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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 24.3.2009
SEC(2009) 570 final

Recommendation for a

COUNCIL DECISION

on the existence of an excessive deficit in France

EXPLANATORY MEMORANDUM

1. The application of the Stability and Growth Pact in the current crisis situation

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan explicated that the stimulus should be timely, targeted and temporary and differentiated across Member States, with more room for manoeuvre for those Member States that have achieved sustainable public finance positions and improved their competitive positions. It also called for structural reforms that support demand and promote resilience in the short term, while paying special attention to actions in the four priority areas of the Lisbon strategy. Finally, several countries have taken measures to stabilise the financial sector, some of which impact on the debt position or constitute a risk of higher deficits and debt in the future, although some of the costs of the government support could be recouped in the future.

The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value. The amendments to the Stability and Growth Pact in 2005 aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation, and thereby ensuring long-term sustainability of public finances.

2. Previous steps in the excessive deficit procedure

Article 104 of the Treaty lays down an excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 "on speeding up and clarifying the implementation of the excessive deficit procedure"[1], which is part of the Stability and Growth Pact.

According to Article 104(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b)

1 OJ L 209, 2.8.1997, p. 6. Account is also taken of the Opinion of the Economic and Financial Committee on the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005, available at: http://ec.europa.eu/economy_finance/other_pages/other_pages12638_en.htm.

whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 104(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

On the basis of the data notified by the French authorities on 6 February 2009 in a letter from the Minister of the Economy, Industry and Employment addressed to the Commissioner of Economic and Financial Affairs and taking into account the Commission services' January 2009 interim forecast, the Commission adopted a report under Article 104(3) for France on 18 February 2009[2].

Subsequently, and in accordance with Article 104(4), the Economic and Financial Committee formulated an opinion on the Commission report on 27 February 2009.

3. THE EXISTENCE OF AN EXCESSIVE DEFICIT

According to the data notified by the French authorities on 6 February 2009, the general government deficit in France reached 3.2% of GDP in 2008, thus exceeding the 3% of GDP reference value, and the Government announced on 4 March that the deficit was expected to have reached 3.4% of GDP in 2008 (estimate not final). The Commission report under Article 104(3) of 18 February considers that the deficit was close to the 3% of GDP reference value but that the excess over the reference value cannot be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact. In particular, it cannot be considered to result from a severe economic downturn in 2008 in the sense of the Treaty and the Stability and Growth Pact. According to the French statistical office (INSEE)[3], GDP growth is estimated to have attained 0.7% of GDP in 2008, after 2.2% in 2007. The excess over the reference value cannot be considered temporary. According to the Commission services' January 2009 interim forecast, the general government deficit is forecast to reach 5.4% of GDP in 2009 and, on a no-policy change basis, to decline only slightly to 5% in 2010 as the budgetary impact of the recovery plan is phased out. Therefore the deficit criterion in the Treaty is not fulfilled.

General government gross debt has been above the 60% of GDP reference value since 2003 and is estimated at 66.7% of GDP for 2008 in the December 2008 update of the stability programme[4]. According to the Commission Services' January 2009 interim forecast, the debt-to-GDP ratio should stand at 67.1% in 2008, and reach 72.4% in 2009 and 76% in 2010. In their 4 March 2009 announcement, the authorities acknowledged that debt ratio would be higher than envisaged in the programme, and published new projections according to which it would rise to 73.9% in 2009 and 77.5% in 2010. The debt ratio cannot be considered as sufficiently diminishing and approaching the reference value at a satisfactory pace within the

2 All EDP-related documents for France can be found at the following website: http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2.

3 Press release of INSEE on 13 February 2009 (Informations rapides nº 47).

4 The Government announced on 4 March that general government gross debt would reach 67.3% of GDP in 2008. This estimate is not final.

meaning of the Treaty and the Stability and Growth Pact. In conclusion, the debt criterion in the Treaty is not fulfilled.

In line with the provisions in the Treaty and the Stability and Growth Pact, the Commission also analysed in its report "relevant factors". According to the Stability and Growth Pact, these can only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the deficit satisfies the double condition of closeness and temporariness. In the case of France, the double condition is not met. Considered on their own merit, the relevant factors in the current case on balance seem to be relatively favourable.

The opinion of the Economic and Financial Committee in accordance with Article 104(4) of the Treaty is consistent with the assessment in the Commission report under Article 104(3).

The Commission, having taken into account its report under Article 104(3) and the opinion of the Economic and Financial Committee under Article 104(4), is of the opinion that an excessive deficit exists in France. This opinion, adopted by the Commission on [24 March 2009], is herewith addressed to the Council according to Article 104(5). The Commission recommends that the Council shall decide accordingly, in conformity with Article 104(6). In addition, the Commission is submitting to the Council a recommendation for a Council recommendation to be addressed to France with a view to bringing the situation of an excessive deficit to an end according to Article 104(7).

4. RECOMMENDATIONS TO END THE EXCESSIVE DEFICIT SITUATION

According to Article 3(4) of Council Regulation (EC) No 1467/97, the Council recommendation under Article 104(7) has to establish a deadline of six months at most for effective action to be taken by the Member State concerned as well as a deadline for the correction of the excessive deficit, which "should be completed in the year following its identification unless there are special circumstances". Article 2(6) of the Regulation implies that the "relevant factors" considered in the Commission report under Article 104(3) of the Treaty have to be taken into account in deciding whether special circumstances exist. Article 3(4) of the Regulation specifies that the Council has to recommend that the Member State achieves a "minimum annual improvement of at least 0.5% of GDP as a benchmark, in its cyclically adjusted balance net of one-off and temporary measures, in order to ensure the correction of the excessive deficit within the deadline set in the recommendation".

In the case of France, special circumstances are considered to exist. In the last quarter of 2008, the economic environment deteriorated sharply and GDP contracted by 1.2% quarter-on-quarter, after a positive growth of 0.1% in the third quarter. This sudden deterioration results from the global financial crisis that affected the European Union more generally and prompted the Council on 12 December 2008 to issue the European Economic Recovery Plan (EERP), calling for a stimulus package. According to the Commission services' January 2009 interim forecast, the downturn in France is projected to continue well into 2009, when GDP should fall by 1.8% despite the implementation of the French recovery plan.

The December 2008 stability programme envisages a further widening of the government deficit in 2009 to 3.9% of GDP taking into account the economic downturn and the fiscal impact of the recovery plan announced on 4 December 2008[5]. Thereafter the programme contains plans for a successive reduction of the deficit to 2.7% of GDP by 2010 and 1.1% of GDP by the end of the programme period. In its opinion of 10 March 2009 on the French stability programme, the Council concluded that the budgetary targets are subject to downside risks. These risks are linked, in particular, to the non binding character of expenditure rules. Another risk mentioned by the Council was linked to the markedly favourable macro assumptions in the stability programme. On 4 March 2009, the Government revised substantially its growth projections for 2009 and 2010 to a range of [-1 and -1.5]% and [0.5-1]%, respectively, acknowledging that the projections in the programme were now outdated. According to the new forecast, the government deficit would reach 3.4% of GDP in 2008, 5.6% in 2009, 5.2% in 2010, 4.0% in 2011 and 2.9% in 2012.

It is appropriate to consider the correction of the excessive deficit in a medium-term framework in accordance with the path for deficit reduction as announced by the government on 5 March 2009[6] with a deadline for the correction of 2012. A credible adjustment path would require the French authorities to, first, implement the fiscal measures 2009 as planned in the Budget, which reflects also the fiscal impulse package presented in the context of the European Economic Recovery Plan. Second, additional annual fiscal efforts might be necessary so as to achieve the government deficit targets up to 2012 if downside risks to the budgetary targets were to materialize in a view to bring the government deficit below 3% of GDP in that year in a credible and sustainable manner.

Enhanced surveillance under the EDP, which seems necessary in view also of the relatively long period for the correction, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy to ensure the correction of the excessive deficit.

[5] Taking into account a base effect stemming from 2008, as well as a new macro scenario and measures announced in February, the deficit would reach 5.6% of GDP in 2009, as announced by the Government on 4 March.

[6] Letter from Finance Minister Mme Lagarde to the European Commission

		2007	2008	2009	2010	2011	2012
Real GDP (% change)	**SP Dec 2008**	**2.2**	**1.0**	**0.2-0.5**	**2.0**	**2.5**	**2.5**
	p.m. MoF[4]	n.a.	n.a.	-1.5 -1.0	0.5-1.0	2.5	2.5
	COM Jan 2009	2.2	0.7	-1.8	0.4	n.a.	n.a.
Output gap[1] (% of potential GDP)	**SP Dec 2008**	**0.4**	**-0.6**	**-1.8**	**-1.6**	**-1.1**	**-0.4**
	COM Jan 2009[2]	1.8	1.0	-1.7	-2.3	n.a.	n.a.
General government balance (% of GDP)	**SP Dec 2008**	**-2.7**	**-2.9**	**-3.9**	**-2.7**	**-1.9**	**-1.1**
	p.m. MoF[4]	*-2.7*	*-3.4*	*-5.6*	*-5.2*	*-4.0*	*-2.9*
	COM Jan 2009	-2.7	-3.2	-5.4	-5.0	n.a.	n.a.
Primary balance (% of GDP)	**SP Dec 2008**	**0.1**	**0.0**	**-1.1**	**0.1**	**0.9**	**1.7**
	COM Jan 2009	0.1	-0.3	-2.6	-2.1	n.a.	n.a.
Cyclically-adjusted balance[1] (% of GDP)	**SP Dec 2008**	**-2.9**	**-2.6**	**-3.0**	**-1.9**	**-1.4**	**-0.9**
	COM Jan 2009	-3.5	-3.7	-4.6	-3.8	n.a.	n.a.
Structural balance[3] (% of GDP)	**SP Dec 2008**	**-2.9**	**-2.6**	**-3.0**	**-1.9**	**-1.4**	**-0.9**
	COM Jan 2009	-3.6	-3.8	-4.6	-3.8	n.a.	n.a.
Government gross debt (% of GDP)	**SP Dec 2008**	**63.9**	**66.7**	**69.1**	**69.4**	**68.5**	**66.8**
	p.m. MoF[4]	63.9	67.3	73.9	77.5	78.3	78.1
	COM Jan 2009	63.9	67.1	72.4	76.0	n.a.	n.a.

Notes:

[1] Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2] Based on estimated potential growth of 1.6%, 1.4%, 0.9% and 1.0% respectively in the period 2007-2010.

[3] Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0 all over the period covered (2007-2012) according to the most recent programme and are 0.1% of GDP in 2007, 0.1% in 2008, all deficit-reducing and 0 in 2009 and 2010 according to the Commission services' January 2009 interim forecast.

[4] New government forecast released on 4th March 2009.

Source:

Stability programme (SP); Commission services’ January 2009 Interim forecasts (COM); Commission services’ calculations

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(6) thereof,

Having regard to the recommendation from the Commission,

Having regard to the observations made by France,

Whereas:

(1) According to Article 104 of the Treaty Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) The excessive deficit procedure (EDP) under Article 104, as clarified by Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[7] (which is part of the Stability and Growth Pact), provides for a decision on the existence of an excessive deficit. The Protocol on the excessive deficit procedure annexed to the Treaty sets out further provisions relating to the implementation of the EDP. Council Regulation (EC) No 3605/93[8] lays down detailed rules and definitions for the application of the provision of the said Protocol.

(4) The 2005 reform of the Stability and Growth Pact sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run. It aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

(5) Article 104(5) of the Treaty requires the Commission to address an opinion to the Council if the Commission considers that an excessive deficit in a Member State exists or may occur. Having taken into account its report in accordance with Article 104(3)

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[7] OJ L 209, 2.8.1997, p. 6.
[8] OJ L 332, 31.12.1993, p. 7.

and having regard to the opinion of the Economic and Financial Committee in accordance with Article 104(4), the Commission concluded that an excessive deficit exists in France. The Commission therefore addressed such an opinion to the Council in respect of France on [24 March 2009][9].

(6) Article 104(6) of the Treaty states that the Council should consider any observations which the Member State concerned may wish to make before deciding, after an overall assessment, whether an excessive deficit exists. In the case of France, this overall assessment leads to the following conclusions.

(7) According to the data notified by the French authorities on 6 February 2009, the general government deficit in France reached 3.2% of GDP in 2008[10], thus exceeding the 3% of GDP reference value. The Commission report under Article 104(3) considers that the deficit was close to the 3% of GDP reference value but that the excess over the reference value cannot be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact. In particular, it cannot be considered to result from a severe economic downturn in 2008 in the sense of the Treaty and the Stability and Growth Pact. According to the French statistical office (INSEE), GDP growth is estimated to have attained 0.7% of GDP in 2008, after 2.2% in 2007. The excess over the reference value cannot be considered temporary. According to the Commission services' January 2009 interim forecast, the general government deficit is forecast to reach 5.4% of GDP in 2009 and, on a no-policy change basis, to decline only slightly to 5% in 2010 as the budgetary impact of the recovery plan is phased out. Therefore the deficit criterion in the Treaty is not fulfilled.

(8) According to Article 2(4) of Council Regulation (EC) No 1467/97, “relevant factors” can only be taken into account in the steps leading to the Council decision on the existence of an excessive deficit in accordance with Article 104(6) if the double condition - that the deficit remains close to the reference value and that its excess over the reference value is temporary - is fully met. In the case of France, this double condition is not met. Therefore, relevant factors are not taken into account in the steps leading to this decision.

HAS ADOPTED THIS DECISION:

Article 1

From an overall assessment it follows that an excessive deficit exists in France.

Article 2

This decision is addressed to the French Republic.

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[9] All EDP-related documents for France can be found at the following website: http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2.

[10] The Government announced on 4 March that the deficit would reach 3.4% of GDP in 2008. This estimate is not final.

Done at Brussels,

For the Council
The President