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**COMMISSION OPINION**

**of 22.11.2017**

**on the Draft Budgetary Plan of France**

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#### GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.
2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

#### CONSIDERATIONS CONCERNING FRANCE

3. On the basis of the Draft Budgetary Plan for 2018 submitted on 16 October 2017 by France, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013. The Commission sent a letter to France on 27 October 2017 asking for further information and highlighted a number of preliminary observations related to the Draft Budgetary Plan. France replied to the Commission's letter on 1 November 2017. This information has been taken into account in the Commission's assessment of budgetary developments and risks.
4. France is currently subject to the corrective arm of the SGP. The Council opened the Excessive Deficit Procedure (EDP) for France on 27 April 2009. On 10 March 2015 the Council adopted a revised recommendation, asking France to correct its excessive deficit by 2017. In order to bring the headline government deficit below the 3% of GDP reference value by 2017, France was recommended to reach a headline deficit target of 4.0 % of GDP in 2015, 3.4 % of GDP in 2016 and 2.8 % of GDP in 2017, which was at that time deemed consistent with delivering an improvement in the structural balance of 0.5 % of GDP in 2015, 0.8 % of GDP in 2016 and 0.9 % of GDP in 2017, requiring additional measures of 0.2 % of GDP in 2015, 1.2 % of GDP in 2016 and 1.3 % of GDP in 2017 based on the extended Commission 2015 winter forecast.<sup>1</sup>

If the excessive deficit were to be corrected in a timely and durable manner, France would be subject to the preventive arm of the SGP from 2018 onwards and should ensure sufficient progress towards its medium term budgetary objective of -0.4% of GDP. In particular, the Council recommended<sup>2</sup> France on 11 July 2017 to pursue a substantial fiscal effort in 2018, taking into account the need to strengthen the ongoing recovery and to ensure the sustainability of France' public finances. According to the commonly agreed adjustment matrix under the Stability and

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<sup>1</sup> The Commission 2015 winter forecast horizon was extended to include 2017 in the projection.

<sup>2</sup> Council Recommendation of 11 July 2017 on the 2017 National Reform Programme of France and delivering a Council opinion on the 2017 Stability Programme of France (OJ C 261, 9.8.2017, p. 36–40).

Growth Pact, this adjustment translates into a requirement of a nominal growth rate of net primary government expenditure which does not exceed 1.2% in 2018, corresponding to an annual structural adjustment of 0.6% of GDP. As the debt-to-GDP ratio exceeds the 60% Treaty reference value, France would also be subject to the transitional arrangements as regards compliance with the debt reduction benchmark during the three years following the correction of the excessive deficit.

5. Overall, the macroeconomic scenario underlying the 2018 Draft Budgetary Plan is cautious in 2017 and plausible in 2018. The macroeconomic scenario underlying the 2018 Draft Budgetary Plan forecasts GDP growth at 1.7% in both 2017 and 2018 (calendar adjusted). Growth is set to be mainly driven by the pick-up in investment, in particular thanks to a sharp rebound in public investment in 2018, and to the gradual recovery in exports, whereas private consumption is projected to lose momentum. Employment is projected to decelerate in 2018, mainly due to the planned decrease in subsidised public employment. In turn, the Draft Budgetary Plan projects HICP inflation to increase to 1.1% in 2017 and to 1.2% in 2018. Compared to the 2017 Stability Programme, the growth projections have been revised up by 0.2 percentage point in both years. The Commission 2017 autumn forecast projects GDP growth at 1.6% in 2017 (1.8% calendar adjusted). For 2018, the growth rate projected by the Commission 2017 autumn forecast is identical to that of the authorities.
6. France complies with the requirement of Regulation EU No 473/2013 that the draft budget has to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have been endorsed by the High Council for Public Finances (HCFP). In its endorsement of the forecasts the HCFP nevertheless flagged that the long term GDP growth forecast are on the high side, as they lead to a positive output gap in 2022 (+1.1% of potential GDP).
7. The Draft Budgetary Plan plans a deficit of 2.9% of GDP for 2017. This is consistent with an improvement in the structural balance<sup>3</sup> of 0.2 % of GDP in 2017. The planned deficit for 2017 is 0.1% of GDP higher than the 2.8% of GDP deficit target set forth in the Stability Programme. Specifically, the revenue-to-GDP ratio was revised upwards by 0.2 percentage point, while the expenditure-to-GDP was increased by 0.4 percentage point to reflect under-budgeting and expenditure overruns unveiled by the June public finances audit report by the French Court of Auditors as well as the recapitalisation of AREVA, a State owned nuclear company, for 0.1% of GDP. The expenditure plans also include the complementary consolidation measures by EUR 4.2 billion adopted in order to ensure that the deficit is reduced below 3% of GDP. For 2018, the deficit is planned to decline to 2.6% of GDP, which implies no improvement in the (recalculated) structural balance. This deficit target is 0.3 percentage point higher than the target of the Stability Programme submitted in April 2017. The planned deficit reduction in 2018 stems mainly from the envisaged reduction of the expenditure-to-GDP ratio by 0.6 percentage point, out of which 0.1 percentage point stems from a further decline in the interest burden. The overall revenue ratio is set to decrease marginally compared to 2017 due to the announced tax cuts by EUR 10.5 billion. The debt ratio is planned to stabilise at 96.8% of GDP as of 2018 and decline to 91.4% of GDP by 2022.

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<sup>3</sup> Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

8. The main revenue measures underpinning the Draft Budgetary Plan are the residence tax relief for the most vulnerable households, replacing the wealth tax with a real estate wealth tax and the introduction on a single flat-tax levy of 30% on interest income. These tax cuts would be partly compensated by an increase in environmental taxation and in public health taxes on tobacco and by the switch from social healthcare and unemployment insurance contributions to the Generalised Social Contribution in two stages. Other fiscal revenues include the planned dividend from the central bank of France, included in the Commission 2017 autumn forecast but with a lower yield– implying an upside risk of around EUR 1 billion (0.05% of GDP).

On the expenditure side, the savings originate from all public administrations. The number of State subsidised contracts and the amount of housing allowances are planned to be reduced while the State wage bill will be kept in check thanks to the reintroduction of the unpaid day in case of illness, the wage freeze and the reduction in the number of civil servants. These measures were included in the Commission forecast. The Commission forecast also takes into account the savings measures specified in enough detail underpinning the target growth of healthcare spending. However, on local authorities the planned savings are only partly included as the cut in State transfers was abandoned and the new contractual approach between the State and local authorities is not fully specified.

9. The correction of the EDP requires a lasting reduction in the headline deficit at or below 3% of GDP. The Commission 2017 autumn forecast expects the headline deficit to be at 2.9% of GDP in 2017, in line with the plans of the authorities. However, two major risks underlie the official target for 2017. First, the budgetary impact in 2017 stemming from the recapitalisation of AREVA could be higher than currently envisaged by the authorities. Compared to the DBP, the risk to the Commission 2017 forecast is even greater to the extent that this operation is not included at all. Second, the total invalidation of the 3% tax on dividends by the French Constitutional Court entails a risk for both the 2017 and 2018 deficit targets. While the total cost of around 0.45% of GDP could be spread over several years, the decision could trigger significant reimbursements already in 2017. The authorities introduced an exceptional tax on companies designed to compensate the budgetary impact of the decision in 2017, that is expected to amount to around half of the total cost and is not included in the Commission 2017 autumn forecast. It is not excluded, however, that the impact in 2017 would be higher. If these risks materialise, the deficit target of 2.9% of GDP and the correction of the excessive deficit in 2017 could be at risk.

For 2018, the Commission 2017 autumn forecast projects the headline deficit to remain at 2.9% of GDP, 0.3 percentage points higher than the planned deficit in the Draft Budgetary Plan. When compared with the Commission forecast, the risks underlying the official plans are mostly related to a more dynamic spending by central and local authorities and stronger social spending. The invalidation of the 3% tax on dividends, which will probably entail some budgetary effect in 2018, is another main risk to the official plans as regards the durability of the correction of the excessive deficit.

The debt trajectory forecast by the Commission is comparable to that in the Draft Budgetary Plan.

10. The structural balance is expected to improve by 0.2% of GDP in 2017, compared to the recommended effort of 0.9% of GDP. Regarding the change in the structural balance adjusted for changes in potential growth and revenue windfalls since the recommendation, the gap vis-à-vis the recommended fiscal effort amounts to 0.7% of GDP in 2017. Based on the bottom-up method, the fiscal effort is projected to have a gap of 0.6% of GDP in 2017. The cumulated shortfall over 2015-2017 would be of 1.6% of GDP based on both the top-down and bottom-up metrics. France is thus not expected to deliver the fiscal effort recommended under the EDP.
11. If the excessive deficit were to be corrected in a timely and durable manner, France would have to comply with the requirements of the preventive arm of the Stability and Growth Pact from 2018 onwards and, as its debt ratio is planned to be at 96.8% of GDP in 2017 according to the Draft Budgetary Plan, would be in the three-year transition period to make sufficient progress towards compliance with the debt reduction benchmark. Based on the Draft Budgetary Plan, France would not make sufficient progress towards compliance with the debt reduction benchmark in 2018. The same conclusion is reached based on the projections in the Commission 2017 autumn forecast as the structural balance is projected to deteriorate by 0.4% of GDP in 2018, which implies a gap of 0.8% of GDP from the required minimum linear structural adjustment.<sup>4</sup>
12. According to the Draft Budgetary Plan, the nominal growth rate of net primary government expenditure exceeds significantly the benchmark rate in 2018 (gap of 0.5% of GDP). The (recalculated) structural balance also signals a risk of significant deviation (gap of 0.6% of GDP). The small difference between both indicators stems primarily from the projected revenue windfalls that are broadly offset by the planned increase in public investment above its four-year average in 2018. Therefore, an overall assessment confirms the reading of the expenditure benchmark and concludes that the Draft Budgetary Plan plans a significant deviation from the requirements of the preventive arm in 2018. The Commission 2017 autumn forecast projects a wider deviation by 0.9% of GDP from the expenditure benchmark and by 1.0% of GDP the required change in the structural balance. The difference between the two pillars is marginal and, accordingly, the overall assessment would point to a risk of significant deviation from the recommended adjustment path towards the MTO in 2018.
13. The country-specific recommendations adopted by the Council on 11 July 2017 mentioned that the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances. The Commission has carried out a qualitative assessment of the strength of the recovery in France while giving due consideration to its sustainability challenges. France does not face short-term sustainability challenges although in the medium term the overall risks to fiscal sustainability are assessed as high. The recovery in France does not appear fragile. In particular, GDP growth is projected to keep growing above potential, although below the euro area average, and accordingly the output gap is closing rapidly. The capacity utilisation rate and the investment-to-GDP ratio are above their historical averages. In turn, the unemployment rate keeps going down thanks to strong employment

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<sup>4</sup> Should the excessive deficit be corrected in 2017, as the debt ratio is projected to be at 96.8% of GDP in 2017 according to the DBP, France would be in the transition period for the following three years to make sufficient progress towards compliance with the debt reduction benchmark as defined by the minimum linear structural adjustment.

growth. As a result, no additional elements in that regard need to be taken into account in the overall assessment.

14. The Draft Budgetary Plan announces a fiscal consolidation strategy centred on the containment of expenditure in real terms in order to finance lasting tax cuts, namely a reduction in the tax burden excluding tax credits of more than 1% of GDP between 2017 and 2022. The approach envisaged differs from the past fiscal consolidation efforts, which in most years since 2011 relied on the contribution of revenue-increasing measures. After several years of decline the authorities plan a first increase of the share of public investment in total expenditure, while as a share of GDP public investment is also planned to be above the euro area average in 2018.

The Draft Budgetary Plan contains measures reducing the tax burden on labour, in particular by cutting both on employees' and employers' contributions, with full implementation expected by the end of 2018 and as of January 2019, respectively. These measures are welcome in that they might entail a positive impact on potential growth and employment. The measure on employees' contributions also partly responds to the country-specific recommendation to broaden the overall tax base.

Concerning the structural part of the fiscal recommendations contained in the Council Recommendation of 11 July 2017, the Draft Budgetary Plan confirms the implementation of a more pronounced decrease over five years in the corporate income statutory rate compared to what was already planned. Further measures are specifically addressed to improve the growth-friendliness of the French tax structure, to promote investment and to increase the purchasing power of households, therefore to sustain domestic demand and growth. Finally, the Draft Budgetary Plan envisages a discontinuation of the most recent approach followed on expenditure reviews and foresees the inclusion of the efforts in this important field under a broader policy initiative ("Public Action 2022") for which however details are not yet known.

15. Overall, and after considering the need to balance the two objectives of strengthening the ongoing recovery and ensuring fiscal sustainability, the Commission is of the opinion that the Draft Budgetary Plan of France for 2018, which is currently under the corrective arm and could become subject to the preventive arm and the transitional debt rule from 2018, is at risk of non-compliance with the provisions of the Stability and Growth Pact. In particular, the Commission projects a risk of significant deviation from the required adjustment towards the MTO for 2018. Therefore, the Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2018 budget will be compliant with the SGP and to use windfall gains to accelerate the reduction of the government debt-to-GDP ratio. Compliance with the preventive arm requirements is a key relevant factor when assessing compliance with the debt criterion.

The Commission is also of the opinion that France has made some progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 11 July 2017 in the context of the 2017 European Semester and invites the authorities to make further progress. A comprehensive assessment of progress made with the implementation of the country-specific recommendations will be made in the 2018 Country Reports and in the context of the country-specific recommendations to be proposed by the Commission in May 2018.

Done at Brussels, 22.11.2017

*For the Commission*  
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*Member of the Commission*