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Recommendation for a

COUNCIL RECOMMENDATION

on France's 2014 national reform programme

and delivering a Council opinion on France's 2014 stability programme

{SWD(2014) 411 final}

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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 policies[1], 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 imbalances[2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission[3],

Having regard to the resolutions of the European Parliament[4],

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

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 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for growth and jobs, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council, on the basis of the Commission's proposals, adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States, which together form

[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ L 306, 23.11.2011, p. 25.
[3] COM(2014) 411 final.
[4] P7_TA(2014)0128 and P7_TA(2014)0129.

the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

(3) On 29 June 2012, the Heads of State or Government decided on a Compact for Growth and Jobs, providing a coherent framework for action at national, EU and euro area levels using all possible levers, instruments and policies. They decided on action to be taken at the level of the Member States, in particular expressing full commitment to achieving the objectives of the Europe 2020 Strategy and to implementing the country-specific recommendations.

(4) On 9 July 2013, the Council adopted a recommendation on France's national reform programme for 2013 and delivered its opinion on France's updated stability programme for 2012-2017. On 15 November 2013 in line with Regulation (EU) No 473/2013[5], the Commission presented its opinion on France's draft budgetary plan for 2014[6].

(5) On 13 November 2013, the Commission adopted the Annual Growth Survey[7], marking the start of the 2014 European Semester of economic policy coordination. On the same day on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report[8], in which it identified France as one of the Member States for which an in-depth review would be carried out.

(6) On 20 December 2013, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.

(7) On 5 March 2014, the Commission published the results of its in-depth review for France[9], under Article 5 of Regulation (EU) No 1176/2011. The Commission's analysis leads it to conclude that France continues to experience macroeconomic imbalances, which require specific monitoring and decisive policy action. In particular, the deterioration in the trade balance and in competitiveness and the implications of the high level of public sector indebtedness deserve continuous policy attention.

(8) On 7 May 2014, France submitted its 2014 national reform programme and its 2014 stability programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(9) The objective of the budgetary strategy outlined in the 2014 stability programme is to correct the excessive deficit by 2015 and reach the medium-term objective in 2017. The programme confirms the previous medium-term objective of a balanced budget in structural terms, which is more stringent than what the Stability and Growth Pact requires. The programme plans to bring the deficit to 3% of GDP in 2015, above the target set in the Council recommendation of 21 June 2013. Thereafter, the planned (recalculated) annual progress towards the medium-term objective is lower than the minimum requirement of 0.5% of GDP. Overall, the budgetary strategy outlined in

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5 OJ L 140, 27.5.2013, p.11.
6 C(2013) 8004 final.
7 COM(2013) 800 final.
8 COM(2013) 790 final.
9 SWD(2014) 81 final.

the programme is only partly in line with the requirements of the Stability and Growth Pact. The programme projects that the government debt will peak at 95.6% of GDP in 2014 and 2015 and then drop to 91.9% in 2017. The macroeconomic scenario underpinning the budgetary projections in the programme is plausible for 2014 and slightly optimistic for 2015, with GDP projected to grow by 1.0% and 1.7% this year and next, against 1.0% and 1.5% according to the Commission 2014 Spring Forecast. In April 2014, the independent High Council for Public Finances ("Haut Conseil des finances publiques") issued an opinion on the macroeconomic scenario of the programme. On 5 March 2014, France was recommended by the Commission to make further efforts to ensure the full compliance with the Council recommendation under the EDP. The stability programme outlines a number of additional measures for 2014, among which the cancellation of ministerial appropriations to be adopted as part of a supplementary budget and the first effects of the EUR 50 billion savings plan announced by the government. On this basis, and also taking into account the fact that the fiscal effort achieved in 2013 was higher than expected at the time of the Commission recommendation, the programme can be considered to broadly respond to the Commission recommendation. The level of detail of the fiscal consolidation measures is insufficient to credibly ensure the correction of the excessive deficit situation by 2015, as supported by the Commission forecast of a deficit at 3.4% of GDP next year and an underlying structural adjustment falling well short of the level recommended by the Council. Moreover, risks to the government's targets are tilted to the downside. In particular, part of the additional measures for 2014 announced in the programme remains to be adopted and the planned amount of savings for 2015 is very ambitious. Based on the Commission Forecast, the fiscal effort over 2013-2014 falls short by 0.2 pp of GDP in terms of (corrected) change in the structural balance and by 0.1 pp of GDP in terms of the amount of measures estimated as necessary at the time of the Council recommendation. Based on its assessment of the programme and the Commission forecast, pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that the measures underpinning the budgetary strategy need to be specified further and that further efforts are needed to comply with the Council recommendation and to ensure an appropriate path towards the medium-term objective thereafter. In particular, additional efforts should be spelled out in the forthcoming amending budget law for 2014.

(10) Given the high and still increasing government debt and the fact that the deadline for correcting the excessive deficit was extended to 2015, it is all the more important that the 2014 budget is strictly implemented and substantial consolidation efforts are firmly pursued in 2015. In particular, public spending should grow at a much slower pace than in previous years, as planned by the French government. Hence, there is a need to further specify the strategy on reducing expenditure by intensifying the on-going spending review and by redefining, where relevant, the scope of government action. Sizeable short-term savings cannot be achieved without reducing significantly the increase in social security spending, which accounts for nearly half of public sector expenditure. This implies curbing healthcare and pension costs, for example through setting more ambitious annual healthcare expenditure targets and temporarily freezing pensions, as well as other social benefits, as currently envisaged by the government. In addition, the planned new decentralisation law should streamline the various administrative layers in France to eliminate administrative overlap and achieve further synergies, efficiency gains and savings by merging or suppressing administrative layers. In this respect, not only the structural reforms

outlined in the stability programme will take effect only in the medium term, although the planned timetable has been brought forward since the stability programme, but they are also subject to significant implementation risks. The control of local government expenditure should also be strengthened, including by capping the annual increase in local government tax revenue while rigorously implementing the planned reduction in grants from the central government. Beyond the need for savings in the short run, the long-term sustainability of public finances is also an issue of concern. While public expenditure on health has been kept under control over the last few years, further efforts are needed to improve the cost-effectiveness of the health system. In particular, there is a need to implement further cost-containment policies as the health system is projected to face a significant rise in expenditure over the medium and long term. Areas where efficiency should be enhanced include pharmaceutical and administrative spending as well as hospital care. Lastly, a pension reform was adopted in December 2013 with a view to ensuring the long-term sustainability of the system. However the pension reform will not suffice to eliminate the system's deficit, in particular the deficit arising from schemes for state government officials and employees working in a number of state-controlled companies. All in all, according to projections from the French authorities, the new pension measures will only halve the system's total deficit to some 0.5% of GDP by 2020. Moreover, the size of adjustment is subject to significant risks as the macroeconomic scenario underpinning these projections could prove overly optimistic. The newly created pensions monitoring committee ("Comité de suivi des retraites") should ensure that the system's deficit is gradually eliminated.

(11) France is among the Member States where the cost of labour is the highest. In particular, the high tax burden on labour reduces firms' profitability. In order to support cost competitiveness, the French government has taken a number of initiatives to reduce the tax burden on labour. A tax rebate for competitiveness and employment (CICE), equivalent to a decrease in the cost of labour for wages below 2.5 times the minimum wage, was adopted in December 2012. A further EUR 10 billion cut in the cost of labour was announced as part of a "responsibility and solidarity pact" in January 2014. The two measures will account for EUR 30 billion or 1.5% of GDP, which is commensurate with the overall increase in corporate taxation recorded in 2010-2013 and would only bridge half of the gap between France and the euro area average in terms of employer social security contributions. Moreover, exporting firms, which tend to pay high wages, will benefit less from the CICE than non-exporting firms, thus reducing the impact of the measure on competitiveness. The responsibility and solidarity pact includes a reduction in the cost of labour for low wages and one targeting wages between 1.6 and 3.5 times the minimum wage. The latter measure, expected to enter into force from 2016, would have a more direct impact on exporting firms. Wage-setting in France tends to result in distortions of the wage structure and limit the ability of firms to adjust wages in economic downturns. The High Council for the Financing of Social Protection ("Haut Conseil du financement de la protection sociale") has assessed the impact of various scenarios for social security exemptions on employment, but limited emphasis has been put on the impact on wage developments and competitiveness. However, although extensive exemptions were granted, for workers paid the minimum wage, the cost of labour at the minimum wage remains high. These exemptions contributed to containing labour costs in 2013, which is a positive development, but the level of the minimum wage in France is such that it provides one of the highest purchasing power levels in the EU. The minimum wage should

therefore continue to evolve in a manner that is supportive of competitiveness and job creation. France has only few exemptions from the statutory minimum wage and additional efforts could be made to reduce the cost of labour for vulnerable groups.

(12) France's global ranking in a number of international business environment surveys has deteriorated. While efforts have been made as part of a "simplification shock" launched in July 2013 to ease relation between firms and the administration, there is a need for further improving the business environment. In addition, a number of measures considered under the simplification plan still need to be defined and implemented. In particular, specific attention should be paid to regulations from the labour code or to accounting rules linked to specific size thresholds that hamper the growth of French firms. These may play a role in SMEs' difficulties in reaching the size that would allow them to export and to innovate. Policy initiatives to boost R&D spending and innovation by private companies, in particular the tax credit on research and the competitiveness poles, have yielded mixed results so far. The decreasing weight of the industrial sector in the French private sector translates into stagnating R&D spending by private companies despite significant efforts at the firm level. As a consequence, a large proportion of R&D spending remains financed by public money either directly through public research or indirectly through subsidies. The effectiveness of the existing tools should be further improved in order to trigger higher R&D expenditures by private firms and innovation in the private sector. In particular, resources allocated to the competitiveness poles could better foster scale effects and improve the diffusion of innovation. In addition, the effectiveness of the policy could be strengthened by enabling these poles to become real networks of firms with positive spillovers. Lastly, the cost of the tax credit on research is expected to reach EUR 5.8 billion in 2014 (close to 0.3% of GDP). In spite of the cost of this measure, no ex post assessment of its effectiveness on R&D is available.

(13) Although barriers on legal forms, shareholding requirements or tariffs have been removed for certain professions (e.g. veterinarians), a majority still face significant barriers to entry or conduct today (e.g. taxis, the health sector, notaries and legal professions more generally). The principle of numerus clausus for the access to many professions (doctors, pharmacists, etc.) is still hampering access to services, and could be reviewed without putting quality and safety at risk. To date, no thorough assessment of the need for, and proportionality of, restrictions affecting regulated professions has taken place. In the retail sector, burdensome authorisation requirements for the opening of trade outlets, notably resulting from urban planning regulations, and the ban on sales at a loss still remain and have an adverse impact on competition and on consumers. To date, no concrete measures have been adopted in France to remove entry barriers in the retail sector. Regarding electricity and gas distribution, regulated prices are being phased out for non-household customers. However, prices continue to be regulated for households and for electricity, they are set below cost levels and the access by alternative suppliers is limited. Regarding energy interconnections, on-going projects, in particular with Spain, should be completed to reinforce the electricity and gas interconnections with the neighboring countries. In the railway sector, market entry barriers are still preventing an efficient market functioning. France has not opened up its domestic rail passenger market to competition, except for international services, where there are few new entrants. It has launched a reform of its railway system with a view to making it more financially sustainable. A draft law was presented in October 2013 and is currently being discussed by Parliament. The measures presented include the set-up of a fully-fledged infrastructure manager within a vertically integrated structure including the

incumbent operator. This new structure may hamper access to the network by alternative operators.

(14) France has a high and rising overall tax burden. In 2013, the tax-to-GDP ratio stood at 45.9%, one of the highest in the EU and up by 3.3 pps since fiscal consolidation started in 2010. Against this background, a special committee ("Assises de la fiscalité") has provided input to a reform of the tax system. Little progress has been made so far in lowering the statutory rates of personal and corporate income tax and increasing VAT efficiency. Instead, a temporary surcharge on large companies has been extended until 2015 and this will result in the all-in statutory corporate income tax rate peaking at 38.1% (the statutory rate is already one of the highest in the EU at 33.3%). The French government has announced a gradual reduction in the statutory rate to 28% by 2020 but there is no information on the exact timing of the measure. Limited progress has also been made over the last year in reducing and streamlining income tax expenditures. In spite of some progress in the area of environmental taxation (e.g. with the gradual introduction of a carbon tax or "contribution climat énergie"), the share of environmental taxation in GDP continues to remain low. In particular, excise duties in France are not indexed with inflation and some important environmentally-harmful subsidies such as the preferential rate of excise duty for diesel remain. Lastly, no additional measures were taken in 2013 to address the debt bias in corporate taxation with a view to preventing a further increase in private indebtedness.

(15) Although a number of policy measures were taken in France, the situation on the labour market continued to deteriorate in 2013 and significant challenges remain. Unemployment continued to increase to 10.3% in 2013 (against 7.5% in 2008). France's labour market remains segmented with very low levels of transitions from temporary to permanent contracts (the likelihood of moving from a temporary to a permanent job was only 10.6% in 2010, as against 25.9% on average in the EU). The inter-professional agreement on securing employment was translated into a law adopted in July 2013. Although this reform is a positive step, its impact remains uneven at this stage. In particular, very few companies have made use of the arrangements for company-level agreements created by the law to increase the flexibility of work conditions in the event of temporary economic difficulties. However, the rate of effective dismissals brought to court has been significantly reduced. While negotiations took place in 2014 between social partners to reform the unemployment benefit system, the new agreement is not expected to substantially reduce the deficit of the system. The cumulated deficit of the unemployment benefit system, which was close to 1% of GDP in 2013, calls for additional structural measures to ensure its sustainability. In particular, some elements, such as the eligibility conditions, the degressivity of benefits over time or the replacement rates for workers with the highest wages were only marginally modified following the last agreement between social partners in March 2014 and they should be further adapted to ensure that incentives to work are adequate. Thanks to successive pension reforms, the employment rate of workers between 55 and 64 years of age has seen a constant increase in the past three years. However, the employment rate among older workers in France (45.6% in 2012) remains well below the average in the EU (-4.5 pps below) and only 55% of older workers in France retire directly after employment (2008-2011). As a result, the unemployment rate for this group has increased strongly over the last few years. Hence, there is a need to strengthen measures to improve their employability while reviewing incentives for them to stay in or return to work.

(16) The 2013 Programme for International Student Assessment survey showed that educational inequality in France is amongst the highest in OECD countries. A sixth of young people in France leave education and training without a qualification. This is particularly worrying as the unemployment rate of young people was of 25.5% at the end of 2013 and as the risk of being unemployed was almost two times higher for the least qualified young people. Schemes to promote apprenticeships should reach in particular the least qualified young people. Some progress in addressing this issue was made through the launch of the reform of compulsory education in July 2013 and the adoption of a law on vocational education and lifelong learning in March 2014. However, it is too early to assess whether these measures will effectively reduce inequalities in the education system and a new plan targeting lower-secondary education schools in disadvantaged areas announced in January 2014, still needs to be implemented. Lastly, transition from school to work has been facilitated but the number of apprentices decreased in 2012 and the schemes increasingly benefitted students in higher education.

(17) In the context of the European Semester, the Commission has carried out a comprehensive analysis of France's economic policy. It has assessed the stability programme and the national reform programme. 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 overall economic governance of the European Union by providing EU-level input into future national decisions. Its recommendations under the European Semester are reflected in recommendations (1) to (7) below.

(18) In the light of this assessment, the Council has examined France's stability programme, and its opinion[10] is reflected in particular in recommendation (1) below.

(19) 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 (6) below.

(20) In the context of the European Semester the Commission has also carried out an analysis of the economic policy of the euro area as a whole. On the basis of this analysis, the Council has issued specific recommendations for the Member States whose currency is the euro. France should also ensure the full and timely implementation of these recommendations.

HEREBY RECOMMENDS that France take action within the period 2014-2015 to:

1. Reinforce the budgetary strategy, including by further specifying the underlying measures, for the year 2014 and beyond to ensure the correction of the excessive deficit in a sustainable manner by 2015 through achieving the structural adjustment effort specified in the Council recommendation under the Excessive Deficit Procedure. A durable correction of the fiscal imbalances requires a credible implementation of ambitious structural reforms to increase the adjustment capacity and boost growth and employment. After the correction of the excessive deficit, pursue a structural adjustment towards the medium-term objective of at least 0.5% of GDP each year, and more in good economic conditions or if needed to ensure that the debt rule is met in order to put the high general government debt ratio on a sustained downward path. Step up efforts to achieve efficiency gains across all sub-

[10] Under Article 5(2) of Council Regulation (EC) No 1466/97.

sectors of general government, including by redefining, where relevant, the scope of government action. In particular, take steps to reduce significantly the increase in social security spending as from 2015 as planned, by setting more ambitious annual healthcare spending targets, containing pension costs, and streamlining family benefits and housing allowances. Set a clear timetable for the on-going decentralisation process and take first steps by December 2014, with a view to eliminating administrative duplication, facilitating mergers between local governments and clarifying the responsibilities of each layer of local government. Introduce a ceiling on the annual increase in local government tax revenue while reducing grants from the central government as planned. Beyond the need for short-term savings, take steps to tackle the increase in public expenditure on health projected over the medium and long term, including in the area of pharmaceutical spending, and take additional measures when and where needed to bring the pension system into balance by 2020 in a sustainable manner, with a special focus on existing special schemes.

2. Ensure that the labour cost reduction resulting from the "crédit d'impôt compétitivité emploi" is sustained. Take action to further lower employer social security contributions in line with commitments under the responsibility and solidarity pact, making sure that no other measures offset its effect and that the targeting currently envisaged is maintained. Further evaluate the economic impact of social security contribution exemptions, putting the emphasis on employment, wage developments and competitiveness and take appropriate measures if necessary. Further reduce the cost of labour in a budget neutral way namely at the lower end of the wage scale notably through targeted reductions in employer social security contributions taking into account the various wage support schemes.

3. Simplify companies' administrative, fiscal and accounting rules and take concrete measures to implement the government's ongoing "simplification plan" by December 2014. Eliminate regulatory impediments to companies' growth, in particular by reviewing size-related criteria in regulations to avoid thresholds effects. Take steps to simplify and improve the efficiency of innovation policy, notably through an evaluation and if necessary an adaptation of the "crédit d'impôt recherche". Ensure that resources are focused on the most effective competitiveness poles and further promote the economic impact of innovation developed in the poles.

4. Remove unjustified restrictions on the access to and exercise of regulated professions and reduce entry costs and promote competition in services. Take further action to reduce regulatory burden affecting the functioning of the retail sector, in particular by simplifying authorisations for the opening of trade outlets and removing the ban on sales at a loss. While maintaining affordable conditions for vulnerable groups, ensure that regulated gas and electricity tariffs for household customers are set at an appropriate level which does not represent an obstacle to competition. Strengthen electricity and gas interconnection capacity with Spain; in particular, increase the gas interconnections capacity to fully integrate the Iberian gas market with the European market. In the railway sector, ensure the independence of the new unified infrastructure manager from the incumbent operator and take steps to open domestic passenger transport to competition before 2019.

5. Reduce the tax burden on labour and step up efforts to simplify and increase the efficiency of the tax system. To this end, starting in the 2015 budget, take measures to: remove inefficient personal and corporate income tax expenditures on the basis of recent assessments and the "Assises de la fiscalité" initiative while reducing the

statutory rates; take additional measures to remove the debt bias in corporate taxation; broaden the tax base, notably on consumption; phase out environmentally-harmful subsidies.

6. Take further action to combat labour-market rigidity, in particular take measures to reform the conditions of the "accords de maintien de l'emploi" to increase their take up by companies facing difficulties. Take additional measures to reform the unemployment benefit system in association with social partners, in order to guarantee its sustainability while ensuring that it provides adequate incentives to return to work. Step up counselling and training for older workers and re-assess the relevant specific unemployment benefit arrangements.

7. Pursue the modernisation of vocational education and training, implement the reform of compulsory education and take further actions to reduce educational inequalities in particular by strengthening measures on early school leaving. Ensure that active labour market policies effectively support the most vulnerable groups. Improve the transition from school to work, notably by stepping up measures to further develop apprenticeship with a specific emphasis on the low-skilled.

Done at Brussels,

For the Council
The President