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REPORT FROM THE COMMISSION

France

Report prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union

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1. INTRODUCTION

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Data notified by the French authorities on 31 March 2020 and subsequently validated by Eurostat[1] show that the general government deficit in France reached 3.0% of GDP in 2019, while general government gross debt stood at 98.1% of GDP, the same lavel as in 2018. According to the 2020 Stability Programme, France plans a deficit of 9.0% of GDP in 2020, while debt is planned at 115.2% of GDP.

The planned deficit for 2020 provides *prima facie* evidence of the existence of an excessive deficit as defined by the Stability and Growth Pact.

Moreover, the data for 2018 and 2019 imply insufficient progress towards compliance with the debt reduction benchmark, which also provides *prima facie* evidence of the existence of an excessive deficit as defined by the Stability and Growth Pact.

Against this backtround, the Commission has therefore prepared this report, which analyses France’s compliance with the deficit and debt criteria of the Treaty. It takes into account all relevant factors and gives due consideration to the major economic shock linked to the COVID-19 pandemic.

[1] https://ec.europa.eu/eurostat/documents/2995521/10294648/2-22042020-AP-EN.pdf/6c8f0ef4-6221-1094-fef7-a07764b0369f

2. DEFICIT CRITERION

Based on the 2020 Stability Programme, France's general government deficit in 2020 is expected to reach 9.0% of GDP, above and not close to the Treaty reference value of 3% of GDP.

The planned excess over the Treaty reference value in 2020 is exceptional, as it results from a severe economic downturn. Specifically, while the measures adopted to counter the COVID-19 pandemic amount to 1.9% of GDP, the deterioration of the macroeconomic situation is expected to contribute 5.3 percentage points of GDP to the planned deficit. Taking into account the impact of the COVID-19 pandemic, the Commission 2020 spring forecast projects a contraction of real GDP in 2020 by 8.2%, leading to a general government deficit of 9.9% of GDP. The deficit-increasing effect of the measures adopted to assuage the effects of the pandemic is the same as in the government's plans..

The planned excess over the Treaty reference value would not be temporary based on the Commission 2020 spring forecast, which projects the deficit to remain above 3% of GDP in 2021.

In sum, the planned deficit for 2020 is above and not close to the 3%-of-GDP Treaty reference value. The planned excess is considered exceptional but not temporary as defined by the Treaty and the Stability and Growth Pact. Hence, the analysis suggests that *prima facie* the deficit criterion as defined by the Treaty and Regulation (EC) No 1467/97 is not fulfilled.

Table 1. General government deficit and debt (% of GDP)

		2016	**2017**	**2018**	**2019**	**2020 COM**	**2021 COM**
Deficit criterion	**General government balance**	**-3.6**	**-2.9**	**-2.3**	**-3**	**-9.9**	**-4**
Debt criterion	**General government gross debt**	**98.0**	**98.3**	**98.1**	**98.1**	**116.5**	**111.9**
	Gap to the debt reduction benchmark	In EDP	In EDP	n.r.	n.r.	n.r.	2.8
	Change in structural balance	n.r.	n.r.	0.1	0	-1.9	n.r.
	Required MLSA	In EDP	In EDP	1.3	1.9	3.9	n.r.

Note: MLSA refers to the Minimum Linear Structural Adjustment Source: Eurostat, Commission 2020 spring forecast

3. DEBT CRITERION

The government debt-to-GDP ratio stabilised at 98.1% in 2018 and in 2019. The debt-increasing effect stemming from the headline primary deficit and interest expenditure was offset mainly by real GDP growth and the increase in the GDP deflator, both through the denominator effect, and by a slight debt-reducing impact of stock-flow adjustments.

Following the abrogation of the excessive deficit procedure in June 2018, France is subject to a three-year transition period to ensure sufficient progress towards compliance with the debt reduction benchmark. The transition period started in 2018 and will end in 2020. In order to ensure continuous and effective progress towards compliance during the transition period, France should respect simultaneously the following two conditions regarding the adjustment of the structural balance:

a. First, the annual structural adjustment should not deviate by more than ¼% of GDP from the Minimum Linear Structural Adjustment (MLSA) ensuring that the debt reduction benchmark is met by the end of the transition period;

b. Second, at any time during the transition period, the remaining annual structural adjustment should not exceed ¾% of GDP (unless the first condition implies an annual effort above ¾% of GDP);

The notified data show that France did not make sufficient progress towards meeting the debt reduction benchmark in 2019 (see Table 1), as the gap to the MLSA amounted to 2.0% of GDP.

The analysis thus suggests that *prima facie* the debt criterion is not fulfilled based on the 2019 outturn data.

4. RELEVANT FACTORS

Article 126(3) of the Treaty provides that, if a Member State does not fulfil the requirements under one or both of those criteria, the Commission has to prepare a report. That report must also "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

Those factors are further clarified in Article 2(3) of Regulation (EC) No 1467/97, which also provides that "any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess compliance with the deficit and debt criteria and which the Member State has put forward to the Council and to the Commission" need to be given due consideration

For the apparent breach of the debt criterion, the analysis of the relevant factors is particularly warranted given that debt dynamics are to a larger extent influenced by factors outside the control of the government than is the case for the deficit. This is recognised in Article 2(4) of Regulation (EC) No 1467/97, which provides that the relevant factors shall be taken into account when assessing compliance on the basis of the debt criterion irrespective of the size of the breach. In that respect, at least the following three main aspects need to be considered when assessing compliance with the debt criterion given their impact on the debt dynamics and sustainability: (i) adherence to the MTO or the adjustment path towards it, (ii) the implementation of structural reforms, and (iii) the prevailing economic conditions.

As specified in Article 2(4) of Regulation (EC) No 1467/97, as regards the deficit criterion in 2020, since the government debt-to-GDP ratio exceeds the 60% reference value and the double condition is not met - i.e. that the deficit remains close to the reference value and that its excess over the reference value is temporary - those relevant factors cannot be taken into account in the steps leading to the decision on the existence of an excessive deficit on the basis of the deficit criterion for France.

In the current situation, a key additional element to take into consideration regarding 2020 is the economic impact of the COVID-19 pandemic, which has a very substantial impact on the budgetary situation and results in a highly uncertain outlook. The pandemic has also led to the activation of the general escape clause.

4.1. COVID-19 pandemic

The COVID-19 pandemic has led to a major economic shock that is having a significant negative impact throughout the European Union. The consequences for GDP growth will depend on the duration of both the pandemic and of the measures taken by national authorities and at European and global level to slow its spread, protect production capacities and support aggregate demand. Member States have already adopted or are adopting budgetary measures to increase the capacity of health systems and provide relief to those individuals and sectors that are particularly affected. Significant liquidity support measures and other guarantees have also been adopted. Subject to more detailed information, the competent statistical authorities are to examine whether those measures entail an immediate impact on the general government balance or not. Together with the fall in economic activity, those measures contribute to substantially higher government deficit and debt positions.

4.2 Medium-term economic position including structural reforms

Since 2016, real GDP in France has been growing above potential, driven by dynamic investment and an improving net exports position, while private consumption remained subdued. Nominal GDP growth picked up in 2017 and remained robust in 2018 and 2019 despite the slow down in economic activity, supported by a higher GDP deflator. Hence, it cannot be argued that macroeconomic conditions are a mitigating factor in explaining France’s lack of sufficient progress towards meeting the debt reduction benchmark in 2019.

Economic activity is projected to be deeply affected by the COVID-19 outbreak and the related containment measures. The Commission 2020 spring forecast projects GDP to decline by 8.2% in 2020, with a negative domestic demand contribution to growth by 7.4 percentage points due to the brisk fall in private consumption and investment, and also by a negative contribution of inventories. In turn, the growth contribution of net exports is expected to be broadly neutral. The macroeconomic outlook is marked by an exceptional degree of uncertainty related to the duration of the pandemic and its economic impact. This a mitigating factor in the assessment of France’s compliance with the deficit criterion in 2020.

In its 2020 Country Report[2], the Commission assessed that France made some progress in addressing the 2019 Country Specific Recommendations. More specifically, France has made substantial progress in fostering the growth of firms, some progress in addressing skills shortages and mismatches, symplifying the tax system, undertaking investments to ensure energy transition and in improving the digital infrastructure. Limited progress was also made in fostering integration on the labour market and ensuring equal opportunities, improving the research and innovation performance and reducing red-tape restrictions. Finally, regarding fiscal structural reforms, while France has made limited progress in reforming the pension system, it has made no progress in further developing and implementing a spending review through the Public Action 2022 programme.

4.3 Medium-term budgetary position, including government investment

The headline deficit increased from 2.3% of GDP in 2018 to 3.0% in 2019, mainly due to the statistical impact of the transformation of the tax credit for competitiveness and employment

[2] See Commission Staff Working Document SWD (2020) 509 final, 26.2.2020, "*Country Report France 2020. Including an In-Depth Review on the prevention and correction of macroeconomic imbalances*".

(CICE) into a permanent outright reduction of employer's social contributions, which accounted for about 0.9% of GDP. Public investment is estimated to have risen from 3.4% of GDP in 2018 to 3.6% in 2019, above the general government deficit in 2019.

On 13 July 2018, France was recommended to ensure that the nominal growth rate of primary government expenditure, net of discretionary revenue measures and one-offs, did not exceed 1.4% in 2019 ('the expenditure benchmark'), corresponding to a structural adjustment of 0.6% of GDP[3]. Based on outturn data and the Commission forecast, expenditure exceeded the benchmark, with a deviation from the recommended adjustment path towards the medium-term budgetary objective of 1.0% of GDP in 2019, thus pointing to a significant devation. The structural balance registered no improvement in 2019[4], thus also pointing to a significant deviation of 0.6% of GDP. A similar assessment is obtained from looking at 2018-2019 taken together. The lack of compliance with the preventive arm requirements is an aggravating factor for the assessment of France's prima facie non-compliance with the debt criterion in 2019.

The Stability Programme provides information on substantial measures to contain the pandemic and to support the economy. It estimates the deficit-increasing impact of those support measures at 1.9% of GDP in 2020. They comprise additional healthcare expenditure of EUR 8 billion, transfers to cover partial unemployment schemes of EUR 24 billion, subsidies under the sectoral compensation fund for SMEs of EUR 7 billion and the creation of an emergency fund of EUR 2.5 billion. Moreover, liquidity measures and public guarantees aimed to support firms, amount to about EUR 385 billion (17.1% of GDP). Provided more detailed information, the competent statistical authorities are to examine whether these entail immediate budgetary impact or not. In any case, the medium-term fiscal outlook remains subject to high uncertainty.

4.4. Medium-term government debt position

After steadily increasing since 2013, government debt remained broadly stable between 2016 and 2018, at around 98% of GDP, due to persistently high general government deficits recorded over the same period as well as to the relatively low nominal GDP growth in most of the years. In 2019, the debt ratio stabilised at 98.1%, reflecting the debt-increasing effect stemming from the primary deficit and, although decreasing, interest expenditure. This was offset by real GDP growth and the increase in prices (inflation effect) and by the slightly debt-reducing impact of stock-flow adjustments.

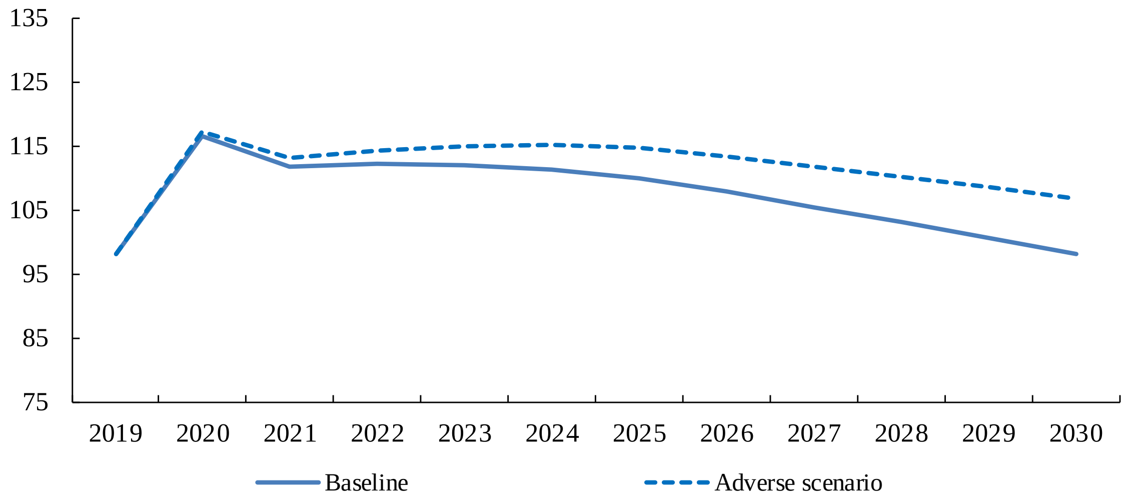
According to the Commission 2020 spring forecast, general government debt is expected to rise from 98.1% of GDP in 2019 to 116.5% in 2020.

[3] Council Recommendation of of 13 July 2018 "on the 2018 National Reform Programme of France and delivering a Council opinion on the 2018 Stability Programme of France" (OJ C 320, 10.9.2018, p. 39)

[4] Outturn data for the headline deficit in 2019 was lower by 0.1% of GDP than in the Commission 2019 autumn forecast, when the structural adjustment was projected to be 0.0%. Despite the lower outturn for the deficit in 2019, the structural adjustment remains at 0.0% of GDP due to the combination of the downward revision of potential growth brought about by the severe economic downturn provoked by the COVID-19 outbreak, and a revision of the series of the one-off measures in 2017 and 2018.

The debt sustainability assessment updated with the Commission 2020 spring forecast confirms that, notwithstanding risks, the debt position remains sustainable over the medium-term in France, which takes into account important mitigating factors (including the debt profile). In particular, while the government debt position has deteriorated as a result of the COVID-19 crisis, the debt-to-GDP ratio in the baseline is expected to be on a sustainable (declining) trajectory over the medium term[5] (Graph 1).

Graph 1: Government debt-to-GDP ratio, France, % of GDP



Source: Commission services.

4.5 Other factors put forward by the Member State

On 14 May 2020, the French authorities transmitted a letter with relevant factors in accordance with Article 2(3) of Regulation (EC) No 1467/97. The analysis presented in the previous sections already broadly covers the key factors put forward by the authorities. Additional factors not yet mentioned above are the accumulated structural effort, according to authorities' calculations, of around 0.4% of GDP over 2018 and 2019; the restrain in public expenditure growth, excluding tax credits and the creation of France Compétences, resulting in an average annual increase of ¼ percent points in real terms over 2018 and 2019 as well as a decline of the public expenditure-to-GDP ratio by 1.3 percentage points between 2017 and 2019.

5. Conclusions

[5] The baseline is based on the Commission Spring 2020 forecast. Beyond 2021, a gradual adjustment of fiscal policy is assumed, consistent with the EU economic and fiscal coordination and surveillance frameworks. Real GDP growth is projected according to the so-called EPC/OGWG T+10 methodology. In particular, (real) actual GDP growth is driven by its potential growth and affected by any additional fiscal adjustment considered (through the fiscal multiplier). Inflation is assumed to converge gradually to 2%. Interest rates assumptions are set in line with financial market expectations. Under the adverse scenario, higher interest rates (by 500 bps.) and lower GDP growth (by -0.5 pp.), with respect to the baseline, are assumed (throughout the projection horizon).

According to the Stability Programme, France’s general government deficit in 2020 is planned to increase to 9.0%, above and not close to the 3% of GDP Treaty reference value. The planned excess over the reference value is considered to be exceptional but not temporary.

The general government gross debt stood at 98.1% of GDP at the end of 2019, above the 60% of GDP Treaty reference value. France did not make sufficient progress towards meeting the debt reduction benchmark in 2019.

In line with the Treaty and the Stability and Growth Pact, this report also examined relevant factors.

As specified in Article 2(4) of Regulation (EC) No 1467/97, as regards compliance with the deficit criterion in 2020, however, since the government debt-to-GDP ratio exceeds the 60% reference value and the double condition is not met - i.e. that the deficit remains close to the reference value and that its excess over the reference value is temporary - those relevant factors cannot be taken into account in the steps leading to the decision on the existence of an excessive deficit on the basis of the deficit criterion for France.

As regards compliance with the debt criterion in 2019, the relevant factors, in particular (i) the observed macroeconomic conditions; (ii) some progress with the implementation of growth enhancing structural reforms in past years, and (iii) the significant deviation from the recommended adjustment path towards the medium term budgetary objective, leads to the conclusion that the debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not complied with.

Overall, the analysis suggests that the deficit and debt criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 are not fulfilled.