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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels,
SEC(2008) 1942/3

COMMISSION RECOMMENDATION

Providing a policy advice on the economic and budgetary policy in France

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THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular Article 211 thereof,

Whereas:

(1) Member States of the European Union are encouraged to adopt structural reforms to strengthen their growth potential following the Lisbon Agenda while respecting the requirements of the Stability and Growth Pact.

(2) According to Article 99 of the Treaty, Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council.

(3) The Stability and Growth Pact is based on the principle of sound government finances - through the avoidance of excessive government deficits and the achievement of a medium-term budgetary objective of close to balance or in surplus -_as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation, an essential part of the macroeconomic framework of the Economic and Monetary Union.

(4) The ECOFIN report of 20 March 2005 to the European Council on 'Improving the implementation of the Stability and Growth Pact', endorsed by the European Council in its conclusions of 22 March 2005, provides that "the Commission will issue policy advice to encourage Member States to stick to their adjustment path [towards the medium term budgetary objective (MTO)]". The so-called Code of Conduct[1] further specifies that the Commission policy advice shall be given in accordance with Article 211, second indent, of the Treaty and that it shall be made public.

(5) Between 1996 and 2005, annual real GDP in France grew by around 2¼ % on average. This was broadly in line with average growth in the euro area, while inflation was marginally below the euro area average. Since 2006, GDP growth in France has fallen below the euro area average, with evidence of structural problems and a related deterioration in competitiveness. Although the unemployment rate has improved since 2005, it remains well above the euro area average, and the employment rate and the hours worked are still low. In addition, despite steps taken to curb spending, notably in social security, France has an expenditure-to-GDP ratio at around 52½% of GDP, which is the highest in the euro area. Its debt ratio, which was below 40% when the Maastricht Treaty was signed, is now around 64% of GDP. In this context, the Government formed after the May 2007 presidential elections announced in July 2007 wide-ranging labour and product market reforms over the five-year presidential mandate, with a view to increasing potential growth and competitiveness and improving the long-term sustainability of public finances.

[1] "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005.

(6) In a macroeconomic environment characterised by large uncertainties in the wake of the financial turmoil of autumn 2007, high inflationary pressures and some tightening of financial conditions, the Commission services' 2008 spring forecast projects real GDP growth to decelerate to 1.6% in 2008 (after 1.9% in 2007) and remain weak in 2009, despite the impact of measures adopted in August 2007 and February 2008 (*inter alia* to support purchasing power). Growth is expected to continue to be largely driven by domestic demand, with net exports providing a negative contribution, albeit less than in previous years. New information released since the cut-off date of the spring forecast (15 April), in particular INSEE's first estimate of annual GDP growth in 2007 of 2.2%, reflecting an upward revision of growth for the first half of 2007 and a small downward revision for the second half, and of quarter-on-quarter GDP growth in Q1 2008 at 0.6 %, would not significantly alter the Commission services' growth scenario for 2008 and 2009.

(7) Against the background of this scenario and following the notification of a deficit outcome of 2.7% of GDP in 2007[2] (against a target of 2.4% of GDP and up from 2.4% of GDP in 2006), the Commission services' 2008 spring forecast expects the general government deficit to increase to 2.9% of GDP in 2008. The deficit forecast for 2009 is 3% of GDP, under the conventional assumption of unchanged policies (i.e. also excluding the impact of announced, but not yet adopted, measures). As regards the structural balance (i.e. cyclically adjusted and net of one-off and other temporary measures), there was no improvement in 2007 and progress appears to be very limited in the period 2008-2009 and in any case below the recommended benchmark adjustment of 0.5% of GDP. The debt ratio is expected to rise marginally in 2008, and increase more significantly in 2009. This assessment remains broadly unchanged in the light of the new information detailed above. In their April forecast, the French authorities project a deficit of 2.5% in 2008 and 2.0% in 2009. A comparison of the key macroeconomic and budgetary projections is presented in the table in Annex.

(8) The Council, in its opinion of 12 February 2008 on the most recent update of the stability programme of France covering the period 2007 to 2012[3] (submitted to the Commission and the Council on 30 November 2007), remarked, among other things, that "France's plans to implement reforms to increase potential growth, improve the competitiveness of the French economy and help sustain the budgetary consolidation process as well as to forcefully restrain expenditure at all levels of government and improve its efficiency would contribute to meeting the key challenges for the coming years". At the same time, it concluded that "the pace of budgetary consolidation and debt reduction had slowed down in 2007 and is significantly less ambitious in the coming years than planned in the previous update of the stability programme, especially as concerns 2008", that "the achievement of the medium-term objective through an expenditure-based adjustment is postponed from 2010 to 2012" and that "even this adjustment path is subject to important risks". Finally, it remarked that "in view of the debt and deficit levels and the projected increase in age-related expenditure, France appears to be at medium risk with regard to sustainability of public finances". It therefore invited France to: "(i) strengthen the pace of budgetary consolidation and debt reduction, including through a rigorous implementation of the 2008 budget, so as to ensure that the safety margin against breaching the 3 % deficit threshold is attained more rapidly and - cyclical conditions permitting - aim to reach

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2 See Eurostat News Release No 54/2008 of 18 April 2008.
3 OJ C 49, 22.2.2008, p. 34.

the MTO by 2010, in order to decisively contribute to the improvement of the long-term sustainability of public finances; (ii) effectively enforce existing expenditure rules and take further steps in order to guarantee the respect of the ambitious multi-annual expenditure reduction targets of the general government by all sub-sectors, thus leading to a reduction in the expenditure to GDP ratio; and (iii) continue and accelerate structural reforms, so as to increase potential growth and curb public expenditure".

(9) In its country-specific recommendations in the context of the 2008 update of the integrated guidelines under the Lisbon strategy[4], the Council, on 4 March 2008, recommended that France ensure the sustainability of public finances, taking into account the ageing of the population, by strengthening the pace of budgetary consolidation and debt reduction, and - cyclical conditions permitting - aim to reach the medium-term objective by 2010. It also recommended that the negotiation on pension systems scheduled for 2008 build on the important gains made following the introduction of the 2003 reform. In addition, the Council recommended progress in product and labour markets, by strengthening competition in network industries and enhancing life-long learning and modernising employment protection within an integrated flexicurity approach.

(10) In June 2007, the new Government launched the General Review of Public Policies (aimed at carrying out an exhaustive audit of public missions in view of a major rationalisation of the administration and greater efficiency in the provision of state services). In July 2007, the authorities took corrective measures to reduce the breach in the national health insurance spending objective (*ONDAM*), after the detection of slippages by the so-called 'Alert Committee'. First structural measures such as the minimum service bill (to help ensure continuity of public services during strikes) and the university reform (to promote university autonomy and increase financial links with private companies or foundations) were adopted in August, followed by a fiscal package (mainly involving tax cuts) aimed at supporting growth and purchasing power, with a deficit-increasing impact on the budget chiefly in 2008. In autumn 2007, an agreement was reached with the social partners to increase the convergence of the "special pension regimes" towards the general regime. Finally, a reform of the *Crédit Impôt Recherche* increasing incentives for corporate research was adopted in the Finance Act for 2008.

(11) As regards the labour market, significant policy initiatives are underway aiming to establish an integrated flexicurity approach: a first agreement among the social partners was stipulated on 11 January 2008, allowing the possibility of additional types of contract on top of the existing ones; it was converted in draft law by the Government ("*Loi de modernisation du marché du travail"*) and is expected to be adopted by Parliament shortly. Moreover, the law on merging the *UNEDIC* (unemployment benefit agency) and *ANPE* (the employment placement agency) with a view to achieving efficiency gains was adopted on 13 February 2008. More recently, after the "*Loi pour le développement de la concurrence en faveur des consommateurs*" of 3 January 2008, the Government adopted a draft law on the modernisation of the French economy ("*Loi de modernisation de l'économie*") aimed at fostering competition in product and service markets, notably by promoting individual entrepreneurship and loosening existing constraints in the retail sector. The provisions of this law are assumed by the authorities to produce effects very rapidly, raising real

[4] Available at http://register.consilium.europa.eu/pdf/en/08/st07/st07275.en08.pdf

GDP growth by 0.3 pp and creating 50.000 jobs already in 2009. Other reforms in the pipeline include notably increasing the cost-effectiveness of the health insurance system, the review of the pension system (as foreseen in the 2003 pension reform), with a view to strengthening its long-term sustainability, and launching the General Review of Taxation, along the model of the ongoing General Review of Public Policies.

(12) Potential growth could be boosted by the announced and adopted structural reforms, but many are at an early state of implementation or still under discussion and the possible impact on growth may only materialise in the medium term. The lack of improvement in public finances, as projected by the Commission services, combined with the softening of growth conditions, does not only imply the absence of room of manoeuvre with respect to the 3% of GDP reference threshold, but also hampers the continuation of the reduction of the debt ratio. The debt ratio, which increased substantially since the early nineties, is a burden on current and future generations and limits the possibility to devote public spending to growth- and welfare-enhancing purposes. This highlights the need for the ongoing structural reform process to go hand in hand with the necessary consolidation of public finances. Therefore, it will be important to strengthen the pace of budgetary consolidation and debt reduction, in particular by implementing measures to enhance control and efficiency of expenditure and by continuing reform and rationalisation of the social security system, in particular health care.

(13) This should provide the framework for sustained growth, which would be further supported by the planned structural measures. Such measures would help increase the potential output of the French economy, support the creation of employment and contribute to sustainable public finances.

HEREBY RECOMMENDS FRANCE :

(1) to pursue with determination the ongoing structural reform process aimed at increasing France's growth potential and competitiveness, including through the implementation of the provisions of the draft law on the modernisation of the economy ("*Loi de modernisation de l'économie*") and of the draft law on the modernisation of the labour market ("*Loi de modernisation du marché du travail"*);

(2) to carry out the necessary consolidation of public finances in order to support the reform process, *inter alia* through an ambitious implementation of the recommendations of the General Review of Public Policies, further reform of the health insurance and the review of the pension system (as foreseen in the 2003 pension reform);

(3) to implement rigorously the policy invitations of the Council issued on 12 February 2008 on the updated stability programme of France for the period 2007 to 2012.

This Recommendation is addressed to the French Republic.

Done at Brussels, 28 May 2008

For the Commission
Joaquin ALMUNIA
Member of the Commission

Annex: comparison of key macroeconomic and budgetary projections

		2006	2007	2008	2009	Average 1996-2005[9]
Real GDP (% change)	**MoF April 2008[1]**	**2.0**	**1.9**	**1.7-2.0**	**1¾-2¼**	**2.2**
	COM Apr 2008	2.0	1.9	1.6	1.4	
	SP Nov 2007	*2.0*	*2 - 2.5*	*2 - 2.5*	*2.5*	
HICP inflation (%)	**MoF April 2008[2]**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**1.7**
	COM Apr 2008	1.9	1.6	3.0	2.0	
	SP Nov 2007	*1.9*	*1.4*	*1.7*	*1.6*	
Output gap (% of potential GDP)	COM Apr 2008[4]	0.1	-0.2	-0.5	-0.8	**0.1**
	SP Nov 2007[3]	*-0.5*	*-0.8*	*-0.8*	*-0.6*	
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	COM Apr 2008	-2.1	-3.0	-3.6	-3.4	**0.9**
	SP Nov 2007	*-2.1*	*-2.3*	*-2.5*	*-2.3*	
Employment (y-on-y % change)	COM Apr 2008	*0.7*	*1.2*	*0.6*	*0.3*	**1.0**
	SP Nov 2007	*0.7*	*1.1*	*1.1*	*0.8*	
Unemployment (as % of civilian labour force)	COM Apr 2008	*9.2*	*8.3*	*8.0*	*8.1*	**9.8**
	SP Nov 2007	*n.a.*	*n.a.*	*n.a.*	*n.a.*	
Export market performance (% change)	**MoF April 2008[8]**	**n.a.**	**n.a.**	**-1.4**	**-1.0**	**-1.1**
	COM Apr 2008	-2.4	-1.9	-2.3	-2.0	
	SP Nov 2007[8]	*n.a.*	*-1.1*	*-0.7*	*0.3*	
Total expenditure, general government (as % of GDP)	**MoF April 2008**	**52.7**	**52.6**	**52.3**	**51.8**	**52.9**
	COM Apr 2008	52.7	52.6	52.5	52.5	
	SP Nov 2007	*52.7*	*53.2*	*52.6*	*51.9*	
General government balance (% of GDP)	**MoF April 2008**	**-2.4**	**-2.7**	**-2.5**	**-2.0**	**-2.8**
	COM Apr 2008	-2.4	-2.7	-2.9	-3.0	
	SP Nov 2007	*-2.5*	*-2.4*	*-2.3*	*-1.7*	
Primary balance (% of GDP)	COM Apr 2008	0.2	0.1	-0.1	-0.3	**0.2**
	SP Nov 2007	*0.0*	*0.2*	*0.5*	*0.9*	
Cyclically-adjusted balance[6] (% of GDP)	COM Apr 2008	-2.4	-2.6	-2.7	-2.6	**-2.9**
	SP Nov 2007[3]	*-2.3*	*-2.0*	*-1.9*	*-1.4*	
Structural balance[5,6] (% of GDP)	COM Apr 2008	-2.7	-2.7	-2.8	-2.6	**n.a.**
	SP Nov 2007	*-2.5*	*-2.0*	*-1.9*	*-1.4*	
Government gross debt (% of GDP)	**MoF April 2008**	**63.6**	**64.2**	**64.0**	**63.2**	**57.6[10]**
	COM Apr 2008	63.6	64.2	64.4	65.1	
	SP Nov 2007	*64.2*	*64.2*	*64.0*	*63.2*	

Notes:

[1] Table reports figures from MoF only where available (i.e. real GDP, inflation, government total expenditure, government budget balance, government gross debt)

[2] The latest figures from the MoF only refer to CPI inflation: after 1.6% in 2006 and 1.5% in 2007, the forecast is 2.2% in 2008 and 1.6% in 2009. COM forecast figures for CPI inflation are 2.8% and 1.9% for the period 2008-2009.

[3] Output gaps and cyclically-adjusted balances according to the programme as recalculated by Commission services on the basis of the information in the programme.

[4] Based on estimated potential growth of 1.9%, 2.1%, 1.9% and 1.7%, respectively, in the period 2006-2009.

[5] Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.1% of GDP in 2006 and 0 for the rest of the period covered (2007-2012) according to the stability programme. According to the Commission services' spring forecast they are 0.3% of GDP in 2006, 0.05% of GDP in 2007 and 0.1% of GDP in 2008.

[6] According to the information contained in MoF, the annual change over the period 2006-2009 in the cyclically adjusted balance is as follows: 0.6%, -0.2%, 0.3%, 0.6% of GDP, while the annual change in the structural balance is as follows: 1.0%, -0.1%, 0.3%, 0.6% of GDP.

[7] On 15 May INSEE released new annual accounts figures: real GDP growth was 2.2% in both 2006 and 2007; general government expenditure and government gross debt were respectively 52.4% and 63.9% of GDP in 2007.

[8] Export markets performance has been estimated as difference between French exports and total world demand addressed to France. In figures from MoF the world demand of goods addressed to France has been retained for the estimation.

[9] Figures reported are simple average for the period 1996-2005. Figures for structural balance are available only since 2003.

[10] Existing stock of government gross debt in 1996.

Source:

Ministère de l'économie, des finances et de l'industrie, Perspectives économiques 2008-2009, April 2008 (MoF); Commission services' spring 2008 economic forecasts (COM); Stability programme (SP); Commission services' calculations.