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REPORT FROM THE COMMISSION

France

Report prepared in accordance with Article 104(3) of the Treaty

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1. THE APPLICATION OF THE STABILITY AND GROWTH PACT IN THE CURRENT CRISIS SITUATION

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan explicated that the stimulus should be differentiated across Member States to reflect their different positions in terms of public finance sustainability and competitiveness and should be reversed when economic conditions improve. Finally, several countries have taken measures to stabilise the financial sector, some of which impact on the debt position or constitute a risk of higher deficits and debt in the future, although some of the costs of the government support could be recouped in the future.

The Stability and Growth Pact requires the Commission to prepare a report such as the present one whenever the deficit of a Member State exceeds the 3% of GDP reference value. This report analyses the reasons for the breach of the reference value with due regard to the economic background and all other relevant factors. The amendments to the Stability and Growth Pact in 2005 aimed specifically at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. This means for instance that, if an "excessive deficit" is deemed to exist, adequate attention needs to be paid to the economic background when making recommendations on the pace of the correction. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

2. LEGAL BACKGROUND

This report, which assesses recent and current budgetary developments in France and reviews the short- and medium-term prospects in the light of overall economic conditions and policy action taken by the government, is prepared according to Article 104(3) of the Treaty.

Article 104 of the Treaty lays down an excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 “on speeding up and clarifying the implementation of the excessive deficit procedure”[1], which is part of the Stability and Growth Pact. According to Article 104(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 104(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to “take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State”.

A previous EDP with regard to France was abrogated by the Council in January 2007[2]. It had been initiated with the Commission's adoption on 2 April 2003 of a report under Article 104(3) in view of a deficit of 3.1% of GDP in 2002. The Council, upon the corresponding Commission recommendations, placed France in excessive deficit in June 2003 and addressed recommendations to it with a view to bringing the excessive deficit situation to an end by 2004. On 14 December 2004, the Commission adopted a Communication to the Council (*The situation of Germany and France in relation to their obligations under the excessive deficit procedure following the judgement of the Court of Justice*, COM (2004) 813 final), which concluded that the year 2005 should be considered as the relevant deadline for the correction.[3] Upon the Commission recommendation of November 2006, the Council decided on 30 January 2007 to abrogate its decision on the existence of an excessive deficit in France (under

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1 OJ L 209, 2.8.1997, p. 6. Regulation as amended by Regulation (EC) No 1056/2005 (OJ L 174, 7.7.2005, p. 5). The report also takes into account the “Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes”, endorsed by the ECOFIN Council of 11 October 2005, available at http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

2 All the necessary documents can be found at: http://ec.europa.eu/economy_finance/sg_pact_fiscal_policy/excessive_deficit9109_en.htm

3 This followed the October 2003 Commission recommendations based on Articles 104(8) and (9), respectively, for (i) a Council decision stating that measures taken by France had been insufficient and (ii) giving notice to France to take measures to correct the excessive deficit by 2005 (rather than 2004 as part of the budgetary slippage could be attributed to the deterioration in cyclical conditions). On 25 November 2003, the Council voted on the two recommendations but did not adopt them. Instead, it adopted conclusions addressing recommendations to France for the correction of the excessive deficit by 2005, which were annulled by the European Court of Justice in July 2004.

Article 104(12)) not only taking into account the decline of the deficit below 3% of GDP in 2005 (including through one off measures) and a first decrease in the debt ratio to 65.4% in 2006 but also based on an expected continuous decline in these ratios over subsequent years.

The French Minister of the Economy, Industry and Employment, in a letter addressed to the Commissioner of Economic and Financial Affairs on 6 February 2009 announced that the general government deficit should attain 3.2% of GDP in 2008, 4.4% in 2009 and 3.1% in 2010. Therefore, the 3% of GDP reference value will have been already exceeded in 2008. This represents an upward revision of the deficit estimates with respect to the December 2008 Stability Programme update of France[4], according to which, the general government deficit in France was planned to reach 2.9% in 2008, 3.9% of GDP in 2009, and 2.7% in 2010. The new projected deficit targets for 2009 and 2010 take into account, as it was already the case in the December 2008 updated stability programme, the measures included in the recovery package unveiled by the French President on 4 December 2008, which are broadly in line with the European Economic Recovery Plan that called for frontloading investment and supporting employment. In this context, and given the initial budgetary position of France of a deficit above 3% of GDP in 2008, the breach well above the 3% threshold also in 2009 and 2010 is a consequence of the severity of the downturn and the implementation of the package. Furthermore, the general government gross debt-to-GDP ratio, which has been above the 60% threshold since 2002, and rising again since 2007, would be, according to the most recent update of the stability programme, at 66.7% in 2008 to increase to 69.4% of GDP in 2010, reflecting the above-mentioned deficit developments and the financial sector support measures that were taken in response to the financial crisis. The debt ratio was not updated in the above mentioned letter from the Minister, but, given the worsening of the general government balance position from 2008 and in the following years, public debt figures should be higher than projected in the update.

Table 1: General government deficit and debt [a]

	2004	2005	2006	2007	2008		2009		2010	
					COM	Dec 08 SP	COM	Dec 08 SP	COM	Dec 08 SP
General government balance	-3.6	-2.9	-2.4	-2.7	-3.2	-2.9	-5.4	-3.9	-5.0	-2.7
General government gross debt	64.9	66.4	63.6	63.9	67.1	66.7	72.4	69.1	76.0	69.4

Note:

[a] In percent of GDP.

Source: Eurostat and Commission services' January 2009 interim forecasts and December 2008 national Stability Programme..

The new estimated figure for the 2008 deficit and the gross debt figures for 2008 and 2009 provide *prima facie* evidence on the existence of an excessive deficit in France in the sense of the Treaty and the Stability and Growth Pact. The Commission has therefore decided to initiate the excessive deficit procedure for France with the adoption of this report. Section 3 of the report examines the deficit criterion and Section 4 the debt criterion. Section 5 deals with public investment and other relevant factors. Technical analysis underpinning the conclusions of the report is provided in the forthcoming macro-fiscal assessment of the Stability

4 According to Council Regulation (EC) No 3605/93, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels.

Programme of France[5]. Both documents take into account the Commission services' January 2009 interim forecast, released on 19 January 2009.

3. DEFICIT CRITERION

In 2008, the general government deficit is estimated to have reached 3.2% of GDP.

In excess of 3% of GDP, the estimated deficit is close to the Treaty reference value. This is emphasized by the Commission forecast also showing a deficit of 3.2% in 2008.

The excess over the 3% of GDP reference value is not exceptional.

- It does not result from an unusual event in the sense of the Treaty and the Stability and Growth Pact. This definition is to be applied narrowly to cover events such as wars or natural disasters;

- In particular, it cannot be considered to result from a severe economic downturn in 2008 in the sense of the Treaty and the Stability and Growth Pact. According to the French statistical office (INSEE)[6], GDP is estimated to have decelerated in 2008 to 0.7% of GDP from 2.2% in 2007. This annual average 2008 growth figure does not allow by itself to qualify the excess deficit as exceptional. However, the economic environment deteriorated sharply in the last quarter of the year, in which GDP contracted by 1.2% in quarterly terms, which compares with a positive growth of 0.1% in the third quarter. This sudden deterioration results from the global financial crisis and prompted the Council on 12 December 2008 to issue the European Economic Recovery Plan (EERP), calling for a stimulus package[7]. The downturn is projected to continue over 2009, when GDP should fall by 1.8% of GDP despite the implementation of the recovery plan.

Apart from the above-mentioned economic downturn impact, the excess over the 3% threshold from 2008 is also a reflection of the fact that, since 2002, the deficit in France has been high and, either above, or still close to the 3% threshold, therefore not providing any room for manoeuvre for a downturn, either severe or normal. The structural balance deteriorated in 2007, although economic circumstances were better and the government did not plan a significant structural adjustment for 2008 either, when the economic outlook was still substantially more favourable. Even after the previous excessive deficit procedure was abrogated in early 2007, and despite repeated commitments for an acceleration of the budgetary adjustment in successive stability programmes and related Council recommendations, as well as in its policy advice of 28 May 2008[8], the necessary fiscal consolidation was not carried out or planned.

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5 Macro-fiscal assessment of the Stability Programme of France of December 2008 by the Commission services.

6 Press release of INSEE on 13 February 2009 (Informations rapides nº 47)

7 Council of the European Union 17271/08 – Presidency Conclusions – Brussels, 11 and 12 December 2008.

8 Commission Recommendation of 28 May 2008, providing a policy advice on the economic and budgetary policy in France.

Table 2: Macroeconomic and budgetary developments [a]

	2004	2005	2006	2007	2008		2009		2010	
					COM	Dec 08 SP	COM	Dec 08 SP	COM	Dec 08 SP
Real GDP (% change)	2.5	1.9	2.2	2.2	0.7	1.0	-1.8	0.2-0.5	0.4	2.0
Potential GDP (% change)	1.8	1.7	1.6	1.6	1.5	2.0	0.9	1.7	1.0	1.8
Output gap (% of potential GDP)	0.5	0.7	1.3	1.8	1.0	-0.6	-1.7	-1.8	-2.3	-1.6
General government balance	-3.6	-2.9	-2.4	-2.7	-3.2	-2.9	-5.4	-3.9	-5.0	-2.7
Primary balance	-0.9	-0.3	0.2	0.1	-0.3	0.0	-2.6	-1.1	-2.1	0.1
One-off and other temporary measures	0.1	0.6	0.3	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Government gross fixed capital formation	3.1	3.3	3.2	3.3	3.3	3.3	3.6	3.5	3.4	3.2
Cyclically-adjusted balance	-3.9	-3.3	-3.0	-3.5	-3.7	-2.6	-4.6	-3.0	-3.8	-1.9
Cyclically-adjusted primary balance	-1.1	-0.7	-0.5	-0.8	-0.8	0.3	-1.7	-0.2	-1.0	0.9
Structural balance [b*]	-4.0	-3.9	-3.3	-3.6	-3.8	-2.6	-4.6	-3.0	-3.8	-1.9
Structural primary balance	-1.2	-1.3	-0.8	-0.9	-0.9	0.3	-1.7	-0.2	-1.0	0.9

Notes:
* As recalculated by COM on the basis of the information in the programme.
[a] In percent of GDP unless specified otherwise.
[b] Cyclically-adjusted balance excluding one-off and other temporary measures.
Source: Eurostat and Commission services' January 2009 interim forecast and December 2008 Stability Programme

The excess over the 3% of GDP reference value is not temporary in the sense of the Treaty and the Stability and Growth Pact. As mentioned above, according to the announcement of the Ministry of the Economy, Industry and Employment, the general government deficit will increase from 3.2% of GDP in 2008 to 4.4% in 2009 and then diminish to 3.1% in 2010, i.e, in each year above the 3% threshold. These projections for 2009 and 2010 are based on the implementation of the 2009 Budget Law, as well as on a GDP growth rate of 0.5% and 2% for 2009 and 2010, respectively[9]. However, this macro-economic scenario, which was not updated when the new official deficit forecast was announced, now appears outdated and there are clear signs of a much less favourable growth scenario in both the domestic market and major trading-partner economies, especially the euro-area countries, as well as of a further tightening of credit conditions. According to the Commission services January 2009 interim forecast, GDP is expected to contract by 1.8% in 2009 and then grow by a meagre 0.4% in 2010. This implies that the general government deficit is forecast to reach 5.4% of GDP in 2009 and to slightly decline to 5% in 2010 as the budgetary impact of the recovery plan is phased out. Thus, given the size of these projections, it is unrealistic to expect that the deficit could be brought below the 3% of GDP threshold by the end of the forecasting period (2010) even if growth is expected to have become slightly positive by that time.

In sum, the deficit is close to the 3% of GDP reference value and, the excess over the reference value cannot be regarded as exceptional and it is not temporary in the sense of the Treaty and the Stability and Growth Pact. This analysis suggests that the deficit criterion in the Treaty is not fulfilled.

4. DEBT CRITERION

In 2008, the general government gross debt is estimated in the December 2008 updated stability programme at 66.7% of GDP, well above the 60% of GDP Treaty reference value

9 The announcement of the Minister was not accompanied by an update of the macroeconomic scenario, which, therefore, remains the one presented in the December 2008 Stability Programme.

and up from 63.9% and 63.6 in 2007 and 2006, respectively[10]. Indeed, between 2006 and 2007, the ratio already increased by 0.3 percentage points of GDP, reversing the previous declining path between 2005 and 2006. While the increase in the debt ratio in 2007 can be largely explained by a positive (debt-increasing) stock-flow adjustment (SFA) amounting to 0.5% of GDP, in 2008, it has been the result of a combined positive SFA (1.9% of GDP) and a positive "snowball" effect (1% of GDP). Specifically, the bank rescue measures and debt issues to increase public liquidity help explain, according to the most recent update of the stability programme, around 2/3 of the 2008 SFA. Additionally, the positive snow-ball effect stems from interest payments, which, in terms of their debt impact, have not been fully offset by real economic growth and inflation. The close-to-zero contribution of the primary balance to changes in the debt-to-GDP ratio highlights the fact that fiscal consolidation has not been sufficiently intense as to decisively impact on debt reduction.

Table 3: Debt dynamics [a]

	2004	2005	2006	2007	2008		2009		2010	
					COM	Dec 08 SP	COM	Dec 08 SP	COM	Dec 08 SP
Government gross debt ratio	64.9	66.4	63.6	63.9	67.1	66.7	72.4	69.1	76.0	69.4
Change in debt ratio [b] (1 = 2+3+4)	2.0	1.5	-2.7	0.3	3.1	2.8	5.4	2.4	3.6	0.3
Contributions:										
• Primary balance (2)	0.9	0.3	-0.2	-0.1	0.3	0.0	2.6	-1.1	2.1	0.1
• “Snowball” effect (3)	*0.3*	*0.2*	*-0.5*	*-0.1*	*0.9*	*0.9*	*2.8*	*1.3*	*1.4*	*0.3*
of which:										
Interest expenditure	*2.7*	*2.6*	*2.5*	*2.7*	*2.9*	*2.9*	*2.9*	*2.8*	*2.9*	*2.8*
Real GDP growth	*-1.5*	*-1.2*	*-1.4*	*-1.3*	*-0.4*	*-0.6*	*1.2*	*-0.3*	*-0.3*	*-1.3*
Inflation (GDP deflator)	*-1.0*	*-1.3*	*-1.6*	*-1.5*	*-1.5*	*-1.3*	*-1.3*	*-1.2*	*-1.1*	*-1.2*
• Stock-flow adjustment (4)	0.8	1.0	-2.1	0.5	1.9	1.9	0.0	0.0	0.0	0.0

Notes:
[a] In percent of GDP.
[b] The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$$

where t is a time subscript; *D, PD, Y* and *SF* are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and *i* and *y* represent the average cost of debt and nominal GDP growth. The term in parentheses represents the “snow-ball” effect, measuring the combined effect of interest expenditure and economic growth on the debt ratio.
Source: *Eurostat and Commission services’ Jan 2009 interim forecast and December 2008 Stability Programmes.*

In 2009, debt should increase and attain 69.1% of GDP. A declining primary balance in a context of a worsening of economic prospects, together with a positive contribution of the "snowball" effect, would be the main reasons behind a growing debt ratio. Moreover, the current and past deficit levels, as well as the estimates of medium-term growth are not compatible with a debt ratio converging to a level below 60% of GDP. In 2010, the debt ratio would slightly rise to 69.4% of GDP. According to the Commission Services' January 2009 interim forecast, debt increases at a quicker pace in view of the worse projected primary balance and the snowball effect stemming from lower growth and should attain 76% of GDP

10 As mentioned above, debt ratios were not updated during the announcement of the Minister of Budget.

in 2010. This forecast includes the measures taken by the government to stabilise the financial market, estimated at around 1% of GDP.

In view of these debt trends, the debt ratio is not diminishing towards the reference value, suggesting that the debt criterion stipulated in Article 104(3) of the Treaty is not fulfilled.

5. RELEVANT FACTORS

Article 104(3) of the Treaty provides that the Commission report "shall also take into account whether the government deficit exceeds government investment expenditure and take into account other relevant factors including the medium-term economic and budgetary position of the Member State". These factors are further clarified in Article 2(3) of Council Regulation (EC) No 1467/97, which also specifies that "any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess in qualitative terms the excess over the reference value and which the Member State has put forward to the Commission and to the Council" need to be given due consideration.

In view of the above provisions, the following three subsections consider in turn (1) the medium-term economic position; (2) the medium-term budgetary position (including public investment); and (3) other factors put forward by the Member State.

5.1. Medium-term economic position

Cyclical conditions and potential growth

After having recorded above-potential growth rates over the period 2004-2007 (averaging 2.2%), the French economy slowed down in 2008 to 0.7%, and is projected to experience a period of recessive or low economic growth until 2010 due to the sharp and sudden deterioration of economic conditions resulting from the global financial crisis. With potential growth rates estimated at 1.4% in 2008 and around 1% in 2009 and 2010, the Commission Services' January 2009 interim forecast projects headline growth at 0.7%, -1.8% and +0.4% in 2008, 2009 and 2010, respectively, in response to which the output gap would deteriorate from 1.1% in 2008 to -2.3% in 2010. This output gap profile is consistent with the unfavourable economic environmentreflecting the global economic downturn in the context of the financial crisis.

Recent structural reforms

The government implemented several structural reforms, which are expected to have a positive impact on the potential growth of the economy and, therefore, on public finances. As far as the goods and services markets are concerned, the Government adopted a law on the modernisation of the French economy aiming at fostering competition in product and service markets and thus raising potential growth, notably by promoting individual entrepreneurship and loosening existing constraints in the retail sector. Actions to foster R&D and innovation, which depend in part on financing from EU Structural Funds, are expected to be reinforced in the programming period 2007-2013 and should also help foster potential growth. On the labour market front, there has been some progress, notably as regards flexicurity. The law, which represents the transposition of the social partners' first inter-professional agreement, aims to develop more flexible contracts. An important reform of social dialogue procedures has also been brought in to facilitate majority agreements.

5.2. Medium-term budgetary position

Structural deficit and fiscal consolidation in good times

After some progress in 2005 and 2006 to consolidate public finances, the fiscal stance eased again in 2007, pointing to an insufficient consolidation effort when economic conditions were more favourable. The structural deficit (cyclically-adjusted deficit net of one-offs)[11] increased from 3.3% of GDP in 2006 to 3.6% of GDP in 2007. According to the Commission Services' January 2009 interim forecast, the French headline general government deficit should have increased from 2.7% of GDP in 2007 to 3.2% in 2008. Consequently, the structural deficit deteriorated further from 3.6% of GDP in 2007 to 3.8% of GDP in 2008, whereas, in the November 2007 stability programme, the government had announced a slight improvement of 0.1% of GDP when growth was expected to be substantially higher. Looking forward, the Commission services' January 2009 interim forecast project that the structural government deficit in 2009 would keep on deteriorating by around 0.8 percentage points of GDP (in line with the impact of the recovery package) to attain a deficit of 4.6% of GDP. In 2010 structural balance deficit is projected to improve to a deficit of 3.8% of GDP as the recovery package will be phased out.

Public investment

The general government deficit ratio exceeded the ratio of general government gross fixed investment to GDP between 2000 and 2004, whereas the opposite has occurred between 2005 and 2007. In 2008, general government gross fixed capital formation, at 3.3% of GDP in 2008, was roughly the same as the expected deficit. According to the Commission Services' January 2009 interim forecast, public investment should rise in 2009 due to the recovery plan although the ratio (3.5% in 2009) would remain well below the general government deficit ratio in 2009 as well as in 2010.

Quality of public finances

Between 2004 and 2006, France implemented a fiscal adjustment of 1.1 pp of GDP, based on both lower expenditure (a reduction of 0.7 pp of GDP over the three years) and higher revenue (0.4 pp of GDP). Current expenditure fell by 0.6% of GDP, mainly due to lower social transfers and interest payments. In 2007, both revenue and expenditure ratios fell substantially, by 1 pp and 0.8 pp of GDP respectively. Concerning revenue, the three main tax categories (direct taxes, indirect taxes and social contributions) account each for around 1/3 of public income reduction. Referring to expenditure, still the highest in the euro area in percent of GDP, the bulk of the reduction can be largely explained by a fall of social transfers (0.5 pp of GDP) and compensation of employees (0.2 pp of GDP). In 2008, while revenues remained broadly stable, expenditure rose by 0.4% of GDP, equally explained by an increase in social transfers and interest payments.

The government implemented a number of reforms in the area of the budgetary process. In particular, the reform of the Constitution, adopted by Parliament in July 2008, introduced the non-binding objective of a balanced budget for public administrations and a multi-annual budget. The present zero volume growth rule is not binding for local authorities and social security spending and, even without the recovery plan, the rule might have been breached in

[11] Estimated by the Commission services, applying the common methodology on estimating output gaps.

2009 with expenditure growing by 0.1% in volume. According to the last update of the stability programme, the rule would be respected between 2010 and 2012.

In 2007, the Government took a number of initiatives to improve the quality of public finances. First, they launched the General Review of Public Policies (GRPP) aimed at carrying out an exhaustive audit of public missions in view of a major rationalisation of the administration and greater efficiency in the provision of state services. According to the Government, the GRPP should deliver savings amounting to €7.7 billion (0.4% of GDP) by 2011 overall, mostly thanks to cut down on payroll (non-replacement of a third of retiring civil servants in 2008, and of a half from 2009 onwards). Second, it reached an agreement with social partners to increase the convergence of the special pension regimes towards the general regime.

Long-term sustainability of public finances

The long-term budgetary impact of ageing is slightly lower than the EU average, with pension expenditure showing a somewhat more limited increase, as a result of the pension reforms already enacted, among which the reform of the so-called régimes spéciaux (special pension regimes), aimed at aligning the required contribution period with the rules of other regimes. The budgetary position in 2008, as estimated in the programme, which is worse than the starting position of the previous programme, compounds the budgetary impact of population ageing on the sustainability gap. If the 2009 budgetary position of the Commission services' interim forecast was taken as the starting point, the sustainability gap would worsen substantially. Moreover, the current level of gross debt is above the Treaty reference value. The above-mentioned risks from the financial sector stabilisation schemes (e.g. recapitalisation, guarantees) put in place by France could have a potential negative impact on the long-term sustainability of public finances, primarily via their potential impact on government debt, although some of the costs of the Government support might not materialize or could be recouped in the future. Ensuring higher primary surpluses over the medium term, as already foreseen in the programme, would contribute to reducing the medium risks to the sustainability of public finances.

5.3. The French response to the EERP

On 4 December, the French President announced a € 26 billion (1.3% of GDP) stimulus package to tackle the economic downturn, following the 26 November 2008 Communication from the Commission to the Council and adopted by the Council in December. The announced measures are concentrated in public investment (€ 10.5bn or 0.6% of GDP) and support to enterprises (€ 11.4bn or 0.6% of GDP). According to the French government, the recovery plan would raise the deficit by 0.9% of GDP over the next two years, with the main impact in 2009. This figure is smaller that the total amount of the stimulus (€ 26 billion or 1.3% of GDP), as some measures do not have an impact on the deficit (notably investments by public enterprises). The deficit increase as a direct result of the plan will be € 15.5 billion in 2009 (0.8% of GDP). For 2010, taking into account the acceleration of reimbursement of taxes in 2009, initially paid in 2010, the impact would be € 1.0 billion in (0.05% of GDP). According to the authorities, the stimulus has a temporary nature and will have no long-term impact on the deficit.

5.4. *Other factors considered relevant by the Commission*

In response to the financial crisis, the French government undertook a number of measures addressed to ensure the stability of the financial sector. In order to dampen its consequences on solvency ratios of French banks, the government decided, thanks to a €40 bn fund[12], to purchase subordinated bank debt without acquiring voting rights. In exchange, banks are notably supposed to commit to increase loans to the economy in order to guarantee a degree of financing in line with the needs of economic agents. Furthermore, a €320bn[13] fund will guarantee bank debts. This guarantee scheme is aimed at improving the access to finance of banks, in the context of the severe pressure the market for interbank loans has had to face since the beginning of the financial crisis. Banks will pay a premium for the government guarantee for their loans.

6. CONCLUSIONS

The general government deficit in France is estimated to have reached 3.2% of GDP in 2008, breaching the reference value although remaining close to it. The deficit for 2009 and 2010 is planned to be well above the 3% of GDP. These deficit developments result from the severity of the downturn as well as the impact of the France's specific response to the EERP, a "recovery plan" amounting to € 26 billion or 1.3% of GDP. However, the excess deficit also reflects insufficient fiscal consolidation effort when economic conditions were more favourable, not providing sufficient safety margin against breaching the 3% of GDP threshold in the downturn.

The excess over the reference value cannot be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact, neither can it be considered temporary. This suggests that the deficit criterion in the Treaty is not fulfilled.

General government gross debt has been above the 60% of GDP reference value since year 2002 and is estimated to have reached 66.7% of GDP in 2008, according to the updated stability programme (and around 67% of GDP in the Commission forecast). The debt ratio can be considered as increasing and departing from the reference value within the meaning of the Treaty and the Stability and Growth Pact. This suggests that the debt criterion in the Treaty is not fulfilled.

In line with the Treaty, this report has also examined “relevant factors”, which, according to the Stability and Growth Pact, can only be taken into account in the steps leading to the decision on the existence of a excessive deficit if the double condition – that the deficit remains close to the reference value and that its excess over the reference value is temporary – is fully met. Considered on their own merit, the relevant factors in the current case on balance seem to be relatively favourable.

The existence of a severe economic downturn, the implementation of a recovery plan and the financial sector support package, with the above-mentioned public finance implications, increase the need to undertake enhanced surveillance under the EDP.

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12 Of which, the Commission has authorised € 21 billion.

13 Of which, the Commission has authorised € 265 billion.