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Assessment of the 2018 Stability Programme for

France

(Note prepared by DG ECFIN staff)

CONTENTS

1. INTRODUCTION

On 25 April 2018, France submitted its 2018 Stability Programme (hereafter called Stability Programme), covering the period 2018-2022. The government approved the Programme on 11 April and it was submitted to the Parliament on 13 April.

France is currently subject to the corrective arm of the Stability and Growth Pact (SGP). The Council opened the Excessive Deficit Procedure for France on 27 April 2009. The country is recommended to correct the excessive deficit by 2017. The year following the correction of the excessive deficit, France would become subject to the preventive arm of the SGP and should ensure sufficient progress towards its MTO, provided that a timely and durable correction of the excessive deficit is achieved. As the debt ratio in 2017 is projected at 97% of GDP, exceeding the 60% of GDP reference value, France would also become subject to the transitional arrangements as regards compliance with the debt reduction benchmark during the three years following the correction of the excessive deficit (transitional debt rule), during which it should make sufficient progress towards compliance with the debt reduction benchmark.

This document complements the Country Report published on 7 March 2018 and updates it with the information included in the Stability Programme.

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2018 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

The macroeconomic scenario underlying the 2018 Stability Programme forecasts GDP growth at 2.0% in 2018 and 1.9% in 2019, after 2.0% in 2017 (calendar-adjusted). Compared to the 2018 Draft Budgetary Plan (DBP), the growth projection has been revised up by 0.3 percentage point in 2018, and by 0.2 percentage point in 2019. Economic activity would be driven by strengthening private consumption, in line with higher household purchasing power thanks to the improvement of the labour market situation and to fiscal measures. Corporate investment would also remain buoyant. Moreover, the ongoing economic expansion in the euro area and the robust expansion of global demand projected for 2018 and 2019 would lead to a sustained increase in exports. As import growth would remain stable since 2017, at 4.1% in both 2018 and 2019, the contribution of net exports to growth would become broadly neutral. Concerning 2019, the slight deceleration in economic activity would stem from a slight deceleration of global demand with respect to 2018 - while still showing a robust growth - and to the dampening effect of increasing interest rates on investment. Inflation would increase from 1.0% in 2017 to 1.4% in 2018 and then decline slightly to 1.2% in 2019. Employment growth would remain strong, at +0.8% in both 2018 and 2019. Given the GDP growth projections, the output gap as recalculated by the Commission following the commonly agreed methodology, stands at −0.7% in 2017 and is slightly smaller than in the

Stability Programme itself. It is expected to close in 2018 and to turn increasingly positive, to 2% in 2022.

The Commission 2018 spring forecast projects the same GDP growth rate in 2018 (2.0%), and slightly lower growth in 2019 (1.8%). The composition of growth in both years is expected to remain similar. However, the Commission 2018 forecast projects lower growth in compensation per employee for 2018 by 0.3 percentage point. Overall, the macroeconomic scenario underlying the 2018 Stability Programme, albeit slightly more favourable than the Commission forecast, is plausible. In its opinion, the High Council of Public Finances (HCFP) also considers the government's GDP growth forecast for 2018 as realistic. However, the HCFP highlights the uncertainties related to the real-time estimates of the output gap and considers that the longer-term projections for GDP growth are optimistic.

Table 1: Comparison of macroeconomic developments and forecasts

	2017		2018		2019		2020	2021	2022
	COM	**SP**	**COM**	**SP**	**COM**	**SP**	**SP**	**SP**	**SP**
Real GDP (% change)	1.8	1.8	2.0	2.0	1.8	1.9	1.7	1.7	1.7
Private consumption (% change)	1.1	1.3	1.4	1.6	1.6	1.9	1.8	1.8	1.8
Gross fixed capital formation (% change)	3.5	3.8	3.7	3.9	2.8	3.3	2.3	2.1	2.6
Exports of goods and services (% change)	3.1	3.3	4.7	4.9	4.4	4.6	4.4	4.4	4.4
Imports of goods and services (% change)	4.0	4.1	3.9	4.1	4.1	4.1	3.7	3.7	3.7
Contributions to real GDP growth:									
- Final domestic demand	1.7	1.9	1.9	1.9	1.8	1.8	1.5	1.5	1.5
- Change in inventories	0.4	0.4	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	-0.3	-0.3	0.1	0.1	0.0	0.0	0.2	0.2	0.2
Output gap[1]	-0.7	-0.7	0.1	0.1	0.6	0.6	1.0	1.4	2.0
Employment (% change)	1.0	1.0	0.8	0.8	0.9	0.8	0.8	0.6	0.6
Unemployment rate (%)	9.4		8.9		8.3				
Labour productivity (% change)	0.9	0.8	1.2	1.2	0.9	1.1	0.9	1.1	1.1
HICP inflation (%)	1.2	1.0	1.7	1.4	1.4	1.2	1.5	1.8	1.8
GDP deflator (% change)	0.8	0.8	1.1	1.1	1.5	1.2	1.5	1.8	1.8
Comp. of employees (per head, % change)	1.8	2.1	2.3	2.6	0.3	0.4	2.2	2.8	2.9
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-2.9	-2.9	-3.1	-2.9	-3.0	-2.8	-2.6	-2.4	-2.3

Note:

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

Source :

Commission 2018 spring forecast (COM); Stability Programme (SP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2017 AND 2018

In 2017, according to data notified to Eurostat[1], the general government deficit reached 2.6% of GDP. This outturn is below the targets set both in the 2017 Stability Programme and in the Draft Budgetary Plan (DBP) for 2018, which expected the headline deficit to reach 2.8% and 2.9% of GDP, respectively. The result is associated with a contraction in the fiscal stance corresponding to an improvement of 0.5 percentage point of the structural balance.

The better-than-expected budget outcome was the result of sustained GDP growth which reached 1.8% in 2017 – in volume terms, unadjusted – compared to 1.5% and 1.7% growth projeceted in the 2017 Stability Programme and the 2018 DBP, respectively. Moreover, it was the consequence of a higher-than-expected elasticity, therefore an acceleration of windfall revenues, in particular corporate income tax and VAT. In particular, the former included the deficit-decreasing impact of the one-off exceptional contribution introduced at the end of the year to offset the refund of the 3% tax on dividends in 2017.[2] As a result, the share of total revenues in GDP reached 53.9% compared to 53.1% foreseen in the 2018 DBP.

The outcome on the revenue side more than compensated for higher-than-expected expenditure, which was driven up compared to the 2018 DBP by the recording as an expenditure item of the the refund in 2017 of the 3% tax on dividends as well as by the resumption in investment of local authorities after years of containment. Overall the expenditure-to-GDP ratio reached 56.5%, up by 0.4 percentage point compared to the 2018 DBP.

The government plans a headline balance of -2.3% of GDP in 2018, in line with last year's Stability Programme but stemming from a substantially revised combination of its cyclical and structural components. The planned deficit is 0.3 percentage point below the deficit projeceted in the 2018 DBP although the contraction in the fiscal stance is expected to remain the same, that is an improvement of 0.1 percentage point of the structural balance. However, the improvement in the structural balance recalculated by the Commission on the basis of the information in the Programme according to the commonly agreed methodology would be null.

The expected improvement in the headline deficit is mainly the result of higher revenues stemming both from a higher starting position in 2017 as well as continued growth above previous expectations. On the one hand, the Stability Programme foresees a GDP growth rate of 2.0% in 2018 – in volume terms, unadjusted – compared to 1.7% underpinning the 2018 DBP. On the other hand, the elasticity of revenues is expected to remain slightly above one.

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[1] Eurostat has expressed a reservation on the quality of the data reported by France. Firstly, Eurostat considers that the Agence Française de Développement should be classified inside the general government sector, which would result in an increase in government debt. Secondly, Eurostat considers that the capital injection by the State into AREVA (0.1% of GDP) in 2017 should be treated as a capital transfer, with an impact on the deficit.

[2] In October 2017, the French Constitutional Court issued a decision invalidating in full the 3% contribution on dividend distributions introduced in 2012. The full invalidation of the tax entails a total cost for reimbursement to companies (including interests) of around EUR 10 billions (0.4% of GDP) which is to be recorded as government expenditure about half in 2017 and half 2018, in line with Eurostat's decision of March 2018.

As a result, the share of total revenues in GDP is expected to reach 53.7% compared to 53.0% foreseen in the 2018 DBP.

On the revenue side, although at a slower pace also the expenditure-to-GDP ratio projected in 2018 increased and is now expected to reach 56.0%, compared to 55.5% in the 2018 DBP. This is mainly the result of higher expected capital transfers due to the one-off refund of the 3% tax on dividends due in 2018.

The Commission 2018 spring forecast projects the general government deficit to decrease to 2.3% of GDP in 2018, in line with the Stability Programme. There are only slight differences in the composition between the two sets of projections. Specifically, the Stability Programme projects slightly higher taxes on income and wealth than the Commission. As for expenditure, the Stability Programme plans slightly lower intermediate consumption and social payments, partially offset by more dynamic public investment.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

The Stability Programme plans to reach a headline surplus of 0.3% of GDP by 2022. The Programme therefore plans to keep the headline deficit below 3% of GDP in a durable manner.

At the same time, the structural balance is projected to gradually improve over the same horizon and to reach -0.6% of GDP by 2022. The MTO, a structural deficit of 0.4% of GDP as set in the programming law of public finances 2018-2022 of 23 January 2018, is therefore not planned to be achieved. The chosen MTO is more stringent[3] than the minimum MTO.

For 2019 the headline deficit would slightly increase to 2.4% of GDP and then steadily decrease to -0.9% and -0.3% of GDP in 2020 and 2021, respectively, before turning into a surplus at the end of the Programme horizon. The improvement in the recalculated structural balance would be of 0.3% of GDP in each year.

The specific time-profile of the consolidation strategy, namely the increase of the headline deficit in 2019 is the result of the statistical impact of the transformation of the tax credit for competitiveness and employment (CICE) into a permanent reduction of employer's social contributions, which accounts for about 0.9% of GDP and is treated by the authorities as a one-off, therefore not impacting the projected fiscal stance.

The Commission 2018 spring forecast projects the headline deficit in 2019 to rise to 2.8% of GDP. The difference with the authorities' plan is explained by less dynamic revenues, in particular taxes on income and wealth stemming from a lower projected eleasticity as well as by higher expenditure under the no-policy-change assumption. The Commission also forecasts the structural deficit to increase to 3.1% of GDP which reflects the temporary impact of the CICE transformation. Without this specific factor, the structural deficit would have worsened by 0.1 % of GDP, compared to the 0.3% improvement planned by the authorities.

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[3] The MTO selected by the Member State is more ambitious than the minimum MTO by more than 1/2 percentage point. The minimum MTOs are country-specific and calculated based on an agreed methodology.

The planned headline and structural deficits have been revised downwards compared to the 2018 DBP, mainly due to higher growth projections. Compared to last year's Stability Programme the difference in the 2019 headline deficit is explained by the CICE transformation (see Figure 1). The structural balance in last year's Stability Programme was planned to be in equilibrium as of 2019. These pojections have now been revised into structural deficits over the whole programm horizon due to more prudent assumptions regarding potential growth and output gaps.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2017	2018		2019		2020	2021	2022	Change: 2017-2022
	COM	COM	SP	COM	SP	SP	SP	SP	SP
Revenue	**53.9**	**53.7**	**53.7**	**52.4**	**52.6**	**52.4**	**52.2**	**52.0**	**-1.9**
of which:									
- Taxes on production and imports	16.3	16.5	16.5	16.6	16.6	16.6	16.7	16.7	0.4
- Current taxes on income, wealth, etc.	12.9	13.1	13.2	13.0	13.2	13.1	13.0	12.8	-0.1
- Social contributions	18.9	18.2	18.2	16.9	17.0	16.9	16.9	16.9	-2.0
- Other (residual)	5.9	5.9	5.8	5.9	5.8	5.8	5.6	5.6	-0.3
Expenditure	**56.5**	**56.0**	**56.0**	**55.1**	**54.9**	**53.3**	**52.5**	**51.7**	**-4.8**
of which:									
- Primary expenditure	54.7	54.3	54.3	53.5	53.2	51.5	50.6	49.7	-5.0
of which:									
Compensation of employees	12.7	12.5	12.5	12.3	12.3	12.1	11.9	11.7	-1.0
Intermediate consumption	5.0	4.9	4.8	4.8	4.7	4.6	4.5	4.4	-0.6
Social payments	25.9	25.6	25.5	25.3	25.1	24.8	24.5	24.1	-1.8
Subsidies	2.6	2.8	2.8	2.6	2.6	1.8	1.7	1.7	-0.9
Gross fixed capital formation	3.4	3.4	3.5	3.5	3.5	3.4	3.3	3.2	-0.2
Other (residual)	5.3	5.2	5.3	5.0	5.0	4.9	4.8	4.7	-1.5
- Interest expenditure	1.8	1.7	1.7	1.6	1.7	1.8	1.9	2.0	0.2
General government balance (GGB)	**-2.6**	**-2.3**	**-2.3**	**-2.8**	**-2.4**	**-0.9**	**-0.3**	**0.3**	**2.9**
Primary balance	**-0.8**	**-0.6**	**-0.6**	**-1.1**	**-0.6**	**0.9**	**1.6**	**2.3**	**3.1**
One-off and other temporary measures	-0.1	-0.2	-0.3	0.0	-1.0	0.0	0.0	0.0	0.1
GGB excl. one-offs	**-2.5**	**-2.0**	**-2.0**	**-2.7**	**-1.4**	**-0.9**	**-0.3**	**0.3**	**2.8**
Output gap[1]	-0.7	0.1	0.1	0.6	0.6	1.0	1.4	2.0	2.6
Cyclically-adjusted balance[1]	-2.2	-2.4	-2.3	-3.1	-2.8	-1.5	-1.2	-0.9	1.3
Structural balance[2]	**-2.1**	**-2.1**	**-2.0**	**-3.1**	**-1.8**	**-1.5**	**-1.2**	**-0.9**	**1.2**
Structural primary balance[2]	-0.3	-0.4	-0.3	-1.5	-0.1	0.3	0.7	1.1	**1.4**

Notes:

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

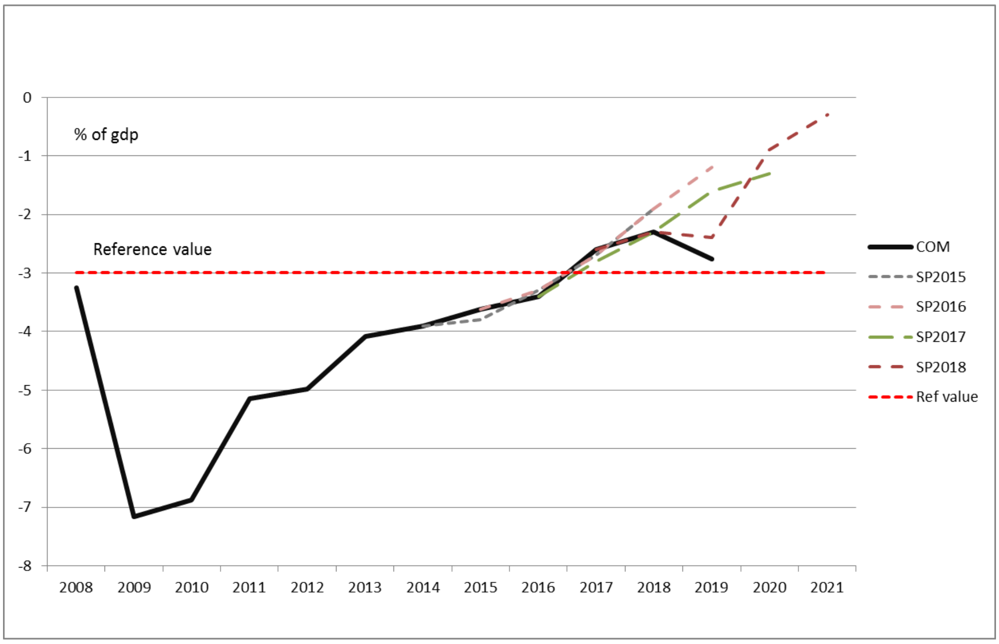
[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Stability Programme (SP); Commission 2018 spring forecasts (COM); Commission calculations.

The Stability Programme confirms a budgetary strategy based on increasing efforts in terms of expenditure control at all levels of the general government, increasing towards the outer years, aimed at financing the progressive reduction of the tax burden. The expenditure-to-GDP ratio is planned to decrease by almost five percentage points, from 56.5% in 2017 down to 51.7% in 2022, with a reduction in all its components and mainly in social payments. Such a sizeable decline is however not sufficiently underpinned by measures in the Programme, in particular as from 2020. In particular, specific measures under the broad Public Action 2022 have not yet been specified. The share of total revenues in GDP would decline from 53.9% in 2017 to 52.0% in 2022, mainly due to a 2% of GDP reduction in social contributions, with the tax burden overall falling by more than one percentage point, from 45.4% in 2017 to 44.3% in 2022.

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



Source: Commission 2018 spring forecast; Stability and Convergence Programmes

3.3. MEASURES UNDERPINNING THE PROGRAMME

The measures underpinning the 2018 Stability Programme are in line with the expenditure-based consolidation strategy presented in the 2018 Draft Budgetary Plan. Targeted cuts in the public expenditure will constitute the main tool for compensating the announced tax reductions.

Policy measures on the revenue side consist of several deficit-increasing measures such the housing tax relief for 80% of the households having residence in France, at a cost of EUR 3.2 billion (0.1 % of GDP). Also, they include the transformation of a wealth tax into a real estate wealth tax for EUR 3.2 billion (0.1 % of GDP) and the introduction of a single flat-rate levy of 30% on interest income for EUR 1.3 billion (0.1 % of GDP). Adopted exceptional and temporary revenue measures deteriorate government's revenues by 0.3 % of GDP in 2018 and 1.0 % in 2019, notably due to the transformation of the CICE into permanent reductions in employers' social security contributions. On the contrary, environmental taxation and excise duties on tobacco along with the switch from social contributions to the CSG are expected to increase government revenues in 2018, respectively by EUR 4.4 billion (0.2 % of GDP) and by EUR 4.5 billion (0.2 % of GDP).

On the expenditure side, the HCFP pointed out that respecting theauthorities' targets remains necessary to realise public finance trajectories planned in the 2018 Stability Programme. Indeed, expenditure growth (excluding tax credits) in real terms is expected to halve, passing from 1.5% in 2017 to 0.7 % in 2018. The expenditure-to-GDP ratio is also aimed to decrease by 0.7 percentage points in 2018 and by a total of more than 3 percentage points at horizon 2022. The expenditure directly controlled by the State and the operational expenditure of local authorities will contribute to reach the authorities' targets. The public expenditure directly controlled by the State are planned to increase by EUR 7.7 billion by 2020 (EUR 5.1 bn in 2018, EUR 1.6 bn in 2019, and EUR 1.0 bn in 2020), that is EUR 2.7 billion less than the increase of this expenditure taking place in 2017 only. At the same time, a contractual relationship between central and local administrations will replace the system of transfers from the State to local authorities as of 2018. New contracts with local authorities are expected to leave the local operational expenditure to growth by 1.2% yearly and the total local public expenditure by 1.5% in 2018 and 2.1% in 2019 (after 2.5% in 2017). On the contrary, the healthcare spending norm (ONDAM) remains at 2.3%, after having been revised upwards in the draft budgetary plan for 2018, which implied EUR 0.4 billion additional expenditure and led the *Comité d'alerte de l'ONDAM* calling for additional buffers to accommodate possible in-year expenditure slippages.[4]

On the State wage bill, savings of around EUR 2 billion would be allowed 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. A number of similar consolidation measures concern labour market and social policies. The number of State subsidised contracts is significantly reduced, implying savings of around EUR 1.5 billion, while a significant cut in housing allowances would lead to EUR 2.1 billion additional savings.

Main budgetary measures

Revenue	**Expenditure**
2017	
• Exceptional levy to replace 3 % dividends distribution tax (0.2 % of GDP) • Continuation of the crédit d'impôt pour la transition énergétique (-0.1 % of GDP)	• Cancellation of credits (0.2 % of GDP)
2018	
• Exceptional levy to replace 3% dividends distribution tax (-0.2 % of GDP) • Cancellation of the 3% dividends distribution tax (-0.1 % of GDP) • Progressive decrease in the corporate	• Savings in State wage bill (0.1 % of GDP) • Decrease in subsidised contracts (0.1 % of GDP) • Changes in housing allowances (0.1 % of

[4] *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*

income tax rate from 33 % to 25 % in 2022 (-0.1 % of GDP) • Transformation of a wealth tax into a real estate wealth tax (-0.1 % of GDP) • Introduction of a single flat-rate levy of 30% on interest income (-0.1 % of GDP) • Switch from social contributions to the CSG (0.2 % of GDP) • Housing tax relief for 80% of the households having residence in France (-0.1 % of GDP) • Tobacco and environmental taxation (0.2 % of GDP)	GDP)
2019	
• Progressive decrease in the corporate income tax rate from 33 % to 25 % in 2022 (-0.1 % of GDP) • Switch from social contributions to the CSG (-0.2 % of GDP) • Housing tax relief for 80% of the households having residence in France (-0.2 % of GDP) • Transformation of the CICE into permanent reductions in employers' social security contributions. (-0.9 % of GDP) • Tobacco and environmental taxation (0.1 % of GDP) • Agirc-arrco pension scheme: increase in the contribution rate (0.1 % of GDP)	
Note: The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.	

3.4. DEBT DEVELOPMENTS

Public debt increased at a fast pace between 2012 and 2017, rising from 90.7% to 97.0% of GDP. This development was driven by the cumulated general government deficits recorded over the same period as well as by the low GDP growth in most of the years. In 2017, the headline primary deficit and interest expenditure continued to contribute to the increase in public debt although to a lower extent compared to previous years. For the first time since 2012 a debt-increasing contribution was also associated with the stock-flow adjustment and in particular the net impact of debt issuance premiums. All these impacts were only partially compensated by the debt-reducing contribution of inflation and especially of economic growth (through the denominator effect).

Table 3: Debt developments

(% of GDP)	Average 2012-2016	2017	2018		2019		2020	2021	2022
			COM	SP	COM	SP	SP	SP	SP
Gross debt ratio[1]	**94.2**	**97.0**	**96.4**	**96.4**	**96.0**	**96.2**	**94.7**	**92.3**	**89.2**
Change in the ratio	1.8	0.4	-0.6	-0.6	-0.3	-0.2	-1.5	-2.4	-3.1
Contributions[2] *:*									
1. Primary balance	**1.8**	**0.8**	**0.6**	**0.6**	**1.1**	**0.6**	**-0.9**	**-1.6**	**-2.3**
2. "Snow-ball" effect	**0.7**	**-0.7**	**-1.3**	**-1.2**	**-1.4**	**-1.1**	**-1.2**	**-1.3**	**-1.1**
Of which:									
Interest expenditure	2.2	1.8	1.7	1.7	1.6	1.8	1.8	1.9	2.0
Growth effect	-0.7	-1.7	-1.9	-1.9	-1.7	-1.8	-1.6	-1.6	-1.5
Inflation effect	-0.7	-0.8	-1.1	-1.0	-1.4	-1.1	-1.4	-1.6	-1.6
3. Stock-flow adjustment	**-0.8**	**0.3**	**0.1**	**0.0**	**0.0**	**0.3**	**0.6**	**0.5**	**0.3**
Of which:									
Cash/accruals diff.									
Acc. financial assets									
Privatisation									
Val. effect & residual									

Notes:

[1] End of period.

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

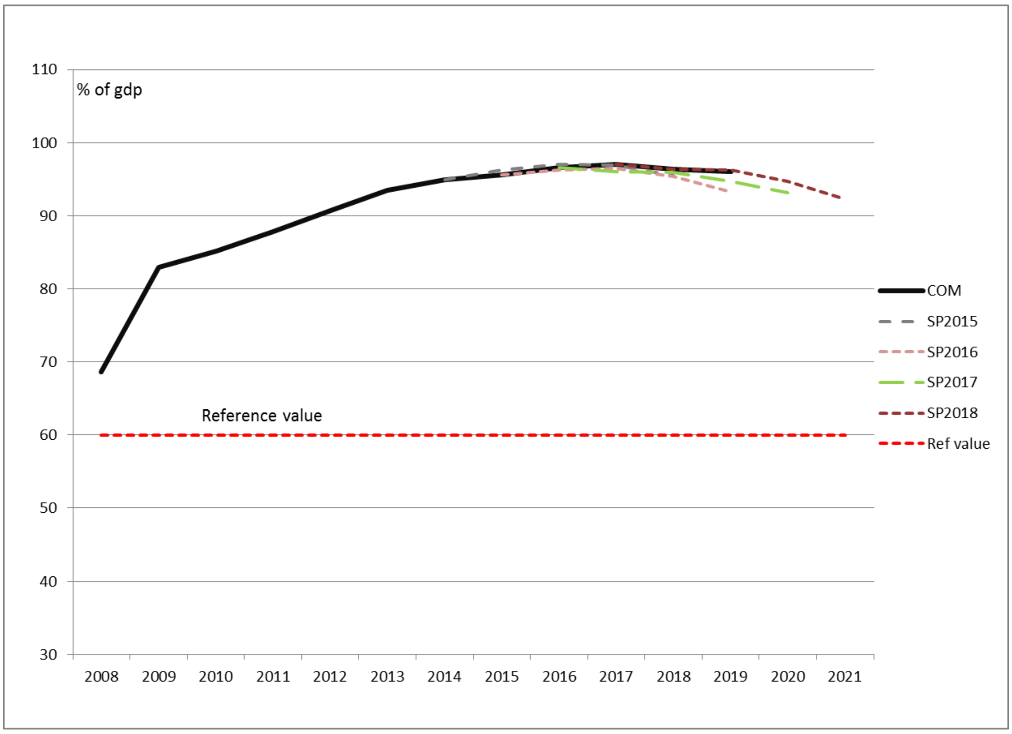
Source :

Commission 2018 spring forecast (COM); Stability Programme (SP), Commission calculations.

According to the Stability Programme, the public debt ratio would start decreasing in 2018 (see Figure 2). The primary balance would continue to improve over the period to 2022 and a surplus will be reached in 2020. At the same time, the snow-ball effect would contribute to the decrease of public debt until the 2022 horizon as the moderate increase in interest expenditure is expected to be outweighed by the recovery in GDP growth and inflation (see Table 3). The stock-flow adjustments are expected to be neutral in 2018 and then to increase the public debt ratio afterwards, notably due to net impact of premium on debt issuance ("prime et décote à l'émission net de l'étalement des primes passées") as well as the residual effects of the CICE transformation after 2019.

For 2018 and 2019 the Commission spring forecast projects a gross debt ratio broadly in line with the Stability Programme.

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



Source: Commission 2018 spring forecast; Stability and Convergence Programmes

3.5. RISK ASSESSMENT

The macro-economic scenario used in Stability Programme is comparable to the one of the Commission spring forecast for 2018. The Stability Programme plans a headline deficit of 2.3% of GDP for 2018, in line with the Commission spring forecast. Regarding 2019, the headline deficit projected in the Stability Programme is 0.4 pps lower than in the Commission forecast, while the GDP growth rate is 0.1 pp. higher. Differences are related to the no-policy change assumption underpinning the Commission forecast and a slightly lower elasticity of revenues. In particular, the latter forecast an increase in the deficit to 2.8% of GDP in 2019, which is explained by the temporary deficit-increasing impact of 0.9% of GDP stemming from the replacement of the CICE (Tax Credit for Competitiveness and Employment) by a permanent cut in social security contributions. Netting out this effect, the deficit would decline to 1.9% of GDP, mainly due to positive cyclical conditions.

Risks to the fiscal projects appear broadly contained, with some uncertainty regarding the final effectiveness of the new contractual approach between the central government and local authorities on operational expenditure targets. Further factors that may increase the 2018 headline deficit projected in the Stability Programme are linked to the possible under-budgeting of defence spending, a high GDP elasticity of revenues assumed by the French authorities for public revenues, and difficulties in respecting the expenditure ceilings guiding public spending related to the health sector (ONDAM) and the State expenditure.

Lastly, the Stability Programme does not include the announcements made after its submission. Notably, the government has recently declared a possible intervention in the restructuring of the SNCF debt at horizon 2020, as well as the complete removal of the housing tax from 2020 onwards, the deletion of inefficient taxes and the reduction in production taxes. However, no specific measure has been identified yet to counterbalance the eventual effects of these announcements on public finances, which might make the government's target of a surplus of 0.3 % in 2022 more challenging.

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

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

Following a durable correction of its excessive deficit in 2017 based on validated outturn data, France will become subject to the preventive arm of the Stability and Growth Pact from 2018 onwards and to the three-year transition period as regards compliance with the debt criterion. France will need to ensure an appropriate adjustment path towards its medium-term budgetary objective (MTO), defined as a structural deficit of 0.4% of potential GDP.

Box 1. Council Recommendations addressed to France

On 10 March 2015, the Council the Council recommended France under Art. 126(7) of the Treaty to correct its excessive deficit by 2017. To this end, France was recommended to 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. Furthermore, France should fully implement the already adopted measures for 2015 and ensure, by the end of April 2015, an additional fiscal effort of 0.2% of GDP. This would require the specification, adoption and implementation of additional structural discretionary measures equivalent to 0.2% of GDP to close the gap with the recommended improvement in the structural balance of 0.5% of GDP for 2015.

On 11 July 2017 , the Council also addressed recommendations to France in the context of the European Semester. In particular, in the area of public finances the Council recommended to France to ensure compliance *with the Council recommendation of 10 March 2015 under the excessive deficit procedure. The Council noted that for 2018, should a timely and durable correction eventually 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 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. As recalled in the Commission Communication on the 2017 European Semester accompanying these country-specific recommendations, 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 France's public finances.*

4.1. Compliance with EDP recommendations (in EDP years)

In 2017, France achieved a headline deficit of 2.6% of GDP, below the recommended 2.8% of GDP in the 10 March 2015 Council recommendation. However, the improvement in the structural balance amounted to 0.5% of GDP in 2017, thus falling short of the recommended fiscal effort of 0.9% of GDP. As France was compliant with the headline deficit target but not with the recommended improvement in the structural balance, a careful analysis of the reasons behind the shortfall is needed.

After correcting for changes in potential growth as well as for revenue windfalls since the time of the Council recommendation, the adjusted change in the structural balance, estimated at 0.2% of GDP in 2017 (see Table 4) fell short of the recommended fiscal effort of 0.9% recommended by the Council. In particular, revenue windfalls are estimated to have contributed by 0.4% of GDP to the improvement in the headline balance. In cumulative terms over 2015-2017, the gap vis-à-vis the recommended structural improvement is estimated to have amounted to 1.5% of GDP. The fiscal effort assessed on the basis of the bottom-up method amounted to 0.6% of GDP, also falling short of the 1.3% of GDP deemed necessary to comply with the Council recommendation of 10 March 2015. In cumulative terms over 2015-2017, the gap vis-à-vis the requirements based on the bottom-up method is 1.6% of GDP.

HICP inflation was 1.2% in 2017, whereas the recommendation was based on an inflation forecast of 1.0%. The small inflation differential with respect to the scenario underlying the EDP recommendation would entail an only marginally positive effect on the estimated structural effort, which does not alter the assessment. Overall, the fiscal effort has not been delivered according to all metrics

For 2018 and 2019, the Commission 2018 spring forecast projects the headline deficit to remain below 3% of GDP reference value in the Treaty.

Table 4: Compliance with the requirements of the corrective arm

(% of GDP)	2017	2018		2019	
	COM	SP	COM	SP	COM
Headline balance					
Headline budget balance	-2.6	-2.3	-2.3	-2.4	-2.8
EDP requirement on the budget balance	-2.8				
Fiscal effort - change in the structural balance					
Change in the structural balance[1]	0.5	0.0	0.0	0.3	-1.0
Cumulative change[2]	0.9				
Required change from the EDP recommendation	0.9				
Cumulative required change from the EDP recommendation	2.2				
Fiscal effort - adjusted change in the structural balance					
Adjusted change in the structural balance[3]	0.2	-		-	
of which: *correction due to change in potential GDP estimation (α)*	0.0	-		-	
correction due to revenue windfalls/shortfalls (β)	0.4	-		-	
Cumulative adjusted change [2]	0.7	-		-	
Required change from the EDP recommendation	0.9				
Cumulative required change from the EDP recommendation	2.2				
Fiscal effort - calculated on the basis of measures (bottom-up approach)					
Fiscal effort (bottom-up)[4]	0.6	-		-	
Cumulative fiscal effort (bottom-up)[2]	1.1	-		-	
Requirement from the EDP recommendation	1.3				
Cumulative requirement from the EDP recommendation	2.7				

Notes

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

[2] Cumulated since the latest EDP recommendation.

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

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

Source :

Stability Programme (SP); Commission 2018 spring forecasts (COM); Commission calculations.

4.2. Compliance with the debt criterion

After the correction of the excessive deficit in 2017, government debt would remain above the 60% Treaty reference value, according to both the Stability Programme and the Commission forecast. France will therefore be subject to the Minimum Linear Structural Adjustment (MLSA) during the three-year transition period following the abrogation. According to the information provided in the Stability Programme, the recalculated change in the structural balance would be 0.0% of GDP in 2018, in line with the required MLSA (see Table 5) gauged based on data in the Programme.

On the basis of the Commission forecast, the structural balance is also projected to remain broadly unchanged in 2018, falling short of the required structural improvement of 0.4% of GDP. Thus, France is not projected to make progress towards compliance with the debt criterion in 2018, based on the Commission forecast. This conclusion is confirmed based on the Commission forecast.

For 2019, based on the figures provided in the Stability Programme, the recalculated change in the structural balance is planned at 0.3% of GDP in 2019, above the requirement of a structural effort of 0.0% of GDP. This effort is however gauged after netting out the effect stemming from the replacement of the tax credit on competitiveness and employment (CICE) by a permanent reduction in social contributions, which is considered as a one-off in the programme.

Based on the Commission forecast, the structural balance is projected to deteriorate by 0.1% of GDP in 2019 once the effect of the replacement of the CICE by the cut in social contributions is netted out (-1.0% of GDP without netting out this effect). This implies a substantial deviation from the required improvement of 0.6% of GDP. The discrepancy between the two sets of projections is mainly due to the no-policy change assumption used for Commission's projections for 2019. Therefore, based on the Commission 2018 spring forecast, France is not projected to make progress towards compliance with the debt criterion in 2019 either.

Table 5. Compliance with the debt criterion

	2017	2018		2019	
		SP	COM	SP	COM
Gross debt ratio	**97**	**96.4**	**96.4**	**96.2**	**96.0**
Gap to the debt benchmark [1,2]		n.r.	n.r.	n.r.	n.r.
Structural adjustment [3]	0.5	0.0	0.0	0.3	-1.0
To be compared to:					
Required adjustment [4]		0.0	0.4	0.0	0.6

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 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 (S/CP) budgetary projections for the previous years are achieved.

Source :
Commission 2018 spring forecast (COM); Stability Programme (SP), Commission calculations.

4.3. Compliance with the adjustment path towards the MTO

For 2018, according to the information provided in the Stability Programme, nominal growth of government expenditure, net of discretionary revenue measures and one-offs, will exceed the applicable expenditure benchmark of 1.2% by 0.2 pps. of GDP, thereby pointing to a risk of some deviation (see Table 6). In turn, the recalculated change in the structural balance is estimated at 0.0% of GDP, falling short of the required adjustment by 0.6% of GDP, thus pointing to a risk of a significant deviation. This calls for an overall assessment. Compared with the growth of expenditure, net of discretionary revenue measures and one-offs, the fiscal effort measured by the structural balance is underestimated by the projected revenue shortfalls by 0.1% of GDP and the pick in public expenditure in 2018 with respect to its four-year average. These are offset only in part by the different potential growth used in its calculation. Accordingly, the overall assessment, based on data in the programme, would point to some deviation from the recommended adjustment path towards the MTO in 2018.

Based on the Commission 2018 spring forecast, both pillars highlight a risk of significant deviation from the adjustment towards the MTO. The two indicators are projected to deviate by 0.6% of GDP with respect to the required improvement. The overall assessment does not show any material discrepancy between the two metrics. Thus, the overall assessment would point to a risk of significant deviation from the recommended adjustment path towards the MTO in 2018 based on the Commission forecast.

The Country-Specific Recommendation 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. Following the Commission's assessment of the strength of the recovery in France while giving due consideration to its sustainability challenges, carried out in the context of its opinion on Country's Draft Budgetary Plan, no additional elements in that regard need to be taken into account.

Regarding 2019, according to the information in the Stability Programme, the nominal growth of government expenditure, net of discretionary revenue measures and one-offs, is expected to exceed the applicable expenditure benchmark of 1.4% by 0.3 pps. of GDP, thereby pointing to a risk of some deviation. In turn, the recalculated change in the structural balance is estimated at 0.3% of GDP, falling short of the required adjustment by 0.3% of GDP, thus pointing a risk of some deviation . The overall assessment does not show material differences between the two pillars. Taking 2018 and 2019 together, the average deviation from the expenditure benchmark pillar amounts to 0.3% of GDP, while the average shortfall in the accumulated change in the structural balance would amount to 0.5% of GDP. Accordingly, the overall assessment, based on data in the programme, would point to a risk of significant deviation from the recommended adjustment path towards the MTO in 2019.

Based on the Commission 2018 spring forecast, at unchanged policies, the nominal growth of government expenditure, net of discretionary revenue measures and one-offs, is projected to exceed the applicable expenditure benchmark of 1.4% by 1.5% pps, pointing to a risk of a significant deviation in 2019 Likewise, the recalculated change in the structural balance, estimated at -1.0% of GDP, is expected to fall short of the required improvement of 0.6% of GDP by 1.6 pps., also implying the risk of a significant deviation. However, the fiscal effort based on these two pillars is negatively affected by the transitory effect from the replacement of the CICE by the cut in social contributions. Once this effect is netted out, the deviation from the expenditure benchmark would amount to -0.6 pps. of GDP, whereas the structural balance is projected to deteriorate by 0.1% of GDP, thereby falling short of the required effeort by 0.7% of GDP. The overall assessment shows that the fiscal effort as measured by the change in the structural balance is underestimated due to the projected revenue shortfalls by 0.2% of GDP. Taking this into account, the overall assessment would point to a risk of a significant deviation in 2019. The same conclusion is drawn when assessing 2018 and 2019 together and when the the transitory effect from the replacement of the CICE by the cut in social contributions is netted out.

Table 6: Compliance with the requirements under the preventive arm

<table>
<tr><td>(% of GDP)</td><td>2017</td><td colspan="2">2018</td><td colspan="2">2019</td></tr>
<tr><td colspan="6">Initial position[1]</td></tr>
<tr><td>Medium-term objective (MTO)</td><td>-0.4</td><td colspan="2">-0.4</td><td colspan="2">-0.4</td></tr>
<tr><td>Structural balance[2] (COM)</td><td>-2.1</td><td colspan="2">-2.1</td><td colspan="2">-3.1</td></tr>
<tr><td>Structural balance based on freezing (COM)</td><td>-2.3</td><td colspan="2">-2.1</td><td colspan="2">-</td></tr>
<tr><td>Position vis-a -vis the MTO[3]</td><td>Not at MTO</td><td colspan="2">Not at MTO</td><td colspan="2">Not at MTO</td></tr>
<tr><td rowspan="2">(% of GDP)</td><td>2017</td><td colspan="2">2018</td><td colspan="2">2019</td></tr>
<tr><td>COM</td><td>SP</td><td>COM</td><td>SP</td><td>COM</td></tr>
<tr><td colspan="6">Structural balance pillar</td></tr>
<tr><td>Required adjustment[4]</td><td>0.6</td><td colspan="2">0.6</td><td colspan="2">0.6</td></tr>
<tr><td>Required adjustment corrected[5]</td><td>0.6</td><td colspan="2">0.6</td><td colspan="2">0.6</td></tr>
<tr><td>Change in structural balance[6]</td><td>0.5</td><td>0.0</td><td>0.0</td><td>0.3</td><td>-1.0</td></tr>
<tr><td>One-year deviation from the required adjustment[7]</td><td>0.0</td><td>-0.6</td><td>-0.6</td><td>-0.3</td><td>-1.6</td></tr>
<tr><td>Two-year average deviation from the required adjustment[7]</td><td>0.0</td><td>-0.3</td><td>-0.3</td><td>-0.45</td><td>-1.1</td></tr>
<tr><td colspan="6">Expenditure benchmark pillar</td></tr>
<tr><td>Applicable reference rate[8]</td><td>-0.1</td><td colspan="2">1.2</td><td colspan="2">1.4</td></tr>
<tr><td>One-year deviation adjusted for one-offs[9]</td><td>0.0</td><td>-0.2</td><td>-0.6</td><td>-0.3</td><td>-1.5</td></tr>
<tr><td>Two-year deviation adjusted for one-offs[9]</td><td>0.0</td><td>-0.1</td><td>-0.3</td><td>-0.3</td><td>-1.1</td></tr>
<tr><td>PER MEMORIAM: One-year deviation[10]</td><td>0.0</td><td>-0.5</td><td>-0.7</td><td>-0.9</td><td>-1.3</td></tr>
<tr><td>PER MEMORIAM: Two-year average deviation[10]</td><td>0.0</td><td>-0.3</td><td>-0.4</td><td>-0.7</td><td>-1.0</td></tr>
</table>

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 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, 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 2017) is carried out on the basis of Commission 2018 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 :

Stability Programme (SP); Commission 2018 spring forecast (COM); Commission calculations.

5. FISCAL SUSTAINABILITY

France does not appear to face fiscal sustainability risks in the short run. Nonetheless, there are some indications that the fiscal side of the economy poses potential challenges.[5]

[5] This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 5 for a definition of the indicator.

Based on Commission 2018 spring forecasts and a no-fiscal policy change scenario beyond the forecast horizon, government debt, at 97.0 % of GDP in 2017, is expected to increase to 108.2% in 2028), thus remaining above the 60% of GDP Treaty threshold. Over this horizon, government debt is projected to peak in 2028. Sensitivity analysis shows similar risks.[6] Overall, this highlights medium risks for the country from debt sustainability analysis in the medium term. The full implementation of the Stability Programme would put debt on a clearly decreasing path by 2028, although remaining above the 60% of GDP reference value in 2028.

The medium-term fiscal sustainability risk indicator S1[7] is at 5.5 percentage points of GDP, primarily related to the high level of government debt and the initial budgetary position, which contribute with 2.7 and 2.4 percentage points of GDP respectively, thus indicating high risks in the medium term. The full implementation of the Stability Programme would put the sustainability risk indicator S1 at 2.8 percentage points of GDP, leading to similar medium-term risk. Overall, risks to fiscal sustainability over the medium term are, therefore, high. Fully implementing the fiscal plans in the Stability Programme would decrease those risks.

The long-term fiscal sustainability risk indicator S2 is at 1.0 percentage points of GDP. In the long term, France therefore appears to face low fiscal sustainability risks, primarily related to the initial budgetary position, contributing with 2.5 percentage points of GDP. Full implementation of the programme would nonetheless put the S2 indicator at -1.8 percentage points of GDP, leading to an even lower long-term risk. [8]

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[6] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Debt Sustainability Monitor 2017 for more details).

[7] See the note to Table 5 for a definition of the indicator.

[8] The projected costs of ageing used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the updated projections, endorsed by the EPC on 30 January 2018, and to be published in the forthcoming Ageing Report 2018.

Table 5. Fiscal Sustainability Assessment
France

Time horizon				Commission Scenario		Stability / Convergence Programme Scenario	
Short Term				**LOW risk**			
	S0 indicator [1]			0.2			
	Fiscal subindex			0.4	HIGH risk		
	Financial & competitiveness subindex			0.1	LOW risk		
Medium Term				**HIGH risk**			
	DSA [2]			HIGH risk			
	S1 indicator [3]			5.5	HIGH risk	2.8	HIGH risk
	of which						
		Initial Budgetary Position		2.4		-0.3	
		Debt Requirement		2.7		2.9	
		Cost of Ageing		0.4		0.3	
		of which					
			Pensions	0.3		0.2	
			Health-care	0.2		0.1	
			Long-term care	0.1		0.1	
			Other	-0.2		-0.2	
Long Term				**LOW risk**		**LOW risk**	
	S2 indicator [4]			1.0		-1.8	
	of which						
		Initial Budgetary Position		2.5		-0.1	
		Cost of Ageing		-1.5		-1.8	
		of which					
			Pensions	-1.9		-2.1	
			Health-care	0.4		0.3	
			Long-term care	0.5		0.5	
			Other	-0.5		-0.4	

Source: Commission services; 2018 stability/convergence programme.

Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2018 forecast covering until 2019 included. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.

[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.

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

[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2032. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2020 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.

[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.

* For more information see Fiscal Sustainability Report 2015 and Debt Sustainability Monitor 2017.

6. FISCAL FRAMEWORK

The 2018-2022 multiannual programming law for public finances has reinforced spending norms at the State level as well as set the indicative ceilings for operational spending by local authorities until 2022 and the healthcare expenditure growth ceilings until 2020. In particular, this law has introduced two new expenditure ceilings improving the control of spending by the State: one focuses on a narrower definition of spending directly under the control of the government whereas the other applies to the total spending of the State. These two ceilings have replaced the former State expenditure ceilings imposing no growth for public expenditure measured in real terms and setting a ceiling on all public spending out of the perimeter of debt and pensions. While the previous expenditure ceilings have been broadly useful for controlling State spending, the new ceilings are expected to be more effective as they relate to aggregates on which the government can intervene more easily.

The achievement of the planned budgetary targets will rely on the results of the new approach to the evaluation of public policies. In October 2017, the government announced the replacement of the previous spending review by a new initiative called *Action Publique 2022* (AP2022), aiming to enhance the quality of public services for their users, to provide for a modern work environment in the public administration, and to accompany the decrease in public expenditure, targeting a fall of more than 3 percentage points of GDP by 2022. The roadmap for this initiative will be set on the basis of the report to be submitted by a committee of experts (*Comité AP2022*) before summer 2018. While the political ownership accompanying the AP 2022 initiative will likely to be stronger thanks to a periodical coverage in the Council of Ministers, new savings are not to be expected before 2020.

As already mentioned in Section 3.3, the growth ceiling for healthcare expenditure, the ONDAM (*Objectif National de Dépenses d'Assurance Maladie*), covering a third of social security spending, has been increased from 2.1% in 2017 to 2.3 % for the years 2018-2020. This increase reflects the dynamism of spending for innovative treatments and the impact of pay-related measures in 2018. Notwithstanding the respect of this ceiling continues to be achieved every year, the *Comité d'alerte de l'ONDAM* pointed out that the healthcare expenditure ceiling did not respect the initial target set in 2017 (2.1 %) and that additional buffers would be needed to compensate for possible in-year expenditure slippages.

The spending ceiling for operational expenditure at local level has been set at a rate of 1.2 % up to horizon 2022. Investments for local authorities are instead expected to grow by 5.7 % in 2018, following the same growth rate observed in 2017 and in coherence with the electoral cycle. Cuts in transfers from the State to local authorities are going to be replaced by a contract agreement between the State and local authorities. Indeed, spending at local level is guided by the ODEDEL (*Objectif d'évolution de la Dépense Locale*), indicating yearly non-binding growth targets for both total and operational public expenditure at local level. In order to respect the ODEDEL targets, State transfers to local authorities were cut over a period of three years (2014-2017). Starting from 2018, this approach is replaced by contracts – to be signed by the State and the biggest local authorities by 30 August 2018 – indicating local authorities' contribution to the savings effort until 2022. The new contracts between the State and local authorities might allow to mitigate the risk that a pick up in investment spending could lead to overruns in the local authorities' total expenditure, despite the respect of operational spending ceilings. However, the new contracts will not modify the role of each layer of regional or local administration. Notwithstanding the creation of metropolitan areas and the reduction in the number of regions from 22 to 13 as of January 2016, the number of regional and local administrative layers is unchanged and the role of each layer of regional or local administration has only been partly clarified. Local authorities' contribution to the savings effort until 2022, hence, will remain constrained by the current structure of the local administration.

Based on the information provided in the 2018 Stability Programme, the past, planned and forecast fiscal performance in France appears to broadly comply with the requirements of the applicable numerical fiscal rules. The Stability Programme can also be considered as the national medium-term fiscal plan in line with the requirements of the Two Pack regulation 473/2013, although this document does not explicitly recall the obligations set out in Art. 4(1) according to which euro area MSs have to make public by 30 April each year their national medium-term fiscal plans, including an assessment of the expected economic returns on non-defence public investment projects having a significant budgetary impact.

The macroeconomic forecast underlying the Stability Programme

The High Council for Public Finances (HCPF), the independent monitoring body attached to the French Court of Auditors, released on 13 April an opinion on the macroeconomic forecasts underlying the Stability Programme. In its opinion, the HCPF considers that the macroeconomic scenario underpinning the Stability Programme is plausible regarding the 2018 projections for GDP growth, as well as the forecast used for inflation, employment and salary mass. The HCFP also flagged that the GDP growth forecast for 2019 is within reach, while it is optimistic between 2020 and 2022 with economic growth consistently above its potential. Moreover, the HCPF highlights the necessity to respect the objectives planned in terms of public expenditure reduction, which are a key condition to achieve the structural balance trajectory. As already noted by the HCFP in its opinion on the second amended budget law for the year 2017[9], the non-existent structural effort in 2017 and the very weak one in 2018 are at odds with the long way to go for bringing the structural balance back to the medium-term objective and the more favourable conditions for the realization of such an effort created by the improvement in the economic situation.

7. SUMMARY

In 2017, France achieved a headline deficit of 2.6% of GDP, below the target under the EDP and in line with the deadline for the correction of the excessive deficit set by the Council. However, the fiscal effort has not been delivered according to all metrics. Based on both the information provided in the Stability Programme and the Commission 2018 spring forecast, the headline deficit is expected to remain below the 3.0% of GDP reference value over the Programme period and the forecast horizon, respectively.

France would be subject to the preventive arm of the Stability and Growth Pact from 2018 onwards and to the transition period as regards compliance with the debt criterion. According to the information in the Stability Programme, France would be at risk of some deviation from the recommended adjustment path towards the MTO in 2018 and at risk of significant deviation in 2018 and 2019 taken together. According to the Commission 2018 spring

[9] Avis n° 2017-6 du Haut Conseil pour les Finances Publiques relatif au deuxième projet de loi de finances rectificative pour l'année 2017.

forecast though, France would be at risk of significant deviation from the recommended adjustment path towards the MTO in both 2018 and 2019. Moreover, while France plans compliance with the debt criterion in 2018 and 2019, the Commission forecast projects that the debt criterion will not be met in any of both years.

8. ANNEXES

Table I. Macroeconomic indicators

	2000-2004	2005-2009	2010-2014	2015	2016	2017	2018	2019
Core indicators								
GDP growth rate	2.1	0.7	1.2	1.1	1.2	1.8	2.0	1.8
Output gap [1]	1.6	1.2	-1.2	-1.4	-1.3	-0.7	0.1	0.6
HICP (annual % change)	2.0	1.7	1.6	0.1	0.3	1.2	1.7	1.4
Domestic demand (annual % change) [2]	2.3	1.2	1.2	1.6	1.9	2.1	1.8	1.8
Unemployment rate (% of labour force) [3]	8.3	8.4	9.8	10.4	10.1	9.4	8.9	8.3
Gross fixed capital formation (% of GDP)	21.2	22.6	22.2	21.6	22.0	22.4	22.8	23.1
Gross national saving (% of GDP)	22.8	22.0	20.0	20.5	20.4	21.0	21.5	21.9
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-2.7**	**-3.8**	**-5.0**	**-3.6**	**-3.4**	**-2.6**	**-2.3**	**-2.8**
Gross debt	**61.3**	**69.5**	**90.4**	**95.6**	**96.6**	**97.0**	**96.4**	**96.0**
Net financial assets	**-38.2**	**-40.3**	**-64.4**	**-75.8**	**-79.1**	**n.a**	**n.a**	**n.a**
Total revenue	49.6	49.9	51.9	53.2	53.2	53.9	53.7	52.4
Total expenditure	52.3	53.7	56.9	56.8	56.6	56.5	56.0	55.1
of which: Interest	2.9	2.7	2.5	2.0	1.9	1.8	1.7	1.6
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**-0.2**	**-0.3**	**-1.2**	**-1.7**	**-2.0**	**-3.0**	**-3.2**	**-2.5**
Net financial assets; non-financial corporations	**-86.1**	**-97.1**	**-98.4**	**-98.7**	**-95.8**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**4.5**	**0.4**	**12.1**	**13.2**	**4.4**	**n.a**	**n.a**	**n.a**
Gross capital formation	11.8	12.3	12.6	13.7	13.9	14.8	15.0	15.2
Gross operating surplus	18.0	17.9	17.2	17.9	17.7	17.5	17.3	18.2
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**3.8**	**3.0**	**3.6**	**3.0**	**2.9**	**2.7**	**2.4**	**2.2**
Net financial assets	**125.6**	**133.1**	**142.4**	**154.0**	**163.2**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	37.9	38.0	38.8	38.5	38.7	38.9	38.9	39.0
Net property income	5.9	5.8	5.4	4.9	4.7	4.6	4.6	4.5
Current transfers received	23.7	24.4	26.4	26.8	26.9	26.8	26.6	26.2
Gross saving	9.8	9.6	9.7	8.8	8.7	8.8	8.8	8.8
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**1.0**	**-1.0**	**-2.6**	**-2.3**	**-2.5**	**-2.9**	**-3.1**	**-3.0**
Net financial assets	**-3.9**	**6.4**	**12.4**	**10.7**	**11.2**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	1.1	-1.1	-2.1	-1.5	-1.9	-2.5	-2.5	-2.3
Net primary income from the rest of the world	1.5	2.0	1.7	1.5	1.6	1.6	1.6	1.5
Net capital transactions	-0.1	0.0	0.0	-0.1	0.1	0.1	-0.2	-0.3
Tradable sector	39.2	35.9	34.4	34.4	34.4	34.3	n.a	n.a
Non tradable sector	50.8	54.0	55.4	55.0	55.0	54.8	n.a	n.a
of which: Building and construction sector	4.6	5.4	5.3	4.9	4.9	4.9	n.a	n.a
Real effective exchange rate (index, 2000=100)	93.2	100.0	100.4	97.5	97.4	98.8	100.6	98.2
Terms of trade goods and services (index, 2000=100)	101.2	99.6	98.6	102.7	103.5	102.7	102.2	102.6
Market performance of exports (index, 2000=100)	114.9	102.7	103.8	103.7	101.4	100.0	99.4	99.4

Notes:

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

[2] The indicator on domestic demand includes stocks.

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

Source :
AMECO data, Commission 2018 spring forecast