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COMMISSION OPINION

of 21.11.2018

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 poicy 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 2019 submitted on 15 October 2018 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 19 October 2018 asking for further information and the reply by France of 22 October 2018 has been taken into account in the Commission's assessment of budgetary developments and risks.

4. France is subject to the preventive arm of the SGP. On 13 July 2018, the Council recommended France to ensure that the nominal growth rate of net primary government expenditure does not exceed 1.4 % in 2019, corresponding to an annual structural adjustment of 0.6 % of GDP towards the medium-term budgetary objective of -0.4% of GDP, and to use windfall gains to accelerate the reduction of the general government debt ratio[1]. As its public debt amounted to 98.5% of GDP in 2017, the year in which the excessive deficit was corrected, France also needs to make sufficient progress towards compliance with the debt reduction benchmark.

5. According to the Commission 2018 autumn forecast, the French economy is expected to grow by 1.7% in 2018 and 1.6% in 2019. Growth is forecast to be mainly driven by a rebound in private consumption and still dynamic investment, although the latter is set to gradually lose momentum. The macroeconomic scenario underlying the Draft Budgetary Plan is similar, with GDP forecast to grow by 1.7% in both 2018 and 2019 and a similar growth composition. The government expects employment growth to gradually lose some of its momentum, while inflation is projected to increase to 2.1% in 2018, before cooling down to 1.5% in 2019. The macroeconomic scenario underlying the 2019 Draft Budgetary Plan is plausible in 2018 and 2019. France complies with the requirement of Regulation (EU) No 473/2013 since the draft budget is based on independently endorsed macroeconomic

[1] Council Recommendation of 13 July 2018 on the 2018 National Reform Programme of France and delivering a Council opinion on the 2018 Stability Programme of France, OJ C 320, 10.9.2018, p.39

forecasts. In its opinion, the High Council of Public Finances (HCFP) considers the government's GDP growth forecast as credible for 2018 and plausible for 2019. Moreover, the HCFP takes notice of the higher uncertainty surrounding the external environment scenario in 2019.

6. The Draft Budgetary Plan projects a deficit of 2.6% of GDP for 2018, which implies no improvement in the structural balance[2] with respect to 2017. For 2019, the deficit is planned to increase to 2.8% of GDP due to the one-off impact of the transformation of the Crédit d'impôt pour la compétitivité et l'emploi (CICE) into an outright reduction in social security contributions by around 0.9% of GDP. Without this impact the deficit would amount to 1.9% of GDP. The planned headline deficit is consistent with an improvement in the structural balance of 0.2% of GDP. The Commission 2018 autumn forecast projects headline deficits of 2.6% of GDP in 2018 and of 2.8% of GDP in 2019, fully in line with the targets set out in the Draft Budgetary Plan. The projected changes in the structural balance in the Commission's projections are also broadly in line with those in the Draft Budgetary Plan.

7. The consolidation strategy in the Draft Budgetary Plan is mainly expenditure-based and mostly relies on the continued impact of measures already adopted. On the revenue side, the main new measures entail a net deficit-reducing impact of about 0.1% of GDP. They include the exemption from a higher Contribution Sociale Généralisée amount for low-income pensioners, the exemption of overtime pay from employees' social security contributions as of September 2019, the elimination of employers' social security contribution for small and medium-sized enterprises, which are expected to reduce the tax wedge on labour for average wage earners. They are more than compensated by revenue-increasing new measures such as the postponement of the additional reduction of employers' social contributions at the minimum wage until October 2019, the increase in the 5th payment by instalment of the corporate income tax and the elimination of the tax break for off-road uses of diesel oil. On the expenditure side the main measures in the Draft Budgetary Plan entail savings at around 0.3% of GDP. They include the moderation of the indexation of retirement pensions and other social benefits, the continued reduction of subsidised employment contracts and the number of public sector employees and the continued control of healthcare spending. All those measures are specified in sufficient detail and they are included in the Commission 2018 autumn forecast accordingly.

8. With respect to the Recommendation of 13 July 2018 addressed by the Council to France to implement expenditure savings in 2018 and fully specify the objectives and new measures needed, the Draft Budgetary Plan does not fully specify expenditure savings and efficiency gain measures in the context of Public Action 2022 and, despite some anouncements, does not put forward concrete proposals for the reform of the pension system. The revenue measures on track and foreseen are meant to reduce the cost of labour and favour job creation. The fiscal stance envisaged in the Draft Budgetary Plan for 2019 is mildly contractionary and slightly countercyclical. In response to the Council Recommendation of 13 July 2018, France has introduced a new mechanism so as to use windfall gains to accelerate the reduction of general government debt.

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

9. In 2018, for France to comply with the requirements of the preventive arm, the nominal growth rate of government expenditure, net of discretionary revenue measures and one-offs[3], should not exceed 1.2%, corresponding to an annual structural adjustment by 0.6% of GDP. According to the data in the Draft Budgetary Plan, the expenditure benchmark shows a gap of 0.6% of GDP, which points to a significant deviation from that requirement. In turn, the Commission 2018 autumn forecast implies a slightly lower expenditure benchmark gap, pointing to a risk of some deviation from the requirement.

In 2019, for France to comply with the requirements of the preventive arm, the nominal growth rate of government expenditure, net of discretionary revenue measures and one-offs, should not exceed 1.4%, corresponding to an annual structural adjustment by 0.6% of GDP. The expenditure benchmark shows a gap of 0.1% of GDP, which points to some deviation from that requirement. However, for 2018 and 2019 taken together, the expenditure benchmark shows a significant deviation as the gap amounts to 0.4% of GDP on average. Those conclusions are confirmed by the Commission 2018 autumn forecast, which points to an expenditure benchmark gap of 0.3% of GDP for 2019 and to an expenditure benchmark gap of 0.4% of GDP for 2018 and 2019 taken together.

10. The Draft Budgetary Plan indicates that government debt will reach 98.6% of GDP in 2019, broadly in line with the Commission's projections. The Draft Budgetary Plan does not include sufficient information to assess compliance with the transitional arrangements to make sufficient progress towards compliance with the debt reduction benchmark. Based on the Commission 2018 autumn forecast, France is not projected to make sufficient progress towards compliance with the debt reduction benchmark in 2018 and 2019, with a gap of 0.5% and 0.8% of GDP, respectively.

11. Overall, the Commission is of the opinion that the Draft Budgetary Plan of France 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 medium-term budgetary objective for 2018 and 2019 taken together. Moreover, France is not expected to make sufficient progress towards compliance with the debt reduction benchmark in 2018 and 2019. Therefore, the Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2019 budget will be compliant with the SGP and to use windfall gains to accelerate the reduction of the government debt-to-GDP ratio.

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

The Commission is also of the opinion that France has made limited progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 13 July 2018 in the context of the European Semester and thus invites the authorities to accelerate progress. A comprehensive description of progress made with the implementation of the CSRs will be made in the 2019 Country Reports and assessed in the context of the country-specific recommendations to be proposed by the Commission in May 2019.

Done at Brussels, 21.11.2018

For the Commission
Pierre MOSCOVICI
Member of the Commission