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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
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Subject:	COMMISSION OPINION of 15.11.2013 on the Draft Budgetary Plan of FRANCE

Delegations will find attached document C(2013) 8004 final.

This document is aimed for discussion in the **Eurogroup.**

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COMMISSION OPINION

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{SWD(2011) 604 final}

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GENERAL CONSIDERATIONS

1. Regulation (EU) No. 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No. 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING FRANCE

3. On the basis of the Draft Budgetary Plan for 2014 submitted on 1 October 2013 by France, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No. 473/2013.

4. France is currently subject to the corrective arm of the Pact. In addition to the Draft Budgetary Plan, France submitted a report on effective action and an Economic Partnership Programme as recommended by the Council on 21 June 2013. The Council opened the Excessive Deficit Procedure for France on 27 April 2009 and recommended to correct the excessive deficit by 2012, a deadline which was extended to 2013 on 2 December 2009. On 21 June 2013, the Council concluded that France had taken effective action but adverse economic events with major implications on public finances had occurred, and hence issued a revised recommendation. France was given a deadline of 1 October 2013 to take effective action to ensure a sustainable correction of the excessive deficit by 2015. The Council called on France to reduce its deficit to 3.9% of GDP in 2013, 3.6% in 2014 and 2.8% in 2015, consistent with 1.3%, 0.8% and 0.8% of GDP improvements in the structural balance, respectively.

5. The macroeconomic scenario underpinning the Draft Budgetary Plan projects real GDP growth to be 0.1% in 2013, as in the April Stability Programme, and slightly below the 0.2% projected in the Commission 2013 Autumn Forecast (Commission forecast hereafter). The latter difference is mainly due to positive developments in economic sentiment indicators and revisions to quarterly GDP data since the Draft Budgetary Plan was submitted. Real GDP growth is forecast to accelerate next year and reach 0.9% on the back of a rebound in exports, improved business investment prospects and rising employment which in turn will support private consumption. Downward revisions to the outlook for exports and business investment are the main factors behind the 0.3 pp. difference compared to the 1.2% growth rate projected at the time of the Stability Programme. The Commission forecast depicts a similar

picture for the economic outlook, with real GDP growth also projected at 0.9% next year. However, the expected composition of domestic demand is slightly different, with private consumption growing at a higher pace under the Draft Budgetary Plan, driven by more dynamic job creation thanks to a stronger short-term effect of the competitiveness tax rebate (CICE) on employment. In contrast, the Commission forecast projects higher public investment. Risks to the macroeconomic scenario underpinning the Draft Budgetary Plan are broadly balanced and relate mainly to corporate behaviour. Overall, the macroeconomic scenario appears realistic.

6. The macroeconomic forecast underlying the Draft Budgetary Plan, which was made by the Ministry for the Economy and Finance, has been endorsed by the newly created High Council for Public Finances (HCPF). In its endorsement of the plans the High Council nevertheless considered expected labour market developments as optimistic and flagged a number of risks to the macroeconomic scenario which taken together are tilted to the downside. Regarding the institutional set-up, the HCPF is an independent authority by law and it has been attached to the Court of Auditors. In the discharge of their duties members of the High Council shall not seek or receive instructions from the government or from any authority external to the High Council. The president of the HCPF is also the president of the Court of Auditors and is thus irremovable. The entity's budget is managed autonomously by the president of the High Council.

7. According to the Draft Budgetary Plan, the general government deficit is set to reach 4.1% of GDP in 2013, in line with the Commission forecast but above the 3.7% of GDP target set in the April Stability Programme. Based on recent outturn data, economic activity is now expected to be less tax rich, with shortfalls in tax receipts estimated at some 0.2% of GDP (when also taking into account a slight upward revision to the expected budgetary impact of revenue measures). On the expenditure side, the contribution to the EU budget will be 0.1% of GDP higher than what the 2013 budget and the Stability Programme had assumed. Other overruns mentioned by the authorities include extra unemployment benefit costs and higher local government spending. Regarding 2014, the authorities project the deficit to reach 3.6% of GDP on the back of the measures outlined in the Draft Budgetary Plan. This is much higher than the 2.9% of GDP target contained in the Stability Programme but the Council recommendation of 21 June 2013 extended the deadline for correcting the excessive deficit by two additional years against one extra year assumed in April. The difference comes solely from expected revenue developments.

8. The Commission forecast projects a somewhat worse budgetary outlook for 2014 than does the Draft Budgetary Plan, with the general government deficit expected at 3.8% of GDP. The main reason behind this is divergent spending projections. In particular, the authorities anticipate a sharp fall in public investment next year, with local elections scheduled for March 2014. While these are highly likely to trigger a deceleration in local government investment, judging from previous electoral cycles, the Commission forecast is based on a more conservative assumption. The wage bill is also expected to increase at a somewhat higher pace than in the macroeconomic scenario underpinning the Draft Budgetary Plan. In that respect, the High Council for Public Finances found that official spending projections were sensitive to wage and local spending developments. On the revenue side, the Commission forecast anticipates that economic activity will be somewhat less tax rich than projected in the Draft Budgetary Plan. There are both upside and downside risks to the expected

budgetary outcome. As far as 2013 is concerned, specific fiscal risks pertain to sub-sectors of general government such as local authorities and state agencies for which in-year data reporting is incomplete. Also, it cannot be excluded that the government takes action to reduce ministerial expenditure by the end of the year, including by carrying over some spending into 2014. Regarding 2014, possible revisions to the macroeconomic outlook would likely affect the nominal balance. Specific risks to the fiscal outlook include insufficient detail and implementation risks for a number of measures contained in the Draft Budgetary Plan. In particular, the latter has to a large extent been amended by parliament and the budgetary impact of some measures is difficult to quantify and/or to allocate to particular years. In addition, the authorities on 29 October announced the suspension of a green tax on heavy goods vehicles, the so-called 'éco-taxe poids lourds', which was due to enter into force in January 2014.

9. The ratio of general govenment debt to GDP reached 90.2% in 2012. The Stability Programme projected it to increase further in 2013-14 but with the rise markedly slowing down in 2014. The Draft Budgetary Plan depicts a very similar picture regarding this year's outturn, with the expected higher deficit (more than) offset by opposite revisions to stock-flow adjustments. In contrast, the debt ratio is set to deteriorate by close to 1 pp. in 2014 compared to April. This mainly reflects the projected higher headline deficit as well as downward revisions to (nominal) GDP growth. Official debt projections appear plausible in light of the Commission forecast, although expected stock-flow developments are subject to uncertainty.

10. The Draft Budgetary Plan contains a significant set of revenue measures, with an estimated budgetary impact of ½% of GDP. However, most of these will only compensate for a number of temporary income tax payments enacted by the authorities in 2013 that will expire next year. Indeed, the overall tax burden is expected to increase by 0.1 pp. only to 46.1% of GDP in 2014. The Draft Budgetary Plan aims at spending cuts of some ¾% of GDP. These are split between central government and social security funds and planned to mainly consist of maintaining a freeze on base wages, cutting operational costs including central government transfers to local authorities, healthcare expenditure savings as well as new provisions on how annual pension increases are linked to inflation. However, a number of measures have not been fully specified. In particular, the planned reduction in operating costs of social security funds including the unemployment benefit system run by social partners lacks specifics. Also, the cut in central government grants to local authorities will not necessarily translate into a similar reduction in local spending insofar as local authorities have at the same time been entitled to temporarily raise stamp duties on the sale of immovable property.

11. The Commission forecast anticipates that the nominal deficit will turn out higher than recommended in both 2013 and 2014. The changes in the structural balance underlying the projected headline numbers are estimated at 0.9% and 0.7% of GDP, respectively. However, when correcting for revisions to potential GDP growth estimates and shortfalls in tax receipts compared with the forecast at the time the Council recommendation was issued, the structural effort comes in at 1.3% and 0.8% of GDP. As far as the 2013 budgetary execution is concerned, the latest outturn data point to significant revenue shortfalls compared to spring. These may stem from lower tax richness of economic activity but also from a lower budgetary impact of discretionary measures than estimated initially. However, no major revisions to the expected budgetary impact of these measures have been made so far, as according to

the authorities such revisions would not be justified until full-year data for 2013 are available. In this respect, the Commission forecast factors in a slight shortfall relative to official estimates, but it cannot be excluded that the outturn will be even worse. The corrected structural effort for 2014 also appears just in line with the Council recommendation. However, the composition of fiscal tightening underlying the Commission forecast is somewhat at odds with that outlined in the Draft Budgetary Plan. Indeed, the latter aims at spending cuts accounting for 80% of total adjustment (as measured by the improvement in the structural balance) while the Commission forecast projects that savings will make up less than half of this notably due to expected expenditure overruns and a different treatment of one-off revenue measures. A bottom-up assessment shows that the overall size of measures implemented in 2013 is somewhat below the amount of 1½% of GDP referred to in the Council recommendation. For 2014, the fiscal effort based on the bottom-up analysis falls slightly short of the 'above 1% of GDP' amount of measures deemed necessary to reach the structural target set out in the recommendation, which is another indication of the uncertainties surrounding the fiscal outlook. Regarding 2015, the Draft Budgetary Plan projects the deficit to reach 2.8% of GDP, in line with the Council recommendation. However, the Commission forecast expects it to be 3.7% of GDP under the customary no policy change assumption, implying that a significant set of measures on top of those already specified will be needed to ensure that the target for 2015 is reached. Overall, although there are both upside and downside risks to the expected budgetary outcome and thus to the underlying improvement in the structural balance, France can be considered to have taken effective action in compliance with the Council recommendation of 21 June 2013.

12. In accordance with the Council recommendation of 21 June 2013, France has also submitted an Economic Parternship Programme. The Economic Parternship Programme focuses on measures which, with very few exceptions, either have already been implemented or are in the process of adoption. It provides limited information on the policy strategy of the government for the period up to 2015, which is the deadline for correcting the excessive deficit. The government proposal for a pension reform will reduce the deficit of the pension system but will not suffice to eliminate it by 2020, with notably schemes for state government officials and employees working in a number of state-controlled companies still expected to run significant deficits by that horizon. The on-going spending review has delivered only limited outcomes so far and it remains to be seen to what extent it will translate into sizeable savings. Whether the planned decentralisation reform will improve coordination between local, regional and national levels and bring significant savings for the general government as a whole is also unclear. The Economic Partnership Programme provides little information on measures to tackle the projected medium- to long-term increase in public expenditure on health. Moreover, recent decisions taken by the government in the area of taxation seem to go against the Council recommendation of 9 July 2013 and create uncertainty about the government's strategy. Finally, the measures underpinning the government's commitment to reduce the cost of labour need to be further specified. Overall, while the already legislated reforms are welcome steps, further efforts to address fiscal and structural imbalances are required to effectively support a durable correction of the excessive deficit. On this basis, the Commission has made a proposal for a Council Opinion on the Economic Parternship Programme of France.

13. Overall, the Commission, based on its forecast, is of the opinion that the Draft Budgetary Plan sent on 1 October is compliant with the rules of the SGP, albeit with no margin. In particular, the Commission forecast points to compliance with respect to the EDP recommendation for 2014. The Commission is also of the opinion that France has made limited progress with regard to the structural part of the fiscal recommendations issued by the Council in the context of the European Semester. In light of the risks to the forecast improvements in the structural balance in 2013-14 and the projected significant gap to the target for 2015, France should rigorously implement the budget for 2014 and take a significant set of measures for 2015 on top of those specified so far in order to achieve the improvements in the structural balance recommended by the Council. In addition, any windfall revenues should be used for deficit reduction. Moreover, it invites the authorities to accelerate progress towards implementation of the fiscal recommendations under the European Semester.

Done at Brussels, 15.11.2013

For the Commission
Olli REHN
Vice-President