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Analysis of the budgetary situation in France

Accompanying the document

COMMUNICATION FROM THE COMMISSION

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**

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1. INTRODUCTION

This document assesses France's report on action taken which was submitted to the Council and the Commission on 10 June 2015 as foreseen in the Council recommendation of 10 March 2015 with a view to bringing an end to the excessive government deficit in France. It does so also taking into account the April 2015 Stability Programme of France submitted to the Commission on 30 April 2015.

France is currently subject to the corrective arm of the Stability and Growth Pact. The Council opened the Excessive Deficit Procedure for France on 27 April 2009 with an initial deadline in 2012. This deadline was extended to 2013 on 2 December 2009 and to 2015 on 21 June 2013 based on the finding that effective action had been taken but that unexpected adverse economic events with major unfavourable consequences for government finances had occurred. On 10 March 2015, the Council considered that the available evidence did not allow concluding on no effective action and extended once more the deadline for France to bring an end to its excessive deficit situation, to 2017. It also established a deadline of 10 June 2015 for France to take effective action and to report in detail on the consolidation strategy, in accordance with Article 3(4a) of Regulation (EC) No 1467/97.

The Council recommendation of 10 March 2015 set budgetary targets both in nominal and in structural terms to be complied with every year over the adjustment period. More specifically, it was recommended that the headline deficit reach 4.0 % of GDP in 2015, 3.4% in 2016 and 2.8% in 2017, which was considered consistent with delivering an improvement in the structural balance of 0.5% of GDP in 2015, 0.8% in 2016 and 0.9% in 2017. Based on the extended Commission 2015 winter forecast, the Council required additional measures, which represented 0.2% of GDP in 2015, 1.2% in 2016 and 1.3 % in 2017.

This document provides an assessment of the French budgetary strategy, notably updating the information included in the assessment of the 2015 Stability Programme published on 27 May 2015¹. Section 2 presents the macroeconomic outlook and the main developments which took place since the publication of the Commission 2015 spring forecast on 5 May 2015. The following section presents the recent and planned budgetary developments. In particular, it provides an assessment of the budgetary strategy in the light of the information included in the report on action taken. Section 4 then assesses compliance with the Council recommendation of 10 March 2015, including on the basis of the updated Commission forecast.

2. ECONOMIC DEVELOPMENTS AND OUTLOOK

The macroeconomic forecast underpinning the report on action taken has not been updated compared to the Stability Programme. In its Stability Programme, the government expects economic growth to reach 1% in 2015 after only 0.2% in 2014. Growth is then projected to accelerate to 1.5% in both 2016 and 2017, notably thanks to the implementation of economic policy measures such as the tax credit for competitiveness and employment (CICE) and the responsibility and solidarity pact

¹ 'Assessment of the 2015 Stability Programme for France', 27 May 2015, available at: http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/20_scps/2015/10_fr_scp_en.pdf

(RSP). Meanwhile, inflation, which is projected to be at a standstill in 2015, is expected to rise to 1.0% in 2016 and to 1.4% in 2017.

As pointed out in the assessment of the Stability Programme published on 27 May, the macroeconomic scenario of the authorities appears plausible. The Commission spring forecast projects a slightly stronger GDP growth (1.1% GDP growth in 2015 and 1.7% in 2016). In 2015, the Commission scenario projects a more dynamic private consumption than the authorities, and a positive net export contribution. In 2016, the Commission expects that the contribution of net trade to growth would remain marginal, while the authorities expect a positive impact. On the other hand, the usual no-policy-change assumption means that only the part of the expenditure cuts planned for 2016 that was specified at the time was taken into account in the Commission forecast, which results in a higher contribution of public consumption to GDP growth than in the government's scenario.

Table 1. Comparison of macroeconomic developments and forecasts

	2014		2015		2016		2017
	Outturn ²	COM	COM	SP	COM	SP	SP
Real GDP (% change)	0.2	0.4	1.1	1.0	1.7	1.5	1.5
Private consumption (% change)	0.6	0.6	1.6	1.5	1.5	1.5	1.4
Gross fixed capital formation (% change)	-1.2	-1.5	-0.6	-1.0	3.0	1.5	2.3
Exports of goods and services (% change)	2.7	2.7	4.7	4.9	5.9	5.5	5.5
Imports of goods and services (% change)	3.7	3.6	3.8	4.7	5.8	4.7	4.9
<i>Contributions to real GDP growth:</i>							
- Final domestic demand	0.4	0.4	1.0	0.9	1.6	1.3	1.4
- Change in inventories	0.2	0.3	-0.1	0.0	0.0	0.0	0.0
- Net exports	-0.4	-0.3	0.2	0.0	0.0	0.2	0.2
Output gap ¹	n.a.	-2.3	-2.3	-2.2	-1.7	-1.7	-1.4
Employment (% change)	n.a.	0.2	0.5	0.3	1.0	0.4	0.3
Unemployment rate (%)	n.a.	10.3	10.3	n.a.	10.0	n.a.	n.a.
Labour productivity (% change)	n.a.	0.1	0.6	0.7	0.7	1.0	1.2
HICP inflation (%)	0.6	0.6	0.0	0.0	1.0	1.0	1.4
GDP deflator (% change)	0.6	1.0	1.0	1.0	1.0	0.9	1.3
Comp. of employees (per head, % change)	n.a.	1.2	0.5	0.8	0.9	1.6	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	n.a.	-1.6	-0.8	-0.9	-1.0	-0.6	-0.2
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.							
² Based on detailed accounts published on 13 May 2015.							
Source:							
Commission 2015 spring forecast (COM); Stability programme (SP).							

Economic developments since the publication of the Commission 2015 spring forecast do not point to a need to revise the economic outlook. GDP growth in the first quarter of 2015 reached 0.6%, slightly above the 0.4% expected in this forecast. However, a part of the pick-up in growth stems from temporary factors. In addition, the latest business surveys, i.e. for May 2015, do not point to significant changes. Therefore, the GDP growth projections from the 2015 spring forecast as well as the forecasts for the main GDP components remain valid. Similarly, recent inflation developments have proved in line with the Commission spring forecast.

However, the recent negative developments on the labour market suggest that the Commission forecast of gradually improving labour market outcomes might be too optimistic. Indeed, employment contracted in the first quarter of 2015 (-13 000 jobs in the private sector), and the number of unemployed further increased, reaching 3.5 million in April 2015. This suggests that despite the recovering GDP growth and the policy measures to reduce the cost of labour, employers can be expected to first improve their low profit margins before increasing employment. Therefore, the unemployment rate would be expected to increase further in 2015 (by around 0.2 pp), before decreasing again in 2016.

3. BUDGETARY SITUATION AND UPDATED PROJECTIONS FOR THE PERIOD 2015-2017

The report on action taken confirms the budgetary strategy outlined in the Stability Programme which aims to correct the excessive deficit by 2017, the deadline set by the Council. More specifically, the government plans to bring the headline deficit to 3.8% of GDP in 2015, 3.3% in 2016 and 2.7% in 2017. By comparison, the Council recommended headline targets of 4.0% of GDP, 3.4% and 2.8% in 2015, 2016 and 2017, respectively. The Commission spring forecast also projected the general government deficit to reach 3.8% of GDP in 2015. Based on a no-policy change scenario, as a number of measures were not specified in the Stability Programme, the Commission expected the headline deficit to reach 3.5% of GDP in 2016, slightly above the target set by the Council.

This section provides an update of the budgetary projections included in the Commission 2015 spring forecast. It provides an assessment of budgetary execution for 2014 in light of the latest data on government finances released on 13 May 2015 and the additional information included in the report on action taken. Finally, it analyses the impact of these developments on the government deficit over 2016-2017.

3.1. General government deficit developments in 2014

Detailed data for 2014 released on 13 May 2015 confirm that the general government deficit in 2014 reached 4.0% of GDP compared to 4.3% of GDP expected at the time of the Council recommendation. While the detailed accounts could not be included in the Commission spring forecast released on 5 May, the headline deficit published on 13 May is in line with the level notified to the Commission on 1 April 2015, and included both in the Stability Programme and in the Commission spring forecast. Meanwhile, GDP growth for the year was revised downwards from 0.4% estimated in the notified data, in line with the macroeconomic scenario underpinning the Council recommendation, to 0.2% based on the new estimates. In nominal terms, GDP for 2014 increased by 0.8% compared to a 1.1% growth expected at the time of the Council recommendation and 1.3% based on notified data.

Outturn data for 2014 show that revenues have remained close to the level expected at the time of the Council recommendation. The amount of discretionary revenue measures in the spring forecast is estimated to stand at 0.5% of GDP, in line with the amount expected at the time of the Council Recommendation. While the downward revision in GDP compared to the scenario underpinning the Council recommendation weighed on tax revenues, this was compensated by a higher elasticity of public revenues. Based on the amount of discretionary revenue measures considered, the elasticity of current revenues to GDP, which was estimated to stand at close to 0.8 in 2014 in the Commission 2015 winter forecast, is now estimated at 1.1.

Public expenditures based on the detailed government accounts proved 0.3% of GDP lower than expected at the time of the Council recommendation. Total public expenditures increased by 1.6% in 2014, compared to 1.8% in 2013. Excluding the increasing cost of payable tax credits, which represented EUR 21 billion in 2014 (1.0% of GDP), the slowdown appears stronger as expenditures increased by 0.9% in 2014, after 1.8% in 2013. By comparison, the baseline scenario underpinning the Council recommendation expected public expenditures to grow by 2.2% in 2014. The lower-than-expected public expenditures are notably due to a much stronger-than-expected contraction in gross fixed capital formation in 2014, mostly driven by the fall in investment by local governments. Interest expenditures in 2014 also proved less dynamic than expected at the time of the Council recommendation, due to the low yields on government bonds and to the impact of decreasing inflation on indexed bonds.

3.2. Assessment of the measures included in the report on action taken

The report on action taken submitted on 10 June 2015 does not include new measures compared to the Stability Programme submitted on 30 April 2015. However, it provides further information on the nature and the implementation of the additional measures announced as part of the Stability Programme in response to the Council recommendation of 10 March 2015 whose impact is estimated by the government at EUR 4 billion (0.2% of GDP) in 2015 and EUR 5 billion (0.2% of GDP) in 2016.

Regarding 2015, the report on action taken confirms the implementation of the measures specified in the Stability Programme and that were already fully taken into account in the Commission 2015 spring forecast. The package announced by the government consists of a further reduction in State expenditures (EUR 1.2 billion), lower interest payments (EUR 1.2 billion) and social transfers (EUR 1 billion), as well as additional revenues stemming from the fight against tax fraud and from higher-than-expected dividends from the Banque de France (EUR 0.6 billion). The report on action taken indicates that the expenditure reductions have started to be implemented, with for example the publication of a decree confirming the planned savings for the Central State.

As pointed out in the assessment of the Stability Programme published on 27 May, part of these measures were taken in order to turn the lower-than-expected level of expenditures in 2014 into permanent savings. Compared to the scenario underpinning the 2015 budget and to the EDP baseline scenario, public expenditures in 2014 have proved significantly lower than expected (see Section 3.1). Nominal expenditure targets set by the budget for 2015 had thus to be revised downwards in the Stability Programme to avoid a "rebound" compared to the surprisingly low level of expenditure recorded in 2014. Such measures imply a reduction in the level of expenditures planned by the authorities and have a positive impact on the headline deficit for 2015, which is expected to stand at 3.8% of GDP. However, they do not change the pace of expenditure growth compared to 2014 and hence have no impact on the fiscal effort².

In fact, the additional measures for 2015 included in the Stability Programme are estimated to contribute by EUR 2.8 billion to the adjustment in the structural balance. On State expenditures, out of the EUR 1.2 billion expenditure cuts, only EUR

² The fiscal effort is computed on the basis of the pace of increase in public expenditures rather than on their level.

0.3 billion have an actual impact on the fiscal effort. Indeed expenditures by state agencies proved to be EUR 0.9 billion lower than expected at the time of the budget law for 2015, due to lower disbursements related to the '*programme d'investissement d'avenir*' (PIA) scheme. Part of the additional expenditure cuts on the State thus aim to ensure that the lower budgetary execution in 2014 is durable. The lower interest payments (EUR 1.2 billion), which can be considered as a windfall gains, have indeed been used to reduce the deficit, as recommended by the Council on 10 March 2015 and they contribute fully to the improvement in the structural balance. Savings on social transfers planned in 2015 (EUR 1.0 billion) contribute only EUR 0.7 billion to the fiscal effort. Indeed, savings are notably expected to result from a downward revision in the national norm on healthcare expenditures ('*objectif national de dépenses d'assurance maladie*' or ONDAM) which actually turned out to be EUR 0.3 billion lower than expected in 2014. Finally, the additional revenue measures planned to yield EUR 0.6 billion in 2015 fully contribute to the adjustment in the structural balance.

Regarding 2016, the report on action taken provides additional details on the measures underpinning the EUR 5 billion reduction in expenditures, which were not specified in the Stability Programme and were thus not included in the Commission spring forecast. According to the Stability Programme, the lower expenditures result from savings by the State (EUR 1.6 billion), social security (EUR 2.2 billion) and local government (EUR 1.2 billion). As for the efforts by the State, letters were sent by the Prime Minister to each Minister on 24 April 2015, specifying the savings that are expected to be incorporated in the upcoming draft budgetary plan for 2016, and the related amounts could thus be included in the updated Commission forecast. Regarding social security, the savings are expected to result from a lower ONDAM and from a review of the indexation mechanisms for social transfers. However, the concrete measures envisaged to achieve these savings remain unspecified and could not be taken into account in an updated forecast. Concerning local government, although the report on action taken mentions that a more ambitious objective for local government expenditures would be set, the effectiveness of this newly established, only indicative, spending norm remains to be proven. Hence, the corresponding savings were not considered in the updated forecast.

As concerns 2017, the report on action taken does neither include further measures nor details on the measures underpinning the adjustment planned. Based on the objectives set by the '*loi de programmation des finances publiques*' adopted on 29 December 2014, the Stability Programme included budgetary targets for the various subsectors of general government but provided little detail on the underlying measures. While the Council recommendation of 10 March 2015 requested that France outlined the key budgetary measures planned for 2017, no detailed information was provided in the report on action taken.

In terms of structural reforms, the agenda of the government remains unchanged compared to the National Reform Programme submitted on 30 April 2015. The main structural reform efforts include measures to reduce the cost of labour. Policy measures have been announced, part of which are already implemented, to reduce labour costs and to improve firms' profit margins amounting to EUR 40 billion (2% of GDP). While these measures are expected to reduce the gap between France and the euro area average in terms of labour tax wedge, their impact could be offset by dynamic wage growth, which points to the need for complementary labour market reforms. Reforms in the services sector are broadly pursued through the *draft Law on Growth, Economic Activity and Equal Opportunities* that reduces the administrative burden, notably for the

construction sector. The reform agenda of the government comprises additional measures that could impact on the growth potential of the economy. These include, in particular, a reform of local authorities, energy sector reforms, measures to boost private investment and innovation, as well as initiatives to improve the quality of the education system and its links to the labour market. Meanwhile, as noted in the recommendation for a Council recommendation issued by the Commission on 27 May 2015, the tax-to-GDP ratio in France remains one of the highest in the EU and corporate tax rates are high and weigh negatively on French companies' investment. In addition, France suffers from labour market segmentation, as fixed-term contracts accounting for an increasing proportion of hires, which has a negative impact on long-term growth.

3.3. Updated budgetary projections

The Commission 2015 spring forecast projected the general government deficit to reach 3.8% of GDP in 2015 and, under a no-policy-change assumption, 3.5% of GDP in 2016. This is consistent with an improvement in the structural balance which was estimated at 0.3% of GDP in 2015 and 0.0% in 2016.

For 2015, the information included in the report on action taken does not lead to a revision in the impact of the additional measures planned on public finances compared to the spring forecast. The report on action taken rather confirms the information included in the Stability Programme on the EUR 4 billion package. The impact of this package on public finances is unchanged compared to the Commission spring forecast.

In 2016, only the additional expenditures planned by the State appear sufficiently specified at this stage and would reduce the projected headline deficit by 0.1% of GDP compared to the spring forecast, with a similar impact on the structural balance. As pointed out in the report on action taken, letters sent by the Prime Minister to each Minister on 24 April 2015 specify the amount of savings expected in 2016, which is estimated at EUR 1.6 billion (0.1% of GDP). More specifically, starting from the expenditures ceilings set for 2016 in the '*loi de programmation des finances publiques*' adopted on 29 December 2014, ministers are asked to identify savings generally amounting to 1% of payroll (excluding pensions) and 3% of other expenditures. Efforts are also required on expenditures related to state agencies. Taking this additional information into account, the estimate by the Commission of public expenditures for 2016 has been revised down by a similar amount. As a result, the general government deficit for 2016 is now projected to improve by 0.1% of GDP to 3.4% of GDP compared to 3.5% of GDP in the spring forecast.

3.4. Risk assessment

Risks to the budgetary outlook for 2015 and 2016, as projected in the updated Commission spring forecast, appear overall balanced. As highlighted the Commission services' assessment of the Stability Programme, the main risks to the budgetary outlook lie in the magnitude of the projected economic recovery and its impact on public finances as well as in the actual implementation of the ambitious expenditure cuts planned in 2016 and 2017.

Recent macroeconomic data confirms the projections made in the Commission spring forecast. The government's macroeconomic forecast laid out in the Stability Programme and in the report on action taken, which is close to the spring forecast, remains plausible. The higher-than-expected GDP growth in the first quarter of 2015

(0.6% compared to 0.4% in the Commission spring forecast) suggests that the economic recovery may be gaining ground even faster than anticipated. Still, developments in the labour market appear more muted than expected at the time of the spring forecast (see Section 3.1).

Recent budgetary developments point to new risks but do not lead to a revision in the budgetary outlook. The elasticity of tax revenues in 2014 based on the detailed figures published on 13 May is significantly higher than estimated at the time of the spring forecast (see Section 3.1). This suggests that public revenues may increase more in 2015 than expected in the spring forecast with a positive impact on the headline balance. Conversely, the recent increase in the yields on sovereign bonds represents a potential risk as it could lead to an increase in interest payments. The impact on public finances, which would be gradual due to the relatively long duration of the French negotiable debt, could still put additional pressure on the expenditure reduction targets. In addition, developments in the labour market could have a negative bearing on public finances. In particular, recent announcement that the number of subsidised jobs in 2015 and 2016 could be increased may result in higher expenditures.

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

On 27 April 2009, the Council opened an Excessive Deficit Procedure for France granting until 2012 for the authorities to bring the headline deficit below 3% of GDP. In the face of unforeseen economic developments with negative consequences on public finances, and as France was considered to have achieved effective action, the deadline was postponed three times. On 2 December 2009, the delay was extended to 2013. It was then extended to 2015 by the Council recommendation of 21 June 2013. Finally, on 10 March 2015, the Council decided to extend the deadline for correction of the excessive deficit until 2017 (see Box 1).

Based on the updated information submitted in the report on action taken, the updated Commission spring forecast expects the headline deficit to reach 3.8% of GDP in 2015 and 3.4% in 2016 in line with the recommended targets. According to the report on action taken and to the Stability Programme, the government plans to bring the headline deficit to 3.8% of GDP in 2015, 3.3% in 2016 and 2.7% in 2017, thus below the general government deficit targets recommended by the Council. The Commission spring forecast, which only extends to 2016, projected the general government deficit at 3.8% of GDP in 2015 and 3.5% of GDP in 2016 (on the basis of a no-policy change scenario). The additional expenditures savings for the State specified in the report on action taken would reduce the projected general government deficit by 0.1% of GDP in 2016 to 3.4% of GDP, the level recommended by the Council.

However, the structural adjustment expected based on the updated forecast remains below the target recommended by the Council in both 2015 and 2016. The spring forecast expected that the structural balance would improve by 0.3% of GDP in 2015 and 0.0% in 2016, falling short of the 0.5% and 0.8% of GDP recommended by the Council for these two years. In 2015, the adjustment in the structural balance in the spring forecast was similar to the one expected at the time of the Council recommendation as additional measures announced in the Stability Programme were compensated by a downward revision in the projected elasticity of tax revenues between the winter and the spring Commission forecast. Regarding 2016, the Commission spring forecast considered that the structural balance would remain stable, compared to a 0.4% of GDP deterioration expected at the time of the Council recommendation. The improvement in the structural effort projected for 2016 between the baseline scenario

underpinning the Council recommendation and the spring forecast results notably from a revision in the scenario for local government expenditures as the impact of the electoral cycle and of the announced cuts in grants by the State was much stronger than assumed at the time of the recommendation. In addition, the spring forecast anticipates a rebound in the elasticity of tax revenues in 2016. Compared to the spring forecast, regarding 2015, the information provided in the report on action taken does not change the assessment by the Commission of the various measures included in the Stability Programme and the improvement in the structural balance is expected to remain unchanged at 0.3% of GDP. In particular, the additional package announced in the Stability Programme is set to have an impact of only EUR 2.8 billion (0.1% of GDP) on the structural effort. Regarding 2016, taking into account the expenditure reductions specified in the report on action taken (and amounting to 0.1% of GDP), the structural balance is projected to improve by 0.1% of GDP, still much below the 0.8% of GDP improvement recommended by the Council.

Table 2. France- comparison of budgetary projections

% of GDP	Headline budget balance			Adjustment in the structural balance	
	2015	2016	2017*	2015	2016
Commission 2015 spring forecast	-3.8%	-3.5%	-	0.3%	0.0%
Updated Commission 2015 spring forecast	-3.8%	-3.4%	-	0.3%	0.1%
Stability Programme	-3.8%	-3.3%	-2.7%	0.3%	0.1%
Baseline scenario (2015 winter forecast)**	4.1%	4.1%	4.1%	0.3%	-0.4%
EDP target	-4.0%	-3.4%	-2.8%	0.5%	0.8%

Notes:

Structural balances based on the Stability Programme are recalculated by Commission on the basis of the Stability Programme scenario using the commonly agreed methodology.

* The 2015 Commission spring forecast extends only to 2016

** Scenario underpinning the Council Recommendation of 10 March 2015

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 lower than recommended by the Council in both years. This situation calls for a careful analysis of the fiscal effort based on the improvement in the adjusted structural balance and on the amount of measures taken (see Box 1).

Box 1. Methodology for assessing effective action

According to Regulation (EC) No 1467/97 and the Code of Conduct³, a Member State should be considered to have taken effective action if it has acted in compliance with the Article 126(7) TFEU recommendation. The Code of Conduct states that the assessment of effective action should in particular take into account whether the Member State concerned has achieved the annual budgetary targets and the underlying improvement of its cyclically adjusted balance, net of one-off and other temporary measures, as recommended by the Council.

The methodology for assessing effective action⁴ requires first considering whether the Member State is compliant with the nominal target and the underlying improvement in the structural balance required in the EDP recommendation. If this is the case, the procedure is held in abeyance.

If the Member State fails or is at risk of failing to meet the headline deficit target or the required improvement in the structural balance, a careful analysis of the reasons of the shortfall is undertaken. The careful analysis assesses whether the Member State has acted in compliance with the recommendation building on two complementary fiscal effort measures: (i) the 'top-down' approach, which measures the change in the structural balance adjusted for the revision of potential output growth, revenue windfalls/shortfalls and unexpected events; and (ii) the 'bottom-up' approach, which estimates the budgetary impact of the individual discretionary fiscal measures implemented and the development in expenditures under the control of the government compared to the baseline scenario underpinning the Council Recommendation. The careful analysis is also complemented by other relevant qualitative considerations allowing the Commission to provide a qualified judgment on whether the Member State has taken enough policy actions to comply with the EDP recommendation.

If the careful analysis indicates that the Member State concerned has delivered on its policy commitments, the assessment will conclude that effective action has been taken. If the careful analysis shows that policy commitments have not been delivered and the headline deficit targets are expected to be missed, the assessment will conclude that effective action has not been taken. However, if the headline deficit targets are expected to be met, the procedure shall be held in abeyance, even when the recommended change in the structural balance is not achieved. At the same time, a careful analysis should be conducted to better understand the nature of the underlying budgetary developments.

Regarding 2015, the careful analysis confirms that the fiscal effort is expected to fall short of the level recommended by the Council. The information included in the report on action taken confirms the assessment of expenditure developments made by the Commission. Correcting for changes in potential growth as well as for revenue shortfalls since the time of the Council recommendation, the improvement in the adjusted structural balance is estimated to represent 0.4% of GDP in 2015, unchanged compared to the one

³ “Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes”, available at: http://ec.europa.eu/economy_finance/economic_governance/sgp/index_en.htm .

⁴ As endorsed by the Council on 20 June 2014: (http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/143293.pdf).

estimated in the Commission services' assessment of the 2015 Stability Programme. This compares with an improvement of 0.3% of GDP expected at the time of the Council recommendation. The adjusted structural effort is thus expected to remain lower than the 0.5% of GDP recommended by the Council. The bottom-up fiscal effort is projected to be unchanged at 0.0% of GDP as estimated in the Commission 2015 spring forecast, compared to 0.2% of GDP recommended by the Council. Indeed, part of the additional measures described in the report on action taken consists in savings resulting from lower interest payments. Savings have also resulted from the impact of the lower inflation on inflation-indexed government bonds. These savings on interest payments are considered as outside the government's control according to the commonly agreed methodology for assessing effective action and hence are not taken into account in the calculation of the bottom-up fiscal effort⁵. Excluding interest payments, expenditure growth appears similar to the one expected in the EDP scenario and the bottom-up effort is thus projected to stand at 0.0% of GDP.

In 2016, the careful analysis also shows a shortfall compared to the fiscal effort recommended by the Council. Taking into account the measures specified in the report on action taken and 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 remain constant compared a deterioration of 0.1% of GDP expected in the Commission services' assessment of the Stability Programme and to an improvement of 0.8% of GDP recommended by the Council. Similarly, the additional bottom-up fiscal effort compared to fiscal developments projected at the time of the Council recommendation of 10 March amounts to 0.4% of GDP compared to 0.3% of GDP expected by the Commission based on the Stability Programme. Still, the fiscal effort for 2016 is expected to fall significantly short of the 1.2% of GDP recommended by the Council on 10 March 2015.

Table 3. France Assessment of the fiscal effort

% of GDP	Adjusted change in the structural balance		Bottom-up effort	
	2015	2016	2015	2016
Commission 2015 spring forecast	0.4%	-0.1%	0.0%	0.3%
Updated Commission 2015 spring forecast	0.4%	0.0%	0.0%	0.4%
Baseline scenario (2015 winter forecast)*	0.3%	-0.4%		
EDP target	0.5%	0.8%	0.2%	1.2%

* Scenario underpinning the Council Recommendation of 10 March 2015

Efforts have been made to step up expenditure reviews and windfall gains have been used for deficit reduction, as recommended by the Council. Expenditure savings are expected to be supported by spending reviews, which are either on-going or still to be launched. Notably, the *'loi de programmation des finances publiques'* of 29 December 2014 foresees that annual expenditure reviews will be conducted as part of the budgetary cycle, starting in 2016. The government has decided that an exercise would already be launched in 2015 to support the slowdown in public expenditure growth planned in 2016. Still, the report on action taken provides no details on the expected outcome of these reviews. In case the efficiency gains identified through these reviews turn out to be insufficient, the budgetary targets set in the Stability Programme and in the report on

⁵ By contrast, they contribute to the change in the structural balance.

action taken could be at risk. Moreover, windfall gains, notably resulting from the lower interest payments compared to those expected at the time of the Council recommendation, have contributed to the downward revision in the headline targets for 2015 and 2016 and can thus be considered to have been used for deficit reduction, as recommended by the Council.

The assessment of the key measures underpinning the adjustment for 2016 and 2017 recommended by the Council is not provided in the report on action taken. The Council recommended that an evaluation is provided well ahead of the deadline of 10 June 2015. Providing an evaluation of the key measures underpinning the adjustment, in particular as the latter is mainly based on expenditure reductions, improves the transparency of the budgetary strategy and allows for a better assessment of the credibility of the fiscal targets. Finally, the government has not updated its '*loi de programmation des finances publiques*' to reflect the updated budgetary targets set by the Council, as was recommended.

Box 2. Summary of the Council recommendation of 10 March 2015

On 10 March 2015, the Council recommended France under Article 126(7) of the Treaty to correct its excessive deficit by 2017 at the latest.

(a) To this end, France should reach a headline deficit of 4.0% of GDP in 2015, 3.4% of GDP in 2016 and 2.8 % of GDP in 2017, which was 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 required 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 services' 2015 winter forecast.

(b) 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.

(c) In addition, France should step up efforts to identify savings opportunities across all sub-sectors of general government, including at social security and local government levels, and use all windfall gains for deficit reduction. Budgetary consolidation measures should secure a lasting improvement in the general government structural balance and should not be detrimental to the improvement of the competitiveness of the French economy.

(d) The Council established the deadline of 10 June 2015 for France to take effective action and, in accordance with Article 3(4a) of Regulation (EC) No 1467/97, to report in detail on the consolidation strategy that is envisaged to achieve the targets. France should report in detail on (i) the additional structural discretionary measures, representing 0,2% of GDP, adopted to ensure the achievement of the recommended improvement in the structural balance in 2015; and (ii) the outlined key budgetary measures for reaching the targets in 2016 and 2017. The '*loi de programmation des finances publiques*' should be updated to reflect the new adjustment path. An evaluation of the key measures underpinning the adjustment for 2016 and 2017 shall be provided well ahead of the deadline of 10 June 2015.

5. CONCLUSION

The report on action taken submitted by France on 10 June 2015 confirms the plan of the French government to correct the excessive deficit by 2017, the deadline set by the Council, and provides some further clarifications on the measures underpinning the budgetary strategy set forth in the Stability Programme of France. However, no additional measures are presented compared to those already announced in the Stability Programme.

Overall, based on the information available at this stage, the general government deficit is expected to reach 3.8% of GDP in 2015 and 3.4% in 2016, in line with the targets recommended by the Council on 10 March 2015. The improvement in the structural balance, as estimated by the Commission based on the information available on 10 June, appears to fall short of the recommended effort in both 2015 and 2016. A careful analysis, based both on an assessment of the adjusted change in the structural balance ('top-down' approach) and of the amount of measures planned ('bottom-up' approach), also concludes that the fiscal effort is expected to fall short of the level recommended by the Council. Furthermore, although the Council recommendation called for an evaluation of the key measures planned for 2016 and 2017, this assessment was not provided in the report on action taken. Finally, the *'loi de programmation des finances publiques'* was not updated as recommended by the Council.

The consolidation strategy pursued by France relies primarily on the improving cyclical conditions and a continuation of the low interest environment. The expenditure savings planned for 2016 and 2017 have not yet been fully specified and based on the experience with the previous expenditure reviews, there are risks that the savings opportunities identified in the upcoming exercises may not be sufficient to effectively support the implementation of the ambitious expenditure targets set for the coming years. An ambitious budgetary strategy is key to ensure a durable correction of the excessive deficit.

EDP related tables

Table A1. Adjustment of apparent structural effort for the revision in potential growth – details of calculation

	Potential GDP growth underlying the Council Recommendation (%)	Potential GDP growth at the time of assessment (%)	Forecast error (%)	Structural expenditure (% of potential GDP)	Correction coefficient α (% of nominal potential GDP)
	(1)	(2)	(3)=(1)-(2)	(4)	(5)=(3)*(4)/100
2015	1.0	1.0	0.0	55.8	0.0
2016	1.1	1.1	0.0	55.5	0.0
Based on the 2015 Commission spring forecast					

Table A2. Adjustment of apparent structural effort for the revision in revenue shortfalls/windfalls – details of calculation

	Change in current revenues (yoy) (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	(6)=[(1')-(2')]-[(3')+(ϵ -1)*(4)/100]*(5')]-[(1)-(2)-[(3)+(ϵ -1)*(4)/100]*(5)]	assessment	(8)=100*(6)/(7)
	(1)	(1')	(2)	(2')	(3)	(3')	(4)	(4')	(5)	(5')		(7)	(8)
2015	20.4	19.1	2.5	1.8	1.8%	2.1%	0.0	0.1	1135.6	1135.7	-3.8	2186.7	-0.2
2016	25.8	28.8	-2.9	-0.5	2.8%	2.7%	0.7	0.6	1156.0	1154.8	2.6	2244.8	0.1
*revenue elasticity (ϵ): 1.1													
Based on the 2015 Commission spring forecast													