FRENCH STABILITY PROGRAMME 2009-2012

DECEMBER 2008

Liberté • Égalité • Fraternité
RÉPUBLIQUE FRANÇAISE

Le Ministre

Paris, le 2 2 DEC. 2008

Monsieur le Commissaire, cher Joachim,

La crise financière qui sévit actuellement dans le monde a bouleversé le cadre économique du programme de stabilité et de croissance des pays européens.

La faillite de la banque américaine Lehman Brothers le 15 septembre a transformé des turbulences financières déjà inquiétantes en une crise bancaire et économique internationale d'une ampleur historique.

Dès le 26 novembre, la Commission a fait connaître ses propositions en matière de relance des économies européennes. Dans le sillage de ce document, le Conseil Ecofin des 1er et 2 décembre puis le Conseil européen des 11 et 12 décembre 2008 ont approuvé un plan de relance de l'économie européenne.

En décembre, la France a adopté un plan de relance respectueux de ces lignes directrices. Ce plan a été construit pour se traduire par un effet immédiat, être limité dans le temps et ciblé sur les secteurs le plus touchés et les plus importants au regard de la structure de l'économie.

La mise en œuvre du plan de relance ne remet pas en question les efforts de consolidation structurelle des comptes publics. En premier lieu, l'effet du plan de relance sur le déficit public est temporaire et très concentré sur l'exercice 2009. La cible de solde structurel en 2012 reste inchangée.

Par ailleurs, les réformes structurelles, en favorisant la croissance à moyen terme, permettent et favorisent l'assainissement des finances publiques. En 2008, cette orientation fondamentale de la politique économique française s'est matérialisée dans de nombreuses et importantes réformes sur le marché du travail et sur le marché des biens et services.

Pour atteindre le retour à l'équilibre des finances publiques d'ici à 2012, le taux de prélèvements obligatoires resterait globalement constant sur la période de la programmation, autour de son niveau atteint en 2008, soit 43,2% du PIB.

Ce programme de stabilité présenté par la France a donc pour ambition d'allier la nécessaire réponse rapide à une crise historique au non moins nécessaire respect des engagements d'assainissement de nos comptes publics à moyen terme.

Je vous prie de croire, Monsieur le Commissaire, à l'assurance de ma haute considération.

Christine Lagarde

Monsieur Joachim Almunia
Membre de la Commission européenne
200 rue de la Loi (BERL – 11238)
1048 Bruxelles
Belgique

MINISTÈRE DE L'ÉCONOMIE
DE L'INDUSTRIE ET DE L'EMPLOI

Paris, 22 December 2008

Joaquin Almunia
Member, European Commission
200 rue de la Loi (BERL – 11238)
1048 Brussels
Belgium

Dear Joaquin,

The financial crisis currently sweeping the world has upset the economic framework of the Stability Programme of the Member States.

When Lehman Brothers, the American financial services firm, went bankrupt on 15 September, the already worrisome financial turmoil became an international banking and economic crisis of historic proportions.

On 26 November, the Commission announced a European Economic Recovery Plan. In the wake of this proposal, the Ecofin Council meeting on 1 and 2 December 2008 and the European Council of 11 and 12 December 2008 approved a strategy to stimulate the European economy.

In December, France adopted its own recovery plan reflecting these guidelines. This plan is built to become effective immediately, has a limited time span and targets the most significant and hardest-hit economic sectors.

The implementation of this plan does not affect the Government's structural efforts to consolidate France's public accounts. First, the impact of the recovery plan on the public deficit is temporary and limited mostly to 2009. We have not changed our structural balance objective for 2012.

In addition, the purpose of the structural reforms is to promote consolidation of public finances in order to achieve a sustainable recovery of growth. In 2008, this basic focus of economic policy was reflected in many important reforms in the labour market and in the market for goods and services.

Public finances can only reach equilibrium by 2012 if the aggregate tax burden remains constant at the level recorded in 2008, i.e. 43.2% of GDP, during the entire programme period.

The aim of France's Stability Programme is therefore to combine the need for a fast response to an historic crisis with the no less vital need to comply with France's medium-term public finance consolidation commitments.

Very truly yours,

Christine Lagarde

Introduction

The financial crisis currently sweeping the world has upset the economic framework of France's Stability Programme.

When Lehman Brothers, the American financial services firm, went bankrupt on 15 September, the already worrisome financial turmoil became an international banking and economic crisis of historic proportions. In times when interest rate cuts are less effective, budget policy becomes an important tool for stopping an adverse chain reaction with irreversible consequences.

On 26 November, the Commission announced a European Economic Recovery Plan. In the wake of this proposal, the Ecofin Council meeting on 1 and 2 December 2008 and the European Council of 11 and 12 December 2008 – both of which took place under the French Presidency – approved a strategy to stimulate the European economy. It offers a coherent framework for EU action and for the measures adopted by each Member State in light of its particular situation. It also includes priority actions to speed up economic adjustment to the challenges facing us today.

On 4 December, France adopted its own recovery plan reflecting these guidelines. This plan is built to become effective immediately, has a limited time span and targets the most significant and hardest-hit economic sectors.

The implementation of this plan does not affect the Government's structural efforts to consolidate France's public accounts.

First, the impact of the recovery plan on the public deficit is temporary and limited mostly to 2009. We have not changed our structural balance objective for 2012.

Second – as already emphasised in the previous Stability Programme – the purpose of the structural reforms is to promote consolidation of public finances in order to achieve a sustainable recovery of growth. In 2008, this basic focus of economic policy was reflected in many important reforms in the labour market and in the market for goods and services. Their aim is to make the economy more competitive by making the labour market more flexible and by stimulating competition in the goods and services markets.

Public finances can only reach structural equilibrium by 2012 if the aggregate tax burden remains constant at the level recorded in 2008, i.e. 43.2% of GDP, during the entire programme period.

Finally, Parliament has approved the Government's public finance governance reform, reflected in multi-year public finance estimates and a multi-year State budget.

The aim of France's Stability Programme is therefore to combine the need for a fast response to an historic crisis with the no less vital need to comply with France's medium-term public finance consolidation commitments.

Contents

1. Macroeconomic scenario

1.1. Current situation and short-term outlook (2008-2009)

After resisting the global slowdown until the beginning of 2008, French activity slumped in the second quarter and picked up slightly in the third quarter. The latest economic surveys of the industry and service sectors and recent construction figures suggest the likelihood of a downturn in the fourth quarter.

For the past year, the international environment has worsened for both France and its European partners. In the first half of 2008, the euro continued to rise sharply and oil prices reached record levels (including in euros). The slowdown of the French economy is also attested to by weak domestic demand. Overall household consumption, which showed average growth of 2.5% p.a. since 2000, remained flat in the first half of 2008, hampered by the negative impact of high inflation on purchasing power.

Since the fall of 2008, the developed economies have had to cope with a financial and economic crisis of historic proportions. The interbank market remains sluggish after the paralysis in October, and the housing market – under siege since late 2006 – continued to slump as household investment declined. Business investment is expected to fall until the end of 2008. French growth should hover around 1% in 2008.

In 2009, the financial crisis will likely continue to hurt growth in the euro area and in France. The recovery plan announced on 4 December 2008 by the French President should significantly absorb much of its adverse impact. In the median growth scenario, the Government's recovery measures will tweak growth by 0.8 points of GDP (see the box "Macroeconomic impact of the recovery plan"). If we take into account the government's policy to not compensate for tax losses triggered by the economic slowdown but to let automatic stabilisers work freely, the measures should lift GDP by a total of 1% in 2009.

The marked slowdown of global demand for France and persistently unattractive borrowing terms should affect both capital expenditure and household residential investment in 2009. The global downturn is also likely to hurt export sales. This would nevertheless be partly offset by the recent depreciation of the euro, which would keep French exporters competitive. The sharp drop in oil prices – down to one-third of where they stood last summer – can be expected to drive down inflation and underpin consumption, helped by government measures. The Act of 3 January 2008 to Promote Consumer-Oriented Competition and the Economic Modernisation Act of 4 August 2008 should help keep inflation at sustainable levels by encouraging competition among retailers. Household income will be supported by the Act of 21 August 2007 on Labour, Employment and Purchasing Power, the Act on Purchasing Power of 8 February 2008 and certain provisions in the economic recovery plan announced on 4 December 2008. All in all, French growth is expected to range from 0.2% to 0.5% in 2009.

This growth scenario suffers from unusually high uncertainty. While the latest economic figures are grim, Europe and the United States have implemented large-scale recovery plans likely to dampen the negative consequences of the crisis. Activity should be propped up by the sharper-than-expected drop in oil prices, slashed key rates, normalisation of interbank lending rates and new recovery measures taken by our partners. Conversely, slower absorption of the negative consequences of the financial crisis would reduce growth even further in 2009.

1.2. Medium-term outlook (2010–2012)

The economic scenario underlying the multi-year estimates assumes 2% growth p.a. in 2010 and 2.5% from 2011 onwards. The upturn in 2010 would reflect a gradual normalisation of the international environment and partial closure of the output gap in 2008 and 2009. In this scenario, average growth should settle slightly above potential growth, expected to rise gradually to 2.3% by 2012, helped by the structural reforms implemented by the Government in the goods and services markets and in the labour market.

The structural reforms on the labour market should help edge the economy gradually closer to full employment by 2012. The Government has launched various mechanisms to improve the labour supply. These are set out in greater detail in Section 5.1 of this report (such as reasonable job offers, *revenu de solidarité active* [working solidarity benefit] and a concerted national action plan for the employment of elderly people). Lastly, the Government has created *Pôle Emploi* to help match labour demand to supply.

Potential growth should also be lifted by stabilisation of per-capita hours, helped by the new rules on overtime tax and social security exemptions introduced by the Act on Labour, Employment and Purchasing Power ("TEPA") and the Act on Modernisation of the Social Democracy and Reform of Working Hours.

Lastly, implementation of the Economic Modernisation Act and a three-fold increase in the research tax credit should boost the overall productivity of production factors, partly explaining the increase in potential growth by 2012.

Box: macroeconomic impact of the recovery plan

The recovery plan announced on 4 December 2008 has a total budget of €26 bn, i.e. 1.3 points of GDP, divided as follows (for a detailed description of this plan, see 2.2, Action of the French Government within the framework of the European Economic Recovery Plan):

- €11.6 bn in cash to remove borrowing constraints for businesses, particularly by speeding up repayment of business claims on the State;
- €10.5 bn in public investment, divided between the State (€4 bn), public enterprises (€4 bn) and the local authorities, which will be supported for this purpose by the State (€2.5 bn);
- €2 bn for the sectors most exposed to the crisis: housing and the automotive industry;
- €2 bn for measures to support employment and the income of the poorest households.

The macroeconomic impact of the recovery plan is estimated to be 0.8 point of GDP (including the effect of measures on interest-free loans ("PTZ") and exemption from business tax on new investments in 2009). Its total impact is estimated to be 1 point of GDP including the impact of the automatic stabilisers.

Much of this impact would come from spending on infrastructures. This kind of expenditure has a particularly strong impact in the short term owing to its amount (€10.5 bn) since it has a direct effect on activity and a low import content. Consequently, its multiplying effect is extremely high, close to 1.

In early 2009, at a time when borrowing constraints remain high, the Government will begin to repay business claims on the State (more than €11 bn) before they are due. This will allow businesses to stick to their investment decisions and to avoid bankruptcy and so boost growth almost immediately. These measures will alleviate the cash position and allow straitened businesses to finance planned investments.

The remaining measures are intended to provide direct support for available household income and household consumption (*prime de solidarité active* - active solidarity bonus), automotive manufacturing (*prime à la casse* - scrapping bonus), construction (housing measures) and job creation (active employment policies and recruitment incentives for very small businesses).

The uncertainties linked to the financial crisis may spark a wait-and-see attitude on the part of private agents (postponement of business investments and major household purchases). The Government's recovery plan, which gives first place to investment by the State and public enterprises, will soften the pessimism of private agents through its direct impact on the economy.

The aggregate effect of the measures adopted against the crisis is an estimated 0.8 point of GDP including exemption from business tax for investments made in 2009 (see 2.2. Action of the French Government within the framework of the European Economic Recovery Plan) and the interest-free green loan ("éco-PTZ" - Included in the Budget Bill for 2009, this zero-rate loan is intended to finance thermal upgrades in the home). The impact of the automatic stabilisers is estimated at 0.25 point of GDP. To sum up, the Government's budget policy should tweak growth on an ex-post basis by more than 1% of GDP in 2009.

Table 1: Macroeconomic scenario, 2010-2012

	2010	Average 2011-2012
GDP	2.0	2.5
Domestic demand	2.0	2.4
Household spending	2.5	2.8
General government spending	0.5	0.5
Gross fixed capital formation	2.4	3.2
o.w. businesses [1]	6.0	4.9
Contribution from inventories	0.1	0.1
Contribution from foreign exchanges	0.0	0.0
Exports	5.0	6.5
Imports	4.6	6.1
GDP deflator	1.75	1.75
Consumer price index	1.75	1.75
Private-sector wage bill	4.0	4.6
Average nominal private-sector wage per capita	3.7	3.7
Dependent employment in the private sector	0.3	0.9

[1] Non-financial companies and individual enterprises.

2. General government balance and debt

2.1. Public finance objectives and overall strategy

The Government's medium-term objective (MTO) is to restore the structural balance of public finances in 2012 by a judicious combination of controlled public expenditure and a stable tax burden.

This general strategy responds to the long-term challenges facing the French economy:

- The return to equilibrium of the structural balance is a powerful lever to **restore the long-term sustainability of public finances** while population is aging and to complement the structural reforms of the pension system. The medium-term objective of a return to a structural balance will make it possible to pre-finance two-thirds of the additional expenditure generated in the long term by the aging process (see the section on Sustainability);
- Lower public expenditure will make it possible to reduce the tax burden and thus **make the French economy more competitive and increase its growth potential**.

Looking beyond the current exceptional circumstances, the Government reaffirms its strategy to control expenditure in the long term while preserving the public revenue ratio. This will ensure regular structural consolidation of public finances while allowing the automatic stabilisers free play during recessions in order to avoid a procyclical policy.

The ongoing financial crisis, its sudden, heavy impact on activity and the risk of a lasting recession call for exceptional measures. However, these should not undermine the general reform policy or the long-term strategy. This is the idea underlying the recovery plan announced by the French President on 4 December 2008.

Some of the **measures adopted as part of plans to rescue the financial system and revive investment** have a short-term cost for public finances. However, they **do not affect the public accounts consolidation objective**:

- **The plan to bail out the financial system does not weigh on public finances:** the State's guarantees accrue interest at the market rate; the capital investments - also interest-bearing - automatically raise gross public debt but do not affect net public debt or the public deficit. In time, the State plans to sell these holdings. Any capital gains would be used to reduce debt.
- **Most of the measures taken as part of investment recovery plan are temporary**; one-time expenditure will primarily affect the deficit in 2009; the accelerated investments in 2009 and 2010 will not be included in budget estimates for subsequent years.

Since the presentation of the Initial Budget Bill and the latest public-finance notification to the European Commission on 1 October 2008, the Government has revised its growth and public finance forecasts. Initially, the slowdown and the decision to let the automatic stabilisers play their role prompted the Government to lower its growth estimates. However, the Government subsequently adjusted its forecasts taking into account the impact of the public finance recovery plan announced on 4 December 2008. In view of the worsening economic environment - faster and deeper than expected at the end of October - the implementation of the recovery plan, coordinated with the other European countries, can be expected to achieve the Government's growth objectives for 2009.

For 2008, the deficit forecast was revised upward from **2.7 to 2.9 points of GDP** due to lower revenues (about €3 bn). First, the State's net tax revenue was revised downward by €2 bn, particularly revenue from corporation tax and VAT. Secondly, the slowing wage bill can be expected to affect social security revenue.

For 2009, the deficit forecast was revised upward from **2.7 to 3.9 points of GDP**: -0.8 point of GDP due to the recovery plan and -0.4 point of GDP owing to adjustment of macroeconomic forecasts with nearly zero elasticity of the State's net tax revenue to activity (0.3).

As the budgetary impact of the recovery plan will be felt mostly in 2009, **the 3% boundary is crossed only temporarily**. The underlying drive to control expenditure in the medium term will be maintained. The public balance should recover to 2.7 points of GDP in 2010 and subsequently, with the return to a growth rate close to the potential, to a nominal deficit of 1.1 point of GDP in 2012.

Table 2: Multi-annual public finance trajectory

	2007	2008	2009	2010	2011	2012
Public balance (% GDP)	-2.7	-2.9	-3.9	-2.7	-1.9	-1.1
Public debt (% GDP)	63.9	66.7	69.1	69.4	68.5	66.8
Structural balance (% potential GDP)	-2.7	-2.4	-2.7	-1.4	-0.7	0.0
o.w. impact of the recovery plan	*0.0*	*0.0*	*-0.8*	*-0.05*	*0.0*	*0.1*
Change in structural balance (% potential GDP)	-0.2	0.3	-0.3	1.3	0.6	0.7
Change in structural balance excluding recovery plan	*-0.2*	*0.3*	*0.5*	*0.6*	*0.6*	*0.6*

2.1.1. Trajectory of structural balance

In 2008, the worsening public balance overshadowed a major structural effort: the structural balance is in fact expected to improve by 0.3 point of GDP thanks to expenditure control.

In 2009, not including the impact of the investment-driven recovery plan, the structural balance should improve by 0.5 point of GDP. Including the recovery plan - whose short-term measures will worsen the public balance by 0.8 point of GDP - the structural balance should temporarily worsen by about 0.3 point of GDP.

From 2010 to 2012, the trajectory will be consistent with the adjustment pace recommended by the revised Pact: the structural improvement should be 0.6 point of GDP p.a. excluding the measures in the recovery plan. Taking account of the recovery plan's impact on the structural balance, the improvement should be 1.3 point of GDP in 2010, 0.6 point of GDP in 2011 and 0.7 point of GDP in 2012.

In view of the conservatism of the macroeconomic assumptions applied to the programme period under review (the output gap – significantly widened in 2008 and 2009 – is not expected to have disappeared by this horizon, in contrast with the traditional approach) the public deficit in 2012 should be mainly cyclical and the **structural balance should be close to equilibrium in 2012**.

2.1.2. Public debt trajectory

The forecast for 2008 factors in the impact on public debt of the *Société de Prises de Participation de l'État* (SPPE – State Holding Authority) as part of the plan to support the financing of the economy and the creation of the *Fonds Stratégique d'Investissement* (FSI - Strategic Investment

Fund). It reflects, *inter alia*, the acquisition of bank securities (0.6 point of GDP)[2], an increase in the State's cash position (0.5 point of GDP) to prefinance the measures of the recovery plan and the cash endowment of the FSI. These claims flows are in addition to the acquisition of assets by the *Fonds de Réserve pour les Retraites* (FRR – Pension Reserve Fund) and by complementary pension schemes, against a market background which makes it impossible to sell non-strategic assets before the end of 2008.

Net financial asset acquisition flows are assumed to be nil over the programme period (2009-2012)[3]. The weak economic environment at the start of the period should raise debt. A decreasing public deficit and stronger growth should improve the debt ratio by about 0.9 point of GDP in 2011 and about 1.75 point of GDP by 2012.

To sum up, public gross debt is higher in this Stability Programme (see table 8) than in the previous version. This adjustment does not appear to affect the sustainability of French public debt. In fact, the debt is increased by the acquisition of very high quality assets (super-subordinated notes) which will be sold some time in the future. It also reflects the consequences of financing the recovery plan, made vital by the worsening economic environment and in line with the recommendations of the European Commission. Lastly, the ailing equity markets make it impossible to sell non-strategic assets on satisfactory terms to reduce debt.

2.1.3. Public finance trajectory by sub-sector of the general government

Table 3: lending capacity (+) / borrowing requirement (-) of the general government (% of GDP)

	2007	**2008**	**2009**	**2010**	**2011**	**2012**
General government	-2.7	-2.9	-3.9	-2.7	-1.9	-1.1
Central government	-2.2	-2.5	-3.3	-2.3	-1.8	-1.2
o.w.: State	*-2.1*	*-2.5*	*-3.5*	*-2.5*	*-2.1*	*-1.5*
o.w.: Central government agencies	*-0.1*	*0.0*	*0.2*	*0.1*	*0.2*	*0.3*
Local governments	-0.4	-0.3	-0.3	-0.2	-0.1	0.0
Social security funds	-0.1	0.0	-0.3	-0.2	0.0	0.1

Each sub-sector should help reduce the general government's borrowing requirement by 2.8 points of GDP from 2009 to 2012:

- The State's borrowing requirement should decrease by 2.0 points of GDP from 2009 to 2012; 0.9 point of this improvement should come from the automatic impact of the economic recovery plan on the State's borrowing requirement during this period; spending control would account for most of the remaining 1.1 point.
- The financing capacity of the central government agencies should continue to show a surplus during the period from 2009-2012, reaching about 0.3 point of GDP, in particular thanks to the debt reduction of the *Caisse d'Amortissement de la Dette Sociale* (CADES – Social Security Debt Amortization Fund).
- The local governments should gradually reduce their deficit by just under 0.1 point of GDP p.a. and reach a balance close to equilibrium at the end of the programme period.

---

[2] The forecast includes the cost of the acquisition of shares of Dexia (€1 bn) and SPPE's acquisition of super-subordinated securities in the six main French banks (€10.5 bn). By contrast, public debt does not include the debt of the *Société de Financement de l'Economie Française* (SFEF), which should not be part of the general government owing to its financial intermediation business.

[3] These flows measure the impact of financial transactions on gross public debt.

- The balance of the social security funds - which includes the general regime as well as the complementary pension schemes and unemployment insurance - should begin to recover in 2010 and come close to break-even in 2011, thanks to tight spending control, particularly health insurance spending.

2.2. Action of the French Government within the framework of the European Economic Recovery Plan

The Ecofin Council of 1 and 2 December 2008 and the European Council of 11 and 12 December 2008, which were held under the French Presidency, approved a European Economic Recovery Plan. This plan offers a consistent framework for Union action and for the measures adopted by the Member States in the light of their particular situation. It includes priority actions to speed up economic adjustment to the challenges facing us today.

2.2.1. A timely, targeted and temporary budgetary response

The European Council recommends ensuring that measures to support demand have an immediate impact, have a limited time span and target the most significant and hardest-hit economic sectors (such as the automobile industry and the construction sector).

The French plan meets this three-fold requirement. The measures announced by the French President during his address on 4 December 2008 in Douai will come into force at the start of 2009: the tax measures have been included in the Supplementary Budget Bill for 2008, and the new appropriations are included in the Supplementary Budget Bill for 2009 adopted by the Cabinet on 19 December, which will be examined by Parliament starting 6 January 2009. These measures are mostly temporary. In the medium term, some will even have a positive impact on public finances. Lastly, the French plan focuses on measures to revive investment and so helps close the competitiveness gap accumulated by the French economy (see table A in Annex 2).

This **investment effort** is reflected in measures with a temporary impact on public finances:

- The State's direct investments in strategic areas (sustainable development, higher education and research, defence equipment) will increase by €4 bn in 2009 and 2010.
- The investments of public enterprises will increase by €4 bn.
- The State will support investment by local governments by early payment of the *Fonds de Compensation de la TVA* (FCTVA - VAT Compensation Fund) (estimated at €2.5 bn).
- A total of 70,000 additional subsidised flats and intermediate dwellings will be built and the interest-free loan for the acquisition of new dwellings will be doubled in 2009 to support the housing market.
- The State will speed up repayment of €11.6 bn in claims held by businesses to provide them in the months ahead with the additional financing needed – and all too often lacking – to have a viable cash position or to wrap up borrowing plans.
- Car owners who scrap cars that are more than ten years old will receive a "scrapping bonus" in order to support the automotive industry and to reduce CO_2 emissions.

These measures complement two important investment-oriented decisions already adopted before announcement of the recovery plan:

- The business tax has been reformed to lower production costs by eliminating taxation based on the value of investments. The tax exemption of investments made between October 2008 and 1 January 2010 will have an immediate impact on the economy.
- The Budget Bill for 2009 includes several measures to support household residential investment while lowering greenhouse gas emissions, particularly an interest-free green loan ("éco-PTZ") for energy-oriented renovations and an increase in the interest-free loan for first-time buyers of newly built homes.

The recovery plan also **strengthens employment policies:**

- Small businesses in particular have been weakened by the crisis since they do not always have the resources required to cope with unexpected developments. In 2009, employer charges for new employees in businesses with fewer than ten employees will be entirely offset up to the level of the guaranteed minimum wage to help such businesses weather the crisis and encourage recruitment.
- In the months ahead, the crisis will spark an increased need to finance new employment policies. The Supplementary Budget Bill for 2009 includes an additional appropriation of €0.5 bn to cover this need.

Lastly, the French plan **offers a fair deal for those worst hit by the crisis**: the *revenu de solidarité active* (RSA, active solidarity income), whose Act was promulgated on 1 December, offers a solution to promote employment and fight poverty. The RSA will begin to be implemented on 1 June 2009. Ahead of its implementation, the Government will pay an exceptional bonus of €200 to 3.8 million households in the first half of 2009.

2.2.2. Guaranteeing successful application of the recovery plan and ensuring that medium-term objectives will be met

The implementation of this investment recovery plan does not call into question the Government's structural efforts to consolidate France's public accounts. In 2008, the Government launched a major reform of public finance governance with, for the first time, the approval by Parliament of multi-year public finance estimates and a multi-year State budget (see the section on Governance of Public Finances).

The recovery plan must therefore be implemented in exemplary fashion, *inter alia* by making sure that short-term additional expenses and tax cuts are not maintained once the economy begins to pick up again, which would hurt efforts to consolidate France's public finances. The measures adopted for this purpose are summarised in Table B in Annex 2.

2.2.3. Emergency measures without budget cost to cope with the financial crisis

Since the beginning of the legislative, the Government has been implementing a vast array of structural reforms to make France more competitive by stimulating innovation and competition and by making the labour market more flexible (see Section 5.1 on the Continuation of Structural Reforms; see also the National Reform Programme forwarded to the Commission in October 2008).

Between October, when the National Reform Programme was sent to Brussels, and the beginning of December, when the recovery plan was announced, the Government took many emergency measures designed to support economic activity in the context of the financial crisis. These measures have no direct cost for public finances. They are intended to avoid an uncontrolled decline of public finances by preventing irreversible growth-adverse mechanisms.

These measures are mostly contained in the bail-out plan for the financial sector (see box) and the mechanisms developed to facilitate financing for small and medium-size enterprises (SMEs).

Box: Bail-Out Plan for the financial sector

The bankruptcy of the American financial services firm Lehman Brothers on 15 September transformed the already worrisome financial turmoil into an international banking and economic crisis of historic proportions.

France began to adopt emergency measures in the first days of October. In response to the President's speech in Toulon on 25 September, the Government tackled the financial crisis energetically and immediately.

On 13 October, the Government announced a plan to bail out the banking system. Its purpose was to restore the flows of financial channels, particularly in the interbank market, which were paralysed at the time and which were putting the operation of the entire economy at risk.

This plan served two aims: supplying the banking system with cash to finance the economy and giving banks a capital injection.

To achieve the first objective, the Government set up a refinancing company with a State guarantee of €320 bn intended to secure the refinancing of banks. The State's guarantee bears interest. The mission of the *Société de Financement de l'Economie Française* is to provide banks with medium-term cash to ensure that the economy continues to be financed. This company has so far launched two public issues with a total value of €11 bn. The resulting revenue was immediately re-lent to financial institutions.

To achieve the second objective, giving banks more capital, companies owned by the State may subscribe securities issues to strengthen their equity up to a ceiling of €40 bn. This mechanism was recently approved by the European Commission. The first subordinated securities, in the amount of €10.5 bn, were subscribed in December.

The amounts involved in either case are not new budget expenses. They are merely caps on transactions covered by the State's guarantee. The purpose of these mechanisms is not to spend actual money but to restore confidence between financial players by giving them the certainty needed to carry out entirely secure transactions.

The government has also taken measures to ensure that small and medium-size enterprises continue to have access to credit.

The European Investment Bank has agreed to increase its loans to small and medium-size enterprises in Europe by 50%, i.e. €30 bn in additional loan facilities.

France has further earmarked €22 bn in favour of SMEs, including €17 bn from savings collected through the *livret populaire d'épargne* savings account and the *livret de développement durable* savings account. The remaining €5 bn is available through OSEO and banks.

2.3. Alignment with the National Reform Programme

The National Reform Programme sent to the Commission in October 2008, which focuses on measures adopted to ensure the long-term sustainability of public finances, is an integral part of the strategy to restore the structural balance of public finances in the medium term. The reforms are intended to stimulate sustainable growth, innovation and business expansion and to improve the operation of the labour market. They will raise the growth potential of the French economy and so help consolidate public finances.

The priorities set by the French President as part of the State budget - measures to upgrade France's higher education and research, promote "green growth" and support the digital economy - have been taken into account in the multi-year public finance estimates and reflected in the trajectory of this Stability Programme. These commitments were made without deviating from the principle of 0% real growth of State expenditure excluding the impact of the recovery plan.

3. Analysis of sensitivity and comparison with the previous programme

3.1. Sensitivity to external assumptions

The international scenario underlying the projections is as follows:

- Oil prices will settle at US$72/bbl from autumn 2008 through 2009. and subsequently maintain this level in real terms (i.e. the nominal price per barrel will rise by 1.75% p.a. from 2010 to 2012);
- It is conventionally assumed that the exchange rate between the euro and the dollar will be US$1.33 during the entire period under review;
- Global activity and world trade will begin to returning to their long-term average in 2010. Global demand for France should increase by 6.5% p.a. in 2011 and subsequent years, i.e. its average during the period from 1987 to 2007.

Overall, these assumptions are almost the same as those of the Commission as published early November. They can nevertheless be used to evaluate the effect of unforeseen economic developments on the French economy. Below we will look at the impact of weakening global demand for France, declining oil prices, a rising exchange rate and lower interest rates.

a) Effects of weakening global demand for France[4]

Declining global demand for France will initially affect exports only and subsequently spread to the rest of the economy, primarily through downward adjustment of business investment.

At constant nominal interest rates, a permanent decrease of 1% in global demand would reduce activity by about 0.25 point of GDP and cost about 40,000 jobs after three years. The impact on inflation would be low at constant exchange rates[5].

For example, a 1% decline in global demand for France would mean a temporary US downturn of 2/3rd point, since such a decline would spread to the entire world economy. Should global demand grow faster, the orders of magnitude would be the same but in reverse.

Table 4: Impact on the French economy of a 1% decline in global demand for goods from France[(1)]

(deviation from baseline scenario as a %)	**2009**	**2010**	**2011**
GDP	-0.2	-0.2	-0.25
Total employment (thousands)	-9	-27	-40
Consumer prices	0.0	-0.1	-0.1
Public net lending (points of GDP)	0.0	-0.1	-0.1

[(1)] Lasting 1% decrease in global demand at the beginning of 2009.

This demand shock combines a significant drop in activity and employment with relatively low inflation. Weakening growth of taxable jobs and payroll income would have a negative impact on tax revenue (VAT, corporation tax, personal income tax, contributions and other levies). The marginal negative impact on inflation triggered by this shock would have little effect on expenditure growth, which would not slow down as fast as revenue. In all, public net lending would suffer by about 0.1 point of GDP in and after 2010.

[4] The global demand variant and the oil variant have been revised to reflect the most recent evaluations based on the MESANGE France model. See the DGTPE working paper, *Présentation du modèle MESANGE version 2008* by Caroline Klein and Olivier Simon (not yet published).

[5] In this variant, oil prices are considered exogenous and therefore not expected to respond to changes in global demand.

b) Effects of lower oil prices

A drop in oil prices would decrease imported inflation. This would directly lower consumer prices at constant exchange rates. This automatic effect would be strengthened by the induced change in production costs and the moderation of wages, which would add to the deflationary impact. Activity would be supported by lower consumer prices and higher business margins. These effects would also be felt in other net oil importing countries. By contrast, declining oil revenue would hurt the activity and imports of net oil exporting countries.

The usual macroeconomic models showing an endogenous response by the rest of the world suggest a lasting 20% decrease in oil prices, dropping for example from US$72 to US$58 bbl. At real interest rates and constant exchange rates, this would boost activity by about 0.1 point and lower consumer prices by 0.3 point after one year.

Table 5: Impact on the French economy of a 20% drop in oil prices [(2)]

(deviation from baseline scenario as a %)	**2009**	**2010**	**2011**
GDP	0.1	0.1	0.2
Total employment (thousands)	4	26	50
Consumer prices	-0.3	-0.6	-0.9
Public net lending (in points of GDP)	0.0	0.1	0.15

[(2)] 20% drop per barrel at the start of 2009, exogenous real interest rate, endogenous response by the rest of the world.

The decrease in oil prices should have a qualified impact on public revenue. First, the increase in economic activity should have a positive impact on the general government's tax revenue until 2011, particularly corporation tax. Secondly, revenue sensitive to inflation (such as VAT) would go down in nominal terms. The net impact on revenue would be roughly neutral. By contrast, slowing expenditure, largely due to lower inflation and improvement of the labour market, would become sensitive to price cuts in the second year. As a result, the public balance would improve by 0.1 point of GDP in the second year and 0.15 point of GDP in the third year.

c) Effects of a 10% appreciation of the euro against all other currencies without an economic policy response

A significant 10% appreciation of the euro against other currencies would reduce activity in France by about 0.7 point in the first year as it would make France less competitive on the export market and depress activity in other countries of the euro area. The fall in exports would be magnified by the usual multiplying and accelerating effects. Employment would also be affected by this slowdown.

As in the rest of the euro area, inflation would be moderated by appreciation of the effective exchange rate.

Table 6: Impact on the French economy of a 10% appreciation of the euro versus other currencies [3]

(deviation from baseline scenario as a %)	**2009**	**2010**	**2011**
GDP	-0.7	-0.8	-0.8
Salaried employment (thousands)	-40	-114	-131
Consumer prices	-0.6	-1.4	-2.4
Public net lending (in points of GDP)	-0.2	-0.3	-0.5

[3] At constant nominal interest rates.

Appreciation of the euro would have a negative impact on most taxes and therefore on public finances due to its adverse influence on activity and inflation. Moreover, a higher exchange rate would reduce social security contributions (which are based on the payroll). The resulting loss of income for the general government would amount to 0.3 point of GDP from the first year onwards. This phenomenon would be partly offset by lower expenditure (about 0.1 point of GDP in the first year).

d) Effects of an interest rate cut of 100 bp

A slower than expected upturn could spark faster interest rate cuts in the euro area. Downward adjustment of both short and long-term interest rates would support activity in three ways:

- rate cuts would underpin productive investment since lower interest expense would strengthen solvency and raise returns on investment in the business community;
- less expensive credit would also promote housing investment since rate cuts would encourage consumption rather than savings (substitution effect);
- if the euro depreciated as a result of such cuts, the euro area would become more competitive vis-à-vis other countries, which would boost activity.

At constant exchange rates, a 1% drop in short and long-term interest rates in the euro area would raise activity by 0.2 point of GDP during the first year and 0.5 to 1 point of GDP during the second and third year. Inflation would remain low.

These evaluations factor in the macroeconomic balancing effect within the euro area. In other words, increased demand in other euro-area countries would have a positive impact on the French economy.

Table 7: Impact on the French economy of a 100 bp cut in short and long-term interest rates in the euro area[4]

(deviation from baseline scenario as a %)	**2009**	**2010**	**2011**
GDP	0.2	0.5	0.8
Total employment (thousands)	10	60	100
Consumer prices	0.0	+0.1	+0.2
Public net lending (in points of GDP)	0.0	+0.2	+0.4

[4] Lasting 100 bp drop of short and long-term interest rates at the beginning of 2009, at constant exchange rates.

Public finances would be improved two ways by a drop in interest rates. First, lower borrowing and refinancing costs would reduce the general government's debt burden. Secondly, increased activity would improve the public accounts.

The resulting growth would automatically raise tax and social security revenue. Moreover, improvement of the labour market and lower interest expense would reduce nominal expenditure (about €1 bn in interest less during the first year, about €3 bn during the third). On the other hand, nominal expenditure would be marginally lifted by its sensitivity to inflation.

3.2. Comparison with previous programme

Table 8: Comparison of 2007 and 2008 programmes

	2007	2008	2009	2010	2011	2012
2007 programme						
Growth rate (%)	2; 2.5	2; 2.5	2.5	2.5	2.5	2.5
General government balance (% of GDP)	-2.4	-2.3	-1.7	-1.2	-0.6	0.0
Structural balance (% of GDP)	-2.2	-2.1	-1.6	-1.1	-0.6	0.0
General government gross debt (% of GDP)	64.2	64.0	63.2	61.9	60.2	57.9
2008 programme						
Growth rate (%)	2.2	1.0	0.2; 0.5	2.0	2.5	2.5
General government balance (% of GDP)	-2.7	-2.9	-3.9	-2.7	-1.9	-1.1
Structural balance (% of GDP)	-2.7	-2.4	-2.7	-1.4	-0.7	0.0
General government gross debt (% of GDP)	63.9	66.7	69.1	69.4	68.5	66.8

The updated Stability Programme confirms the Government's medium-term objective to achieve a structural balance close to equilibrium by the end of the legislative. Nevertheless, owing to the negative growth of economic activity in 2008 and probably in 2009, the Government has opted for a conservative assumption as to the rate at which the output gap will be closed in the medium term and the pace at which the recovery plan will be implemented, and has therefore lowered its nominal public deficit projections for the entire programme period.

For 2008, the previous Stability Programme forecast a public deficit of 2.3 points of GDP, versus 2.9 points of GDP in the newly updated version. This downward adjustment of the forecast primarily reflects the downward adjustment of expected growth, now expected to be 1% in real terms, whereas the Budget Bill for 2008 was based on a growth range of 2 to 2.5%.

For 2009, the updated version expects the public balance to worsen by 1.1 point of GDP compared with 2008. This contrasts with the previous Stability Programme, which projected a 0.6 point improvement of GDP. The adjustment primarily reflects the cost of the investment recovery plan, concentrated in 2009 (0.8 point) and the downward adjustment of growth by about 2 points in 2009. Excluding the cost of the recovery plan, the structural balance would improve by 0.5 point of GDP, i.e. about the same as in the previous programme.

In the medium term, the general government balance remains practically unchanged compared with the previous programme. First, expenditure is higher in the new programme, mainly owing to the non-renewal of expenditure initially planned for 2011 and 2012 and advanced to 2009 or 2010. Secondly, the spontaneous dynamism of taxes and social security contributions has been adjusted slightly upward to reflect the economic upturn and the conservative projections for the spontaneous elasticity of tax revenue in 2009.

The adjustment of the public debt trajectory reflects the updated deficit and nominal growth forecasts together with higher claims flows in 2008 due to implementation of the recovery plan for the financial system.

In all, the public deficit adjustments appear to result entirely from cyclical factors and the implementation of the recovery plan, whose impact is mostly felt in 2009. The structural balance target for 2012 is not affected.

4. Change in general government expenditure and revenue

4.1. General government expenditure

Table 9: change in general government expenditure

(in real terms, average p.a., %)	**1998-2007**	**2008-2012**
General government	**2.25**	**1 – 1.25**
Central government (APUC)	1	0
Local governments (APUL)	4.25	1.25
APUL without decentralisation impact	*3.25*	*1.25*
Social security funds (ASSO)	2.75	1.75

The economic recovery plan adopted in compliance with the European Commission communication of 26 November provides for an increase in certain expenditure items in 2009 to avoid an irreversible chain of macroeconomic events.

This plan is temporary and focuses largely on the 2009 fiscal year. The Government is standing by its objective to achieve a structural balance close to equilibrium in 2012. This calls for an effort to control general government expenditure in and after 2010. In other words, expenditure growth will need to be half the medium-term trend. This is an ambitious but not impossible roadmap, as the experience of other European countries can attest.

4.1.1. State expenditure

The change in State expenditure during the period from 2008 to 2012 will be limited to a nominal increase of 1.6% in 2009 and 1.75% in 2010, 2011 and 2012, i.e. a change in real terms of only 0.1% in 2009 and nil in 2010, 2011 and 2012. This is before the impact of the recovery plan and after neutralising the effect of changes in perimeter. On 6 November 2008, after the introduction of the Budget Bill, the inflation forecast for 2009 was lowered from 2% to 1.5%. This projection was applied to overall expenditure, which is expected to increase by only 1.5%, except for the cost-sharing contributions paid by the State to regional authorities. The resulting general increase is 1.6% in nominal terms, i.e. 0.1% in real terms.

The Supplementary Budget Bill for 2009 on measures to revive the economy provides for allocation of the State's additional expenditure under the recovery plan:

- **the State's exceptional investments will amount to €4 bn in 2009-2010, including €2.7 bn in cash-limit appropriations in 2009 and after.** This will directly strengthen demand and therefore economic growth;
- **support for business investment and employment will be €2.6 bn (excluding the endowment of the Strategic Investment Fund).** These appropriations are intended to finance recruitment aid for very small businesses (€700 m), the complementary measures of the active employment policies (€500 m) and the scrapping bonus (€220 m) as well as additional measures to support SMEs (€225 m). A further €1 bn will be used to bolster the advances paid on the State's public procurement contracts in 2009;

- **the measures in favour of housing and solidarity (€1.9 bn in 2009-2010**) are intended to strengthen the State's support for construction and urban renewal and to finance the *prime de solidarité active* (active solidarity bonus) (€760 m) paid to stimulate the purchasing power of the poorest households, worst hurt by the crisis.

The appropriations of the recovery plan are earmarked to a special mission in the State budget. This approach makes it easier to control the expenditure of other missions.

As in the Initial Budget Act for 2008, the effort to control expenditure embraces a broader perimeter[6] and remains ambitious:

- the 2009 budget, excluding the recovery plan, based on the levels presented in the Initial Budget Act for 2008, does not factor in adjustments for the €4 bn increase in expenditure generated by the inflation shock in 2008;
- expenditure inherited from the past is rising faster than before and absorbing a growing proportion of the State's room for manoeuvre. The baby-boom generations are reaching the retirement age, boosting pension spending. This phenomenon was highlighted in 2009 by the way the benefits indexation rules reflected the 2008 inflation shock. At a like-for-like perimeter, pension spending should rise on average by almost €2.5 bn p.a. during the period from 2009 to 2011.

To sum up, pensions and the debt charge, which represented less than 30% of the State's spending increase from 2003 to 2007, now absorb about 70% of the room for manoeuvre left by an increase in expenditure limited to inflation.

The momentum of the expenditure inherited from the past is strengthened by:

- cost-sharing contributions taken from tax revenue and allocated to the regional authorities, which are increasing in line with inflation (+€1 bn p.a. on average), except in 2009 when they should increase by about 0.5% in real terms, excluding the impact of the recovery plan;
- the creation of a "budget reserve", a provision not allocated thus far but required to cover unforeseen changes in unavoidable expenditure projections.
- cost-sharing contributions taken from tax revenue and allocated to the European Union.

In all, the room for manoeuvre is nearly entirely absorbed by the increase in these expenses: **the public finance resources funded by the general budget (personnel, operating, intervention and investment expenses) will therefore on average be stable in current euros**, versus an average increase of €3 bn p.a. from 1997 to 2007, also in current euros.

Table 10: multi-year budget for 2009 to 2011: change in State expenditure

	2009	2010	2011	2012
Change in real expenditure, 2008 perimeter, excluding recovery plan	***0.1%***	***0.0%***	***0.0%***	***0.0%***
Change in nominal expenditure, 2008 perimeter, excluding recovery plan	*1.6%*	*1.75%*	*1.75%*	*1.75%*
Change in real expenditure, including recovery plan	*3.0%*	*-2.3%*	*-0.4%*	*0.0%*
Change in nominal expenditure, including recovery plan	*4.5%*	*-0.5%*	*1.4%*	*1.75%*
Inflation forecast	*1.5%*	*1.75%*	*1.75%*	*1.75%*

[6] The application perimeter of this standard henceforth includes cost-sharing contributions in favour of the regional authorities and the European Union as well as new appropriations of revenues.

4.1.2. Expenditure of central government agencies

Central government agencies considered State operators[7] will also be very directly involved in the State's effort to control expenditure. The rule that half of all civil servants who retire will not be replaced, applied since 2008 by the State, will apply to operators from 2009 onward. Since the Budget Bill for 2008, tax appropriations have been factored into the State expenditure norm, which limits new appropriations and promotes expenditure control. State operators will no longer be authorised to take out debt. This measure will make it impossible for them to finance expenditure otherwise than from current revenue. Moreover, the State operators are collaborating on a vast project to survey, specify and value their real-estate inventories. Lastly, the State is increasingly using performance contracts with cultural operators. This important management tool reflects the measures adopted as part of the *révision générale des politiques publiques* (RGPP - General Review of Public Policies).

These rules of conduct and governance for State operators are in addition to the tools implemented to upgrade supervision of the overall sub-sector of central government agencies (ODACs).

Central government agencies other than State operators will also contribute to the government's spending effort.

4.1.3. Expenditure of the social security funds

The expenditure of the social security funds should increase by an average 3.6% p.a. from 2010 to 2012. This contained expenditure trend includes a moderate increase in expenditure covered by the *Objectif National des Dépenses de l'Assurance Maladie* (ONDAM - National Health Insurance Spending Objective) (up 3.3% during the period under review), a relatively strong but slowing increase in old-age benefits (on average 4.8% p.a.), marginal growth of family allowances (on average 2.4% p.a.) and decreasing unemployment benefits. These trends would follow in the wake of dynamic growth in 2009 (3.8%) during which pensions and family allowances will be revalued in real terms to offset the inflation spurt in 2008.

Healthcare benefits

After 4.2% in 2007, the increase in ONDAM expenditure is expected to be 3.3% in 2008. This contained growth of healthcare expenditure is the combined outcome of measures to cut down unnecessary prescriptions by the contracting partners, the implementation of deductibles for pharmaceuticals, paramedical treatment and health transportation, and the impact in 2008 of measures launched as part of the alert procedure in 2007.

Efforts to control ONDAM expenditure are expected to continue in 2009. The objective is 3.3%, the same as in the forecast for 2008. Ambulatory healthcare and hospital treatment should contribute to the consolidation effort with a similar growth rate for both. The effort to control ambulatory healthcare will focus mostly on further measures to cut down unnecessary prescriptions, stronger incentives to follow official healthcare procedures, targeted price reductions of pharmaceuticals and an active policy in favour of generic drugs. These actions will be complemented by measures to

[7] The salient features of State operators are that they carry on public service activities, are mostly financed by the State and are under the State's direct control. The concept of operator nevertheless reflects other criteria than those found in the national accounting. Many State operators fall outside the central government agencies (ODAC) sub-sector – some fall within the social security funds (ASSO) or local governments (APUL) sphere – or even outside the perimeter of the general government. These non-Central government agencies entities represent about 10% of operator expenditure. Conversely, about ten Central government agencies other than State operators accounted in 2007 for almost one-third of the expenditure of this sub-sector.

lower fee rates and prices in areas where they may be considered too high compared with production costs.

In a multi-year outlook, the continuation of earlier efforts and the implementation of complementary control measures should make it possible to keep nominal ONDAM growth at 3.3% during the period from 2010 to 2012, i.e. an increase of 1.5% p.a. in real terms. This target is included in the multi-year public finance budget estimates.

These measures will notably be underpinned by the provisions of the law bill on Hospitals, Patients, Healthcare and Territorial Organisation ("HPST"), which lays the groundwork for a general modernisation of the healthcare system. It provides for the organisation of regional healthcare agencies (*agences régionales de santé* - ARS) with authority over ambulatory healthcare, hospital treatment and medico-social institutions. It is important to refocus the work of health institutions on the treatment of acute illnesses. This can be achieved by strengthening the interface with ambulatory healthcare and by developing downstream structures. Such an approach will make it possible to channel patients to the most suitable treatment solutions (homes, medico-social institutions, follow-up treatment, etc.) and so to provide quality service at lower cost. Similarly, the creation of regional hospital groups should streamline the geographical map of healthcare services by encouraging the conversion of underused institutions for the treatment of acute illnesses into follow-up healthcare units or homes for the elderly. Finally, the certification of hospital accounts will improve the transparency of hospital expenditure while the creation of the *Agence Nationale d'Appui à la Performance des établissements de santé et médico-sociaux* (ANAP - National Agency to Support the Performance of Healthcare and Medico-Social Institutions) will help modernise the management of such institutions and improve their performance.

Old-age benefits

Old-age benefits can be expected to continue rising relatively strongly during the programme period, matching the population trend. Benefits are expected to be revalued significantly in 2009 (2.2%, i.e. a 5.4% nominal increase in old-age benefits) to offset the inflation shock in 2008. During the period from 2010 to 2012, growth should remain below the high rates observed in 2007 and 2008 (average annual growth of 4.8% in nominal terms, versus 5.3% during 2007 and 2008), which was mainly driven by the combined impact of two specific factors: the success of the early-retirement mechanism for long careers and the retirement of the first generations of baby boomers.

Several measures have been taken to ensure the long-term survival of France's old-age insurance system, which is based on the principle of solidarity between generations.

At the end of 2007, the special regimes were reformed to make the system fairer and to align the rules of the various regimes. Henceforth, the main pension calculation parameters will be shared by all regimes, such as extension of the insurance payment period to 40 years and subsequently 41 years, the introduction of discounts and the indexation of benefits to consumer prices.

As provided for in Article 5 of the Act of 21 August 2003, the insurance period required to be entitled to a full pension will be lengthened each year by one quarter, starting from the generation born in 1949 (which will be 60 in 2009) and rising to 41 annuities for the generation born in 1952 (60 in 2012).

Lastly, the PLFSS for 2009 includes additional measures to strengthen solidarity with poor elderly people and to encourage employment of older workers:

- as regards old-age pensions, the PLFSS provides for a 25% revaluation out to 2012 of the *allocation de solidarité aux personnes âgées* (ASPA – solidarity allowance for the elderly) for single persons, the revaluation of low agricultural pensions and the adjustment of survivorship pensions for the poorest widows and widowers from 54% to 60% of the pension of the deceased spouse.

- increased focus on employment by older workers has culminated in several measures: the unrestricted right to combine pensions with earned income after the pension insurance period, restrictions on automatic retirement in the private sector, the right to continue working for the civil service after the retirement age and the alignment of premium rates to 5%.

Other social benefits

In 2009, indexation mechanisms should raise family benefits by a significant 3.0%. During the period from 2010 to 2012, family benefits are likely to rise more slowly as the *prestation d'accueil du jeune enfant* (PAJE - Child-Rearing Allowance) reaches maturity and the thresholds at which family allowances are raised (11 and 16 years of age) are gradually replaced by a single increase at the age of 14.

Lastly, improvement of the French labour market and better management of support for job seekers (creation of *Pôle Emploi*, born from the merger between the ANPE and UNEDIC) should make it possible to lower the average expenditure of the unemployment insurance regime by 2.5% p.a. during the period from 2010 to 2012.

Table 11: Change in expenditure of the social security funds between 2009 and 2012

	2007	2008	2009	2010-2012*
ONDAM	4.2%	3.3%	3.3%	3.3%
Family	2.6%	2.2%	3.0%	2.4%
Old Age	5.3%	5.4%	5.4%	4.8%
Unemployment	-7.2%	0.5%	6.1%	-2.5%
TOTAL EXPENDITURE	5.4%	3.0%	3.8%	3.6%

** Average annual growth rate, 2010-2012*

4.1.4. Expenditure of local governments

The programme assumes a limited increase in local spending compatible with a very gradual return to equilibrium of the balance of local governments. The spending trend of local governments depends primarily upon the choices made by these authorities. Their return to equilibrium will of course only be possible with their active participation.

However, several factors can be expected to help slow down local spending in the medium term. The newly created Committee for Local Government Reform chaired by Edouard Balladur, the former Prime Minister, is expected to streamline the organisation of levels of authority, to help rationalise management of the regional authorities and to slow down current operating expenditure. Moreover, the coming onstream of certain benefits (*allocation personnalisée d'autonomie* [Personal Independence Allowance], *prestation de compensation du handicap* [Disability Compensation Benefit]) should help curtail social security expenditure.

The Government helps local governments control their expenditure. The local governments were invited to help define the civil service wage policy. The limited increase in the civil service point over the next three years will generate budgetary room for manoeuvre.

Lastly, the Supplementary Budget Bill also provides support for the local governments, the foremost public investor, to help them assume their full responsibilities in the fight against the economic crisis. The plan is to allow an advance from the Fonds de Compensation de la TVA (FCTVA - VAT Compensation Fund) to provide local governments with additional investment capacity. This measure will be reserved for the regional authorities, which will undertake to raise their investments in 2009 under an agreement between the authorities in question and the State representative. Starting 2009, they will receive the FCTVA funds for investment expenditure incurred in 2008, in addition to the funds normally received during 2009 for 2007 investments. The cost of this measure is estimated to be €2.5 billion.

4.2. General government revenues

4.2.1. The Government's fiscal strategy

In order to make the French economy more competitive and attractive, and to restore the structural balance of public finances in the medium term, the Government's fiscal policy is to reform the structure of taxes and social security contributions without altering their overall weight during the period from 2009 to 2012.

An initial series of reforms was implemented during the President's first year in office:

- reforms intended to enhance the value of labour and purchasing power: exemption of overtime, a tax credit when buying a primary residence, purchase of days of Reduction of Working Hours, early payment of profit shares and reform of the incentive bonus;
- reforms in the service of growth and competitiveness, by granting priority to small and medium-size enterprises: a three-fold increase in the research tax credit, lower wealth tax to promote investment in small and medium-size enterprises, the tax measures in the Economic Modernisation Act (particularly the status of independent entrepreneur);

In line with the measures already implemented, fiscal policy in the years ahead will focus on three objectives:

- **justice and fair taxation to ensure all taxpayers are taxed according to their ability to contribute:** the Budget Bill for 2009 includes a series of measures to cap "tax niches" in order to put an end to the least equitable situations. Moreover, the Committee for Local Government Reform chaired by Mr Edouard Balladur, the former Prime Minister, is looking at ways to reorganise local powers and local taxation in order to avoid inappropriate transfers between authorities and so to provide the regional authorities with fairer, more modern and more effective property taxes;
- **environmental effectiveness to make taxation a tool in the service of sustainable and environmentally friendly growth**: the "sustainable development" tax credit will be reformed and the "green" component of tax credits for the acquisition of a primary residence and interest-free loans will be strengthened;
- **economic effectiveness to put taxation at the service of competitiveness, growth and employment;** the reform of the business tax and the gradual elimination of the annual flat-rate corporation tax will help restore the attractiveness of French territory.

These priorities are reflected in the measures provided for in the Budget Bill for 2009:

- the Bill introduces several measures to put taxation at the service of sustainable development, particularly three measures to reduce greenhouse gases and to improve the energy efficiency of buildings: an interest-free green loan ("éco-PTZ") for energy-related renovation works, an increase in the interest-free green loan for first-time buyers of new residences and a higher cap on the right to deduct loan interest for residences with high energy efficiency.
- to put taxation more at the service of a more competitive economy, one of the key measures taken by the Government for 2009 was the decision to eliminate the annual flat-rate

corporation tax (IFA - *impôt forfaitaire annuel*), expected to involve the adjustment of tax brackets. The first companies to benefit from the elimination of this tax should be companies with sales of under €1.5 million, which would no longer have to pay this tax with effect from 1 January 2009. Effective from 1 January 2010, companies with sales of under €15 million would no longer pay this tax. On 1 January 2011, the IFA would be repealed for all companies.

4.2.2. Overall stabilisation of the tax burden during the period 2008–2012

To return to a public finance equilibrium by 2012, the tax burden should remain on the whole constant during the programme period at around the level reached in 2008, i.e. 43.2% of GDP.

This projection is based on prudent assumptions for the elasticity of taxes and social security contributions, assumed to be close to unity in a scenario providing for an economic upturn in 2010 after two years of growth well below the potential (2008 and 2009). Over the long term, the elasticity of taxes and social security contributions to growth is close to unity but may experience cyclical fluctuations. Thus, the elasticity of taxes and social security contributions, and especially of State tax revenue, appears to be higher than unity when growth is strong.

The programme includes the tax relief measures adopted since 2007. Under the impact of the measures of the economic recovery plan (early payment in 2009 of the research tax credit and corporation tax carry-backs), the tax burden should go down by 0.3 point of GDP in 2009, and subsequently pick up marginally on the back of the measures in the recovery plan from 2010 onward. During the period under review, the tax burden can be expected to remain on the whole stable at the 2008 level (i.e. 43.2% of GDP).

Other revenue, including income from production and ownership, is assumed to grow marginally faster than GDP.

4.2.3. Change in revenue per sub-sector

a) State revenue

In 2009, net tax revenue excluding the recovery plan is expected to decline by €0.8 billion versus 2008 due to three phenomena:

- first, the macroeconomic environment: the slow growth in 2008 can be expected to hurt personal income tax and corporation tax while the lack of growth in 2009 is likely to affect VAT. The spontaneous increase in net tax revenue can be expected to be no more than 0.7%, with GDP in nominal terms expected to grow by 2.3%, i.e. an elasticity to GDP of 0.3;
- the new measures adopted prior to the Budget Bill for 2009 should continue to come onstream (tax credit on loan interest, tax exemption of overtime and research tax credit);
- by contrast, excluding the finance for the public audiovisual sector and the recovery plan, the new measures proposed in the Budget Bill for 2009 should have a zero net cost (modification of the biofuel regime to offset for the gradual repeal of the annual flat-rate corporation tax,IFA).

The recovery plan includes an important tax measure intended to speed up the State's repayment of amounts owed to economic agents, amounting to €9.2 billion worth of revenue and reflecting:

- early payment of the research tax credit at the beginning of 2009;
- the adoption of a monthly payment schedule for VAT reimbursements to businesses; the plan is to make this measure permanent, which will not generate added costs for public finances after 2009;
- early repayment to businesses of corporation tax carry-back claims. This measure is designed to benefit loss-making businesses, nearly all of which are SMEs.

Starting 2010, the recovery plan can be expected to preserve the level of revenue. The cost of arranging early amortisation of investments made in 2009 and doubling the interest-free loan for the acquisition of a new residence in order to support household property investment should be offset by lower research tax credits and lower corporation tax carry-backs. From 2011 onwards, the impact of the recovery plan will gather momentum owing to the partial closure of the output gap, on the back of stronger growth and the resulting increase in net tax revenue.

b) Revenues of social security funds

After two years of strong growth (4.7% in 2007 and 4.4% in 2008), the revenues of the social security funds slowed down in 2009 (2.7%) due to the weakening momentum of the assessment basis (2.75% for the private-sector payroll).

The implementation of new revenue-related measures will make it possible to limit the decline, such as the implementation of a tax on supplementary social security schemes (*taxe sur les organismes complémentaires*) (+ €1 billion) and the flat-rate social security levy on wage savings (*forfait social sur l'épargne salariale*) (+ € 0.4 billion), which will ensure that all revenues help finance the social umbrella according to the solidarity principle.

This turn-around strategy includes the discontinuation of the Fund for Financing Agricultural Social Security Benefits (FFIPSA – *Fonds de Financement des Prestations Sociales Agricoles*) and assumption of its debt by the State. For financial purposes, health insurance for farmers will be attached to the CNAMTS. To keep this restructuring measure financially neutral, the entire revenue generated by the Company Car Tax (TVS – *taxe sur les véhicules de société*) will be used to finance these healthcare benefits.

During the period from 2010 to 2012, social security funds revenue should be tweaked by the renewed momentum of the assessment bases with an average annual growth rate of 4.2%, in line with the average annual growth rate of the private-sector payroll (4.4%) and of GDP (4.1%).

c) Revenues of local governments

Without prejudging the choices made at the discretion of the regional authorities, the projection is based on the assumption that local tax rates will remain constant during the period from 2010 to 2012. The regional authorities would nevertheless benefit from the transfers of the domestic tax on petroleum products (TIPP) provided for in the three-year State budget programme. To factor in the low spontaneous dynamism of assessment bases in the past, the elasticity of local taxes is assumed to be slightly below unity during the period under review.

The conservative growth estimates for local revenues (with a stable tax rate after a probable increase in 2009 in connection with the electoral cycle, and moderate growth of local direct tax bases) need to be set against the moderate increase in expenditure during the programme period.

5. Sustainability of public finances

5.1. Continuation of structural reforms

The previous Stability Programme noted that the structural reforms will restore growth in a sustainable manner and so will permit and promote the consolidation of public finances. As explained by the French President, they are the second pillar of the French Government's strategy to consolidate the public accounts.

In 2008, this fundamental objective of economic policy was reflected in many important reforms in the labour market and in the goods and services market.[8]

Greater efficiency of the French labour market calls for reforms both in this market and elsewhere. The level of employment in the economy will also be lifted by broader reforms, particularly reforms intended to strengthen competition in the products market. Similarly, public and private investment in research and development (R&D) needs to be stepped up and businesses need to be given an incentive to innovate in order to keep France in the forefront of global technology.

As of July 2007, the decision not to raise the guaranteed minimum wage (SMIC) above the legal indexation level encouraged employment of unskilled labour, reflecting the Government's wish to pursue a policy benefiting all wages and not limited to the minimum wage only.

As announced in the previous Stability Programme, the **research tax credit was tripled** in the Budget Act for 2008. This Budget Act offers businesses an extremely attractive framework under which R&D investments are encouraged by corporation tax reductions. This is estimated to tweak growth by about 0.05% of GDP p.a.

In the **labour market**, more efficient use of labour is the backbone of the Government's employment policy. In France, this means first of all a longer working week.

The Act on Labour, Employment and Purchasing Power of 21 August 2007 raised **overtime** pay (for businesses with fewer than 20 employees the legal increase was raised from 10% to 25% and exempted from social security contributions and income tax). Employers were granted a fixed reduction in employers' contributions.

Since the implementation of this law, reported overtime has increased steadily from 150 million hours in the fourth quarter of 2007 to more than 180 million hours in the second quarter of 2008[9]. Almost 40% of businesses resort to the exemption mechanism. At companies that have switched to a 35-hour working week, the number of additional hours reported by full-time employees increased by 34.6% between the first quarter of 2007 (before the mechanism was introduced) and the first quarter of 2008, i.e. 1.3 hour per employee per quarter. Even if overtime growth will depend upon economic growth, the first results suggest a potentially significant increase in working hours.

The Act of 13 February 2008 on the Organisational Reform of the Public Employment Services provides for the creation of a single operator for registration and placement, and for paying benefits and providing support to job seekers. This was accomplished by **merging the ANPE with the unemployment insurance network**.

This reform will facilitate formalities for users (businesses and job seekers), who will be offered a wider range of services. The resources of both networks will be pooled to free up additional staff for deployment at local offices. *Pôle Emploi*, the new institution born from the merger between the

[8] The National Reform Programme for 2008-2010 presents a detailed and complete overview of the Government's structural reform strategy and the reforms implemented since the beginning of the legislative.

[9] ACOSS data.

ANPE and the unemployment insurance network, will manage unemployment insurance on behalf of UNEDIC.

The Act of 1 August 2008 on the **Rights and Duties of Job Seekers** offers a legal framework for the definition of a "reasonable employment offer". This law provides for reciprocal agreements: the Public Employment Service agrees to do whatever is needed to help job seekers find a job and offers job opportunities considered reasonable. In return, job seekers agree to accept such offers and may be penalised in the case of repeated rejections. The refusal of two reasonable employment offers may result in a 2-month suspension from the list of job seekers.

To stimulate employment in low-income households, a major reform of the social minima was enacted on 1 December 2008 with the creation of the ***Revenu de Solidarité Active*** (RSA - working solidarity benefit), scheduled to be implemented towards the middle of 2009. The RSA is a new benefit, which allows the beneficiary to combine earned income with solidarity benefits. Its aim is to make sure that every working hour increases the beneficiary's available income. The RSA regime also simplifies the system of social minima.

The single benefit of the RSA will replace the *Revenu Minimum d'Insertion* (RMI - minimum integration income), the *Allocation de Parent Isolé* (API - single parent allowance) and the social-minimum bonuses awarded when returning to employment. Support for people looking for a job and for underemployed people will be stepped up.

For people without earned income, the RSA takes the form of a guaranteed minimum income whose amount is equivalent to the existing RMI or API. For people with earned income, the guaranteed income is equal to the minimum income plus part of earned income. The cumulative ratio between the benefit and earned income is 62%.

Two million households, i.e. about five million people, are expected to be eligible for the RSA at an average total cost of about €120 per month. The RSA will be interfaced with the *Prime pour l'Emploi* (employment bonus) to make sure everyone gets the benefit of the most favourable regime.

The RSA is expected to raise the participation rate in the labour market. Studies in other countries of similar mechanisms to the RSA - WFTC (Working Family Tax Credit) implemented in Great Britain in 1971, and EITC (Earned Income Tax Credit) implemented in the United States in 1974 – show that this type of mechanism has a positive impact on participation in the job market.

Life-long vocational training reform is a key to improving life-long employability. The French vocational training system suffers from certain drawbacks. Training opportunities differ considerably with the least access for unskilled workers, older workers and employees in SMEs. The compartmentalisation of the various mechanisms makes the system hard to understand for the participants. Moreover, the fund collection system is not sufficiently transparent and generates excessive management costs.

Based on a Government orientation paper released in July 2008, in-depth interprofessional negotiations were launched in the second half of 2008 to work out a reform outline. In this paper, the Government proposes *inter alia* to strengthen the link between training and employment, to develop a fairer and more effective training system and to turn the individual participant into a player with genuine input in his or her professional career. The Government will be drafting a law bill once this negotiation phase has been wrapped up.

The Government has developed a coherent plan to boost the supply of and demand for **older workers**, involving a series of coordinated measures for workers and businesses (including the right to combine income from employment with a pension, a higher premium when postponing retirement, repeal of the automatic retirement of employees at the age of 65, etc.).

This plan is an integral part of the **retirement reforms,** which have a potentially enormous impact on the labour supply. The talks in 2008 culminated in many adjustments and reforms, especially of the special regimes. After dialoguing with the social partners, the Government announced on 28 April its guidelines for stronger support for the employment of older workers and greater solidarity with the lowest pensions. These measures will be implemented as part of the Budget Act and the Social Security Budget Act for 2009.

In particular, the reform endeavours to achieve a financial equilibrium for the general regime by providing employees with incentives to delay retirement (the premium rate has been improved and the automatic retirement age has been raised), by developing a combined employment-retirement system and by allocating revenues available from other social security risks. It has been decided not to wait for the programme deadline of 2012 but to schedule a new dialogue in 2010 in order to look at ways to improve the employment rate of older workers and the financial sustainability of France's retirement system.

Moreover, since the dialogue and the debates in 2007, the special retirement regimes (mainly for public institutions and enterprises) have been reformed to align them with the civil service regime. This reform was necessary to ensure the same treatment for all workers: the insurance contribution period will be gradually extended to 40 years by 2012 and reach the length of the contribution period of the general regimes by 2016. As for the general regimes, a premium and a discount will be introduced and pensions will be indexed to prices from 2009 onwards. Moreover, personnel recruited in 2009 and after will no longer be entitled to pension credits.

All these labour market reforms help the employment rate and therefore public finances:

- the labour supply will take advantage of the reform of social-minima eligibility conditions, a wider gap between the beneficiaries of social minima and low-income workers and efforts to stimulate employment of older workers within the context of the pension reform.
- labour demand will increase since the indirect cost of labour will be lowered (rigidities of labour law should be made more flexible with the planned employment contract reform).
- the reform of the public employment service will make it easier to match labour supply to demand.

In the **goods and services market**, the **Economic Modernisation Act** promulgated on 4 August 2008 includes many structural measures designed to produce a lasting improvement in market efficiency and potential growth without affecting public finances. The Act is particularly intended to promote the creation of businesses, to stimulate competition - notably in the retail sector in order to reduce prices, to boost innovation and to generate productivity gains – and to make the territory of France more economically attractive:

- to promote the creation of businesses, start-up regulations have been enormously simplified, allowing anyone to set up a business in a very short time. Supplier payment deadlines have been shortened to reduce the working capital requirements of small and medium-size enterprises and so free up funds for investment purposes. The threshold effects connected with certain tax and social security mechanisms have been smoothened to remove a significant obstacle to the growth of SMEs.
- to stimulate competition, the right of suppliers and mass retailers to negotiate freely has been restored and commercial town planning rules have been simplified in order to lower prices. The Government has further set up a Competition Authority with broader powers. The same competition-driven strategy underlies the extension of the Livret A savings account to all banks.

  Stronger competition in the goods and services market stimulates productivity gains, technological innovation and job creation. It supports consumer purchasing power by reducing business margins. It lowers the structural unemployment rate. Its cost for public finances is at worst marginal, at best nil. The entire economy benefits from increased competition and not just the sector where competition is strengthened.

- Finally, France will also be made more attractive by extending the high-speed broadband network as fast as possible.

To sum up, the Economic Modernisation Act is expected to cost only €0.4 billion in the years ahead and to boost the growth rate by about 0.3% p.a. during the next 5 years.

5.2. Structural reforms to facilitate consolidation of the budget

Fully in line with the Lisbon strategy, these structural reforms will facilitate and support consolidation of the budget in the medium term.

The sustainability indicators show a large tax gap in 2008, about 3.3 points of GDP, partly due to the initial public finance situation. With the return of public finances to a structural balance, the tax gap should be reduced to no more than 1.0 point of GDP, highlighting the importance of the structural adjustment planned in the medium term (see box).

Once the budget has been consolidated, it will finally be possible to lighten the tax burden for the economic agents.

Box: Evaluation of S2 sustainability indicator for France

To assess the sustainability of public finances, the European Commission and the ECOFIN Council use the S2 indicator, which measures immediate and lasting improvement of public finances required to make sure current debt is covered in the long term by future surpluses (i.e. the tax gap).

The tax gap is the sum of two terms. The first term reflects the initial public finance situation which, when worsening, can lead to a snowball effect. The second term takes account of the expected expenditure momentum generated by the ageing process.

This box evaluates this indicator for France according to two public finance scenarios:

- In the first scenario ("2008 scenario"), the component of France's structural balance excluding interest expenses, excluding property income and excluding expenditure connected with the ageing process, is assumed to be constant and to remain equal to its 2008 level until 2050. In this scenario, the tax gap would go up to 3.3 points of GDP, including 0.6 point of GDP due to the initial public finance situation in 2008 and 2.6 points of GDP due to additional future expenditure linked to the ageing process.
- In a scenario based on the assumptions of the current Stability Programme, the tax gap would be only 1.0 point of GDP, reflecting a positive contribution by the initial public finance situation (-1.7 point of GDP), covering most of the expenditure linked to the ageing process (2.6 points of GDP). This estimate is very close to the result found in the previous Stability Programme. In fact, although the Stability Programme has revised nominal public deficit and debt targets for 2012, France's medium-term objective remains a structural balance in equilibrium in 2012.

In conclusion, to achieve the medium-term objective of restoring the structural balance of the public accounts by 2012, it will be necessary to generate a primary surplus which makes it possible to "prefinance" almost two-thirds of the discounted budget cost of ageing population.

Table 12: Calculation of public finance sustainability indicator (S2)

In points of GDP	S2	Including impact of initial position	Including impact of ageing
Base year 2008	3.3	0.6	2.6
Base year 2012	1.0	-1.7	2.6

6. Governance of public finances

6.1. Multi-year public finance planning act

On 23 July 2008, the Constitution was amended to include the objective of balancing the general government accounts and to add a new legal instrument: the multi-year public finance planning act (Article 34).

a) Public finance trajectory estimates

This multi-year public finance planning act makes it possible to submit to Parliament the trajectory projected for the entire general government (APU) during the period from 2009 to 2012, within the same perimeter and according to the same accounting rules as the Stability Pact. They set out the trajectory per sub-sector towards a public finance equilibrium. For the State this includes a detailed three-year spending budget for the period from 2009 to 2011. For the social security branch this includes the programme developed to achieve the health insurance spending objective.

The public finance strategy underlying the programme is based on the *révision générale des politiques publiques* (RGPP - General Review of Public Policies) and therefore based on precisely calculated measure. Similarly, the expenditure of the social security administrations is controlled by the measures introduced in the law bill on Hospitals, Patients, Healthcare and Territories, and the extension of the insurance period under the Act of 2003 on the Pension Reform.

The recovery plan of 4 December 2008 does not call into question our basic public finance objectives:

- first, its impact is felt largely in 2009. Most measures are temporary and therefore will no longer affect the public accounts from 2011 onwards;
- secondly, the budget for 2009 does not include any change in personnel and operating expenses.

b) New governance rules

The multi-year public finance planning act also sets out the governance rules safeguarding the public finance trajectory, specifying *inter alia* the conditions on which State surplus revenue may be used and defining objectives for both tax expenditure and social niches. In both areas, it lays down the principle of budgetary neutrality for new measures, whose aggregate cost must therefore be fully offset.

The planning act further sets annual costing objectives for existing mechanisms. Any surplus tax revenue recognised during the year will be entirely used to reduce the budget deficit.

The law bill also stipulates that new measures resulting in lower tax revenues and/or lower social security premiums or contributions will be secured, during the entire programme period, by a corresponding increase in revenue as long as the level of State and social security revenue provided for by the estimates has not been reached.

6.2. The three-year State budget

The three-year State budget reflects a broader perimeter than the budget appropriations alone. For each year of the programme, it covers the perimeter used to calculate the spending norm.

For 2009, the spending cap for the missions (excluding the recovery plan mission) and the division per programme correspond to those of the Budget Bill for 2009. For 2010, the caps are set per mission, complemented by an indicative division of appropriations per programme, as presented in the budget documents of the Budget Bill for 2009 (the final distribution will be decided in the Budget Bill for 2010). For 2011, appropriations per mission may adjusted further, subject to the overall spending cap and the general economic structure of the programme.

The operating principles of the three-year budget are not affected by the recovery plan of 4 December 2008 since the planned expenditure is segregated within a mission dedicated to the State budget. The management of this mission is supervised by the minister responsible for implementing the recovery plan.

6.3. Statistical governance

INSEE, France's national statistics institute, is responsible for methodological matters involving the compliance of French national accounting statistics practices with the European System of Accounts (ESA95). INSEE maintains regular contact with Eurostat about these matters. Within the framework of the Treaty and specific regulations, the sources and methods used to evaluate national general government accounting data have been inventoried.

The **semi-final and final accounts** are prepared in the light of detailed information, particularly for the State and the central government agencies (ODAC). For the State, the main accounting reference is the General Account of the Finance Administration ("CGAF") published by the Public Finances General Directorate (DGFiP). Restatement of the final outturn of budget acts as government net lending requires a series of corrections (timing differences, different treatments of certain transactions in the budgetary accounting and in the national accounting, etc.). The method used to evaluate the central government agencies' accounts is to restate the accounts of all these agencies. The consolidated account produced for the national accounts is prepared after transcription of the accounts of the individual central government agencies in the national accounting. Production of the local government accounts (S13131) is based upon the individual cash-based accounts kept by the public accounting officers. The documents used to prepare the accounts of local government agencies (S13132) are not homogeneous due to the number of different legal statuses. The accounts of the social security funds (ASSO) are based upon different accounting plans (social security scheme, general social security scheme, hospitals).

Information is less complete for the **provisional account**. For the State, the accounting year ends at the end of January in year n+1. The public accounts of the State are finalised towards the middle of March in year n, which means that the information used for notification purposes is likely to be reviewed, particularly the corrections needed to switch to accrual basis accounting. The central government agencies' accounts are partly based on projections. The accounting sources cover about 70% of revenue and expenditure. For the local governments, the accountants use information recorded in the accounting documents of the State and, since 2003, direct figures, which are exhaustive and centralised for the regions and *départements* (administrative districts) and based upon a sample for the communes. This is complemented by a number of estimates and forecasts. Finally, for the first notification, the accounts of the social security funds are essentially based on estimates since the accounting figures of the regimes are not yet known. Nevertheless, the availability of many – still provisional – accounting figures (benefits for the UNEDIC and the general regime, sample of hospitals, etc.) makes it possible to prepare the accounts of the main organisations with some reliability.

Finally, at the Government's initiative, the French Parliament adopted in July an Article 144 for the Economic Modernisation Act which grants legal recognition to the professional independence of public statisticians. This recognition reflects the European Statistics Code of Practice adopted by the Statistics Programme Committee on 24 February 2005 and included in the European Commission's recommendation of 25 May 2005 on the independence, integrity and accountability of national and Community statistics authorities. The Code's first principle on professional independence specifies that the independence of a statistics authority in producing and disseminating public statistics must be made into law. To this end, Article 144 creates a Public Statistics Authority responsible for ensuring compliance with the European Statistics Code of Practice, whose powers embrace anyone producing public statistics.

Annex 1: Statistics tables

Table 1a. Macroeconomic forecasts

	ESA code	2007 Level	2007 Rate of change	2008 Rate of change	2009 Rate of change	2010 Rate of change	2011 Rate of change	2012 Rate of change
1. Real GDP	B1*g		2.2	1.0	0.2-0.5	2.0	2.5	2.5
2. Nominal GDP	B1*g	1 892 244	4.7	3.2	2.3	3.8	4.3	4.3
Components of GDP								
3. Private consumption expenditure	P.3	1 071 957	2.4	1.1	1.3	2.4	2.8	2.8
4. General government consumption expenditure	P.3	438 012	1.4	1.3	1.1	0.5	0.5	0.5
5. Gross fixed capital formation	P.51	406 341	4.9	0.2	-3.6	2.4	3.2	3.2
6. Change in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	-	0.5	0.7	0.8	0.7	0.8	0.9
7. Export of goods and services	P.6	501 902	3.1	1.6	1.3	5.0	6.5	6.5
8. Imports of goods and services	P.7	538 304	5.5	1.5	0.3	4.6	6.1	6.1
Contributions to GDP growth								
9. Final domestic demand excluding inventories		-	2.7	1.0	0.2	2.0	2.4	2.4
10. Change in inventories and net acquisition of valuables	P.52 + P.53	-	0.2	0.0	0.0	0.1	0.1	0.1
11. External balance of goods and services	B.11	-	-0.7	0.0	0.3	0.0	0.0	0.0

(*) The Budget Bill is based on 0.5% growth

Table 1b. Price trend

	ESA code	2007 Level	2007 Rate of change	2008 Rate of change	2009 Rate of change	2010 Rate of change	2011 Rate of change	2012 Rate of change
1. GDP deflator		-	2.5	2.2	1.8	1.75	1.75	1.75
2. Private consumption deflator		-	2.0	2.8	1.5	1.75	1.75	1.75
3. Harmonised index of consumer prices (HICP)1		-	1.6	3.3	1.5	1.75	1.75	1.75
4. Public consumption deflator		-	2.2	2.2	1.5	1.75	1.75	1.75
5. Investment deflator		-	3.0	3.1	1.2	1.75	1.75	1.75
6. Export price deflator (goods and services)		-	0.5	1.3	0.5	1.1	1.1	1.1
7. Import price deflator (goods and services)		-	0.6	3.8	-0.9	1.1	1.1	1.1

[1] Optional

Table 1c. Labour market

	ESA code	2007	2007	2008	2009	2010	2011	2012
		Level	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
1. Employment, persons[1]		25 696	1.3	0.8	0.1	0.3	0.8	0.8
2. Employment, hours worked[2]								
3. Unemployment rate (%)[3]								
4. Labour productivity, persons[4]			1.2	0.3	0.4	1.7	1.7	1.7
5. Labour productivity, hours worked[5]								
6. Compensation of employees	D.1	984 520	4.3	3.7	2.8	3.7	4.2	4.2
7. Compensation per employee		38,3	3.0	2.9	2.7	3.4	3.4	3.4

[1]Occupied active population active in the meaning of the National Accounts

[2]National accounts definition

[3]ILO definition

[4]Real GDP per person employed

[5] Real GDP per hour worked

Table 1d. Sector balance

as a % of GDP	ESA code	2007	2008	2009	2010	2011	2012
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-2.8	-3.4	-2.6	-2.5	-2.4	-2.4
o.w.: - Balance of goods and services		-1.9	-2.6	-1.9	-1.8	-1.8	-1.7
- Balance of primary incomes and transfers		-0.9	-0.9	-0.8	-0.8	-0.7	-0.7
- Capital account		0.1	0.1	0.1	0.1	0.1	0.1
2. Net lending/borrowing of the private sector	B.9						
3. Net lending/borrowing of the general government	EDP B.9	-2.7	-2.9	-3.9	-2.7	-1.9	-1.1
4. Statistical discrepancy			optional	optional	optional	optional	optional

Table 2. General government budgetary outlook

unit: € bn	ESA code	2007	2007	2008	2009	2010	2011	2012
		level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending per sub-sector								
1. General government	S.13	-50.3	-2.7	-2.9	-3.9	-2.7	-1.9	-1.1
2. Central government	S.1311	-41.5	-2.2	-2.5	-3.3	-2.3	-1.8	-1.2
3. State government	S.1312							
4. Local governments	S.1313	-7.2	-0.4	-0.3	-0.3	-0.2	-0.1	0.0
5. Social security funds	S.1314	-1.6	-0.1	0.0	-0.3	-0.2	0.0	0.1
General government (S.13)								
6. Total revenue	TR	940.4	49.7	49.8	49.6	50.0	50.0	50.2
7. Total expenditure	TE[1]	990.7	52.4	52.7	53.5	52.7	52.0	51.3
8. Net lending/borrowing	EDP B.9	-50.3	-2.7	-2.9	-3.9	-2.7	-1.9	-1.1
9. Interest expense	EDP D.41	51.4	2.7	2.9	2.8	2.8	2.8	2.8
10. Primary balance		1.1	0.1	0.0	-1.1	0.1	0.9	1.7
11. One-off measures [3]		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Key components of revenue								
12. Total taxes (12=12a+12b+12c)		510.5	27.0	26.9	26.4	26.7	26.7	26.7
12a. Taxes on production and imports	D.2	284.8	15.1	14.9	15.0	15.0	15.0	15.0
12b. Current taxes on income, wealth, etc.	D.5	216.8	11.5	11.6	11.1	11.3	11.3	11.4
12c. Capital taxes	D.91	8.9	0.5	0.4	0.4	0.4	0.4	0.4
13. Social security contributions	D.61	340.9	18.0	18.0	18.2	18.3	18.4	18.4
14. Property income	D.4	14.8	0.8	0.9	0.9	0.9	0.9	0.9
15. Other[4]		74.2	3.9	4.1	4.1	4.1	4.2	4.2
16=6. Total revenue	TR	940.4	49.7	49.8	49.6	50.0	50.0	50.2
p.m.: Tax burden (D.2+D.5+D.61-D612+D.91-D.995) [5]		818.9	43.3	43.2	42.9	43.2	43.2	43.2
Key components of expenditure								
17. Compensation of employees and intermediate consumption	D.1+P.2	339.0	17.9	17.9	18.0	17.7	17.4	17.1
17a. Compensation of employees	D.1	243.3	12.9	12.8	12.9	12.8	12.5	12.4
17b.Intermediate consumption	P.2	95.8	5.1	5.1	5.1	5.0	4.9	4.7
18. Social transfers (18=18a+18b)		436.9	23.1	23.2	23.7	23.7	23.5	23.4
18a. Social transfers in kind	D.6311. D.63121. D.63131	106.9	5.6	5.7	5.8	5.7	5.6	5.5
18b. Social transfers in cash	D.62	330.0	17.4	17.5	18.0	18.0	17.9	17.9
19=9. Interest expense	EDP D.41	51.4	2.7	2.9	2.8	2.8	2.8	2.8
20. Subsidies	D.3	26.1	1.4	1.3	1.4	1.3	1.3	1.2
21. Gross fixed capital formation	P.51	61.8	3.3	3.3	3.5	3.2	3.0	2.9
22. Other [6]		75.4	4.0	4.1	4.1	4.0	4.0	3.9
23=7. Total expenditure	TE[1]	990.7	52.4	52.7	53.5	52.7	52.0	51.3
p.m.: Government consumption (nominal)	P.3							

[1]Adjusted for the net interest flows connected with swaps, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3] A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (except D.91).

[5]Including taxes collected by the European Union and adjustment for uncollected taxes and social security contributions (D.995) if appropriate.

[6] D.29+D4 (except D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG	**2007**	**2012**
1. General public services	1	7.0	:
2. Defence	2	1.8	:
3. Public order and safety	3	1.3	:
4. Economic affairs	4	2.8	:
5. Environmental protection	5	0.9	:
6. Housing and community amenities	6	1.9	:
7. Health	7	7.2	:
8. Leisure, culture and religion	8	1.5	:
9. Education	9	5.9	:
10. Social protection	10	22.2	:
11. Total expenditure	TE[1]	52.4	51.3

1 [1]Adjusted for the net interest flows connected with swaps, so that TR-TE=EDP B.9˙

Table 4. Change in public debt

as a % of GDP	ESA code	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
1. Gross debt[1]		63.9	66.7	69.1	69.4	68.5	66.8
2. Change in gross debt ratio		0.3	2.8	2.4	0.2	-0.9	-1.7
Contributions to changes in gross debt							
3. Primary balance[2]		0.1	0.0	-1.1	0.1	0.9	1.7
4. Interest expense[3]	EDP D.41	2.7	2.9	2.8	2.8	2.8	2.8
5. Stock flow adjustment		0.5	1.9	0.0	0.0	0.0	0.0
o.w.: - Differences between cash and accruals		0.2	0.2	:	:	:	:
- Net accumulation of financial assets		0.2	1.7	:	:	:	:
o.w.: *- privatisation proceeds*		-0.4	:	:	:	:	:
- Valuation effects and other		0.0	0.0	:	:	:	:
p.m.: Implicit interest rate on debt[4]		4.5	4.7	4.3	4.3	4.3	4.3
Other relevant variables							
6. Liquid financial assets 5		28.6	:	:	:	:	:
7. Net financial debt (7=1-6)		35.3	:	:	:	:	:

[1]As defined in Regulation 3605/93; the concept is not part of the European System of Accounts (ESA).

[2]See item 10 in table 2.

[3]See item 9 in table 2.

[4] Interest expense divided by debt outstanding the previous year.

[5]AF1, AF2, AF3 (consolidated at market value), AF5.

Table 5. Cyclical changes and adjusted data of the cycle

as a % of GDP	ESA code	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
1. Real GDP growth (%)		2.2	1.0	[0.2;0.5]	2.0	2.5	2.5
2. Public balance	EDP B.9	-2.7	-2.9	-3.9	-2.7	-1.9	-1.1
3. Interest expense	EDP D.41	2.7	2.9	2.8	2.8	2.8	2.8
4. One-off measures [1]		0.0	0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		2.2	2.2	2.2	2.2	2.2	2.3
contributions:							
- labour		0.5	0.5	0.4	0.4	0.4	0.4
- capital		0.9	0.9	0.7	0.7	0.8	0.8
- total productivity of production factors		0.8	0.8	1.0	1.0	1.0	1.0
6. Output gap		0.0	-1.1	-2.7	-2.8	-2.5	-2.3
7. Cyclical balance		0.0	-0.4	-1.2	-1.3	-1.2	-1.1
8. Cyclically adjusted public balance (2 - 7)		-2.7	-2.4	-2.7	-1.4	-0.7	0.0
9. Cyclically adjusted primary balance (8 + 3)		0.0	0.5	0.1	1.5	2.1	2.8
10. Structural balance (8 - 4)		-2.7	-2.4	-2.7	-1.4	-0.7	0.0

[1] A plus sign means deficit-reducing one-off measures

Table 6. Divergence from previous programme update

	ESA code	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
GDP growth (%)							
previous update		[2; 2.5]	[2; 2.5]	2.5	2.5	2.5	2.5
current update		2.2	1.0	[0.2;0.5]	2.0	2.5	2.5
Difference		[-0.3;0.2]	[-1.5; -1.0]	[-2.3;-2.0]	-0.5	0.0	0.0
Net lending (as a % of GDP)	EDP B.9						
previous update		-2.4	-2.3	-1.7	-1.2	-0.6	0.0
current update		-2.7	-2.9	-3.9	-2.7	-1.9	-1.1
Difference		-0.2	-0.6	-2.2	-1.5	-1.4	-1.2
Public debt (as a % of GDP)							
previous update		64.2	64.0	63.2	61.9	60.2	57.9
current update		63.9	66.7	69.1	69.4	68.5	66.8
Difference		-0.3	2.7	5.9	7.5	8.3	8.9

Table 7. Long-term sustainability of public finances (source: EPC, 2006 Ageing report)

as a % of GDP	2004	2010	2020	2030	2040	2050
Total expenditure	:	:	:	:	:	:
o.w.: age-related expenditure	26.9	27.0	27.9	29.0	30.1	30.1
Pension expenditure	12.8	12.9	13.7	14.3	15.0	14.8
o.w.: General regimes	:	:	:	:	:	:
Old-age and early pensions	:	:	:	:	:	:
Other pensions (survivors, disability)	:	:	:	:	:	:
o.w.: Employer's regimes (if in the general government)	:	:	:	:	:	:
Healthcare expenditure	7.7	8.0	8.4	8.9	9.3	9.5
Long-term care expenditure	0.3	0.3	0.3	0.4	0.5	0.5
Education expenditure	5.0	4.7	4.6	4.5	4.5	4.5
Other age-related expenditure (unemployment)	1.2	1.1	0.9	0.9	0.9	0.9
Interest expense	:	:	:	:	:	:
Public revenue	:	:	:	:	:	:
o.w.: property income	0.6	0.6	0.6	0.6	0.5	0.5
o.w.: pension contributions (or social security contributions if appropriate)	:	:	:	:	:	:
Financial assets of supplementary pension schemes and FRR (*)	:	:	:	:	:	:
o.w.: consolidated financial assets of supplementary pension schemes and the FRR	:	:	:	:	:	:
Assumptions						
Labour productivity growth rate						
Real GDP growth rate						
Participation rate of man (aged 20-64)						
Participation rate of women (aged 20-64)						
Participation rate (age 20-64)						
Unemployment rate						
Population aged 65 and over in the total population						

(*) in 2007, the non-consolidated (resp. consolidated) financial assets of the public pension schemes (Agirc-Arrco) and the FRR came to 7.2 points of GDP (resp. 6.4 points of GDP)

Table 8. Basic assumptions

	2007	2008	2009	2010	2011	2012
Short-term interest rates (annual average)						
Long-term interest rates (annual average)						
Exchange rate €/$ (annual average)	1.37	1.47	1.33	1.33	1.33	1.33
Nominal effective exchange rate (basis 100 in 1995)	110.7	113.4	111.2	111.2	111.2	111.2
Global GDP excluding the EU	5.8	4.7	3.9	3.7	4.2	4.2
GDP of the EU	2.9	1.2	0.4	1.9	2.4	2.4
Global demand for France	5.7	3.3	1.3	5.0	6.5	6.5
World trade excluding the EU	6.9	4.2	4.1	5.6	7.1	7.1
Oil prices (Brent/bbl in US$)	72.5	101	72.0	73.3	74.5	75.9

[1]If necessary, assumptions purely technical

Annex 2: Tables summarising the French recovery plan

Table A: Short-term impact on public finances of the measures included in the recovery plan presented by the French President on 4 December 2008.

Title	Status	Description	Impact on public deficit (% GDP)			
			2009	2010	2011	2012
(1) Exceptional programme for State investment	PLFR to revive the economy 2009	**Objective:** supporting aggregate demand in the short term and growth in the long term. **Measures:** - Advancing the schedule of the State's direct investments in infrastructures, structural facilities, higher education, research, defence, security and property (negative budget impact in 2009 and 2010, positive impact in 2011 and 2012).	0.1	0.1	0.0	0.0
(2) Exceptional programme to support economic activity and employment	PLFR to revive the economy 2009	**Objective:** supporting activity and employment, particularly in SMEs and the automotive industry. **Measures:** - Financing small and medium-size enterprises; - Advances paid on State public procurement contracts (negative impact on public finances in 2009 and positive impact in 2010-2012); - Aid with replacement of old vehicles; - Aid with recruitment at very small enterprises; - Active employment policies; - *Fonds Stratégique d'Investissement* (strategic investment fund - property-oriented operation without impact on public deficit).	0.1	0.0	0.0	0.0
(3) Exceptional programme to promote housing and solidarity	PLFR to revive the economy 2009	**Objective:** supporting housing activity and the purchasing power of the poorest households. **Measures:** - Support for construction and subsidised home acquisition (2009 and 2010) - Accelerating the urban renovation plan - Fighting against slum housing and promoting thermal renovation (2009 and 2010) - Host accommodations and structures - *Prime de Solidarité Active* (active solidarity bonus)	0.1	0.0		
Total mission to revive the economy (1)+(2)+(3)			**0.3**	**0.1**	**0.0**	**0.0**
Support for local government investment	PLFR to revive the economy 2009	**Objective:** supporting aggregate demand in the short term and growth in the long term **Measure:** - Advancing payment by the *Fonds de Compensation de la TVA* (FCTVA - VAT Compensation Fund) for local governments that agree to invest more and that stick to their investment commitments.	0.1			
Measures to strengthen the cash position of businesses	Supple-mentary Budget Act 2008	**Objective:** easing the cash position of companies at a time when loan facilities are difficult to obtain. **Measures:** - Early payment of a "research tax credit" and backwardation of corporation tax losses in 2009 (positive impact on public finances in 2010-2012); - Advancing VAT reimbursement to ease the cash position of businesses (cash measures without impact on the national accounting). - Advancing State payments to Defence suppliers.	0.3	-0.1	-0.1	-0.1
Other measures	Supple-mentary Budget Act 2008	**Objective:** stimulating investment **Measure:** - Gradually extending the interest-free loan in the new housing sector; - Arranging accelerated depreciation of investments made in 2009: negative impact on public finances in 2010 and 2011, positive impact in 2012.		0.0	0,1	0,0
Total			**0,8**	**0,0**	**0,0**	**-0.1**

Note: unless otherwise indicated, the cost of the above measures for the public finances is limited to 2009.

<u>Table B</u>: Measures to improve the quality of public finances and long-term sustainability, included in the recovery plan presented by the French President on 4 December 2008.

Title	**Status**	**Description**
Supervision of the recovery plan	measure effective / announced (2009)	**Objective:** ensuring successful implementation of the recovery plan and guaranteeing its temporary application **Measures:** - A minister has been appointed to implement the recovery plan. - A special budget (as part of a special mission) has been provided in a Supplementary Budget Act, adopted by the Cabinet on 19 December 2008 and to be examined by Parliament from 6 January 2009 onwards. This will make it possible to check that the corresponding resources are in fact allocated and do not interfere with other government business. - Each quarter, a report will be submitted to the Cabinet to take stock of the recovery plan. This report will be published.
Simplification of the Public Procurement Code	announced; adoption in 2009	**Objective:** establishing conditions to ensure the efficiency of the recovery plan (particularly public investment plans) **Measure:** - Depending upon the conclusions of the Warsmann report, public programme and procurement extension procedures will be amended (lower thresholds for the various procedures, les rigid prohibition for players to negotiate prices in the Public Procurement Code). For procedures at regulatory level, new provisions will be adopted in early January 2009. Procedures at legislative level will be adopted by the same deadline as the Supplementary Budget Act. **Impact on quality of public finances:** shorter response time for the general government and lower costs, easier access to public procurement for small businesses.

<u>Table C</u>: Structural measures to support demand and the robustness of the economy without cost for public finances, included in recovery plan presented by the French President on 4 December 2008.

Title	**Status**	**Description**
Increased investment by large public enterprises	measure announced (effective in 2009)	**Objective:** supporting aggregate demand and potential growth **Measures:** - **EDF** will invest €2,5 bn more than in 2009. This amount will be invested mostly in production, including €300 m in renewable energies and €300 m € in the DOM (overseas *départements*, or districts). - **GDF Suez** will invest an additional €200 m in gas transportation and distribution in France. - **RATP** will invest an additional €450 m to replace and add to its rolling stock, and to improve access to stations and renovate and modernise stations. - **SNCF** plans to increase its investments by €300 m after considerable investments in 2008. This effort will focus on rolling stock, faster renovation and modernisation of stations, energy savings and information systems. - **La Poste** will invest an additional €600 m, mainly to improve service at post offices and to renovate the energy component of its buildings.
Temporary easing of town planning rules	announced; adoption in 2009	**Objective:** promoting construction without affecting the principles of sustainable development **Measure:** - extending building permits, adjusting public enquiry thresholds, anticipating the provisions in the Grenelle 2 law bill. The measures on construction rights will be included in an amended to the Housing Support Act to be adopted in early 2009.