FRANCE

STABILITY PROGRAMME 2011-2014

APRIL 2011

Contents

1. Introduction

After suffering the repercussions of the international crisis, the French economy began to recover in 2010. The improvement in the labour market has been stronger and faster than expected, allowing for the net creation of nearly 125,000 jobs in 2010. Combined with measures taken by the Government to support household purchasing power, the improved labour market has helped to maintain domestic demand, which is the main driver of GDP growth in France. Despite the crisis, household purchasing power continued to increase in 2009 and 2010.

The indicators in early 2011 confirm the acceleration of activity and the increasingly self-sustained nature of growth: industrial production has shown a sustainable increase that should allow it to rapidly return to its pre-crisis level; economic surveys show an improvement in the business climate and in the outlook for companies in the coming months; job creation is becoming more dynamic, and household consumption remains strong. In this favourable domestic environment, recent economic developments on the international scene could have an adverse effect. Higher oil prices have accelerated the rise in consumer prices, which led the Government to raise its projected inflation rate for 2011 to 1.8%. However, the encouraging first-quarter indicators suggest that a stronger than expected cyclical recovery could have a positive effect. Overall, the Government's growth forecast for 2011 remains at 2%.

In this context, the Government has resolved to pursue its fiscal consolidation policy in order to reduce the deficit to 3% of GDP by 2013, regardless of the economic situation. To this end, the Government intends to stimulate the economy's potential growth by expanding the structural reforms undertaken since 2007, particularly in the areas of education, innovation, research and development, and competition. The Government's strategy in this regard is detailed in the National Reform Programme.

The Government has also intensified its efforts to control public spending over the long term, and these efforts began to show results in 2010. Given the already high level of the tax burden in France, the Government is determined to focus its efforts on reducing spending.

This Stability Programme complies with the expenditure rule prescribed by the 2011-2014 Multiyear Public Finance Planning Act: stable State expenditure in both nominal terms (excluding interest and pensions) and real terms. The national healthcare expenditure target (ONDAM), met in 2010 for the first time in ten years, will be reduced by 0.1 percentage point in 2011 and 2012 to reach 2.9% and 2.8% respectively. In an effort to increase revenue, the Government will continue to reduce tax expenditures and social contribution exemptions, as prescribed in the Multiyear Public Finance Planning Act.

In order to maintain this budgetary discipline over the long term, and in accordance with the commitments made in the previous Stability Programme, the Government adopted in March 2011 a draft constitutional law on balanced public finances, which will be submitted to Parliament before summer 2011.

This Stability Programme is thus sharply focused on the sustainable consolidation of France's public finances, while concentrating the Government's capacity for action on future-oriented investments.

2. Macroeconomic scenario

2.1 Situation in 2010 and outlook for 2011

The economic recovery continued and picked up in France over the course of 2010. At first driven by the stimulus packages of France and other countries and by the inventory cycle, since mid-2010 the economy has seen more self-sustained growth in private domestic demand: household consumption has been robust (+1.7% as an annual average) and business investment began to recover in the second quarter of 2010, after eight consecutive quarters of decline.

The pick-up in production was also stimulated by the strong performance of exports, which grew substantially in 2010 (+10.1%). The contribution of foreign trade to growth was clearly positive (0.4 point of GDP) for the first time since 2001. Overall, growth in 2010 reached 1.5% based on working-day adjusted data and 1.6% based on raw data, figures very close to the forecast associated with the January 2010 Stability Programme (1.4%) and in line with the forecast in the 2011 budget bill. This rebound in economic activity was reflected more quickly than expected in the labour market. During the course of 2010, 125,000 jobs were created in the non-agricultural market sectors, helping to reduce the unemployment rate, which fell to 9.2% of the labour supply in metropolitan France in the fourth quarter of 2010, after having peaked at 9.5% a year earlier.

In 2011, the recovery is expected to spread to all sectors of the economy, as illustrated by the improved business climate in the manufacturing and service sectors, as well as the recent upturn in construction. **Growth is expected to reach 2%**, a rate that will help accelerate job creation in the market sectors (+160,000 over the year).

Economic activity is expected to be supported by business investment, which traditionally acts as a catalyst during periods of recovery and to take advantage of the substantial reduction in taxes on productive capital permitted by local business tax reform. Household consumption would benefit from increased revenues linked to the progressive improvement of the labour market, coupled with a reduction of savings rate. These elements would help cushion the repercussions expected in 2011 from ending the premium for scrapping old cars and the impact of rising commodity prices on inflation, expected to average 1.8% over the year. Economic activity would also benefit from the end of de-stocking in the manufacturing sector with improving demand prospects. After the exceptional rebound in exports in 2010, the contribution of foreign trade to growth is expected to fall, but should remain more favourable than the average for 2000-2008 (-0.4 point): world demand is expected to slow down but should stay above its historical rates, driven in particular by growth in Germany and the emerging economies.

However, there are various risks associated with this scenario. A continuation of the upward trend in commodity prices, in particular oil prices, could dampen household consumption and reduce profit margins. On the other hand, the cyclical rebound of production could be faster than expected. Business surveys point to a strong acceleration in economic activity in the first quarter and business prospects are good, suggesting solid growth in the second quarter: in its forecasts published in early April, the OEDC projects France's GDP to rise by 0.8-0.9% and 0.7% in the first and second quarters respectively.

2.2 Medium-term outlook (2012-2014)

The economic scenario underlying the multiyear fiscal plan is based on achieving a growth rate of 2¼% in 2012 and 2.5% in 2013 and 2014. In 2012, strong domestic demand is expected to compensate for the depletion of the favourable effects of the inventory cycle and should allow for a slight acceleration of economic activity compared to 2011. Household consumption, in particular, should benefit from the strengthened wage bill and the lower government deficit, which will encourage households to reduce their precautionary savings. The rebound in consumption is expected to continue in 2013 and 2014, thanks to the continued improvement of the labour market. Global trade is also expected to accelerate after 2011, when the short-term effects of fiscal consolidation in the main trade partners with France begin to fade. Overall, exports should be in line with global demand, indicating France's retention of market shares thanks to the effects of reforms aimed at making our businesses more competitive (particularly by tax cuts on capital through abolition of the local business tax) and at improving the quality and innovation of exports (with support for R&D through research tax credits and future-oriented investments). This strong domestic and external demand should stimulate business investment, which would also benefit from a period of "catching up" after several years of limited equipment renewal.

The assumption of such a cyclical rebound is justified by the very large negative output gap that developed during the crisis, which is expected to be only partially closed by end-2011. It also takes into account the reforms implemented to increase economic growth potential over the medium term, through increased spending for research and development and expansion of the labour supply (pension reform). France also has a number of structural assets: household debt remains relatively low, and the banking system proved its strength during the crisis. These various factors allow us to envision a more dynamic recovery in France than in some other countries where the process of reducing the debt burden of households and firms will inevitably act as a drag on economic activity over the short and medium term.

Table 1: Macroeconomic scenario 2010-2014

	2010[1]	2011	2012	2013-2014 average
GDP	1.5	2.0	2¼	2½
Contribution from domestic demand excluding inventories	1.0	1.8	2.3	2.4
Household consumption	1.7	1.7	2.4	3.0
General government consumption	1.4	0.0	-0.1	-0.1
Gross fixed capital formation	-1.6	4.2	4.6	3.2
o.w. businesses[2]	-1.3	4.7	6.7	4.0
Contribution from inventories	0.1	0.4	0.1	0.1
Contribution from foreign trade	0.4	-0.1	-0.1	-0.1
Exports	10.1	7.6	6.0	6.5
Imports	7.8	7.5	5.9	6.1
GDP deflator	0.5	1.5	1.8	1¾
Household consumption deflator	1.2	1.8	1¾	1¾
Wage bill (competitive sector, categories EB to EP)	2.2	3.2	4.2	4.5
Nominal average wage per capita (EB to EP)	2.4	2.3	2.9	3.3
Salaried employees (EB to EP)	-0.2	0.9	1.2	1.2

[1] INSEE quarterly accounts (working-day adjusted) [2] Non-financial businesses

3. Public finance scenario

3.1 Overall strategy and medium-term objective

France's Medium-Term Objective (MTO) is to restore the structural balance of public finances.

To this end, the **Government will take all the necessary measures to ensure that its public deficit targets are met:** 5.7% of GDP in 2011[1], 4.6% of GDP in 2012, 3.0% of GDP in 2013 and 2.0% of GDP in 2014, in accordance with the 2011-2014 Multiyear Public Finance Planning Act (LPFP). The public finance trajectory is thus in line with the recommendations of the Ecofin Council of 2 December 2009.

The structural adjustment strategy described in this programme relies upon both **a significant effort to contain public spending and the continued reduction of tax expenditures and social contribution exemptions**, in accordance with the commitments of the LPFP. Given the high level of taxes and social security contributions before the crisis, the choice was in fact made to avoid any general tax increase.

With respect to expenditure, efforts will be made by all general government sectors. For the State, this will be accomplished through the twofold budgetary rule: overall expenditures will not rise faster than inflation, and expenditures excluding interests and pensions will be stabilised in current euro terms, in line with the 2011-2013 three-year budget. The stricter of these two constraints will prevail every year. Efforts to contain healthcare expenditures, which made it possible to meet the national healthcare expenditure target (ONDAM) in 2010, will be continued, with the increase in the target limited to 2.9% in 2011 and 2.8% a year from 2012 to 2014. In addition, rapid implementation of the 2010 pension reform will help to reduce significantly the increase in social expenditures over the period of the programme.

Thanks to this strategy based on a combination of growth-supportive reforms, described in detail in the National Reform Programme, and strict, sustainable containment of public expenditure, the government debt ratio is expected to stabilise in 2012 and begin to fall from 2013 onwards.

This structural adjustment strategy will be implemented **with an aim to enhance the quality of public finances.** This will be achieved in particular through efforts to streamline spending: for example, through continuation of the General Review of Public Policies (RGPP) or implementation of future-oriented investments, which will allow the Government to focus spending on investments with a high socio-economic return. On the revenue side, reducing the least efficient social contribution exemptions and tax expenditures and the coming reform of taxes on personal wealth will also help rationalise the tax system.

At the same time, **the Government aims to strengthen the governance of public finances**. A draft constitutional reform, based on the propositions of the working group led by Michel Camdessus, was submitted by the Government in March 2011, .It will be reviewed by Parliament before the summer. This reform would create a new legal instrument on balanced public finances, the "lois-cadres d'équilibre des finances publiques", which would define a multiyear trajectory of structural effort. This multiyear trajectory would impose upon the annual budget laws. The 2011-2014 Multiyear Public Finance Planning Act prefigures these future "lois-cadres d'équilibre des finances publiques". It establishes expenditure ceilings for the period through 2014, as well as floors for discretionary tax measures, on the field directly managed by the Government and Parliament. A circular issued by the Prime Minister and dated 4 June 2010 states that Budget Acts and Social Security Budget Acts **shall be the only government-issued documents regulating**

[1] The public deficit forecast for 2011 was revised from 6.0% of GDP in the 2011-2014 Multiyear Public Finance Planning Act (LPFP) to 5.7% of GDP.

taxes and social security revenues, thus helping to avoid a dispersion of taxes and social security contributions reforms among too many legislations, as well as enhancing the overall coherence of the strategy for taxes and social security contributions and public finances.

Table 2: Multiyear public finance trajectory

	2010	**2011**	**2012**	**2013**	**2014**
Public balance (% GDP)	-7.0	-5.7	-4.6	-3.0	-2.0
Public debt (% GDP)	81.7	84.6	86.0	85.6	84.1

3.2 Change in structural balance

In 2010, the structural balance improved by 0.7 point of GDP. This improvement is the result of both the gradual withdrawal of stimulus package measures (0.7 point of GDP) and significant efforts to contain spending throughout the general government sector.[2] Conversely, the local business tax reform contributed to the degradation of the balance by 0.4 point of GDP, of which 0.2 point resulting from the temporary cost of implementing the reform in 2010. Public spending increased by 0.6% in real terms excluding stimulus measures and deliveries of military equipments.[3] This is mainly due to compliance with the State budget expenditure rule and the national target for health insurance expenditure (3%), as well as a marked slowdown in local spending.

In 2011, the structural adjustment is more pronounced, reaching 1.2 point of GDP, as a result of two main factors: first, the discretionary tax measures in the Initial Budget Act and the Social Security Budget Act for 2011, accounting for a total of over €11 billion, essentially through reductions of tax expenditures and social contribution exemptions; and secondly, continued efforts to reduce general government expenditures. These efforts include compliance with the twofold rule on the growth of State expenditure ("zero real spending growth" and "zero nominal spending growth, excluding interests and pensions"), limitation of the growth of healthcare expenditure to 2.9%, and implementation of the pension reform. The total withdrawal of stimulus measures (0.4 point of GDP) and the end of the temporary cost of reforming the local business tax (0.2 point of GDP) will also help to improve the structural balance in 2011.

In 2012-2014, structural adjustment will be continued at an average rate of 1.0 point of GDP per year through continued efforts to reduce spending throughout the general government sector, i.e. compliance with the twofold State budgetary rule, growth of healthcare expenditure not exceeding 2.8% per year, and the increasing impact of pension reform. At the same time, the strategy for streamlining and reducing tax expenditure and social contribution exemptions will be pursued, with a reduction in their costs to ensure compliance with the minimum of €3 billion per year through discretionary revenue measures prescribed by the 2011-2014 Multiyear Public Finance Planning Act s.

[2] At this stage of our knowledge concerning the macroeconomic environment in 2010 (on 13 May 2011 INSEE will publish the 2010 annual accounts, which incorporate the effects of a comprehensive revision), the positive effect of the spontaneous rebound in taxes and social security contributions (elasticity of 1.4) following their drop to abnormally low levels in 2009 would have been nearly offset in 2010 by the terms of trade shock (0.5% growth in GDP prices compared with a 1.5% rise in the CPI excluding tobacco). The increase in taxes and social security contributions is measured against nominal GDP, while the CPI excluding tobacco serves as a reference point for evaluating growth in public spending in real terms, as this index is used in establishing the budget expenditure rule and for indexing social benefits.

[3] The time lag between delivery of and payment for military goods contributed to a degradation of the public balance by 0.2 points of GDP in 2010 as compared with 2009.

Table 3: Multiyear structural balance trajectory

	2010	2011	2012	2013	2014
Structural balance (% potential GDP)	-5.1	-3.8	-2.9	-1.6	-0.9
Change in structural balance (% potential GDP)	0.7	1.2	1.0	1.2	0.8

3.3 Change in public balance by sub-sector

Each sub-sector will help reduce the general government borrowing requirement through 2014.

Table 4: Lending capacity (+) / borrowing requirement (-)
of the general government (% of GDP)

	2010	2011	2012	2013	2014
General government	-7.0	-5.7	-4.6	-3.0	-2.0
Central government	-5.8	-4.6	-3.7	-2.6	-2.0
o.w.: State	*-6.2*	*-4.4*	*-3.6*	*-2.5*	*-1.9*
o.w.: Other government bodies	*0.5*	*-0.3*	*-0.1*	*-0.1*	*-0.1*
Local governments	-0.1	-0.2	-0.2	-0.1	0.0
Social security funds	-1.2	-0.9	-0.7	-0.4	-0.1

Note: For the entire period, the figures shown take into consideration the changes in perimeter introduced with the comprehensive revision of the national accounts (from base 2000 to base 2005): they group the Social Security Debt Amortization Fund (CADES) and the Pension Reserve Fund (FRR) together with social security funds, rather than with other government bodies, as was the case in base 2000. This contributes to improving the balance of the accounts of social security funds (ASSO) and degrading of that of other government bodies (ODAC) by an average of 0.5 point of GDP over the entire period.

The **central government** borrowing requirement would decrease by about 4 points of GDP from 2010 to 2014, thanks to the State's complying with the twofold budgetary rule, the dissemination of cross-cutting rules from the State to its operators, the reduction in tax expenditures, and the "catch-up" effect of revenues that dropped to abnormally low levels during the crisis. Also playing a role in this decrease in 2011 are the extinction of the stimulus measures taken to counter the economic and financial crisis and the disappearance of the temporary cost of reforming the local business tax, both of which were financed by the State in 2010.

The breakdown of the central government balance into the State's balance and that of other government bodies (ODAC) was noticeably affected by the State's 2010 grants to the organisations responsible for future-oriented investments, most of which are other government bodies. Between 2011 and 2012, the balance of ODACs would improve owing to smaller disbursements for future-oriented investments, as 2011 would see a peak in spending related to the postponement of certain operations initially planned for 2010.

Following a slight degradation of the **local government** balance in 2011, due largely to an upswing in local investment after two years of decline, the programme is based on the assumption that the local authorities will gradually reduce their deficit and return to a balanced budget by the end of the programme. In a context of a moderate increase in revenues, linked to the freeze in current euro terms of endowments from the State (excluding the VAT Compensation Fund) and a limited increase in the rate of direct local taxes, this adjustment could be done by continuing the efforts made in 2010 to contain spending.

The balance of the **social security funds** – which includes the "Régime Général" as well as the Social Security Debt Amortization Fund (CADES) and the Pension Reserve Fund (FRR), the supplementary pension schemes and the unemployment insurance – should recover from 2011 on. This recovery can be explained by the ongoing efforts to contain spending, particularly on healthcare insurance, the implementation of the 2010 pension reform, and the reductions in social contribution exemptions carried out over the period, as well as the spontaneous decrease in expenditures for unemployment benefits and a better outlook for the private-sector wage bill as the economic situation improves. By 2014, the social security funds' budget should be nearly balanced.

3.4 Change in general government expenditure

The Government's strategy will require efforts to control spending by every general government sub-sector.

Table 5: Change in general government expenditure

Average per year in real terms (*)	2011-2014
General government	**0.8%**
Central government (APUC)	-0.1%
Local governments (APUL)	0.8%
Social security funds (ASSO)	1.2%

(*) The average change for 2010-2011, 2011-2012, 2012-2013, and 2013-2014, expressed in current scope excluding the effects of the stimulus package and one-off transfers related to the local business tax reform.

3.4.1 State expenditure

2010 budget implementation

In 2010, State expenditures were contained: the target defined in the Initial Budget Act, where expenditure growth is strictly limited to the inflation rate (the "zero real spending growth" rule), was met (expenditure was €0.1 billion below this ceiling). The containment of spending even made it possible, within the total authorized ceiling, to discharge the State's entire debt to "Crédit Foncier de France" under the home savings plans (€0.7 billion)[4] and to settle European Union clearance operations (€0.1 billion) in the year of occurrence (and not the following year). The mobilization of excess revenues allocated to social security schemes (€1.4 billion) allowed for discharging the State's outstanding gross debt to social security.

The general budget also incurred in 2010 some one-off expenditures that are not renewable beyond 2010, related to the end of the recovery plan (€5.2 billion) and future-oriented investments (€32.4 billion). Besides, the introduction of the "*compensation relais*", intended to provide financial compensation to local authorities on an interim basis in 2010 for revenue loss in connection with the local business tax reform, resulted in a one-time expenditure of €32.4 billion, with the State receiving that year, in exchange, all revenues collected under the new tax system and the local business taxes due for previous years.

Overall programming of State expenditure for 2011-2014 and applying it to the 2011-2013 three-year budget

In line with the principle of a multiyear framework for the State budget, first adopted in 2008, a new three-year budget for 2011-2013 was submitted by the Government and adopted by Parliament in autumn 2010.

[4] The budget expenditure to discharge the CFF debt is not considered as a 2010 expenditure in national accounts, as it was recorded in the past, when claims and obligations arised (flows are recorded on accrual basis).

It contributes significantly to the consolidation of public finances, as **it was developed in compliance with the twofold budgetary rule**, described in a particular article of the 2011-2014 Multiyear Public Finance Planning Act:

- stabilization in current euro terms ("zero nominal spending growth") of budget appropriations and levies on revenue allocated to the European Union and local authorities, excluding debt service and civil servant pensions;
- with the inclusion of these two expenditure items, an annual increase in appropriations that will still be limited to the inflation rate ("zero real spending growth") within the perimeter of the expanded norm.

The addition of the rule on "zero nominal spending growth excluding debt and pensions" is particularly beneficial for the future. Indeed, this rule guarantees that the savings achieved on civil servant pensions resulting from the 2010 pension reform, which gradually takes effect over the programming period, will not be recycled to cover other expenditures. The full amount of this savings will thus contribute to the structural consolidation of our public finances. In addition, a smaller increase in the cost of debt service compared to the projections for the period would not be recycled in the budgeting process for other State expenditures.

It is also an **unprecedented effort in comparison with previous budgets**. In the Initial Budget Acts from 2006 to 2010, general budget appropriations and levies on revenue, which are now subject to the "zero nominal spending growth" rule, grew on average by about €2.9 billion a year, whereas they will henceforth be stabilised. Such an effort requires significant savings, as stabilising appropriations imposes limits on expenditures, which have tended to rise spontaneously.

Indeed, without measures to contain expenditure, most programmes subject to the "zero nominal spending growth" rule grow spontaneously. That is why savings must be achieved to counterbalance the spontaneous trend of expenditure growth and free up new resources to finance priorities, while stabilising overall appropriations.

To achieve these objectives, preparation of the 2011-2013 three-year budget was based on cross-cutting savings targets, documented by the **General Review of Public Policies** (see Section 5.1):

- the target of replacing only one out of every two retiring civil servants is reaffirmed by the 2011-2013 three-year budget and extended to operators which must reduce their staffs by 1.5% each year, which represents an effort comparable to that of the State;
- a target of reducing the operating expenditures of the State and operators by 10% over the 2011-2013 period, including a 5% reduction in 2011;
- a systematic review of intervention programmes with a similar target of reducing expenditures by 10% by 2013.

The social security funds will also participate, through the implementation of target-based management agreements, in the effort to replace only one out of every two retiring staff and to reduce their operating expenditures.

The 2012 State budget

The 2012 Budget Bill will be prepared in compliance with the 2011-2014 Multiyear Public Finance Planning Act and the 2011-2013 three-year budget (see Annex 2), of which it is the second instalment.

The "zero nominal spending growth" rule limits State appropriations, excluding debt service and pension contributions, to €275.6 billion at 2011 perimeter. Assuming a 1.75% increase in prices in 2012, applying the "zero real spending growth" rule to a perimeter including the cost of debt service and pensions imposes a ceiling of €363.1 billion at 2011 perimeter.

Beginning in 2011, these ceilings apply to all general budget appropriations and levies on revenue, with the exception of appropriations to compensate for the local business tax revenue, to which the expenditure rules will not be applied in 2012, as in 2010 and 2011.

Within these overall ceilings, in accordance with the operating principles of the three-year budget, this budget determines the ceiling for each mission in the State budget. The ministries are responsible for ensuring compliance with these ceilings: in accordance with the principle of "self-insurance," they are required, when needed, to find the way for financing any new needs that arose after the preparation of the three-year budget.

The rule of replacing only one out of every two retiring civil servants will be continued in 2012, resulting in the suppression of about 30,000 jobs (in full-time equivalents), as foreseen in the three-year budget. The target of reducing operating and intervention expenditures by 10% over three years will lead to a reduction of about 2.5% in 2012, after a fall of 5% in 2011.

Consistent with the "zero nominal spending growth" rule, all contributions paid by the State to local authorities, with the exception of VAT compensation fund, which has its own dynamic, will be stabilised in nominal terms, like in 2011.

The distribution of 2012 budget allocations among programmes, within missions, will be presented to Parliament during the public finance policy debate scheduled to take place in late June.

3.4.2 Expenditure of other government bodies

Other government bodies that are considered as "State operators"[5] will be directly involved in the efforts to control public spending, as the cross-cutting rules applied to the State under the 2011-2013 three-year budget concerning operations and jobs are also applied to them:

- Operators must make a collective effort, similar to that of the State, to reduce their operating expenditures by 10%, beginning with 5% in 2011.
- The rule of replacing only one of every two retiring civil servants applicable to the State is also applied to operators, but adapted to their specific situation, in terms of demographics. This rule, which for operators, excluding higher education and research, means an overall staff reduction of 1.5% per year, , will lead to the suppression of about 2,600 jobs in 2011.

To achieve this savings, an initiative to audit operators representing important economic stakes was launched in 2009 and will be continued throughout the programme period. By end-2011, nearly half of the workforce and budgets of operators (excluding universities) will have been reviewed as part of this initiative.

The prohibition for other government bodies to borrow from banks and issue securities with a maturity of over 12 months should help contain their expenditure. This provision of the 2011–2014 Multiyear Public Finance Planning Act will also contribute to a better debt management at the general government level.

The impact of future-oriented investments on the deficit will remain moderate for public finances, in light of the strategic decisions taken, which leave much room for accumulating assets. Thus non-consumable appropriations and loans, equity purchases and capital injections, which account for two-thirds of appropriations, will have no impact on the deficit, the former because the interest paid will be secured by savings achieved elsewhere in the State budget, and the latter because they are considered to be financial transactions in national accounts. Only subsidies and

[5] The salient features of State operators are that they carry out public service activities, are mostly financed by the State and are under the State's direct control. The purview of State operators and that of other government bodies are not exactly the same.

repayable advances[6], which account for the remaining third of appropriations, will have an impact on the public balance, as the subsequent repayment of these advances will result in additional revenues. The impact on the public debt will be spread out over time as disbursements are actually made, because of the obligation to deposit the funds in dedicated accounts opened at the Treasury until they are eventually paid to the final beneficiary.

After the first phase of project selection in 2010, rapid implementation of future-oriented investments is expected in 2011, together with an adjustment for expenditures not implemented in 2010, for a total of slightly under €4 billion.[7] The programme is expected to reach cruising speed in 2012, with an impact on the public balance of €2-3 billion per year. The impact on the public debt, which takes financial transactions into account, would be €5½ billion in 2011 and €3½ billion per year starting in 2012.

3.4.3 Expenditure of social security funds

Benefits paid out by the social security funds increased at a relatively high rate in 2010 (+3.8% in nominal terms) owing to high expenditures on unemployment benefits (+8.0%) and strong momentum in old-age benefits (+3.7%). In 2011, they are expected to rise more slowly (+3.5%) due to a fall in unemployment benefits, continued efforts to contain healthcare expenditure, with the national healthcare expenditure target (ONDAM) expected to grow by 2.9%, and the implementation of pension reform. Over the 2012–2014 period, the upward trend in benefits should be moderate (3.0% on average), thanks to the cumulative effects of the pension reform voted in 2010, the implementation of ambitious objectives concerning healthcare expenditure, as well as the expected improvement in the labour market.

Table 6: Change in expenditure of the social security funds in nominal terms

	2009	2010	2011	2012-2014*
ONDAM	3.5%	3.0%	2.9%	2.8%
Family-Housing	3.4%	2.5%	2.2%	2.6%
Old age	4.5%	3.7%	4.6%	3.6%
Unemployment	21.1%	8.0%	-2.6%	-0.9%
Total expenditure	5.1%	3.8%	3.5%	3.0%

** Average annual growth rate, 2012-2014.*

Healthcare benefits

In 2010, thanks to the implementation of targeted savings measures, the slowdown in healthcare expenditure observed since 2008 continued. For the first time since its creation in 1997, the actual growth of healthcare expenditure in 2010 complied with the annual national healthcare expenditure target established by Parliament in the Social Security Budget Act. At 3.0%, the growth rate of this expenditure would be one-half point below the average annual growth rate observed between 2006 and 2009. All the sectors constituting this target contributed in 2010 to the reduction of expenditure. In particular, the target for private practice would have been respected thanks to stronger measures to control unnecessary prescriptions or lower prices (of pharmaceuticals and professionals in the radiology and biological sectors), together with targeted measures to increase the contribution of

[6] Repayable advances, which were considered to be financial transactions in the previous programme, are here treated as expenditures.

[7] 80% of the expenditure for future-oriented investments is borne by other government bodies and the rest is borne by funds that are separate from the State in terms of budgetary accounting but attached to it in national accounts.

persons covered by insurance (a €2 increase in the flat-rate charge in hospitals, and a reduction from 35% to 15% of the reimbursement rate for drugs whose usefulness is deemed to be limited). The €0.6 billion plan for additional measures decided on by the early warning committee in spring 2010, as well as the freezing decisions taken later, are also thought to have contributed to the meeting of this target.

For 2011, the national healthcare expenditure target is based on pursuing efforts to contain spending with a target of 2.9% corresponding to a further slowdown. These efforts are in line with ongoing attempts to increase the efficiency of the healthcare system and the resulting anticipated consumption of medical services. That is why, one year after establishing the Regional Healthcare Agencies (ARS), the proactive policy for containing healthcare expenditure is being pursued and targets three concomitant areas of intervention: risk management through the control of unnecessary medical costs, implementing a policy of price and fee adjustments, and a gradual focusing of expenditure on the most medically useful types of care.

For 2011, additional measures amounting to €2.4 billion have been taken, reducing expenditure growth from 4.4% (spontaneous growth taking into account the effect of revised fees for certain procedures) to the agreed-on target. This figure shows the continued intensified efforts to manage risk and efficiency that are expected to result in savings of €1.2 billion, including €0.6 billion from controlling private practice medical costs and €0.3 billion in the medico-social sector. The quest for greater efficiency in the hospital sector would result in savings of approximately €0.2 billion (supplementary list of high-cost innovative treatments, savings on appropriations for general interest tasks, assistance with contracting management services…). With respect to fee adjustments, the combined reductions of fees for certain medical specialties (radiology and biological testing) and certain hospital services (public and private sector convergence) coupled with lower prices for patented medications should result in savings of €0.9 billion. Finally, focused expenditure would permit savings of about €0.3 billion, two-thirds of which is due to the 5-point increase in copayments for medical treatment and the continued reduction of reimbursement for drugs whose usefulness is deemed to be limited.

From 2012 onward, the 2011-2014 Multiyear Public Finance Planning Act sets the healthcare expenditure growth target at 2.8% per year in nominal terms. In the same way that the additional measures taken over the course of 2010 made it possible to comply strictly with the 2010 target, enhanced governance and monitoring of healthcare expenditure growth decided on following the Briet report will help meet future targets. The launching of a steering committee is already helping to better identify and monitor the infra-annual expenditure determinants. In order to ensure that the target agreed on in the Social Security Budget Act is met, this committee will help implement additional measures if deemed necessary by an early warning committee with enhanced powers. On the basis of the warning threshold for the healthcare expenditure growth target, reduced from 0.75% to 0.5% percent by 2013, this committee will announce a decision several times a year: an initial opinion for the coming year will be delivered when the Social Security Budget Bill (PLFSS) is submitted, and updates will be announced in mid-April and end-May at the latest. This timetable will make it possible to identify more quickly any possible deviations and to take the necessary measures to ensure that the targets are met for the year. The introduction of systematic mechanisms to maintain reserve allocations also enhances the capacity for infra-annual fine-tuning of the target.

Old-age benefits

Growth in old-age benefits is expected to slow down during the programme period (+3.6% per year in 2012-2014, down from 3.7% and 4.6% in 2010 and 2011 respectively), thanks to the rapid implementation of the 2010 pension reform. Corrected for price indexation, growth in benefits would actually slow down from +2.8% in 2010 and 2011 to +1.8% over the 2012-2014 period.

The 2010 pension reform will counter the effects of a rising life expectancy and large numbers of baby-boomers reaching retirement age. It focuses on a reduction in benefit expenditures resulting from later retirements and thus a drop in the number of pensioners. The main provision of the reform is to raise retirement age gradually by two years for everyone (from 60 to 62 for employees under the general scheme), and the age for automatic entitlement to full retirement benefits from 65 to 67. The effects of the reform will be visible from 2011 on, and are expected to increase throughout the programme period and even beyond, since the implementation of the reform is staggered over a period ending about 2020 (see Section 6).

Other social benefits

Family and housing benefits grew by 2.5% in 2010 and are expected to rise by 2.2% in 2011, with housing benefits growing slower than family benefits. Over the 2012-2014 period, the average growth of family and housing benefits is projected at 2.6%.

Finally, after two years of increase linked to rising unemployment, expenditure for unemployment benefits is expected to fall by 2.6% in 2011. Over the programme period, the expected upturn in the labour market should allow it to fall by an average of about 1% from 2012 to 2014.

3.4.4 Expenditure of local governments

The programme is based on the assumption that local authorities seek a gradual return to equilibrium in their financing capacity over the programme period. This improvement would be achieved mainly through a marked slowdown in local expenditure over the period, to which several factors are expected to contribute.

The local investment cycle will be less dynamic than the previous one, which was characterised by a marked rise in construction costs. The programme projects local investment to grow at a rate close to GDP growth over the years 2011-2013, the period preceding local elections in 2014, followed by a slowdown in 2014, in a pattern consistent with the one observed during past election cycles.

Local authorities can be expected to continue the efforts made in 2010 to contain current expenditure. The State will also contribute to the slowdown in current expenditure by freezing financial endowments to local authorities (excluding the VAT compensation fund) and limiting the number of regulations that apply to them. The reform of regional and local authorities, which will help contain local expenditure, is consistent with this approach. Full implementation of the Disability Compensation Benefit (PCH) will contribute to a slowdown in local public expenditure. The improving economic situation will also help to reduce the social inclusion benefit (*RSA socle*).

3.5 Changes in public revenues

After recovering partially in 2010 following its sharp decline in 2009, the aggregate tax and social security rate is expected to continue to increase until 2013, owing to the continued spontaneous post-crisis "catch-up" of revenues and the reductions in tax expenditure and social contribution exemptions projected for the period. The rate is expected to stabilise in 2014 at 43.9% of GDP.

This is based on the assumption of an average elasticity in taxes and social security contributions between 1.0 and 1.1 during the 2011-2014 period (compared to 1.2 during the 2011-2013 period under the previous programme), which over the programme period would compensate for the sharp fall in taxes and social security contributions, particularly the corporation tax, observed during the crisis.

This assumption is consistent with a scenario where growth gradually catches up to its potential. 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, especially taxes collected by the State, may be slightly above unity during periods when the growth rate is above potential.

The programme period also includes the full set of measures enacted (see Section 5). **Significant efforts aimed at increasing public revenue are expected in 2011**, consistent with the target of

€11 billion in discretionary measures set in the 2011–2014 Multiyear Public Finance Planning Act. Additional new measures amounting to 0.6 point of GDP were taken in the Initial Budget Act (LFI) and the Social Security Budget Act for 2011, particularly in connection with pension reform, financing the social security debt, and rationalising exemptions that are considered too costly in view of their effectiveness. In addition to these measures, other factors that should contribute to the improvement are the end of the temporary cost of reforming the local business tax and the payback effect of early reimbursement of the research tax credit (part of the stimulus package), which brings to 0.9 point of GDP the contribution of discretionary measures to growth in the aggregate tax and social security rate in 2011. Between 2012 and 2014, additional efforts to reduce the cost of tax expenditure and social security exemptions should help meet the minimum target of €3 billion per year for new measures set in the 2011–2014 Multiyear Public Finance Planning Act.

In addition, the GDP share of revenue excluding taxes and social security contributions is expected to remain nearly constant between 2011 and 2014.

3.5.1 State revenues

In 2011, the State's net tax revenue is expected to rise slightly compared to 2010, despite the disappearance of the 2010 one-off revenue in conjunction with the local business tax reform (new revenue temporarily allocated to the State budget in 2010 and subsequently allocated to regional and local authorities starting in 2011, and other transferred revenue).[8] Without this effect, net tax revenue would grow strongly in 2011.

Against a background of economic recovery, this strong increase can be explained first of all by the continued catching-up effect of tax revenue against wealth produced after its steep decline in 2009. This revenue would come mainly from the corporation tax and, to a lesser extent, from the income tax, owing to the improvement in 2010 of companies' performance, the private-sector wage bill, and pensions, as well as capital gains on financial assets due to the stock-market recovery.

In addition, net tax revenue would benefit from the positive effect of new measures, and in particular:

- tax measures taken in accordance with the 2011 Initial Budget Act (see Section 5.2), consisting essentially of reduced tax exemptions. These measures are expected to increase the State's net tax revenue by €2.8 billion, particularly with the creation of the systemic risk tax on banks, elimination of the reduced VAT rate on "triple play" (telephone, internet, TV) services, and increasingly targeted tax credits for sustainable development.
- the payback effect of early reimbursements under the recovery plan (research tax credit and corporation tax carry-back), amounting to €3.6 billion

In 2012, the State's net tax revenue is expected to grow spontaneously faster than nominal GDP, thanks to the continued catching-up effect (most of all the corporation tax). The Government's efforts to reduce tax expenditure would also contribute to increased revenue, particularly owing to the measures taken in accordance with the 2011 Initial Budget Act (reduction of the tax credit for solar energy equipment, 10% reduction of a series of income tax credits and reductions, reform of the home ownership tax regime, etc.).

In 2013 and 2014, tax revenue is expected to grow faster than GDP, in connection with above-potential growth of economic activity, and the end of the catching up of revenue following its steep decline in 2009. At the same time the reduction of tax expenditure and social contribution exemptions would continue, to comply with the minimum requirements for new tax and social security measures prescribed by the 2011-2014 Multiyear Public Finance Planning Act.

[8] Abolition of the local business tax will result, in 2011, in the transfer to local authorities of the new taxes created in 2010 to replace the local business tax (value-added contribution and property tax on corporations) as well as a number of other taxes (particularly the special tax on insurance contracts and the tax on retail establishments).

The reform of taxes on personal wealth, which will be submitted to Parliament in May 2011, will have a neutral effect on the State's tax revenue for the period.

3.5.2 Revenues of social security funds

In 2010, the revenue of the social security funds increased by 2.0% excluding exceptional measures,[9] mainly owing to the increase in the private-sector wage bill (+1.9% as defined by *Agence centrale des organismes de sécurité sociale [ACOSS]*). This is mostly due to the 1.9% increase in social security contributions. At the same time, the tax revenue of the social security funds have benefited from new measures (doubling the flat-rate social security levy, abolishing the CSG [generalised social security contribution] exemption for the inheritance of certain types of life insurance contracts).

In 2011, growth in social security revenues is expected to be dynamic (4.5% not adjusted for one-offs) thanks to the significant new measures voted in the Budget Act and the Social Security Budget Act in fall 2010 and a larger wage bill (+3.2%). First of all, pension systems should receive about €3.7 billion from targeted new revenues[10]: a one-point increase in the marginal rate for the highest income tax bracket, higher taxes on stock options and supplementary pensions for senior executives, annualization of general reductions of social security contributions for low-paid workers (see Sections 5.2 and 6). In addition, three new resources have been allocated to social security as part of the transfer of the social security debt, amounting to €3.6 billion: a special tax on insurance contracts, the taxing of sums placed in the capital reserve by insurance companies, and levying social security contributions on the euro components of life insurance contracts. Finally, various measures (particularly the two-point increase in the flat-rate social security levy and the 0.1 point increase in the contribution rate for work accidents and occupational diseases) are expected to generate about €0.9 billion in additional resources. In all, about €8 billion worth of new measures would support social security revenue in 2011.

In 2012-2014, the stronger recovery should allow the private-sector wage bill to grow strongly (+4.2% in 2012, +4.5% in 2013 and 2014), resulting in increased social security contributions. Given the slower growth of the public-sector wage bill and certain tax revenues, the revenues of social security funds are expected to grow at an average rate of nearly 4.0% between 2012 and 2014.

3.5.3 Revenues of local governments

The taxes for local governments are expected to grow spontaneously at a rate close to GDP (with elasticity slightly below unity). Moreover, in view of the local elections scheduled for 2014, the programme assumes a moderate increase in local tax rates resulting in increased revenues averaging about €0.7 billion per year throughout the period.

3.6 Public debt and stock-flow adjustment

In 2010, the public debt ratio according to the Maastricht definition rose by 3.4 points of GDP, a rate considerably slower than in 2009. This is due not only to a reduction in the deficit, but also to stronger growth in economic activity and negative stock-flow adjustment (-2 points of GDP).

[9] The Pension Reserve Fund benefited from the one-off proceeds from the sale of the last third-generation mobile telephone licence and awarding of the last available frequency slots, amounting to a total of €0.8 billion. In addition, in 2010, the excess from the "Panier Fillon" was used exceptionally to repay the State's debt to social security. These revenues were reallocated to the State in the national accounts.

[10] This figure applies only to social security funds, and the overall figure for general government is presented in Table 11.

This stock-flow adjustment results primarily from a significant reduction in the general government's cash position (-1.5 points of GDP), particularly that of the State, with a reduction of over €22 billion in the Treasury account balance owing to a drop in the precautionary cash balance necessary to cover cash requirements from the beginning of the year, as well as the high level of government securities issue premiums en 2010 (-0.4 point of GDP). The gradual withdrawal of measures to manage the economic and financial crisis also contributed, with the repayment of a part of the loans to car manufacturers (€2.2 billion) and investments made in banks by the Corporation for State Equity Holdings (SPPE), which allowed it to reduce its debt by €3.5 billion. By contrast, the emergency loans granted to Greece (0.2 point of GDP) contributed to the rise in the gross debt ratio.

In 2011, the debt ratio is expected to rise by 2.9 points of GDP, essentially as a result of the gap between the public balance and the stabilising point. The stock-flow adjustment should be close to zero, as a result of various transactions having opposite effects. The financial support provided to euro area member states facing difficulties (direct loans to Greece, loans to Ireland through EFSF[11]) and the financial transactions carried out within the framework of future-oriented investments should contribute positively to the stock-flow adjustment. Repayments in connection with the withdrawal of crisis-management measures (loans to car manufacturers and investments in banks through SPPE) would contribute negatively, as would the sale of private securities by the Pension Reserve Fund (FRR), not only to help reduce the debt of the Social Security Debt Amortization Fund (CADES) (€2.1 billion per year beginning in 2011) but also owing to the modified investment strategy resulting from its participation in pension reform, which led it to reallocate part of its portfolio to more certain investments, particularly government securities.

In 2012, the increase in public debt should be smaller (1.5 point of GDP), thanks to the reduced deficit. The stock-flow adjustment will contribute only marginally to the increase in the debt ratio (0.2 point of GDP). The adjustment would result mainly from continued financial support to Greece and Ireland.

Beginning in 2013, with the conventional assumption of zero stock-flow adjustment, the debt ratio should start falling thanks to the return of the public balance above the stabilising point. Thus, after reaching 86.0 points of GDP in 2012, the debt ratio is expected to fall to 84.1 points of GDP in 2014.

4. Sensitivity analysis and comparison with the previous programme

4.1 Sensitivity to external assumptions

The international scenario underlying the projections is as follows:

• Oil prices will settle at US$100/bbl starting in the second quarter of 2011 and subsequently remain at this level until 2012, followed by an increase in the nominal price per barrel in line with inflation (i.e. 1¾% per year from 2013 to 2014);

• It is conventionally assumed that the exchange rate between the euro and the dollar will be stabilized at US$1.40 during the entire period under review;

• Global activity and world trade will begin to return to their long-term average as of 2012. World demand for French goods and services would increase by 6½ % per year starting in 2013, i.e. its average during the period from 1987 to 2007, after growing by 11.6% in 2010 and 6.4% in 2011.

[11] The forecast at this stage does not include the effect of potential financial support to Portugal, for which neither the amount nor the procedures have been determined.

Overall, these assumptions are close to those of the Commission. It is nevertheless possible to evaluate the effect of other external assumptions on the French economy. Below, we will examine the impact of greater world demand for French goods and services, higher oil prices and an increase in the exchange rate and the interest rates.

4.1.1 Impact of a stronger increase in world demand for French goods and services

An increase in world demand for French goods and services would pass almost entirely on exports, after which it would spread to the rest of the economy, primarily through increased corporate investment.

Assuming constant nominal interest rates, a permanent increase of 1% in world demand would improve activity by about 1/4 point of GDP and generate about 40,000 extra jobs after three years. The impact on inflation would be low at constant exchange rates[12].

To illustrate the point, a 1% increase in world demand for French goods is equivalent to a temporary increase in US growth of about 1 point, given the importance of the American market in French exports of goods (8%) and the spill-over effects for the world economy. Should global demand slow down, the orders of magnitude would be almost exactly the same, but in a negative direction.

Table 7: Impact on the French economy of a 1% increase in world demand for French goods and services (*)

(deviation from baseline scenario as a %)	**2012**	**2013**	**2014**
GDP	0.2	0.2	¼
Total employment (thousands)	9	27	40
Consumer prices	0.0	0.1	0.1
Public net lending (in points of GDP)	0.0	0.1	0.1

(*) Permanent increase of 1% in world demand occurring in early 2012.

This shock would be the result of a significant increase in activity, an improved labour market and relatively low positive effect on inflation. Increased momentum of demand and payroll income would have a positive impact on tax revenue (VAT, corporation tax, personal income tax, social security contributions and other taxes). The slight effect on inflation triggered by this demand shock would have little impact on expenditure growth, which would speed up less quickly than revenue. In all, public net lending would improve by about 0.1 point of GDP as of 2013.

4.1.2 Impact of higher oil prices

A rise in oil prices would increase imported inflation, which in turn would directly increase consumer prices at constant exchange rates. This automatic effect would be strengthened by the induced change in production costs and increases in wages to offset – in whole or in part – higher prices, which would add to the inflationary impact. The rise in consumer prices and the weakening of corporate profits would then converge to curb activity. These effects would also be felt in other net oil-importing countries, resulting in their reduced contribution to world demand for French goods and services but also, on the positive side, improvements in price competitiveness owing to the weaker sensitivity of production prices to oil prices in France compared to its main trade partners. In addition, higher oil prices support economic activity in the net oil-exporting countries due to the increased oil revenues they produce.

A model including a macroeconomic balancing effect with the rest of the world suggests that a lasting $20 increase in the price of a barrel of oil: from $100 to $120 for example, and at constant

[12] In this variant, the price of oil is considered exogenous and thus unresponsive to changes in world demand.

real interest rates and exchange rates, would bring about a drop in activity of 0.1 point and raise consumer prices by 0.3 point the first year, compared to a situation with no increase in oil prices.

Table 8: Impact on the French economy of a 20% increase in oil prices (*)

(deviation from baseline scenario as a %)	**2012**	**2013**	**2014**
GDP	-0.1	-0.2	-0.2
Total employment (thousands)	-3	-28	-62
Consumer prices	0.3	0.8	1.2
Public net lending (in points of GDP)	0.0	-0.1	-0.2

(*) A 20% rise per barrel at the start of 2012, exogenous real interest rate, endogenous response by the rest of the world.

The increase in oil prices would have a mixed impact on public revenue. On one hand, the drop in economic activity would have a negative impact on general government tax revenues through 2014, particularly from the corporation tax. On the other hand, revenue sensitive to inflation and wages (such as VAT or social security contributions) would increase in nominal terms. The net impact on revenue would be roughly neutral. By contrast, the impact of increased spending, largely due to higher inflation and a less robust labour market, would already be felt in the second year and would last through the third year. As a result, the public balance would deteriorate by 0.1 point of GDP in the second year and 0.2 point of GDP in the third year.

4.1.3 Effects of a 10% appreciation of the euro against all other currencies

An appreciation of the euro against all other currencies would automatically lead to a degradation of France's price competitiveness compared to countries outside the euro area and to a negative impact on economic activity in our euro area trade partners. Exports slowdown would affect both activity and employment. As in the rest of the euro area, inflation would be moderated by an appreciation of the effective exchange rate.

A model including a macroeconomic balancing effect with the rest of the world suggests that a 10% appreciation of the exchange rate of the euro against all other currencies, and at constant real interest rates, would bring about a drop in activity of 0.6 point and would lower consumer prices by 0.5 point the first year, compared to a situation with no appreciation of the euro.

Table 9: Impact on the French economy of a 10% appreciation of the euro against all other currencies (*)

(deviation from baseline scenario as a %)	**2012**	**2013**	**2014**
GDP	-0.6	-1.0	-1.2
Total employment (thousands)	-30	-85	-149
Consumer prices	-0.5	-0.7	-1.2
Public net lending (in points of GDP)	-0.2	-0.4	-0.6

(*) A 10% appreciation of the euro against all other currencies, at constant nominal interest rates.

An 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 total wage bill). This phenomenon would be only partially offset by a drop in expenditure in connection with lower inflation. Overall, the public balance would deteriorate by 0.4 point of GDP during the second year, and 0.6 point of GDP the third year.

4.1.4 Impact of a 100-bp interest rate increase

Faster-than-expected growth in the euro area or signs, not visible at this stage, of the effects of another round of oil price hikes on core inflation could lead to an earlier hike in interest rates in the euro area. An upward adjustment of both short- and long-term interest rates would penalise activity in three ways:

• Productive investment would be affected by an increase in interest rates since higher interest payments would weaken solvency and lower profitability of capital.

• More expensive credit would also depress housing investments; moreover, rate hikes would encourage savings instead of consumption (substitution effect).

• If the euro appreciated as a result of such rate increases, the euro area would be less competitive vis-à-vis other countries, which would dampen activity.

At constant exchange rates,[13] a 1% rise in short- and long-term interest rates in the euro area would reduce activity by 0.2 point of GDP during the first year and 1/2 to 1 point of GDP during the second and third years. Inflation would register a mild decrease.

These evaluations take the macroeconomic balancing effect within the euro area into account. In other words, decreased demand in other euro-area countries would have a negative impact on the French economy.

Table 10: Impact on the French economy of a 100 bp rise in short- and long-term interest rates in the euro area(*)

(deviation from baseline scenario as a %)	**2012**	**2013**	**2014**
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)	-0.1	-0.2	-0.4

(*)Lasting 100 bp increase in short- and long-term interest rates at the start of 2012 at constant exchange rates.

Public finances would be negatively affected in two ways by a drop in interest rates. First, the cost of general government debt would rise due to higher financing and refinancing costs. Secondly, public accounts would deteriorate owing to weaker activity.

Decreasing growth would automatically push down tax and social security revenue. In addition, nominal expenditure would rise due to a depressed labour market and higher interest payments, which would be only slightly compensated for by the effect of lower inflation.

[13] Combined with a rise in the exchange rate, an interest rate increase would have a significantly greater economic effect.

4.2 Comparison with previous programme

Table 9: Comparison of 2010–2013 and 2011–2014 programmes

	2009	2010	2011	2012	2013	2014
2010-2013 Programme						
GDP growth rate (% in real terms)	-2.3	1.4	2½	2½	2½	
Public balance (% of GDP)	-7.9	-8.2	-6.0	-4.6	-3.0	
Structural balance (% of GDP)	-5.8	-5.8	-4.0	-2.8	-1.6	
Public debt (% of GDP)	77.4	83.2	86.1	87.1	86.6	
2011-2014 Programme						
GDP growth rate (% in real terms)	-2.6	1.6*	2.0	2¼	2½	2½
Public balance (% of GDP)	-7.5	-7.0	-5.7	-4.6	-3.0	-2.0
Structural balance (% of GDP)	-5.7	-5.1	-3.8	-2.9	-1.6	-0.9
Public debt (% of GDP)	78.3	81.7	84.6	86.0	85.6	84.1

** quarterly accounts using raw data*

The 2010 deficit reached 7.0 points of GDP, significantly lower than projected in the previous Stability Programme (8.2 points of GDP). This difference can be explained mainly by the following:

- **The impact of growth on public revenues has been higher than expected** (0.4 point of GDP). GDP growth in 2010 (1.6 %[14]), as well as elasticity of taxes and social security contributions to GDP were higher than projected in the previous programme (1.6% compared to 1.4% for GDP growth and 1.4 compared to 0.9 for elasticity). Public revenues picked up faster than expected after they dropped to abnormally low levels in 2009. For example, tax revenues related to housing transactions collected by local authorities rebounded by 35% after having fallen by 26% in 2009, and social security contributions benefited from the improving labour situation and thus from the larger private-sector wage bill. Indeed compensation of employees in the private sector, as defined by ACOSS, grew by a total of 0.7% during the 2009-2010 period, compared to a cumulative drop of 1.3% projected in the previous programme.
- **temporarily lower than expected cost of certain measures implemented by the Government,** which contributes to an upward revision by 0.4 point of GDP, without significantly modifying their total long-term cost. The temporary cost of implementing the 2010 local business tax reform was revised downward by 0.2 point of GDP, without significantly changing the cost of the reform at its cruising speed. At the same time, the implementation of future-oriented investments was slower than anticipated, owing to delays in selecting investment projects, thus incurring lower public expenditures than anticipated in 2010 (0.1 point of GDP). Finally, the implementation of the in-work income supplement (*RSA activité*) was slower than expected, thus improving the 2010 balance by 0.1 point of GDP.
- **strong improvement in the balance of local governments**, essentially due to an 8% overall drop in investment during the 2009-2010 period (0.3 point of GDP). In connection

[14] Quarterly accounts using raw data.

with the start of the electoral cycle, the previous programme projected a moderate increase in local investment in nominal terms (a total of 3% during the 2009-2010 period). The significant drop in investment observed would seem to indicate prudent behaviour on the part of local authorities in a general climate of public expenditure moderation. It would also seem to indicate the beginning of a local investment cycle significantly less dynamic than the previous one, which was characterised by rapidly growing construction costs.

The 2011 public balance is expected to reach 5.7 points of GDP, compared to 6.0 points in the previous programme.

- The factors contributing to the improved 2010 public balance lead to an improvement in the 2011 balance (0.4 point of GDP in total). The improvement in public revenues in 2010 would lead to a smaller rebound in 2011, with elasticity of taxes and social security contributions to GDP lower than in the previous programme (1.1 compared to 1.2). Moreover, the total cost in 2011 of measures whose impact was revised downward for 2010 (future-oriented investments, reform of the local business tax and the in-work income supplement) is greater by 0.1 point of GDP than the cost indicated in the previous programme, particularly because some investments planned for 2010 were deferred until 2011.

- The Government greatly increased its efforts to reduce tax expenditures and social contribution exemptions. New tax and social security measures amounting to over €11 billion have been passed in accordance with the Initial Budget Act and the Social Security Budget Act for 2011, mostly in the form of reduced tax expenditures and social contribution exemptions, including pension reform measures and others concerned with financing the transfer of the social security debt to CADES. Compared to the previous programme's target (a €2 billion reduction in tax expenditures and social contribution exemptions), this effort will result in additional savings equivalent to 0.5 point of GDP.

- On the other hand, the revision of the growth forecast (from 2.5% to 2.0%) contributes to the degradation of the public balance by 0.3 point of GDP. This revision reflects slower spontaneous growth of government revenues and increased expenditures for unemployment benefits. At the same time, the 2011 inflation forecast was revised upward (from 1.5% to 1.8% based on the CPI excluding tobacco), resulting in faster growth in public spending, particularly for social benefits.

- **Finally, a number of factors that are less favourable than expected** explain the rest of the downward revision of the 2011 public balance by 0.3 point of GDP compared to the previous programme: in particular increased spending on public service in electricity (CSPE) related to financing renewable energy sources, faster growth in interest charges paid by the general government as a result of more rapidly rising interest rates, and slower than expected growth in the State's non-tax revenues.

In 2012 and 2013, the deficit is expected to reach 4.6 and 3.0 points of GDP respectively, as projected in the previous programme. The spontaneous growth of government revenues will be slower than in the previous programme, owing to slower growth in economic activity in 2012 (2¼% compared to 2½%) and lower elasticity of taxes and social security contributions to GDP (1.1 compared to 1.2), given that the "catch-up" effect of revenues after their abnormal drop in 2009 began in 2010. The nominal public finance targets should still be met, thanks to greater structural efforts compared to the previous programme: intensified efforts to reduce tax expenditures and social contribution exemptions, making it possible to comply with the minimum requirement of €3 billion per year in new tax and social security measures called for in the 2011-2014 Multiyear Public Finance Planning Act (compared to the targeted €2 billion annual reduction in tax expenditures and social contribution exemptions in the previous programme) and better control of government spending, thanks in particular to the rapid implementation of the 2010 pension reform, the twofold budgetary rule, and 2.8% annual growth in health care spending subject to the ONDAM target.

With respect to the public debt, the revised trajectory is primarily the result of the updated forecasts for the deficit and nominal growth. The stock-flow adjustment was lower in 2010 than projected in the previous programme (-2.0 points of GDP compared to –0.5 point of GDP), thanks in particular to a greater than expected reduction in the general government cash position and the early repayment of the emergency loans to car manufacturers and investments in banks as part of the measures to manage the economic and financial crisis. Beginning in 2011, the stock-flow adjustment will be relatively close to zero in this programme as in the previous one.

5. Quality of public finances

Improving the quality of public finances is a crucial issue, particularly during periods of fiscal consolidation. Enhancing the efficiency of government expenditures and revenues helps mitigate the impact of savings measures on economic activity and maintain the quality of public services, while at the same time reducing costs.

France has intensified its efforts in this area in recent years. Efforts have focused on streamlining expenditure, through continuation of the General Review of Public Policies (RGPP) and its extension to the State's operators, local government reform, and other measures aimed at making healthcare services more efficient. At the same time, maintaining the research budget within the three-year State budget and implementing future-oriented investments help stimulate the economy's growth potential. On the revenue side, the reduction of the least efficient tax expenditures and social contribution exemptions, based on cost-benefit analysis, and the coming reform of taxes on personal wealth will help streamline the tax and social contribution system.

5.1 Quality of public spending

5.1.1 General Review of Public Policies (RGPP)

Since the RGPP was launched, **about 400 measures, affecting all ministries, have been agreed upon.** These measures are subject to a transparent, regular, and rigorous monitoring: as of March 2011, 87% of the measures introduced since 2007 have progressed in accordance with the initial targets, 10% have required corrective action, and 4% are significantly behind schedule. Moreover, about 50 new measures were adopted on 9 March 2011 at the 5th meeting of the Public Policy Modernisation Council, which mainly concern simplifications, audits of operators, and intervention expenditures.

The 2011 Budget Act includes about €5 billion of savings which, added to those resulting from the RGPP in 2009 and 2010, bring the total amount to over €7 billion for the 2009-2011 period, consistent with the initial targets.

The RGPP gave rise to a **major reorganisation of administrative structures**: central government entities were reconfigured and State's decentralised administrations were regrouped into two or three inter-ministerial departmental directorates and eight regional directorates. Major sectorial reforms have also helped streamline judicial jurisdictions and the defence apparatus, as well as the tax and public accounting authorities with the creation of the Public Finances General Directorate (DGFiP).

Efforts have also been made to promote the **pooling and sharing of government support functions**: establishing the Public Procurement Department, enhancing the role of "*France Domaine*" in the area of real estate, linking all State expenditure programmes to the *Chorus* management software, which has been in general use since 1 January 2011, and creation of the National Payroll Department (ONP) and the Inter-ministerial Directorate for State Information and Communication Systems (DISIC).

The RGPP has also **extended the rules of good public governance to operators,** which must now apply the same rules as their line ministries.

The RGPP has also helped make good progress in **improving the quality of public services** by creating a number of "one-stop counters" for taxpayers (one-stop tax counters), job seekers (*Pôle Emploi*), and businesses (Regional Directorates for Businesses, Competition Policy, Consumer Affairs, Labour and Employment, "one-stop business counters" to simplify procedures for entrepreneurs) and by providing on-line services for high-priority uses.

With regard to staffing, the RGPP continues to apply the rule on **replacing only one out of every two retiring civil servants**. This rule has helped produce savings with respect to wage bill expenditures, as nearly 100,000 vacancies are expected to go unfilled between 2009 and 2011, for a gross savings of €2.7 billion. To this short- and medium-term impact will be added the significant long-term reduction of the State's commitments for remuneration and pensions of staff who will not have been hired. By 2012, the number of civil servants is expected to return to its level during the 1990s, which means 150,000 fewer civil servants over the period from 2007 to 2012, the equivalent of a 7% reduction in the central government civil service. In accordance with the Government's commitment, half of the savings generated by these efforts to enhance productivity has been passed on to civil servants and will continue to be. By end-2011, additional funds amounting to about €1.4 billion will have been paid to civil servants compared with 2009.

Overall, the entire programme of reforms implemented through the RGPP constitutes the cornerstone of the 2011-2013 three-year State budget, as was the case for the first three-year budget.

5.1.2 Higher education and research: the Government's budget priority

The higher education and research sector is the priority objective of the 2011-2013 three-year budget. In fulfilment of President Sarkozy's commitment, additional fund amounting to about €9 billion—not including stimulus measures and future-oriented investments—will have been dedicated to higher education and research over the 2007-2013 period.

These efforts are being made first of all through major structural reforms and the allocation of resources aimed at enhancing the appeal of careers in higher education and research, increasing the autonomy of universities, stimulating their education and research initiatives, and developing an enhanced social policy to ensure that students succeed.

Efforts are also being made to protect jobs in higher education establishments and research centres, at a time when all the other ministries (excluding Justice) and other State operators will see their staffs and operating budgets decrease over the 2011-2013 programme period. In addition, exceptional resources have been allocated to universities under both the "*Plan Campus*" and as part of the future-oriented investments.

5.1.3 Future-oriented investments

By focusing public spending on **investments with a high socio-economic return,** future-oriented investments contribute significantly to improving the quality of public finances. Funds allocated for this purpose, totalling €35 billion, will be invested in higher education and training, research, innovative industrial sectors and SMEs, sustainable development and digital technology, in order to better prepare France for tomorrow's challenges.

The investment programme is implemented primarily by the State, through its operators, which finance projects that are too large or risky to be carried out by the private sector, but that generate substantial returns for the economy. Co-financed by the private sector and thus able to be further leveraged, the programme will stimulate growth potential and generate more revenue over the long term.

This targeting of expenditures that are most supportive of growth is entirely consistent with the Government's intention to streamline public intervention and make it more efficient. In accordance with a timeline of calls for projects spread out over the 2010-2012 period, juries composed of international experts will select the projects to be awarded financing on the basis of their scientific merit, profitability, and expected impact on potential growth.

The governance of the future-oriented investments programme is based on the evaluation of public intervention, and each project is monitored by the office of the Commissioner-General for Investments responsible for overseeing the programme under the leadership of the Prime Minister. The operators responsible for implementing the projects will closely monitor activities and conduct regular evaluations of the efficiency of the appropriations from the scientific, economic, social and environmental points of view, under the control of a supervisory committee and in partnership with internal or external specialised audit teams.

5.1.4 Streamlining healthcare and local expenditure

With regard to healthcare expenditure, many reforms have been implemented over the past several years to make healthcare services more efficient and improve the quality of expenditure. Prime examples are the efforts to control unnecessary prescriptions and the cost of medical treatment, a fee-for-service payment system for hospitals, and the creation of new Regional Healthcare Agencies designed to improve coordination between hospitals and other healthcare providers. In addition, the annual setting of the national healthcare expenditure target (ONDAM) makes it possible to reconcile long-term variations in supply and the shorter-term meeting of the target, as it is based on an evaluation of structural changes, ongoing efforts to increase efficiency, and as a last resort, measures to achieve savings that have more immediate returns. Finally, Article 12 of the Multiyear Public Finance Planning Act provides for containing the debt of public healthcare establishments.

The reform of local and regional authorities that was passed in 2010 should contribute to the **streamlining of local expenditure.** Thanks to enhanced inter-communal coordination and the creation of the Territorial Councillor (an elected official who, starting in 2014, will be a member of both the Regional Council and the *département*-level Council), this reform will help clarify the powers and responsibilities at the various levels of local and regional government, and thus help reduce the main sources of inefficiency at the local level, while enhancing public services. In addition, the quality of local expenditure will also benefit from a limitation of the number of regulations imposed on the authorities and improved balancing out of inequalities among them, in accordance with the recommendations of the working group headed by Gilles Carrez and Michel Thénault.

5.2 Quality of public revenue

5.2.1 Reforms implemented through 2010

The General Review of the Tax and Social Security Contribution System, begun in September 2007 at the request of President Sarkozy, called for a restructuring of the system aimed at achieving greater tax efficiency and equity. Its recommendations, already partially implemented in accordance with the 2007 Act on Labour, Employment and Purchasing Power (TEPA), subsequently led to the 2008 research tax credit reform, creation of the local economic contribution to replace the local business tax starting on 1st January 2010, and a series of tax incentives related to environmental issues.

With the provision in the TEPA Act making **overtime hours tax-free**, the objective was to enhance household purchasing power and increase the labour supply, and in turn potential economic activity.

The **research tax credit reform** was also aimed at boosting potential long-term growth. The tripling of the tax credit for R&D expenditures (from 10% to 30%) and abolition of the ceiling have helped to reduce the cost of innovation and increase its private return, thus bringing it more in line with its overall social return.

Reform of the local business tax and its replacement by the local economic contribution have reduced the tax burden on businesses. More precisely, this reform has helped reduce the burden on productive capital, replacing it in part by a tax base that is economically less distortionary: real property. The reform is fully consistent with the recommendations on optimal taxation made by international organisations such as the OECD.

Tax policy has also been used since 2007 as an incentive to **environment-friendly behaviour:** sustainable development tax credit, ecological reward/penalty system for the automobile sector, general tax on polluting activities.

To counter the crisis, tax policy was used along with other public action levers beginning in late 2008 and throughout 2009 as part of the **stimulus package**. In particular, measures to improve cash flow were taken to help businesses (early reimbursement of VAT claims and corporation tax credits) as well as measures to support household purchasing power (targeted income tax reductions).

5.2.2 Efforts to reduce tax expenditure and social contribution exemptions

Starting in 2011, the Government's fiscal consolidation strategy will focus on expenditure control and a targeted increase in revenue. Given the already high level of taxes and social security contributions before the crisis, the Government opted to avoid a general tax increase and chose instead to reduce tax expenditures and social contribution exemptions (see Table 11).

This decision to reduce tax expenditures and social contribution exemptions is fully justified by the need to streamline our tax and social contribution system, as a step toward **economic efficiency and social justice.** The reduction of exemptions should focus on those that have not proved efficiency in terms of the targeted objective. In order to guide lawmakers, the Government must submit to Parliament an evaluation of the effectiveness and cost of new tax expenditures within three years of its adoption. For the measures in force as at 1 January 2009, this evaluation must be submitted no later than 30 June 2011 (Article 13 of the 2011-2014 Multiyear Public Finance Planning Act).

More generally, reducing tax and social contribution exemptions will help move toward **a system with a broader tax base, which minimises economic distortions** and provides more flexibility for setting rates. With regard to equity and social justice, limiting certain tax measures makes it possible to better align contributions with ability to pay, thus reinforcing the rationale for measures taken earlier to set an overall cap on certain income tax advantages.

At the same time, the incentive function of tax policy was not forgotten in the 2011 Budget Act. In particular, claims for the research tax credit will be paid immediately to SMEs from now on, thus making permanent the effect of the measures taken as part of the stimulus plan.

Table 11: New Tax and Social Security Measures in the Initial Budget Act and the Social Security Budget Act for 2011

In billions of euros	*2011*	*2012*
Pension reform	**3.9**	**0.6**
Measures concerning stock-options and supplementary pensions for senior executives (*)	0.2	0.0
Imposition of capital gains from sale of financial assets from the first euro (*)	0.0	0.2
Annualisation of general reductions in social security contributions (*)	2.0	0.0
Abolition of tax credit on dividends (*)	0.6	0.0
Abolition of cap on share of expenses and charges on dividends (*)	0.2	0.0
Supplementary 1% contribution on high incomes and capital incomes	0.4	0.1
Increase of 0.2 point of 2% social security contribution on capital income	0.2	0.0
Gradual alignment of contribution rate for civil servants with that of private sector (SS funds)	0.1	0.1
Gradual alignment of contribution rate for civil servants with that of private sector (State)	0.2	0.2
Financing the social security debt	**3.6**	**-0.2**
Taxing the capitalisation reserve of insurance companies (“exit tax” stock) (*)	0.9	0.0
Ongoing taxation of life insurance contracts (*)	1.6	-0.2
Special tax on insurance contracts (TSCA) for qualifying contracts (*)	1.1	0.0
Other measures in the 2011 Initial Budget Act	**3.3**	**2.7**
Elimination of reduced VAT rate on “triple play” (telephone, internet, TV) services (*)	1.1	0.0
Taxing the capitalisation reserve of insurance companies (taxing future flows) (*)	0.2	0.0
Reduced incentives for investments in solar energy equipment (*)	0.2	0.7
Revised rules for filing income tax returns (marriage, civil union, divorce) (*)	0.0	0.5
Increased targeting of incentives to invest in SMEs (*)	0.0	0.1
Lowering from 75% to 50% the reduced wealth tax rate for investments in SMEs (*)	0.1	0.1
Application of the tourism company passenger vehicle tax to category N1 vehicles (*)	0.0	0.0
Abolition or reduction of exemptions for employer contributions (*)	0.8	0.3
10% reduction of a series of income tax credits and reductions (*)	0.0	0.4
Modification of research tax credit (*)	0.0	0.2
Limiting tax credits for premiums distributed under profit-sharing schemes to companies with fewer than 50 employees (*)	0.1	0.0
2% increase in flat rate applicable to capital gains on immovable property	0.1	0.0
Tax on banks to cover systemic risk	0.5	0.1
Delaying the total abolition of the annual flat-rate corporation tax (IFA) to 2014	0.6	-0.2
Reform of house purchase incentive programme	0.0	0.6
Immediate payment of claims for research tax credit to SMEs	-0.3	0.0
Other measures in the 2011 Social Security Budget Act	**0.9**	**0.0**
Two-point increase in the flat-rate social security levy (from 4 to 6 points) (*)	0.4	0.0
Limiting the 3% for deduction of business expenses applicable to general social security contribution (CSG) (*)	0.0	0.0
Subjecting remunerations paid by third parties to social security contributions (*)	0.1	0.0
Increase in rate of contributions for work-related accidents and illnesses	0.4	0.0
Other	**0.1**	**-0.6**
Impact on income tax and corporation tax of measures taken in the 2011 Budget Act and Social Security Budget Act	0.0	-0.7
Other	0.1	0.1
Total tax expenditures and social contribution exemptions	**9.5**	**2.2**
Total new measures passed since July 2010 (excluding contribution for public service in electricity [CSPE])	**11.9**	**2.4**

(*) measures concerning tax expenditures or social contribution exemptions

5.2.3 Outlook and reform of taxes on personal wealth

President Sarkozy announced a **reform of taxes on personal wealth and income stemming from it for Spring 2011**, which will focus mainly on the wealth tax (ISF) and the tax cap.

This reform will consist mainly of eliminating the "tax cap" that allows taxpayers to limit the amount of their tax liability to 50% of their income. At the same time, wealth tax scale will be considerably simplified with a proportional scale including only two rates (instead of the current six). The tax liability threshold will also be raised from €800,000 to €1.3 billion and an "exit tax" will be imposed.

This reform will have a neutral effect on public finances as it will be fully financed, primarily through an increase in certain inheritance and gift taxes.

6. Sustainability of public finances

6.1 Continuation of structural reforms

The continuation of structural reforms, which will contribute in particular to improving the economy's long-term growth potential and thus the sustainability of public finances, is a priority for the Government, whose strategy is described in detail in the National Reform Programme.

6.2 The 2010 pension reform

The ageing of the population, along with the effects of the crisis, presents serious financial risks to our pension system. The November 2010 reform is aimed at ensuring its sustainability by extending the length of service. It thus contributes significantly to restoring the sustainability of public finances (see Box 1).

The main provision of the reform calls for **gradually raising the minimum age of pension entitlement from 60 to 62, and the age for automatic eligibility for a full pension from 65 to 67.** This two-year increase applies to everyone in both the private and public sectors. It will be implemented at the rate of four months per year, based on "generations." The first generation concerned includes persons born in the second half of 1951, who will be eligible to retire at the age of 60 plus four months. The new age limits will be applied to persons born in 1956, who will have to wait until the year in which they turn 62 to claim their pension, and who will be automatically eligible for a full pension at age 67.

Along with these raised age limits there will be an **increase in the number of contribution years, in line with future increases in life expectancy**, as planned in the 2003 reform. Indeed, the 2010 reform confirms the core principle of the 2003 reform, basing the number of contribution years required to be eligible for a full pension on the notion that increased life expectancy should be divided between years spent working and years of retirement. The required number of contribution years thus increases to 41.25 for persons born in 1953 and 1954 and to 41.5 for those born in 1956.

In order to **take into consideration the specific nature of certain working careers**, the possibility of an earlier retirement available since the 2003 reform to persons with "long working careers" (early start of work and high number of contribution years) is retained and even expanded, with strict requirements in terms of number of contribution years, for persons who began working before the age of 18, to take into account the postponement of the legal age of entry into the labour market. The minimum age of eligibility for this benefit will be raised in the same way as the other age limits: it will increase from 56 to 58. In addition, persons with a 10% permanent disability resulting from a work-related illness or injury related to harsh working conditions will be eligible for full retirement at age 60.

The reform continues ongoing efforts to **enhance equity between the public and private sectors**, by standardising certain rules: abolishing the possibility of early retirement for parents of three children with 15 years of effective service, beginning 1 July 2011; ending phased-in retirements for civil servants; gradual alignment of the contribution rate for civil servants with that of private-sector employees (raising it from 7.85% to 10.55% by 2020), and convergence of the minimum guaranteed pension and minimum contribution rules. These measures will help achieve savings and generate new revenues, while also helping to harmonise the rules among the various schemes.

Finally, thanks to the reform, retirement systems will benefit from **new targeted revenues, based on contributions levied on high incomes and capital returns** and applicable to both households and businesses: a one-point increase in the marginal rate on the highest income-tax bracket, increased taxes and social security contributions on stock options and supplementary pensions for senior executives, and streamlining of the general reductions of social security contributions for low-paid workers. These measures help strengthen the reform's equity without impeding growth.

6.3 Estimate of the sustainability gap

The S2 indicator measures the sustainability gap of public finances, that is, the immediate and lasting budget adjustment (in points of GDP) that would be necessary to prevent a divergent public debt trajectory over the long term, assuming no change in policy. The S2 indicator consists of two parts:

- the impact of the initial budgetary position, which corresponds basically to the gap between the primary structural balance and the long-term debt-stabilising primary balance;
- the effect of the ageing of the population, assuming no change in policy, on expenditures for pensions, healthcare and long-term care, after the end of the programme, that is, beginning in 2015.

Table 12: S2 indicator of the sustainability gap of public finances

(in points of GDP)

Base year	**Sustainability gap (S2 indicator)**	Of which impact of the initial budgetary position	Of which impact of ageing (beginning 2015)
2010	**5.5**	3.8	1.7
2014	**0.7**	-1.0	1.7

<u>Note</u> :

- *The S2 indicator in 2010 is estimated on the basis of a counterfactual scenario in which the primary structural balance is assumed to be constant over the programme period (2010-2014), independent of the impact of ageing: it corresponds to the lasting budget adjustment that would have to be made in 2015 to stabilise the debt ratio over the extended long term, taking into account the impact of ageing beginning in 2015.*
- *The S2 in 2014 is estimated on the basis of the 2014 primary structural balance projected in the programme. It corresponds to the lasting budget adjustment that would have to be made in 2015 to stabilise the debt ratio over the extended long term, taking into account the impact of ageing beginning in 2015.*

In 2010, the sustainability gap reached 5.5 points of GDP.

In 2014, thanks to the adjustment measures implemented under this programme, including the 2010 pension reform (see Box 1), the S2 indicator is expected to fall below one point of GDP, which means that sustainability would in large part have been restored. The primary structural balance would be 1.0 points of GDP below the long-term debt-stabilising balance, making it possible to reduce the debt over the medium term and **create some leeway for financing the long-term cost associated with the ageing of the population,** estimated at 1.7 points of GDP.[15]

Box 1: Impact of pension reform on the sustainability gap (S2)

The 2010 pension reform, the main measures of which are described in Section 6.2, significantly helped to improve the sustainability of public finances. Compared to a scenario without reform, it implies a reduction of the sustainability gap by 0.9 points of GDP: 0.8 points owing to the improved primary structural balance between 2010 and 2014, and 0.1 points owing to a reduction of the updated cost of ageing beginning in 2015 (see Table 13).

Table 13: Impact of pension reform on the sustainability gap (S2) in 2014

(in points of GDP)	**Total impact on S2**	Of which impact on the 2014 primary structural balance	Of which impact on the updated cost of ageing beginning in 2015
Total impact of pension reform	**0.9**	**0.8**	**0.1**
Slower expenditure growth (age-related measures, after taking into account arrangements for "long working careers," harsh working conditions, and convergence among schemes)	**0.3**	0.3	0.0
Impact of age-related measures on potential GDP growth	**0.3**	0.2	0.1
Increase in contribution rates (public-private convergence measures)	**0.1**	0.1	0.0
New targeted revenues	**0.2**	0.2	0.0

The reform's impact on sustainability comes mainly from the **effect of raising the retirement age**, which not only helps slow down the growth of pension expenditure but also helps gradually increase the labour force and thus the level of potential economic activity, and ultimately, long-term public revenues. The convergence of the contribution rate for civil servants with private-sector rate and the mobilisation of new targeted revenues (measures in the 2011 Social Security Budget Law) would also contribute to the improvement of the S2 indicator, by 0.1 and 0.2 point of GDP respectively.

Owing to its rapid implementation, the 2010 pension reform is helping to improve the sustainability of public finances, chiefly through its positive effect on the primary structural balance up to 2014, but also, although to a lesser extent, through its effect on the variations in the weight of pension expenditures in GDP after 2015. In this way, the reform contributes significantly to efforts to consolidate public finances over the medium term described in this programme.

[15] Before the 2010 pension reform, the impact of ageing was estimated at 1.8 points of GDP (see box).

7. Institutional aspects and governance of pubic finances

7.1 Draft constitutional reform

Building on the efforts carried out in 2010 by the working group led by Michel Camdessus, the Government submitted in Spring 2011 a draft reform of the Constitution, including three series of provisions aimed at radically modifying the governance of public finances. This bill will be reviewed by Parliament before the summer.

The primary objective is to **create a new legal instrument** on balanced public finances**,** the "*lois-cadres d'équilibre des finances publiques*"**, certain provisions of which the budget acts and social security budget acts will have to comply with** and which will be aimed at ensuring that the general government accounts are balanced over a particular time frame.

These new type of laws will guide overall changes in public finances, particularly the general government balance and debt based on the Maastricht definition. According to the Government's plan, they will impose constraints[16] on public finance components that are at the discretion of the Government and lawmakers, that is:

- the maximum amount of State budgetary expenditures and social security expenditures established by the Social Security Budget Act, for each year of the programme;
- the global amount of new tax and social security measures for each year of the programme.

Rules to offset expenditure caps against minimum new revenue measures will be authorised in each framework law to allow lawmakers to determine the composition of budgetary adjustments, while supporting overall efforts to consolidate public finances.

Limiting expenditure growth net of new tax and social security measures makes it possible to avoid any pro-cyclical behaviour in budgetary policy: in particular, any positive surprises in the spontaneous growth of tax and social security revenues would be dedicated exclusively to the reduction of the public deficit.

This reform will contribute greatly to the sustainable rebalancing of public accounts, as a temporary deficit should be associated with a definition of the ways and means for restoring balance.

The second series of reform proposals submitted to Parliament is aimed at creating a mechanism that can effectively contain the number of tax exemptions permitted by law. This rule, already implemented by the Prime Minister's circular dated 4 June 2010, will help to to avoid a dispersion of taxes and social security contributions reforms among too many legislations, as well as enhancing the overall coherence of the strategy for taxes and social security contributions and public finances.

Thirdly, it has been proposed writing into the Constitution a requirement that **France's Stability Programme be systematically transmitted to the National Assembly and Senate** before being sent to the European Commission, as it has already been done for this programme. This fuller involvement of Parliament will help to enhance the legislature's ownership of the country's multiyear public finance commitments.

Like the 2011-1014 Multiyear Public Finance Planning Act, this draft constitutional reform is entirely consistent with the draft European directive on national budgetary frameworks. Indeed, the amendment would allow France to develop a multiyear budgetary framework encompassing the annual budget laws, which will define in an intangible manner a trajectory for expenditures net of new revenue measures on the field directly controllable by the Government and Parliament.

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[16] A budget bill or social security budget bill that does not comply with the provisions of the framework laws would be subject to censure by the Constitutional Council.

7.2 Progress under the 2011-2014 Multiyear Public Finance Planning Act

The 2011-2014 Multiyear Public Finance Planning Act (LPFP), passed by Parliament in December 2010, contains a number of advances, without constitutional reform, with respect to the governance of public finances. This law prefigures in particular the provisions of the future ”*lois-cadres d’équilibre des finances publiques*”.

For the 2011-2014 period, the LPFP sets a trajectory for expenditures net of new revenue measures, in billions of euros, on the field directly controllable by the Government and submitted for vote by Parliament:

- **State expenditure ceilings** (general budget expenditures and levies on revenue), with a twofold growth rule: “zero real growth” for all expenditures and “zero nominal growth” for expenditures excluding interest charges and general budget contributions to pension expenditures (Article 5). Each year, the stricter of the two rules will be applied. These ceilings, broken down by mission over the 2011-2013 period (Article 6, see table in Annex 2), and the underlying reforms described in the attached report, constitute the three-year State budget.
- **expenditure targets for basic compulsory social security schemes and national healthcare** (ONDAM), set in value and at a constant scope (Article 8). Meeting the latter target will be ensured through implementation of the findings of the working group led by Raoul Briet, particularly with regard to establishing an ONDAM steering committee and lowering the warning threshold (to 0.5% of the target).
- **a series of new tax and social security measures,** requiring a minimum increase in tax and social security revenues amounting to €11 billion in 2011 and €3 billion per year in 2012-2014 (Article 9). These include all the new tax and social security measures taken by Parliament or the Government as from 1 July 2010, in particular the reduction in tax expenditures and social contribution exemptions.[17]

In order to let the Government and Parliament decide on the composition of the budgetary adjustment carried out, the savings in expenditures and revenues are fungible over the programme period (Article 15).

The LPFP also stipulates that any surplus of tax or social security revenues over the amounts projected in the Budget Act and the Social Security Budget Act shall be totally dedicated to the reduction of the deficit (Article 11), thus avoiding any pro-cyclical behaviour in case of positive surprises in the spontaneous growth of public revenues.

In addition, **several provisions in the LPFP will help ensure compliance with the programme,** in particular by reducing the risks of circumvention by the sub-sectors not covered by the expenditure ceilings net of new revenue measures:

- other government bodies (ODAC) are prohibited from obtaining loans with maturities of over 12 months; this prohibition is legally binding on these bodies (Article 12);
- freeze in nominal terms on State transfers to local authorities, excluding the value-added tax compensation fund (FCTVA) and appropriations related to local business tax reform (Article 7);
- four-year limit on the validity of new tax and social security exemptions created after 1 January 2009 (Article 10).

[17] Compared with a reduction of tax expenditure and social contribution exemptions, the choice to adopt new tax and social security measures (including exemptions) will help avoid the difficulty of determining the exact definition of tax expenditures and social contribution exemptions.

Finally, the LPFP contains several measures that will help **enhance Parliament's ownership of the multiyear public finance commitments.** First, the draft Stability Programme will be sent to the National Assembly and Senate, which will express their opinion through a vote before forwarding it to the European institutions (Article 14), which prefigures the third element of the coming constitutional reform. Moreover, the Government will submit to Parliament each year, in June, a public report assessing the implementation of the LPFP and its consistency with the Stability Programme, and in October, together with the budget bill and the Social Security Budget Bill, an assessment of the cost of the new tax and social security measures (Article 15) and their efficiency (Article 13).

7.3 Statistical governance

INSEE, France's national statistics institute, is responsible for publishing the country's national accounts, including in particular the key aggregates of public finances in national accounting terms. The national accounts are prepared in compliance with the European System of Accounts (ESA95). INSEE maintains regular contact with Eurostat to ensure compliance.

The **semi-final and final accounts** of the general government are prepared on the basis of detailed information. For the State, the main reference is the budgetary implementation of the budget acts, supported by the State's General Account (CGE) 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, particularly to take into account timing differences and different treatments of certain transactions in the budgetary accounting and in the national accounting. The method used to evaluate the other government bodies' accounts is to restate the accounts of all these bodies, which are transcribed individually in the national accounting. Production of the local government (APUL) accounts is based upon the individual cash-based accounts kept by the public accounting officers, with the exception of other local government bodies (ODAL), for which the accounts are not homogeneous due to the number of different legal statuses. Finally, the accounts of the social security funds (ASSO) are based upon different accounting plans of social security funds, hospitals, and UNEDIC [the national unemployment insurance management association].

Information is less complete for the general government's **provisional account**. For the State, budget implementation ends at mid-January in year n+1, and the public accounts of the State are finalised towards the middle of March in year n+1, which means that the information used for notification purposes on 1 April of that year is likely to be slightly revised, particularly the corrections needed for the switch to the national accounting. The ODAC's accounts are partly based on projections, as the accounting sources cover about two-thirds of revenue and expenditure. For the local governments, the accountants use information recorded in the accounting documents of the State and direct figures, which are exhaustive and centralised for the regions and *départements* and nearly all the communes. This is complemented by a certain number of estimates and forecasts. Finally, for the notification on 1 April, the accounts of the social security funds are essentially based on estimates since the accounting figures of the regimes are not yet known. Nevertheless, many accounting figures (general scheme social security funds, benefits from UNEDIC, public hospitals, etc.), although still provisional, are used. The public debt according to the Maastricht definition is calculated using the provisional account based on accounting data from nearly all the general government entities. The consolidation of the debt among the general government sub-sectors is carried out using the Banque de France's statistics on securities and the information collected directly by DGFiP from the major bodies holding government securities.

The transmission of accounting data to INSEE is regulated by an agreement between INSEE and the Public Finances General Directorate (DGFiP).

Concerning the **independence of statistical production**, in July 2008 the French Parliament adopted the Economic Modernisation Act, Article 144 of 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.

8. Excessive deficit procedure (EDP)

On 2 December 2009, the ECOFIN Council issued a recommendation to France with a view to bringing an end by 2013 to the excessive government deficit observed in 2008.

In the 2010-2013 Stability Programme submitted in January 2010, France described its strategy for reducing the deficit to 6.0% of GDP in 2011, 4.6% in 2012, and under 3% of GDP by 2013, by carrying out a structural adjustment of more than 4 points of GDP over the 2010–2013 period.

On 13 July 2010, the ECOFIN Council stated that France had complied with this recommendation, and that no additional measures were needed at this stage within the framework of the excessive deficit procedure.

Since then, France has continued its efforts to ensure its compliance with the December 2009 recommendation:

- **For 2011,** the savings measures required to reduce the deficit to 6.0% of GDP were described in detail in the Initial Budget Act (LFI) and the Social Security Budget Act (LFSS) passed in December 2010. When the GDP growth projection for 2011 was revised downward to 2.0% (compared to 2.5% in the previous programme), the Government increased its efforts to reduce the cost of tax expenditures and social contribution exemptions, while continuing its efforts to contain public spending, to ensure that it could meet its commitments. Over €11 billion in new tax and social security measures were passed in the LFI and LFSS for 2011 (see Section 5.2), mainly through reductions in tax expenditures and social contribution exemptions, compared to a target of €2 billion in the previous Stability Programme.
- The 2010 deficit turned out to be lower than projected, reaching 7.0% of GDP according to the figures published by INSEE. As part of this revision will have a positive impact on the 2011 balance, the 2011 deficit will be reduced, in accordance with Article 11 of the 2011–2014 Multiyear Public Finance Planning Act and the recommendation of 2 December 2009. It is expected to reach 5.7% of GDP according to the projections of this programme.
- **For 2012 and 2013**, the 2011-2014 Multiyear Public Finance Planning Act passed by Parliament in December 2010 confirms the public balance trajectory of the 2010-2013 Stability Programme. Given the early rebound of tax and social security contributions after the crisis, and thus to slower medium-term spontaneous growth (elasticity averaging 1.1 for 2012-2013 instead of 1.2), the underlying effort in terms of new tax and social security measures was accentuated, with a minimum of €3 billion per year (instead of a €2 billion target for reducing tax expenditures and social contribution exemptions). Moreover, the rapid implementation of the 2010 pension reform is expected to help reduce public expenditure growth over the period.

Overall, **the measures described in this Stability Programme will help reduce the deficit to less than 3% of GDP in 2013,** by implementing a structural adjustment of over 4 points of GDP over the 2010-2013 period, in accordance with the December 2009 recommendation of the ECOFIN Council and its subsequent recommendation in July 2010.

Moreover, in accordance with this recommendation, France continues to implement measures that allow it to:

- improve the quality of public finances, thanks to continued implementation of the General Review of Public Policies, future-oriented investments, and the reduction of the least efficient tax expenditures and social contribution exemptions (see Section 5);
- improve the governance of public finances, with the proposed constitutional reform called for in the 2011-2014 Multiyear Public Finance Planning Act (see Section 7);
- improve the long-term sustainability of public finances, thanks to the passing of the 2010 pension reform and other structural reforms that have helped spur the economy's potential growth (see Section 6 and the National Reform Programme).
- enhance the containment of public expenditure, particularly with respect to local spending, thanks to implementation of the findings of the working group led by Gilles Carrez, and in particular the freeze on State transfers other than the VAT Compensation Fund; and the containment of healthcare expenditure thanks to enhanced management of the ONDAM healthcare expenditure target, based on the recommendation of the group led by Raoul Briet (see Section 7).

9. Annex: Statistics tables

Table 1a. Macroeconomic forecasts

	ESA code	2009	2009	2010*	2011	2012	2013	2014
		Level	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
1. Real GDP	B1*g	-	-2.6	1.6	2.0	2 1/4	2 1/2	2 1/2
2. Nominal GDP	B1*g	1,907.1	-2.1	2.1	3.6	4.1	4 1/4	4 1/4
Components of GDP								
3. Private consumption expenditure	P.3	1,112.8	0.6	1.7	1.7	2.3	3.0	3.0
4. General government consumption expenditure	P.3	469.8	2.7	1.4	0.0	-0.1	-0.2	0.0
5. Gross fixed capital formation	P.51	392.1	-7.1	-1.6	4.2	4.6	3.2	3.2
6. Change in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53							
7. Export of goods and services	P.6	439.6	-12.4	10.1	7.6	6.0	6.5	6.5
8. Imports of goods and services	P.7	476.6	-10.7	7.8	7.5	5.9	6.1	6.1
Contributions to GDP growth								
9. Final domestic demand excluding inventories		-	-0.6	1.0	1.8	2.3	2.4	2.4
10. Change in inventories and net acquisition of valuables	P.52 + P.53	-	-1.9	0.1	0.4	0.1	0.1	0.1
11. External balance of goods and services	B.11	-	-0.2	0.4	-0.1	-0.1	-0.1	-0.1

** GDP in raw data and GDP components in CSV/NWD data (from quarterly accounts)*

Table 1b. Price trend

	ESA code	2009	2009	2010*	2011	2012	2013	2014
		Level	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
1. GDP deflator		-	0.5	0.5	1.5	1.8	1 3/4	1 3/4
2. Private consumption deflator		-	-0.4	1.2	1.8	1 3/4	1 3/4	1 3/4
3. Harmonised index of consumer prices[1]		-	0.1	1.7	2.0	1.9	1 3/4	1 3/4
4. Public consumption deflator		-	1.3	1.3	1.5	1.5	1.5	1.5
5. Investment deflator		-	-0.6	1.1	1.7	1.9	1 3/4	1 3/4
6. Export price deflator (goods and services)		-	-3.5	1.6	2.0	1.4	1.1	1.1
7. Import price deflator (goods and services)		-	-5.2	4.5	3.1	1.2	1.0	1.0

[1] *Optional*

** CSV/NWD quarterly accounts*

Table 1c. Labour market

	ESA code	2009	2009	2010	2011	2012	2013	2014
		Level	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
1. Employment, persons[1]		25,561	-1.2	0.0	0.9	1.0	0.9	0.9
2. Employment, hours worked[2]								
3. Unemployment rate (%)[3]								
4. Labour productivity, persons[4]		-	-1.3	1.2	1.2	1.3	1.6	1.6
5. Labour productivity, hours worked[5]								
6. Compensation of employees	D.1	1,014.4	0.1	2.2	3.2	3.6	3.7	3.7

[1] Total domestic employment 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	2009	2010	2011	2012	2013	2014
1. Net lending/borrowing of the total economy	B.9	-2.8	-3.2	-3.7	-3.8	-3.7	-3.7
o.w.: - Balance of goods and services		-1.9	-2.3	-2.7	-2.7	-2.6	-2.6
- Balance of primary incomes and current transfers		-0.9	-0.9	-1.0	-1.1	-1.1	-1.1
- Capital account		0.0	0.0	0.0	0.0	0.0	0.0
2. Net lending/borrowing of the private sector	B.9						
3. Net lending/borrowing of the public sector	EDP B.9	-7.5	-7.0	-5.7	-4.6	-3.0	-2.0
4. Statistical discrepancy							

Table 2. General government budgetary outlook

	ESA code	2010 Level (€ billion)	2010 as a % of GDP	2011 as a % of GDP	2012 as a % of GDP	2013 as a % of GDP	2014 as a % of GDP
Net lending (B9) per sub-sector							
1. General government	S.13	-136.5	-7.0	-5.7	-4.6	-3.0	-2.0
2. Central government	S.1311	-112.0	-5.8	-4.6	-3.7	-2.6	-2.0
3. State government	S.1312						
4. Local governments	S.1313	-1.7	-0.1	-0.2	-0.2	-0.1	0.0
5. Social security funds	S.1314	-22.8	-1.2	-0.9	-0.7	-0.4	-0.1
General government (S.13)							
6. Total revenue	TR	957.8	49.2	50.0	50.3	50.8	50.8
7. Total expenditure	TE[1]	1,094.4	56.2	55.7	54.9	53.8	52.8
8. Net lending/borrowing	EDP B.9	-136.5	-7.0	-5.7	-4.6	-3.0	-2.0
9. Interest	EDP D.41	48.8	2.5	2.6	2.9	3.0	3.0
10. Primary balance[2]		-87.7	-4.5	-3.1	-1.7	-0.1	1.0
11. One-off measures[3]							
Key components of revenue							
12. Total taxes (12=12a+12b+12c)		499.2	25.6	26.5	26.8	27.3	27.4
12a. Taxes on production and imports	D.2	287.4	14.8	15.0	15.0	15.0	15.0
12b. Taxes on income and wealth	D.5	204.1	10.5	11.1	11.4	11.8	11.8
12c. Capital taxes	D.91	7.7	0.4	0.4	0.4	0.5	0.5
13. Social security contributions	D.61	360.5	18.5	18.5	18.5	18.4	18.4
14. Property income	D.4	15.6	0.8	0.8	0.9	0.9	0.9
15. Other revenue (15=16-12-13-14)		82.5	4.2	4.2	4.1	4.2	4.1
16=6. Total revenue	TR	957.8	49.2	50.0	50.3	50.8	50.8
NB: Tax burden (D.2+D.5+D.61-D612+D.91-D.995) [4]		822.1	42.2	43.1	43.4	43.9	43.9
Key components of expenditure							
17. Compensation of employees and intermediate consumption	D.1 + P.2	368.4	18.9	18.4	17.9	17.4	16.9
17a. Compensation of employees	D.1	259.3	13.3	13.1	12.7	12.4	12.0
17b. Intermediate consumption (incl. FISIM)	P.2	109.0	5.6	5.3	5.1	5.0	4.9
18. Social transfers (18=18a+18b)		496.0	25.5	25.4	25.1	24.7	24.4
18a. Social transfers in kind	D.6311. D.63121. D.63131	117.9	6.1	6.0	6.0	5.9	5.8
18b. Social transfers in cash	D.62	378.1	19.4	19.4	19.2	18.9	18.6
19=9. Interest expenditure	EDP D.41	48.8	2.5	2.6	2.9	3.0	3.0
20. Subsidies	D.3	33.4	1.7	1.6	1.5	1.5	1.4
21. Gross fixed capital formation	P.51	59.2	3.0	3.1	3.1	3.0	3.0
22. Other expenditure (22=23-17-18-19-20-21)		88.6	4.5	4.6	4.4	4.3	4.2
23=7. Total expenditure	TE[1]	1,094.4	56.2	55.7	54.9	53.8	52.8

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

Table 3. Government expenditure by function (*)

% of GDP	COFOG code	2009	2014
1. General public services	1	7.0	:
2. Defence	2	1.8	:
3. Public order and safety	3	1.3	:
4. Economic affairs	4	3.0	:
5. Environmental protection	5	0.9	:
6. Housing and community amenities	6	2.0	:
7. Health	7	8.1	:
8. Recreation, culture and religion	8	1.6	:
9. Education	9	6.0	:
10. Social protection	10	23.0	:
11. Total expenditure	**TE**	**:**	**:**

(*) The data in this table are expressed in terms of base year 2000. The data in terms of base year 2005, which would be consistent with the aggregates presented in this programme, are not yet available.

Table 4. Change in public debt

% of GDP	ESA code	2009	2010	2011	2012	2013	2014
1. Gross debt[1]		78.3	81.7	84.6	86.0	85.6	84.1
2. Change in gross debt ratio		10.6	3.4	2.9	1.5	-0.5	-1.5
Contributions to changes in gross debt							
3. Primary balance[2]		-5.1	-4.5	-3.1	-1.7	-0.1	1.0
4. Interest expense[3]	EDP D.41	2.4	2.5	2.6	2.9	3.0	3.0
5. Stock-flow adjustment		1.7	-2.0	0.0	0.2	0.0	0.0
o.w. : *- differences between cash and accruals* *- net accumulation of financial assets* - o.w. privatisation proceeds *- valuation effects and other*							
p.m.: Implicit interest rate on the debt[4]		3.5	3.3	3.3	3.5	3.6	3.7
Other relevant variables							
6. Liquid financial assets[5]		16.2	:	:	:	:	:
7. Net financial debt (7=1-6)		62.1	:	:	:	:	:

[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]Evaluated as the gross interest expense for the year divided by the gross outstanding debt as at 31 December of the preceding year.

[5]AF1, AF2, AF3 (consolidated at market value), AF511 (listed shares), AF52 (units of collective investment schemes).

Table 5. Cyclical and structural changes

% of GDP	ESA code	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
1. Real GDP growth (%)		-2.6	1.6*	2.0	2 1/4	2 1/2	2 1/2
2. Public balance	EDP B.9	-7.5	-7.0	-5.7	-4.6	-3.0	-2.0
3. Interest expense	EDP D.41	2.4	2.5	2.6	2.9	3.0	3.0
4. One-off measures[1]							
5. Potential GDP growth (%)		0.8	1.6	1.8	2.0	2.0	2.0
contributions:							
- labour		0.1	0.2	0.3	0.5	0.4	0.4
- capital		0.7	0.6	0.6	0.7	0.7	0.7
- total factor productivity		0.1	0.8	0.8	0.8	0.8	0.8
6. Output gap		-3.8	-3.8	-3.6	-3.3	-2.8	-2.3
7. Cyclical balance		-1.8	-2.0	-1.8	-1.7	-1.4	-1.1
8. Cyclically-adjusted public balance (8 = 2 - 7)		-5.7	-5.1	-3.8	-2.9	-1.6	-0.9
9. Cyclically-adjusted primary balance (9 = 8 + 3)		-3.3	-2.6	-1.2	0.0	1.3	2.1
10. Structural balance (10 = 8 - 4)		-5.7	-5.1	-3.8	-2.9	-1.6	-0.9

[1]A plus sign means deficit-reducing one-off measures.
* quarterly accounts in raw data

Table 6. Divergence from previous programme update

	ESA code	**2010**	**2011**	**2012**	**2013**	**2014**
Real GDP growth (%)						
Previous programme (2010-1013)		1.4	2 1/2	2 1/2	2 1/2	
Current programme (2011-2014)		1.6*	2.0	2 1/4	2 1/2	2 1/2
Difference		0.2	-0.5	- 1/4	0.0	
Net lending (as a % of GDP)	EDP B.9					
Previous programme (2010-1013)		-8.2	-6.0	-4.6	-3.0	
Current programme (2011-2014)		-7.0	-5.7	-4.6	-3.0	-2.0
Difference		1.2	0.3	0.0	0.0	
Public debt (as a % of GDP)						
Previous programme (2010-1013)		83.2	86.1	87.1	86.6	
Current programme (2011-2014)		81.7	84.6	86.0	85.6	84.1
Difference		-1.5	-1.5	-1.1	-1.0	

* quarterly accounts in raw data

Table 7. Long-term sustainability of public finances (source: 2009 report on ageing by the Ageing Working Group, updated to take into account the effect of the 2010 pension reform)

as a % of GDP	**2007**	**2010**	**2020**	**2030**	**2040**	**2050**	**2060**
Total expenditure	:	:	:	:	:	:	:
o.w.: age-related expenditure	28.4	29.0	28.6	29.9	30.8	30.8	30.7
Pension expenditure	13.0	13.5	12.8	13.6	14.0	13.8	13.6
Healthcare expenditure	8.1	8.2	8.6	8.9	9.2	9.3	9.4
Long-term care expenditure	1.4	1.5	1.6	1.8	2.0	2.2	2.2
Education expenditure	4.7	4.6	4.6	4.7	4.6	4.7	4.6
Other age-related expenditure (unemployment)	1.2	1.2	0.9	0.9	0.9	0.9	0.9
Interest expense	:	:	:	:	:	:	:
Public revenue	:	:	:	:	:	:	:
o.w.: property income	:	:	:	:	:	:	:
o.w.: pension contributions (or social security contributions if appropriate)	:	:	:	:	:	:	:
Financial assets of supplementary pension schemes and Pension Reserve Fund (*)	:	:	:	:	:	:	:
o.w.: consolidated financial assets of supplementary pension schemes and the Pension Reserve Fund	:	:	:	:	:	:	:
Assumptions							
Labour productivity growth rate	:	:	:	:	:	:	:
Real GDP growth rate	:	:	:	:	:	:	:
Participation rate of men (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 2009, the non-consolidated financial assets (excluding AF7) of the supplementary pension schemes (Agirc, Arrco, CNAVPL, ERAFP, Ircantec and RSI) and the Pension Reserve Fund came to 8.1 points of GDP. Their consolidated assets came to 7.8 points of GDP.

Table 8. Basic assumptions

	2009	**2010**	**2011**	**2012**	**2013**	**2014**
Short-term interest rates (annual average)[1]	:	:	:	:	:	:
Long-term interest rates (annual average)	:	:	:	:	:	:
Exchange rate €/$ (annual average)	1.39	1.33	1.39	1.40	1.40	1.40
Nominal effective exchange rate (basis 100 in 1995)	113.5	109.1	109.3	109.5	109.5	109.5
Global GDP excluding the EU	0.0	5.6	5.0	5.0	4.0	4.0
GDP of the EU	-4.2	1.7	1.6	1.7	2.4	2.4
World demand for French goods & services	-12.0	11.6	6.4	7.3	6 1/2	6 1/2
World trade excluding the EU	-12.0	13.4	8.0	8.6	7.7	7.7
Oil prices (Brent/bbl in US$)	62	80	101	100	102	104

[1]If necessary; purely technical assumptions.

Annex 2: Ceilings on Appropriations for Missions of the State's General Budget in the 2011-2013 Three-year Budget (€ billion)

€ billion	Multiyear Programme (constant 2010 prices)									2011 Budget Bill (current prices)		
	Commitment Appropriations (AE)			Payment Appropriations (CP)			Of which Contributions to Special Pension Allocation Account (CP CAS)			AE	CP	Of which CP CAS
	2011	2012	2013	2011	2012	2013	2011	2012	2013			
External State intervention	2.95	2.89	2.88	2.95	2.91	2.89	0.13	0.13	0.14	2.96	2.97	0.13
General & local State administration	2.64	3.02	2.48	2.52	2.76	2.49	0.50	0.51	0.54	2.57	2.45	0.50
Agriculture, fishing, food, forests and rural affairs	3.41	3.41	3.32	3.49	3.44	3.36	0.24	0.25	0.27	3.58	3.67	0.23
Official development assistance	4.58	2.76	2.68	3.34	3.34	3.34	0.03	0.03	0.03	4.58	3.33	0.02
Veterans, memorials and ties with the nation	3.33	3.21	3.11	3.33	3.21	3.11	0.04	0.04	0.04	3.31	3.32	0.03
State consulting and supervision	0.62	0.59	0.64	0.59	0.60	0.61	0.12	0.12	0.13	0.62	0.59	0.12
Culture	2.74	2.59	2.64	2.70	2.70	2.71	0.18	0.19	0.19	2.72	2.68	0.18
Defence	41.97	38.04	38.74	37.41	38.04	38.74	7.27	7.53	7.73	41.97	37.41	7.26
Government Intervention	0.95	0.54	0.55	0.58	0.59	0.60	0.03	0.03	0.04	1.53	1.11	0.05
Ecology and sustainable development	10.27	9.77	9.78	9.76	9.73	9.71	0.94	0.96	1.00	10.02	9.51	0.93
Economy	1.93	1.90	1.88	1.93	1.91	1.89	0.23	0.24	0.25	2.06	2.06	0.23
State financial commitments *(including interest payments)*	46.93	52.03	56.73	46.93	52.03	56.73	0.00	0.00	0.00	46.93	46.93	0.00
Education	61.91	62.05	62.67	61.80	62.10	62.71	16.25	16.70	17.54	61.91	61.79	16.25
Public finance and human resources management	11.68	11.55	11.56	11.70	11.59	11.57	2.45	2.51	2.62	11.72	11.75	2.45
Immigration, asylum and integration	0.56	0.55	0.54	0.56	0.56	0.55	0.01	0.01	0.01	0.56	0.56	0.01
Justice	8.91	9.68	10.03	7.09	7.30	7.33	1.29	1.35	1.43	8.96	7.14	1.30
Media, books and cultural industries	1.43	1.24	1.23	1.44	1.26	1.18	0.00	0.00	0.00	1.45	1.45	0.00
Overseas territories	2.14	2.16	2.19	1.97	2.03	2.10	0.03	0.05	0.05	2.16	1.98	0.03
Local and regional policy	0.34	0.33	0.30	0.32	0.34	0.31	0.00	0.00	0.00	0.35	0.32	0.00
Provisions	0.03	0.07	0.07	0.03	0.07	0.07	0.00	0.00	0.00	0.03	0.03	0.00
Research and higher education	25.03	25.30	25.49	24.85	25.08	25.28	1.16	1.19	1.25	25.36	25.18	0.58
Social and retirement schemes	6.03	6.24	6.53	6.03	6.24	6.53	0.00	0.00	0.00	6.03	6.03	0.00
Relations with local authorities	2.69	2.56	2.59	2.64	2.51	2.52	0.00	0.00	0.00	2.69	2.64	0.00
Health	1.22	1.22	1.22	1.22	1.22	1.22	0.00	0.00	0.00	1.22	1.22	0.00
Security	16.83	16.92	17.30	16.83	17.01	17.27	5.29	5.53	5.82	16.80	16.81	5.28
Civil security	0.46	0.42	0.44	0.44	0.45	0.46	0.04	0.04	0.05	0.46	0.43	0.04
Solidarity, integration and equal opportunity	12.52	12.95	13.36	12.52	12.95	13.37	0.27	0.28	0.29	12.37	12.37	0.20
Sports, youth and associations	0.41	0.41	0.45	0.42	0.42	0.46	0.00	0.00	0.00	0.42	0.43	0.00
Labour and employment	12.46	10.07	9.32	11.65	10.11	9.27	0.17	0.17	0.18	12.35	11.57	0.16
Urban affairs and housing	7.67	7.63	7.61	7.63	7.56	7.50	0.00	0.00	0.00	7.67	7.63	0.00
Note: Public authorities	1.02	1.02	1.02	1.02	1.02	1.02	0.00	0.00	0.00	1.02	1.02	0.00