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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

{SWD(2015) 130 final}

1. INTRODUCTION

On 10 March 2015 the Council issued a recommendation to France under Article 126(7) of the Treaty, with a view to bringing an end to the excessive deficit situation by 2017. France was recommended to reach a headline deficit of 4.0% of GDP in 2015, 3.4% of GDP in 2016 and of 2.8% of GDP in 2017. Based on the macroeconomic forecast underlying the Council recommendation, this was considered consistent with an improvement of the structural balance of 0.5% of GDP in 2015, 0.8% for 2016 and 0.9% in 2017 and would require additional measures of 0.2% of GDP in 2015, 1.2% in 2016 and 1.3% in 2017.

In accordance with Article 3(4a) of Council Regulation (EC) No 1467/97, the Council established the deadline of 10 June 2015 for France to report in detail on action taken regarding (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. In addition, France was required to provide an ex-ante evaluation of the key measures underpinning the adjustment for 2016 and 2017 ahead of the deadline.

At the established deadline, the French authorities submitted a report to the Commission presenting the measures taken in response to the Council recommendation and outlining the consolidation strategy envisaged to achieve the targets set by the Council.

The Commission has examined the budgetary strategy of France based on the information included in the report on action taken, in order to assess whether France has complied with the Council recommendation of 10 March 2015.

2. MEASURES INCLUDED IN THE REPORT ON ACTION TAKEN AND UPDATED BUDGETARY PROJECTIONS

The report on action taken released on 10 June 2015 confirms the budgetary strategy outlined in the Stability Programme of France submitted on 30 April 2015, which aims to correct the excessive deficit by 2017, the deadline set by the Council. The report does not include new measures, but provides further information on the nature and the implementation of the additional measures announced in the Stability Programme in response to the Council recommendation of 10 March 2015 representing EUR 4 billion in 2015 and EUR 5 billion in 2016.

Regarding 2015, the report confirms the EUR 4 billion (0.2% of GDP) package of measures announced in the Stability Programme that were already fully taken into account in the Commission 2015 spring forecast. This package 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 revenue measures (EUR 0.6 billion). As pointed out in the Commission's services' assessment of the Stability Programme[1], EUR 1.2 billion of these measures have been taken in order to turn the lower-than-expected level of expenditures observed in 2014 into permanent savings. These measures imply a reduction in the level of

[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

expenditures planned by the authorities. However, they do not change the pace of public expenditure growth and hence have no impact on the fiscal effort[2].

Regarding 2016, the report on action taken provides additional information on the measures underpinning the EUR 5 billion (0.2% of GDP) expenditure savings, which were not sufficiently specified in the Stability Programme and were thus not included in the Commission 2015 spring forecast. The lower expenditures would result from savings by the State (EUR 1.6 billion), social security (EUR 2.2 billion) and local government (EUR 1.2 billion). At this stage, only the additional expenditure reductions planned by the State (EUR 1.6 billion), which have been documented by letters sent by the Prime Minister to each Minister on 24 April 2015, appear sufficiently specified to be taken into account in the Commission's assessment. The remaining savings planned by the authorities can only be included in the Commission forecast once the measures underpinning the budgetary strategy have been sufficiently specified.

For 2017, the report on action taken does neither include further measures nor details on the measures underpinning the adjustment planned.

The Commission 2015 spring forecast, which extends to 2016, projected the general government balance to reach a deficit of 3.8% of GDP in 2015, thus below the headline target of 4.0% of GDP set in the Council recommendation. For 2016, under a no-policy-change assumption, the deficit was projected at 3.5% of GDP, above the recommended 3.4% of GDP target.

In light of the information provided in the report on action taken, the updated Commission spring forecast expects the headline deficit to remain unchanged in 2015 at 3.8% of GDP and to decrease to 3.4% of GDP in 2016. For 2015, the report on action taken confirms the impact on public finances of the EUR 4 billion package as estimated in the spring forecast. For 2016, only the additional consolidation measures planned on State expenditures, representing EUR 1.6 billion (0.1% of GDP) appear sufficiently specified at this stage and have therefore been included in the updated Commission forecast. Accordingly, the projected general government deficit for 2016 is revised down to 3.4% of GDP from 3.5% in the spring forecast.

Risks to the budgetary outlook for 2015 and 2016, as projected in the updated Commission spring forecast, appear overall balanced. 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 faster than anticipated. In addition, a higher-than-expected elasticity of tax revenues could have a positive impact on the headline deficit over 2015 and 2016. On the contrary, the disappointing developments in the labour market may have a negative impact on public finances. Similarly, the recent increase in the yields on sovereign bonds could lead to an increase in interest payments and hence put additional pressure on the expenditure reduction targets.

[2] The fiscal effort is computed on the basis of the pace of increase in public expenditures rather than on their level (See Box 1).

3. ASSESSMENT OF ACTION TAKEN

Based on the information submitted in the report on action taken, the updated Commission spring forecast expects a headline deficit of 3.8% of GDP in 2015, below the target set by the Council for that year, and 3.4% in 2016, in line with the target set by the Council. The adjustment in the structural balance is, however, set to remain lower than recommended by the Council in both years.

Box 1. Methodology for assessing effective action

According to Regulation (EC) No 1467/97 and the Code of Conduct[3], 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 action[4] 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

[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).

achieved. At the same time, a careful analysis should be conducted to better understand the nature of the underlying budgetary developments.

The improvement in the structural balance stemming from the updated Commission forecast amounts to 0.3% of GDP in 2015 and 0.1% in 2016, falling short of the effort of 0.5% and 0.8% of GDP recommended by the Council. Regarding 2015, the expected improvement in the structural balance remains unchanged compared to the spring forecast at 0.3% of GDP and is similar to the one expected at the time of the Council recommendation. More specifically, the additional package of EUR 4 billion announced in the Stability Programme is set to increase the structural effort by EUR 2.8 billion (0.1% of GDP). However, this impact is compensated by a downward revision in tax elasticities. Regarding 2016, the improvement in the structural balance was estimated to be 0.0% of GDP in the spring forecast and -0.4% of GDP in the EDP baseline scenario. Taking into account the further reduction in expenditure specified in the report on action taken, the structural balance is now projected to improve by 0.1% of GDP, still well below the 0.8% of GDP improvement recommended by the Council.

As is foreseen by the methodology for assessing effective action (see Box 1), this situation calls for a careful analysis of the fiscal effort based on the adjusted improvement in the structural balance (top-down approach) and on the amount of measures taken (bottom-up approach).

Table 1. 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

Regarding 2015, the careful analysis confirms that the fiscal effort is expected to fall short of the level recommended by the Council. 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 compared to 0.5% 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, the impact of the additional measures for 2015 described in the report on action taken is offset by the correction for savings on interest payments, which 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 effort for 2015.

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 to an improvement of 0.8% of GDP recommended by the Council. Similarly, the additional savings on the State are expected to bring the bottom-up fiscal effort from 0.3% of GDP estimated in the spring forecast to 0.4% of GDP, falling short of the 1.2% of GDP recommended by the Council on 10 March 2015.

The Council recommendation of 10 March 2015 also called for an evaluation of the key measures planned for 2016 and 2017. This assessment is not provided in the report on action taken. In particular, expenditure savings in 2016 and 2017 are expected to be supported by the outcome of spending reviews which are either on-going or still to be launched. Moreover, the *'loi de programmation des finances publiques'* has not been updated as recommended by the Council.

Table 2. Comparison of adjusted change in the structural balance and fiscal efforts based on Commission 2015 spring forecast

% 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

4. CONCLUSIONS

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. Therefore, in order to ensure a durable correction of the excessive deficit by the established deadline, the budgetary strategy would need to be further reinforced. In particular, the expenditure savings planned for 2016 and 2017 need to be further specified and windfall gains, notably resulting from higher-than-expected tax revenues or lower interest rates, should be used for deficit reduction. Moreover, efforts should be stepped up to make the spending review more effective and identify savings opportunities across all sub-sectors of general government, including on social security and local government, as recommended by the Council. Moreover, it will be important to back the fiscal consolidation by the implementation of comprehensive and ambitious structural reforms, in line with the Council recommendations addressed to France in the context of the European Semester and in particular those related to the Macroeconomic Imbalance Procedure.

In sum, the headline deficit targets are expected to be met both in 2015 and 2016, while the fiscal effort, according to all metrics, falls short of the recommended one in 2015 and 2016. Therefore, according to the methodology for assessing effective action, the Commission considers that the procedure is to be held in abeyance.

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		assessment	
	(1)	(1')	(2)	(2')	(3)	(3')	(4)	(4')	(5)	(5')	(6)=[(1')-(2')-[(3')+(ε-1)*(4')/100]*(5')]-[(1)-(2)-[(3)+(ε-1)*(4)/100]*(5)]	(7)	(8)=100*(6)/(7)
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