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COMMISSION OPINION

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING FRANCE

3. On the basis of the Draft Budgetary Plan for 2017 submitted on 14 October 2016 by France, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. The Commission opinion is to be seen in light of the latest economic and budgetary data. In this context, as indicated in the Commission recommendation for a Council Recommendation on the economic policy of the euro area as well as in the Commission Communication 'Towards a positive fiscal stance for the euro area', it is important that the aggregate fiscal stance of the euro area is positive and supports the ongoing recovery, while ensuring the long-term sustainability of national public finances.

5. France is currently subject to the corrective arm of the SGP. The Council opened the Excessive Deficit Procedure (EDP) for France on 27 April 2009. Subsequently, the Council adopted revised Recommendations under Article 126(7) of the Treaty on 2 December 2009, on 21 June 2013 and on 10 March 2015, when it recommended France to correct its excessive deficit by 2017. In order to bring the headline government deficit below the 3% of GDP reference value by 2017, France was recommended to reach a headline deficit target of 4.0 % of GDP in 2015, 3.4 % of GDP in 2016 and 2.8 % of GDP in 2017, which is consistent with delivering an improvement in the structural balance of 0.5 % of GDP in 2015, 0.8 % of GDP in 2016 and 0.9 % of GDP in 2017. This would require additional measures of 0.2 % of GDP in 2015, 1.2 % of GDP in 2016 and 1.3 % of GDP in 2017 based on the extended Commission 2015 winter forecast.

6. Overall, the Draft Budgetary Plan is based on somewhat optimistic macroeconomic projections. The macroeconomic scenario underlying the Draft Budgetary Plan forecasts GDP growth at 1.5% in both 2016 and 2017. Growth is projected to be mainly supported by a dynamic private consumption and, to a lesser extent, by a pick-up in investment. The Draft Budgetary Plan projects that inflation, measured by the national consumer price index, will remain close to zero in 2016 and accelerate to 0.8% in 2017. The macroeconomic scenario underpinning the Draft Budgetary Plan is similar to that of the Stability Programme submitted in April 2016, although with a

somewhat different growth composition. The GDP growth projections for 2016-2017 contained in the Draft Budgetary Plan are somewhat more optimistic than those of the Commission 2016 autumn forecast. For 2016, the Commission 2016 autumn forecast stands at 1.3%, 0.2 pp lower than the authorities', whereas for 2017 the Commission's forecast is 1.4% against 1.5% in the Draft Budgetary Plan. For both years, the differences are mainly due to a less dynamic private consumption as well as to a more negative contribution of net exports. Lower private consumption growth in both years in the Commission 2016 autumn forecast stems from a significantly lower growth of households' purchasing power in both 2016 and 2017. The differences with respect to net exports in 2016 are largely due to the fact that the Commission 2016 autumn forecast takes into account the strong negative contribution of the external sector in the third quarter of 2016. In 2017, the Commission forecasts a slower recovery of exports than the French authorities. Finally, the Commission forecasts inflation to pick up from 0.3% in 2016 to 1.3% in 2017. That forecast is higher than the authorities' forecast for the national CPI forecast in 2017, in part due to the higher oil price assumptions.

7. France complies with the requirement of Regulation (EU) No 473/2013 that the Draft Budgetary Plan must be based on independently endorsed or produced macroeconomic forecasts. 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. As required by law, the HCPF published on 24 September 2016 an opinion on the macroeconomic forecasts underpinning the Draft Budgetary Plan as well as on the underlying budgetary strategy. In its opinion, the HCPF considers the 2016 GDP growth forecast of the Draft Budgetary Plan as slightly elevated. Concerning 2017, the HCPF assesses the growth projection as optimistic in the light of the downside risks that have materialised in recent months. Overall, the HCPF considers that the macroeconomic scenario tends to depart from the prudence principle. On the budgetary strategy, the HCPF notes that the favourable macroeconomic assumptions of the Draft Budgetary Plan poses risks to the revenue side, whereas the risk of expenditure overruns is assessed as being higher than in previous years. Therefore, the HCPF considers the return to a headline deficit below 3% of GDP in 2017 as uncertain.

8. In line with the latest Stability Programme, the Draft Budgetary Plan projects that the deficit will decrease to 3.3% of GDP in 2016 and to 2.7% in 2017. The (recalculated) improvement in the structural balance amounts to 0.1 pp of GDP in 2016 and 0.5 pp in 2017. Compared to the latest Stability Programme, the planned revenue and expenditure ratios in 2017 are around 0.6 pp of GDP higher. Half of this is due to a base effect related to the downward revision of GDP for 2015. Public debt is projected to decrease slightly to 96.1% of GDP in 2016 and to 96.0% in 2017.

Euro area sovereign bond yields remain at historically low levels. Based on the information included in the Draft Budgetary Plan, interest expenditure in France is expected to fall from 2.0% of GDP in 2015 to 1.8% in 2016 and projected to remain at that level in 2017, well below the 2.6% recorded back in 2012 at the peak of the euro area sovereign debt crisis. The 0.1pp of GDP improvement in the structural balance forecast for 2016 is thus fully due to interest rate windfalls.

9. The main measure on the revenue side is the replacement of the final phase of the Responsibility and Solidarity Pact, which planned to cut corporate and production taxes, with corporate tax cuts in 2018 and an increase of the rate of the tax credit on competitiveness and employment (CICE) from 6% to 7% of payrolls in 2017. This

yields a saving of 0.2 pp of GDP in 2017, but has an equivalent budgetary impact in 2018. Other revenue measures include the upward revision of the yield of fiscal regularisations by 0.1 pp of GDP compared to the latest Stability Programme and the change of modalities of certain taxes bringing forward their yield by one year. On the expenditure side, the norm for state expenditure (¼ % of GDP) as well as the norm for health care spending and the cuts in transfers to local authorities (together 0.1 pp of GDP) have been relaxed. Consolidation measures relate to health care expenditure (0.2 pp of GDP), unemployment benefits (0.1 pp of GDP), local authorities and investment in innovation (together 0.1pp of GDP). The difference on measures between the Commission 2016 autumn forecast and the Draft Budgetary Plan mainly relates to the yield of measures on healthcare and unemployment benefits.

10. The Commission 2016 autumn forecast projects a deficit of 3.3% of GDP for 2016, in line with the Draft Budgetary Plan and the latest Stability Programme. For 2017, the Commission forecast expects a deficit of 2.9% of GDP, 0.2% of GDP higher than in the Draft Budgetary Plan. This difference is due for 0.1 pp of GDP to a more negative macro-economic scenario and for 0.1 pp of GDP to differences in the discretionary measures that have been taken into account in the Commission 2016 autumn forecast. Downside risks to the budgetary target of the authorities for 2017 are related to the planned recapitalisation of AREVA and the risks stemming from the recurrent under-budgeting identified by the HCPF. Also, authorities count on additional expenditure savings, resulting from the UNEDIC negotiation between social partners, which at the time of the Commission 2016 autumn forecast were still underway, and are therefore not included in the Commission forecast. In terms of structural balance, the Commission 2016 autumn forecast projects an improvement of 0.1 pp of GDP in 2016 and 0.2 pp in 2017. The difference in 2017 with the structural effort planned in the Draft Budgetary Plan is for 0.2 pp of GDP due to a different headline deficit estimate and for 0.1 pp due to differences in one-off measures. Finally, at unchanged policy, the deficit is forecast to increase to 3.1% of GDP in 2018. The debt-to-GDP ratio is forecast to stand at 96.4% of GDP in 2016 and to increase to 96.8% of GDP in 2017. The difference with the French authorities' forecast is due to a lower nominal GDP growth projection in 2016 and 2017 and a higher deficit projection in 2017.

11. According to the Commission 2016 autumn forecast, the headline deficit in 2016 is projected at 3.3% of GDP, below the recommended headline target of 3.4% of GDP. The fiscal effort is not projected to be achieved. The structural balance is expected to improve by 0.1 pp of GDP in 2016, falling well short of the recommended effort of 0.8 pp of GDP. In addition, the change in the adjusted structural balance, which takes into account windfall revenues and changes in potential output growth, is projected to well fall short of the recommended level by 0.8 pp of GDP. Similarly, the fiscal effort assessed on the basis of the bottom-up method is estimated to fall well short of the recommended level by 0.9 pp of GDP in 2016.

In 2017, the headline deficit is projected at 2.9% of GDP, below the Treaty reference value of 3% of GDP but above the recommended headline target of 2.8% of GDP. The structural balance is expected to improve by 0.2 pp, falling well short of the recommended effort of 0.9 pp of GDP. Concerning the change in the adjusted structural balance, the gap vis-à-vis the recommended fiscal effort is 0.7 pp of GDP in 2017. Based on the bottom-up method, the fiscal effort is forecast to be missed by 0.5 pp of GDP in 2017. The cumulated shortfall over 2015-2017 would be of 1.7% of GDP based on both the top-down and bottom-up metrics.

12. Over the period 2014-2016, the tax burden on labour declined by about 2 pps of GDP due to the introduction of the tax credit on competitiveness and employments (CICE) and the cuts in social security contributions of the Responsibility and Solidarity Pact. That increase in the rate of the CICE from 6% to 7% of payrolls in 2017 will further reduce the tax burden on labour. Concerning fiscal governance, progress has been limited. The amount of savings generated by the spending reviews has not been stepped-up as the the second wave would yield fewer savings than the first wave and no mechanism exists to ensure that the savings and recommendations identified in the review process are translated into actions, especially at the local government level. Positive elements relate to the publication of the first wave of spending reviews, enhancing transparency, and to the evaluation of the public policy evaluations conducted under the *modernisation de l'action publique* process. The fiscal framework of local authorities is broadly unchanged, with the expenditure target for local authorities (ODEDEL) in place but without any correction mechanism in case of expenditure overruns. The implementation of territorial reform over 2016-2020 would lead to higher spending in the short run and to efficiency gains only in the longer run. Regarding taxation, efforts to simplify the system are mixed as very little has been done to streamline the tax system while the withholding income tax is to be implemented as of 2018 if approved.

13. Overall, the Commission is of the opinion that the Draft Budgetary Plan of France, which is currently under the corrective arm, is broadly compliant with the provisions of the SGP, as the autumn forecast projects that the deficit will be slightly below the threshold value of 3% in 2017, although the correction would not be durable in 2018 under a no policy change scenario. The Commission 2016 autumn forecast for 2017 projects that the excessive deficit will be corrected in a timely manner, but there is a significant shortfall in fiscal effort compared to the recommended level. Moreover, the projected correction of the excessive deficit would not be durable as the deficit in 2018 is projected to increase to 3.1% of GDP at unchanged policies. In line with the Commission Communication 'Towards a positive fiscal stance for the euro area', the Commission therefore invites the French authorities to take the necessary measures within the national budgetary process to ensure that the 2017 budget will be compliant with the SGP rules.

The Commission is also of the opinion that France has made limited progress with regard to the structural part of the fiscal country-specific recommendations issued by the Council in the context of the 2016 European Semester and thus invites the authorities to accelerate progress. A comprehensive assessment of progress made with the implementation of the country-specific recommendations will be made in the 2017 Country Reports and in the context of the country-specific recommendations to be adopted by the Council in 2017.

Done at Brussels, 16.11.2016

For the Commission
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