EUROPEAN
COMMISSION

Brussels, 29.5.2013
SWD(2013) 384 final

COMMISSION STAFF WORKING DOCUMENT

Analysis by the Commission services of the budgetary situation in France following the adoption of the COUNCIL RECOMMENDATION to France of 2 December 2009 with a view to bringing an end to the situation of an excessive government deficit

Accompanying the document

Recommendation for a

COUNCIL RECOMMENDATION

with a view to bringing an end to the situation of an excessive government deficit in France

{COM(2013) 384 final}

1. INTRODUCTION

On 2 December 2009, the Council decided, in accordance with Article 126(6) of the Treaty on the Functioning of the European Union (TFEU), that an excessive deficit existed in France and issued a recommendation to correct the excessive deficit by 2013 at the latest, in accordance with Article 126(7) TFEU and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure. In order to bring the general government deficit below 3% of GDP in a credible and sustainable manner, the French authorities were recommended (a) to implement the consolidation measures in 2010 as planned and strengthen the fiscal effort from 2011 onwards; (b) to ensure an average annual fiscal effort of above 1% of GDP over the period 2010-13; (c) to specify the measures that were necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turned out better than expected at the time of the recommendation.

On 15 June 2010, the Commission concluded that based on the Commission services' 2010 Spring Forecast, France had taken effective action in compliance with the Council recommendation of 2 December 2009 to bring its government deficit below the 3% of GDP reference value and considered that no additional step in the excessive deficit procedure was therefore necessary.

This document provides an assessment of whether France has undertaken effective action towards correcting its excessive deficit and suggests a new adjustment path that would durably bring the general government deficit below the 3% of GDP threshold. In particular, the document examines the budgetary developments since the Commission communication to the Council on action taken as of 15 June 2010.

2. RECENT MACRO-ECONOMIC AND BUDGETARY DEVELOPMENTS AND OUTLOOK FOR 2014

The French economy weathered the 2008-09 global economic crisis better than most other euro area countries. GDP contracted by 0.1% and 3.1%[1] in those two years, respectively, compared with a 0.4% growth in 2008 and a 4.4% contraction in 2009 in the euro area as a whole. Resilience of both public and private consumption helped alleviate the impact of strongly contracting international demand. In 2010-11, annual growth rebounded to 1.7%. However, the continued lack of confidence among both companies and households, in a context where room for fiscal stimulus dwindled, led to a gradual erosion in growth which came to a standstill in the last quarter of 2011. As a consequence, unemployment started rising again in the course of the year.

In 2012, GDP remained flat on the back of rising unemployment, an only slow return of confidence and continued fiscal consolidation, which weighed on domestic demand. The quarterly growth pattern showed a downward trend, with GDP contracting by 0.3% in the last quarter. The unemployment rate rose to 10.5% in the last quarter of 2012 from 9.8% a year

[1] Unless stated otherwise, all historical data are based on the information available at the cut-off date of the Commission services' 2013 Spring Forecast.

earlier and the number of registered unemployed exceeded 3 million people. Driven by rising energy prices, inflation remained almost unchanged at 2.2% despite sluggish economic growth. All in all, households' real disposable income fell slightly last year and households reduced savings to maintain consumption levels.

In their 2013 Spring Forecast, the Commission services expect GDP to decrease by 0.1% this year. The weakness of households' real disposable income linked in particular to rising unemployment and tax increases will be only partly offset by inflation slowing down, while low business confidence is expected to lead to a continued fall in investment. A slight rebound of the external sector is forecast to translate into a modest pick-up in activity during the second half of the year. Gradually improving confidence and recovering real disposable income – assuming no further consolidation measures – are set to translate into positive growth in 2014 (1.1%). Despite efforts to support employment through subsidised schemes, the unemployment rate is forecast to further increase, reaching 10.6% and 10.9% this year and next, respectively. Inflation is set to fall to 1.2% in 2013 on the back of lower energy prices before accelerating again next year on the back of planned VAT rises.

Table 1 – Comparison of macroeconomic developments and forecasts

	2009		2010		2011		2012		2013		
	COM 2009 AF	outturn	COM 2009 AF	outturn	COM 2009 AF	outturn	COM 2009 AF	outturn	COM 2009 AF	COM 2013 SF	SP 2013
Real GDP (% change)	-2.2	-3.1	1.2	1.7	1.5	1.7	n.a.	0.0	n.a.	-0.1	0.1
Contributions to real GDP growth											
Domestic demand	-0.6	-1.5	0.4	1.6	1.2	0.9	n.a.	0.3	n.a.	-0.2	0.2
Changes in inventories	-1.4	-1.2	0.8	0.1	0.4	0.8	n.a.	-1.1	n.a.	-0.1	-0.4
Net exports	-0.1	-0.5	0.1	0.0	-0.1	0.0	n.a.	0.8	n.a.	0.2	0.3
Employment (% change)	-1.8	-1.7	-0.9	1.0	0.4	0.5	n.a.	-0.2	n.a.	0.0	-0.2
GDP deflator (% change)	1.9	0.7	1.2	1.1	1.7	1.3	n.a.	1.6	n.a.	1.4	1.5
Output gap (% of potential GDP)	-2.5	-2.7	-2.5	-2.0	-2.4	-1.4	n.a.	-2.4	n.a.	-3.4	-3.3
Potential output growth	1.2	1.0	1.2	1.0	1.4	1.0	n.a.	1.0	n.a.	0.9	1.4

Source: COM 2009 AF – Commission services' 2009 Autumn Forecast; COM 2013 SF – Commission services' 2013 Spring Forecast; SP 2013 – Stability Programme 2013.

The economic crisis has also had a significant impact on the general government balance. The deficit rose to an unprecedented 7.5% of GDP in 2009 from an already elevated 3.3% in 2008 due to the play of automatic stabilisers and the discretionary fiscal stimulus implemented by the authorities as part of the European Economic Recovery Plan (EERP). At 7.1% of GDP the outcome for 2010 was slightly better, with the partial phasing-out of the recovery plan more than offsetting the negative budgetary impact of the local business tax reform and that of reducing VAT on restaurant services. Fiscal consolidation started in earnest in 2011, in line with the Council recommendation of 2 December 2009. Strengthened fiscal efforts together with the complete phasing-out of the stimulus measures and still relatively robust GDP growth helped reduce the deficit to 5.3% of GDP (revised up from 5.2%).

According to the national statistics office, the general government deficit reached 4.8% of GDP in 2012, thus falling short of the 4.5% official target. Overall, the state budget execution showed relatively limited tax revenue shortfalls and spending was kept under control; healthcare expenditure was also below target while spending by local governments increased at a somewhat higher pace than targeted.

Based on the Commission services' 2013 Spring Forecast, the headline deficit is set to decrease further in 2013 on the back of the measures adopted notably as part of the budget. The overall amount of revenue measures is estimated at 1.4% of GDP. Current expenditure rules (central government and healthcare) are renewed and this will contribute to maintaining spending restraint. Lower than previously projected inflation and the partial suspension of indexation for second-pillar pensions in agreement with social partners will also help contain expenditure. However, GDP growth, which is projected well below potential, will negatively affect the headline balance. Overall, the deficit is expected to reach 3.9% of GDP. Under the customary no-policy-change assumption, the deficit is forecast to slightly deteriorate in 2014. Indeed, part of the measures aimed at funding the recent corporate tax credit for competitiveness and employment (*compétitivité-emploi*) are yet to be specified in sufficient detail and a number of one-off tax payments will expire at end-2013.

Regarding risks to this year's budgetary outlook, while no major expenditure slippages are expected at this stage, an even lower than currently forecast tax content of economic activity cannot be discarded. The tax revenue elasticity with respect to GDP underpinning the spring forecast is 0.9 and 1.0 for 2013 and 2014, respectively. However, historical data covering the years 1990 to 2010 show that protracted periods of low growth are often associated with low (below standard) elasticity.

The debt ratio, which exceeded 90% of GDP last year, will continue to rise over the forecast horizon on the back of still relatively high general government deficits and subdued nominal GDP growth. Stock-flow adjustments including contributions to the European Stability Mechanism and direct loans to euro area programme counties will also contribute to increasing public debt.

3. EFFECTIVE ACTION

3.1. Background information

The current assessment of effective action is based on the Commission services' 2013 Spring Forecast. It takes into account the economic and budgetary developments since the last Council recommendation under Article 126(7) TFEU was issued in December 2009. The assessment starts by comparing the recommended fiscal effort in the Council recommendation, the apparent fiscal effort, measured by the change in structural budget balance, and the adjusted fiscal effort. The adjustment of the structural balance takes into account (i) the impact of revisions in potential output growth compared with the growth scenario underpinning the Council recommendation and (ii) the impact of revenue windfalls/shortfalls relative to the standard assumptions. This top-down approach in the assessment is complemented by a careful analysis, including a bottom-up assessment of the consolidation measures undertaken by the French authorities over the reference period.

3.2. Assessment of effective action in 2010-13 – overview

Based on the Commission services' 2013 spring forecast, the structural deficit is estimated to fall to 2.2% of GDP this year from 6.1% in 2009. This implies an (apparent) average annual fiscal effort of 1.0% of GDP over the 2010-13 reference period. When correcting for downward revisions in potential output growth (+0.1% of GDP) and revenue windfalls (-0.2% of GDP) compared with the time the Council recommendation was issued, the average annual fiscal effort comes at 0.9% of GDP, thus falling slightly short of the recommended effort of above 1% of GDP (see Table 2).

Table 2 – Change in the structural balance corrected for revisions in potential output growth and revenue windfalls/shortfalls

Uncorrected average annual fiscal effort over 2010-13	Corrected average annual fiscal effort over 2010-13	Required average annual fiscal effort (2009 Council recommendation)	Deadline for correction
1.0	0.9	above 1.0	2013

Source: Commission services' 2013 Spring Forecast and Commission services' calculations.

Average potential output growth was estimated at 1.3% at the time of the Council recommendation, vs. 1.1% according to the spring forecast. The main reason behind is a downward revision in the contribution of total factor productivity, which has been negatively affected by the economic crisis.

Revenue[2], net of discretionary measures, is forecast to have increased in 2010-13 at a slightly higher pace than nominal GDP, implying an apparent aggregate revenue elasticity of 1.1 over that period. This compares with the 0.9 benchmark elasticity used for the calculation of the cyclically-adjusted balance[3]. The difference mainly stems from corporate income tax receipts and, to a lesser extent, social contributions, which are set to have increased more than what standard elasticities of individual revenue categories would have implied.

3.3. Assessment of effective action 2010-13 – detailed analysis of measures

The cumulated impact of the discretionary measures implemented by the French authorities over 2010-13 is currently estimated at some 5¼% of GDP using a purely bottom-up approach (see Table 4).

The overall tax burden increased from 42.1% of GDP in 2009 to 44.9% in 2012 and is expected to reach 46.3% this year. Discretionary revenue measures are estimated to have yielded a cumulated 3¾% of GDP over 2010-13, with windfalls and one-offs (in 2013) explaining the rest of that increase. This compares with total revenue measures of some -3% of GDP in 2000-09.

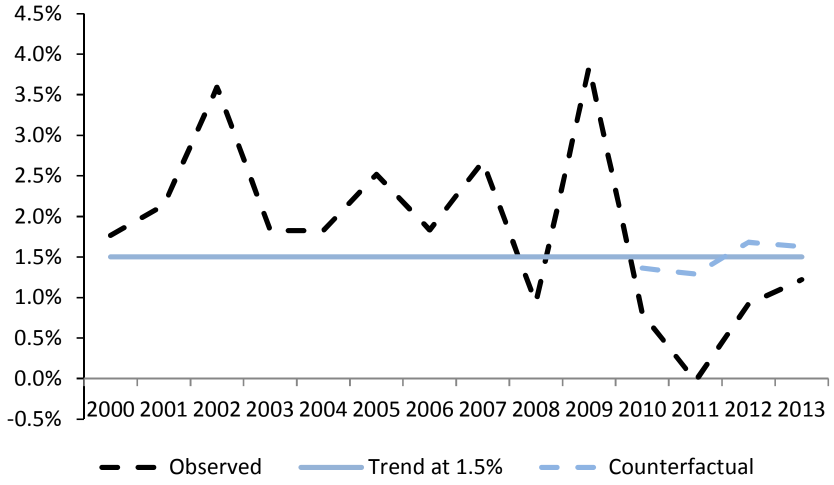
General government expenditure is forecast to grow by an average 0.7% over 2010-13 in real terms when deflated by the national consumer price index (CPI). This compares with an average annual increase of 2.3% in 2000-09. While the latter increase cannot be necessarily taken as a counterfactual, it clearly points to strengthened efforts at reining in spending growth in recent years.

A recent report from the *Inspection générale des finances* concluded that the average trend increase in general government expenditure (i.e. without any discretionary measures) for the period 2012-16 is 1.5% in real terms. When correcting the actual increase over 2010-13 for the measures identified hereafter, we come out at something very close to this estimate, which also confirms that efforts have been strengthened over the past few years (see Graph).

[2] Total current revenue of general government.

[3] See *The cyclically-adjusted budget balance used in the EU fiscal framework: an update*, European Commission, Economic Papers 478, March 2013.

Graph – General government expenditure growth corrected for discretionary measures over 2010-13 (counterfactual scenario)



Based on a bottom-up approach identifying only discretionary measures known in sufficient detail or that have been subject to an independent assessment[4] and which come on top of 'customary' efforts already observed in the past and thus considered as part of the counterfactual, expenditure savings over 2010-13 are estimated at some 1½% of GDP. These include savings at central government and social security level. Freeze in transfers from central government as well as relatively constrained financing conditions have probably contributed to the subdued growth of local spending but this is difficult to substantiate.

Regarding central government, savings were achieved through the General Review of Public Policies (*révision générale des politiques publiques* or RGPP) which was launched by the authorities in July 2007. The initial aim was to reduce public spending while increasing the efficiency and quality of public action by reviewing underlying government policies, coverage of activities by the public sector and delivery modes of public services. However, actual measures were confined to merging ministerial departments, rationalising the central government's administration in local territories and sharing support services that cut across all ministries (HR policy, procurement, etc.) without truly reviewing major social and economic policies. One symbolic measure of the RGPP was the non-replacement of half of retiring central government civil servants. Overall, the underlying savings have contributed to meeting the double spending norm at central government level over the last few years[5]. The RGPP has now been replaced by the MAP (*modernisation de l'action publique*), whose aim is to achieve further savings through a genuine review of all public policies, including in the areas of social security and local government. While a number of programmes are currently being reviewed, no measures have up to date been officially announced.

Public sector wages have been frozen in nominal terms since July 2010, and no indexation is foreseen before next year. This measure affects all sub-sectors of general government.

[4] For example by the Court of Auditors, the *Inspection générale des finances* and the *Inspection générale des affaires sociales*.

[5] Central government expenditure excluding interest payments and civil servants' pensions has been frozen in nominal terms since 2011. This rule comes on top of the zero volume rule introduced in 2004, which applies to all central government expenditure.

Concerning pensions, the 2010 reform included a gradual increase in the minimum retirement age from 60 to 62 and in the full-pension age from 65 to 67. The age of 60 was restored for certain categories of workers as from November 2012.

Finally, healthcare expenditure is subject to a nominal target fixed on an annual basis (*objectif national de dépenses d'assurance maladie* or ONDAM). This rule was strengthened in 2010, notably through (i) an improved governance (establishment of a steering committee and a statistical committee within the administration, in charge of following healthcare expenditure on a monthly basis); (ii) an increased role for the independent committee in charge of alerting the authorities in case of substantial slippages; (iii) setting aside funds at the beginning of each year, which are released in the course of the year depending on whether the target is (expected to be) met. Overall, annual targets have since been more ambitious and, most importantly, fully achieved.

Overall, while a purely top-down approach provides a mixed picture when it comes to assessing effective action, a comprehensive analysis suggests that the cumulated impact of discretionary measures exceeds the recommended fiscal effort. Furthermore, looking at individual measures yields a more positive picture regarding expenditure savings, with these estimated to account for one-third of the total budgetary impact, against an exclusively revenue-based fiscal consolidation according to the structural balance approach[6].

Table 3 – Composition of budgetary adjustment

% of GDP	2009		2010		2011		2012		2013		
	COM 2009 AF	outturn	COM 2009 AF	outturn	COM 2009 AF	outturn	COM 2009 AF	outturn	COM 2009 AF	COM 2013 SF	SP 2013
Revenue	47.0	49.2	46.8	49.5	47.1	50.6	n.a.	51.7	n.a.	53.3	53.1
of which:											
- Taxes on production and imports	14.4	15.1	14.5	14.9	14.4	15.3	n.a.	15.4	n.a.	15.5	15.6
- Current taxes on imcome, wealth, etc.	9.9	9.9	10.1	10.6	10.7	11.2	n.a.	12.0	n.a.	13.0	12.8
- Social contributions	17.4	18.8	17.0	18.6	16.8	18.8	n.a.	19.0	n.a.	19.2	19.3
- Other (residual)	5.3	5.4	5.2	5.4	5.2	5.4	n.a.	5.3	n.a.	5.5	5.4
Expenditure	55.3	56.8	55.1	56.6	54.8	55.9	n.a.	56.6	n.a.	57.2	56.8
of which:											
- Primary expenditure	52.5	54.3	52.2	54.1	51.8	53.3	n.a.	54.0	n.a.	54.7	54.4
of which:											
- Compensation of employees	13.1	13.5	13.0	13.4	12.9	13.1	n.a.	13.2	n.a.	13.2	13.2
- Intermediate consumption	5.3	5.6	5.2	5.8	5.1	5.5	n.a.	5.6	n.a.	5.6	5.6
- Social payments	24.6	25.5	24.8	25.6	24.6	25.5	n.a.	26.0	n.a.	26.6	26.4
- Subsidies	1.5	1.7	1.4	1.7	1.4	1.5	n.a.	1.5	n.a.	1.5	1.5
- Gross fixed capital formation	3.5	3.4	3.3	3.1	3.3	3.1	n.a.	3.1	n.a.	3.2	3.2
- Other (residual)	4.5	4.7	4.4	4.5	4.4	4.6	n.a.	4.6	n.a.	4.5	4.5
- Interest expenditure	2.8	2.4	2.9	2.4	3.0	2.6	n.a.	2.6	n.a.	2.5	2.4
General government balance (GGB)	-8.3	-7.5	-8.2	-7.1	-7.7	-5.3	n.a.	-4.8	n.a.	-3.9	-3.7
Primary balance	-5.5	-5.1	-5.4	-4.7	-4.7	-2.7	n.a.	-2.3	n.a.	-1.4	-1.3
One-off and other temporary measures	0.0	0.0	-0.4	-0.2	0.0	0.1	n.a.	0.0	n.a.	0.1	-0.1
Structural balance	-7.0	-6.1	-6.6	-5.8	-6.5	-4.7	n.a.	-3.6	n.a.	-2.2	-1.8
Change in structural balance	-3.1	1.9	0.4	0.3	0.1	1.2	n.a.	1.1	n.a.	1.3	1.6
Real GDP growth	-2.2	-3.1	1.2	1.7	1.5	1.7	n.a.	0.0	n.a.	-0.1	0.1
GDP deflator growth	1.9	0.7	1.2	1.1	1.7	1.3	n.a.	1.6	n.a.	1.4	1.5
Nominal GDP growth	-0.3	-2.5	2.5	2.7	3.3	3.1	n.a.	1.6	n.a.	1.3	1.7

Source: COM 2009 AF – Commission services' 2009 Autumn Forecast; COM 2013 SF – Commission services' 2013 Spring Forecast; SP 2013 – Stability Programme 2013.

[6] Following a top-down approach suggests that fiscal consolidation has been revenue-driven: based on the Commission services' 2013 Spring Forecast, the cyclically-adjusted ratio of revenue to GDP net of one-off measures is estimated to increase from 47¾% in 2009 to 51¼%, while the expenditure ratio is set to remain broadly flat in structural terms.

3.4. Budgetary implementation in 2010

After peaking at 7.5% of GDP in 2009, the general government deficit decreased to 7.1% in 2010, reflecting both cyclical effects[7] and an improvement in the structural balance (partly offset by deficit-increasing one-offs). The stimulus package implemented as part of the EERP, which included both revenue and expenditure measures, was partly withdrawn. Savings also came from the RGPP review exercise conducted at central government level and the healthcare spending norm that was fully achieved for the first time since more than a decade. On the other hand, the local business tax reform[8] and the VAT rate decrease restaurant services weighed on tax receipts. Another significant development was the strong decline in investment by local authorities, which accounts for some 70% of total general government gross fixed capital formation, which clearly contributed to the subdued increase in public expenditure.

Overall, the cumulated impact of discretionary measures excluding one-offs is estimated at ¾% of GDP in 2010. However, this is only partly reflected in the structural balance, which improved by 0.3% of GDP, reflecting different baseline scenarios. Indeed, the benchmark for measuring the fiscal effort as per the structural balance is potential output growth, whereas the benchmark for assessing the budgetary impact of measures as per bottom up is often different across revenue/expenditure items and often diverges from potential output growth. When correcting for downward revisions in potential output growth (estimated impact of +0.1% of GDP) and revenue windfalls (estimated impact of -0.2% of GDP in 2010, mainly due to the strong rebound in corporate income tax receipts) compared with the time the Council recommendation was issued, the fiscal effort as measured by the change in the structural balance comes at 0.2% of GDP.

[7] GDP growth was 1.7% vs. potential output growth estimated at 1.0%.

[8] The local business tax was paid by companies and essentially based on the rental value of fixed assets. It was abolished in 2010 and replaced by a new economic contribution for businesses (*contribution économique territoriale* or CET) and a flat-rate tax on network businesses; additional tax revenue was also transferred to local governments.

Table 4: Main budgetary measures over 2010-13 (excluding one-offs)

Revenue	Expenditure
2010	
Phasing-out of the recovery plan (+0.6% of GDP) Reduced VAT on restaurant services (-0.1% of GDP) Local business tax reform (-0.2% of GDP)	Phasing-out of the recovery plan (-0.1% of GDP) Savings stemming from the RGPP spending review at central government level (-0.1% of GDP) Savings in healthcare expenditure (-0.1% of GDP)
2011	
Application of the standard VAT rate to triple-play services (+0.1% of GDP) Other increases in indirect taxation (+0.1% of GDP) Complete phasing-out of the recovery plan (+0.1% of GDP) Increase in income taxation/reduction in income tax expentitures (+0.3% of GDP) Increase in social contributions/reduction in social security exemptions (+0.2% of GDP)	Phasing-out of the recovery plan (-0.1% of GDP) Freeze in base wages of civil servants (-0.1% of GDP) Savings stemming from the RGPP spending review at central government level (-0.2% of GDP) 2010 pension reform (-0.1% of GDP) Savings in healthcare expenditure (-0.1% of GDP) Other measures (-0.1% of GDP)
2012	
New intermediate VAT rate (+0.1% of GDP) Other increases in indirect taxation (+0.2% of GDP) Increase in income taxation/reduction in income tax expentitures (+0.6% of GDP) No indexation of tax brackets of personal income tax and tax on wealth (+0.1 of GDP) Higher social levies on capital income and gains (+0.1% of GDP) Local business tax reform (-0.1% of GDP) Increase in social contributions/reduction in social security exemptions (+0.1% of GDP)	Freeze in base wages of civil servants (-0.1% of GDP) Savings stemming from the RGPP spending review at central government level (-0.1% of GDP) Additional savings at central government level (-0.1% of GDP) 2010 pension reform (-0.2% of GDP) Savings in healthcare expenditure (-0.1% of GDP) *Investissements d'avenir* programme (+0.1% of GDP) Other measures (+0.1% of GDP)
2013	
Increase in indirect taxation (+0.2% of GDP) Increase in income taxation/reduction in income tax expentitures (+0.5% of GDP) No indexation of tax brackets of personal income tax and tax on wealth (+0.1 of GDP) Higher social levies on capital income and gains and on employee savings schemes (+0.2% of GDP) Increase in social contributions/reduction in social security exemptions (+0.3% of GDP)	Freeze in base wages of civil servants (-0.1% of GDP) Savings stemming from the RGPP spending review at central government level (-0.1% of GDP) 2010 pension reform (-0.1% of GDP) Savings in healthcare expenditure (-0.1% of GDP) *Investissements d'avenir* programme (+0.1% of GDP)

	Other measures (+0.1% of GDP)	
Note: A positive sign implies that revenue / expenditure increases as a consequence of this measure. Annual budgetary impacts are estimated by the Commission services. Measures with a budget impact of at least 0.1% of GDP are listed.		

3.5. Budgetary implementation in 2011

In 2011, the deficit decreased significantly to reach 5.3% of GDP. While GDP growth remained unchanged at 1.7%, the improvement mainly stemmed from strengthened consolidation efforts.

Beyond the phasing-out of the remaining stimulus measures, the 2011 budget contained a significant set of tax increases. These included a cut in tax expenditures, an increase in the top rate of personal income tax from 40% to 41%, an advance payment of social contributions on life insurance policies, higher taxation of supplementary health insurance schemes, standard VAT rate being applied to triple-play services and a new tax on banks. Additional revenue measures were announced in August 2011 but most implied a significant budgetary impact in 2012 only. Overall, the tax burden increased to 43.7% of GDP from 42.5% in 2010, also on the back of one-offs and somewhat higher increase in tax revenue (net of discretionary measures) than nominal GDP growth.

On the expenditure side, the RGPP programme review process yielded additional savings at central government level. The healthcare spending norm was again (over)achieved along with substantial savings from the 2010 pension reform. Compensation of employees grew much less compared with historical trends as base wages across all government sub-sectors were frozen in nominal terms (on top of replacing only half of retiring central government civil servants decided as part of the RGPP). On the whole, public expenditure remained flat in real terms (when deflated by national CPI) against an annual increase of 2.3% on average between 1999 and 2009. However, part of this was due to exceptional factors such as the counter-effect of unusually high military equipment deliveries in 2010 (which alone contributed to lowering expenditure growth by 0.4 pp.).

The overall budgetary impact of discretionary measures excluding one-offs is estimated at 1½% of GDP in 2011. The fiscal effort as measured by the change in the structural balance was 1.2% of GDP. Correcting for downward revisions in potential output growth (impact of +0.1% of GDP) brings it to 1.3% of GDP. However, large revenue windfalls (impact of -0.4% of GDP) reflected personal and income income tax receipts but also social contributions growing above what standard elasticities woud have implied. Based on this, the fiscal effort comes at 0.9% of GDP in 2011.

3.6. Budgetary implementation in 2012

According to the national statistical office, the headline deficit came out at 4.8% of GDP last year, thus falling short of the 4.5% targeted until recently by the authorities (although part of the difference stemmed from the cost of bailing out Dexia, which Eurostat consided as a capital transfer in late March). GDP growth well below potential affected negatively the headline numbers and partly offset the budgetary impact of fiscal consolidation.

On the revenue side, measures included a further cut in tax expenditures, no indexation of tax brackets of personal income tax and tax on wealth in 2012-13, limiting the possibilities for carrying over losses in the calculation of corporate income tax, an additional temporary tax on top incomes and large companies, higher taxation on capital income and gains, a new intermediate VAT rate (implying an increase from 5.5% to 7% for a number of goods and services) and a rise in excise duties on tobacco and alcohol. An additional fiscal package was decided in the course of the year to compensate for lower than previously expected GDP growth. Measures included a new cut in tax expenditures, a one-off contribution on wealth (which has since been partly replaced by higher statutory rates of tax on wealth), doubling the financial transaction tax adopted earlier that same year and some advance tax payments. Overall, the tax burden increased by another 1.2 pp. to 44.9% of GDP.

Regarding expenditure, savings at central government level came again from the on-going programme review process. Budgetary appropriations were also cancelled as part of the successive fiscal packages. The ONDAM spending norm was overachieved for the third year in a row, thus adding savings compared with the trend increase in healthcare expenditure. The 2010 pension reform yielded additional savings and the gradual increase in retirement ages was accelerated. In addition, the indexation of housing and family allowances on inflation was partly suspended. The freeze in base wages across all sectors of general government was maintained thus contributing to an only subdued increase in the public sector's wage bill. On the other hand, the back-to-school allowance was raised by 25% and the *investissements d'avenir* programme (notably consisting in public investments) gave rise to first disbursements of funds. Overall, the increase in general government expenditure was 0.9% in real terms, thus remaining well below historical trends. The impact of one-off measures (e.g. recapitalisation of Dexia, sale of mobile phone licenses recorded in national accounts as negative expenditure) appeared broadly balanced.

The total budgetary impact of discretionary measures excluding one-offs is estimated at 1½% of GDP while the structural balance improved by 1.1% of GDP. Taking revisions in potential output growth into account (impact of +0.1% of GDP) brings the latter to 1.2% of GDP. However, revenue net of discretionary measures grew again above what standard elasticities would have implied (impact of -0.1% of GDP), driven by indirect taxes, personal income tax receipts and social contributions. Altogether, this brings the fiscal effort to 1.1% of GDP in 2012.

3.7. Budgetary developments in 2013

According to the Commission services' 2013 Spring Forecast, this year's deficit is expected to reach 3.9% of GDP. This is slightly higher than projected in the winter forecast and mainly due to lower growth prospects and the base effect stemming from 2012. Cyclical effects will again impact negatively on the headline figures.[9].

On top of the measures included in last summer's fiscal package, which will now yield their full-year effects, the 2013 budget contained a significant set of new tax hikes and tax expenditure cuts. Additional revenues compared with 2012 will come mainly from increasing personal income tax on high incomes – the top rate has been increased from 41% to 45% –, reducing corporate income tax credits, increasing donation and inheritance taxes, abolishing tax and social security exemptions on overtime, increasing social contributions on employee savings schemes as well as on capital income and gains. However, a number of measures have only a one-off budgetary impact meaning that next year's revenue will actually fall assuming no further policy action is taken. On the whole, the tax burden is expected to increase by some 1.4 pp. to 46.3% of GDP, implying that it will have risen by 4.2 pp. over the 2010-13 reference period.

[9] GDP is set to decrease by 0.1% vs. potential output growth estimated at 1.0%.

Although the RGPP programme review process has since mid-2012 been officially replaced by the *modernisation de l'action publique* or MAP, it is set to continue yielding savings at central government level this year as well. Although several programme reviews have already been launched as part of the MAP, no measures have been specified so far and the target amount of savings remains unclear. The freeze in public sector wages has been maintained with compensation of employees again set to increase below historical levels. In the area of social security, the healthcare spending norm is forecast to be met as it was in the period 2010-12. While the 2010 pension reform will provide additional savings along with the gradual increase in the minimum retirement age, these will be partly offset by the partial rollback of the reform. Indeed, people who started work before the age of 20 and achieved a full contribution career have since November 2012 been allowed again to retire at 60. However, the budgetary impact of this measure has been compensated by an increase in employers' and employees' social contributions. On the pension front as well, social partners reached a historical agreement in March allowing for pensions from supplementary schemes to be only partly adjusted for annual inflation over 2013-15. While the agreement has already been applied, substantial savings will be made from 2014 onwards. On the other hand, an additional set of disbursements under the *investissements d'avenir* programme will affect negatively the general government balance. Recent measures such as subsidised employment schemes (*emplois d'avenir*, *contrats de generation*) are planned to be funded through additional savings. On the whole, general government expenditure is set to increase by around 1% in real terms this year. However, the ratio of public expenditure to GDP is set to increase again on the back of low nominal GDP growth projected.

Overall, the budgetary impact of discretionary measures excluding one-offs is estimated at 1½% of GDP in 2013. According to the spring forecast, the structural balance is projected to improve by another 1.3% of GDP. Adjusting for revisions in potential output growth compared with the time the Council recommendation was issued (impact of +0.1% of GDP) brings the fiscal effort at 1.5% of GDP. Also taking into account expected windfall revenues compared with standard elasticities (impact of -0.2% of GDP) brings it back to 1.3% of GDP (factors do not add up due to rounding effects).

The average annual fiscal effort over the entire 2010-13 period is estimated at 1% of GDP. Adjusting for revisions in potential output growth and revenue windfalls brings it to 0.9% of GDP. The cumulated impact of discretionary measures over that period is estimated at 5¼% of GDP.

4. PROPOSED NEW ADJUSTMENT PATH

According to the Commission services' 2013 Spring Forecast, France is not expected to correct its excessive deficit by the deadline established in the Council recommendation of 2 December 2009 despite an average annual fiscal effort over 2010-13 very close to the level recommended by the Council and an even higher cumulated budgetary impact of discretionary measures. At the same time, while the macroeconomic scenario underpinning the recommendation assumed that the output gap would gradually narrow, GDP is actually expected to grow below potential over that period. This has clearly had a negative impact on the headline budget balance. It therefore appears justified to issue a revised EDP recommendation and to extend the deadline for correction of the excessive deficit.

Based on the spring forecast, the deficit is set to reach 4.2% of GDP next year under the usual no policy change assumption which implies that only measures specified in sufficient detail have been taken into account. In particular, it remains unclear whether the MAP spending review will translate into sizeable (and easy to quantify) savings and current plans to reform the pension system need to be further detailed. In addition, maintaining the freeze in base wages beyond 2013 has not been explicitly confirmed. Specifics are also lacking on the projected slowdown in local government spending. On the revenue side, a number of one-off tax payments will expire at end-2013 and no specific measures to compensate for these have been announced so far. In addition, the recent tax credit for competitiveness and employment appears insufficiently backed by clearly specified expenditure savings even though these are planned to account for half of its funding.

Building on this, different scenarios have been considered in order to assess the delay needed for France to realistically correct its excessive deficit. In particular, an extension by one year of the deadline would require a fiscal effort in 2013-14 well above the level currently recommended, on top of what is already contained in the spring forecast, when also taking into account second-round effects of fiscal consolidation on growth. Given the size of the fiscal effort required, the negative impact on GDP growth would be significant and a recession in 2014 could not be discarded. Such a scenario would also probably imply additional measures already this year, on top of those already implemented by the authorities.

On the other hand, a two-year extension would allow bringing the headline deficit below 3% in 2015 and growth would remain positive in both years, even after taking into account second-round effects on growth. Given that 2015 is not covered by the spring forecast, it has been assumed in the baseline scenario that at unchanged policies (i) the output gap would close in five years' time with this leading to GDP growth in 2015 at 1.9% (vs. potential growth at 1.1% based on the spring forecast) and (ii) the structural balance would remain unchanged in 2015. Together, these two assumptions imply a slight improvement in the headline deficit in 2015 (3.9% of GDP vs. 4.2% in 2014).

On the basis of the considerations above, granting France two additional years for correcting its excessive deficit appears warranted. This would be consistent with a fiscal adjustment conducted in the context of well-specified medium-term plans, at a steady underlying pace that would ensure the reduction in the deficit without undermining the recovery. Such an extension would be based on a strict implementation of this year's budget and a fiscal effort of 0.8% of GDP in both 2014[10] and 2015, which is below the pace of fiscal adjustment since 2010. This would be consistent with headline deficit targets of 3.9% of GDP for 2013, 3.6% for 2014 and 2.8% for 2015[11]. The targets for annual improvement in the structural balance take into account the need to compensate for negative second-round effects of fiscal consolidation on growth and thus on public finances.

The Commission services' 2013 Spring Forecast incorporates only measures adopted or known in sufficient detail. Therefore expenditure savings and/or revenue measures would need to be specified, adopted and rapidly implemented in order to achieve the correction of the excessive deficit by 2015 at the latest while at the same time fulfilling the proposed fiscal effort in both 2014 and 2015. The situation will have to be monitored closely and the authorities should stand ready to take corrective action in the event of expenditure slippages or revenue shortfalls.

[10] Does not equal difference 2013/14 in Table 6 due to rounding effects.

[11] The headline targets take into account one-off measures whose impact on the general government balance is currently estimated at 0.1% of GDP in 2013 and -0.1% in both 2014 and 2015.

Furthermore, the consolidation of public finances and their sustainability would be supported by (i) proceeding as currently planned with a thorough review of spending categories across all sub-sectors of general government, including at social security and local government level, which could translate into a more expenditure-based fiscal consolidation and (ii) strengthening the medium- and long-term sustainability of the pension and healthcare systems by further adjusting all relevant parameters.

Table 5 – Forecast of key macroeconomic and budgetary variables under the baseline scenario

% of GDP	**2012**	**2013**	**2014**	**2015**
Revenues	51.7	53.3	52.9	52.6
Current revenues	51.4	52.9	52.6	52.2
Discretionary measures with impact on current revenue (1)	1.1	1.3	-0.4	-0.1
Expenditure	56.6	57.2	57.2	56.4
Real GDP growth (%)	0.0	-0.1	1.1	1.9
Nominal GDP growth (%)	1.6	1.3	2.8	3.6
Potential GDP growth (%)	1.0	0.9	1.0	1.1
Structural balance	-3.6	-2.2	-2.3	-2.3
General government balance	-4.8	-3.9	-4.2	-3.9
p.m CAB methodology revenue elasticity	0.9	0.9	0.9	0.9
p.m Apparent revenue elasticity	1.0	1.2	1.0	0.9
p.m Output gap (% of potential output)	-2.4	-3.4	-3.3	-2.6

(1) Measures clearly specified and committed to by governments ahead of the recommendation.

Table 6 – Forecast of key macroeconomic and budgetary variables under the EDP scenario

% of GDP	**2012**	**2013**	**2014**	**2015**
Real GDP growth (%)	0.0	-0.1	0.6	1.1
Potential GDP growth (%)	1.1	0.9	0.9	0.9
Structural balance	-3.5	-2.2	-1.5	-0.7
General government balance	-4.8	-3.9	-3.6	-2.8
p.m Output gap (% of pot. output)	-2.5	-3.4	-3.7	-3.5

5. CONCLUSIONS

On current information, the average annual fiscal effort after correction for the effects of revisions in potential output growth and revenue windfalls is estimated to amount to 0.9% of GDP. This falls slightly short of the average annual fiscal effort of above 1% of GDP over 2010-13 recommended by the Council in December 2009.

However, the bottom-up approach estimates the cumulated size of individual consolidation measures at some 5¼% of GDP over 2010-13. It confirms that fiscal consolidation has so far been more revenue-based but suggests that expenditure savings (beyond "customary" savings already observed in the past) have also contributed to improving the general government balance. Thus, the bottom-up calculation of the discretionary consolidation measures implemented by the authorities over 2010-13 provides a more positive picture than does the purely top-down approach based on the structural balance.

The deficit is expected to remain well above the 3% of GDP reference value this year. It is set to slightly deteriorate in 2014 under the usual no policy change assumption underpinning the Commission services' forecasts.

The substantial cyclical deterioration in the budgetary position resulting from the weaker overall position of the economy relative to the macroeconomic scenario underlying the 2009 Council recommendation and medium-term growth prospects suggest that extending the deadline for correction of the excessive deficit by 2015 at the latest is appropriate.

Granting France two additional years appears commensurate with headline deficit targets of 3.6% of GDP for 2014 and 2.8% for 2015. The underlying improvement in the structural budget balance would be 0.8% of GDP both in 2014 and 2015.

Table 7 – Comparison of key macroeconomic and budgetary projections

		2009	2010	2011	2012	2013	2014
Real GDP (% change)	COM AF 09	-2.2	1.2	1.5	n.a.	n.a.	n.a.
	COM SF 13	-3.1	1.7	1.7	0.0	-0.1	1.1
	SP 2013	-3.1	1.7	1.7	0.0	0.1	1.2
Output gap (1) (% of potential GDP)	COM AF 09	-2.5	-2.5	-2.4	n.a.	n.a.	n.a.
	COM SF 13	-2.7	-2.0	-1.4	-2.4	-3.4	-3.3
	SP 2013	-2.7	-2.1	-1.5	-2.5	-3.3	-3.2
General government balance (% of GDP)	COM AF 09	-8.3	-8.2	-7.7	n.a.	n.a.	n.a.
	COM SF 13	-7.5	-7.1	-5.3	-4.8	-3.9	-4.2
	SP 2013	-7.5	-7.1	-5.3	-4.8	-3.7	-2.9
Primary balance (% of GDP)	COM AF 09	-5.5	-5.4	-4.7	n.a.	n.a.	n.a.
	COM SF 13	-5.1	-4.7	-2.7	-2.3	-1.4	-1.8
	SP 2013	-5.1	-4.7	-2.7	-2.3	-1.3	-0.4
Cyclically-adjusted balance (1) (% of GDP)	COM AF 09	-7.0	-7.0	-6.5	n.a.	n.a.	n.a.
	COM SF 13	-6.1	-6.0	-4.5	-3.5	-2.1	-2.5
	SP 2013	-6.1	-5.9	-4.5	-3.5	-1.9	-1.2
Structural balance (2) (% of GDP)	COM AF 09	-7.0	-6.6	-6.5	n.a.	n.a.	n.a.
	COM SF 13	-6.1	-5.8	-4.7	-3.6	-2.2	-2.3
	SP 2013	-6.1	-5.8	-4.6	-3.4	-1.8	-1.1
Government gross debt (% of GDP)	COM AF 09	76.1	82.5	87.6	n.a.	n.a.	n.a.
	COM SF 13	79.2	82.4	85.8	90.2	94.0	96.2
	SP 2013	79.2	82.4	85.8	90.2	93.6	94.3

(1) Output gaps and cyclically-adjusted balances according to the Stability Programme as recalculated by Commission services on the basis of the information in the Stability Programme.
(2) Cyclically-adjusted balance excluding one-off and other temporary meaures.
Source: COM 2009 AF – Commission services' 2009 Autumn Forecast; COM 2013 SF – Commission services' 2013 Spring Forecast; SP 2013 – Stability Programme 2013.

ANNEX

Table A1 – Adjustment of the apparent fiscal effort for revisions in potential output growth - details of calculation

Average potential GDP growth underlying the Council Recommendation (%)	Average potential GDP growth at the time of assessment (%)	Forecast error (%)	Structural expenditure (% of potential GDP)	Correction coefficient (% of nominal potential GDP)
(1)	(2)	(3)=(1)-(2)	(4)	(5)=(3)*(4)/100
1.3	1.1	0.3	53.7	0.1

Source: Commission services' 2009 Autumn Forecast, 2013 Spring Forecast and calculations.

Table A2 – Adjustment of the apparent fiscal effort for revenue windfalls/shortfalls as compared to standard elasticities - details of calculation

	Change in current revenues (yoy) (billions of national currency)	Discretionary current revenue measures (billions of national currency)	Nominal GDP growth assumptions (%)	Current revenues in year t-1 (billion of national currency)	Revenue gap (billion of national currency)	Correction coefficient (% of nominal potential GDP)
	(1)	(2)	(3)	(4)	(5)= (1)-(2)-ε*(3)*(4)	
2010	29.8	4.1	2.7	923.7	3.3	0.2
2011	53.8	19.6	3.1	953.5	8.3	0.4
2012	38.4	22.4	1.6	1007.3	1.8	0.1
2013	43.6	27.4	1.3	1045.7	3.9	0.2
average						0.2

Source: Commission services' 2009 Autumn Forecast, 2013 Spring Forecast and calculations.