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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 for 2014 on 1 October 2013 in compliance with Regulation 473/2013 of the Two-Pack together with a report on effective action and an Economic Partnership Programme as recommended by the Council in June 2013.

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 a revised recommendation. France was given a deadline of 1 October 2013 to take effective action to ensure a sustainable correction of the excessive deficit by 2015.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2013 Autumn Forecast (Commission forecast hereafter). The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission forecast. In particular, it also includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2013-14 (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 the fiscal-structural reforms presented in the Economic Partnership Programme, as requested in the Council recommendation of 21 June 2013. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The Draft Budgetary Plan anticipates real GDP growth to be 0.1% in 2013, with real output expected thus to remain broadly flat for the second consecutive year (0.0% in 2012). Weak household disposable income linked to rising unemployment and tax increases will only be partly offset by lower inflation while low business confidence is expected to lead to a continued fall in investment. This is fully in line with the macroeconomic scenario underpinning the April 2013 Stability Programme. GDP growth is forecast to accelerate in 2014 and reach 0.9%. Exports are set to rebound on the back of an improved outlook for the global economy but slightly less than expected at the time of the Stability Programme, which partly explains the gap with the 1.2% growth rate projected. Recent measures to boost the competitiveness of French companies are set to gradually mitigate export market share losses, without however fully reversing the trend. Business investment is forecast to support the recovery, although the newly created tax rebate on payroll ('crédit d'impôt compétitivité-emploi' or CICE) is likely to be primarily used to improve firms' low profitability. The

contribution to growth from business investment has been revised down compared to spring as well, with this explaining the remaining forecast revision. The Draft Budgetary Plan also builds on rising employment thanks to subsidised job schemes in the public sector and the expected positive effect of the CICE tax rebate on job creation in the private sector. This is forecast to support household purchasing power, which in turn, together with the reduction in the savings ratio, will fuel a rebound in private consumption. Finally, inflation is set to accelerate in 2014 on the back of planned VAT rises but is projected to remain significantly below 2%.

The Commission forecast depicts an economic outlook which is broadly similar to the one anticipated by the Draft Budgetary Plan, with real GDP growth projected at 0.2% and 0.9% this year and next. Regarding 2013, the expected slightly better outcome (0.1 pp.) is mainly due to positive developments in economic sentiment indicators and revisions to quarterly GDP data since the Draft Budgetary Plan was submitted. As for 2014, the forecast composition of domestic demand is slightly different, with private consumption growing at a somewhat higher pace under the Draft Budgetary Plan, driven by a better outlook for job creation thanks to a stronger short-term effect of the CICE tax rebate on employment. In contrast, the Commission forecast projects higher public investment. Risks to the growth assumptions underpinning the Draft Budgetary Plan are broadly balanced and mainly relate to corporate behaviour. A stronger recovery could stem from a more rapid effect of structural reforms on competitiveness and employment. The pick-up in business confidence could push companies to take more advantage of the CICE tax rebate and spend more on investment, while the June 2013 labour market reform could lead them to create more jobs than forecast in the baseline. On the downside, a further deterioration in firm profitability would mitigate the sharp but still fragile rebound in business confidence. Firms could also refrain from investing with possible negative effects on competitiveness and exports, while further job losses would affect the resilience of private consumption. Overall, the Draft Budgetary Plan is based on realistic macroeconomic assumptions.

Box 1: The macroeconomic forecast underpinning the budget in France

The macroeconomic forecast underpinning the Draft Budgetary Plan is developed by the Ministry for the Economy and Finance. This forecast has been endorsed by the newly created High Council for Public Finances (HCPF) which was created when transposing of the Treaty on Stability, Coordination and Governance (TSCG) into national law. In accordance with Article 14 of the organic law of 17 December 2012, the HCPF's opinion on the draft budget was made public on 25 September. The real GDP growth forecast for 2014 was found plausible. The HCPF identified a number of risks to the macroeconomic scenario which taken together are tilted to the downside. These relate to a possibly weaker outlook for the global economy, less benign financial market conditions and higher energy prices. Expected labour market developments were considered optimistic. On the upside, the HCPF pointed out that on-going economic and financial governance reforms being implemented faster than currently anticipated might trigger positive confidence effects and the European Central Bank's first time ever forward guidance could translate into improved lending conditions to the euro area.

The HCPF has also been tasked with assessing the consistency of annual fiscal targets with the country's multi-year budgetary strategy. In that respect, it found that the improvement in the structural balance targeted for 2014 was optimistic since both expected revenue and spending projections were considered fragile.

Regarding the institutional set-up, the HCPF is an independent authority by law and it has been attached to the Court of Auditors. In the discharge of their duties members of the High

Council shall not seek nor receive instructions from the government or from any authority external to the High Council. The president of the HCPF is also the president of the Court of Auditors and is thus irremovable. Four out of ten members of the governing body of the HCPF come from the Court of Auditors as well. Four other members are appointed by Parliament for their expertise and they cannot stand for elective office. The same goes for the member appointed by the Economic, Social and Environmental Council. The tenth member is the director-general of the INSEE statistics office. The entity's budget is managed autonomously by the president of the High Council.

Table 1. Comparison of macroeconomic developments and forecasts

	2012	2013			2014		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	0.0	0.1	0.1	0.2	1.2	0.9	0.9
Private consumption (% change)	-0.3	0.2	0.3	0.5	0.9	0.9	0.6
Gross fixed capital formation (% change)	-1.2	-0.8	-1.8	-2.3	1.2	0.0	0.6
Exports of goods and services (% change)	2.4	2.0	1.2	1.4	4.5	3.5	4.3
Imports of goods and services (% change)	-1.1	0.8	1.0	1.4	3.5	3.0	3.5
Contributions to real GDP growth:							
- Final domestic demand	-0.1	0.2	0.2	0.2	0.9	0.7	0.7
- Change in inventories	-0.9	-0.4	-0.1	0.0	0.1	0.1	0.0
- Net exports	1.0	0.3	0.0	0.0	0.2	0.1	0.1
Output gap[1]	-2.1	-3.3	-2.6	-2.9	-3.2	-2.6	-3.0
Employment (% change)	0.0	-0.2	-0.1	-0.2	0.6	0.6	0.3
Unemployment rate (%)	10.2	n.a.	n.a.	11.0	n.a.	n.a.	11.2
Labour productivity (% change)	0.1	0.4	0.3	0.4	0.6	0.3	0.6
HICP inflation (%)	2.2	1.3	1.0	1.0	1.8	1.4	1.4
GDP deflator (% change)	1.5	1.5	1.6	1.5	1.8	1.4	1.6
Comp. of employees (per head, % change)	2.2	1.9	0.3	1.4	1.9	0.3	1.3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-2.2	-1.8	-1.7	-1.8	-1.3	-1.6	-1.4

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 (SP); Draft Budgetary Plan (DBP); Commission 2013 Autumn Forecast (COM).

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

According to the Draft Budgetary Plan, the general government deficit is set to reach 4.1% of GDP in 2013. This is in line with the Commission forecast but above the 3.7% of GDP target set in the April Stability Programme. The revision comes from worse than expected developments regarding both revenue and expenditure. Based on the amount collected from personal and corporate income tax but also VAT in the eight months to August as well as on local government tax receipts recorded so far, the overall tax elasticity with respect to (nominal) GDP has been revised down to 0.4 from 0.9 in the Stability Programme. This implies a revenue shortfall of some 0.3% of GDP (the nominal GDP growth forecast has been maintained broadly unchanged at 1.8%). On the other hand, the budgetary impact of revenue measures taken together has been revised up by 0.05% of GDP, with notably lower tax litigation losses now expected. On the expenditure side, the contribution to the EU budget will be 0.1% of GDP higher than what the 2013 budget and the Stability Programme had assumed,

without this being compensated by additional savings. Other overruns mentioned by the authorities include extra unemployment benefit costs and higher local government spending. Overall, general government expenditure is now forecast to grow by 2.5% in nominal terms this year versus 2.1% targeted at the time of the Stability Programme, resulting in a deficit increase of 0.2% of GDP.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2012	2013			2014			Change: 2012-2014
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**51.8**	**53.1**	**52.9**	**52.9**	**53.5**	**53.1**	**53.0**	**1.3**
of which:								
- Taxes on production and imports	15.4	15.6	15.6	15.6	16.3	16.0	16.0	0.6
- Current taxes on income, wealth, etc.	12.0	12.8	12.6	12.6	12.4	12.2	12.3	0.2
- Capital taxes	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.0
- Social contributions	19.0	19.3	19.3	19.2	19.4	19.4	19.2	0.4
- Other (residual)	4.9	4.9	4.9	4.9	4.9	5.0	5.0	0.1
Expenditure	**56.6**	**56.8**	**57.0**	**57.0**	**56.4**	**56.7**	**56.8**	**0.1**
of which:								
- Primary expenditure	54.1	54.4	54.7	54.7	53.9	54.2	54.4	0.1
of which:								
Compensation of employees	13.2	13.2	13.2	13.2	13.1	13.1	13.2	-0.1
Intermediate consumption	5.6	5.6	5.6	5.6	5.4	5.6	5.5	0.0
Social payments	26.0	26.4	26.5	26.5	26.3	26.4	26.5	0.4
Subsidies	1.5	1.5	1.5	1.5	1.5	1.6	1.5	0.1
Gross fixed capital formation	3.1	3.2	3.2	3.2	3.1	3.0	3.1	-0.1
Other (residual)	4.7	4.5	4.7	4.6	4.5	4.5	4.5	-0.2
- Interest expenditure	2.5	2.4	2.3	2.4	2.5	2.5	2.4	0.0
General government balance (GGB)	**-4.8**	**-3.7**	**-4.1**	**-4.1**	**-2.9**	**-3.6**	**-3.8**	**1.2**
Primary balance	**-2.3**	**-1.3**	**-1.8**	**-1.8**	**-0.4**	**-1.1**	**-1.4**	**1.2**
One-off and other temporary measures	0.0	-0.1	0.0	0.2	-0.1	-0.1	-0.1	-0.1
GGB excl. one-offs	**-4.8**	**-3.6**	**-4.1**	**-4.3**	**-2.8**	**-3.5**	**-3.7**	**1.3**
Output gap[1]	-2.1	-3.3	-2.6	-2.9	-3.2	-2.6	-3.0	-0.5
Cyclically-adjusted balance[1]	-3.6	-1.9	-2.7	-2.5	-1.2	-2.2	-2.2	1.5
Structural balance (SB)[2]	**-3.7**	**-1.8**	**-2.7**	**-2.7**	**-1.1**	**-2.1**	**-2.0**	**1.6**
Change in SB	*1.1*	*1.6*	*1.1*	*0.9*	*0.7*	*0.6*	*0.7*	-
Two year average change in SB	*1.1*	*1.4*	*1.1*	*1.0*	*1.2*	*0.9*	*0.8*	-
Structural primary balance[2]	-1.1	0.6	-0.4	-0.4	1.4	0.4	0.4	1.6
Change in structural primary balance		*1.4*	*0.9*	*0.8*	*0.8*	*0.8*	*0.7*	-

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance recalculated by Commission services on the basis of the macroeconomic scenario provided in the Draft Budgetary Plan, using the commonly agreed methodology.

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

Source:

Stability Programme (SP); Draft Budgetary Plan (DBP); Commission 2013 Autumn Forecast (COM); Commission staff calculations.

The authorities project the deficit to reach 3.6% of GDP in 2014 on the back of the measures outlined in the Draft Budgetary Plan. This is much higher than the 2.9% of GDP target contained in the Stability Programme but the Council recommendation of 21 June extended the deadline for correcting the excessive deficit by two additional years against one extra year assumed by the authorities in April. The difference comes solely from expected revenue developments (when correcting for the denominator effect on the ratio of public expenditure

to GDP). The weak level of tax receipts in 2013 relative to previous estimates makes up approximately 0.25% of GDP (base effect). In addition, new revenue measures will account for 0.15% of GDP against 0.3% planned at the time of the Stability Programme, a difference of 0.15% of GDP. Finally, the forecast for nominal GDP growth has been revised down to 2.3% from 3.0%, with the expected amount of tax receipts thus lower by some 0.3% of GDP[1]. On the expenditure side, the negative base effect from 2013 is 0.1% of GDP when correcting for the one-off extra contribution to the EU budget. This is fully offset by slower than previously projected expenditure growth next year; indeed, the latter is now projected at 1.9% in nominal terms (again when correcting for the exceptionally high 2013 contribution to the EU budget) versus 2.1% contained in the Stability Programme (which had not factored in the latter one-off), which entails a deficit reduction of 0.1% of GDP.

The Commission forecast projects a somewhat worse budgetary outlook for 2014 than does the draft budget, with the general government deficit expected at 3.8% of GDP. The main reason behind this is divergent spending projections. In particular, the authorities anticipate a sharp fall in public investment next year (-3.5% as against +3.5% expected for 2013), with local elections scheduled for March 2014. While these are highly likely to trigger a deceleration in local government investment, judging from previous electoral cycles, the Commission forecast is based on a more conservative assumption (-1.5% projected). Compensation of public sector employees is also expected to increase at a somewhat higher pace than what the Draft Budgetary Plan is built on. Overall, expenditure growth is projected to be 2.1%, higher than the 1.7% underpinning the Draft Budgetary Plan, a difference of 0.2% of GDP. In that respect, the High Council for Public Finances found that official spending projections were sensitive to wage and local spending developments. On the revenue side, the Commission forecast anticipates weaker private sector wage bill growth, the tax base for social contributions. In contrast, the Draft Budgetary Plan projects lower income and wealth tax receipts. On the whole, the expected absolute amount of revenue is broadly the same but slightly higher nominal GDP growth in the Commission forecast mechanically implies lower tax elasticity compared with the draft budget baseline (0.9 and 1, respectively).

There are both upside and downside risks to the expected budgetary outcome and to the underlying improvement in the structural balance. As far as 2013 concerned, specific fiscal risks pertain to sub-sectors of general government such as local authorities and state agencies for which in-year data reporting is incomplete. Also, it cannot be excluded that the government takes action to reduce ministerial expenditure by the end of the year, including through carrying over some spending into 2014. Regarding next year, possible revisions to the macroeconomic outlook, be they positive or negative, would likely affect the nominal balance. Specific risks to the fiscal outlook include insufficient detail and implementation risks for a number of measures contained in the Draft Budgetary Plan. In particular, the latter has to a large extent been amended by Parliament and the budgetary impact of some measures is difficult to quantify and/or to allocate to particular years (e.g. operating savings at ministerial and social security levels, fight against tax evasion and fraud). Moreover, the authorities on 29 October announced the suspension of a green tax on heavy goods vehicles, the so-called 'éco-taxe poids lourds', which was due to enter into force in January 2014 and expected to yield some 0.05% of GDP next year. This implies that shortfalls in tax receipts and overspending may eventually turn out larger than projected in the Commission forecast.

[1] The assumption for tax elasticity with respect to (nominal) GDP is unchanged at 1.

According to the Draft Budgetary Plan, the recalculated structural balance[2] will improve by 1.1% and 0.6% of GDP this year and next, respectively. This is 0.5 and 0.1 pp. lower than the targets contained in the Stability Programme (1.6% and 0.7%, respectively). The downward revision to the 2013 number is due to shortfalls in tax receipts (0.3% of GDP) and expenditure overruns (0.2% of GDP). According to the Commission forecast, the structural balance is projected to improve by 0.9% and 0.7% of GDP in 2013 and 2014, respectively.

3.2. Debt developments

The ratio of general government debt to GDP reached 90.2% in 2012. The April Stability Programme projected it to further increase in 2013-14 but with the rise markedly slowing down in 2014. The Draft Budgetary Plan depicts a very similar picture regarding this year's outturn, with the expected higher deficit (more than) offset by opposite revisions to stock-flow adjustments. In contrast, the debt ratio is set to deteriorate by close to 1 pp. in 2014 compared to April. This mainly reflects the projected higher headline deficit as well as downward revisions to (nominal) GDP growth.

Table 3. Debt developments

(% of GDP)	2012	2013			2014		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**90.2**	**93.6**	**93.4**	**93.5**	**94.3**	**95.1**	**95.3**
Change in the ratio	4.4	3.4	3.2	3.3	0.7	1.7	1.8
Contributions[2]:							
1. Primary balance	**2.3**	**1.3**	**1.8**	**1.8**	**0.4**	**1.1**	**1.4**
2. "Snow-ball" effect	**1.2**	**0.9**	**0.7**	**0.9**	**-0.2**	**0.9**	**0.1**
Of which:							
Interest expenditure	2.5	2.4	2.3	2.4	2.5	2.5	2.4
Growth effect	0.0	-0.1	-0.1	-0.2	-1.1	-0.8	-0.8
Inflation effect	-1.3	-1.4	-1.5	-1.3	-1.6	-0.8	-1.5
3. Stock-flow adjustment	**0.9**	**1.2**	**0.7**	**0.6**	**0.5**	**-0.2**	**0.3**
Of which:							
Cash/accruals difference		n.a.	n.a.		n.a.	n.a.	
Net accumulation of financial assets		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 effects.
Source:
Stability Programme (SP), Draft Budgetary Plan (DBP); Commission 2013 Autumn Forecast (COM); Commission staff calculations.

Official debt projections appear plausible in light of the Commission forecast. Beyond risks to deficit outcomes, stock-flow developments are subject to significant uncertainty. Indeed, the contribution of these to the increase in government debt has been revised down since the

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

Stability Programme and this is actually why the forecast for 2013 has been broadly unchanged (see above). However, no activation of existing guarantees or further financial rescue operations are expected to materialise. Insofar as general government debt exceeds 90% of GDP, any nominal GDP forecast error, be it positive or negative, would affect the debt ratio by roughly the same amount through the denominator effect.

3.3. Measures underpinning the Draft Budgetary Plan

The Draft Budgetary Plan contains a significant set of revenue measures, with an estimated budgetary impact of ½% of GDP in 2014. These include reducing the amount of tax rebates available to higher-income households based on their number of children, abolishing a number of tax expenditures, introducing a new levy on gross operating surplus and extra receipts to come from reinforced fight against tax evasion and fraud. Also, employee social contributions will be raised and a 10% bonus pensioners with three or more children receive on their pensions submitted to income tax as part of the government proposal for a pension reform. However, several measures have been abandoned since the draft budget was submitted to Parliament for discussion in early October. Specifically, the new levy on gross operating surplus has been replaced by a corporate tax surcharge for large companies more than doubled and tax benefits for education-related expenses will be maintained. Members of Parliament have also introduced a number of measures aimed at boosting household purchasing power. This will result in additional budgetary costs but due to legal constraints the latter need to be compensated for by additional receipts elsewhere.

Most of the measures contained in the Draft Budgetary Plan will only compensate for the expiry, in 2014, of a number of temporary income tax increases enacted by the authorities in 2013. Indeed, several corporate income tax measures adopted as part of the 2013 budget are expected to yield twice as much their estimated annual impact this year due to what can be seen as retroactivity effects. Similarly, abolishing the withholding tax on dividends and interest payments and instead charging these at standard, progressive personal income tax rates are set to temporarily boost receipts in 2013. Overall, the expiry of these temporary receipts will imply a reduction in tax receipts of 0.25% of GDP in 2014, an amount which is assumed in the Commission forecast to be a one-off effect. This assumption implies quite a different reading of structural balance developments in 2013-14 relative to the estimates contained in the Draft Budgetary Plan for those two years (see Section 4). Overall, the authorities project the tax burden to increase by 0.1 pp. only next year to 46.1% of GDP, with notably the one-off effect mentioned above partly offsetting the amount of measures outlined in the Draft Budgetary Plan.

The Draft Budgetary Plan aims at spending cuts of some EUR 15 billion or ¾% of GDP. These are split between central government and social security funds (EUR 9 and 6 billion, respectively) and mainly consist of maintaining a freeze on base wages, cutting operational costs including central government transfers to local authorities, healthcare expenditure savings, as well as new provisions on how annual pension increases are linked to inflation. However, the amount of savings contained in the Draft Budgetary Plan is assessed against a counterfactual scenario where general government expenditure increases substantially on the back of e.g. ageing, inflation developments and past trends regarding public sector wage bill growth. This is why spending will actually continue rising next year despite the announced savings. Moreover, a number of measures have not been fully specified. In particular, the planned reduction in operating costs of social security funds including the unemployment benefit system run by social partners lacks detailed explanation. Also, the EUR 1.5 billion cut in central government transfers to local authorities will not necessarily translate into a similar reduction in local spending insofar as local authorities have at the same time been entitled to temporarily raise stamp duties on the sale of immovable property in 2014-15. On the whole,

the Commission forecast for 2014 factors in a 0.1% of GDP overspending in relation to these risks.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by general government - revenue side

Components	Budgetary impact (% GDP)	
	2013	**2014**
Taxes on production and imports	0.3	0.4
Current taxes on income, wealth, etc.	0.8	-0.4
Capital taxes	0.1	0.0
Social contributions	0.3	0.1
Property income	0.0	0.0
Other (residual)	0.1	0.0
Total	1.5	0.1

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.
Source: Draft Budgetary Plan.

B. Discretionary measures taken by general government - expenditure side

Components	Budgetary impact (% GDP)	
	2013	**2014**
Compensation of employees	n.a.	n.a.
Intermediate consumption	n.a.	n.a.
Social payments	n.a.	n.a.
Subsidies	n.a.	n.a.
Gross fixed capital formation	n.a.	n.a.
Capital transfers	n.a.	n.a.
Other (residual)	n.a.	n.a.
Total	n.a.	n.a.

(1) Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.
Source: Draft Budgetary Plan.

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

The Draft Budgetary Plan projects the headline deficit to reach 4.1% and 3.6% of GDP this and next year, respectively. The deficit forecast for 2013 is above the 3.9% of GDP target set in the Council recommendation of 21 June while the projected outturn for 2014 is fully in line with the recommendation. The Commission forecast anticipates that the nominal deficit will turn out higher than recommended in both 2013 and 2014.

The Council considered that the recommendation was consistent with 1.3% and 0.8% of GDP improvements in the structural balance in 2013 and 2014. Based on the Commission forecast, the change in the structural balance is estimated at 0.9% and 0.7% of GDP, respectively. However, when correcting for revisions in potential GDP growth estimates and shortfalls in

tax receipts compared with the time the Council recommendation was issued, the structural effort comes in at 1.3% and 0.8% of GDP.

As far as this year's budgetary execution is concerned, the 0.2% of GDP slippage in spending compared to the Stability Programme had to a large extent been anticipated in the extended Commission 2013 Spring Forecast underlying the Council recommendation, implying that expenditure developments are broadly unchanged relative to what was expected at the time of the Council recommendation. In contrast, the latest outturn data point to significant revenue shortfalls compared to spring. These may stem from lower tax richness of economic activity but also from the budgetary impact of discretionary measures being overestimated initially. In particular, shortfalls in corporate income tax receipts may be partly due to measures yielding less than initial estimates made under questionable behavioural assumptions. However, no major revisions to the expected budgetary impact of those measures have been made so far, with the authorities arguing this would require that full-year data for 2013 are available. In this respect, the Commission spring forecast had already factored in a shortfall of 0.1% of GDP relative to official estimates. A similar assumption underpins the autumn forecast numbers but it cannot be excluded that the gap between official estimates and outturn is actually larger.

Box 2. Council recommendations addressed to France

On 21 June 2013, the Council recommended France under Art. 126(7) of the Treaty to correct its excessive deficit by 2015. To this end, France should (1) put an end to the present excessive deficit situation by 2015; (2) 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% of GDP in 2013, 0.8% in 2014 and 0.8% in 2015, based on the extended Commission services 2013 spring forecast; (3) 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.

On 9 July 2013, the Council also 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 and pursue the budgetary strategy in 2013. Enhance the credibility of the adjustment by specifying, by autumn 2013, and implementing the necessary measures for the year 2014 and beyond to ensure a correction of the excessive deficit in a sustainable manner by 2015 at the latest and the achievement of the structural adjustment effort specified in the Council recommendations under the EDP. Use all windfall gains for deficit reduction. 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. Maintain a growth friendly fiscal consolidation course and further increase the efficiency of public expenditure, in particular by proceeding as planned with a review of spending categories across all sub sectors of general government. Take action through the forthcoming Decentralisation Law to achieve better synergies and savings between central and local government levels. After the correction of the excessive deficit, pursue the structural adjustment effort at an adequate pace so as to reach the MTO by 2016. Take measures by the end of 2013 to bring the pension system into balance in a sustainable manner no later than 2020, for example by adapting indexation rules, by increasing the full pension contribution

period, by further increasing the effective retirement age, by aligning the retirement age or pension benefits to changes in life expectancy and by reviewing special schemes, while avoiding an increase in employers' social contributions, and increase the cost effectiveness of healthcare expenditure, including in the areas of pharmaceutical spending.

The corrected structural effort for 2014 also appears just in line with the Council recommendation. However, the composition of fiscal tightening underlying the Commission forecast is somewhat at odds with that outlined in the Draft Budgetary Plan. Indeed, the latter aims at spending cuts accounting for 80% of total adjustment while the Commission forecast projects that savings will make up less than half of this. One reason for this is the 0.2% of GDP overspending the Commission forecast is built on. Divergent potential GDP growth estimates add to that difference insofar as the contribution of expenditure to the structural effort takes potential GDP growth as a reference value. A divergent treatment of one-off measures is yet another factor. Specifically, as already mentioned, the Commission forecast considers the 0.25% of GDP of temporary increase in tax receipts that will expire in 2014 as one-off measures; the Draft Budgetary Plan provides for permanent tax hikes to replace these. This will not affect the overall tax burden but based on the Commission methodology the structural balance will improve only in 2014 (in the authorities' scenario, the 2013 extra receipts were not considered as one-offs and thus contributed to improving the structural deficit already in 2013). All things being equal this implies a lower structural adjustment in the Commission forecast in 2013 than what the Draft Budgetary Plan is built on but a higher one in 2014.

The assessment based on the forecast (corrected) improvements in the structural balance in 2013-14 is complemented by a bottom-up assessment which estimates the size of the fiscal effort in those years on the basis of the additional discretionary revenue measures and the expenditure developments under the control of the government between the baseline scenario underpinning the Council recommendation of 21 June and the Commission forecast. As far as 2013 is concerned, the Council recommendation did not call for additional measures beyond those already adopted (1½% of GDP) and which were included in the baseline scenario underpinning the Council recommendation. The additional fiscal effort compared to this baseline scenario is slightly negative (-0.1% of GDP), which suggests that the overall size of measures implemented by the authorities in 2013 is somewhat below the amount referred to by the Council. Regarding 2014, the fiscal effort as described above adds up to 0.9% of GDP. Specifically, the Draft Budgetary Plan contains a significant set of discretionary revenue measures (see Section 3.3 for a detailed description of measures), which together with revisions to the budgetary impact of previously adopted measures make up 0.6% of GDP in 2014 (excluding one-offs). The additional effort on the expenditure side compared with the baseline scenario underpinning the Council recommendation is estimated at some 0.3% of GDP. 0.2% of GDP is explained by the measures contained in the Draft Budgetary Plan among which a freeze on base wages for the fourth consecutive year, cuts in operational costs, healthcare expenditure savings as well as new provisions on how annual pension increases are linked to inflation, partly offset by additional costs linked to a second 'investissements d'avenir' programme being launched and some targeted wage increases. The remaining revision to projected expenditure growth is due to a slower increase in spending items under the control of the government compared with the baseline scenario, notably relating to local government gross fixed capital formation. The fiscal effort for 2014 thus obtained falls slightly short of the amount of measures of 'above 1% of GDP' deemed necessary to reach the structural target set out in the Council recommendation.

On this basis, France can be considered to have met the targets included in the Council recommendation of 21 June 2013. However, as already mentioned, the amount of discretionary revenue measures is a particular area of uncertainty in the Commission deficit forecast for 2013. In addition, most risks to the headline deficit targets for 2013 and 2014 identified in Section 3.1 also apply to the planned improvements in the structural balance. A bottom-up assessment provides another indication of the uncertainties surrounding both this year's budgetary execution and the outlook for 2014. Regarding 2015, the Draft Budgetary Plan projects the deficit to reach 2.8% of GDP, in line with the Council recommendation of 21 June. It includes the targets for general government expenditure and tax revenue and provides information on the nature of the measures envisaged for achieving this target. Specifically, the projected improvement in the structural balance is planned to come from savings within central government and social security funds but also from a further cut in central government grants to local authorities and state agencies. However, the Commission forecast projects the deficit to reach 3.7% of GDP in 2015 under the customary no policy change assumption, implying that a significant set of measures on top of those already specified will be needed to ensure that the target for 2015 is reached.

5. ANALYSIS OF THE ECONOMIC PARTNERSHIP PROGRAMME

The Economic Partnership Programme outlines the policy measures and structural reforms already adopted or planned to support an effective and lasting correction of the excessive deficit. In line with the Council recommendation of 9 July 2013 addressed to France in the context of the European Semester, and in particular in the context of the Macroeconomic Imbalance Procedure, the government's economic strategy is to underpin fiscal consolidation efforts with structural reforms aimed at increasing France's growth potential, notably by tackling the competitiveness challenge and improving the functioning of the labour market. The report focuses on measures which, with very few exceptions, either have already been implemented or are in the process of adoption. The Economic Partnership Programme provides limited information on the policy strategy of the government for the period up to 2015, which is the deadline to correct the excessive deficit situation. Also, with the exception of the planned pension reform, the document provides little information on the expected budgetary impact of the structural reform measures in the fiscal area. The Economic Partnership Programme does not include a table on fiscal-structural reforms following the template laid down in the Two Pack Code of Conduct although the related information is presented. The optional quantitative assessment of the impact of structural reforms recommended by the Code of Conduct is not provided either.

The government's fiscal strategy is based on four pillars: improved governance, a pension reform, improved efficiency of public expenditure and a reform of the tax system. Regarding the governance of public finances, the High Council for Public Finances was created in December 2012 following the adoption of the Treaty on Stability, Coordination and Governance. This institution provides an opinion on the macroeconomic scenario underpinning draft budgets and stability programmes and on the consistency of annual fiscal targets with the multi-annual budgetary strategy and contributes to increasing the credibility of fiscal policy (see Box 1).

In order to improve the long-term sustainability of public finances, the Economic Partnership Programme expands on the government draft law to reform the pay-as-you-go pension system unveiled on 18 September 2013 (see Box 3). Up to 2020 the correction of the pension system deficit will mainly rely on additional tax receipts. From 2020, the minimum number of years an employee must pay into the system before qualifying for a full pension will increase by one quarter every three years to reach 43 years by 2035. While the planned measures will help

reduce the deficit of the pension system by 2020-40, they will not suffice to eliminate it. In particular, the reform will only halve the system's total gap to some 0.5% of GDP by 2020 when adding the projected deficit of supplementary plans. In addition, the size of the adjustment is subject to significant risks as the underlying macroeconomic scenario could prove overly optimistic based on current economic developments but also when compared with the macroeconomic assumptions of the 2012 Ageing Report. Furthermore, no review of public sector worker schemes has been conducted although such a measure was advocated by the Council. Finally, the budgetary cost of measures to better take strenuous activities into account is subject to significant uncertainty and is yet another risk to the long-term financial position of the pension system.

Box 3. Presentation of the government proposal for a pension reform

On 18 September 2013 the government introduced a draft law to reform the pay-as-you-go pension system, with a pre-reform deficit projected to reach some 1% of GDP by 2020. The objective for the reform is to bring a number of pension schemes to balance by 2020 and until 2040, including the main private sector worker scheme. The measures will primarily affect first-tier, state-controlled pension schemes, known as 'régimes de base', which cover both public sector and private sector workers. Supplementary, second-tier pension plans for private sector workers, run by social partners and known as 'régimes complémentaires', will also be affected since their rules are partly aligned with those of the former.

Until 2020 additional revenues will account for the bulk of the adjustment. Based on estimates from the authorities, tax hikes will represent around 0.3% of GDP by that horizon. Employer and employee contributions to the system will both increase by 0.15% in 2014 and by 0.05% in each of the following three years. However, the government has announced that the increase in employer contributions will be offset through a decrease in family contributions – as part of an upcoming reform of welfare funding – in order to keep the tax burden on businesses unchanged in 2014 and to decrease it in the following years. In addition, a 10% bonus pensioners with three or more children receive on their pensions will now be submitted to income tax. In addition to revenue measures, the reform proposal will move the month for adjusting pensions for inflation from April to October, with initial savings expected to amount to some EUR 0.8 billion in 2014 and rising to EUR 1.9 billion (0.1% of GDP) by the end of the decade.

Measures to increase the effective retirement age will start from 2020. The minimum number of years an employee must pay into the system before she/he qualifies for a full pension will rise to 43 years by 2035 from 41¾ in 2020, thus building on previous reforms which have provided for an increase in the pay-in period until 2020. This will yield an expected 0.2 and 0.3% of GDP by 2030 and 2040, respectively. This is lower than the 1% of GDP savings targeted by 2020 by the 2010 reform, reflecting the relative speed and size of measures (a two-year increase in the minimum retirement age spread over 2011-17 versus a five-quarter lengthening of the pay-in period spread over 2020-35).

A steering committee will be created with the aim to revise the pension system annually and make recommendations to the government if a shortfall in contributions caused by slow growth or a rise in unemployment needed addressing, based on a yearly assessment of indicators provided by the Pensions Advisory Council ('Conseil d'orientation des retraites' or COR). The government will then consult social partners and possibly take or submit to Parliament corrective measures.

The reform proposal contains also a number of measures to better take strenuous activities into account and improve women's pensions. A hardship pension will be introduced from

2015 to help the estimated 20% of private sector employees who have worked under tough conditions, such as night work. The cost of this will gradually increase over time to reach an estimated 0.1% of GDP by 2030-40. There will also be measures to improve the equality of pensions between women and men, with notably maternity leaves and very part-time jobs better factored in the pay-in period. Finally, farmer pensions will be increased and apprenticeship contracts will count fully as periods worked.

Overall, the proposed measures will partly address the Council recommendations under the European Semester, but will not be sufficient to ensure the long-term sustainability of the pension system. While the reform will lead to an increase in the effective retirement age and reduce significantly the system's deficit by 2020-40, it will not suffice to eliminate it. In particular, schemes for state government officials and employees working in a number of state-controlled companies will need additional funding (on top of the reform) to cover the cost of pension payments. This is estimated at around 0.3-0.4% of GDP by 2020 in the reform proposal. In this respect, any review of the scope and specific rules of public sector worker schemes has been abandoned. Overall, the proposed measures will only halve the system's total gap to some 0.5% of GDP by that horizon when adding the projected deficit of supplementary plans (0.2% of GDP by 2020). Moreover, the outlook could be worse should the macroeconomic scenario underpinning the reform prove overestimated, which seems plausible based on current economic developments but also when compared with the macroeconomic assumptions of the 2012 Ageing Report. Substantial expenditure savings will materialise only in the long term while tax hikes will be effective from next year. It remains to be seen to what extent the newly created steering committee will be effective in addressing possible deviations from the baseline scenario.

To increase the efficiency of expenditure, and in line with the Council country-specific recommendations, the government has launched a spending review ('modernisation de l'action publique' or MAP), which looks at the various domains of intervention of the general government. While a number of public policy assessments have been finalised and have translated into specific proposals, such as streamlining support schemes for businesses and reforming vocational training, the expected savings are not systematically quantified. In addition, part of the measures announced so far consist in limiting and/or abolishing tax and social security exemptions, which will actually raise the tax burden rather than lower expenditure. More generally, it remains unclear to what extent the on-going spending review will indeed result in major reforms of government policies, coverage of activities by the public sector and delivery modes of public services. In that respect, the RGPP, the predecessor of the MAP, delivered only partial results and was confined to merging ministerial departments, rationalising central government administration at local level and sharing support services that cut across all ministries. The government has also initiated a decentralisation reform aimed at clarifying the responsibilities of local and central government in order to increase the efficiency of local government expenditure. The first draft law on decentralisation, currently being discussed in Parliament, creates a new layer of local government, the metropolitan areas. The adoption of two additional legislative texts on decentralisation is foreseen by the end of 2014. It is unclear at this stage whether this process will indeed meet its objective to increase the efficiency of local government expenditure and the expected savings have, here again, not been quantified. Beyond the significant amount of savings targeted for 2014, little information is available on measures to improve the cost-effectiveness of healthcare spending in the medium to long run, including in the area of pharmaceuticals, in view of the projected increase in this spending.

In line with the Council country-specific recommendations, the government has pursued efforts to simplify the tax system and increase its efficiency. In particular, the government has continued to review and selectively abolish tax expenditures on personal and corporate income tax. In particular, the cap on corporate interest deduction will be lowered further in 2014, a measure decided in the budget for 2013. On the other hand, the proposed increase in a corporate tax surcharge for large companies (see Section 3.3) will result in a de facto higher statutory rate for the companies concerned, contrary to the Council recommendation for reducing statutory rates while broadening the tax base. Besides the change in VAT rates decided in 2012 and which will be effective in January 2014, no further effort has been made to bring reduced rates closer to the standard rate. Regarding the recommendation by the Council to shift the tax burden away from labour, beyond the implementation of the tax rebate for competitiveness and employment adopted in December 2012, the government is committed to maintaining the cost of labour unchanged in 2014 before reducing it in subsequent years but details have not been provided so far. Furthermore, the efforts presented in the Economic Partnership Programme to increase environmental taxation appear at odds with the announcement by the government on 29 October that a tax on heavy goods vehicles will be suspended (see Section 3.1). Indeed, the latter, which was due to enter into force in January 2014, was expected to yield significantly more in 2014 than the measures included in the Economic Partnership Programme.

Besides reforms with a direct bearing on public finances, the Economic Partnership Programme also provides an update on other areas covered by the Council recommendation of 9 July. Most of these were known at the time of the Council recommendation. To improve the business environment, the government has launched a process to simplify interactions between the administration and companies. In the area of services, no reform seems to have been envisaged so far with respect to an easing of regulations in retail. Similarly, no horizontal reform has been initiated to remove unjustified restrictions in regulated sectors and professions although some targeted measures have been announced to increase competition in some regulated sectors (e.g. notaries, accountants). The announced reform of the railway system, which seeks to improve the overall efficiency by notably grouping the infrastructure manager and the network operator (SNCF) within a single entity, does not provide for the opening of domestic passenger transportation to competition as called for in the Council country-specific recommendations. Moreover, it remains to be seen whether the infrastructure manager is sufficiently independent to ensure fair and non-discriminatory access to all operators. Measures to support access to finance for innovative companies and to help exporting firms have also been taken. In particular, a second 'investissements d'avenir' programme has been launched representing EUR 12 billion between 2014 and 2024. No additional measure to fight unemployment has been announced since the Council recommendation was adopted. The actual impact of the law on securing employment adopted in June 2013 will only be seen over time. Additional reforms on lifelong learning and on apprenticeship have been announced although limited details are available. In the short term, the number of subsidised employment will increase thanks to the implementation of the 'jobs of the future' programme by 100 000 in 2013 and by an additional 50 000 in 2014. By contrast, the negotiation between social partners on the unemployment benefit system, which was supposed to take place by the end of 2013, has been postponed to 2014.

6. SUMMARY

Based on the Commission forecast, the headline deficit is expected to reach 4.1% of GDP in 2013 and 3.8% of GDP in 2014. This is higher than the levels recommended by the Council on 21 June 2013 (3.9% and 3.6% of GDP, respectively). However, the underlying improvements in the structural balance corrected for revisions in potential GDP growth and shortfalls in tax receipts appear in line with the Council recommendation. The analysis based on the forecast (corrected) improvements in the structural balance in 2013-14 is complemented by a bottom-up analysis which estimates the size of the fiscal effort in those years on the basis of the additional discretionary revenue measures and the expenditure developments under the control of the government between the baseline scenario underpinning the Council recommendation and the Commission forecast. The fiscal effort thus obtained falls in both years slightly short of the amount of measures deemed necessary to reach the structural targets set out in the recommendation, which is an indication of the uncertainties surrounding the fiscal outlook.

ANNEX. EDP RELATED TABLES

Table A1. Baseline scenario underlying the EDP recommendation

% of GDP	2013	2014	2015
Revenues	53.3	52.9	52.6
Current revenues	52.9	52.6	52.2
Discretionary measures with impact on current revenue	1.3	-0.4	-0.1
Expenditure	57.2	57.2	56.4
Real GDP growth (%)	-0.1	1.1	1.9
Nominal GDP growth (%)	1.3	2.8	3.6
Potential GDP growth (%)	0.9	1.0	1.1
Structural balance	-2.2	-2.3	-2.3
General government balance	-3.9	-4.2	-3.9
p.m CAB methodology revenue elasticity	0.9	0.9	0.9
p.m Apparent revenue elasticity	1.2	1.0	0.9
p.m Output gap (% of pot. Output)	-3.4	-3.3	-2.6

Source: Commission Staff Working Document accompanying the document Recommendation for a Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in France*, SWD(2013) 384 final.*

Table A2. EDP scenario underlying the EDP recommendation

% of GDP	2013	2014	2015
Real GDP growth (%)	-0.1	0.6	1.1
Potential GDP growth (%)	0.9	0.9	0.9
Structural balance	-2.2	-1.5	-0.7
General government balance	-3.9	-3.6	-2.8
p.m Output gap (% of pot. output)	-3.4	-3.7	-3.5

Source: Commission Staff Working Document accompanying the document Recommendation for a Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in France*, SWD(2013) 384 final.*

Table A3. Current estimates of the macroeconomic and fiscal developments

% of GDP	2013	2014	2015
Revenues	52.9	53.0	52.9
Current revenues	52.5	52.6	52.5
Discretionary measures with impact on current revenue	1.3	0.1	0.0
Expenditure	57.0	56.8	56.6
Real GDP growth (%)	0.2	0.9	1.7
Nominal GDP growth (%)	1.7	2.5	3.2
Potential GDP growth (%)	1.0	1.0	1.0
Structural balance	-2.7	-2.0	-2.4
General government balance	-4.1	-3.8	-3.7
p.m CAB methodology revenue elasticity	0.9	0.9	0.9
p.m Apparent revenue elasticity	0.7	1.0	1.0
p.m Output gap (% of pot. Output)	-2.9	-3.0	-2.3

Source: Commission 2013 Autumn Forecast.

Table A4. Adjustment of apparent structural effort for the revision in potential growth – details of calculation

	Potential GDP growth underlying the Council Recommendation (%)	Potential GDP growth at the time of assessment (%)	Forecast error (%)	Structural expenditure (% of potential GDP)	Correction coefficient α (% of nominal potential GDP)
	(1)	(2)	(3)=(1)-(2)	(4)	(5)=(3)*(4)/100
2013	0.9	1.0	0.0	54.1	0.0
2014	1.0	1.0	0.0	53.7	0.0
2015	1.1	1.0	0.1	53.4	0.1

Source: Commission Staff Working Document accompanying the document Recommendation for a Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in France, *SWD(2013) 384 final; Commission 2013 Autumn Forecast; Commission staff calculations.*

Table A5. Adjustment of apparent structural effort for the unexpected revenue windfalls/shortfalls – details of calculation

	Change in current revenues (yoy) (billions of national currency)		Discretionary current revenue measures (billions of national currency)		Nominal GDP growth assumptions (%)		Current revenues in year t-1 (billions of national currency)		Revenue gap (billions of national currency)*	Correction coefficient β (% of nominal potential GDP)
	2013 EDP	2013 AF	2013 EDP	2013 AF	2013 EDP	2013 AF	2013 EDP	2013 AF	(5)=[(1')-(2')-ε*(3')*(4')]-[(1)-(2)-ε*(3)*(4)]	
	(1)	(1')	(2)	(2')	(3)	(3')	(4)	(4')		
2013	43.6	39.2	27.4	27.3	1.3	1.7	1045.7	1045.7	-7.6	-0.4
2014	23.6	29.7	-8.2	2.9	2.8	2.5	1089.3	1084.9	-2.5	-0.1
2015	35.2	34.5	0.0	0.0	3.6	3.2	1112.9	1114.6	2.7	0.1

* Revenue elasticity ε = 0.89.

Source: Commission Staff Working Document accompanying the document Recommendation for a Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in France, *SWD(2013) 384 final (2013 EDP); Commission 2013 Autumn Forecast (2013 AF); Commission staff calculations.*