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COMMISSION STAFF WORKING DOCUMENT

Analysis of the draft budgetary plan of France

Accompanying the document

COMMISSION OPINION

on the draft budgetary plan of France

{C(2018) 8018 final}

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1. INTRODUCTION

France submitted its Draft Budgetary Plan for 2019 on 15 October 2018 in compliance with Regulation (EU) No 473/2013. France is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium term budgetary objective (MTO).

As the debt ratio was 98.5% of GDP in 2017 (the year in which France corrected its excessive deficit), exceeding the 60% of GDP reference value, during the three years following the correction of the excessive deficit France is also subject to the transitional arrangements to make sufficient progress towards compliance with the debt reduction benchmark.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2018 autumn forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission 2018 autumn forecast. In particular, it also includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2018-2019 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations in the context of the European Semester adopted by the Council in July 2018, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underlying the 2019 Draft Budgetary Plan (DBP) forecasts GDP growth at 1.7% in both 2018 and 2019, after 2.2% in 2017. Compared to the 2018 Stability Programme, the GDP growth projections have been revised down by 0.3 and 0.2 percentage points in 2018 and 2109 respectively. After a weak start to the year, economic growth gained momentum in the third quarter of 2018.

Exports are expected to pick up in the second half of 2018, buoyed by notable deliveries of transport equipment. Imports would decelerate to 2.5% in 2018 and 3.1% 2019 (after 4.0% in 2017). As a result, the contribution of net exports to growth would remain positive in 2018 and 2019 (after +0.1 percentage point in 2017). Private consumption growth would remain modest in 2018, at 1.1% (after 1.0% in 2017). Indeed, temporary factors had a negative impact on household consumption in the first half of 2018. Private consumption is expected to pick-up afterwards, driven by robust purchasing power. Investment is set to slow down gradually after a buoyant year in 2017. Employment growth would decline from 1.1% in 2017 to 0.9% in 2018 and 0.6% in 2019. After an important increase in job creation at the end of 2017, the apparent productivity of labour is forecast to decrease temporarily in 2018. Finally, inflation would increase from 1.2% in 2017 to 2.1% in 2018, before cooling down to 1.5% in 2019 as the rises in oil prices and tobacco and environmental taxes slow down.

Given the GDP growth projections, the output gap as recalculated by the Commission following the commonly agreed methodology stands at −0.3% in 2017, 0.2% in 2018 and 0.7% in 2019. The recalculated output gap is higher than at face value (−0.2% in 2018 and 0.2% in 2019), given the higher recalculated estimates for 2017 and the slightly lower potential growth estimated under the commonly agreed methodology in both 2018 and 2019.

Table 1. Comparison of macroeconomic developments and forecasts

	2017	2018			2019		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	2.2	2.0	1.7	1.7	1.9	1.7	1.6
Private consumption (% change)	1.0	1.6	1.1	1.1	1.9	1.7	1.6
Gross fixed capital formation (% change)	4.5	3.9	3.3	2.7	3.3	2.1	2.3
Exports of goods and services (% change)	4.5	4.9	3.7	3.4	4.6	3.6	3.4
Imports of goods and services (% change)	4.0	4.1	2.5	1.8	4.1	3.1	3.3
Contributions to real GDP growth:							
- Final domestic demand	1.8	1.9	1.6	1.5	1.8	1.6	1.7
- Change in inventories	0.2	0.0	-0.2	-0.3	0.0	0.0	0.0
- Net exports	0.1	0.1	0.3	0.5	0.0	0.1	0.0
Output gap[1]	-0.3	0.1	0.2	0.1	0.6	0.7	0.5
Employment (% change)	1.1	0.8	0.9	0.7	0.8	0.6	0.7
Unemployment rate (%)	9.4			9.0			8.8
Labour productivity (% change)	1.2	1.2	0.8	1.1	1.1	1.1	1.0
HICP inflation (%)	1.2	1.4	2.1	2.1	1.2	1.5	1.7
GDP deflator (% change)	0.7	1.1	0.9	0.9	1.2	1.3	1.4
Comp. of employees (per head, % change)	1.9	2.6	2.1	2.3	0.4	0.5	0.4
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-0.6	-2.9	-0.7	-0.5	-2.8	-0.5	-0.5

Note:

[1] In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:
Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

The Commission 2018 autumn forecast projects GDP growth at 1.7% in 2018, in line with the projection of the Draft Budgetary Plan. Gross fixed capital formation growth is more favourable in the DBP in 2018, while net trade contribution to growth is more cautious. In 2019, the Commission's GDP forecast is slightly lower than the authorities', at 1.6% (against 1.7% in the Draft Budgetary Plan), with a more cautious contribution from net trade. The slowdown in employment growth in 2018 is also more pronounced in the autumn forecast.

Overall, the macroeconomic scenario underlying the 2019 Draft Budgetary Plan is plausible in 2018 and 2019. In its opinion, the High Council of Public Finances (HCFP) considers the government's GDP growth forecast as credible for 2018 and plausible for 2019. Moreover, the HCFP takes notice of the higher uncertainty surrounding the external environment scenario in 2019.

Box 1: The macroeconomic forecast underpinning the budget in France

The High Council for Public Finances (HCPF), the independent monitoring body attached to the French Court of Auditors, adopted on 19 September an opinion on the macroeconomic forecasts underlying the DBP as well as on the underlying budgetary strategy. This opinion is attached to the DBP submitted to the National Assembly, and was made public by the HCFP on its website at the same time. In its opinion[1], the HCPF considers that the macroeconomic scenario underpinning the DBP is credible for 2018 and plausible for 2019 regarding the projections for GDP growth, inflation, employment and salary mass. The HCFP nevertheless flagged the growing uncertainty surrounding the external environment scenario. Moreover, the HCPF assesses the public finances scenario, pointing to the low level of the adjustment in both 2018 and 2019.

3. Recent and planned fiscal developments

3.1. Deficit developments

The Draft Budgetary Plan projects a deficit of 2.6% of GDP for 2018, 0.3 percentage points above the deficit target set forth in the Stability Programme of April 2018 and in line with the Commission 2018 autumn forecast. The difference compared to the Stability Programme is mainly explained by the projected deterioration in the macroeconomic outlook and by the reclassification of SNCF Réseau under the general government from 2016, the latter with a deficit-increasing impact of about 0.1% of GDP in each year.

The revenue-to-GDP ratio is planned to remain stable compared to the Stability Programme, at 53.7% of GDP as the downward revision to GDP growth since April has entailed a similar revision to revenue projections, thereby leaving the revenue-to-GDP ratio unchanged. A broadly similar ratio is also projected in the Commission autumn forecast, in line with a broadly consistent macroeconomic outlook. Additionally, no significant differences emerge when comparing the split between different revenue categories.

The expenditure-to-GDP ratio would post an increase of 0.3 percentage points with respect to the projection of the Stability Programme, reflecting the change in the macroeconomic projections and the higher rigidity on the expenditure side which translates into slightly higher social payments and interest expenditure compared to April. Both the posted overall level of expenditure-to-GDP ratio and the split between expenditure categories are broadly in line with the projections in the Commission autumn forecast. In 2018, the Draft Budgetary Plan projects a growth of expenditure net of tax credits by 1.6% in nominal terms, which corresponds to a zero increase in real terms.

[1] Haut Conseil des Finances Publiques (2018), Avis nº HCFP-2018-3 relatif aux projets de finances et de financement de la sécurité sociale pour l'année 2019.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2017	2018			2019			Change: 2017-2019
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**53.8**	**53.7**	***53.7***	**53.6**	**52.6**	***52.8***	**52.7**	**-1.0**
of which:								
- Taxes on production and imports	16.2	16.5	*16.5*	16.5	16.6	*16.9*	16.8	0.7
- Current taxes on income, wealth, etc.	12.8	13.2	*13.2*	13.0	13.2	*13.1*	13.1	0.3
- Capital taxes	0.6	0.6	*0.6*	0.6	0.6	*0.6*	0.6	0.0
- Social contributions	18.8	18.2	*18.2*	18.2	17.0	*17.0*	17.0	-1.8
- Other (residual)	5.3	5.2	*5.2*	5.3	5.2	*5.2*	5.2	-0.1
Expenditure	**56.5**	**56.0**	**56.3**	**56.2**	**54.9**	**55.6**	**55.4**	**-0.9**
of which:								
- Primary expenditure	54.6	54.3	54.5	54.4	53.2	53.8	53.6	-0.8
of which:								
Compensation of employees	12.7	12.5	12.5	12.5	12.3	12.3	12.4	-0.4
Intermediate consumption	4.9	4.8	4.8	4.8	4.7	4.8	4.7	-0.1
Social payments	25.8	25.5	25.6	25.7	25.1	25.3	25.5	-0.5
Subsidies	2.6	2.8	2.8	2.7	2.6	2.8	2.6	0.2
Gross fixed capital formation	3.4	3.5	3.5	3.4	3.5	3.6	3.5	0.2
Other (residual)	5.3	5.2	5.3	5.2	5.0	5.0	4.9	-0.3
- Interest expenditure	1.9	1.7	1.8	1.9	1.7	1.8	1.8	-0.1
General government balance (GGB)	**-2.7**	**-2.3**	**-2.6**	**-2.6**	**-2.4**	**-2.8**	**-2.8**	**-0.1**
Primary balance	**-0.8**	**-0.6**	**-0.7**	**-0.8**	**-0.6**	**-1.0**	**-0.9**	**-0.2**
One-off and other temporary measures	0.0	-0.3	-0.2	-0.2	-1.0	-0.9	-0.8	-0.9
GGB excl. one-offs	**-2.6**	**-2.0**	**-2.4**	**-2.4**	**-1.4**	**-1.9**	**-1.9**	**0.7**
Output gap[1]	-0.3	0.1	0.2	0.1	0.6	0.7	0.5	1.0
Cyclically-adjusted balance[1]	-2.5	-2.3	-2.7	-2.7	-2.8	-3.2	-3.1	-0.7
Structural balance (SB)[2]	**-2.4**	**-2.0**	**-2.5**	**-2.5**	**-1.8**	**-2.3**	**-2.3**	**0.2**
Structural primary balance[2]	-0.6	-0.3	-0.7	-0.6	-0.1	-0.5	-0.4	0.1

Notes:

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

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

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

For 2019, the Draft Budgetary Plan expects the deficit to increase to 2.8% of GDP, 0.4 percentage points above the target set in the Stability Programme. No reason is provided in the Plan in order to explain the change, although part of it can be certainly associated with the permanent impact of the reclassification of SNCF Réseau into the general government as from 2016 for about 0.1% of GDP each year. Other likely factors explaining the change in the target could be identified in the deterioration of the macroeconomic scenario as well as the base effect from 2018. All in all, the higher deficit compared to the Stability Programme is the result of a larger upward revision in the expenditure-to-GDP ratio than in the revenue-to-GDP ratio. In particular, the former is expected to reach a level of 55.6% of GDP, 0.7 percentage points higher than projected in spring, due the combined effect of lower GDP projections and of more dynamic social payments and subsidies and, to a lesser extent, higher interest payments. Expenditure net of tax credits is set to grow by 1.9% in nominal terms compared to 1.4% growth planned in the Stability Programme.

On the other hand, the overall revenue ratio is set to increase by 0.2 percentage points compared to the Stability Programme, up to a level of 52.8% of GDP and mostly supported by higher proceeds from indirect taxation.

The Commission 2018 autumn forecast also projects a deficit of 2.8% of GDP in 2019, in line with the deficit posted in the Draft Budgetary Plan. This reflects the alignment of the deficit projections for 2018, implying no specific differences due to base effects, as well as the substantial consistency of the discretionary measures included in the two sets of projection and of their estimated impact. Moreover, in both cases the deficit for 2019 includes the one-off impact of the transformation of the *Crédit d'impôt pour la compétitivité et l'emploi* (CICE) into a direct reduction in social security contributions for broadly the same amount. Such a transformation will therefore be accounted for in 2019, leading to a double-counting effect for about 0.9% of GDP. Once this double-counting impact is netted out, the nominal deficit for 2019 would reduce to 1.9% of GDP. This impact is not taken into account in the calculation of the structural deficit.

The revenue- and expenditure-to-GDP ratios are both slightly lower in the Commission forecast, by 0.1 percentage point and 0.2 percentage points, respectively. In the case of revenues, this can be explained by lower proceeds from indirect taxation, consistent with a somewhat lower projected economic growth compared to the Draft Budgetary Plan. In the case of expenditure, the difference stems from a marginally different composition in terms of expenditure categories. Namely, compared to the Draft Budgetary Plan the Commission autumn forecast projects that the higher compensation of public employees as well as social payments are more than offset by lower subsidies, public investment and intermediate consumption. These last three elements explain the lower expenditure-to-GDP ratio projected by the Commission.

Overall, public expenditure net of tax credits is expected to grow by 0.2% in real terms in the Commission forecast versus 0.6% in the Draft Budgetary Plan. Once the different projections on inflation are accounted for, the growth rates of public expenditure in 2019 concur.

Although not leading to a different deficit projection in the Commission autumn forecast, some more general risks to the 2019 budgetary targets may be identified. These stem, on the one hand, from the uncertainties associated with the macroeconomic scenario and, on the other hand, with the evolution of expenditure by local authorities. Concerning the latter, while the newly-adopted contractual approach foresees a correction mechanism in case of slippages in operating expenditure, its concrete and timely implementation remains to be proven. This holds in particular for the recently-observed resumption of both operational and investment expenditure at local level, after a period of significant containment, if not decline, and consistent with the implications of the electoral cycle.

The Draft Budgetary Plan expects an improvement in the structural balance[2] of 0.2% of GDP in 2019, 0.1 percentage point lower than the target posted in the 2018 Stability Programme and in line with the structural adjustment projected in the Commission autumn forecast. In 2019, the change in the (recalculated) structural balance would be below the improvement of 0.6% of GDP required under the provisions of the preventive arm of the Stability and growth Pact (see section 4).

In its September opinion[3], the High Council for Public Finances (HCPF) considered the government's revenue and expenditure forecast as realistic for 2018 and attainable for 2019, while it pointed to the low level of the structural adjustment in both 2018 and 2019.

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in France currently standing at 0.79%[4]. As a consequence, total interest payments by the general government have continued to decrease as a share of GDP. Based on the information included in the Draft Budgetary Plan, interest expenditure in France is expected to fall from 1.9% of GDP in 2017 to 1.8% in 2018 and is projected to remain stable next year, at 1.8% of GDP, well below the 2.6% recorded in 2012 at the peak of the euro area sovereign debt crisis. The picture stemming from France's plans is broadly confirmed by the Commission forecast.

The Draft Budgetary Plan targets in terms of deficit, expenditure and revenue are deemed to comply with the requirements of the national fiscal framework and notably with the numerical fiscal rules in place.

The new State expenditure norm covering the spending under control of the State was increased by EUR 0.6 billion for 2019 to reflect additional spending on priority areas such as security, defence and education. The healthcare spending norm (ONDAM) was temporarily revised from the annual 2.3% increase over the 2018-2022 period to 2.5% in 2019. Finally, at local level, new contract agreements between the State and local authorities, valid for the overall 2018-2022 period, should help to respect the Objectif d'évolution de la Dépense Locale (ODEDEL), which is an expenditure norm indicating yearly non-binding growth targets for both operational public expenditure and financing needs at local level.

3.2. Debt developments

After accounting for the impact of the reclassification of SNCF Réseau[5], the Draft Budgetary Plan envisages a different evolution of the debt-to-GDP ratio vis-à-vis the one included in the 2018 Stability Programme. While the latter projected a decrease already in 2018[6], the Draft

[2] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

[3] Footnote 1

[4] 10-year bond yields as of 24 October 2018. Source: Bloomberg. As part of the agreement on the EFC Opinion on "Improving the predictability and transparency of the SGP: a stronger focus on the expenditure benchmark in the preventive are", which was adopted by the EFC on 29 November 2016, the expenditure benchmark, that is the maximum allowable growth rate of expenditure net of discretionary revenue measures, is expressed in nominal terms as from 2018.

[5] The reclassification of SNCF Réseau as part of the general government sector as from 2016 increased public debt by EUR 35.8 billion at the end of 2016 and by EUR 39.4 billion in 2017. The debt-to-GDP ratio was therefore revised from 96.8% in 2017 to 98.5%.

[6] In the order of 0.6 percentage points with respect to the level of 97.0% of GDP in 2017 which was tabled ahead of the SNCF reclassification.

Budgetary Plan forecasts an increasing debt ratio in 2018, up to 98.7% of GDP, which then slightly reduces by 0.1 percentage point in the following year. The difference in 2018 is explained by a slightly higher debt-increasing impact of the primary balance and of interest expenditure in the Draft Budgetary Plan, coupled with a significantly less favourable contribution of the stock-flow adjustment as well as lower nominal GDP growth forecast. In 2019 the less pronounced reduction compared to the Stability Programme mainly stems from a higher debt-increasing impact of the primary balance which more than compensates a more favourable contribution of the stock-flow adjustment.

The Commission autumn forecast projects a very similar trend compared to the Draft Budgetary Plan. The latter does not provide a breakdown of the various components of the stock-flow adjustment.

Table 3. Debt developments

(% of GDP)	2017	2018			2019		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**98.5**	**96.4**	**98.7**	**98.7**	**96.2**	**98.6**	**98.5**
Change in the ratio	0.3	-2.1	0.2	0.2	-0.2	-0.1	-0.1
Contributions[2] :							
1. Primary balance	**0.8**	**0.6**	**0.7**	**0.8**	**0.6**	**1.0**	**0.9**
2. “Snow-ball” effect	**-0.8**	**-1.2**	**-0.5**	**-0.7**	**-1.1**	**-1.1**	**-1.0**
Of which:							
Interest expenditure	1.9	1.7	1.8	1.9	1.7	1.8	1.8
Growth effect	-2.1	-1.9	-1.6	-1.6	-1.8	-1.6	-1.6
Inflation effect	-0.6	-1.0	-0.8	-0.9	-1.1	-1.2	-1.3
3. Stock-flow adjustment	**0.4**	**-1.5**	**0.0**	**0.1**	**0.3**	**0.0**	**0.0**
Of which:							
Cash/accruals difference							
Net accumulation of financial							
of which privatisation proceeds							
Valuation effect & residual							

Notes:

[1] End of period.

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

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the draft budgetary plan

The Draft Budgetary Plan confirms the consolidation strategy already defined by the government in the Public Finances Programming Law for the period 2018-2022 which aims at compensating tax reductions over the five-year presidential term via targeted cuts in and control of public expenditure. On this basis and mostly on the revenue side, the Draft Budgetary Plan does not envisage a large number of new measures with major budgetary impact in 2019[7]. It rather relies on the continued impact of measures already adopted in order to advance on the implementation of the defined fiscal strategy. Such measures are specified in sufficient detail so as to be already included in the trend underlying the Commission forecast.

On the revenue side, the new measures presented have a net deficit-reducing impact of about 0.1% of GDP. New main measures are the exemption of overtime pay from employee's social security contributions as of September 2019, for a cost of about EUR 0.6 billion; the elimination of the employer contribution (forfait social) for small and medium-sized enterprises, for a cost of EUR 0.5 billion; the exemption from higher CSG amount for low-income pensioners, for a cost of EUR 0.3 billion; the suppression of small, low-yield taxes for a cost of about EUR 0.1 billion. These are more than compensated by revenue-increasing new measures such as the postponement till October 2019 of the additional reduction of employers' social contributions at the minimum wage in the cotext of the CICE transformation for about EUR 2.0 billion; the temporary increase in the 5th payment by instalment on corporate income tax, for EUR 1.5 billion; the elimination of the tax break for off-road uses of diesel oil for about EUR 1.0 billion.

On the expenditure side the Draft Budgetary Plan envisages new consolidation measures on the State and on healthcare while confirming the contractual approach already defined at the level of local authorities in order to contain growth of operational expenditure. The main measure concerns the moderation of the indexation of retirement pensions and other social benefits, with savings estimated at EUR 3.5 billion. Despite the increase of the healthcare spending norm (ONDAM), savings compared to trend are credibly estimated at EUR 3.8 billion.

Other saving measures concern the update of means-testing for housing benefits, associated with EUR 0.9 billion savings; the continued reduction of subsidised employment contracts (contrats aidés) which would imply savings for EUR 0.8 billion; the reduction of production subsidies for EUR 0.3 billion and, on the State wage bill, the continued reduction in the number of public sector employees with net cuts of 4,164 central government jobs.

Finally, the main expenditure-increasing mesures are the targeted increases in social benefits such as in-work benefit (prime d'activité), minimum old-age pension and adult disability allowance for EUR 0.8 billion; the increase in incentives for ecological transition for EUR 0.4 billion; the extension of unemployment insurance benefits to workers who resign and the self-employed for EUR 0.1 billion.

The impact of non-recurring measures classified as one-offs in the Commission forecast is significant, namely due to the already adopted measure transforming the CICE into a direct reduction in employers' social security contributions, which alone has an impact of EUR 20.2 billion. For this as for other already adopted measures, such as the reimbursement of the 3% tax on dividends there is agreement between the Draft Budgetary Plan and the Commission forecast in terms of their one-off treatment. However, the Draft Budgetary Plan reports as structural the new measure of a temporary increase in the 5th payment by instalment on corporate income tax, for EUR 1.5 billion, which is instead considered as one-off by the

[7] The budgetary impacts reported in table 4 refer to measures as reported by national authorities in the DBP. These include both new measures and measures already adopted. The measures underlying the expenditure side are however incomplete.

Commission, in line with relevant guidelines as well as the treatment of similar measures in the recent past.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2018	**2019**	**2020**
Taxes on production and	0.3	0.2	0.0
Current taxes on income,	0.0	-1.1	0.0
Capital taxes	0.0	0.0	0.0
Social contributions	-0.7	-0.1	0.0
Property Income			
Other			
Total	-0.4	-1.0	0.0

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.

Source: Draft Budgetary Plan for 2019

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2018	**2019**	**2020**
Compensation of employees			
Intermediate consumption			
Social payments			
Interest Expenditure			
Subsidies			
Gross fixed capital formation			
Capital transfers			
Other	0.0	0.2	0.0
Total	0.0	0.2	0.0

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.

Source: Draft Budgetary Plan for 2019

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

France is subject to the preventive arm of the Pact and should ensure sufficient progress towards its Medium Term Objective. Box 2 reports the latest country specific recommendations in the area of public finances. France is also subject to the transitional arrangements to make sufficient progress towards compliance with the debt reduction benchmark.

Box 2. Council recommendations addressed to France

On 13 July 2018, the Council addressed recommendations to France in the context of the European Semester. In particular, in the area of public finances the Council recommended to ensure that the nominal growth rate of net primary government expenditure does not exceed 1.4 % in 2019, corresponding to an annual structural adjustment of 0.6 % of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio.

4.1. Compliance with the debt criterion

France corrected its excessive deficit in 2017. As the debt ratio was 98.5% of GDP in 2017 (the year in which France corrected its excessive deficit), exceeding the 60% of GDP reference value, during the three years following the correction of the excessive deficit France is also subject to the transitional arrangements to make sufficient progress towards compliance with the debt reduction benchmark. This implies that, during this period, it is required to make sufficient progress (as defined by the minimum linear structural adjustment (MLSA)) towards compliance with the debt reduction benchmark at the end of the transition period.

The Draft Budgetary Plan does not include sufficient information to assess compliance with the transitional arrangements regarding the debt reduction benchmark based on the Member State's plans.

Based on the Commission forecast, the change in the structural balance is also projected at 0.0% of GDP in 2018, in line with the recalculated effort based on the DBP figures. This effort falls short of the required improvement of 0.5% of GDP under the MLSA. For 2019, the change in the structural balance is also forecast to amount to 0.2% of GDP, which implies a deviation from the required improvement of 0.8% of GDP under the MLSA. The projected deviation of 0.6% of GDP according to the Commission forecast exceeds ¼% of GDP, although the remaining annual structural adjustment does not exceed ¾% of GDP. As both conditions are not respected simultaneously, France would exceed the room for manoeuvre embedded in the rule.

Consequently, based on an overall assessment of the draft budgetary plan, France is not projected to make sufficient progress towards compliance with the debt reduction benchmark in 2018-2019.

Table 6. Compliance with the debt criterion*

	2017	2018			2019		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio	98.5	96.4	98.7	98.7	96.2	98.6	98.5
Gap to the debt benchmark [1,2]							
Structural adjustment [3]	0.3	0.0	0.0	0.0	0.3	0.2	0.2
To be compared to:							
Required adjustment [4]		0.0	n.a.	0.5	0.0	n.a.	0.8

Notes:

[1] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[2] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[3] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[4] Defines the remaining minimum annual structural adjustment over the transition period which ensures that – if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP) budgetary projections for the previous years are achieved.

Source:
Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

* An ex-ante assessment of planned compliance with the debt criterion can be based on the DBP only for the concerned countries providing extended data series (i.e. covering years up to t+4) in the DPB on a voluntary basis, as agreed at the EFC-A on 22 September 2014 and reflected in the updated Code of Conduct of the two-pack.

4.2. Adjustment towards the Medium Term Objective

According to the information provided in the Draft Budgetary Plan, the nominal growth rate of government expenditure, net of discretionary revenue measures, in 2018 exceeds the applicable expenditure benchmark rate[8] of 1.2%, leading to a deviation of 0.6% of GDP (see Table 7). In turn, the recalculated change in the structural balance is estimated at 0.0% of GDP, falling short of the required adjustment to be on an appropriate convergence path towards the MTO by 0.6% of GDP, thus pointing to a significant deviation. This calls for an overall assessment. The adjustment measured by the change in the structural balance is penalised by the pick-up in public investment also linked to the electoral cycle of local administrations. However, this effect is largely offset by the projected revenue windfalls, the effect of the decrease in interest payments and the estimated higher potential growth with respect to its long-term average. As the gap from the required effort is very similar based on both indicators, the overall assessment, based on data in the DBP, points to a risk of a significant deviation from the required adjustment path towards the MTO in 2018.

Based on the Commission 2018 autumn forecast, expenditure benchmark is exceeded by almost 0.5% of GDP, thereby pointing to a risk of some deviation. In turn, the structural balance is projected to deviate by 0.6% of GDP, implying the risk of a significant deviation. This calls for an overall assessment. Although the gap from the required effort is very similar

[8] As part of the agreement on the EFC Opinion on "Improving the predictability and transparency of the SGP: a stronger focus on the expenditure benchmark in the preventive are", which was adopted by the EFC on 29 November 2016, the expenditure benchmark, that is the maximum allowable growth rate of expenditure net of discretionary revenue measures, is expressed in nominal terms as from 2018.

with both indicators, the expenditure benchmark is found to give a more accurate picture of the fiscal effort, taking into account the same factors as outlined above. Accordingly, the overall assessment points to a risk of some deviation from the recommended adjustment path towards the MTO in 2018, although with a very small margin, as it stands very close to the threshold to flag a risk of significant deviation.

The Commission Communication on the 2017 European Semester of May 2017[9] stated that the Commission stands ready to use its margin of appreciation in cases where the impact of a large fiscal adjustment on growth and employment is particularly significant. The Country-Specific Recommendation adopted by the Council on 11 July 2017 mentioned that the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances. Following the Commission's assessment of the strength of the recovery in France while giving due consideration to its sustainability challenges, carried out in the context of its opinion on France's 2018 Draft Budgetary Plan, no additional elements in that regard need to be taken into account.

For 2019, according to the information provided in the Draft Budgetary Plan, the expenditure benchmark is planned to be exceeded by 0.1% of GDP. In turn, the recalculated change in the structural balance amounts to 0.2% of GDP, falling short of the 0.6% of GDP required improvement by 0.4% of GDP. Thus, for 2019 alone the two indicators point to a risk of some deviation. The overall assessment shows that the adjustment measured by the change in the structural balance is penalised by the revenue shortfalls and the pick-up in public investment, both by around 0.1% of GDP, for which the expenditure benchmark is found to give a more accurate picture of the fiscal effort.

However, over 2018 and 2019 taken together, the expenditure benchmark is planned to be exceeded by 0.4% of GDP on average. In turn, the two-year average adjustment gap based on the recalculated change in the structural balance is estimated at 0.5% of GDP. Consequently, based on data in the DBP, the two indicators point to a risk of a significant deviation from the recommended adjustment path towards the MTO in 2018-2019.

These conclusions are confirmed by the Commission 2018 autumn forecast. The growth rate of government expenditure, net of discretionary revenue measures, in 2019 is projected to exceed the applicable expenditure benchmark rate (indicate reference rate 1.4%), leading to a deviation of 0.3% of GDP in 2019 alone. In turn, the recalculated change in the structural balance amounts to 0.2% of GDP, falling short of the 0.6% of GDP required improvement by 0.4% of GDP. Accordingly, given that the difference between the two pillars is small, the overall assessment would point to a risk of some deviation from the recommended adjustment path towards the MTO in 2019. However, when 2018 and 2019 taken together, the two-year average adjustment gap based on the growth rate of government expenditure, net of discretionary revenue measures, in 2018-2019 amounts to 0.4% of GDP and to 0.5% of GDP when the two-year average adjustment gap is gauged on the change in the structural balance, thereby pointing to a risk of a significant deviation in 2018-2019.

[9] https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-specific-recommendations-commission-recommendations-communication.pdf

Following an overall assessment based on both the Draft Budgetary Plan and the Commission's 2018 autumn forecast, the adjustment path points to a risk of some deviation in 2018 and to a risk of significant deviation from the adjustment path towards the MTO in 2018 and 2019 when both years are taken together.

Table 7: Compliance with the requirements of the preventive arm

(% of GDP)	2018		2019	
Initial position[1]				
Medium-term objective (MTO)	-0.4		-0.4	
Structural balance[2] (COM)	-2.5		-2.3	
Structural balance based on freezing (COM)	-2.1		-	
Position vis-a -vis the MTO[3]	Not at MTO		Not at MTO	
(% of GDP)	**2018**		**2019**	
	DBP	**COM**	**DBP**	**COM**
Structural balance pillar				
Required adjustment[4]	0.6		0.6	
Required adjustment corrected[5]	0.6		0.6	
Change in structural balance[6]	0.0	0.0	0.2	0.2
One-year deviation from the required adjustment [7]	-0.6	-0.6	-0.4	-0.4
Two-year average deviation from the required adjustment [7]			-0.5	-0.5
Expenditure benchmark pillar				
Applicable reference rate[8]	1.2		1.4	
One-year deviation adjusted for one-offs [9]	-0.6	-0.5	-0.1	-0.3
Two-year average deviation adjusted for one-offs [9]			-0.4	-0.4

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2017) was carried out on the basis of Commission 2018 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations.

5. COMPOSITION OF PUBLIC FINANCES AND IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

The Draft Budgetary Plan for 2019 recalls the main objectives of the multiannual budgetary strategy defined by the government in the Public Finances Programming Law for the period 2018-2022[10]. These objectives are four and, in terms of GDP, consist in: i) cutting the deficit by more than 2 percentage points, ii) reducing the government expenditure rate by more than 3 percentage points, iii) cutting aggregate taxes and social security contributions by 1 percentage point, and iv) reducing debt by more than 5 percentage points.

It is not clear to which extent the new spending review programme (*Action Publique 2022*) will contribute to reach the government's target to reduce the government expenditure rate by more than 3 percentage points by 2022. On 13 July 2018, the Council recommended to France to "fully specify the objectives and new measures needed in the context of *Action Publique 2022*, for them to translate into concrete expenditure savings and efficiency gains measures in the 2019 budget"[11]. The economic, social and financial report[12] - annexed to draft budget law for 2019 – recalls on-going initiatives in terms of digitisation of public services, revision of public broadcasting, and decrease in the number of civil servants. Yet, a complete picture of government actions to reach *Action Publique 2022*'s goals is missing at present, along with the timing, expected results and progress monitoring method chosen for each reform falling under the perimeter of this spending review programme[13].

While the expenditure norms for the healthcare sector and local administrations helped containing developments in the public spending related to these two items (see Section 3.3), an overrun of the planned thresholds does not lead the government to undertake immediate actions. For example, the growth ceiling for healthcare expenditure (*Objectif National de Dépenses d'Assurance Maladie,* ONDAM) was increased for the period 2018-2020, passing from the initial target of 2.1 % set in the Public Finances Programming Law for 2018-2022, to a revised target of 2.3 % in budget law for 2018, up to 2.5 % in the draft budget for 2019. At local level, new contract agreements between the State and local authorities, valid for the overall 2018-2022 period, should help to respect the *Objectif d'évolution de la Dépense Locale* (ODEDEL), which is an expenditure norm indicating yearly non-binding growth targets for both operational public expenditure and financing needs at local level. It is too early to assess though the extent to which the norms of these new contract agreements will be able to limit negative consequences for the budget in case local authorities would exceed the planned spending ceilings.

A new tool to accelerate the reduction of the general government debt ratio was introduced in 2018 and provides for the appropriation of windfall gains to this end. The effectiveness of this tool has not yet been proven. In addition, a reform of the pension system has been announced

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[10] LOI n° 2018-32 du 22 janvier 2018 de programmation des finances publiques pour les années 2018 à 2022.

[11] European Commission (2018), "Council Recommendation of 13 July 2018 on the 2018 National Reform Programme of France and delivering a Council opinion on the 2018 Stability Programme of France", https://ec.europa.eu/info/publications/2018-european-semester-country-specific-recommendations-council-recommendations_en

[12] *Rapport économique, social et financier* (RESF), *document général annexé au projet de loi de finances 2019* https://www.performance-publique.budget.gouv.fr/sites/performance_publique/files/farandole/ressources/2019/pap/pdf/RESF19.pdf

[13] See the common principles for spending reviews agreed by the Eurogroup: https://www.consilium.europa.eu/media/23664/spending-reviews_commission_note.pdf

for 2019. The goal of this reform is to streamline the number of pension regimes currently co-existing in France, increasing the fairness of the pension system. This reform may also improve the financial situation of the system, whose equilibrium is planned to be reached in 2051 according to the 2018 Ageing Report[14].

The current fiscal consolidation strategy aims at maintaining investment expenditure to promote long-term economic growth. Public expenditure reduction is hence not affecting investment. Rather, the DBP projects an increase of public investment by 0.1 percentage point of GDP between 2018 and 2019, up to a level of 3.6 % of GDP which is about 1 percentage point above the euro area average. The projected increase in investment is associated with the on-going Great Investment Plan (*Grand Plan d'Investissement*). Also in 2019, the priorities for this five-year plan will continue to concern investments to accelerate the ecological transition, to create a skill-based society, to foster competitiveness and innovation, and to achieve the digital transformation of the public sector. Investments at local level will continue to be dynamic, in line with the electoral cycle. In nominal terms, they are forecast to grow at 7 % in 2019, after an increase of slightly more than 8 % in 2018. A small decrease in local investments is instead planned in 2020 (about -1.8 %), once local elections at municipality level will be over.

Tax measures included in the DBP for 2019 are equally meant to be growth friendly. In particular, the aggregate tax and social security contribution rate is expected to fall from 45.3 % in 2017 to 44.5% in 2022. As of 2019, the transformation of tax credit for competitiveness and employment (*crédit d'impôt pour la compétitivité et l'emploi*, CICE) into a permanent reduction of employers' social security contributions and the decrease in the corporate tax rate would increase firms' results (Box 4). Improved cash balances for firms could lead to investment and employment. In addition, decreased contributions on extra worked hours could increase workers' revenues and hence consumption. Taxation is also used as one of the main tools to accelerate the ecological transition and the DBP for 2019 confirms government's willing to go ahead with its carbon trajectory and diesel/petrol tax equalisation plans for 2022.

The budgetary strategy of the French government remains anyways subject to risks. First, the consolidation of the government debt is planned to take place only in the second half of the five-year term. While the objective in terms of aggregate taxes and social security contributions would be attained in 2019, actions for reducing public spending, notably through a spending review process have not been fully clarified yet. This leaves the bulk of the adjustment necessary to reach the deficit and debt goals to the end of the government mandate when electoral considerations might make these objectives more difficult to be reached. Second, a parliamentary report has recently stressed that the State's general accounting does not allow a rigorous assessment of the expenses associated with litigation. At present, this latter would cause a budgetary cost of EUR 3.6 billion per year, on average. Over

[14] European Commission (DG ECFIN) and Economic Policy Committee (AWG) (2017) "2018 Ageing Report: Economic and Budgetary Projections for the 28 EU Member States (2016-2070)", European Commission, European Economy, Institutional Paper 079, May 2018.

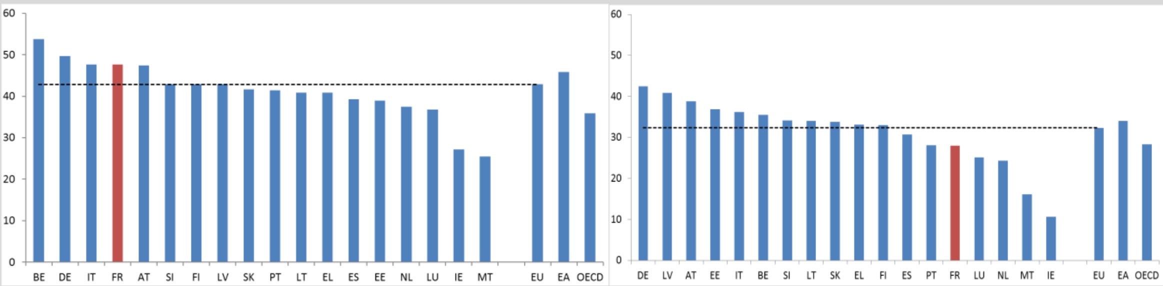
time, the risk for unbudgeted public expenditures coming from litigation would be increasing according to the analysis of the report[15].

Box 4 – Addressing the tax burden on labour in the euro area

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

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

The tax burden on labour in France at the average wage and at low wage (2017)



Notes: No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.

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

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

In the context of the 2018 European Semester, France was issued the recommendation to "simplify the tax system, by limiting the use of tax expenditures, removing inefficient taxes and reducing taxes on production levied on companies". Taxes on production are capital and labour taxes for which companies are liable as result of engaging in production and regardless of their economic performance.

[15] Rapport d'information de la commission des finances, de l'économie générale et du contrôle budgétaire, en conclusion des travaux d'une mission d'information relative à la gestion du risque budgétaire associé aux contentieux fiscaux et non fiscaux de l'État, http://www.assemblee-nationale.fr/15/rap-info/i1310.asp

In the EU, France has a very high level of taxes on production, worth 3.1 % of GDP in 2016. Beside transforming the tax credit for competitiveness and employment into permanent reductions in employers' social security contributions, the DBP 2019 foresees cuts only for one tax on the production for companies with fewer than 50 employees - the tax on incentives and profit-sharing schemes (*forfait social*) -, while it reduces the weight of this tax for companies with up to 250 employees. This measure may decrease employers' social security contributions and could increase firms' results leading in the longer term to investment and employment.

The DBP also exempts very small firms with maximum 20 employees to contribute to two taxes on production (*versement transport* and the contribution to the *Fond National d'Aide au Logement*). Other taxes on production remain untouched. As far as efforts to simplify the tax system are concerned, the withholding personal income tax reform (*prélèvement à la source*) will be introduced starting from 2019. A total of 17 inefficient taxes worth EUR 7.5 million will be cut, while three new tax expenditures will be created and the tax base on consumption has not been broadened.

6. OVERALL CONCLUSION

Based on the Commission 2018 autumn forecast, the structural improvement in 2018 and 2019 falls short of the minimum linear structural adjustment to ensure sufficient progress towards compliance with the debt criterion.

Following an overall assessment of the DBP, the planned structural adjustment is well below the required adjustment path towards the MTO and, accordingly, is at risk of significant deviation from it both in 2018 and 2019.

This assessment is broadly confirmed following an overall assessment based on the Commission 2018 autumn forecast, which concludes on a risk of some deviation in 2018, although with a very small margin, as it stands very close to the threshold to flag a risk of significant deviation. For 2018 and 2019 taken together the overall assessment confirms a risk of significant deviation from the adjustment path towards the MTO as recommended by the Council.