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COVER NOTE

from:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
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to:	Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union
No Cion doc.:	COM(2013) 384 final
Subject:	Recommendation for a Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in France

Delegations will find attached Commission document COM(2013) 384 final.

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Recommendation for a

COUNCIL RECOMMENDATION

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

{SWD(2013) 384 final}

Recommendation for a

COUNCIL RECOMMENDATION

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

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(7) thereof,

Having regard to the recommendation from the European Commission,

Whereas:

(1) According to Article 126 of the Treaty on the Functioning of the European Union (TFEU), Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) On 27 April 2009, the Council decided, in accordance with Article 104(6) of the Treaty establishing the European Community (TEC), that an excessive deficit existed in France and issued recommendations to correct the excessive deficit by 2012 at the latest[1], in accordance with Article 104(7) TEC and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[2].

(4) On 2 December 2009, the Council decided, in accordance with Article 126(7) TFEU, that although effective action had been taken by the French authorities, unexpected adverse economic events with major unfavourable consequences for government finances had occurred after the adoption of the recommendation. As a consequence, the Council recommended that France correct its excessive deficit by 2013 at the latest. In order to bring the general government deficit below 3% of GDP in a credible and sustainable manner, the French authorities were recommended to (a) implement the consolidation measures in 2010 as planned and strengthen the fiscal effort from 2011 onwards; (b) ensure an average annual fiscal effort of above 1% of GDP over the

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1 All documents related to the excessive deficit procedure of France can be found at: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/france_en.htm

2 OJ L 209, 2.8.1997, p. 6.

period 2010-13; and (c) to specify the measures that were necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turned out better than expected at the time of the recommendation. In its recommendations, the Council established a deadline of 2 June 2010 for effective action to be taken in line with the provisions of Article 3(4) of Regulation (EC) No 1467/97.

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

(6) According to Article 3(5) of Regulation (EC) No 1467/97, the Council may decide, on a recommendation from the Commission, to adopt a revised recommendation under Article 126(7) TFEU, if effective action has been taken and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that recommendation. The occurrence of unexpected adverse economic events with major unfavourable budgetary effects shall be assessed against the economic forecast underlying the Council recommendation.

(7) In accordance with Article 126(7) TFEU and Article 3 of Council Regulation (EC) No 1467/97, the Council is required to make recommendations to the Member State concerned with a view to bringing the situation of an excessive deficit to an end within a given period. The recommendation has to establish a maximum deadline of six months for effective action to be taken by the Member State concerned to correct the excessive deficit. Furthermore, in a recommendation to correct an excessive deficit the Council should request the achievement of annual budgetary targets which, on the basis of the forecast underpinning the recommendation, are consistent with a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of at least 0.5% of GDP as a benchmark.

(8) The Commission services' 2009 Autumn Forecast, which was underlying the Council recommendation under Article 126(7) TFEU of 2 December 2009, projected that the French economy would expand by 1.2% in 2010 and 1.5% in 2011. The years 2012 and 2013 were beyond the forecast horizon, but under the assumption of a gradual closure of the large negative output gap by 2015, higher growth than in 2011 was expected for 2012 and 2013. GDP growth in 2010 was substantially above that expected in the Commission services' 2009 Autumn Forecast, in 2011 it was slightly above the projected 1.5%, while in 2012 the French economy stagnated.

(9) The Commission services' 2013 Spring Forecast projects GDP to decrease by 0.1% this year, implying a much worse scenario also for 2013 than the one underpinning the December 2009 Council recommendation. The weakness of households' real disposable income linked in particular to rising unemployment and tax increases will be only partly offset by inflation slowing down, while low business confidence is expected to lead to a continued fall in investment. A slight rebound of the external sector is forecast to translate into a modest pick-up in activity during the second half of the year. Gradually improving confidence and recovering real disposable income – assuming no further consolidation measures – are set to translate into positive growth

in 2014 (1.1%). Despite the government's efforts to support employment, in particular of young people and senior workers, the unemployment rate is forecast to further increase, reaching 10.6% and 10.9% in 2013 and 2014 respectively. Inflation is set to fall to 1.2% in 2013 on the back of lower energy prices before accelerating again next year notably due to planned VAT rises.

(10) The economic crisis has also had a significant impact on the general government balance. The deficit rose to an unprecedented 7.5% of GDP in 2009 from an already elevated 3.3% in 2008 due to the play of automatic stabilisers and the discretionary fiscal stimulus implemented by the authorities as part of the European Economic Recovery Plan (EERP). In 2010, the general government deficit decreased to 7.1% of GDP, reflecting both cyclical effects and an improvement in the structural balance (partly offset by deficit-increasing one-offs). The structural balance improved by 0.3% of GDP. In 2011, the deficit decreased significantly to reach 5.3% of GDP. While GDP growth remained unchanged with respect to 2010, at 1.7%, the improvement mainly stemmed from strengthened consolidation efforts and the complete phasing-out of the EERP. The fiscal effort as measured by the change in the structural balance was 1.2% of GDP. In 2012, the headline deficit came out at 4.8% of GDP, falling short of the 4.5% targeted by the authorities, despite a sizeable set of new measures. Part of the difference stemmed from the cost of bailing out the banking group Dexia (0.1% of GDP). The structural balance improved by 1.1% of GDP.

(11) According to the Commission services' 2013 Spring Forecast, the headline deficit is set to decrease further this year on the back of the measures adopted notably as part of the budget. Revenue measures include a further increase in direct taxes and social contributions. Current expenditure rules (central government and healthcare) are renewed and this will contribute to maintaining spending restraint. Lower than previously projected inflation and the partial suspension of indexation for second-pillar pensions in agreement with social partners will also help contain expenditure. However, GDP growth projected again well below potential will negatively affect the headline balance. Overall, the deficit is expected to reach 3.9% of GDP. The structural balance is projected to improve by another 1.3% of GDP. In 2014, the deficit is set to reach 4.2% of GDP under the usual no policy change assumption, which implies that only measures known in sufficient detail have been taken into account. In particular, part of the measures aimed at funding the recent corporate tax credit for competitiveness and employment are yet to be specified and a number of one-off tax payments will expire at end-2013. Overall, the stuctural balance is projected to remain broadly stable next year.

(12) The structural deficit, based on the Commission services' 2013 Spring Forecast, is estimated to fall to 2.2% of GDP this year from 6.1% in 2009, i.e. 1.0% of GDP on average over the 2010-13 reference period. When correcting for downward revisions in potential output growth (+0.1% of GDP) and revenue windfalls (-0.2% of GDP) compared with the time the Council recommendation was issued, the average annual fiscal effort comes at 0.9% of GDP, thus falling slightly short of the recommended effort of above 1% of GDP. However, a comprehensive assessment of the discretionary measures implemented by the French authorities over 2010-13 leads to the conclusion that the cumulative budgetary impact of these amounts to some 5¼% of GDP, i.e. 1.3% of GDP per year on average. On top of the improvement achieved in the structural balance, the impact of individual discretionary measures over this period has allowed to offset the trend in autonomously rising public expenditure due to

factors such as ageing and thus the bottom-up analysis provides a more positive picture than does the top-down approach based on the structural balance. Measures include a substantial increase in personal and corporate income taxation, complemented by hikes in indirect taxes and social security contributions, a freeze in base wages of civil servants as well as savings stemming from the General Review of Public Policies (RGPP), the 2010 pension reform and the fact that the healthcare spending norm (ONDAM) has been systematically (over)achieved. In view of the above, the French authorities can be considered to have taken effective action.

(13) The ratio of public debt to GDP, which represented 79.2% in 2009, exceeded 90% last year. According to the Commission services' 2013 Spring Forecast, the debt ratio will continue to rise over the forecast horizon, to 94.0% and 96.2% of GDP in 2013 and 2014, respectively, on the back of still relatively high general government deficits and subdued nominal GDP growth. Stock-flow adjustments including contributions to the European Stability Mechanism and direct loans to euro area programme countries will also contribute to increasing public debt.

(14) The substantial deterioration in the budgetary position resulting from the weaker overall position of the economy relative to the one underlying the 2009 Council recommendation suggests that revised recommendations under Article 126(7) TFEU for France extending the deadline to correct the excessive deficit are justified, consistent with the rules of the Stability and Growth Pact.

(15) Against the background of high uncertainties regarding economic and budgetary developments, the budgetary target recommended for the final year of the correction period should be set at a level clearly below the reference value, in order to guarantee an effective and lasting achievement of the correction within the requested deadline.

(16) An extension by only one year of the deadline for correction of the excessive deficit would require a fiscal effort in 2014 well above the average annual fiscal effort over 2010-13 recommended by the Council on 2 December 2009, which would also hamper significantly the projected economic recovery next year. A two-year extension would allow bringing the headline deficit below 3% of GDP in 2015 while limiting the impact on growth in 2014 and 2015. Granting France two additional years would be consistent with headline deficit targets of 3.9% of GDP for 2013, 3.6% for 2014 and 2.8% for 2015. The underlying annual improvement in the structural budget balance would be 1.3% of GDP in 2013 and 0.8% both in 2014 and 2015. Also taking into account a possible trend deterioration of the structural balance, this would imply that discretionary measures of above 1% of GDP per year would be needed in 2014 and 2015.

(17) In order to achieve the budgetary targets, it is crucial that the authorities fully implement the already adopted measures for 2013 (currently estimated at 1½% of GDP) and specify, adopt and implement rapidly expenditure savings and/or revenue measures of above 1% of GDP per year in 2014 and 2015 (the overall impact of the measures adopted/specified in sufficient detail so far for 2014-15 is only marginal). In particular, most planned savings backing the various spending norms for 2014-15 still need to be specified. Maintaining the freeze in base wages beyond 2013, which applies to all sub-sectors of general government, has not been explicitly confirmed. Moreover, while the MAP ('modernisation de l'action publique') spending review is on going, it remains unclear whether it will translate into sizeable (and easy to quantify) savings.

Regarding the pension system, the actual measures that would underpin the planned reform remain to be unveiled. Specifics are also lacking on the projected slowdown in local government spending. On the revenue side, a number of one-off tax payments will expire at end-2013 and no specific measures to compensate for these have been announced so far. Risks to next year's macroeconomic scenario of the French authorities are also clearly tilted to the downside. Indeed, while GDP growth is forecast to be 1.2% and thus very close the Commission services' 2013 Spring Forecast (1.1%), the underlying fiscal scenarios are at odds: the former factors in a structural effort of 1% in 2014 whereas the latter is built on a slightly deteriorating structural balance. The newly created fiscal council ('Haut Conseil des finances publiques') has also considered the macroeconomic scenario underpinning the current 2014 deficit target as markedly optimistic. Overall, the situation will have to be monitored closely and the authorities should stand ready to take corrective action in the event of expenditure slippages or revenue shortfalls.

(18) The Commission Fiscal Sustainability Report 2012 shows that France does not appear to face a risk of fiscal stress in the short term. In the medium and long term, risks appear medium and low. However, recent developments affecting the pension system are of more concern. In particular, the most recent projections by the Pensions Advisory Council ('Conseil d'orientation des retraites') point to persistent deficits of the system by 2020. This confirms the urgent need for an additional pension reform in order to fully restore the long-term sustainability of public finances.

(19) France fulfils the conditions for the extension of the deadline for correcting the excessive general government deficit as laid out in Article 3(5) of Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure,

HAS ADOPTED THIS RECOMMENDATION:

(1) France should put an end to the present excessive deficit situation by 2015 at the latest.

(2) France should reach a headline deficit of 3.9% of GDP in 2013, 3.6% in 2014 and 2.8% in 2015, which is consistent with delivering an improvement in the structural balance of 1.3% of GDP in 2013, 0.8% in 2014 and 0.8% in 2015, based on the extended Commission services' 2013 Spring Forecast.

(3) France should fully implement the already adopted measures for 2013 (1½% of GDP) and specify, adopt and implement rapidly the necessary consolidation measures for 2014 and 2015 to achieve the recommended improvement in the structural balance, while proceeding as currently planned with a thorough review of spending categories across all sub-sectors of general government, including at social security and local government level.

(4) France should use all windfall gains for deficit reduction. Budgetary consolidation measures should secure a lasting improvement in the general government structural balance in a growth-friendly manner.

(5) The Council establishes the deadline of 1 October 2013 for France to take effective action and, in accordance with Article 3(4a) of Council Regulation (EC) No 1467/97, to report in detail the consolidation strategy that is envisaged to achieve the targets.

Furthermore, the French authorities should strengthen the long-term sustainability of the pension system by further adjusting all relevant parameters. In particular, the planned reform should be adopted by the end of this year, as currently envisaged, and bring the system into balance in a sustainable manner no later than 2020 while avoiding any further increase in the cost of labour. In addition, to ensure the success of the fiscal consolidation strategy, it will be important to back the fiscal consolidation by comprehensive 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.

Beyond the report foreseen in recommendation (5), the French authorities should report on progress made in the implementation of these recommendations at least every six months as well as in a separate chapter in the stability programmes, until full correction of the excessive deficit has taken place.

This recommendation is addressed to the Republic of France.

Done at Brussels,

For the Council
The President