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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 2020 on 15 October 2019 in compliance with Regulation (EU) No 473/2013. France is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term budgetary objective .

As the debt ratio was 98.4% of GDP in 2017 (the year in which France corrected its excessive deficit), exceeding the 60% of GDP reference value, during the three years following the correction of the excessive deficit France is also subject to the transitional arrangements to make sufficient progress towards compliance with the debt reduction benchmark.

While the Draft Budgetary Plan for 2020 broadly complies with the formal requirements of the Code of Conduct, employment projections in terms of hours worked, necessary to estimate potential growth, were not provided at the time of the submission.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2019 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 2019 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 2019-2020 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations in the context of the European Semester adopted by the Council in July 2019, including those to reduce 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 2020 Draft Budgetary Plan forecasts GDP growth at 1.4% in both 2019 and 2020[1], after 1.7% in 2018. Compared to the 2019 Stability

[1] Not calendar-adjusted. Calendar-adjusted growth is set to reach 1.4% in 2019 and 1.3% in 2020. The 2020 Draft Budgetary Plan do not provide not calendar-adjusted figures for the GDP components. The growth rates mentioned thereafter for GDP components are hence calendar-adjusted.

Programme, the GDP growth projection remains unchanged in 2019 and has been revised down by 0.1 percentage points in 2020.

Economic activity grew by 0.3% in the first three quarters of 2019. Investment remained buoyant, while private consumption showed mild growth. The contribution of net exports to economic activity growth was subdued.

According to the 2020 Draft Budgetary Plan, households are expected to support GDP growth in 2019 and 2020. Private consumption is forecast to grow by 1.2% in 2019 and 1.4% in 2020, after 0.9% in 2018, strongly supported by robust job creation, as well as by labour and purchasing power adjustment measures.

Table 1. Comparison of macroeconomic developments and forecasts

	2018	2019			2020		
	COM	**SP**	**DBP**	**COM**	**SP**	**DBP**	**COM**
Real GDP (% change)[1]	1.7	1.4	1.4	1.3	1.4	1.3	1.3
Private consumption (% change)	0.9	1.6	1.2	1.1	1.3	1.4	1.4
Gross fixed capital formation (% change)	2.8	2.1	2.9	2.7	1.4	2.0	1.9
Exports of goods and services (% change)	3.5	2.4	2.3	2.2	2.7	2.5	2.2
Imports of goods and services (% change)	1.2	2.4	2.2	2.1	2.3	2.5	2.4
Contributions to real GDP growth:							
- Final domestic demand	1.3	1.6	1.5	1.4	1.3	1.4	1.4
- Change in inventories	-0.3	-0.1	-0.2	-0.2	0.0	0.0	-0.1
- Net exports	0.7	0.0	0.0	0.0	0.1	0.0	-0.1
Output gap[2]	0.5	0.4	0.8	0.7	0.5	0.9	0.8
Employment (% change)	1.0	0.6	0.9	1.0	0.5	0.6	0.7
Unemployment rate (%)	9.1			8.5			8.2
Labour productivity (% change)	0.8	0.9	0.5	0.2	0.9	0.7	0.5
HICP inflation (%)	2.1	1.3	1.3	1.3	1.3	1.3	1.3
GDP deflator (% change)	0.8	1.2	1.3	1.4	1.2	1.2	1.2
Comp. of employees (per head, % change)	1.8	0.2		-0.2	1.7		1.4
Net lending/borrowing vis-à-vis the rest of	-0.5	-0.5	-0.4	-0.4	-0.3	-0.3	-0.5

Note:

[1]Calendar-adjusted in the SP and the DBP (GDP and GDP components), not calendar-adjusted in the Commission forecast.

[2]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:

Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

Other supporting factors include ongoing high business investment, which is set to grow by 3.3% in 2019 and 2.7% in 2020. In a less buoyant international environment, net exports are no longer forecast to support GDP growth in 2019 and 2020, with a neutral contribution to GDP growth in both years. Employment growth would remain broadly stable in 2019 compared to the previous year, at 0.9%, and decrease to 0.6% in 2020. After an important increase in job creation at the end of 2018 and the beginning of 2019, the productivity of

labour is forecast to decrease temporarily in 2019. Finally, inflation is forecast to decrease from 2.1% in 2018 to 1.3% in 2019 as the rises in oil prices and tobacco and environmental taxes slow down before stabilising at this level in 2020.

Given the GDP growth projections, the output gap as recalculated by the Commission following the commonly agreed methodology stands at 0.5% in 2018, 0.8% in 2019 and 0.9% 2020. The recalculated output gap is higher than the one at face value in the Draft Budgetary Plan (0.0% in 2019 and 0.1% in 2020), given the higher recalculated estimates for 2018 and the slightly lower potential growth estimated under the commonly agreed methodology (-0.1 percentage point).

The Commission 2019 autumn forecast projects GDP growth at 1.3% in 2019, slightly below the projection of the 2020 Draft Budgetary Plan (1.4%). Gross fixed capital formation and private consumption growth are more favourable in the Draft Budgetary Plan in 2019, while the net trade contribution to growth is in line with the Commission's forecast. In 2020, the Commission's GDP forecast is again slightly lower than the one of the authorities, at 1.3% (against 1.4% in the Draft Budgetary Plan, not calendar adjusted), with a more cautious contribution from net trade. The slowdown in employment growth in 2020 is in line with the autumn forecast.

Overall, the macroeconomic scenario underlying the 2020 Draft Budgetary Plan is plausible and broadly in line with the Commission's forecast in 2019 and 2020. In its opinion, the High Council of Public Finances considers the government's GDP growth forecast is within reach for 2019 and plausible for 2020.

Box 1: The macroeconomic forecast underpinning the budget in France

The High Council of Public Finances, the independent monitoring body attached to the French Court of Auditors, adopted on 23 September an opinion on the macroeconomic forecasts underlying the Draft Budgetary Plan as well as on the underlying budgetary strategy. This opinion is attached to the Draft Budgetary Plan submitted to the National Assembly, and was made public by the High Council of Public Finances on its website on 27 September. In its opinion[2], the High Council of Public Finances considers that the macroeconomic scenario underpinning the Draft Budgetary Plan is within reach for 2019 and plausible for 2020 regarding the projections for GDP growth. The High Council of Public Finances assess the inflation, employment and salary mass forecasts as coherent with the available information for 2019 and as reasonable for 2020. The High Council of Public Finances nevertheless flagged the growing uncertainty surrounding the external environment scenario (especially related to the possibility of a Brexit without a deal at that time). Moreover, the High Council of Public Finances assesses as plausible the public finances scenario (see section 3.1).

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The Draft Budgetary Plan projects a headline deficit of 3.1% of GDP in 2019, unchanged compared to the deficit target put forward in the Stability Programme of April 2019 and in

[2] Haut Conseil des Finances Publiques (2019), Avis n° HCFP-2019-3 relatif aux projets de finances et de financement de la sécurité sociale pour l'année 2020.

line with the Commission 2019 autumn forecast. All three sets of projections include the one-off impact of about 0.9% of GDP stemming from the transformation of the CICE (*crédit d'impôt pour la compétitivité et l'emploi*) into a permanent cut in employers' social contributions.

The revenue-to-GDP ratio, planned at 52.5% of GDP in the Draft Budgetary Plan, remains almost stable compared to the Stability Programme, without significant differences in terms of revenue categories. The ratio is identical to the one tabled in the Commission forecast, although resulting from a slightly different composition of revenue categories. In particular, given a broadly consistent macroeconomic outlook, compared to the Commission forecast, the Draft Budgetary Plan posts a faster increase in proceeds from indirect taxation, compensated by less dynamic receipts from direct taxation.

The overall expenditure-to-GDP ratio and the split across expenditure categories posted in the Draft Budgetary Plan are in line with the projections in both the Stability Programme and the Commission 2019 autumn forecast. In 2019, the Draft Budgetary Plan projects a growth of expenditure net of tax credits by 2.1% in nominal terms, which corresponds to a 0.8% increase in real terms using the GDP deflator.

For 2020, the Draft Budgetary Plan projects a deficit at 2.2% of GDP. While the marked decrease vis-à-vis 2019 clearly reflects the end of the one-off impact associated to the transformation of the CICE, the target is 0.2 percentage points above the one set in the Stability Programme. No reason is explicitly provided in the Draft Budgetary Plan explaining the change. The deterioration seems to come, on the one hand, from a lower projected economic growth and, on the other hand, from the inclusion of the measures announced in April by the French President, following the Grand Débat and as a further response to the 'yellow vests' movement. After partial compensation, these measures have a deficit-increasing impact of about 0.1% of GDP.

Overall, the higher deficit compared to the Stability Programme is the result of an upward revision in the expenditure-to-GDP ratio and a downward revision of the revenue-to-GDP ratio. The former is expected to reach a level of 54.4% of GDP, 0.1 percentage point above spring, due to a higher contribution by social payments, compensation of employees and investment, only partially offset by lower interest payments and residual expenditure categories. In 2020, the Draft Budgetary Plan projects a growth of expenditure net of tax credits by 1.8% in nominal terms, which corresponds to a 0.6% increase in real terms using the GDP deflator.

On the other hand, the overall revenue ratio is set to decrease by 0.1 percentage point compared to the Stability Programme, to reach 52.2% of GDP, and reflects the net impact of the new measures foreseen to reduce direct taxation.

The Commission 2019 autumn forecast also projects a headline deficit at 2.2% of GDP in 2020, unchanged from spring and in line with the one posted in the Draft Budgetary Plan. This reflects the projection of the same deficit for 2019 and the same assessment of the impact of newly announced measures in the Draft Budgetary Plan.

The revenue-to-GDP ratio is slightly lower in the Commission forecast, by 0.1 percentage point. As for 2019, this can be explained by some differences in underlining revenues elasticities, thus lower and higher proceeds from indirect and direct taxation, respectively compared to the Draft Budgetary Plan.

The expenditure-to-GDP ratio is the same in the two sets of projections, with almost no differences in terms of expenditure categories but mainly for a lower contribution over GDP of interest expenditure in the Commission forecast, linked to slightly lower interest rates assumptions. Overall, in 2020 the growth rates of public expenditure concur.

The main risk to the budgetary targets for 2020 stem, on the one hand, from the uncertainties associated with the macroeconomic scenario and, on the other hand, from the expected evolution of public expenditure. In particular, the respect of progressively more ambitious expenditure objectives needed to finance the engaged reduction of the tax burden will require a strict adherence to plans by social security institutions and local authorities. Regarding the latter, while the newly-adopted contractual approach has proven so far effective in containing operational expenditure, slippages remain possible especially for investment expenditure, after a period of significant containment, if not decline, and the consequent build-up of sizeable savings.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2018	2019			2020			Change: 2018-2020
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**53.5**	**52.4**	***52.5***	**52.5**	**52.3**	***52.2***	**52.1**	**-1.3**
of which:								
- Taxes on production and imports	16.5	16.8	*16.8*	16.5	16.8	*16.8*	16.6	0.3
- Current taxes on income, wealth,	13.3	13.1	*13.2*	13.4	13.1	*13.0*	13.3	-0.3
- Capital taxes	0.6	0.6	*0.6*	0.6	0.6	*0.6*	0.6	0.0
- Social contributions	18.0	16.8	*16.8*	16.8	16.7	*16.7*	16.7	-1.3
- Other (residual)	5.1	5.1	*5.1*	5.1	5.1	*5.1*	5.0	0.0
Expenditure	**56.0**	**55.5**	**55.6**	**55.5**	**54.3**	**54.4**	**54.4**	**-1.6**
of which:								
- Primary expenditure	54.3	54.0	54.1	54.0	52.8	53.0	53.1	-1.3
of which:								
Compensation of employees	12.5	12.3	12.3	12.3	12.1	12.2	12.2	-0.3
Intermediate consumption	4.9	4.9	4.9	4.9	4.9	4.9	4.9	0.0
Social payments	25.5	25.4	25.5	25.4	25.1	25.3	25.3	-0.2
Subsidies	2.7	2.7	2.7	2.7	2.0	2.0	2.0	-0.7
Gross fixed capital formation	3.4	3.5	3.5	3.5	3.4	3.5	3.5	0.1
Other (residual)	5.3	5.2	5.2	5.2	5.3	5.1	5.3	-0.2
- Interest expenditure	1.7	1.5	1.5	1.5	1.5	1.4	1.3	-0.3
General government balance (GGB)	**-2.5**	**-3.1**	**-3.1**	**-3.1**	**-2.0**	**-2.2**	**-2.2**	**0.3**
Primary balance	**-0.8**	**-1.5**	**-1.6**	**-1.6**	**-0.5**	**-0.8**	**-0.9**	**0.0**
One-off and other temporary measures	-0.2	-1.0	-0.9	-0.9	-0.1	-0.1	-0.1	0.1
GGB excl. one-offs	**-2.3**	**-2.1**	**-2.2**	**-2.2**	**-1.9**	**-2.1**	**-2.1**	**0.2**
Output gap[1]	0.5	0.4	0.8	0.7	0.5	0.9	0.8	0.4
Cyclically-adjusted balance[1]	-2.9	-3.3	-3.6	-3.5	-2.3	-2.8	-2.8	0.1
Structural balance (SB)[2]	**-2.7**	**-2.3**	**-2.7**	**-2.7**	**-2.2**	**-2.7**	**-2.6**	**0.0**
Structural primary balance[2]	-1.0	-0.8	-1.2	-1.2	-0.7	-1.3	-1.3	-0.3

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 corresponds to cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

In 2020, the Draft Budgetary Plan projects the structural balance to remain flat, compared to an improvement of 0.1 percentage point both in the Stability Programme and in the Commission forecast. The reduced adjustment compared to the former mostly stems from the deterioration of the headline deficit (0.2% of GDP), partially offset by the worsening of the (recalculated) structural balance in 2019 (i.e. due to the updated quantification of some one-off measures), which implies a positive base effect on the 2020 fiscal stance. The difference vis-à-vis the improvement of the structural balance projected in the Commission forecast is explained by the treatment as one-offs, in the latter, of the residual liabilities associated to the CICE after its replacement by a permanent cut in social contributions as of 2019.

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in France currently standing at -0.05%[3]. As a consequence, total interest payments by the general government have continued to decrease as a share of GDP. Based on the information included in the Draft Budgetary Plan, interest expenditure in France is expected to fall from 1.7% of GDP in 2018 to 1.5% in 2019 and is projected to decrease further next year, at 1.4% of GDP, well below the 2.6% recorded in 2012 at the peak of the euro area sovereign debt crisis. The picture stemming from Member States' plans is broadly confirmed by the Commission forecast.

The Draft Budgetary Plan targets in terms of expenditure are deemed to comply with the numerical fiscal rules in place. In its September opinion, the High Council of Public Finances considered the targets in terms of expenditure, revenues and deficits for 2019 and 2020 as plausible although pointing out the low underlying structural adjustment in both years. In particular, the Council stressed that the low planned adjustment lacks coherence with the multiannual public finances programming law for 2018-2022, leading to a gap with the targets set herewith. Such gap is warned to be very close to the threshold foreseen by the national fiscal framework for triggering the automatic correction mechanism.

3.2. Debt developments

The Draft Budgetary Plan presents an increase in the debt ratio by 0.4 percentage points in 2019, to 98.8% of GDP, and only a slight decline by 0.1 percentage point in 2020. The debt trajectory is very similar to that in the Stability Programme, with only marginal differences between the two. Specifically, for 2019, the Draft Budgetary Plan plans a marginally higher primary deficit that is more than compensated by a higher increase in prices. For 2020, the slightly less pronounced decline in the debt ratio projected in the Draft Budgetary Plan stems from a higher primary deficit, partly offset by a lower debt-increasing contribution from stock-flow adjustments. While the snowball effect is similar in both sets of projections, the slightly lower effect stemming from real growth in the Draft Budgetary Plan is offset by also lower interest expenditure.

The Commission autumn forecast projects a very similar trend compared to the Draft Budgetary Plan. Specifically, the Commission's debt forecast of 98.9% of GDP for 2019 and 2020 is only marginally higher than the projections in the Draft Budgetary Plan for both years.

[3] 10-year bond yields as of 28 October 2019. Source: Bloomberg.

Table 3. Debt developments

(% of GDP)	2018	2019			2020		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**98.4**	**98.9**	**98.8**	**98.9**	**98.7**	**98.7**	**98.9**
Change in the ratio	0.0	0.5	0.4	0.6	-0.2	-0.1	0.0
Contributions[2]:							
1. Primary balance	**0.8**	**1.5**	**1.6**	**1.6**	**0.5**	**0.8**	**0.9**
2. "Snow-ball" effect	**-0.7**	**-0.9**	**-1.1**	**-1.0**	**-1.1**	**-1.1**	**-1.1**
Of which:							
Interest expenditure	1.7	1.5	1.5	1.5	1.5	1.4	1.3
Real growth effect	-1.7	-1.3	-1.3	-1.2	-1.4	-1.3	-1.2
Inflation effect	-0.8	-1.1	-1.2	-1.3	-1.1	-1.1	-1.2
3. Stock-flow adjustment	**-0.1**	**-0.1**	**-0.1**	**0.0**	**0.4**	**0.2**	**0.2**

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:

Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the draft budgetary plan

Most of the new measures[4] envisaged in the Draft Budgetary Plan were announced at the end of April by the French President, following the Grand Débat and as a further response to the 'yellow vests' movement. They were not included in the Stability Programme. All these measures are specified in sufficient detail or considered realistic and thus are included in the Commission forecast, without differences in estimates.

On the revenue side, the main measure is the permanent reduction, as of 1st January 2020, of the personal income tax targeted at middle-income earners. The reduction, with an expected budgetary impact of EUR 5 billion (0.2% of GDP), will take place via a decrease of the marginal rate of the lowest tax bracket. According to French authorities, it would benefit 17 million households. Another relevant measure, although only implemented after 2020, is the progressive suppression of the housing tax for the remaining wealthiest 20% of households. The estimated cost is about EUR 2.4 billion in 2021.

In order to compensate the reduction of income tax revenues, the Draft Budgetary Plan tables some revenue-increasing measures. These include: the smoothing of the reduction of the corporate income tax for big companies, for EUR 0.8 billion; the limitation of a reduction in social security contributions for certain sectors (*déduction forfaitaire spécifique*), for EUR 0.4 billion and the suppression of the tax expenditure on the use of off-road diesel, for EUR 0.2 billion.

[4] The budgetary impacts reported in table 4 refer to measures as reported by national authorities in the Draft Budgetary Plan. The measures underlying the expenditure side are however incomplete.

On the expenditure side, the Draft Budgetary Plan includes the cancelation of the under-indexation of lower pensions (below EUR 2000 per month) and the increase in minimum pensions. Together these measures imply a budgetary cost of EUR 1.5 billion, or 0.1% of GDP.

Expenditure savings for about EUR 1.4 billion are projected from the reform of the reference income for allocation of housing benefits (*aides personnalisés au logement*, APL). After having been delayed, the reform is finally expected to be implemented as of January 2020. Overall, the Draft Budgetary Plan refers to the expenditure control approach already under way, based on the respect of expenditure norms. After a temporary increase in 2019, the healthcare spending ceiling (ONDAM) is brought back to a maximum annual increase of 2.3%, in line with the trajectory set in the public finances programming law 2018-2022. This corresponds to estimated savings, compared to trend, of EUR 4.2 billion. At the same time, the contractual approach defined at the level of local authorities is projected to keep containing growth of operational expenditure.

The impact of non-recurring measures classified in 2020 as one-offs is not particularly significant, while there is broad agreement between the Draft Budgetary Plan and the Commission forecast in terms of their treatment. However, the Draft Budgetary Plan reports as structural the residual liabilities by EUR 2.0 billion associated to the CICE after its replacement by a permanent cut in social contributions as of 2019. These liabilities are instead considered as one-offs by the Commission, in line with relevant guidelines and the treatment of similar measures in 2019.

Table 4. Main discretionary measures reported in the Draft Budgetary Plan

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2019	**2020**
Taxes on production and imports		0,0
Current taxes on income, wealth, etc.		-0,2
Capital taxes		
Social contributions		0,0
Property Income		
Other		
Total		**-0,1**

Note:

The budgetary impact in the table is the aggregated impact of measures as reported by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.

Source:
Draft Budgetary Plan for 2020

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2019	**2020**
Compensation of employees		
Intermediate consumption		
Social payments		
Interest Expenditure		
Subsidies		
Gross fixed capital formation		
Capital transfers		
Other		
Total		

Note:

The budgetary impact in the table is the aggregated impact of measures as reported by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.

Source:
Draft Budgetary Plan for 2020

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

France is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term budgetary objective of -0.4% of GDP. Box 2 reports the latest country specific recommendations in the area of public finances. France is also subject to the transitional arrangements to make sufficient progress towards compliance with the debt reduction benchmark.

By letter of 22 October 2019, the Commission asked France to provide complementary information on the respect, in its Draft Budgetary Plan for 2020, of the budgetary effort required under the provisions of the preventive arm of the Stability and Growth Pact. The Commission has taken the reply by France of 23 October 2019 into account in its assessment of budgetary developments and risks.

Box 2. Council recommendations addressed to France

On 9 July 2019, 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 that the nominal growth rate of net primary government expenditure does not exceed 1.2% in 2020, corresponding to an annual structural adjustment of 0.6 % of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio.

4.1. Compliance with the debt criterion

After it corrected its excessive deficit in 2017, France is in the transition period for the following three years until 2020. This implies that, during this period, it is required to make sufficient progress (as defined by the minimum linear structural adjustment) towards compliance with the debt reduction benchmark at the end of the transition period.

The Draft Budgetary Plan does not include sufficient information to assess compliance with the transitional arrangements regarding the debt reduction benchmark based on the Member State's plans.

Based on the Commission forecast, the change in the structural balance is projected at 0.0% of GDP in 2019, in line with the recalculated effort based on the Draft Budgetary Plan figures. This effort falls short of the required improvement of 1.0% of GDP under the minimum linear structural adjustment. For 2020, the change in the structural balance is forecast to amount to 0.1% of GDP, which implies a deviation by 1.9% of GDP from the required improvement under the minimum linear structural adjustment. The projected deviation according to the Commission forecast in both years exceeds ¼% of GDP and the remaining annual structural adjustment exceeds in both years ¾% of GDP. As both conditions are not respected simultaneously, France would exceed the room for manoeuvre embedded in the rule.

Consequently, based on an overall assessment of the Draft Budgetary Plan, France is not making sufficient progress towards compliance with the debt reduction benchmark in 2019-2020.

Table 6. Compliance with the debt criterion*

	2018	2019			2020		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio	**98,4**	**98,9**	**98,8**	**98,9**	**98,7**	**98,7**	**98,9**
Gap to the debt benchmark [1,2]							
Structural adjustment [3]	0,0	0,2	0,0	0,0	0,1	0,0	0,1
To be compared to:							
Required adjustment [4]	0,7	0,8		1,0	1,4		2,0

Notes:

[1] Not relevant for Member Sates 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.

Source:

Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

4.2. Adjustment towards the medium-term budgetary objective

According to the information provided in the Draft Budgetary Plan, the nominal growth rate of government expenditure, net of discretionary revenue measures, in 2019 exceeds the applicable expenditure benchmark rate of 1.4%, leading to a deviation of 0.7% 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 medium-term budgetary objective by 0.6% of GDP, thus pointing to a significant deviation. This calls for an overall assessment. The adjustment measured by the change in the structural balance is favoured by the projected decrease in interest payments and some revenue windfalls. At the same time, the fiscal effort measured with the change in the structural balance is penalised, although by a smaller amount, by the pick-up in public investment, also linked to the electoral cycle of local administrations. As the gap from the required effort is very similar based on both indicators, the overall assessment, based on data in the Draft Budgetary Plan, points to a risk of a significant deviation from the required adjustment path towards the medium-term budgetary objective in 2019.

These conclusions are confirmed by the Commission 2019 autumn forecast. In Commission's projections, the applicable expenditure benchmark is exceeded by 0.8% of GDP, while the structural balance is projected to deviate by 0.6% of GDP. Both pillars point to a risk of a significant deviation. Accordingly, the overall assessment points to a risk of some deviation from the recommended adjustment path towards the medium-term budgetary objective in 2019.

For 2020, according to the information provided in the Draft Budgetary Plan, the expenditure benchmark is planned to be exceeded by 0.7% of GDP. In turn, the recalculated change in the structural balance amounts to 0.0% of GDP, falling short of the 0.6% of GDP required improvement by 0.6% of GDP. Thus, for 2020 alone the two indicators point to a risk of significant deviation. The overall assessment shows that the adjustment measured by the change in the structural balance is overestimated by further projected decreases in interest payments and the estimated higher potential growth with respect to its long-term average. These factors are offset only in part by some revenue shortfalls. As the expenditure benchmark is found to give a more accurate picture of the fiscal effort, the overall assessment, based on data in the Draft Budgetary Plan, also points to a risk of a significant deviation from the required adjustment path towards the medium-term budgetary objective in 2020. The same conclusion holds when 2019 and 2020 are taken together.

Table 7: Compliance with the requirements of the preventive arm

(% of GDP)	2018	2019		2020	
Initial position[1]					
Medium-term budgetary objective (MTO)	-0.4	-0.4		-0.4	
Structural balance[2] (COM)	-2.7	-2.7		-2.6	
Structural balance based on freezing (COM)	-2.1	-2.6		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
	2018	**2019**		**2020**	
(% of GDP)	**COM**	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.6	0.6		0.6	
Required adjustment corrected[5]	0.6	0.6		0.6	
Change in structural balance[6]	0.2	0.0	0.0	0.0	0.1
One-year deviation from the required adjustment[7]	-0.4	-0.6	-0.6	-0.6	-0.5
Two-year average deviation from the required		-0.5	-0.5	-0.6	-0.6
Expenditure benchmark pillar					
Applicable reference rate[8]	1.2	1.4		1.2	
One-year deviation adjusted for one-offs[9]	-0.3	-0.7	-0.8	-0.7	-0.8
Two-year average deviation adjusted for one-offs[9]		-0.5	-0.6	-0.7	-0.8

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 is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance corresponds to cyclically-adjusted government balance excluding one-off measures.

[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 ed. 2018, 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 2018) was carried out on the basis of Commission 2019 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.

Source :

Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations.

These conclusions are confirmed by the Commission 2019 autumn forecast. The Commission’s projections show broadly similar adjustment gaps to those estimated with data in the Draft Budgetary Plan, both for 2020 and for 2019 and 2020 taken together.

Accordingly, following an overall assessment based on both the Draft Budgetary Plan and the Commission's 2019 autumn forecast, the adjustment path points to a risk of significant deviation from the adjustment path towards the medium-term budgetary objective in 2019 and 2020, and also when 2019 and 2020 are taken together.

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

The Draft Budgetary Plan confirms the consolidation strategy defined by the government in the multiannual public finances programming law for 2018-2022. This strategy aims at compensating progressive tax reductions over the five-year presidential term via targeted cuts in and control of public expenditure. However, since its initial definition in 2018, the consolidation trajectory has been progressively back loaded and reflects now a lower level of ambition. Thus, while the objective to reduce the tax burden by one percentage point by the end of the presidential term is almost already achieved, the reduction of government expenditure is proving much slower. As a result, the original objectives of cutting the deficit by more than 2 percentage points and reducing debt by more than 5 percentage points by 2022 have been considerably scaled down. The Draft Budgetary Plan does not outline any progress in terms of fiscal consolidation in 2020 as the planned reduction of deficit is mainly explained by the fading of the one-off impact of the transformation of the CICE in 2019. At the same time, the expenditure reduction is mainly due to the planned decline in public debt servicing costs.

The current fiscal consolidation strategy aims at maintaining and channelling investment expenditure in order to promote long-term economic growth. In this respect, without introducing new specific actions, the Draft Budgetary Plan confirms the steps already taken and the resources already mobilised via the on-going Great Investment Plan (*Grand Plan d'Investissement*). The priorities for this five-year plan are confirmed and concern investments to accelerate the ecological transition, to create a skill-based society, to foster competitiveness and innovation, and to achieve the digital transformation of the public sector. Between 2019 and 2020, the share of public investment over GDP will stabilise at 3.5 %, reflecting the marked deceleration expected at local level due to the electoral cycle. In nominal terms, local investment is forecast to contract by 1.8% in 2020, after an increase of more than 8% in 2019.

The government announced its intention to develop as of 2020, in the context of the next budgetary cycle, a ‘green budget’. The objective is to officially present in a comprehensive way the impact of all revenue and expenditure measures on the environmental and climate commitments of the country. To this end, given the methodological complexity of the task, the government announced a public consultation in view of creating the broadest consensus possible around the approach to follow.

The main new tax measure contained in the Draft Budgetary Plan is the permanent reduction from 2020 of the personal income tax (see Box 4). Together with measures already taken, this is expected to continue enhancing the growth-friendliness of the tax structure.

In the context of the 2019 European Semester, France was issued three fiscal-structural recommendations. Regarding the use of windfalls gains to accelerate the reduction of the

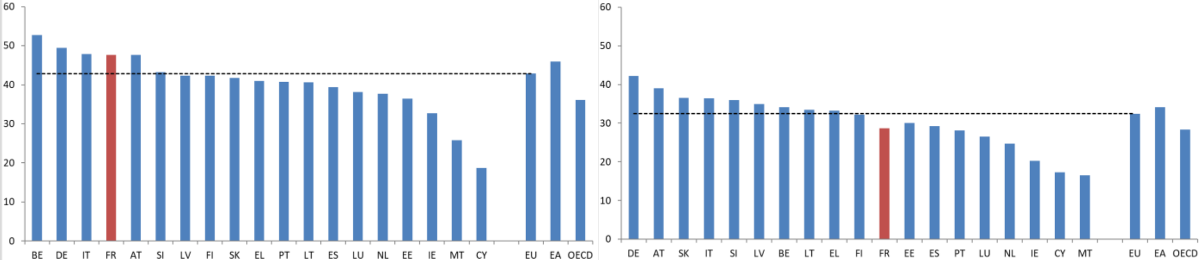
general government debt ratio, an ad hoc provision was already introduced in 2018 in the national fiscal framework. The effectiveness of this tool has however not yet been proven.

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 that 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 those 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 a low wage (2018)



Notes: 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.

France's Draft Budgetary Plan contains a main measure affecting the tax wedge on labour, namely the permanent reduction, as of 1st January 2020, of the personal income tax, targeted at middle-income earners although its benefits will be broader. The measure has an expected budgetary cost of EUR 5 billion (0.2% of GDP) and is financed, although not fully, via some expenditure cuts and other revenues’ increase. It represents a further response to the ‘yellow vests’ movement and, as such, it is not part of a broader labour market or tax system reform. Rather, it falls under the series of measures already taken by the government in budget laws or ad hoc laws and aimed at incentivising investment, job creation and labour’s pay off (e.g. reduction of employers’ social contributions, increase of monthly wage for workers at the minimum wage, exemption from employee’s social contributions and income tax on overtime work). No detailed simulation of the impact of the measure is available but the government expects it to support households’ purchasing power and consumption, to incentivise participation in the labour market and, ultimately, boost growth.

As for the achievement of expenditure savings and efficiency gains across all sub-sectors of the government, the Draft Budgetary Plan includes a number of measures to contain public expenditure. However, specific spending review actions under the broader 'Public Action 2022' programme have not yet been specified. In particular, it is not clear how the programme will contribute to the fiscal consolidation strategy via a detailed and ex ante quantification of expected expenditure savings, including their timing and monitoring.

Finally, regarding the reform of the pension system, to be aimed at enhancing its fairness and sustainability, its announcement has been postponed until the first half of 2020, presumably after local elections. In the meantime, the government has started a wide public consultation, involving all stakeholders, which should help defining the main characteristics of such a sensitive reform and creating consensus around it.

6. OVERALL CONCLUSION

Based on data in the Draft Budgetary Plan, no fiscal effort is foreseen for either 2019 or 2020. Based on the Commission 2019 autumn forecast, the structural improvement in 2019 and 2020 falls short of the minimum linear structural adjustment to ensure sufficient progress towards compliance with the debt criterion.

Following an overall assessment of the Draft Budgetary Plan, the planned structural adjustment is well below the required adjustment path towards the medium-term budgetary objective. This is confirmed by the overall assessment based on the Commission 2019 autumn forecast. Accordingly, France is at risk of significant deviation from the adjustment path towards the medium-term objective as recommended by the Council in both 2019 and 2020.