EUROPEAN
COMMISSION

Brussels, 28.11.2014
SWD(2014) 8805 final

COMMISSION STAFF WORKING DOCUMENT

Analysis of the draft budgetary plan of FRANCE

Accompanying the document

COMMISSION OPINION

on the draft budgetary plan of FRANCE

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1. INTRODUCTION

France submitted its Draft Budgetary Plan (DBP) for 2015 on 15 October in compliance with Regulation (EU) No 473/2013 of the Two-Pack. France is currently subject to the corrective arm of the Stability and Growth Pact. The Council opened the Excessive Deficit Procedure for France on 27 April 2009 and recommended France to correct the excessive deficit by 2012, a deadline which was extended to 2013 on 2 December 2009. On 21 June 2013, the Council concluded that France had taken effective action but adverse economic events with major implications on public finances had occurred, and issued revised recommendations. On 5 March 2014, the Commission addressed an autonomous recommendation to France under Article 11 of Regulation (EU) No 473/2013. This recommendation warned the French authorities that, based on the Commission Winter 2014 forecast, both the headline deficit and the structural effort targets for 2013-15 were to be missed and called for additional efforts to ensure compliance with the recommended structural effort. The Council recommendation of 8 July 2014 indicated that the Stability Programme could be considered to broadly respond to the Commission recommendation.

Section 2 of this document presents the macroeconomic outlook underlying the DBP and provides an assessment based on the Commission's current forecast. The following section presents the recent and planned fiscal developments, according to the DBP, including an analysis of risks to their achievement based on the Commission autumn forecast. In particular, it also includes an assessment of the measures underpinning the DBP. Section 4 assesses the recent and planned fiscal developments in 2014-2015 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations adopted by the Council on 8 July 2014, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

According to the DBP, GDP will grow by 0.4% in 2014 after 0.3% in 2013, and will accelerate slightly to 1% in 2015, on the back of increasing private consumption and exports. Household real disposable income will be sustained by relatively dynamic wages in real terms against a background of low inflation and some improvement in employment supported by economic growth and initiatives such as the jobs for the future and the tax rebate on competitiveness and employment (CICE). Private consumption is expected to grow accordingly by 1.3% in 2015, from 0.3% in 2014, with a stable households' savings ratio. Equipment in investment would begin picking up again following the growth in aggregate demand, helped by measures to support the supply side of the economy (the CICE and the responsibility and solidarity pact). Exports will be sustained by a particularly dynamic world demand (5.1%, after 3.8% in 2014), assuming lower losses in export market shares.

The macroeconomic scenario in the DBP is significantly less dynamic than that of the Stability Programme, with GDP revised down by 0.6 pp. in 2014 and 0.7 pp. in 2015. These revisions mainly stem from the surprising stagnation of GDP in the first half of 2014, owing to a fall in investment, flat private consumption and weak export growth. Besides, the latest indicators do not suggest that a firm recovery is to be expected in the short term. As a consequence, the authorities have revised downwards private consumption by 0.4 pp. and 0.3 pp. and investment by 2.6 pps. and 2.4 pps. in 2014 and 2015 respectively. As for the external sector, the contribution of net exports to GDP was similar in 2014, and slightly revised upwards, by 0.2 pp., in 2015, as a consequence of the downward correction in domestic demand, which would impact imports.

In 2014, the Commission's current growth forecast is only slightly below that published by the authorities (0.3% against 0.4%). Regarding 2015, the Commission's forecast is slightly more pessimistic (0.7% against 1.0 %). The main differences stem from investment and the external sector. As the first impact of the CICE seems to have boosted wages in the context of a rigid labour market to the detriment of firms' profit margins and investment capacity, the Commission does not assume a pickup in investment as early as 2015. Besides, the external assumptions of the authorities appear quite optimistic, with a rise in expected world demand 0.7 pp. above that of the Commission, and an assumed sharp reduction in export market share losses.

Box 1. The macroeconomic forecast underpinning the draft budget

Regulation (EU) No 473/2013 requires the draft budget to be based on independently endorsed or produced macroeconomic forecasts. As by law, the High Council for Public Finances (HCFP), which was established as a monitoring body attached to the French Court of Auditors and whose independence is formally guaranteed by law, has published on 26 September two opinions, on the DBP as well as on the overall budgetary strategy underlying the draft budget.

In its opinion on the DBP, the HCPF considered that the GDP growth forecast for 2014 was realistic but that for 2015 it was optimistic as the international economic environment, investment and household consumption could prove disappointing. Moreover, the HCPF considered that, in light of the measures presented, there are risks that the planned slowdown in public expenditure for 2015 may not be reached. As a consequence, although the planned structural effort has been revised down significantly since the stability programme, the planned 0.2 % of GDP may not be respected.

For the latter years, the HCPF stressed that the macroeconomic scenario is over-optimistic for 2016-2019 and that the slowdown in public expenditure planned over the period is not granted given the measures planned.

Table 1. Comparison of macroeconomic developments and forecasts

	2013	2014			2015		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	0.3	1.0	0.4	0.3	1.7	1.0	0.7
Private consumption (% change)	0.2	0.8	0.3	0.2	1.6	1.3	1.1
Gross fixed capital formation (% change)	-1.0	0.2	-2.4	-2.1	1.3	-1.1	-1.2
Exports of goods and services (% change)	2.2	3.4	2.8	2.3	4.7	4.6	3.9
Imports of goods and services (% change)	1.7	3.1	2.6	2.7	4.1	3.6	3.4
Contributions to real GDP growth:							
- Final domestic demand	0.4	0.6	-0.1	-0.1	1.4	0.7	0.5
- Change in inventories	-0.2	0.3	0.4	0.5	0.2	0.0	0.1
- Net exports	0.1	0.0	0.0	-0.2	0.1	0.3	0.1
Output gap[1]	-1.7	-2.9	-2.2	-2.3	-2.5	-2.1	-2.5
Employment (% change)	-0.2	0.6	0.2	0.1	0.7	0.3	0.3
Unemployment rate (%)	10.3	n.a.	n.a.	10.4	n.a.	n.a.	10.4
Labour productivity (% change)	0.5	0.4	0.2	0.2	1.0	0.7	0.4
HICP inflation (%)	1.0	1.2	0.7	0.6	1.5	1.1	0.7
GDP deflator (% change)	0.8	1.2	0.8	0.7	1.5	0.9	0.8
Comp. of employees (per head, % change)	1.6	1.5	1.7	1.4	1.8	1.9	0.9
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-2.0	-1.4	-1.6	-1.9	-1.2	-1.4	-1.7

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

In 2013, the general government deficit reached 4.1% of GDP, 0.2 pp. below the level notified in spring 2014. Still, the headline deficit was significantly higher than the 3.9 % of GDP target recommended by the Council on 21 June 2013. In the DBP, the government expects that the headline deficit will increase to 4.4 % of GDP in 2014 and amount to 4.3 % of GDP in 2015. The DBP therefore rests on the assumption that the 2015 deadline for France to correct its excessive deficit set by the Council in is recommendation of 21 June 2013 will not be respected.

The Stability Programme submitted in April 2014 expected the general government deficit to decrease to 3.8 % of GDP in 2014 and 3.0 % in 2015 with a structural effort estimated by the government in the DBP at 0.8 % of GDP for both years. According to the government, the strong revision in the budgetary targets since spring comes mainly from the downward revision in inflation and GDP growth. Indeed, while nominal growth in total expenditure in

2014 remains similar in the Stability Programme and in the DBP[1] (+1.4 % in both cases despite significantly lower interest payments expected in the DBP), base effects and revenue shortfalls lead to a significantly higher public deficit.

The government considers in the DBP that the adjustment in the structural balance will represent 0.1 % of GDP in 2014 and 0.2 % in 2015. The revision in the impact of payable tax credits linked to the changeover to ESA 2010 reduces the adjustment in the structural balance by 0.1 % for both years compared to spring. Indeed, payable tax credits are accounted for in ESA 2010 as soon as the fiscal claim is registered, while in ESA 1995, they were only taken into account based on actual reimbursements. In the case of the tax credit on competitiveness and employment, this means that the cost in national accounting terms according to ESA 2010 is significantly higher in 2014 and 2015 (0.2 pp. and 0.1 pp. of GDP respectively). For 2014, this effect is partly compensated by a 0.1 pp. decrease in the cost of the tax credit on research in ESA 2010. The impact on public finances of the changeover to ESA 2010 was not considered at the time of the Council recommendation of 21 June 2013 and can be considered as being outside the control of the government. Therefore, the assessment of the structural effort conducted can be adjusted for the impact of the changeover to ESA 2010. On 27 October 2014, the government announced that additional measures on the revenue side would be taken which, together with updated estimates on some other items, are expected to increase the adjustment in the structural balance by 0.2 % of GDP according to the government. Taking into account this package at face value and adjusting for the impact of the changeover to ESA 2010 would therefore bring the adjustment in the structural balance expected by the government for 2015 in the DBP to 0.5 % of GDP. Based on the economic scenario underpinning the DBP, the potential growth estimated following the commonly agreed methodology stands at 1.1 % in 2014 and 0.9 % in 2015. As a consequence, the (recalculated) structural effort[2] based on the DBP, not taking into account the additional package announced on 27 October, comes out at 0.2 % of GDP in 2014 and 0.1 % in 2015. Regarding 2015, including the impact of the additional measures announced (0.2 % of GDP according to the government) and adjusting for the increase in the cost of tax credits linked to the changeover to ESA 2010 (0.1 % of GDP) would bring down the (recalculated) adjustment of the structural balance to 0.4 % of GDP.

According to the Commission autumn forecast, the general government deficit for 2014 amounts to 4.4 % of GDP, in line with the forecast of the government. In 2015, the Commission expects that the government balance will continue deteriorating to 4.5% of GDP. This is notably due to a significant base effect as the Commission expects that both GDP growth and inflation will be below the level expected by the government (see above). Moreover, the government has announced that expenditure savings of EUR 21 billion (1.0 % of GDP) will be implemented in 2015. However, some of these measures, representing close to EUR 2 billion or 0.1 % of GDP, were not incorporated into the forecast. Finally, the additional package presented in late October 2014 could not be taken into account in the forecast as available information on the underlying measures was not sufficiently detailed at the cut-off date.

Risks to the expected budgetary outcomes and to the underlying improvements in the structural balance are clearly tilted to the downside. Indeed, as pointed out by the High Council on Public Finances, the macroeconomic forecast underpinning the DBP for 2015

[1] In the case of the DBP, due to accounting changes, growth in expenditures is provided net of tax credits.

[2] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the Draft Budgetary Plan, using the commonly agreed methodology.

appears on the optimistic side. In particular, a further drop in economic confidence, to which potential uncertainty on fiscal policy would contribute, could postpone the expected pick-up in private consumption and in investment and act as a drag on France's already fragile recovery. In addition, in light of the measures presented so far, there are risks that the slowdown in public expenditure growth planned in 2015 (+1.1 % net of payable tax credits according to the government) will not be achieved.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2013	2014			2015			Change: 2013-2015
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**53.0**	**52.9**	***53.4***	**53.5**	**52.6**	***53.3***	**53.5**	**0.3**
of which:								
- Taxes on production and imports	15.5	16.1	*15.9*	15.8	16.2	*16.0*	16.0	0.5
- Current taxes on income, wealth, etc.	12.7	12.0	*12.6*	12.7	11.9	*12.5*	12.6	-0.2
- Capital taxes	0.5	0.5	*0.5*	0.5	0.5	*0.5*	0.5	0.0
- Social contributions	18.9	19.5	*19.0*	19.1	19.1	*18.9*	19.0	0.0
- Other (residual)	5.4	4.8	*5.4*	5.5	4.9	*5.4*	5.6	0.0
Expenditure	**57.1**	**56.6**	**57.7**	**57.9**	**55.6**	**57.6**	**58.1**	**0.5**
of which:								
- Primary expenditure	54.9	54.2	55.5	55.7	53.1	55.3	55.8	0.4
of which:								
Compensation of employees	12.9	13.2	13.0	13.0	12.9	12.9	13.0	0.0
Intermediate consumption	5.2	5.5	5.2	5.2	5.5	5.2	5.3	0.0
Social payments	25.8	26.2	26.1	26.1	25.8	26.0	26.2	0.2
Subsidies	1.7	1.5	2.3	2.3	1.5	2.5	2.6	0.8
Gross fixed capital formation	4.0	3.1	4.0	4.0	2.8	3.8	3.8	-0.2
Other (residual)	5.1	4.7	4.9	5.1	4.6	4.9	5.0	-0.2
- Interest expenditure	2.3	2.4	2.2	2.2	2.5	2.3	2.3	0.0
General government balance (GGB)	**-4.1**	**-3.8**	**-4.4**	**-4.4**	**-3.0**	**-4.3**	**-4.5**	**-0.2**
Primary balance	**-1.9**	**-1.4**	**-2.2**	**-2.3**	**-0.5**	**-2.0**	**-2.2**	**-0.1**
One-off and other temporary	0.2	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.3
GGB excl. one-offs	**-4.3**	**-3.8**	**-4.4**	**-4.4**	**-2.9**	**-4.2**	**-4.4**	**0.1**
Output gap[1]	-1.7	-2.9	-2.2	-2.3	-2.5	-2.1	-2.5	-0.4
Cyclically-adjusted balance[1]	-3.1	-2.2	-3.1	-3.1	-1.7	-3.0	-3.0	0.1
Structural balance (SB)[2]	**-3.3**	**-2.2**	**-3.1**	**-3.0**	**-1.6**	**-2.9**	**-2.9**	**0.4**
Structural primary balance[2]	-1.0	0.2	-0.9	-0.9	0.9	-0.6	-0.7	0.4

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

3.2. Debt developments

The ratio of general government debt to GDP reached 92.2% in 2013, significantly below the 93.5 % level expected as part of the Spring forecast, also due to the changeover to ESA2010. Still, the Commission expects that public debt will increase to 95.5 % of GDP in 2014, due in particular to a denominator effect as the growth in nominal GDP was revised downwards significantly. The difference between the Commission and the DBP forecast for 2014 (95.3 % of GDP) stems from lower nominal GDP growth according to the Commission. In 2015, the Commission expects the debt ratio to increase to 98.1 %, 0.9 pp. above the DPB forecast due to lower nominal GDP growth and significantly higher general government deficit according to the Commission.

Table 3. Debt developments

(% of GDP)	2013	2014			2015		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**92.2**	**95.6**	**95.3**	**95.5**	**95.6**	**97.2**	**98.1**
Change in the ratio	3.0	2.1	3.1	3.3	0.0	1.9	2.5
Contributions[2] *:*							
1. Primary balance	**1.9**	**1.4**	**2.2**	**2.3**	**0.5**	**2.0**	**2.2**
2. "Snow-ball" effect	**1.3**	**0.4**	**1.1**	**1.3**	**-0.4**	**0.5**	**0.9**
Of which:							
Interest expenditure	2.3	2.4	2.2	2.2	2.5	2.3	2.3
Growth effect	-0.3	-0.9	-0.4	-0.3	-1.6	-0.9	-0.7
Inflation effect	-0.7	-1.1	-0.7	-0.6	-1.4	-0.8	-0.7
3. Stock-flow adjustment	**-0.2**	**0.3**	**-0.2**	**-0.2**	**0.0**	**-0.6**	**-0.6**
Of which:							
Cash/accruals difference		n.a.	n.a.		n.a.	n.a.	
Net accumulation of financial		n.a.	n.a.		n.a.	n.a.	
of which privatisation proceeds		n.a.	n.a.		n.a	n.a.	
Valuation effect & residual		n.a.	n.a.		n.a.	n.a.	

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual

Source :

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

3.3. Measures underpinning the Draft Budgetary Plan

The measures included in the DBP for 2015 mainly result, on the revenue side, from the implementation of the solidarity and responsibility pact and, on the expenditure side, from the planned EUR 21 billion (1.0 % of GDP) expenditure cuts.

On the revenue side, the main measure included in the DBP is the announced abolishment of the first revenue bracket for personal income tax. According to the government, this measure is set to reduce tax revenues by EUR 2.7 billion. As part of the solidarity and responsibility pact, a EUR 5 bn reduction in social charges for employers will also be implemented. This measure was adopted as part of the supplementary budget adopted in August. The extension of the surcharge on corporate income tax for large companies, which is expected to yield EUR 2 billion in 2015, was also adopted in the supplementary budget.

On the expenditure side, the government plans to implement a EUR 21 billion reduction in public expenditures, in line with the objective to achieve a EUR 50 billion savings target over 2015-2017 which was already included in the Stability Programme. Out of the expenditure cuts planned for 2015, EUR 7.7 billion are planned to be achieved by the central state, EUR 3.7 billion by local authorities and EUR 9.6 billion by social security. In particular, the government plans to contain the wage bill and other operating costs by maintaining the freeze in base wages (in place since 2010), achieving efficiency gains and rationalising public sector real estate. State-controlled agencies (the *organismes divers d'administration centrale*) will be financially incentivised to reduce their own spending as well. Local governments will see the grant they receive from the state decrease by EUR 3.7 billion. Finally, an ambitious EUR 9.6 billion is to come from savings in social benefits, with in particular EUR 2.3 billion expected from the more ambitious healthcare spending norm (the *objectif national de dépenses d'assurance maladie* or ONDAM). The remaining expenditures cuts in social security notably comprises the multi-year effects of already legislated measures and a one-year nominal freeze in social benefits.

The additional package announced on 27 October would contribute 0.2 % of GDP to the improvement in the structural balance in 2015 according to the government. Underlying new measures include the fight against fraud and tax optimisation. Furthermore, new measures are complemented by updated estimates in particular on interest charges and on the contribution to the EU budget for 2015. The government considers that this package would increase the structural effort for 2015 by EUR 3.6 billion (0.2 % of GDP). As the package includes items whose revenues seem uncertain at this stage, notably on the fight against fraud, the Commission expects that it would lead to an improvement in the structural balance of only 0.1 % of GDP. In its assessment, the Commission also considered that the reduction in the contribution to the EU budget included in the package announced on 27 October would not improve the structural balance for 2015 although it would have a positive impact on the headline deficit.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Box 2. Council recommendations addressed to France

France is currently subject to the corrective arm of the Stability and Growth Pact. The Council opened the Excessive Deficit Procedure for France on 27 April 2009 and recommended it to correct the excessive deficit by 2012, a deadline which was extended to 2013 on 2 December 2009.

On 21 June 2013, the Council concluded that France had taken effective action but that adverse economic events with major implications on public finances had occurred and hence issued the following recommendation: *"(1) France should put an end to the present excessive deficit situation by 2015. (2) France should reach a headline deficit of 3,9 % of GDP in 2013, 3,6 % in 2014 and 2,8 % in 2015, which is consistent with delivering an improvement in the structural balance of 1,3 pps. of GDP in 2013, 0,8 % in 2014 and 0,8 % in 2015, based on the extended Commission 2013 spring forecast. (3) France should fully implement the already adopted measures for 2013 (1½ % of GDP) and specify, adopt and implement rapidly the necessary consolidation measures for 2014 and 2015 in order to achieve the recommended* *improvement in the structural balance, while proceeding as currently planned with a thorough review of spending categories across all sub-sectors of general government, including at social security and local government levels. (4) France should use all windfall gains for deficit reduction. Budgetary consolidation measures should secure a lasting improvement in the general government structural balance in a growth-friendly manner. (5) The Council establishes the deadline of 1 October 2013 for France to take effective action and, in accordance with Article 3(4a) of Regulation (EC) No 1467/97, to report in detail the consolidation strategy that is envisaged to achieve the targets. Furthermore, the French authorities should strengthen the long-term sustainability of the pension system by further adjusting all relevant parameters. In particular, the planned reform, as currently envisaged, should be adopted by the end of this year, and bring the system into balance in a sustainable manner no later than 2020 while avoiding any further increase in the cost of labour. In addition, to ensure the success of the fiscal consolidation strategy, it will be important to back the fiscal consolidation by comprehensive structural reforms, in line with the Council recommendations addressed to France in the context of the European Semester and, in particular, those related to the Macroeconomic Imbalance Procedure.*"

On 8 July 2014, the Council addressed recommendations to France in the context of the European Semester. In particular, in the area of public finances the Council recommended to France: "*to reinforce the budgetary strategy, including by further specifying the underlying measures, for the year 2014 and beyond to ensure the correction of the excessive deficit in a sustainable manner by 2015 through achieving the structural adjustment effort specified in the Council recommendation under the Excessive Deficit Procedure. A durable correction of the fiscal imbalances requires a credible implementation of ambitious structural reforms to increase the adjustment capacity and boost growth and employment. After the correction of the excessive deficit, pursue a structural adjustment towards the medium-term objective of at least 0.5 % of GDP each year, and more in good economic conditions or if needed to ensure that the debt rule is met in order to put the high general government debt ratio on a sustained downward path. Step up efforts to achieve efficiency gains across all sub-sectors of general government, including by redefining, where relevant, the scope of government action. In particular, take steps to reduce significantly the increase in social security spending as from 2015 as planned, by setting more ambitious annual healthcare spending targets, containing pension costs, and streamlining family benefits and housing allowances. Set a clear timetable for the on-going decentralisation process and take first steps by December 2014, with a view to eliminating administrative duplication, facilitating mergers between local governments and clarifying the responsibilities of each layer of local government. Introduce a ceiling on the annual increase in local government tax revenue while reducing grants from the central government as planned. Beyond the need for short-term savings, take steps to tackle the increase in public expenditure on health projected over the medium and long term, including in the area of pharmaceutical spending, and take additional measures when and where needed to bring the pension system into balance by 2020 in a sustainable manner, with a special focus on existing special schemes.*"

4.1. Compliance with EDP recommendations

The (recalculated) adjustment in the structural balance planned by the DBP, excluding the impact of the 27 October package, stands at 0.2 % of GDP in 2014 and 0.1 % in 2015. Taking into account the package announced on 27 October at face value, the planned improvement in the structural balance increases to 0.3 % of GDP in 2015, still below the minimum annual improvement in the structural balance of 0.5 % as a benchmark foreseen in Article 3(4) of Regulation (EC) No 1467/97.

Based on the Commission autumn forecast, correcting for downward revisions in potential growth and revenue windfalls/shortfalls since the Council recommendation was issued, the improvement in the structural balance is estimated at 1.1 % of GDP in 2013, 0.5 % in 2014 and 0.0% in 2015. Taking into account the Commission's assessment of the package announced by France on 27 October and adjusting for the impact of the changeover to ESA 2010, the corrected structural balance is estimated to be around 0.1% and 0.3% of GDP higher 2014 and 2015 respectively. This is much below the 0.8 % of GDP recommended in the Council Recommendation of 21 June 2013. Similarly, the cumulated adjustment for 2013-2014 comes out at 1.7 % of GDP compared to 2.1 % of GDP recommended.

In the context of the Excessive Deficit Procedure, the top-down assessment of the improvement in the structural balance is complemented by a bottom-up evaluation of the fiscal effort on the basis of (i) additional revenue measures taken and (ii) developments in expenditures under the control of the government, compared to the scenario underpinning the Council recommendation of 21 June 2013. Based on the Commission 2014 autumn forecast, the bottom-up assessment of the fiscal effort comes up at -0.1 % and 0.9 % of GDP in 2013 and 2014 respectively. Adjusting for the impact of the changeover to ESA 2010, the bottom-up effort comes out around 0.1% of GDP higher in 2014. As a consequence, the cumulated fiscal effort over 2013-2014 stands at 0.9 % of GDP, hence falling short of the above 1 % of GDP mentioned in the Council Recommendation. This analysis does not take into account recent information on local government expenditure which may turn out lower than expected in the Commission 2014 autumn forecast. A careful analysis shows that the gap between the improvement in the structural balance and the bottom-up assessment of the fiscal effort is mostly explained by revisions in the inflation forecast since June 2013. Indeed, when fiscal adjustment relies on expenditure cuts and when inflation turns out to be lower than expected, which is the case in France in 2014, the top-down assessment tends to identify a much smaller effort than the bottom-up assessment.

Regarding 2015, the bottom-up assessment of the fiscal effort, taking into account the Commission's assessment of the package presented on 27 October and adjusting for the negative impact of the changeover to ESA 2010 comes out at 0.9 % of GDP compared to 0.7 % of GDP based on the Commission 2014 autumn forecast, hence also falling short of the above 1 % of GDP level.

Table 4. Compliance with the EDP recommendation

(% of GDP)	2013	2014		2015	
	COM	DBP	COM	DBP	COM
Headline balance					
Headline budget balance	-4.1	-4.4	-4.4	-4.3	-4.5
EDP requirement on the budget balance	-3.9	-3.6		-2.8	
Fiscal effort - change in the structural balance					
Change in the structural balance[1]	1.0	0.2	0.3	0.1	0.1
Cumulative change[2]	1.0	1.2	1.2	1.4	1.3
Required change from the EDP recommendation	1.3	0.8		0.8	
Cumulative required change from the EDP recommendation	1.3	2.1		2.9	
Fiscal effort - adjusted change in the structural balance					
Adjusted change in the structural balance[3]	1.1	-	0.5	-	0.0
of which: *correction due to change in potential GDP estimation (α)*	0.0	-	0.0	-	0.2
correction due to revenue windfalls/shortfalls (β)	-0.2	-	-0.2	-	0.2
Cumulative adjusted change [2]	1.1	-	1.6	-	1.6
Required change from the EDP recommendation	1.3	0.8		0.8	
Cumulative required change from the EDP recommendation	1.3	2.1		2.9	
Fiscal effort - calculated on the basis of measures (bottom-up approach)					
Fiscal effort (bottom-up)[4]	-0.1	-	0.9	-	0.7
Cumulative fiscal effort (bottom-up)[2]	-0.1	-	0.8	-	1.4
Requirement from the EDP recommendation[5]	0.0	1.0		1.0	
Cumulative requirement from the EDP recommendation[5]	0.0	1.0		2.0	

Notes

[1]Structural balance = cyclically-adjusted government balance excluding one-off measures. Structural balance based on DBP are recalculated by Commission on the basis of the Draft Budgetary Plan scenario using the commonly agreed methodology. Change compared to t-1.

[2] Cumulated since the latest EDP recommendation.

3 Change in the structural balance corrected for unanticipated revenue windfalls/shortfalls and changes in potential growth compared to the scenario underpinning the EDP recommendations.

[4]The estimated budgetary impact of the additional fiscal effort delivered on the basis of the discretionary revenue measures and the expenditure developments under the control of the government between the baseline scenario underpinning the EDP recommendation and the current forecast.

[5]In the case of 2014 and 2015, the minimum requirement is indicated.

Source :

Draft Budgetary Plan 2015 (DBP), Commission 2014 autumn forecast (COM), Commission calculations

5. IMPLEMENTATION OF FISCAL-STRUCTURAL REFORMS

As part of the country-specific recommendations (CSRs) issued on 8 July 2014, the Council recommended that France takes measures to improve the governance and efficiency of local government spending, and to increase the long-term sustainability of public finances. In addition, the Council recommended that France "step up efforts to simplify and increase the efficiency of the tax system".

After a bill was adopted in January 2014 creating new groups of municipalities in metropolitan areas, two further bills were presented in June. One on the grouping of region and the other, on the organisation of competencies between the various layers of local administration. According to the related draft laws, the number of regions would be reduced while most of the responsibilities at the department level would be split between the regions and municipalities. However, the final number of regions and the actual repartition of competences still remains under discussion at this stage. The objective of the government is to have the full package adopted by the end of the year, in line with the deadline included in the CSR and before the elections at the department level planned in March 2015. Steps have also been taken to reinforce the governance of public finances by local authorities. To support expenditure cuts at the local level, the new programming law on public finances introduces a spending norm for local governments (the ODEDEL). This spending norm, which is purely indicative at this stage, is differentiated for the various layers of local authorities.

Little effort has been made to improve the long-term sustainability of public finances. The increasing healthcare costs, as well as the cost of ageing are expected to represent an increasing burden in the medium term. In that respect, the Council had recommended to take measures. Regarding healthcare, whose costs are expected to be contained as part of the plan to cut expenditures by 2017, no mechanism has been set up to effectively improve the long-term sustainability of the system. Regarding pensions, no measures are planned beyond the 2013 reform, which has done little to reform the scheme for state government officials and other special schemes and is expected to only halve the deficit of the system by 2020.

Regarding taxation, the DBP includes measures to simplify the system but also creates new tax expenditures. The DBP proposes to delete seven taxes which have no or only a low yield. Also, the DBP confirms that the C3S tax will be gradually phased out by 2017 and that the corporate tax rate will be reduced by 2020. No new measures have been taken since July 2014 to reduce the debt bias nor to improve the efficiency of the VAT since the increase of the standard and reduced rates on 1 January 2014. On the contrary, the DBP extends the field of application of the reduced rate of 5.5% to social housing in new priority districts.

Finally, there has been little progress in the area of environmental taxation The project for an ‘eco-tax poids lourds’, after having been transformed into a contribution 'transit poids-lourds' with restricted perimeter, was suspended *sine die* on 9 October. In order to compensate for the related loss in revenues, the excise duties on diesel on heavy trucks was increased, yielding close to EUR 0.3 billion in 2015.

Box 3. Addressing the tax wedge

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed its commitment to effectively reduce the tax burden on labour. It will take stock of Member States' plans for reductions of the tax burden when discussing the DBP.

In the context of the European Semester, France was issued the recommendations to "ensure that the labour cost reduction resulting from the ‘crédit d'impôt compétitivité emploi’ is sustained. Take action to further lower employer social security contributions in line with commitments under the responsibility and solidarity pact, making sure that no other measures offset its effect and that the targeting currently envisaged is maintained. Further evaluate the economic impact of social security contribution exemptions, putting the emphasis on employment, wage developments and competitiveness and take appropriate measures if necessary. Further reduce the cost of labour in a budget neutral way, namely at the lower end of the wage scale in particular through targeted reductions in employer social security contributions taking into account the various wage support schemes" and to "reduce the tax burden on labour and step up efforts to simplify and increase the efficiency of the tax system.

The tax wedge in France for some income categories is well above the EU average. Revenues from employers' social security contributions are the highest in the EU. The tax wedge in France for a single person without children earning 50% of the average wage was 33.5% compared to an EU average of 34% in 2013, for 67% of the average wage it was 45.6% (EU average: 37.7%), for the average wage it was 48.9% (EU average: 41.1%). Revenues from employers' social security contributions were amounted to 11.6% of GDP in 2012. While the overall employment rate in 2013 was somewhat above the EU average, it was well below the average for older workers (45.6% against 50.2%). The unemployment rate of young people was above the EU average (at 24.8% against 23.5%).

As part of the responsibility and solidarity pact, a number of cuts to the high tax burden have been announced by the government. As of 2014, the tax credit on competitiveness and employment will reduce the cost of labour for wages of up to 2.5 times the minimum wage. The budgetary cost of this measure will amount to EUR 20 billion when in full effect. In addition, the government has announced an additional EUR 10 billion reduction in social security contributions paid by employers by 2016. Finally, the DBP includes a measure reducing personal income tax for the low earning households by EUR 2.7 billion.

More generally, following the conclusion of the in-depth review of macroeconomic imbalances published in March 2014, France is subject to a specific monitoring of reform implementation as part of the Macroeconomic Imbalances Procedure (MIP). Based on information currently available, notably in the DBP, a number of reforms are progressing, but continued decisive implementation and, where appropriate, adaptation remains necessary. In particular, progress has been recorded in the implementation of the responsibility and solidarity pact which, together with the tax credit on competitiveness and employment, will reduce the cost of labour by close to EUR 30 billion by 2017. Steps have also been taken to further reduce the administrative burden for firms. Efforts to promote competitiveness are planned to be enhanced by an upcoming law on economic activity, which will notably address regulated professions. However, the impact of the law remains uncertain as the actual content of this reform is still under consideration. Potential economic gains of this reform will crucially hinge on their final design and implementation. Finally, efforts could to be stepped up to reduce the rigidities of the labour market.

6. OVERALL CONCLUSION

Based on the Commission autumn forecast, the headline deficit is expected to reach 4.4% of GDP in 2014 and 4.5 % of GDP in 2015. Furthermore, based on the assessment by the Commission of the package announced on 27 October, the Commission expects that, adjusting for the impact of ESA 2010, the corrected structural balance will improve by 0.3 % of GDP in 2015. The Commission 2014 autumn forecast hence shows the improvement in the structural deficit in 2015 falls also short of the minimum annual adjustment foreseen in Regulation (EC) No 1467/97.