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Analysis of the 2016 Draft Budgetary Plan of FRANCE

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of FRANCE

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1. INTRODUCTION

France submitted its Draft Budgetary Plan (DBP) for 2016 on 15 October 2015 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. France is currently subject to the corrective arm of the Pact. The Council opened the Excessive Deficit Procedure for France on 27 April 2009 and recommended France to correct its excessive deficit by 2012, a deadline which was extended to 2013 on 2 December 2009. On 21 June 2013, the Council concluded that France had taken effective action but adverse economic events with major implications on public finances had occurred, and issued a revised recommendation with a deadline to correct the excessive deficit by 2015. On 10 March 2015, the Council concluded that the available evidence did not allow to conclude on no effective action and that the considerable deterioration in the budgetary position resulting from the weaker overall position of the economy suggested that a revised recommendation for France was justified and recommended France to correct its excessive deficit by 2017. Based on the Commission assessment of action taken of 1 July 2015, the Council recommendation of 14 July 2015 concluded that France was broadly compliant with the provisions of the Stability and Growth Pact (SGP) as it was projected to reach its headline deficit targets in 2015 and 2016. Nonetheless, France was recommended to reinforce the budgetary strategy as the fiscal effort was projected to fall short of the recommended fiscal effort in both years, according to all metrics.

Section 2 of this document presents the macroeconomic outlook underlying the DBP and provides an assessment based on the Commission 2015 autumn forecast. 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 DBP. Section 4 assesses the recent and planned fiscal developments in 2015-2016 (also taking into account the risks to their achievement) against the obligations stemming from the SGP. Section 5 provides an analysis of implementation of reforms in the area of fiscal governance in response to the latest Country-specific Recommendations (CSRs) adopted by the Council on 14 July 2015, including those to reduce the tax wedge. Section 6 concludes.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

According to the DBP, GDP will grow by 1.0% in 2015 after 0.2% in 2014, and will accelerate slightly to 1.5% in 2016, on the back of increasing private consumption. Household real disposable income will be sustained by dynamic wages in real terms against a background of low inflation and some improvement in employment supported by economic growth and initiatives such as the jobs for the future, the tax rebate on competitiveness and employment (CICE) and the responsibility and solidarity pact (RSP). Private consumption is expected to grow by 1.7% in 2016, from 1.8% in 2015 and 0.6% in 2014, with a slightly decreasing households' savings ratio. Corporate investment is projected to start picking up again following the growth in aggregate demand, helped by measures to support the supply side of the economy (the CICE and the RSP). Exports are expected to be sustained by a particularly dynamic world demand (5.2%, after 3.7% in 2015), although some export market shares will be lost again as the impact of the euro's depreciation fades away. The DBP projects that inflation will accelerate from 0.1% in 2015 to 1.0% in 2016.

Box 1: The macroeconomic forecast underpinning the Draft Budgetary Plan of France

The High Council for Public Finances (HCPF) was established as a monitoring body attached to the French Court of Auditors and its independence is formally guaranteed by law. The HCPF adopted on 25 September an opinion on the macroeconomic forecasts underlying the DBP as well as on the underlying budgetary strategy. This opinion is attached to the DBP submitted to the National Assembly, and made public by the HCPF at the same time. In its opinion, the HCPF expressed its concerns about the upward revision of potential GDP by the government as it made it more difficult to follow developments in the structural component of the deficit and hampered the overall readability of budgetary policy. For 2015, the HCPF considered that the GDP growth forecast as well as the achievement of the 2015 deficit was plausible although a continued strict control of expenditure remained necessary. Concerning 2016, the HCCPF considered that the GDP growth forecast was plausible but no longer prudent given the increase in uncertainty regarding the external environment since the summer. Moreover, it warned that the forecast for the total private sector wage bill in 2016 might be lower than projected by the government, which would weigh on social security contributions and considered the inflation projection for 2016 optimistic, stressing that a lower-than-expected inflation would make the budgetary adjustment more difficult. Finally, the HCPF considered that significant risks surround the achievement of the headline target in 2016 as the planned slowdown in public expenditure is particularly ambitious in light of past trends.

The Commission projects somewhat higher GDP growth in 2015 and lower growth in 2016 than the authorities. The macroeconomic scenario in the DBP looks similar to that of the Stability Programme. While overall projections for GDP growth have remained the same for 2015 and 2016, the composition of GDP growth has been changed somewhat. Domestic demand has been revised upwards, while net exports have been revised downwards. For 2015, the Commission's GDP growth forecast is slightly above that of the authorities (1.1% against 1.0%). This is due to an assumed higher impact of the euro's depreciation on export market shares and net exports than the authorities, with a contribution to GDP of 0.2% of GDP versus -0.1% in the DBP. Regarding 2016, the Commission 2015 autumn forecast is slightly more pessimistic (1.4% against 1.5%). The main differences stem from investment. The Commission projects investment to grow at only 0.7% whereas the DBP projects investment to grow at 3.7% because it is assumed that the CICE and the RSP have supported wage growth in the context of a rigid labour market to the detriment of firms' profit margins and investment capacity. Therefore, the Commission does not assume a pick-up in investment as early as 2016. Finally, the Commission forecasts inflation to pick up from 0.1% in 2015 to 0.9% in 2016, which is slightly below the dynamics foreseen by the authorities and takes into account the recent deceleration in price developments observed since July 2015. Overall, the DBP is based on plausible macroeconomic assumptions.

Table 1. Comparison of macroeconomic developments and forecasts

	2014	2015			2016		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	0.2	1.0	1.0	1.1	1.5	1.5	1.4
Private consumption (% change)	0.6	1.5	1.8	1.7	1.5	1.7	1.7
Gross fixed capital formation (% change)	-1.2	-1.0	-0.3	-1.3	1.5	2.3	0.7
Exports of goods and services (% change)	2.4	4.9	6.0	6.1	5.5	4.8	4.6
Imports of goods and services (% change)	3.8	4.7	6.1	5.0	4.7	5.2	4.4
Contributions to real GDP growth:							
- Final domestic demand	0.5	0.9	1.2	1.0	1.3	1.6	1.2
- Change in inventories	0.2	0.0	-0.1	-0.1	0.0	0.1	0.2
- Net exports	-0.5	0.0	-0.1	0.2	0.2	-0.2	0.0
Output gap[1]	-1.9	-2.2	-1.7	-1.8	-1.7	-1.2	-1.5
Employment (% change)	0.3	0.3	0.3	0.3	0.4	0.6	0.5
Unemployment rate (%)	10.3	n.a.	n.a.	10.4	n.a.	n.a.	10.4
Labour productivity (% change)	-0.1	0.7	0.7	0.7	1.0	0.9	0.9
HICP inflation (%)	0.6	0.0	0.1	0.1	1.0	1.0	0.9
GDP deflator (% change)	0.6	1.0	1.0	0.9	0.9	1.0	0.9
Comp. of employees (per head, % change)	1.4	0.8	1.6	0.8	1.6	2.1	1.3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-2.3	-0.9	-1.6	-1.1	-0.6	-1.7	-1.1

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 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

3. Recent and planned fiscal developments

3.1. Deficit developments

The general government deficit reached 3.9% of GDP in 2014. This is 0.1 pp. below the level notified in Spring and 0.4 pp. below the level on which the recommendation of 10 March 2015, which revised the deadline to correct the excessive deficit, was based. This was mainly due to a stronger-than-expected contraction in local investment and somewhat higher-than-expected social security contributions. The starting point is thus much better than foreseen at the time of the recommendation, which makes the achievement of the headline deficit targets easier than expected in the baseline scenario underpinning the recommendation.

For 2015, the DBP projects a deficit of 3.8% of GDP, in line with the target put forward in the Stability Programme. The revenue-to-GDP ratio would decline somewhat due to tax and social security contribution cuts and a still low tax elasticity. Nonetheless, this would be more than compensated by the stronger decline in the expenditure-to-GDP ratio in line with the EUR 50 billion expenditure consolidation package over 2015-2017 (see Box 4 in section 3.3). The Commission 2015 autumn forecast also projects a deficit of 3.8% of GDP in 2015 and has a broadly similar composition of the foreseen consolidation.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2014	2015			2016			Change: 2014-2016
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**53.6**	**53.1**	***53.5***	**53.4**	**52.9**	***53.3***	**53.3**	**-0.3**
of which:								
- Taxes on production and imports	15.8	15.8	*15.9*	15.8	15.8	*15.8*	15.9	0.0
- Current taxes on income, wealth, etc.	12.7	12.5	*12.6*	12.6	12.5	*12.5*	12.5	-0.2
- Capital taxes	0.5	0.5	*0.5*	0.5	0.5	*0.5*	0.5	0.0
- Social contributions	19.2	18.8	*19.0*	19.0	18.7	*18.9*	18.9	-0.3
- Other (residual)	5.5	5.5	*5.5*	5.5	5.4	*5.6*	5.5	0.1
Expenditure	**57.5**	**56.8**	**57.2**	**57.2**	**56.1**	**56.5**	**56.8**	**-1.0**
of which:								
- Primary expenditure	55.4	54.7	55.2	55.2	54.0	54.4	54.7	-1.0
of which:								
Compensation of employees	13.0	12.9	13.0	13.0	12.7	12.8	12.8	-0.2
Intermediate consumption	5.2	5.0	5.1	5.1	4.9	5.0	5.0	-0.2
Social payments	26.2	25.9	26.1	26.1	25.7	25.8	25.9	-0.4
Subsidies	2.2	2.4	2.5	2.5	2.4	2.5	2.5	0.3
Gross fixed capital formation	3.7	3.6	3.6	3.5	3.4	3.5	3.5	-0.2
Other (residual)	5.1	4.9	4.9	5.0	4.9	4.8	4.9	-0.3
- Interest expenditure	2.2	2.1	2.0	2.0	2.1	2.1	2.1	-0.1
General government balance (GGB)	**-3.9**	**-3.8**	**-3.8**	**-3.8**	**-3.3**	**-3.3**	**-3.4**	**0.6**
Primary balance	**-1.8**	**-1.7**	**-1.7**	**-1.8**	**-1.2**	**-1.2**	**-1.4**	**0.6**
One-off and other temporary measures	0.0	-0.2	-0.1	0.0	-0.1	-0.1	-0.1	-0.1
GGB excl. one-offs	**-4.0**	**-3.6**	**-3.7**	**-3.8**	**-3.2**	**-3.2**	**-3.3**	**0.8**
Output gap[1]	-1.9	-2.2	-1.7	-1.8	-1.7	-1.2	-1.5	0.6
Cyclically-adjusted balance[1]	-2.8	-2.5	-2.8	-2.7	-2.3	-2.6	-2.5	0.3
Structural balance (SB)[2]	**-2.8**	**-2.3**	**-2.7**	**-2.7**	**-2.2**	**-2.5**	**-2.4**	**0.4**
Structural primary balance[2]	-0.6	-0.2	-0.7	-0.7	-0.1	-0.4	-0.3	0.3

Notes:

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

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

Source:

Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

The Commission forecast projects a deficit of 3.4% of GDP in 2016, which is 0.1 pp higher than the planned deficit in the DBP. In line with the target set in the Stability Programme, the DBP foresees a deficit of 3.3% of GDP in 2016. The revenue-to-GDP ratio would decline further due to the further roll-out of the Responsibility and Solidarity Pact (see Box 3 in section 3.3) and despite a normalisation of the tax elasticity. This would be offset by a planned reduction of the expenditure-to-GDP ratio by 0.7% of GDP due to the continuation of the consolidation package. The Commission autumn forecast projects a somewhat higher deficit at 3.4% of GDP mainly due to differences in the discretionary measures that have been taken into account (see section 3.3). On the revenue side, the Commission also considers that the tax elasticity would normalise to 1 in 2016 and therefore projects a similar revenue-to-GDP ratio. On the expenditure side, the lower nominal GDP in the Commission forecast explains 0.2 pp of GDP of the difference in the overall expenditure-to-GDP ratio. The remaining difference mainly stems from higher social spending in the Commission forecast. Finally, in line with the opinion of the HCPF, the Commission considers that risks surround the achievement of the headline target in 2016 as the planned slowdown in public expenditure growth (0.4% in real terms) is particularly ambitious in light of past trends (1.2% on average over 2010-2014). In this context, there is a risk that the expenditure norm of the State may not be respected in 2016. The norm is getting stricter each year while it is not backed up by structural savings and spending on priorities is increased. Moreover, in 2014 the norm has only been attained due to de-budgeting operations and the postponement of 0.1% of GDP of invoices to 2015[1]. Finally, investment by local authorities could turn out stronger than expected which would weigh on the deficit.

According to the Commission autumn forecast, the headline deficit is set to decline to 3.3% of GDP in 2017 (under the usual no policy change assumption) compared to a target of 2.7% in the Stability Programme. The difference between the Commission forecast and the Stability Programme is due to the higher starting position of the deficit (0.1 pp), differences in the macroeconomic scenario (0.2 pp) and differences in the measures that have been taken into account in the Commission forecast for 2017 which is a no policy change scenario (see section 3.3).

A limited improvement in the structural balance is expected both in 2015 and 2016. The DBP plans an improvement in the structural balance by 0.2% of GDP in both 2015 and 2016[2]. The Commission forecast points to an improvement in the structural balance by 0.1% of GDP in 2015 and 0.3% in 2016. For 2015, the difference between the Commission forecast and the DBP is due to the fact that the Commission classifies the auctioning of 4G licences, with an estimated yield of EUR 2.5 billion (0.1% of GDP), as a positive one-off measure.[3] For 2016, the Commission's improvement in the structural balance is somewhat higher because of a smaller cyclical budgetary component and the classification of part of the impact of the entry into force of the 2014 Own Resources Decision related to the EU budget as a negative one-off measure (of EUR 1 billion, 0.05% of GDP).

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[1] Cour des Comptes (2015), Finances et Comptes Publics, Le Budget de l'Etat en 2014. Résultats et gestion, Mai 2014. And Cour des Comptes (2015) La situation et les perspectives des finances publiques, juin 2015.

[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.

[3] In line with the DBP, the Commission 2015 autumn forecast records the auctioning of the 4G licences in 2015. However, the final statistical impact in ESA 2010 will need to be clarified and will only be known at a later stage.

Box 2: Impact of the current low interest rate environment on compliance with the SGP

Identifying an interest rate windfall/shortfall for 2016

Sovereign bond yields have fallen sharply since end-2013 and reached historical lows in the first half of 2015, before increasing somewhat during the summer months. However, yields in France still remain well below their long-term average of 4.2% (2000-2010), with 10-year rates standing at 0.9% (as of 27 October 2015). As a result of lower interest rates, total interest payments by the general government have also decreased over the last few years. Interest expenditure in France is expected to fall from 2.6% of GDP in 2012 to 2.0% in 2015 and the authorities project it to slightly increase next year, to 2.1% of GDP in 2016.

According to the 2016 DBP, interest expenditure would increase in line with a gradual pick-up in interest rates with the progressive end of the current quantitative easing foreseen from September 2016 on. Short-term interest rates would remain negative until the beginning of 2016 and then increase slowly. The scenario for the medium- to long-term rates rests on the assumption that they would increase by 100 bps between end 2015 and end 2016 to reach 2.4% as economic growth gains traction. The Commission considers the assumptions of the DBP to be prudent and has a similar forecast for interest expenditure in GDP terms (2.1% for both the Commission and the authorities).

Prospects and vulnerability

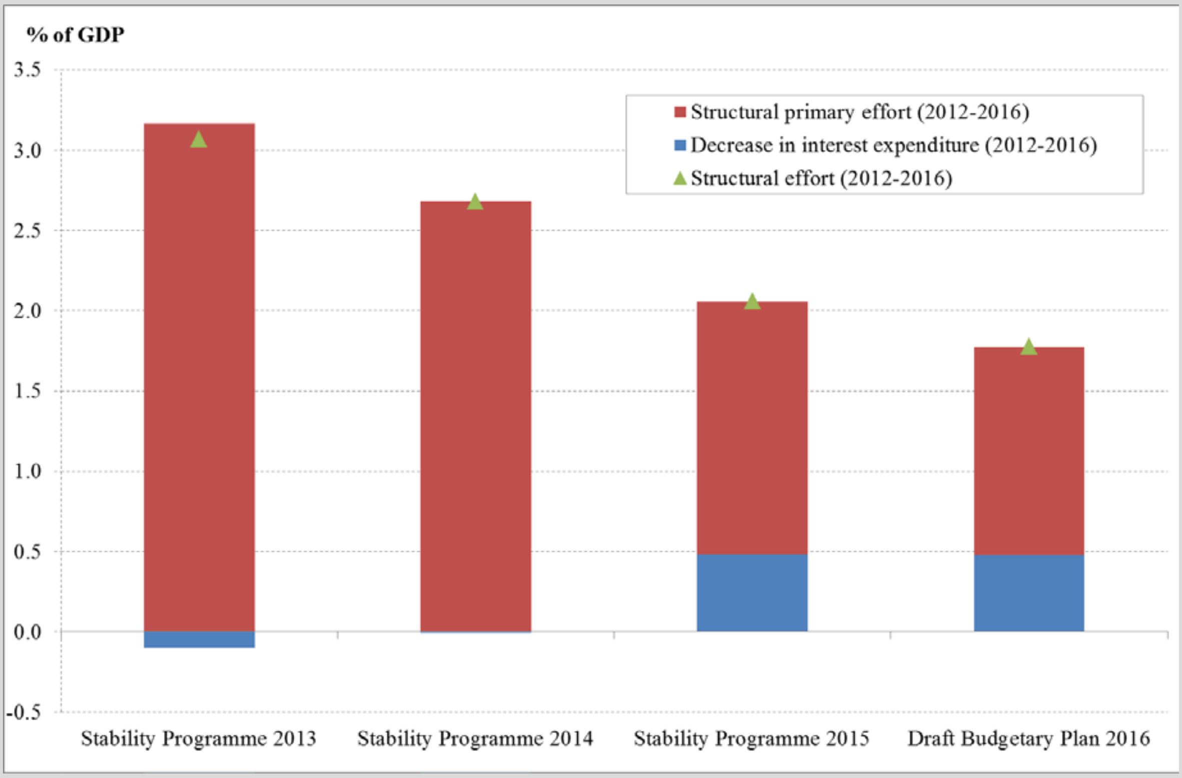
The share of outstanding medium- to long-term debt to be renewed over the 2016-2018 period amounts to 29.8% of GDP and has an average coupon rate of 2.6%. The French interest expenditure in terms of GDP would continue to decline if the low interest rate environment would prevail over this time horizon. At the same time, the significant share (14% of total) of inflation-linked bonds in the total outstanding debt would act as a counterweight to low interest rates as inflation is expected to slowly pick up as of 2016.

Consequences for public finances

Comparing the interest expenditure projections across different vintages of Stability Programmes and the DBP sheds more light on the (unexpected) interest windfall since the fall in interest rates (see Chart 1)[4].

[4] Note that, while it is likely that revisions in the interest expenditure projections across different vintages primarily reflect changes in interest rates, other factors such as debt dynamics, the maturity profile of debt and statistical reclassifications (e.g. the switchover to the ESA 2010 standard of national accounts) may also have played a role.

Chart 1: Structural effort and decrease in interest expenditures between 2012 and 2016 based on government plans



Source: Stability programmes, Draft Budgetary Plan 2016 and AMECO

In the 2013 Stability Programme, France had anticipated interest expenditure to increase to 2.7% of GDP between 2012 and 2016. The unexpected interest windfall over that period would amount to 0.5% of GDP. Part of the planned structural effort could thus have been achieved on the back of lower-than-anticipated interest expenditure. However, despite these windfall gains, France has relaxed its planned structural effort over the period by over 1 pp of GDP in cumulative terms.

Nonetheless, it should be reminded that the contribution of the lower interest expenditure to the deficit reduction over the period 2012-2016 could have been to a certain extent offset by inflation developments.

In the 2013 Stability Programme, it was expected that inflation would be about 1.7% per year from 2012 to 2016. Based on the current assessment inflation would be cumulatively about 4.5 pp lower over the period. In the case of France, the sensitivity of revenues to inflation is higher than that of expenditures, in particular in the short term. Possible explanations for the higher elasticity of revenues to inflation in France could include the wage setting system, the relatively low weight of VAT in the overall tax structure and the delay induced by the low recourse to collection of taxes at the source. On the expenditure side, the social transfers' indexation mechanism based on anticipated inflation reduced their reaction to lower inflation to close to nil. However, the newly introduced indexation of social benefits on realised inflation could mitigate the issue of the impact of inflation surprises on expenditure.

3.2. Debt developments

The debt-to-GDP ratio would increase to 97.1% in 2016. The debt ratio reached 95.6% of GDP in 2014. The Commission expects it to increase to 96.5% of GDP in 2015. For 2016 the Commission projects the debt ratio to increase to 97.1% of GDP, which is 0.6 pp above the forecast in the DBP. The difference between the Commission and the DBP stems from lower nominal GDP growth and a slightly higher general government deficit according to the Commission.

Table 3. Debt developments

(% of GDP)	2014	2015			2016		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**95.6**	**96.3**	**96.3**	**96.5**	**97.0**	**96.5**	**97.1**
Change in the ratio	3.3	0.7	0.7	0.9	0.7	0.2	0.6
Contributions[2] :							
1. Primary balance	**1.8**	**1.7**	**1.7**	**1.8**	**1.2**	**1.2**	**1.4**
2. "Snow-ball" effect	**1.5**	**0.2**	**0.2**	**0.2**	**-0.1**	**-0.2**	**-0.1**
Of which:							
Interest expenditure	2.2	2.1	2.1	2.0	2.1	2.1	2.1
Growth effect	-0.2	-0.9	-0.9	-1.0	-1.4	-1.4	-1.3
Inflation effect	-0.5	-0.9	-0.9	-0.8	-0.8	-0.9	-0.8
3. Stock-flow adjustment	**0.0**	**-1.2**	**-1.2**	**-1.0**	**-0.3**	**-0.8**	**-0.7**

Notes:

[1] End of period.

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

Source:

Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the Draft Budgetary Plan

The government pursues its expenditure-based consolidation strategy. The measures included in the DBP for 2016 result, on the revenue side, from the implementation of the Responsibility and Solidarity Pact (RSP) and, on the expenditure side, from the implementation of the EUR 50 billion consolidation package over the period 2015-2017 (see Box 4). For 2016, EUR 16 billion (0.7 % of GDP) expenditure cuts are planned.

The reduction in taxes and social security contributions continues. On the revenue side, the DBP includes a personal income tax cut in favour of households of EUR 2 billion. As part of the RSP, a EUR 3.1 billion reduction in social charges for employers will also be implemented and the gradual phasing-out of the Company Solidarity Social Contribution (C3S), a tax on turnover, will represent another EUR 1 billion in favour of companies. Finally, a temporary surcharge on corporate income tax for large companies has been abolished from 2016 onwards, leading to EUR 2 billion lower revenues. The main positive revenue measures relate to environmental taxes (EUR 1.7 billion), tariff increases for the public service contribution on electricity (EUR 1.1 billion), increases in local taxes (EUR 1 billion) and increased revenue from fiscal regularisations (STDR) (EUR 0.6 billion).

Box 3: Responsibility and Solidarity Pact

Announced in January 2014, the Responsibility and Solidarity Pact (RSP) contributes to the reduction in the tax burden for companies and households, and aims to increase employment, improve competitiveness and support the purchasing power of households. In total, the RSP will reduce the tax burden for companies and households by EUR 26 billion by 2017, complementing the tax credit on competitiveness and employment (CICE) which is equivalent to a reduction in the labour cost by EUR 20 billion by 2017. For companies, the RSP foresees reductions in employers' social security contributions amounting to EUR 10 billion by 2017 and reduces production and corporate taxes by another EUR 10 billion. Low-income households would see their personal income tax reduced by EUR 5 billion over the period 2014-2016.

Tax and social security contribution cuts (EUR bn)	2014	2015	2016	2017
p.m. CICE tax credit	-10	-17.5	-18.5	-19.5
Measures of the Pact in favour of enterprises		-6.5	-13.5	-20.5
Reductions in social security contributions		*-5.5*	*-9*	*-10*
Progressive abolishment of the C3S		*-1*	*-2*	*-5.5*
Corporate taxes			*-2.5*	*-4.5*
Measures of the RSP in Favour of Households	-1.5	-3	-5	-5
Total	-11.5	-27	-38	-46

Source: DBP 2016

On the expenditure side, the government plans to implement a EUR 16 billion reduction in public expenditures compared to trend expenditure growth. The expenditure cuts planned for 2016 would be achieved on the central state (EUR 5.1 billion), notably through the application of the norm for state expenditure, on local authorities (EUR 3.5 billion) and on social security (EUR 7.4 billion). The main measures include the reduction of the grants from the State to local authorities by EUR 3.5 billion, a saving of EUR 3.4 billion expected from the more ambitious healthcare spending norm of 1.75% (the *objectif national de dépenses d'assurance maladie* or ONDAM), EUR 1.8 billion from negotiations between social partners on complementary pension schemes (EUR 1 billion) and unemployment benefits (EUR 0.8 billion) and EUR 500 million from new modalities for indexation of social benefits.

The Commission does not take into account EUR 1.9 billion of announced measures. For 2016 the Commission forecast only takes into account the measures announced and specified in sufficient detail. Therefore, the Commission fully discounts the measures on unemployment benefits (EUR 800 million) as they have not been identified yet and the negotiations would only start in January 2016. Moreover, on 6 October the *Conseil d'Etat* cancelled the 2014 agreement between social partners as of March 2016 and one of the three measures cancelled would have yielded EUR 260 million savings in 2016. Another difference stems from the treatment of savings under the ONDAM. Based on information provided by the *Comité d'Alerte de l'ONDAM,* EUR 270 million expenditure reductions under the ONDAM in 2016 would not qualify as a savings measure as they are compensated by reduced revenues. Finally, the EUR 2 billion tax cut in favour of households would not be fully compensated for, as EUR 600 million savings remain unspecified at this stage. In its assessment, the Commission also considered that the adjustment in the EU budget contribution following the 2014 Own Resources Decision would impact both the structural balance and the headline deficit in 2016 through a permanent and a one-off component.

Box 4: EUR 50 billion expenditure package 2015-2017

The package consists of a consolidation plan of EUR 50 billion on the expenditure side adopted in the multi-annual programming law for public finances 2014-2019 (LPFP), envisaging the following savings:

Updated EUR 50 billion expenditure package	2015	2016	2017	2015-2017
State and its agencies	8.7	5.1	5.1	18.9
Local authorities	3.5	3.5	3.7	10.7
Social security	6.4	7.4	6.5	20.3
of which health care expenditure	*3.2*	*3.4*	*3.4*	*10*
of which other	*3.2*	*4*	*3.1*	*10.3*
Total	18.6	16	15.4	50

Source: DBP 2016

The savings are calculated against a trend expenditure benchmark estimated by the authorities. The overall trend of all government expenditure would be 2.5% in nominal terms and 1.8% in real terms over 2012-2017 according to the DBP. For each expenditure category a specific trend is calculated, allowing deriving the amount of savings realised. For example, for health care expenditure, trend growth is estimated at 3.6% by authorities, which implies that a planned growth of 1.75% for healthcare expenditure results in EUR 3.4 billion of savings.

The savings initially foreseen for 2016 in the programming law were complemented by additional measures amounting to EUR 5 billion, announced in the Stability Programme, to compensate for the effects of lower-than-expected inflation on public finances.

New measures announced in the Stability Programme	2016
State	1
state spending	*0.6*
investment in the future programme	*0.4*
local authorities	1.2
social security	2.2
health care (ONDAM)	*0.5*
New unemployment agreement (2015-2016)	*0.5*
Modalities of indexation	*0.5*
Other social security	*0.7*
Fiscal regularisations	0.6
Total	5

Source: DBP 2016

The Commission deficit forecast for 2017 is based on the usual no policy change assumption. Therefore, only measures that have been sufficiently specified have been taken into account in the forecast. On the revenue side, the measures planned in the Responsibility and Solidarity

Pact have been taken into account. On the expenditure side, spending under the norms for the State and in the health care sector would evolve in line with recent trends. Moreover, further expenditure-reducing measures amounting to 0.2% of GDP related to local authorities and complementary pension schemes have been included. In total, EUR 6 billion (0.3% of GDP) announced measures were not sufficiently specified at this stage to be taken into account.

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

France is currently subject to the corrective arm of the Pact. Box 5 recalls the main features of the Excessive Deficit Procedure, extended by the Council on 10 March 2015 and the latest CSRs addressed to France in the area of public finances.

Box 5: Council recommendations addressed to France

On 10 March 2015, the Council recommended France under Art. 126(7) of the Treaty to correct its excessive deficit by 2017. To this end, France was recommended to reach a headline deficit of 4.0% of GDP in 2015, 3.4% of GDP in 2016 and of 2.8% of GDP in 2017. Based on the macroeconomic forecast underlying the Council recommendation, this was considered consistent with an improvement of the structural balance of 0.5% of GDP in 2015, 0.8% for 2016 and 0.9% in 2017 and would require additional measures of 0.2% of GDP in 2015, 1.2% in 2016 and 1.3% in 2017. Furthermore, France should fully implement the already adopted measures for 2015 and ensure, by the end of April 2015, an additional fiscal effort of 0.2% of GDP. This would require the specification, adoption and implementation of additional structural discretionary measures equivalent to 0.2% of GDP to close the gap with the recommended improvement in the structural balance of 0.5% of GDP for 2015.

On 14 July 2015, 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 ensure effective action under the excessive deficit procedure and a durable correction of the excessive deficit by 2017 by reinforcing the budgetary strategy, taking the necessary measures for all years and using all windfall gains for deficit and debt reduction; to specify the expenditure cuts planned for these years and provide an independent evaluation of the impact of key measures; to step up efforts to make the spending review effective, continue public policy evaluations and identify savings opportunities across all sub-sectors of general government, including on social security and local government; to take steps to limit the rise in local authorities' administrative expenditure and to take additional measures to bring the pension system into balance, in particular ensuring by March 2016 that the financial situation of complementary pension schemes is sustainable over the long term.

4.1. Compliance with the EDP recommendation

Based on the information in the DBP, the Commission autumn forecast expects the headline deficit to be in line with the recommended targets in 2015 and 2016. The DBP plans to bring the headline deficit from 3.9% of GDP in 2014 to 3.8% in 2015 and 3.3% in 2016, which is below the general government deficit targets recommended by the Council. While the deficit in 2014 was 0.4 pp. lower than expected at the time of the 10 March 2015 Recommendation, the government's deficit targets for 2015 and 2016 are only 0.2 pp. and 0.1 pp. lower than the respective recommended headline targets, suggesting that the better than foreseen starting position has not been used to accelerate the correction of the excessive deficit. The Commission forecast confirms the planned headline deficit of 3.8% of GDP in 2015 and projects a headline deficit of 3.4% in 2016, which is in line with the deficit target recommended by the Council. For 2017, the Commission forecast projects a deficit of 3.3% of GDP under the usual no policy change assumption, which is above the 3% of GDP reference value in the Treaty and the recommended headline target of 2.8% of GDP.

Table 5. Compliance with the EDP recommendation

(% of GDP)	2014	2015		2016	
	COM	**DBP**	**COM**	**DBP**	**COM**
Headline balance					
Headline budget balance	-3.9	-3.8	-3.8	-3.3	-3.4
EDP requirement on the budget balance		-4.0		-3.4	
Fiscal effort - change in the structural balance					
Change in the structural balance[1]	0.7	0.2	0.1	0.2	0.3
Cumulative change[2]		0.2	0.1	0.4	0.4
Required change from the EDP recommendation		0.5		0.8	
Cumulative required change from the EDP recommendation		0.5		1.3	
Fiscal effort - adjusted change in the structural balance					
Adjusted change in the structural balance[3]		-	0.2	-	0.2
of which: *correction due to change in potential GDP estimation (α)*	-	-	0.0	-	0.0
correction due to revenue windfalls/shortfalls (β)		-	-0.1	-	0.1
Cumulative adjusted change [2]		-	0.2	-	0.4
Required change from the EDP recommendation		0.5		0.8	
Cumulative required change from the EDP recommendation		0.5		1.3	
Fiscal effort - calculated on the basis of measures (bottom-up approach)					
Fiscal effort (bottom-up)[4]		-	-0.2	-	0.7
Cumulative fiscal effort (bottom-up)[2]		-	-0.2	-	0.5
Requirement from the EDP recommendation		0.2		1.2	
Cumulative requirement from the EDP recommendation		0.2		1.4	

Notes

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

[2] Cumulated since the first year for correction in the lastest EDP recommendation.

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

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

Source :

Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations.

The structural adjustment remains well below the targets recommended by the Council in both 2015 and 2016. While the EDP recommendation requires France to achieve an improvement in the structural balance of 0.5% of GDP in 2015 and 0.8% in 2016, the DBP foresees an improvement in the (recalculated) structural balance of 0.2% of GDP in both 2015 and 2016. The Commission forecast points to an expected improvement in the structural balance of 0.1% of GDP in 2015 and 0.3% in 2016 (see section 3.1 for a comparison between the recalculated structural balance and the Commission forecast). For 2015, the structural balance has been revised down by 0.2% of GDP compared to the Commission assessment of action taken on 1 July 2015[5] mainly due to the classification of the auctioning of 4G licences as a one-off measure. For 2016, the structural balance has been revised upwards by 0.3% compared to the July 2015 Commission assessment of action taken as the government has specified further the measures announced in the Stability Programme, compensating the lower contribution of the cyclically-adjusted component of the deficit, and as a negative one-off measure related to the EU budget (see above) is taken into account. Although the headline targets set by the Council are expected to be met in 2015 and 2016, the adjustment in the structural balance is set to remain significantly lower than recommended by the Council in both years. This situation calls for a careful analysis.

Regarding 2015, the careful analysis based on the Commission 2015 autumn forecast confirms that the fiscal effort is expected to fall short of the level recommended by the Council. Correcting for changes in potential growth as well as for revenue shortfalls since the time of the Council recommendation, the estimated adjusted change in the structural balance would be 0.2% of GDP in 2015 (see table A4 and A5 in annex for the detailed calculations), i.e. 0.3% of GDP below the effort required in the EDP recommendation. Concerning the impact of inflation developments, the Commission forecast projects inflation at 0.1% whereas the recommendation was based on an inflation forecast of 0.0%. Therefore, the overall impact of inflation compared to the scenario underlying the EDP recommendation is negligible. The latest EDP recommendation required France to adopt additional measures in 2015 amounting to 0.2% of GDP. However, according to a bottom-up assessment which estimates the size the fiscal effort for 2015 on the basis of the additional discretionary revenue measures and the expenditure developments under the control of the government between the EDP scenario and the Commission 2015 autumn forecast, France is expected to record a negative effort of 0.2% of GDP in 2015, which is 0.4% of GDP lower than what was required. Compared to the July 2015 Commission assessment of action taken, the improvement of the structural balance according to both metrics has decreased by 0.2%, in line with the deterioration in the unadjusted structural balance (see above).

For 2016, the careful analysis based on the Commission 2015 autumn forecast also points to a shortfall compared to the fiscal effort recommended by the Council. Correcting for changes in potential growth as well as for revenue windfalls since the time of the Council recommendation, the adjusted structural balance is projected to improve by 0.2% of GDP (see table A4 and A5 in annex for the detailed calculations). This falls well short of the improvement of 0.8% of GDP recommended by the Council. For 2016, the inflation projection in the Commission forecast is only 0.1 pp lower than in the scenario underlying the EDP recommendation. Such a small difference would not materially affect the estimate of the structural balance. Similarly, the additional bottom-up fiscal effort compared to fiscal developments projected at the time of the Council recommendation of 10 March amounts to 0.7% of GDP. This still falls short of the 1.2% of GDP recommended by the Council on 10

[5] COM(2015) 326, Commission Communication, assessment of action taken by France in response to the Council recommendation of 10 March 2015 with a view to bringing an end to the situation of excessive government deficit.

March 2015. Compared to the July 2015 Commission assessment of action taken, the improvement in the structural balance according to both metrics improves by 0.3%, in line with the improvement in the unadjusted structural balance (see above). In cumulative terms, the effort would be 0.4% and 0.5% of GDP over 2015-2016 based on the top-down and bottom-up approaches, respectively, falling short of the recommended effort over the period by 0.9% of GDP according to both metrics.

Whereas the Commission forecast expects the headline deficit to be in line with the recommended headline deficit targets in 2015 and 2016, the structural adjustment in both years is expected to fall significantly short of the recommended effort according to all metrics, which carries risks to the achievement of the targets recommended by the Council.

5. IMPLEMENTATION OF REFORMS IN THE AREA OF FISCAL GOVERNANCE

France was recommended to improve its fiscal governance. As part of the CSRs issued on 14 July 2015, the Council recommended France to provide an independent evaluation of the impact of key measures included in the budget, to step up efforts to make the spending review effective, to limit the increase in local authorities' administrative expenditure and take additional measures to bring the pension system into balance, in particular the complementary pension schemes. Moreover, the Council recommended France to simplify and improve the efficiency of the tax system.

The savings generated by the spending reviews in 2015 are limited, but they could potentially lead to larger savings in the future. The spending reviews conducted in 2015 with a view to underpinning the spending targets of the budget for 2016 eventually resulted in the identification of about EUR 500 million savings. This amount is small compared to the overall expenditure savings target of EUR 16 billion planned by the authorities in 2016. The spending reviews, which were initiated this year, aim at proposing concrete measures to help the achievement of the budgetary targets of the following year. They are fully embedded in the budgetary cycle, concern all the sub-sectors of the general government and financing instruments of public policies, and are focused on generating savings, contrary to the other existing spending review exercise, the *modernisation de l'action publique*. The planned improvements of the process for next year, in particular specifying in advance a savings target per topic, should also increase the amount of savings that eventually can be integrated in the budget. In another area of fiscal governance, notably relating to the independent evaluation of the impact of key measures included in the budget, no progress was made.

The fiscal framework for local authorities has been improved. In the 2015 budget an indicative expenditure norm (ODEDEL) for local authorities was introduced. This year the ODEDEL has been further specified as it is broken down in a norm for operational expenditure and one for total expenditure and as the spending norm is differentiated for the various layers of local authorities. The combination of the indicative expenditure targets, if used to enable timely and effective monitoring, and, importantly, the reduction in State transfers to local authorities should contribute to containing operational expenditure at local authorities' level. However, the reduction in State transfers seems to have also led to a sharper contraction in local investment in comparison to what would have been expected based on the electoral cycle. Finally, with the adoption of the *Loi NOTRe* by Parliament on 16 July

2015, all legal building blocks of the territorial reform[6] are now in place, which should contribute to increasing the efficiency of local government spending in the medium to long term.

Regarding the sustainability of the pension scheme, substantial progress has been made. On 30 October social partners reached agreement on a package of measures for the complementary pension scheme that would yield EUR 6.1 billion savings by 2020. A majority of the savings would come from containing pension expenditure by continuing the current under-indexation of supplementary pensions until 2018, by a delay in the timing of the annual revaluation of pensions from April to November and by measures to improve incentives to work longer.

Regarding taxation, little effort has been made to simplify the tax system and improve its efficiency. The 2016 draft finance law foresees deleting 3 inefficient taxes for a total amount of EUR 36 million, but also creates 3 new ones assigned to the funding of industrial research centres. The elimination of tax expenditures is also progressing slowly with the 2016 draft finance law envisaging deleting 3 for a total amount of EUR 7 million. While the draft law does not create new tax expenditures, it broadens some existing ones, such as the tax expenditure for the cinema industry, with the consequence of further eroding the tax base. An increased reform momentum in the future could come from the inclusion of tax expenditures in the spending reviews, the *Conférences fiscales* in 2016 and the implementation of direct income taxation *(prélèvement à la source)* foreseen for 2018.

A comprehensive assessment of progress made with the implementation of the CSRs will be made in the 2016 Country Reports and in the context of the CSRs adopted by the Commission in May.

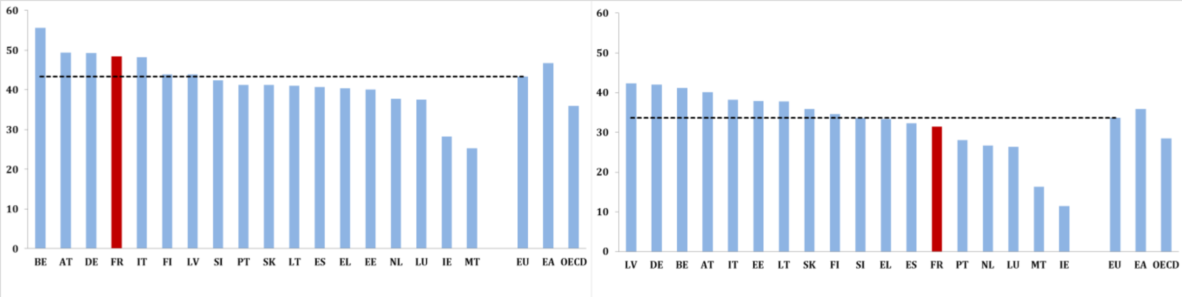
Box 6: Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to screen euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability. Furthermore, the Eurogroup expressed its intention to take stock of the state of play in the reduction of the tax burden on labour when discussing the DBPs of euro area Member States.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker's net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in France for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

[6] The territorial reform foresees a reduction in the number of regions (from 22 to 13), the creation of metropolitan areas from 2015 and the streamlining of the responsibilities of the various layers of local government.

The tax burden on labour in France at the average wage and a low wage (2014)



Notes: Data for Latvia, Lithuania and Malta is for 2013. No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

This screening is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

In the context of the 2015 European Semester, France was issued the recommendation to "ensure that the labour cost reductions stemming from the tax credit for competitiveness and employment and from the responsibility and solidarity pact are sustained, in particular by implementing them as planned in 2016 (...)."

As new measures, France's DBP plans reductions in employers' social security contribution for wages comprised between 1.6 and 3.5 times the minimum wage (EUR 3.1 billion) and a reduction in the personal income tax for low-income households (EUR 2 billion). Both measures were foreseen in the Responsibility and Solidarity Pact, although the social security contribution reductions will enter into force with a delay of 3 months compared to earlier plans (in April instead of January). While the social contribution reductions are financed by expenditure cuts, the reduction in the personal income tax seems to be only partly financed and only for one year. Over the period 2014-2016, the tax wedge would have been reduced by EUR 38 billion, which is somewhat less than 2% of GDP. The social security contribution reductions and the CICE could generate up to 150,000 additional jobs and increase GDP by 0.4% by 2020 according to a forthcoming Commission assessment.

6. OVERALL CONCLUSION

Based on the Commission 2015 autumn forecast the headline deficit is expected to reach 3.8% of GDP in 2015 and 3.4% in 2016, respecting the headline targets recommended by the Council. For 2017, under the usual no policy change assumption, the Commission projects a deficit of 3.3% of GDP, above the recommended headline target of 2.8% of GDP.

At the same time, the Commission expects that the structural effort in both 2015 and 2016 will fall significantly short of the recommended effort in the Council recommendation. Overall, the budgetary strategy is based on the better-than-expected deficit outcome in 2014 and improving cyclical conditions, which carries risks to the timely and durable correction of the excessive deficit by 2017.

EDP RELATED TABLES

Table A1. Baseline scenario underlying the EDP recommendation

% of GDP	2014	2015	2016	2017
Real GDP growth (%)	0.4	1.0	1.8	1.8
Nominal GDP growth (%)	1.1	1.8	2.8	3.3
Potential GDP growth (%)	1.0	1.0	1.1	1.2
Structural balance (in % of pot. output)	-2.9	-2.6	-3.0	-3.3
General government balance (in % of GDP)	-4.3	-4.1	-4.1	-4.1
p.m Output gap (% of pot. Output)	-2.3	-2.3	-1.6	-1.1

Source: Commission Staff Working Document accompanying the Recommendation for a Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in France (COM(2015) 115 final)

Table A2. EDP scenario underlying the EDP recommendation

% of GDP	2014	2015	2016	2017
Real GDP growth (%)	0.4	0.8	0.7	0.8
Nominal GDP growth (%)	1.1	1.6	1.6	2.3
Potential GDP growth (%)	1.0	1.0	1.1	1.2
Structural balance (in % of pot. output)	-2.9	-2.4	-1.5	-0.7
General government balance (in % of GDP)	-4.3	-4.0	-3.4	-2.8
Variation in structural balance (in % of pot. output)	0.4	0.5	0.8	0.9
p.m Output gap (% of pot. output)	-2.3	-2.5	-2.9	-3.4

Source: Commission Staff Working Document accompanying the Recommendation for a Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in France (COM(2015) 115 final)

Table A3. Current estimates of the macroeconomic and fiscal developments

% of GDP	2014	2015	2016	2017
Real GDP growth (%)	0.2	1.1	1.4	1.7
Nominal GDP growth (%)	0.8	2.0	2.3	2.6
Potential GDP growth (%)	0.9	1.0	1.1	1.2
Structural balance (in % of pot. output)	-2.8	-2.7	-2.4	-2.6
General government balance (in % of GDP)	-3.9	-3.8	-3.4	-3.3
p.m Output gap (% of pot. Output)	-1.9	-1.8	-1.5	-1.0
Source: Commission 2015 Autumn Forecast				

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

FR	Potential GDP growth underlying the Council recommendation (%)	Potential GDP growth in Autumn Forecast (%)	Forecast error (%)	Structural expenditure (% of potential GDP)	Correction coefficient α (% of potential GDP)
	(1)	(2)	(3)=(1)-(2)	(4)	(5)=(3)*(4)/100
2015	1.0%	1.0%	0.0%	56.4	0.0%
2016	1.1%	1.1%	0.0%	56.3	0.0%

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

FR	Change in current revenues (billions)		Discretionary current revenue measures (billions)		Nominal GDP growth assumptions (%)		Change in output gap		Current revenues in year t-1 (billions)		Revenue gap (billions)*	Nominal GDP	Correction coefficient β (% of nominal GDP)
	recom.	assessment	recom.	assessment	recom.	assessment	recom.	assessment	recom.	assessment		assessment	
	(1)	(1')	(2)	(2')	(3)	(3')	(4)	(4')	(5)	(5')	(6)=[(1')-(2')-[(3')+(ε-1)*(4')/100]*(5')]-	(7)	(8)=100*(6)/(7)
2015	20.4	18.5	2.51	1.982	1.8%	2.0%	0.0	0.1	1135.6	1135.7	-3.2	2174.5	- 0.1
2016	25.8	23.6	-2.941	-1.875	2.8%	2.3%	0.7	0.5	1156.0	1154.3	2.8	2224.6	0.1

Table A6. Forecast of key variables for the computation of the fiscal effort under the baseline scenario

			2014	2015	2016	2017
Enters top-down	**α**	*Structural expenditure (% of potential GDP)*	*56.4%*	*56.4%*	*56.4%*	*56.4%*
		Potential GDP growth (%)	*1.0%*	*1.0%*	*1.1%*	*1.2%*
	β	*Current revenue (national currency)*	*1135.6*	*1156.0*	*1181.8*	*1216.5*
		Discretionary measures with impact on current revenue (national currency)	*12.4*	*2.5*	*-2.9*	*-4.3*
		Nominal GDP growth (%)	*1.1%*	*1.8%*	*2.8%*	*3.3%*
		p.m Elasticity on current revenue	*0.8*	*0.9*	*0.9*	*1.0*
		p.m Output gap (% of Pot. Output)	*-2.3%*	*-2.3%*	*-1.6%*	*-1.1%*
Enters bottom-up		*Discretionary measures with impact on total revenue net of one-offs and other temporary measures (national currency)*	*15.9*	*4.4*	*-2.0*	*-4.3*
		Total expenditure net of one-offs and other temporary measures (national currency)	*1234.7*	*1252.5*	*1281.9*	*1321.0*
		Interest expenditure (national currency)	*46.8*	*47.4*	*49.8*	*53.3*
		Total unemployment	*3021.3*	*3054.3*	*3012.0*	*2847.8*
		Unemployment benefits (national currency)	*40.8*	*40.5*	*40.0*	*37.8*
		Investment expenditure matched by EU funds (national currency)	*0.0*	*0.0*	*0.0*	*0.0*

Source: Commission Staff Working Document accompanying the Recommendation for a Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in France (COM(2015) 115 final)