recommended target in 2017 but still below the Treaty threshold of 3% of GDP. Although the Commission 2017 autumn forecast appears in line with the target in the DBP for 2017, the Commission's projections, contrary to the DBP, do not incorporate the budgetary effect of the AREVA's recapitalisation as a final decision by Eurostat on its statistical recording is still pending. However, this budgetary

impact might amount to between 0.1% and 0.2% of GDP, thereby representing a risk of the timely correction of the excessive deficit. Another risk to the timely correction relates to the reimbursement of the 3% tax on dividends, following the decision of the French Constitutional Court. While the timing and the exact amount of the reimbursements and arrears interest are still unknown, this element represents a clear risk for the 2017 headline deficit too.

The projected structural adjustment remains well below the target recommended by the Council in 2017. While the EDP recommendation requires France to achieve an improvement in the structural balance of 0.9% of GDP in 2017, the DBP foresees an improvement in the (recalculated) structural balance of 0.2% of GDP in 2017. The Commission forecast also points to an expected improvement in the structural balance by a similar magnitude in 2017. While the headline deficit is projected to fall below the Treaty reference value of 3% in 2017, the adjustment in the structural balance is set to fall short of recommended effort by the Council by a wide margin. This situation calls for a careful analysis of the fiscal effort based on the improvement in the adjusted structural balance and on the amount of measures taken.

The careful analysis based on the Commission 2017 autumn forecast, in terms of both an assessment of the adjusted change in the structural balance ('top-down' approach) and of the amount of measures planned ('bottom-up' approach), also shows that the fiscal effort is expected to fall short of the level recommended by the Council. For 2017, the careful analysis confirms that the fiscal effort falls significantly short of the effort recommended by the Council. The adjusted structural balance, that corrects for changes in potential growth and revenue windfalls since the recommendation, is projected to improve by 0.2% of GDP, falling well short of the improvement of 0.9% of GDP recommended by the Council. In turn, the additional bottom-up fiscal effort is estimated at 0.7% of GDP, which also falls short of the 1.3% of GDP recommended by the Council. In cumulative terms, the effort would amount to 0.6% in terms of the top-down approach and to 1.1% of GDP according to the bottom-up metric over 2015-2017. These cumulative efforts also fall short of the recommended cumulative effort over the period by 1.6% of GDP according to both metrics.

Accordingly, based on an overall assessment of the DBP, France's headline deficit reduction below the 3% of GDP reference value in the Treaty in 2017 appears within reach, although with little or no margin. The budgetary impact of AREVA's recapitalisation and the reimbursement of the 3% tax on dividends stand out as clear risks for the timely correction of the excessive deficit.

4.2. Compliance with the debt criterion

Should the excessive deficit be corrected in 2017, as its debt ratio is projected to be at 96.8% of GDP in 2017 according to the DBP, France would be in the transition period for the following three years to make sufficient progress towards compliance with the debt reduction benchmark. This implies that, during this period, it is required to make sufficient progress towards compliance with the debt reduction benchmark at the end of the transition period, as defined by the minimum linear structural adjustment (MLSA).

According to the information provided in the DBP, the recalculated change in the structural balance would be at 0.0% of GDP in 2018, which falls short of the required MLSA of 0.4% of

GDP. Such deviation exceeds ¼% of GDP, thereby exceeding the room for manoeuvre embedded in the rule.

Based on the Commission forecast, the structural balance is projected to deteriorate by 0.4% of GDP in 2018, which implies a substantial deviation from the required improvement by 0.8% of GDP under the MLSA. The projected deviation according to the Commission forecast exceeds ¼% of GDP and the remaining annual structural adjustment exceeds ¾% of GDP. For both reasons, France would exceed the room for manoeuvre embedded in the rule.

The discrepancy between the projections in the DBP and the Commission forecast for 2018 stems from a number of expenditure-saving measures, for which at the cut-off date of the forecast, are not sufficiently backed by sufficiently detailed measures.

Consequently, France is projected to be in transition period and, based on an overall assessment of the draft budgetary plan, is not projected to make sufficient progress towards compliance with the debt reduction benchmark in 2018.

Table 6. Compliance with the debt criterion*

	2016	2017			2018		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio	96.5	96.0	96.8	96.9	95.9	96.8	96.9
Gap to the debt benchmark ^{1,2}					n.r.	n.r.	n.r.
Structural adjustment ³	0.1	0.4	0.2	0.2	0.4	0.0	-0.4
<i>To be compared to:</i>							
Required adjustment ⁴						n.a.	0.4
Notes:							
¹ Not relevant for Member States that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.							
² Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.							
³ Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.							
⁴ Defines the remaining minimum annual structural adjustment over the transition period which ensures that – if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP) budgetary projections for the previous years are achieved.							
<i>Source:</i> Stability Programme 2017 (SP); Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations							

* An ex-ante assessment of planned compliance with the debt criterion can be based on the DBP only for the concerned countries providing extended data series (i.e. covering years up to t+4) in the DPB on a voluntary basis, as agreed at the EFC-A on 22 September 2014 and reflected in the updated Code of Conduct of the two-pack..

4.3. Adjustment towards the MTO

Should France achieve a timely and durable correction of the excessive deficit, from 2018 on the country would be subject to the provisions of the preventive arm of the Stability and Growth Pact and to the provisions ruling the 3-year transition period to comply with the debt rule. According to the information provided in the Draft Budgetary Plan, the nominal growth rate of government expenditure, net of discretionary revenue measures, in 2018 will exceed the applicable expenditure benchmark rate⁷ of 1.2%, leading to a deviation of 0.5% of GDP (see Table 7). In turn, the recalculated change in the structural balance is estimated at 0.0% of GDP, falling short of the required adjustment to be on an appropriate convergence path towards the MTO by 0.6% of GDP, thus pointing to significant deviation. This calls for an overall assessment.

The difference by 0.1% of GDP lower effort shown by the change in the in the structural balance stems from the projected revenue windfalls (estimated at 0.2% of GDP), that are more than offset by the projected increase in public investment above its four-year average in 2018. Unwinding these effects would point to an adjustment gap by 0.5 % of GDP as shown by the expenditure benchmark. Accordingly, the overall assessment, based on data in the DBP, would point to a risk of significant deviation from the recommended adjustment path towards the MTO in 2018.

Based on Commission 2017 autumn forecast, both pillars also highlight a risk of significant deviation from the adjustment towards the MTO. The nominal growth of government expenditure, net of discretionary revenue measures and one-offs, is projected to exceed the applicable expenditure benchmark by 0.9% of GDP. Likewise, the structural balance is projected to deviate by 1.0% of GDP with respect to the required improvement of 0.6%. This calls for an overall assessment. The difference between the two pillars is actually marginal, below 0.1% of GDP. The change in the structural balance is positively affected by projected revenue windfalls, the different potential GDP and the different deflator with respect to the expenditure benchmark (estimated at 0.1% of GDP each), which are mainly offset by the expected cyclical pick-up in public investment (0.3% of GDP). Accordingly, the overall assessment would point to a risk of significant deviation from the recommended adjustment path towards the MTO in 2018, thereby confirming the conclusion reached from figures in the DBP.

⁷ As part of the agreement on the EFC Opinion on "Improving the predictability and transparency of the SGP: a stronger focus on the expenditure benchmark in the preventive arm", which was adopted by the EFC on 29 November 2016, the expenditure benchmark, that is the maximum allowable growth rate of expenditure net of discretionary revenue measures, is expressed in nominal terms as from 2018.

Table 7: Compliance with the requirements of the preventive arm

(% of GDP)	2018	
Initial position¹		
Medium-term objective (MTO)	-0.4	
Structural balance ² (COM)	-2.7	
Structural balance based on freezing (COM)	-	
Position vis-a-vis the MTO³	Not at MTO	
(% of GDP)	2018	
	DBP	COM
Structural balance pillar		
Required adjustment ⁴	0.6	
Required adjustment corrected ⁵	0.6	
Change in structural balance ⁶	0.0	-0.4
<i>One-year deviation from the required adjustment⁷</i>	-0.6	-1.0
<i>Two-year average deviation from the required adjustment⁷</i>	n.a. in EDP	
Expenditure benchmark pillar		
Applicable reference rate ⁸	1.2	
<i>One-year deviation adjusted for one-offs⁹</i>	-0.5	-0.9
<i>Two-year average deviation adjusted for one-offs⁹</i>	n.a. in EDP	
<i>PER MEMORIAM: One-year deviation¹⁰</i>	-0.5	-0.9
<i>PER MEMORIAM: Two-year average deviation¹⁰</i>	n.a. in EDP	
Conclusion		
Conclusion over one year	Significant deviation	Significant deviation
Conclusion over two years	n.a. in EDP	
Notes		
¹ The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.		
² Structural balance = cyclically-adjusted government balance excluding one-off		
³ Based on the relevant structural balance at year t-1.		
⁴ Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).		
⁵ Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.		
⁶ Change in the structural balance compared to year t-1. Ex post assessment (for 2016) was carried out on the basis of Commission 2017 spring forecast.		
⁷ The difference of the change in the structural balance and the corrected required adjustment.		
⁸ Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.		
⁹ Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.		
¹⁰ Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.		
Source: Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations.		

The Commission Communication on the 2017 European Semester of May 2017⁸ stated that the Commission stands ready to use its margin of appreciation in cases where the impact of a large fiscal adjustment on growth and employment is particularly significant. The country-specific recommendations adopted by the Council on 11 July 2017 mentioned that the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances. Box 3 presents a qualitative assessment of the strength of the recovery in France while giving due consideration to its sustainability challenges.

Box 3. Assessment of the cyclical situation of France

France does not face short-term sustainability challenges. However, government debt is projected at around 96.9% of GDP in 2017 and sustainability risks are considered to be high in the medium term, as highlighted by the S1 sustainability indicator gauged in Spring 2017, which measures sustainability risks at horizon 2031. This indicator implies that a cumulative gradual improvement in the French structural primary balance of 4.7 percentage points of GDP, relative to the baseline scenario, would be required over 5 years to reduce the debt ratio to 60 % of GDP by 2031. The high medium-term sustainability risks stem from a high initial indebtedness and an unfavourable initial budgetary position, whereas the projected increase in age-related public spending is set to have a very limited budgetary impact at that horizon.

The recovery in France does not appear fragile. According to the 2017 autumn forecast, GDP growth is expected to reach 1.7% in 2018, still below the euro area average but well above the estimated potential growth of 1.2%. As a result, the output gap is closing rapidly and is expected to stand at -0.2% in 2018. The capacity utilisation rate increased to 84.4% in the third quarter of 2017 above its long-term historical average. Moreover, the investment-to-GDP ratio increased to 22.0% in 2016, also above its historical average, in particular driven by non-construction investment which reached its highest point since 2001 as a share of GDP. The unemployment rate is on a declining path since 2015, thanks to strong employment growth, reaching 9.5% in the second quarter of 2017 compared to an average of 9.1% over 1996-2007. However, involuntary part-time work as a share of total part-time employment continues to increase, pointing to some additional spare capacity in the labour market. Finally, inflation remains subdued, with core inflation expected to average 0.6% in 2017 and 1.2% in 2018, thus remaining below the ECB target. Overall, available indicators suggest that the French economy, while still experiencing some degree of slack, is experiencing a non-fragile recovery.

In these circumstances, the impact of the fiscal adjustment of 0.6% of GDP derived from the matrix on growth and employment is not expected to be particularly significant.

Overall, France does not face short-term sustainability challenges although in the medium term the overall risks to fiscal sustainability are assessed as high. The recovery in France does not appear fragile. In particular, GDP is projected to keep growing well above potential,

⁸ <https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-specific-recommendations-commission-recommendations-communication.pdf>

although below the euro area average, and accordingly the output gap is closing rapidly. The capacity utilisation rate and the investment-to-GDP ratio are above their historical averages. In turn, the unemployment rate keeps going down thanks to strong employment growth.

Taking that into account in the overall assessment, France's Draft Budgetary Plan appears to plan still a significant deviation from the required adjustment towards the MTO. This assessment is confirmed also on the basis of the Commission autumn forecast.

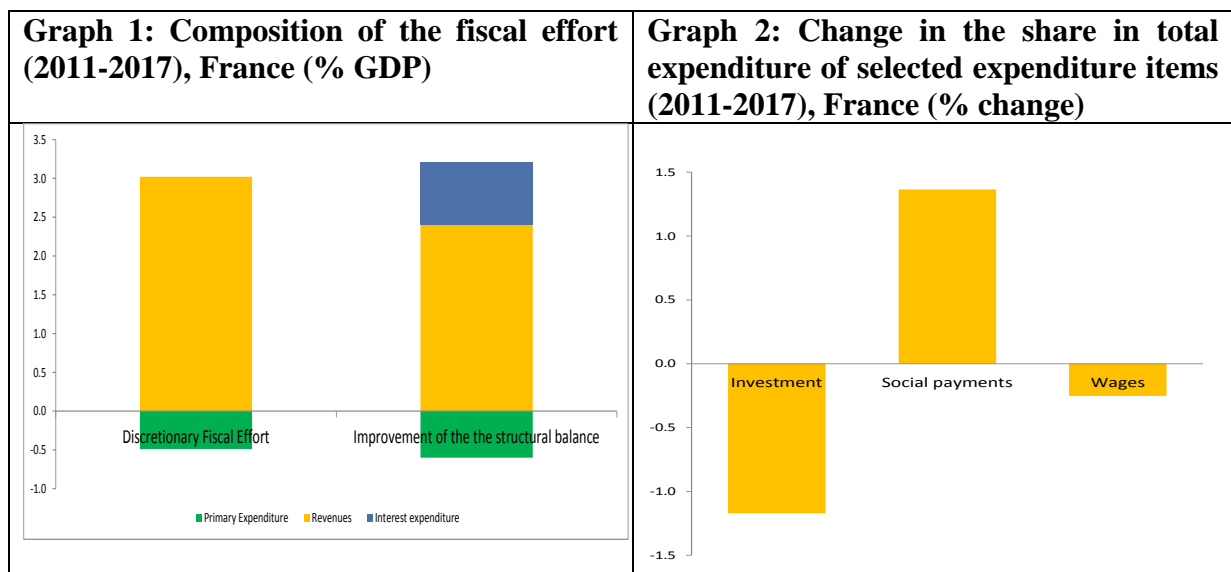
5. COMPOSITION OF PUBLIC FINANCES AND IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

The DBP announces a fiscal consolidation strategy centred on the containment of expenditure in real terms in order to finance lasting tax cuts over a five-year period.

Excluding tax credits, public expenditure's growth in real terms is projected to decelerate significantly compared to the past and to reach on average 0.4% per year between 2017 and 2022. Over the same period the DBP projects a cut of more than 1 percentage point of GDP in the tax burden excluding tax credits.

The approach envisaged differs from the past adjustment. Since 2011 both the discretionary fiscal effort and the improvement of the structural balance have been strongly relying on the contribution of revenue-increasing measures (see Graph 1). The DBP projects a reduction of the expenditure-to-GDP ratio including tax credits, from 56.4% to 56.1% of GDP between 2016 and 2017 and by further 0.6 percentage point the following year, to reach a level of 55.5% in 2018. On the revenues side the ratio is instead expected to remain fairly stable, returning to 53% of GDP in 2018 after a marginal increase in 2017 (see Table 2).

The DBP projects an increase of public investment by 0.2 percentage point of GDP between 2017 and 2018, up to a level of 3.5%, above the euro area average of 2.6%. This implies a first increase of the share of public investment in total expenditure after several years in which it overall decreased by 1.2 percentage points, in particular due to the contraction of investment at the level of local authorities. The projected increase in investment is associated with the announced deployment by the government of the so-called Great Investment Plan (*Grand Plan d'Investissement public*). As a part of the broader economic strategy presented in the DBP, the five-year plan is aimed at channelling resources towards the priorities identified under four main pillars, namely: ecological transition; creation of a skill-based society; competitiveness and innovation; government's digitalisation. While most of the impacts in terms of growth and job creation are expected beyond 2018, the Plan is not expected to have a distinct budget but will rely on a share of the allocations earmarked either to a ministry, to the *Programme d'investissements d'avenir* (PIA) or to social security.



Source:

Draft Budgetary Plans 2018, European Commission 2017 autumn forecast.

Note:

Graph 1 shows the Discretionary Fiscal Effort (DFE) which combines a top-down approach on the expenditure side with a bottom-up or narrative approach on the revenue side. In a nutshell, the DFE consists of the increase in primary expenditure net of cyclical components relative to economic potential on the one hand, and of discretionary revenue measures on the other hand.

See European Commission (2013): Measuring the fiscal effort, Report on Public Finances in EMU, part 3 http://ec.europa.eu/economy_finance/publications/european_economy/2013/pdf/ee-2013-4.pdf

In the context of the 2017 European Semester, France was issued the recommendation to "Comprehensively review expenditure items with the aim to make efficiency gains that translate into expenditure savings". In response to this recommendation, the DBP envisages a discontinuation of the most recent approach followed and foresees the inclusion of the expenditure review efforts under the broader "Public Action 2022" initiative, aimed at an ambitious and coordinated overhaul of public action's scope and methods at all levels of general government.

France was also issued the recommendation to "Broaden the overall tax base and take further action to implement the planned decrease in the corporate income statutory rate". In this respect, the DBP confirms the already planned reduction of corporate income tax rate to 28% for all companies by 2020 although via a new trajectory which is also extended to further reduce the statutory rate down to 25% in 2022. The reduced rate of 15% for SMEs will continue to apply. The measure, with a total budgetary impact of about EUR 11 billion is considered as beneficial in order to improve the growth-friendliness of the French tax structure and to promote investment. Similar beneficial impacts are also expected from specific measures aimed at reducing the tax wedge on labour (see Box 4).

Further measures specifically addressed to support investment are the replacement in 2018 of the wealth tax (*Impôt sur la fortune, ISF*) by a tax on real estate assets (*Impôt sur la Fortune Immobilière, ISF*) and the introduction in 2018 of a single flat-rate levy on capital income, including social levies (*Prélèvement Forfaitaire Unique, PFU*) of 30%.

The DBP also foresees tax cuts expected to increase purchasing power of households, therefore to sustain domestic demand and growth. In particular, the most significant measure,

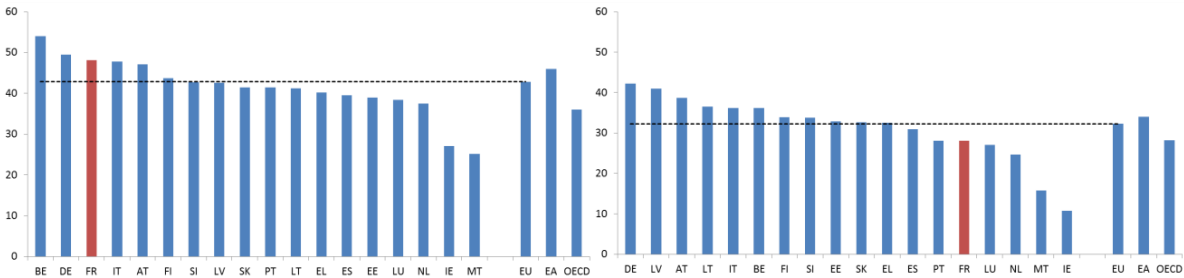
with a budgetary impact over three years of about EUR 10 billion is the phasing out as from 2018 of the residence tax (*taxe d'habitation*) for 80% of households.

Box 4 – Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to benchmark euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker's net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in France for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

The tax burden on labour in France at the average wage and at low wage (2016)



Notes: No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

Benchmarking is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

In the context of the 2017 European Semester, France was issued the recommendation to "Consolidate the measures reducing the cost of labour to maximise their efficiency in a budget neutral manner and in order to scale up their effects on employment and investment. Broaden the overall tax base (...)".

France's Draft Budgetary Plan contains two main measures that affect the tax wedge on labour:

- As already foreseen, the rate of the tax credit for employment and competitiveness (*Crédit d'impôt pour la compétitivité et l'emploi, CICE*) is increased from 6% to 7% in 2017,

implying a reduction of the tax wedge on labour in 2018. The rate will then be decreased again from 7% to 6% in 2018 and the CICE will be transformed as of 1 January 2019 into a permanent reduction of employers' contributions, targeted to payroll salaries below 2.5 times the statutory minimum wage (Smic). The permanent reduction will broaden the scope of the CICE by being extended also to businesses and sectors currently subject to a specific scheme, the payroll tax credit (*Crédit d'impôt sur la taxe sur les salaires, CITS*) which will be abolished. Due to the transformation in 2019 companies will benefit both from the CICE accrued in 2018 (although at a reduced rate) as well as from the newly established reduction of contributions. The overall amount is estimated by the authorities in the Multi-annual Public Finances Programming Law for 2018-2022 at around EUR 21 billion (1% of GDP), which could support the creation of 35 000 and 70 000 jobs in 2019 and 2020, respectively⁹.

- The employees' social contributions for health and unemployment insurance in the private sector will be eliminated in two steps as of 1 January 2018. In parallel, contributions for family benefits and health insurance of self-employed workers will be reduced for lower incomes. The envisaged tax cut will be fully financed through an increase of 1.7 percentage points in social security contribution (*Contribution Sociale Généralisée, CSG*). Overall, the measure will imply a neutral fiscal impact from 2019 onwards as well as a broadening of the tax base financing social security.

6. OVERALL CONCLUSION

Based on the Commission 2017 autumn forecast, France is expected to achieve a headline deficit of 2.9% in 2017 which is the deadline to correct the excessive deficit. While still below the 3.0% of GDP Treaty reference threshold, the recommended headline deficit target of 2.8% of GDP is projected to be missed.

At the same time, the Commission expects that the structural effort in 2017 will fall significantly short of the required effort in the Council Recommendation of 10 March 2015. Overall, the budgetary strategy is largely nominalist, based on the low interest rate environment and improving cyclical conditions, which entails risks to the timely and durable correction of the excessive deficit by 2017.

Should France achieve a timely and durable correction of the excessive deficit, from 2018 on the country would be subject to the provisions of the preventive arm of the Stability and Growth Pact and to the provisions ruling the 3-year transition period to comply with the debt rule. Following an overall assessment of the DBP, there is a risk of significant deviation from the adjustment path towards the MTO as the planned structural adjustment is below the required adjustment path towards the MTO in 2018. Moreover, the structural improvement in 2018 falls short of the minimum linear structural adjustment to ensure sufficient progress towards compliance with the debt criterion.

⁹ Plan d'actions pour l'investissement et la croissance des entreprises, Sep 2017
http://www.gouvernement.fr/sites/default/files/contenu/piece-jointe/2017/09/dossier_de_presse_-_plan_dactions_pour_linvestissement_et_la_croissance_-_11.09.2017.pdf

Annex. EDP related tables

Table A1. Forecast of key macroeconomic and budgetary variables under the baseline scenario

<i>% of GDP</i>	2014	2015	2016	2017	EDP DDL
Real GDP growth (%)	0.4	1.0	1.8	1.8	1.8
Nominal GDP growth (%)	1.1	1.8	2.8	3.3	3.3
Potential GDP growth (%)	1.0	1.0	1.1	1.2	1.2
Structural balance (in % of pot. output)	-2.9	-2.6	-3.0	-3.3	-3.3
General government balance (in % of GDP)	-4.3	-4.1	-4.1	-4.1	-4.1
<i>p.m Output gap (% of pot. Output)</i>	-2.3	-2.3	-1.6	-1.1	-1.1
<i>Source: Commission Staff Working Document accompanying the Recommendation for a Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in France (COM(2015) 115 final)</i>					

Table A2. Forecast of key macroeconomic and budgetary variables under the EDP scenario

<i>% of GDP</i>	2014	2015	2016	2017	EDP DDL
Real GDP growth (%)	0.4	0.8	0.7	0.8	0.8
Nominal GDP growth (%)	1.1	1.6	1.6	2.3	2.3
Potential GDP growth (%)	1.0	1.0	1.1	1.2	1.2
Structural balance (in % of pot. output)	-2.9	-2.4	-1.5	-0.7	-0.7
General government balance (in % of GDP)	-4.3	-4.0	-3.4	-2.8	-2.8
Variation in structural balance (in % of pot. output)	0.4	0.5	0.8	0.9	0.9
<i>p.m Output gap (% of pot. output)</i>	-2.3	-2.5	-2.9	-3.4	-3.4
<i>Source: Commission Staff Working Document accompanying the Recommendation for a Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in France (COM(2015) 115 final)</i>					

Table A3. Forecast of key variables for the computation of the fiscal effort under the baseline scenario

			2014	2015	2016	2017
Enters top-down	α	Structural expenditure (% of potential GDP)	56.4%	56.4%	56.4%	56.4%
		Potential GDP growth (%)	1.0%	1.0%	1.1%	1.2%
	β	Current revenue (national currency)	1135.6	1156.0	1181.8	1216.5
		Discretionary measures with impact on current revenue (national currency)	12.4	2.5	-2.9	-4.3
		Nominal GDP growth (%)	1.1%	1.8%	2.8%	3.3%
		p.m Elasticity on current revenue	0.8	0.9	0.9	1.0
	p.m Output gap (% of Pot. Output)	-2.3%	-2.3%	-1.6%	-1.1%	
Enters bottom-up		Discretionary measures with impact on total revenue net of one-offs and other temporary measures (national currency)	15.9	4.4	-2.0	-4.3
		Total expenditure net of one-offs and other temporary measures (national currency)	1234.7	1252.5	1281.9	1321.0
		Interest expenditure (national currency)	46.8	47.4	49.8	53.3
		Total unemployment	3021.3	3054.3	3012.0	2847.4
		Unemployment benefits (national currency)	40.8	40.5	40.0	37.8
		Investment expenditure matched by EU funds (national currency)	0.0	0.0	0.0	0.0

Source: Commission Staff Working Document accompanying the Recommendation for a Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in France (COM(2015) 115 final)

Table A4. Adjustment of apparent structural effort for the revision in potential growth – details of calculation

FR	Potential GDP growth underlying the Council Recommendation (%)	Potential GDP growth in Autumn Forecast (%)	Forecast error (%)	Structural expenditure (% of potential GDP)	Correction coefficient α (% of potential GDP)
	(1)	(2)	(3)=(1)-(2)	(4)	(5)=(3)*(4)/100
2015	1.0	0.9	0.0	56.2	0.0
2016	1.1	1.0	0.1	55.8	0.1
2017	1.2	1.2	0.1	55.6	0.1

Table A5. Adjustment of apparent structural effort for the revision in revenue shortfalls/windfalls – details of calculation

FR	Change in current revenues (yoy) (billions)		Discretionary current revenue measures (billions)		Nominal GDP growth assumptions (%)		Current revenues in year t-1 (billions)		Revenue gap (billions)*	Correction coefficient β (% of potential GDP)
	recom.	assessment	recom.	assessment	recom.	assessment	recom.	assessment		
	(1)	(1')	(2)	(2')	(3)	(3')	(4)	(4')	(5)=[(1')-(2')- ϵ *(3')*(4')]-[(1)-(2)- ϵ *(3)*(4)]	
2015	20.4	20.4	2.5	1.8	1.8	1.9	1135.6	1136.3	-0.5	0.0
2016	25.8	17.3	-2.9	-4.1	2.8	2.1	1156.0	1156.7	1.3	0.1
2017	34.7	28.7	-4.3	2.5	3.3	2.1	1181.8	1174.0	1.3	0.1