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COMMISSION OPINION

on the existence of an excessive deficit in France – Application of Article 104(5) of the Treaty establishing the European Community

EXPLANATORY MEMORANDUM

According to the Commission, as published in its Spring 2003 forecasts based on the March 2003 reporting by the French authorities on deficit and debt data for 2002, the general government deficit in France amounted to 3.1 per cent of GDP. In 2002, the general government deficit therefore exceeded the reference value and increased substantially relative to the 2001 deficit (1.5 % of GDP). Based on this prima facie evidence, the Commission initiated the Excessive Deficit Procedure for France on 2 April 2003, with the adoption of the report foreseen in Article 104(3) of the Treaty. The application of the excessive deficit procedure (EDP) is governed by Article 104 of the Treaty and by Council Regulation N°1467/97 "on the speeding up and clarifying the implementation of the excessive deficit procedure", which is part of the Stability and Growth Pact. It is also affected by the political commitments enshrined in the Resolution of the Amsterdam European Council on the Stability and Growth Pact of 17 June 1997.

The Commission report according to Article 104(3) of the Treaty concluded that the excess of the French deficit in 2002 over the 3% of GDP Treaty reference value did not result from an unusual event outside the control of the French authorities, nor was it the result of a severe economic downturn in the sense of the Treaty, as real GDP growth reached 1.2% in 2002. Concerning developments in 2003, the report concluded that the general government deficit will very probably increase and therefore remain above 3% of GDP in 2003. The Commission is forecasting the 2003 general government deficit at 3.7% of GDP, which is above the 3.4% of GDP projected by the French authorities in the March reporting. Moreover, the Commission report, based on the Commission Spring forecasts, concluded that the debt-to-GDP will very likely breach the 60% reference value of the Treaty in 2003. According to the March 2003 reporting by the French authorities, the debt-to-GDP ratio in France is expected to rise from 59.1% of GDP in 2002 to 60.5% of GDP in 2003, while the Commission in its Spring forecasts projects the debt-to-GDP ratio at 61.8 per cent of GDP in 2003.

Article 104(4) of the Treaty states that "the Committee provided for in Article 114 (i.e. the Economic and Financial Committee) shall formulate an opinion on the report of the Commission". The Committee issued its opinion on 13 April 2003 (document EFC/ECFIN/151/03), subscribing to the assessment made by the Commission in its report. In particular, the EFC concluded that "budgetary developments in France in 2002 were such that the first criterion in the second paragraph of Article 104 is not respected." Consideration of other relevant factors, in particular the fact that the increase in the government deficit in 2002 is mostly due to a deterioration in the cyclically-adjusted balance and cannot be explained by an increase in the general government investment, supported the assessment based on this criterion. The EFC also considered as likely that the general government deficit exceeds the Treaty's reference value again in 2003, and that general government gross debt exceeds the Treaty's reference value of 60 percent of GDP in 2003.

The Commission, having examined the relevant factors taken into account in its report and having regard to the opinion of the EFC, is of the opinion that an excessive deficit exists in France. This opinion, adopted by the Commission on 7 May 2003, is herewith addressed to the Council, according to Article 104(5) of the Treaty. The Commission recommends that the Council shall decide accordingly, in conformity with Article 104(6). In addition, the Commission is submitting to the Council a recommendation for a Council recommendation to be addressed to France with a view to bringing the situation of an excessive government deficit to an end, according to Article 104(7) of the Treaty.

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GENERAL CONSIDERATIONS

On 1 January 1999, the third stage of economic and monetary union has started. According to Article 104 of the Treaty, Member States shall avoid excessive government deficits. Decisions on the existence of an excessive deficit are ruled by the excessive deficit procedure (EDP) specified by article 104 of the Treaty and Council Regulation (EC) No. 1467/97.[1]

Article 104(2) of the Treaty requires the Commission to monitor the developments of the budgetary situation and of the stock of government debt in the Member States with a view to identifying gross errors. In particular, the Commission shall examine compliance with budgetary discipline on the basis of two criteria, one for the ratio of the planned or actual government deficit to gross domestic product (GDP) and one for the ratio of government debt to GDP. The statistical data on these variables are provided by the Commission on the basis of reporting by the Member States twice a year[2].

Article 104(3) of the Treaty requires the Commission to prepare a report if the requirements under one or both of the criteria of Article 104(2) are not fulfilled or if, notwithstanding the fulfilment of the requirements under the criteria, the Commission is of the opinion that there is a risk of an excessive deficit in a Member State. On the basis of the most recent information available, the Commission has adopted such a report for France on 2 April 2003. The Commission report takes account of whether the government deficit exceeds government investment expenditure and all other relevant factors, including the medium-term economic and budgetary position of the Member State, as required by Article 104(3) of the Treaty.

Subsequently, and in accordance with Article 104(4), the Economic and Financial Committee has formulated an opinion on the report of the Commission on 13 April 2003.

Article 104(5) of the Treaty requires the Commission to address an opinion to the Council if the Commission considers that an excessive deficit in a Member State exists or may occur. In order to reach a conclusion on whether an excessive deficit exists or may occur, the Commission considers that account should be taken of: (i) the findings of its own report, namely whether the requirements under one or both of the criteria of Article 104(2) of the Treaty are not fulfilled, and the relevance of all other factors mentioned in Article 104(3) and (ii) the opinion of the Economic and Financial Committee on the report of the Commission.

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1 The excessive deficit procedure is jointly determined by Article 104 of the Treaty, the Protocol on the excessive deficit procedure annexed to the Treaty and Council Regulation No. 1467/97 “on the speeding up and clarifying the implementation of the excessive deficit procedure”, which is part of the Stability and Growth Pact. It is also affected by the political commitments enshrined in the Resolution of the Amsterdam European Council on the Stability and Growth Pact of 17 June 1997.

2 Government accounts data are to be reported before 1 March and before 1 September, in the terms of Council Regulation (EC) 3605/93 amended by Council Regulation (EC) 475/00 and by Commission Regulation (EC) No. 351/2002.

On the basis of these elements, the Commission has established a number of considerations for France.

CONSIDERATIONS CONCERNING FRANCE

1. According to the Commission, as published in its Spring 2003 forecasts based on the March 2003 reporting by the French authorities on deficit and debt data for 2002, the actual general government deficit in France amounted to 3.1 per cent of GDP. The actual deficit for 2002 therefore exceeded the 3% of GDP reference value of the Treaty and has increased substantially relative to the 2001 deficit (1.5 % of GDP).

2. The excessive deficit in 2002 does not result, in the sense of the Treaty, from an unusual event outside the control of France, nor did it result from a severe economic downturn. In 2002, although general economic conditions have deteriorated in France as elsewhere, real GDP growth reached 1.2% in 2002 and the worsening in the cyclical component of the deficit explains less than half of the deterioration in the budgetary position. According to Commission calculations, the cyclically-adjusted deficit has increased by some 1 percentage point of GDP in 2002, up to 3.3% of GDP. This is mainly due to a slippage in general government expenditures, particularly in the State sector and in the social security sector where health expenditures have exceeded plans by a large amount for the fifth consecutive year, and to the implementation of tax cuts, particularly in income tax.

3. The level reached by the general government deficit in 2002 is 1.7 percentage point of GDP above the value planned in December 2001 when the budget for 2002 was adopted. The fact that a slippage in government finances was occurring became clear relatively early in the year 2002. In February, the French authorities revised downwards the real GDP growth forecast for 2002 from 2.5% to 1.5% and, consequently, adjusted the objective for the 2002 general government deficit upwards from 1.4% of GDP to 1.8% of GDP. In May, the new government launched an audit on government finances, which estimated the 2002 deficit in the range 2.3-2.6% of GDP, and revised downwards the real GDP growth assumption for 2002 from 2.5% to 1.3%. However, neither the corrective budget bills for 2002 implemented in July and November, nor the draft budget bill for 2003 presented in September did include measures to counteract the ongoing slippage in the budgetary situation.

4. The breach of the 3% of GDP threshold in 2002 is also rooted in the reversal of the budgetary consolidation process occurred since 1999, which left French government finances in a vulnerable position at the beginning of 2002. After 1999, fiscal consolidation slowed markedly, the general government deficit declining only marginally from 1999 to 2001, despite real GDP growth averaging 2.8%, a rate above potential. The slowdown in fiscal consolidation can be attributed the fact that, in the course of 2000, the French authorities decided to attach a higher priority to tax alleviation while, at the same time, increases in expenditure exceeded plans. According to Commission calculations, the cyclically-adjusted deficit remained roughly constant, over 2% of GDP, between 1999 and 2001, significantly above the level providing a sufficient safety margin to avoid breaching the 3% of GDP Treaty reference value under normal cyclical conditions.

5. The gross government investment as share of GDP has been roughly constant and higher than the general government deficit ratio up to 2002, when the government deficit and gross government investment were roughly equal. Therefore, the increase in the general government deficit cannot be explained by an increase in the general government investment.

6. In November 2002, the Commission, also considering that the deteriorated cyclically-adjusted budgetary position could lead to the occurrence of an excessive deficit, recommended to the Council to send an early warning to France. In January 2003, the Council adopted a recommendation sending an early warning to avoid the occurrence of an excessive deficit in 2003[3]. In particular, the Council recommended that France adopts measures apt to improve the cyclically-adjusted budgetary position by at least 0.5 percentage point of GDP in 2003. Currently, French budgetary plans do not include measures ensuring an improvement in the cyclically-adjusted balance of that size at least in 2003. Indeed, even if the French authorities have put in reserve 0.25 percentage point of GDP on the State budget, including cancelled expenditures for an amount of 0.1 percentage point of GDP, this should not be sufficient to secure a sizeable improvement in the cyclically-adjusted deficit, nor to avoid an increase in the general government deficit in 2003.

7. Consequently, at the present stage of policy settings and growth prospects, there is a high likelihood that the government deficit exceeds the Treaty reference value again in 2003. The Commission, in its Spring 2003 forecasts, projected the general government deficit in France at 3.7% of GDP in 2003, which is above the 3.4% of GDP projected by the French authorities. Moreover, the gross government debt to GDP ratio is likely to breach the 60% of GDP Treaty reference value in 2003. According to the March 2003 reporting by the French authorities, the debt-to-GDP ratio in France for 2003 is expected to rise from 59.1% of GDP to 60.5% of GDP, while the Commission in its Spring 2003 forecasts projected the debt-to-GDP ratio at 61.8% of GDP in 2003.

8. For 2004, the Commission is forecasting the general government deficit in France at 3.5% of GDP. This forecast is based on the assumption of no policy change and of an acceleration in real GDP growth to 2.3%, a rate close to potential. The French authorities project a general government deficit in 2004 just below the 3% of GDP Treaty reference value, at 2.9%. This result is achieved starting from a more favourable position in 2003, and through the implementation of measures, not yet specified, leading to an improvement in the cyclically-adjusted position by some 0.5 percentage point of GDP. Therefore, while the deficit may be reduced in 2004, it appears uncertain at this stage whether the excessive deficit situation will be corrected.

CONCLUSION

The monitoring of the budgetary situation in France and, in particular, the examination of the compliance with the criteria laid down in Article 104(2) have led the Commission to prepare a report in accordance with Article 104(3) of the Treaty. The Commission, having examined the relevant factors taken into account in this report and having regard to the opinion of the Economic and Financial Committee, is of the opinion that an excessive deficit exists in France.

[3] OJ C 26, 4.2.2003.