COUNCIL OF
THE EUROPEAN UNION

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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject:	COUNCIL RECOMMENDATION to France with a view to bringing an end to the situation of an excessive government deficit

COUNCIL RECOMMENDATION

of

to France

with a view to bringing an end to the situation of an excessive government deficit

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(7) in conjunction with Article 126(13) and Article 136 thereof;

Having regard to the recommendation from the Commission;

Whereas:

(1) According to Article 126(1) of the Treaty on the Functioning of the European Union 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 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 excessive deficit procedure (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.

(4) On 27 April 2009 the Council decided, in accordance with Article 104(6) of the Treaty establishing the European Community, that an excessive deficit exists in France and issued recommendations to correct the excessive deficit by 2012 at the latest, in accordance with Article 104(7) of the Treaty establishing the European Community and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[1]. This would have implied an average annual fiscal effort of at least 1 % of GDP over the period 2010-2012. The Council also established a deadline of 27 October 2009 for effective action to be taken

(5) The Council agreed on 20 October 2009 that, provided that the Commission forecasts continue to indicate that the recovery is strengthening and becoming self-sustaining, fiscal consolidation in all EU Member States should start in 2011 at the latest, that specificities of country situations should be taken into account, and that a number of countries need to consolidate before then.

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[1] OJ L 209, 2.8.1997, p. 6.

(6) Regulation (EC) No 1467/97 (which is part of the Stability and Growth Pact) establishes provisions for the implementation of Article 104 of the Treaty establishing the European Community, which has become Article 126 of the Treaty on the Functioning of the European Union. According to Article 3(5) of Regulation (EC) No 1467/97, if effective action has been taken and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that recommendation, the Council may decide, on a recommendation from the Commission and before taking into account the relevant factors mentioned in Article 2(3) of Regulation (EC) No 1467/97, to adopt a revised recommendation under Article 126(7) of the Treaty on the Functioning of the European Union.

(7) The January 2009 interim forecast had projected a contraction in real GDP by 1,8 % in 2009 and an increase in the general government deficit to 5,4 % of GDP, which also reflected the fact that no consolidation was achieved after the abrogation of the previous EDP in January 2007. Against the background of a 0,2 % of GDP base effect stemming from a higher-than-expected deficit in 2008 and additional fiscal stimulus measures of 0,2 % of GDP adopted in February, the Council recommended a deficit target of 5,6 % of GDP for 2009 in line with the Government's new target. The Commission services' autumn 2009 forecast projects the contraction of economic activity to be higher and to reach 2,2 %, while the general government deficit would increase to 8,3 % of GDP.

The impact of this deeper-than-expected contraction will be significantly higher (by around 2 percentage points) than what would be suggested by using standard budgetary elasticities and what was expected in the interim forecast, specifically due to the sharp deterioration of tax receipts, notably from corporations. Concerning the expenditure side, the implementation of the budget can be considered broadly on track. Expenditure overruns are associated to higher social transfers. In addition, the impact of previously adopted measures in the framework of the recovery plan was higher than planned by ¼ % of GDP. Only 0,1 % of GDP of the higher budget outcome can be attributed to a new discretionary measure (decrease of VAT for the catering sector) after the Council recommendation was adopted. In view of the above, unexpected adverse economic events with major unfavourable consequences for government finances can be considered to have occurred after adoption of the recommendation under Article 104(7) of the Treaty establishing the European Community.

(8) In response to the Council's recommendations of 27 April 2009 under Article 104(7) of the Treaty establishing the European Community, the French government has implemented the fiscal measures as planned in the 2009 budget with the exception of the above-mentioned minor revision to the budget adopted after the Council recommendation in order to include the VAT decrease for the catering sector (increasing the deficit by 0,1 % of GDP). As also mentioned above, the higher-than-targeted expected deficit outcome of 8¼ % of GDP (compared to the 5,6 % of GDP recommended deficit) can be essentially attributed to unexpected adverse economic events with major unfavourable budgetary effects which occurred on the revenue side. This negative revenue surprise and the somewhat stronger-than-expected impact of the fiscal stimulus measures adopted by France almost fully explain the stronger deterioration in the structural balance by 3 % of GDP (instead of 0,8 % of GDP expected in the Commission services' January 2009 interim forecast). As for 2010, based on the Commission services' autumn 2009 forecast, the general government deficit is expected to decrease from 8,3 % of GDP in 2009 to 8,2 % of GDP in 2010.

This projection takes into account the partial phasing out of the recovery measures in line with the EERP (from +1,2 % of GDP in 2009 to +0,4 % of GDP in 2010), which is however partially compensated by new deficit increasing measures in the 2010 draft budget law (with an estimated impact of ½ % of GDP, including 0,4 % of GDP one offs). In structural terms, the balance is expected to improve by ½ % of GDP in 2010[1]. Thus, France plans to start to consolidate its public finances in 2010 essentially through the partial phasing out of the recovery measures. While this consolidation falls short of the minimum average annual structural effort of at least 1 % of GDP over the period from 2010 to 2012, this has to be seen in the context of the still somewhat fragile economy in 2010. Overall, taking into account the particular circumstances of the economic crisis and the European Economic Recovery Plan, the French authorities can be considered to have taken effective action.

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1 In the draft budget law for 2010, the French authorities project an improvement of the structural balance by 0,3 % of GDP, which does not take into account one-off measures.

(9) Since the French authorities are considered to have taken effective action in compliance with the Council recommendations of 27 April 2009 under Article 104(7) of the Treaty establishing the European Community and unexpected adverse economic events with major unfavourable consequences for government finances can be considered to have occurred in France, revised recommendations under Article 126(7) of the Treaty on the Functioning of the European Union for France extending the deadline by one year can be justified.

(10) This would imply an average annual fiscal effort of above 1 % of GDP over 2010-2013[1]. The recommended fiscal effort takes into account the higher deficit level in 2010 (8,2 % of GDP) notably reflecting the significant budgetary impact of the downturn, but also has to be seen against the fact that (i) some deficit-increasing measures were adopted in 2009; (ii) the debt ratio is rising rapidly; and (iii) the fiscal effort is expected to be supported in 2011 by the complete phasing out of the remaining recovery measures of 0,4 % of GDP. It can also not be excluded that some better-than-expected growth or revenue surprises partially mirroring the negative surprises of previous years will turn out to lower the effort required, although this cannot be taken for granted at this stage. Based on the draft budget and after making a correction for the one-off revenue loss in 2010, the improvement in the structural balance announced by the French authorities amounts to around ¾ percentage points[2], which, based on their growth assumptions of 2,5 % from 2011 onwards, would bring the deficit to 5 % of GDP in 2013 and therefore not lead to a halt in the debt increase. Thus, starting from 2011 there is a need for a more ambitious medium-term strategy than the one envisaged by the authorities, in order to bring the deficit below the reference value by 2013.

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[1] In line with the initial recommendations under Article 104(7) of the Treaty establishing the European Community issued by the Council on 27 April 2009, where due consideration was given to the special circumstances and the EERP framework, an average annual fiscal effort is recommended. As in the initial recommendations the required adjustment should take into account all factors relevant for achieving the fiscal policy objectives, starting with the level of the general government deficit and gross debt as well as other indicators, such as the current account position, the level of contingent liabilities of the financial sector, interest payments, risk premia and the expected change in age-related expenditure in the medium term. In particular, in the case of France due consideration was given to the substantial economic downturn, the size of the required budgetary correction, and the high level of the debt. In calculating the average annual fiscal effort, the 2011 deficit in the Commission services' autumn 2009 forecast is taken as the starting point. The total structural adjustment needed to reach the nominal deficit target of 3 % by the deadline is then calculated by assuming a gradual closure of the output gap by 2015.

[2] It is not clear to what extent these calculations follow the commonly agreed method.

(11) According to the French authorities, the debt-to-GDP ratio is projected to increase from 67½ % in 2008 to 91¼ % in 2013, driven by high primary deficits. Those figures take into account the impact of interventions in the financial and automobile sectors, for a total of around ¾ % of GDP[1].

(12) As regards the long term sustainability of public finances, the long-term budgetary impact of ageing in France is lower than the EU average, thanks to reforms to the social security system already enacted. The budgetary position in 2009 compounds the budgetary impact of population ageing on the sustainability gap. Moreover, the current level of gross debt is above the Treaty reference value and the ongoing large structural primary deficits may widen the sustainability gap. The French authorities plan to implement in 2010 further reforms that would ease the budgetary impact of ageing, contributing to reducing the risk to the long-term sustainability of public finances as defined by the Commission Communication[2] on "Long-term sustainability of public finances for a recovering economy" and discussed by the ECOFIN Council[3] on 10 November 2009.

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1 This does not include about 4 % of GDP of borrowing by the SFEF (with Government guarantee) since Eurostat clarified on 15 July 2009 that debt issued by "other central state bodies" in support of the financial sector would not be included in the general government debt.

2 http://ec.europa.eu/economy_finance/publications/publication15996_en.pdf

3 http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111025.pdf

(13) Enhanced surveillance under the EDP, which seems necessary also in view of the deadline for the correction of the excessive deficit, 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. In this context, a separate chapter in the updates of France's stability programme which will be prepared between 2010 and 2013 could usefully be devoted to this issue.

(14) In general, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the efficiency and governance of public finances and reinforcing the growth potential of the economy. Increased enforceability of expenditure control, notably in the areas of healthcare and local authorities would improve the quality of public finances. In addition, France should further reform the pension system as planned which would contribute to long-term fiscal sustainability.

(15) In addition, in view of the importance of achieving its medium-term objective (MTO) to provide an adequate safety margin against cyclical downturns and to ensure convergence of the debt ratio towards a prudent level, also taking into account implicit liabilities related to ageing, France should also ensure that budgetary consolidation towards the MTO is sustained after the excessive deficit will have been corrected,

HEREBY RECOMMENDS:

(1) Recognising that France's budgetary position in 2009 resulted from measures amounting to 1,2 % of GDP, which were an appropriate response to the European Economic Recovery Plan, and the free play of automatic stabilisers, the French authorities should put an end to the present excessive deficit situation by 2013.

(2) The French authorities should bring the general government deficit below 3 % of GDP in a credible and sustainable manner by taking action in a medium-term framework. Specifically, to this end, the French authorities should:

(a) implement the deficit-reducing measures in 2010 as planned in the government proposal for the budget law for 2010 while avoiding a further deterioration of public finances, and implement and strengthen the fiscal effort from 2011 onwards above the consolidation measures already planned;

(b) ensure an average annual fiscal effort of above 1% of GDP over the period 2010-2013, which should also contribute to bringing the government gross debt ratio back on a declining path that approaches the reference value at a satisfactory pace by restoring an adequate level of the primary surplus;

(c) specify the measures that are necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

(3) In addition, the French authorities should seize opportunities beyond the fiscal effort, including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards the reference value.

(4) The Council establishes the deadline of 2 June 2010 for the French government to take effective action to implement the fiscal measures in 2010 as planned in the government proposal for the budget law for 2010 and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

The French authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the stability programmes which will be prepared between 2010 and 2013.

Furthermore, the Council invites the French authorities to continue implementing reforms with a view to enhancing the efficiency and governance of public finances and raising potential GDP growth. France should aim at increased enforceability of expenditure control, notably in the areas of healthcare and local authorities. In addition, France should further reform the pension system as planned which would contribute to long-term fiscal sustainability.

This Recommendation is addressed to the French Republic.

Done at Brussels,

For the Council
The President