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Subject: Recommendation for a COUNCIL RECOMMENDATION on the 2016
national reform programme of France and delivering a Council opinion on
the 2016 stability programme of France

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission proposal COM(2016) 330 final.

COUNCIL RECOMMENDATION
of ...
on the 2016 National Reform Programme of France
and delivering a Council opinion on the 2016 Stability Programme of France

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies¹, and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances², and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

¹ OJ L 209, 2.8.1997, p. 1.

² OJ L 306, 23.11.2011, p. 25.

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

- (1) On 26 November 2015, the Commission adopted the Annual Growth Survey, marking the start of the 2016 European Semester for economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 17-18 March 2016. On 26 November 2015, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report, in which it identified France as one of the Member States for which an in-depth review would be carried out. On the same day, the Commission also adopted a recommendation for a Council Recommendation on the economic policy of the euro area. This Recommendation was endorsed by the European Council on 18-19 February 2016 and adopted by the Council on 8 March 2016³. As a country whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, France should ensure the full and timely implementation of the Recommendation.
- (2) The 2016 country report for France was published on 26 February 2016. It assessed France's progress in addressing the country-specific recommendations adopted by the Council on 14 July 2015 and France's progress towards its national Europe 2020 targets. It also included the in-depth review under Article 5 of Regulation (EU) No 1176/2011. On 8 March 2016, the Commission presented the results of the in-depth review. The Commission's analysis leads it to conclude that France is experiencing excessive macroeconomic imbalances. In particular, with moderate growth and low inflation, France has a high and increasing public debt coupled with a deteriorated competitiveness. The need for action to reduce the risk of adverse effects on the French economy and, given its size, of negative spillovers to the economic and monetary union, is particularly important.

³ OJ C 96, 11.3.2016, p. 1.

- (3) On 29 April 2016, France submitted its 2016 National Reform Programme and its 2016 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.
- (4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council⁴, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of this provision in guidelines on the application of the measures linking the effectiveness of the European Structural and Investment Funds to sound economic governance.

⁴ Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

- (5) France is currently in the corrective arm of the Stability and Growth Pact. In its 2016 Stability Programme, the Government plans to correct the excessive deficit by 2017, in line with the Council Recommendation of 10 March 2015. The headline deficit is planned to decline further to 1,2 % of GDP in 2019. The medium-term budgetary objective – a structural deficit of 0,4 % of GDP – is planned to be achieved by 2018. According to the Stability Programme, the government debt-to-GDP ratio is expected to peak at 96,5 % of GDP in 2017 before declining to 93,3 % of GDP in 2019. The macroeconomic scenario underpinning the budgetary projections is broadly plausible. However, the measures needed to support the planned deficit targets from 2017 onwards have not been sufficiently specified. Based on the Commission 2016 spring forecast, the headline deficit is projected to reach 3,4 % of GDP in 2016, in line with the deficit recommended by the Council in 2015. For 2017, under unchanged policies, the headline deficit is projected to reach 3,2 % of GDP, putting at risk compliance with the deadline to correct the excessive deficit. The recommended fiscal effort is not projected to be delivered in 2016 and 2017 as the consolidation strategy pursued by France relies primarily on improving cyclical conditions and a continuation of the low interest rate environment, which are outside the control of the authorities, thereby entailing compliance risks. Based on its assessment of the Stability Programme and taking into account the Commission 2016 spring forecast, the Council is of the opinion that, although currently projected to achieve its headline target in 2016, there is a risk that France will not comply with the provisions of the Stability and Growth Pact. Therefore, further measures will be needed to ensure a durable correction of the excessive deficit by 2017.
- (6) The public expenditure-to-GDP ratio in France is one of the highest in the Union and, despite a slight decrease in 2015, it remains significantly above the euro area average. France is implementing a plan to reduce public spending by EUR 50 billion compared to trend growth between 2015 and 2017 at all levels of general government, but this may not achieve a significant reduction in public expenditure. Detailing the measures underpinning the spending reductions, while making sure that the savings measures take into account the close-to-zero inflation, would help to increase the efficiency of this plan.

- (7) Challenges remain to reduce further the expenditure ratio as planned, since the process of identifying large areas of potential savings has not delivered enough results and the spending reviews have had modest outcomes so far. In the housing sector, France spends almost twice as much as its European peers without noticeable better outcomes in the housing market. The combined effect of the implementation of the planned reduction in grants to local authorities from the central government and a stronger control of local government expenditure, in particular by containing the rise in administrative costs of local authorities, could preserve their investment capacity. The spending reviews could be an appropriate tool to identify such savings. Moreover, the recent reform of local administration has the potential to increase the efficiency of the system over the medium- to long-term.
- (8) Sizeable short-term savings cannot be achieved without significantly curbing the increase in social security spending, which represents more than half of the general government expenditure. The sustainability of the pension system has been improved through the agreement on complementary pension schemes in 2015 but it could continue to face deficits over the short- to medium-term, especially under adverse macroeconomic conditions. Moreover, the previous pension reforms are only expected to curtail the current high level of public pension expenditure ratio after 2025. France has set ambitious targets for 2016 and 2017 to limit the growth of health expenditure. These targets could be complemented by further efforts to identify efficiency gains in the medium- to long-term.
- (9) Policy measures to reduce labour costs and improve firms' profit margins have been undertaken through the EUR 20 billion tax credit for competitiveness and employment and the EUR 10 billion in additional cuts in employers' social contributions under the responsibility and solidarity pact. The design of these measures, which account for 1,5 % of GDP and contribute to reducing the gap between France and the euro area average in terms of labour cost, may hamper their effectiveness. The results of the planned evaluations of these cost reduction measures will help any decision on the future design of these schemes, to ensure that these measures meet their objectives in terms of efficiency. The effect on wage formation and employment is of particular interest for these evaluations.

- (10) In the current context of high unemployment, there are risks that the cost of labour at the minimum wage hampers employment of low-qualified people. While the minimum wage is high compared with the median wage, the cost of labour at the minimum wage has been reduced by social contribution exemptions. Increases in the minimum wage induce wage increases for most categories of workers and risk creating upward wage compression. Because of the minimum wage indexation mechanism, there are feedback loops between increases in average wages and changes in the minimum wage, which delay the necessary wage adjustment in response to a weak economic situation.
- (11) Recent reforms have created only limited flexibility for employers to depart from branch-wide agreements. This concerns all aspects of employment conditions, including wages, working time, employment and working conditions and limits the possibilities for companies to adjust the workforce according to their needs. At present, branches may prevent companies from determining, on a case by case basis and after negotiations with social partners, the conditions under which working time could depart from branch-wide agreements. The take-up of derogations from branch agreements and general legal provisions on employment conditions, via firm-level agreements, could be facilitated, in consultation with social partners.

- (12) In 2015, the unemployment rate increased to 10,4 %. Unemployment is higher among young people, non-EU nationals and less qualified workers. The structure of the labour market is increasingly polarised, with highly educated workers hired on open-ended contracts and a constant proportion of low-skilled jobs becoming more and more precarious. The proportion of fixed-term contracts of less than one month in total hires rose to close to 70 % in 2015. The legal framework governing labour contracts, in particular as regards the legislation on dismissal for open-ended contracts, may contribute to the high segmentation of the labour market. The long-running deterioration in the labour market has put a strain on the sustainability of the unemployment benefit system. In February 2016, the deficit was projected to be at EUR 4,5 billion in 2015, EUR 4,2 billion in 2016 and EUR 3,6 billion in 2017. This would further increase the system's debt from EUR 25,8 billion in 2015 to EUR 30,0 billion in 2016 and EUR 33,6 billion in 2017. The benefit calculation favours a succession of short-term full-time jobs over long-term part-time jobs and creates incentives for employers to offer short-term employment to be complemented by in-work benefits. Moreover, the design of the unemployment benefit system, in particular as regards eligibility conditions and degressivity of benefits, may weaken incentives to return to work.
- (13) The transition from school to work remains challenging and the least qualified young people are the most affected. Recourse to apprenticeship is decreasing among low-qualified categories in a context of differentiated regional strategies and a limited capacity of the system to adapt to new economic needs. The offer of training for the unemployed, less qualified workers and SME employees remains insufficient. The ongoing vocational training reforms, including on governance, incentives and counselling and the new targeted unemployed training plan are still to be fully implemented and should be reinforced. The unsatisfactory cooperation between the various actors involved in continuous vocational training prevents an efficient allocation of resources. The upcoming personal activity account may help to rebalance access.

- (14) The French business environment continues to be middle ranking, in particular as regards the burden of government regulation, where France ranks poorly in international comparisons. The simplification programme is being pursued as planned but progress with implementation is uneven, especially as regards measures targeting companies, and there remain challenges in a number of areas.
- (15) The French economy has a disproportionately high proportion of smaller businesses compared to other Member States and this limits their productivity level. Recent initiatives to soften the impact of size-related requirements are not expected significantly to affect firms' growth, in particular given their limited scope, and the temporary nature of some measures. As a consequence, threshold effects will continue to limit the growth of French firms.
- (16) Competition in services has improved in some sectors, but barriers remain in place in others, in particular in business services, as a significant proportion of these services were unaffected by the recent reforms, and network industries. A number of barriers to entry and regulations, as well as tariffs, constrain economic activity in regulated professions and weigh on the productivity of other sectors that use these services. The adoption of the Macron Law in 2015 has reduced some constraints but further efforts are needed. Further problems stem from the restrictive application of authorisation requirements.
- (17) France continues to lag behind EU innovation leaders, in spite of the generosity of public support in this area. There has been an inflation and instability of public schemes to support innovation over the past 15 years, which raises concerns as regards the overall coordination, consistency and efficiency of these schemes. This affects SMEs in particular.

- (18) The tax-to-GDP ratio is one of the highest in the Union. Its composition is not conducive to economic growth as it weighs significantly on production factors but relatively little on consumption. Taxes on corporations started decreasing modestly in 2014 and France has begun to close the gap with the EU average in terms of environmental taxation, but revenues from VAT remain low both as a share of GDP and as a percentage of total taxation due to low rates, the widespread application of reduced rates and the high occurrence of exemptions compared to the EU average. Beyond the ongoing phase-out of the solidarity surcharge on companies and the suppression of the exceptional corporate income tax, concrete steps to reach the announced objective of reducing the corporate income statutory rate to 28 % in 2020 have to be fully specified.
- (19) The tax system is very complex. A high number of inefficient taxes yielding little or no revenue remains and personal income taxation is particularly complex, which comes at a significant administrative cost. In spite of the introduction in the 2014-2019 public finance programming law of the requirement regularly to assess and monitor tax expenditures, the projected reduction in tax expenditures for 2016 is modest after several years of increase.
- (20) Overall, the barriers to private investment are moderate, with the high regulatory burden and high corporate tax rates being the main obstacles. The investment environment would be improved by enhancing the business environment, reducing taxes on production and corporate income and simplifying the tax system. All measures taken to improve the cost and non-cost competitiveness of French firms have the potential to increase investment levels and to incentivise firms to invest in physical and human capital, with a view to improving productivity. The long-term growth potential is also limited by subdued investment in innovation activities.

- (21) In the context of the European Semester, the Commission has carried out a comprehensive analysis of France's economic policy and published it in the 2016 country report. It has also assessed the Stability Programme and the National Reform Programme and the follow-up given to the recommendations addressed to France in previous years. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in France but also their compliance with EU rules and guidance, given the need to reinforce the EU's overall economic governance by providing EU-level input into future national decisions. Its recommendations under the European Semester are reflected in recommendations (1) to (5) below.
- (22) In the light of this assessment, the Council has examined the Stability Programme and its opinion⁵ is reflected in particular in recommendation (1) below.
- (23) In the light of the Commission's in-depth review and this assessment, the Council has examined the National Reform Programme and the Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (5) below,

⁵ Under Article 5(2) of Regulation (EC) No 1466/97.

HEREBY RECOMMENDS that France take action within the period 2016-2017 to:

1. Ensure a durable correction of the excessive deficit by 2017 by taking the required structural measures and by using all windfall gains for deficit and debt reduction. Specify the expenditure cuts planned for the coming years and step up efforts to increase the amount of savings generated by the spending reviews, including on local government spending, by the end of 2016. Reinforce independent public policy evaluations in order to identify efficiency gains across all sub-sectors of general government.
2. Ensure that the labour cost reductions are sustained and that minimum wage developments are consistent with job creation and competitiveness. Reform the labour law to provide more incentives for employers to hire on open-ended contracts.
3. Improve the links between the education sector and the labour market, in particular by reforming apprenticeships and vocational training, with emphasis on the low-skilled. By the end of 2016, take action to reform the unemployment benefit system in order to bring the system back to budgetary sustainability and to provide more incentives to return to work.
4. Remove barriers to activity in the services sector, in particular in business services and regulated professions. Take steps to simplify and improve the efficiency of innovation policy schemes. By the end of 2016, further reform the size-related criteria in regulations that impede companies' growth and continue to simplify companies' administrative, fiscal and accounting rules by pursuing the simplification programme.
5. Take action to reduce the taxes on production and the corporate income statutory rate while broadening the tax base on consumption, in particular as regards VAT. Remove inefficient tax expenditures, remove taxes that are yielding little or no revenue and adopt the withholding personal income tax reform by the end of 2016.

Done at Brussels,

For the Council

The President
