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COMMISSION STAFF WORKING DOCUMENT

Analysis by the Commission services of the budgetary situation in France following the adoption of the COUNCIL RECOMMENDATION to France on 21 June 2013 with a view to bringing an end to the situation of an excessive government deficit

Accompanying the document

Recommendation for a COUNCIL RECOMMENDATION

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

{COM(2015) 115 final}

1. INTRODUCTION

On 21 June 2013, 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 Council recommendation of 2 December 2009. As a consequence, the Council recommended that France correct its excessive deficit by 2015 at the latest. In order to bring the general government deficit below 3 % of GDP in a credible and sustainable manner, France was recommended to (a) reach a headline deficit of 3.9 % of GDP in 2013, 3.6 % in 2014 and 2.8 % in 2015, which was considered 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 2013 spring forecast; (b) 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; (c) use all windfall gains for deficit reduction. The Council also recommended to ensure that budgetary consolidation measures result in a lasting improvement in the general government structural balance in a growth-friendly manner. In its recommendations, the Council established 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 on the consolidation strategy envisaged to achieve the targets.

On 15 November 2013, the Commission concluded that based on the Commission 2013 autumn forecast, France had taken effective action in compliance with the Council recommendation of 21 June 2013 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.

On 5 March 2014, the Commission issued a recommendation regarding measures to be taken by France in order to ensure a timely correction of its excessive deficit. In its recommendation, the Commission considered that France had to make further efforts to ensure full compliance with the Council recommendation under the EDP. In its stability programme submitted on 7 May 2014, France outlined a number of additional measures for 2014. Also taking into account the fact that the fiscal effort achieved in 2013 was higher than expected at the time of the Commission recommendation, it was considered that the stability programme broadly responded to the Commission recommendation.

On 13 January 2015, the Commission presented a Communication on Flexibility, providing new guidance on how to apply the existing rules of the Stability and Growth Pact, in order to strengthen the link between effective implementation of structural reforms, investment, and fiscal responsibility in support of jobs and growth. The Communication does not amend any provision of the Pact, but aims to further reinforce the effectiveness and understanding of its rules and to develop a more growth-friendly fiscal stance in the euro area by ensuring the best use of the flexibility enshrined within the Pact while preserving its credibility and effectiveness in upholding fiscal responsibility.

According to the Commission 2015 winter forecast published on 5 February 2015, the general government deficit is projected to reach 4.3 % of GDP in 2014 and 4.1 % of GDP in 2015.

The headline deficit for 2015 is thus expected to remain well above the 2.8 % of GDP level recommended by the Council on 21 June 2013 and also above the 3 % of GDP benchmark.

Based on the 2015 winter forecast of the Commission, this document provides an assessment of whether France has taken effective action towards correcting its excessive deficit and suggests a new adjustment path that would durably bring the general government deficit below the 3 % of GDP threshold. In particular, the document examines the budgetary developments since the Commission communication of 15 November 2013 to the Council on action taken.

2. RECENT MACRO-ECONOMIC AND BUDGETARY DEVELOPMENTS

In 2013, GDP growth in France remained sluggish on the back of rising unemployment and still weak domestic demand. The unemployment rate rose to 10.3 % from 9.8 % a year earlier and the number of registered unemployed exceeded 3 million people. The weakness of domestic demand translated into a decrease in business investment while enabling some slight positive contribution in net exports. Inflation decreased to 1.0 % against a background of sluggish economic growth and declining energy prices. Nevertheless, economic developments in 2013 turned out slightly more positive than expected in the Commission 2013 spring forecast, which projected -0.1 % GDP growth for 2013, as lower-than-expected consumer prices and higher wages supported private consumption.

According to the Commission 2015 winter forecast, GDP growth is projected to remain subdued in 2014 at 0.4 %. In 2014, as in 2013, sluggish activity growth is estimated to have been mainly driven by public and private consumption, while investment is expected to have decreased, on the back of weak aggregate demand and falling business confidence. While net exports have slightly contributed to GDP growth in 2013, a new fall in export market share is set to have translated into a negative contribution in 2014 (-0.3pp), offset by a turnaround in inventories (+0.3pp). Total employment is estimated to have increased in 2014, due notably to subsidised employment and more marginally to the introduction of the tax credit on competitiveness and employment (CICE). However, the higher employment is expected to be only sufficient to absorb the increase in the labour force, leaving the unemployment rate unchanged at 10.3 %. Consumer prices are estimated to have slowed down from 1.0 % in 2013 to 0.6 % in 2014, in line with oil prices (in euros), which decreased by 9 % on average in 2014 after 6 % in 2013.

While GDP growth turned out higher in 2013 than projected in the baseline scenario underpinning the Council recommendation of 21 June 2013 (0.3 % vs. -0.1 %), the growth and inflation projections for 2014 included in the Commission 2015 winter forecast are significantly lower than foreseen in the baseline. The baseline scenario underpinning the Council recommendation expected the economy to recover markedly in 2014 and GDP was expected to grow by 1.1 %. Assuming that the structural balance improved by 0.8 % of GDP, the EDP scenario underpinning the Council recommendation of 21 June 2013 projected GDP growth to reach 0.6 %. Based on the Commission 2015 winter forecast, GDP growth is now forecast to be significantly lower than expected both by the baseline and the EDP scenarios set in June 2013. The main difference between these two forecast exercises stem from downward revisions in external demand, but also in investment which is now set to remain subdued against a background of contained profit margins and further drops in business confidence. In the baseline scenario underpinning the Council recommendation, the GDP deflator was expected to increase by 1.7 % in 2014. In line with

the strong decrease in oil prices in 2014, the Commission 2015 winter forecast now expects the increase in the GDP deflator to be 0.9 pp lower.

Table 1 – Comparison of macroeconomic developments and forecasts

	2013		2014		
	COM 2013 SF	outturn	COM 2013 SF	COM 2015 WF	FL 2015
Real GDP (% change)	-0.1	0.3	1.1	0.4	0.4
Contributions to real GDP growth					
Domestic demand	-0.2	0.4	1.2	0.4	-0.1
Changes in inventories	-0.1	-0.2	0.0	0.3	0.4
Net exports	0.2	0.1	-0.1	-0.3	0.0
Employment (% change)	0.0	-0.2	0.4	0.2	0.2
GDP deflator (% change)	1.4	0.8	1.7	0.8	0.8
Output gap (% of potential GDP)	-3.4	-1.7	-3.3	-2.3	-3.3
Potential output growth	0.9	1.0	1.0	1.0	1.0

Source: COM 2013 SF – Commission services' 2013 Spring Forecast; COM 2015 WF – Commission services' 2015 Winter Forecast; FL 2015 – Finance Law 2015.

Despite better-than-expected GDP growth, the general government deficit reached 4.1 % of GDP in 2013, above the 3.9 % of GDP recommended by the Council on 21 June 2013. Despite a large amount of new discretionary measures, public revenue growth proved disappointing. Tax revenues, excluding discretionary revenue measures, grew at a considerably slower pace than GDP, with an elasticity of only 0.4 according to the Commission.¹ The Commission 2013 spring forecast already assumed that the elasticity of tax revenues to GDP would be lower than unity, at 0.9, and warned that, given the cyclical position, an even lower figure could not be discarded. The negative impact of low public revenue growth on the general government deficit was, however, partly compensated by a slowdown in public expenditures. The latter increased by 2.0 % in nominal terms, excluding the impact of tax credits, a significant slowdown compared to the growth in 2012 (+3.0 %). In particular, the EUR 5.6 billion (0.3 % of GDP) reduction in interest paid on public debt reduced public expenditure growth by 0.5 pp.

Based on the Commission 2015 winter forecast, the headline deficit is set to have increased to 4.3 % of GDP in 2014, on the back of a still increasing output gap and low inflation. The amount of discretionary measures on the revenue side would remain sizeable, representing 0.6 % of GDP. Meanwhile, due notably to GDP growth composition, the spontaneous elasticity of tax revenues is expected to stand at 0.7, which is significantly below the standard value of 1.0. The low elasticity and the slowdown in inflation are both set to weigh on public revenues and on the general government deficit. On the expenditure side, measures were taken to curb public expenditures which, net of tax credits, are expected to grow by 1.3 % in nominal terms. However, the CICE, which is accounted for as an additional expenditure in ESA 2010, is estimated to partly offset these efforts and is expected to increase the general government deficit by 0.5 pp of GDP.

¹ The elasticity of tax revenues was even lower (0.2) according to the government due to a significantly larger estimated yield of the adopted discretionary measures compared to the Commission 2015 winter forecast.

In 2015, the general government is expected to recede to 4.1 % of GDP. New discretionary measures on the revenue side are expected to have an overall neutral impact on the general government balance, while the tax revenues elasticity is projected to increase to 0.8.

Risks to the budgetary outlook appear balanced. While no major expenditure slippages are expected at this stage, the economic recovery remains fragile and an even lower than currently forecast tax content of economic activity cannot be discarded. In particular, the drop in oil prices since autumn 2014 could have a stronger than expected impact on consumer prices, which are notably the bases for the VAT, with a potential negative impact on government revenues. On the positive side, the recent announcement of the European Central Bank could lead to a further easing of interest rates in the coming month, with a positive impact on the general government balance.

The debt ratio, which stood at 92.2 % of GDP in 2013, is projected to keep on rising in 2014 and 2015. The debt ratio is expected to reach 95.3 % of GDP in 2014 and 97.1 % in 2015 due to the still relatively high general government deficits and subdued nominal GDP growth. Stock-flow adjustments are expected to contribute to stabilising public debt.

3. Budgetary implementation over 2013-2015

This section provides a detailed analysis of budgetary developments over 2013-2015. It notably discusses the main discretionary measures adopted on the revenue side and the expenditure cuts implemented.

3.1. Budgetary implementation in 2013

The headline deficit in 2013 is estimated by the statistical office INSEE at 4.1 % of GDP, thus falling short of the 3.9 % of GDP target set by the Council on 21 June 2013. The lower-than-expected elasticity of tax revenues contributed to this deviation, although GDP growth proved slightly stronger than expected at the time of the recommendation. Altogether, the fiscal effort as estimated by the Commission appears slightly below the effort recommended by the Council.

On the revenue side, a large amount of discretionary measures were adopted, representing 1.3 % of GDP according to the Commission. The main measures with an impact on public revenues were enacted as part of the supplementary budget for 2012 adopted on 16 August 2012 as well as in the initial budget law for 2013. Additional revenues compared with 2012 came mainly from reductions in corporate income tax expenditures with measures enacted in the initial budget for 2013 amounting to 0.4 % of GDP. In addition, hikes in social security contributions contributed to the increase in the tax burden. These included in particular the abolition of the exemptions of social charges for over-time work adopted in 2012. Measures were also taken to increase personal income taxes such as the absence of indexation on inflation of the tax brackets for personal income tax and for the tax on wealth as well as a reform of the taxation on capital gains. A number of measures, representing 0.2 pp of GDP, have had only a one-off budgetary impact meaning that they were not taken into account in the calculation of the fiscal effort achieved. Therefore, discretionary measures on the revenue side net of temporary measures and one-offs are estimated to have yielded 1.1 % of GDP, slightly below the 1.3 % of GDP projected in the baseline scenario underpinning the recommendation.

Table 2 – Composition of budgetary adjustment

% of GDP	2013		2014			2015		
	COM 2013 SF	outturn	COM 2013 SF	COM 2015WF	FL 2015	COM 2013 SF	COM 2015 WF	FL 2015
Revenue	53.3	53.0	n.a	53.4	53.4	n.a	53.5	
<i>of which:</i>								
- Taxes on production and imports	15.5	15.5	n.a	15.8	15.9	n.a	15.9	
- Current taxes on income, wealth, etc.	13.0	12.7	n.a	12.7	12.6	n.a	12.6	
- Social contributions	19.2	18.9	n.a	19.1	19.0	n.a	18.9	
- Other (residual)	5.5	5.9	n.a	5.8	5.9	n.a	6.1	
Expenditure	57.2	57.1	n.a	57.7	57.7	n.a	57.5	
<i>of which:</i>								
- Primary expenditure	54.7	54.8	n.a	55.5	55.5	n.a	55.3	
<i>of which:</i>								
- Compensation of employees	13.2	12.9	n.a	13.0	13.0	n.a	12.9	
- Intermediate consumption	5.6	5.2	n.a	5.2	5.2	n.a	5.2	
- Social payments	26.6	25.8	n.a	26.1	26.1	n.a	26.0	
- Subsidies	1.5	1.7	n.a	2.3	2.3	n.a	2.5	
- Gross fixed capital formation	3.2	4.0	n.a	3.9	4.0	n.a	3.7	
- Other (residual)	4.5	5.2	n.a	5.0	4.9	n.a	5.0	
- Interest expenditure	2.5	2.3	n.a	2.2	2.2	n.a	2.2	
General government balance (GGB)	-3.9	-4.1	n.a	-4.3	-4.4	n.a	-4.1	-4.1
Primary balance	-1.4	-1.9	n.a	-2.1	-2.2	n.a	-1.9	
One-off and other temporary measures	0.1	0.2	n.a	0.0	0.0	n.a	-0.1	-0.1
Structural balance	-2.2	-3.3	n.a	-2.9	-2.4	n.a	-2.6	-2.1
Change in structural balance	1.3	1.0	n.a	0.4	0.1	n.a	0.3	
Real GDP growth	-0.1	0.3	n.a	0.4	0.4	n.a	1.0	1.0
GDP deflator growth	1.4	0.8	n.a	0.8	0.8	n.a	0.8	0.9
Nominal GDP growth	1.3	1.1	n.a	1.1	1.2	n.a	1.8	1.9

Source: COM 2013 SF – Commission services' 2013 Spring Forecast; COM 2015 WF – Commission services' 2015 winter Forecast; FL 2015 – Finance Law 2015.

Note: The government forecast for general government balance in 2015 was updated during discussions in Parliament. Revenues and expenditures in 2014 for the government are the ones provided in the Draft Budgetary Plan. Estimate of the structural balance by the government are not recalculated.

Public expenditures slowed down significantly in 2013 due to specific expenditure cuts as well as to the impact of spending norms in a context of decreasing interest rates. The expenditure review process (*révision générale des politiques publiques*, replaced by the *modernisation de l'action publique* since mid-2012) has yielded savings at central government level in 2013. Moreover, the freeze in public sector wages was maintained with compensation of employees increasing by only 1.7 % in nominal terms compared to above 3 % on average over 2000-2008. The spending norm for the central government in nominal terms also contributed to the restrained expenditure growth, although the norm was not strictly achieved, notably due to an unexpected increase in the contribution to the EU budget towards the end of the year. On social security, healthcare spending turned out lower than the target set in the budget. In addition, the 2010 pension reform continued to provide additional savings along with the gradual increase in the minimum retirement age, despite a partial rollback of the reform for workers with long careers. Conversely, investment at the local government level proved dynamic, in line with the usually observed trends in the last year preceding a municipal election. Finally, due to the decreasing interest rates, the cost of debt decreased by 0.2 pp of GDP in 2013 although public debt itself continued to increase. On the whole, general government expenditure increased by 1.9 % in nominal terms (2.0 % excluding tax credits), the second lowest growth rate recorded in the last 20 years. Expenditures under the control of the government, adjusting for interest and developments in the number of unemployed, increased by 1.2 pp of GDP, 0.1 pp below the increase expected in the baseline scenario outlined in June 2013.

Table 3 – Main budgetary measures over 2013-2015 (excluding one-offs)

Revenue	Expenditure
2013	
Increase in indirect taxation (+0.2% of GDP)	Freeze in base wages of civil servants (-0.1% of GDP)
Increase in income taxation/reduction in income tax expenditures (+0.3% of GDP)	Savings stemming from the RGPP spending review at central government level (-0.1% of GDP)
No indexation of tax brackets of personal income tax and tax on wealth (+0.1 of GDP)	2010 pension reform (-0.1% of GDP)
Higher social levies on capital income and gains and on employee savings schemes (+0.2% of GDP)	Savings in healthcare expenditure (-0.1% of GDP)
Increase in social contributions/reduction in social security exemptions (+0.3% of GDP)	<i>Investissements d'avenir</i> programme (+0.1% of GDP)
	Other measures (+0.1% of GDP)
2014	
Reducing various personal income tax exemptions (+0.2% of GDP)	Freeze in base wages of civil servants (-0.1% of GDP)
Increase in social contributions (rate) (+0.1% of GDP)	Savings in healthcare expenditure (-0.1% of GDP)
Temporary 5% increase in corporate income tax for companies with turnover exceeding EUR 250 million (+0.1% of GDP)	Savings stemming from the RGPP spending review at central government level (-0.1% of GDP)
Increase in VAT rates (+0.3% of GDP)	2010 pension reform (-0.1% of GDP)
Reduction in personal income tax for low-earning households (-0.05% of GDP)	Introduction of the tax credit on competitiveness and employment (+0.5 % of GDP)
2015	
Additional reduction in personal income tax for low-earning households (-0.05% of GDP)	2010 pension reform (-0.2% of GDP)
Reduction in employer's social contributions for employees paid between 1 and 1.6 time the minimum wage (0.2 % of GDP)	Savings in healthcare expenditure (-0.2% of GDP)
	Freeze in base wages of civil servants (-0.1% of GDP)
	Postponed indexation of social transfers (-0.1% of GDP)
	Ramp-up of the tax credit on competitiveness and employment (+0.3 % of GDP)
<p><u>Note:</u> A positive sign implies that revenue / expenditure increases as a consequence of this measure. Annual budgetary impacts are estimated by the Commission services. Measures with a budget impact of at least 0.1% of GDP are listed.</p>	

3.2. Budgetary developments in 2014

According to the Commission 2015 winter forecast, the headline deficit in 2014 is expected to reach 4.3 % of GDP, thus falling short of the 3.6 % of GDP target set by the Council on 21 June 2013. Besides a negative base effect resulting from 2013, the lower-than-expected nominal GDP growth accounts for most of the deviation. Meanwhile, the amount of discretionary measures taken on the revenue side and expenditure developments appears broadly in line with the Council recommendation of 21 June 2013.

On the revenue side, discretionary measures are expected to amount to 0.5 % of GDP according to the Commission 2015 winter forecast. The main measures with an impact on public revenues adopted in 2014 include the reshuffling of VAT rates as of 1 January 2014, the doubling of the exceptional tax on corporate income for large companies and the increase

in the contribution for old-age which was adopted as part of the 2013 pension reform. As part of the reform of VAT rates, the standard rate was increased from 19.6 % to 20 % and the intermediary rate from 8 % to 10 %. The minimum rate remained unchanged at 5.5 % and became applicable for work to increase the energy efficiency of dwellings built for more than two years. This measure, which is expected to yield additional revenues of 0.3 pp of GDP, was notably adopted to partly compensate for the negative impact on public finances of the newly introduced CICE. The exceptional tax on corporate income for large companies, which was initially introduced in 2011, was increased from 5 % to 10.7 %, yielding close to 0.1 pp of GDP. Based on the Commission 2015 winter forecast, the elasticity of tax revenues is expected to recover in 2014, although it is set to remain significantly below 1.0, bringing current revenues to 53.1 % of GDP. One-off and temporary measures, including judicial disputes and the exceptional reduction in the contribution to the EU budget recorded in 2014, almost offset each other and are therefore set to have only a marginal impact on the discretionary measures.

Public expenditures are expected to continue slowing down in 2014 in spite of the rising cost of the CICE, which is accounted for as public expenditure under ESA 2010. Efforts conducted by the government to curb expenditure growth would be supported by the continued decrease in interest rates and to a fall in local investment in line with the electoral cycle. The freeze in public sector wages has been maintained with compensation of public sector employees expected to increase again by 1.7 % in nominal terms. The spending norm on central government expenditures in nominal terms is expected to be respected. On social security, the healthcare spending growth objective was set at 2.3 %, after a 2.4 % growth rate was achieved in 2013. Investment at the local government level is also expected to contract starkly, in line with the trend usually observed in the year of a municipal election. While interest rates are expected to continue decreasing, the impact would be somewhat weaker than in 2013 (-0.1 pp of GDP). Meanwhile, the CICE, which was adopted in 2012 and will ramp up over 2014-2015, is expected to increase public expenditures in 2014 by 0.5 pp of GDP. Overall, general government expenditures are expected to increase by 2.2 % in nominal terms (1.3 % excluding the impact of tax credits). Including the impact of the tax credits on public expenditures in ESA 2010, expenditures under the control of the government are set to increase by 1.3 pp of GDP, 0.1 pp below the increase expected in the baseline scenario outlined in June 2013.

3.3. Budgetary developments in 2015

According to the Commission 2015 winter forecast, the headline deficit in 2015 is expected to reach 4.1 % of GDP, much above the 3 % of GDP benchmark and of the 2.8 % of GDP target set by the Council on 21 June 2013. Besides a negative base effect resulting from 2014, the lower-than-expected nominal GDP growth account for most of the deviation. According to the Commission 2015 winter forecast, the structural balance is expected to improve by 0.3 % of GDP in 2015.

On the revenue side, discretionary measures are expected to represent 0.1 % of GDP as revenue-increasing measures are almost entirely offset by the implementation of the Responsibility and Solidarity Pact. Indeed, the reduction in employers' social security contributions which was adopted in a supplementary budget for 2014 will be effective on 1 January 2015 and is expected to reduce public revenues by 0.2 pp of GDP. The planned reduction in personal income tax for low earning households is set to further reduce the tax burden by 0.1 pp of GDP. The impact of these measures on tax revenues will be offset notably by an increase in indirect taxation and by the extension by one year of the exceptional

tax on large companies which was supposed to expire in 2015. Based on the Commission 2015 winter forecast, the elasticity of tax revenues is expected to come close to 0.8 in 2015, with current revenues remaining stable at 53.1 % of GDP. Due to the extinction of one-off measures expected in 2014, the 2013 spring forecast expected one-off measures to increase by 0.1 pp of GDP the overall amount of discretionary measures in 2015. By comparison, the 2015 winter forecast expects one-off and temporary measures, which result from judicial disputes, to decrease the amount of discretionary measures by 0.1 pp of GDP.

On the expenditure side, the government plans a EUR 21 bn reduction in public expenditure, in line with the objective to achieve a EUR 50 billion savings target over 2015-2017. Savings expected from the central government would amount to close to EUR 8 bn. In particular, the government plans to contain the wage bill and other operating costs by maintaining the freeze in base wages. Efforts are also planned to achieve efficiency gains and rationalise public sector real estate. State-controlled agencies (the *organismes divers d'administration centrale*) will be financially incentivised to reduce their own spending. The grant paid by the State to local government will be cut by EUR 3.7 billion. Finally, savings in social security are expected to come close to EUR 9 billion on the back of a further reduction in the healthcare spending objective and to a one-year nominal freeze in social benefits. The methodology used by the authorities to quantify these savings does not appear to be fully consistent. Regarding the State, efforts have been made to estimate a trend increase in expenditure against which savings are quantified. By contrast, part of the decrease in local investment expected in 2015 is linked to the electoral cycle and should not be considered as actual savings while local taxes are also expected to increase, notably due to measures announced to the Commission on 27 October and adopted as part of the second supplementary budget for 2014 in December. Overall, based on the Commission 2015 winter forecast, general government expenditures are expected to increase by 1.5 % in nominal terms (1.0 % excluding the impact of tax credits). Including tax credits, expenditures under the control of government are expected to increase by 0.8 pp of GDP, much below the 1.3 pp growth expected in June 2013.

4. EFFECTIVE ACTION in 2013-14

4.1. Background information

The current assessment of effective action is based on the Commission 2015 winter forecast. It takes into account the economic and budgetary developments since the last Council recommendation under Article 126(7) TFEU of 21 June 2013. The methodology for assessing effective action is the one endorsed by the Council in June 2014. The assessment starts by comparing the headline deficit target and the recommended improvement in the structural balance in the Council recommendation with the headline deficit and the apparent fiscal effort, measured by the change in structural budget balance. If not achieved, a careful analysis based on (i) the adjusted change of the structural balance and (ii) a bottom-up assessment of the consolidation measures undertaken by the French authorities in 2013 and 2014 is carried out.

The adjustment of the structural balance takes into account (i) the impact of revisions in potential output growth compared with the growth scenario underpinning the Council recommendation, (ii) the impact of revenue windfalls/shortfalls relative to the ones used in the baseline scenario, and (iii) the negative impact of the changeover to ESA 2010 on the cost of tax credits.

4.2. Headline targets and adjustment in the structural balance

The general government deficit is estimated to have remained above the level recommended in 2013 and 2014. In its recommendation of 21 June 2013, the Council recommended France to achieve headline targets of 3.9 % of GDP in 2013 and 3.6 % in 2014. In 2013, the general government deficit has actually reached 4.1 % of GDP. Based on the Commission 2015 winter forecast, it is expected to increase further to 4.3 % of GDP in 2014.

In its recommendation of 21 June 2013, the Council recommended France to improve its structural balance by 1.3 pp of GDP in 2013 and 0.8 pp in 2014 and 2015. Based on the Commission 2015 winter forecast, the structural deficit is estimated to fall to 3.3% of GDP in 2013 from 4.3% of GDP in 2012 and to continue decreasing to 2.9% of GDP in 2014 and 2.6 % in 2015. This implies an annual fiscal effort of 1.0 % of GDP in 2013, 0.4% in 2014 and 0.3 % in 2015, below the targets in each year.

Altogether, the fact that both the headline targets and the structural deficit targets have been missed in 2013 and 2014 warrants a careful analysis.

Table 4: Comparison of budgetary projections

% of GDP	Headline budget balance		Change in the structural balance		
	2013	2014	2013	2014	Cumulated (2013-14)
Commission 2015 winter forecast	-4.1	-4.3	1.0	0.4	1.4
2015 Draft Budgetary Plan*	-4.1	-4.4	1.0	0.2	1.2
2014 Stability Programme*	-4.3	-3.8	0.8	0.9	1.7
Target of the latest EDP recommendation (June 2013)	3.9	3.6	1.3	0.8	2.1

Note:

* Structural balance according to the programme/DBP as recalculated by the Commission on the basis of the programme scenario using the commonly agreed methodology

4.3. Careful analysis

Top down assessment

The correction for revisions in potential growth since June 2013 have a marginal impact on the estimated improvement in the structural balance in 2013 and 2014. At the time of the Council recommendation of 21 June 2013, potential output growth was estimated to stand at 0.9 % in 2013 and 1.0 % in 2014. Based on its 2015 winter forecast, the Commission estimates that potential growth reached 1.0 % both in 2013 and 2014. All other things being equal, an upward revision of potential growth increases the output gap and reduces the estimated structural deficit. Correcting for this development has, however, a non-significant impact for 2013 and 2014.

Compared to the baseline, the 2015 winter forecast shows revenue shortfalls of 0.2 pp of GDP in 2013 and 2014. In a context where real GDP growth was expected to be negative in 2013, the Commission 2013 spring forecast projected revenue to grow at a faster rate than what standard elasticities of public revenues to GDP would suggest both in 2013 and 2014. By contrast, the Commission 2015 winter forecast now expects revenue shortfalls, meaning that current revenues increase at a slower pace than nominal GDP in both years. By

comparison to the baseline scenario, correcting the Commission 2015 winter forecast for revenue shortfalls and windfalls therefore leads to an increase in current revenues in 2013 and 2014.

Adjusting for the negative impact of the changeover to ESA 2010 increases by 0.1 pp of GDP the improvement in the structural balance in 2014. In 2014, the European System of Account (ESA) experienced a number of methodological changes on the occasion of the changeover from ESA 1995 to ESA 2010. In particular, payable tax credits, which were accounted for as negative measures on the revenue side in ESA 1995 are now recorded as expenditures. In addition, while such tax credits, including notably the CICE and the tax credit on research, were formerly recorded at the time the related amounts were claimed, the additional expenditure is now taken into account as soon as a tax liability is recorded. This methodological change, which was not foreseen at the time of the Council recommendation and can be considered outside the control of government, increases the total cost of these measures by 0.1 pp of GDP in 2014. They therefore reduce the improvement in the structural balance by 0.1 pp of GDP.

Taking into account the relevant adjustment, the cumulated improvement in the structural balance over 2013-2014 is expected to fall short of the level recommended by the Council. Correcting for downward revisions in potential output growth and revenue shortfalls/windfalls compared with the time the Council recommendation was issued as well as for the negative impact of the changeover to ESA 2010, the improvement in the structural balance effort comes in at 1.2 % of GDP in 2013 and 0.7 % in 2014. The cumulated effort over 2013-2014 therefore falls short by 0.2 pp of the 2.1 % of GDP recommended by the Council.

Table 5 – Adjusted change in the structural balance (top-down) and fiscal effort (bottom-up)

% of GDP	Adjusted change of structural balance			Bottom-up		
	2013	2014	Cumulated (2013-14)	2013	2014	Cumulated (2013-14)
Commission 2015 winter forecast	1.2	0.7	1.9	-0.1	1.1	1.0
EDP target	1.3	0.8	2.1	0.0	above 1	above 1

Bottom-up assessment

In its recommendation of 21 June 2013, the Council deemed that in order to be consistent with the adjustment in the structural balance recommended, measures for an amount of 0.0 % of GDP in 2013 and above 1.0 % in 2014 were needed on top of the baseline scenario underpinning the recommendation. Accordingly, the bottom-up assessment of budgetary developments compares the baseline scenario underpinning the Council Recommendation of 21 June 2013 with (i) the discretionary measures, net of one-off

and temporary measures, adopted on the revenue side and (ii) developments in expenditures under the control of the government.²

For 2013, the bottom-up assessment of the effort amounts to -0.1 % of GDP compared to the baseline scenario. On the revenue side, based on measures specified at the time of the Council Recommendation, the baseline scenario expected discretionary measures to amount to 1.3 % of GDP in 2013, while expenditures under the control of the government were expected to increase by 1.3 pp of GDP. Estimates by the Commission of the discretionary measures actually implemented in 2013 amount to only 1.1 % of GDP (see table 3 for details). Meanwhile, expenditures under the control of the government proved less dynamic than expected in the baseline scenario (+1.2 pp of GDP).

In 2014, based on the Commission 2015 winter forecast, a bottom-up effort representing 1.1 % of GDP has been implemented on top of the baseline scenario, corrected for the negative impact of the changeover to ESA2010. The baseline scenario underpinning the Council Recommendation of 21 June 2013 expected measures on the revenue side for 2014 to amount to -0.2 % of GDP, while expenditures under the control of the government were expected to increase by 1.4 pp of GDP. The Council recommendation of 21 June 2013 considered that, compared to that scenario, additional measures of above 1 % of GDP were necessary for the budgetary targets to be reached. Based on the Commission 2015 winter forecast, additional revenues yielded by discretionary measures for 2014 are actually expected to amount to 0.7 % of GDP. On the expenditure side, expenditures under the control of the government are projected to increase by 1.2 pp in 2014 once the impact of the changeover to ESA 2010 on the cost of payable tax credits is adjusted for.

The cumulated effort over 2013 and 2014 is estimated to stand just above 1 % of GDP, in line with the level deemed necessary by the Council on 21 June 2013. The effort for 2013 shows a shortfall of 0.1 % GDP compared to the level deemed consistent with the variation in the structural balance recommended by the Council. This shortfall is, however, compensated by a bottom up effort of 1.1 % of GDP in 2014, which is above 1 %, the level deemed necessary by the Council for that year. In terms of composition, the additional effort compared to the baseline has mainly consisted in revenue measures while expenditures developments have remained close to those considered in the baseline scenario underpinning the Council Recommendation.

Conclusion of the careful analysis

The downward revision in inflation recorded in 2014 has had a negative impact on the general government deficit. In 2014, inflation turned out to be significantly lower than expected. While the scenario underpinning the Council recommendation expected inflation to reach 1.4 % in 2013 and 1.7 % in 2014 (based on the GDP deflator), the 2015 winter forecast estimates that it reached only 0.8 % in both years. Such a negative inflation shock has an adverse impact on tax bases and leads to downward revisions in tax revenues. By comparison, expenditures are less sensitive to inflation revisions, especially in France where public expenditures are partly guided by norms set in nominal terms. In addition, a number of expenditures, notably public wages and social transfers related to pensions and housing, were frozen in nominal terms in 2014, making the achievement of further savings more difficult.

² Excluding the cost of interest and the impact on public finances of developments in the number of unemployed people.

The difference between the top-down and bottom-up indicators in 2014 mainly comes from this large downward revision in inflation: the top-down assessment is strongly impacted by the inflation shock, unlike the bottom-up assessment. The deterioration in the headline deficit leads to a worsening of the structural balance, thus leading to an estimated lower effort according to the top-down assessment. This is because the output gap, which is used to estimate the cyclical part of the deficit, is computed in volume terms and is hence not impacted by inflation. In turn, the cyclical part of the headline deficit is not affected by the downward revision in inflation, and hence all the inflation-related deterioration in the headline deficit results in a similar deterioration of the structural balance.

By contrast, the bottom-up assessment appears less sensitive to inflation revisions than the top-down assessment. The direct quantification of the discretionary revenue measures adopted in 2014 has been only marginally impacted by the lower-than-expected inflation. In addition, as already indicated, expenditure targets are generally set in nominal terms, implying that a large part of expenditures do not adjust to lower inflation. The overall impact of the downward revision in inflation on the bottom-up effort is thus likely to have been limited. More specifically, as some public expenditures are sensitive to inflation and could have been revised somewhat downwards, the bottom-up indicator could have been affected positively but, in any case, much less than the top-down in the specific case of France.

The gap between the top-down assessment - which shows a shortfall of 0.2 % of GDP compared to the recommendation – and the bottom up effort – which is in line with the recommendation - is mostly due to the downward revision in inflation. The lower inflation reduced the top-down effort by around 0.6 % of GDP. Conversely, the lower-than-expected interest payments, which are not taken into account in the bottom-up approach, increased the top-down effort by 0.4 % of GDP. The conjunction of the two effects, which partly offset one another, explains the 0.2 % of GDP shortfall in the top-down effort.

Overall, on the basis of the 2015 Commission winter forecast, the information available does not allow to conclude that the recommended effort has not been delivered in 2013-2014.

5. PROPOSED NEW ADJUSTMENT PATH

According to the Commission 2015 winter forecast, France is not expected to correct its excessive deficit by the deadline established in the Council recommendation of 21 June 2013 although the cumulated fiscal effort for 2013-2014, as measured by discretionary measures adopted on the revenue side and expenditure developments, is in line with the level indicated by the Council. Indeed, while the macroeconomic scenario underpinning the recommendation assumed that the output gap would gradually narrow, GDP is actually expected to grow below potential, although the estimated potential growth itself was revised down since the 2013 spring forecast. Although additional measures amounting to "above 1 % of GDP" were taken since June 2013, the lower-than-expected economic growth has had a negative impact on the headline budget balance. In addition, while the cumulated adjustment in the structural effort appears lower than the level recommended by the Council in June 2013, it seems to be mainly due to lower inflation estimated in the Commission 2015 winter forecast than at the time of the recommendation. It therefore appears justified to issue a revised recommendation and to extend the deadline for correction of the excessive deficit.

5.1. Expected impact of structural reforms

The 2015 Country Report concluded that France is experiencing excessive macroeconomic imbalances requiring specific monitoring and continued determined policy action, as reflected in persistently low external competitiveness and high public sector indebtedness. The deterioration in the trade balance and in competitiveness deserves continued policy attention. In particular, in a context of low growth and low inflation and given the insufficient policy response so far, risks stemming from weak competitiveness and the high public debt are significant. The need for action so as to reduce the risk of adverse effects on the French economy and, given the size of the French economy, of spillovers to the economic and monetary union, is particularly important.

In its Communication of 13 January 2015, the Commission strengthened the link between effective implementation of structural reforms, investment, and fiscal responsibility in support of jobs and growth, within the existing rules of the Stability and Growth Pact. The Communication clarified that structural reforms will be taken into account when recommending the length of the extension of the deadline to correct the excessive deficit. As part of this Communication, the Commission indicated that it will also take account of reforms that have not yet been implemented, provided that they have been clearly specified - with a credible timetable for adoption - in a structural reform plan that has to be adopted by the Member State in question.

In a letter sent to the Commission in November 2014, the French authorities committed to a number of structural reforms implementing the 2014 country-specific recommendations issued by the Council in July 2014. On 12 December 2014, the government published a reform agenda outlining reform priorities until 2017. This reform agenda was confirmed in a communication on the National Reform Programme presented by the Prime Minister to the "*Conseil des Ministres*" on 18 February 2015. The measures presented by the French authorities are expected to have a positive impact on growth and therefore on the sustainability of public finances. The French authorities estimate the overall impact of all reforms implemented or initiated since 2012, regardless of their current state of implementation, at 3.3 pp of GDP by 2020.

The most important reform steps taken since the Council recommendation of 21 June 2013 notably include the reductions in the cost of labour as well as the pension reform enacted in January 2014. The reductions in the cost of labour include the CICE as well as the *pacte de responsabilité et de solidarité* (PRS). The CICE reduces the labour cost for wages up to 2.5 times the minimum wage for a total amount of EUR 20 billion. The PRS includes a number of additional reductions in the cost of labour amounting to EUR 10 billion. In 2015, employers' social security contributions will be reduced for wages up to 1.6 times the minimum wage at a cost of EUR 4.5 billion and independent workers' contributions will be decreased for a cost of EUR 1 billion. In 2016, a further reduction in employer's social security contributions is foreseen of EUR 4.5 billion for wages between 2.5 and 3.5 times the minimum wage. These measures are expected to close about half of the gap in terms of tax wedge between France and the euro area average. The 2014 reform of the pension system seeks to improve the long-term sustainability of the system. Up to 2020, revenue measures, mostly higher social contributions, account for the bulk of the adjustment. Thereafter, the minimum number of years an employee must pay into the system before he/she qualifies for a full pension will gradually rise to 43 years by 2035 from 41¾ projected in 2020. Overall, the

reform proposal would halve the deficit of the pension system by 2020, and will contribute to increasing the active population from 2020 on.

Other reform plans include, inter alia, measures to reform local authorities, to improve the business environment, and to increase competition in services. In particular, the reform of local authorities and a draft Law on Economic Activity are currently under discussion in Parliament. The reform of local authorities aims to reduce administrative fragmentation and to avoid overlapping competences. This reform can increase the efficiency and productivity of local authorities and should translate into public expenditure savings in the medium term. Measures to improve the business environment include an on-going simplification agenda but also the planned revision of the labour regulations that are associated with specific-size thresholds that may hamper the growth of French firms. The draft Law on Economic Activity reduces the administrative burden, notably for the construction sector, and addresses competition concerns for legal professions, opens up the coach transport sector, reduces entry barriers for the retail trade and relaxes rules for Sunday work. Moreover, it also foresees a reform of the procedures for individual dismissal disputes.

Overall, these reforms are expected to increase the growth potential of the French economy, although the quantification of their impact by the authorities seems over-estimated. In particular, the French authorities expect the reductions in the tax burden on labour to increase GDP by 1.7 pp by 2020. This estimate does not take into account the cost of financing of the labour cost reductions. Simulations done by the European Commission using the QUEST III model taking into account a full ex-ante financing of the reforms concludes that the CICE and the PRS would have a significant though much smaller impact on GDP by 2020. Moreover, as pointed out in the Commission 2015 Country Report on France, the impact of the reduction in the cost of labour could be offset by dynamic wage growth. In addition, the quantification of the shocks is in some cases not sufficiently specified and seems generous, as evidenced by the large magnitude of the shocks that would be necessary in the Commission model (QUEST) to produce comparable results. This is notably the case for the impact expected by the authorities from the law on energy policy (+0.8 pp of GDP by 2020). Finally, the estimates include the quantified impact of legislation which has not yet been adopted. This is notably the case of the draft law on growth and activity which is currently being discussed in Parliament and whose impact on GDP could potentially be reduced by changes introduced during the legislative process.

Overall, while the reform agenda set by the French authorities goes in the right direction, limited progress has been made in implementing the Council recommendation of 8 July 2014. In light of the remaining challenges in the policy areas identified in the 2015 Country Report and the fact that the measures enacted so far have not yet resulted in a significant correction of France's macroeconomic imbalances, continued commitment to swift adoption and full implementation of structural reforms covering all country-specific recommendations is essential. Against this background France has been invited to announce further details on structural reforms in its National Reform Plan, which the Commission will keep on closely monitoring. As mentioned in its Communication "2015 European Semester: Assessment of growth challenges, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011", the Commission will consider in May, taking into account the level of ambition of the National Reform Programme and other commitments presented by that date whether to recommend to the Council to adopt recommendations, pursuant to Article 7(2) of Regulation 1176/2011, establishing the existence of an excessive imbalance and recommending that France take corrective action to be set out in a Corrective Action Plan.

5.2. Baseline scenario

In order to define the effort required by France, the Commission 2015 winter forecast was extended. For 2015 and 2016, the baseline scenario is identical to the Commission 2015 winter forecast. More specifically, the recovery is expected to gradually become firmer as the falling inflation and still sustained wage growth are expected to support consumer spending. GDP growth is thus projected to reach 1.0 % in 2015 and, in a no-policy-change scenario, 1.8 % in 2016. In 2015, inflation is projected at 0.0 %, due notably to the recent sharp decrease in oil prices and to the still large economic slack. Inflation would rebound somewhat to 1.0 % in 2016. For 2017, in the baseline scenario, it is assumed that, in the absence of any policy measures, the output gap would close in five years' time. Measures already adopted which are expected to have a significant impact on the general government deficit beyond 2015 have also been taken into account in the baseline scenario. Measures included in the baseline for 2016 notably include, based on the 2015 winter forecast, the planned decrease in employers' social security contributions (-0.2 % of GDP) as well as the planned reduction in the *contribution sociale de solidarité des sociétés* (C3S) (-0.05 % of GDP) and the increase in environmental taxation (0.1 % of GDP). For 2017, revenue measures taken into account in the extended forecast increase the general government deficit by 0.2 % of GDP. They notably include the announced extinction of the C3S (0.1 % of GDP) and the planned reduction in the general rate for corporate income tax (0.05 % of GDP). In addition, the structural balance is considered to deteriorate by close to ¼ pp of GDP due to expenditure spontaneously growing faster than potential GDP.

The extended forecast assumes that, under a no-policy-change scenario, GDP growth would reach 1.8 % in 2017. GDP growth would therefore be higher than potential growth (estimated at 1.2 % in 2017). The assumptions underpinning the baseline scenario, as described above, imply a stabilisation of the headline deficit in 2015-2017.

Table 6 – Forecast of key macroeconomic and budgetary variables under the baseline scenario

	2014	2015	2016	2017
GDP growth (constant prices - in %)	0.4%	1.0%	1.8%	1.8%
GDP growth (current prices - in %)	1.1%	1.8%	2.8%	3.3%
Potential GDP growth (constant prices)	1.0%	1.0%	1.1%	1.2%
Output gap (in % of potential GDP)	-2.3%	-2.3%	-1.6%	-1.1%
General government deficit (in % of GDP)	-4.3%	-4.1%	-4.1%	-4.1%
Structural balance (in % of potential GDP)	-2.9%	-2.6%	-3.0%	-3.3%

5.3. Proposed extension of the deadline

The proposed deadline for correcting the excessive deficit situation notably takes into account the economic conditions together with other relevant factors. Based on the baseline scenario outlined above, the second-round effects of the additional consolidation efforts required to bring an end to the excessive deficit situation are assessed. Apart from this, also other relevant factors, in particular the implementation of structural reforms in line with the provisions of the Commission Communication of 13 January 2015 on "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact", are considered. In any case, the annual adjustment in the structural balance considered is at least equal to the minimum benchmark of 0.5 % of GDP set by the Stability and Growth Pact.

Building on this, different scenarios have been considered in order to assess the time needed for France to correct its excessive deficit. Based on the Commission 2015 winter forecast, an extension of the deadline by one year would require a cumulated adjustment in the structural balance over 2015 and 2016 representing at least 2.2 % of GDP. This would bring the average effort required for those two years above the average annual effort recommended in 2013-2015 in the Council recommendation of 21 June 2013. Given the size of the cumulated fiscal effort required, the negative impact on GDP growth would be significant.

The new deadline of two years, i.e. by 2017, would allow bringing the headline deficit below 3 % while allowing GDP growth to reach to 0.8 % in 2017. In order to define the adjustment path for 2015 and further, it is assumed that additional measures needed have a negative second-round impact on GDP growth through a multiplier effect which is close to 0.7 for revenue-increasing measures and 1.0 for expenditure cuts. In terms of composition of the additional measures, it is assumed that the authorities would make additional expenditure cuts on top of those already included in the baseline scenario (amounting to close to EUR 25 billion over 2015-2017) to reach an overall amount of EUR 50 billion over 2015-2017, as mentioned in the programming law on public finances. Beyond that amount, it is assumed that the additional effort needed would be split evenly between revenue-increasing measures and expenditure cuts. Based on these assumptions, the general government deficit should reach 4.0 % of GDP in 2015, 3.4 % of GDP in 2016 and 2.8 % of GDP in 2017. Such a budgetary path is consistent with an adjustment in the structural balance of 0.5 % of GDP in 2015, 0.8 % of GDP in 2016 and 0.9% in 2017. Compared to the baseline scenario outlined above, additional measures should be taken representing 0.2 % of GDP in 2015, 1.2 % in 2016 and 1.3% in 2017. Taking into account the second-round effects on economic growth of the additional consolidation measures needed, GDP growth would reach 0.8 % in 2015, 0.7 % in 2016 and 0.8 % in 2017.

Table 7 – Forecast of key macroeconomic and budgetary variables under the EDP scenario

	2014	2015	2016	2017
GDP growth (constant prices - in %)	0.4%	0.8%	0.7%	0.8%
GDP growth (current prices - in %)	1.1%	1.6%	1.6%	2.3%
Potential GDP growth (constant prices)	1.0%	1.0%	1.1%	1.2%
Output gap (in % of potential GDP)	-2.3%	-2.5%	-2.9%	-3.4%
General government deficit (in % of GDP)	-4.3%	-4.0%	-3.4%	-2.8%
Structural balance (in % of potential GDP)	-2.9%	-2.4%	-1.5%	-0.7%
Variation in structural balance (in % of potential GDP)	0.4%	0.5%	0.8%	0.9%

6. CONCLUSIONS

Based on current information, the cumulated adjustment in the structural balance over 2013-2014 is estimated to amount to 1.9% of GDP. This falls short of the cumulated adjustment in the structural balance of 2.1 % of GDP recommended by the Council in June 2013. However, the bottom-up approach estimates that the fiscal effort would amount to -0.1 % in 2013 and 1.1 % in 2014 with the cumulated effort being in line with the "above 1.0 % of GDP" indicated by the Council.

As the gap between the top-down and the bottom-up indicator mainly stems from revisions in inflation since spring 2013, the careful analysis concludes that the bottom-up approach should

be given a prominent role in the assessment of budgetary developments over 2013-2014. Overall the available evidence does not allow concluding that the recommended effort has not been delivered in 2013-2014.

The deficit is expected to remain well above the 3% of GDP reference value in 2015. The substantial cyclical deterioration in the budgetary position resulting from the weaker overall position of the economy relative to the macroeconomic scenario underlying the 2013 Council recommendation and medium-term growth prospects, together with the first steps towards an ambitious structural reform agenda that need to be further complemented as indicated in the Communication from the Commission "2015 European Semester: Assessment of growth challenges, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011, suggest that extending the deadline for correction of the excessive deficit to 2017 at the latest is appropriate also in the light of the Commission Communication No (2015)12 of 13 January 2015 on "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact".

Setting a new two-year deadline for France to correct its excessive deficit appears commensurate with headline deficit targets of 4.0 % of GDP in 2015, 3.4 % of GDP in 2016 and 2.8 % of GDP in 2017. The underlying improvement in the structural budget balance would be 0.5 % of GDP in 2015, 0.8 % in 2016 and 0.9% in 2017. In cumulated terms, the effort should therefore reach 0.5 % in 2015, 1.3 % in 2016 and 2.2 % in 2017. To that avail, additional measures beyond the baseline scenario outlined in the present staff working document should be taken, which should amount to 0.2 % of GDP in 2015, 1.2 % of GDP in 2016 and 1.3% of GDP in 2017. In cumulated terms, additional measures needed should therefore amount to 0.2 % in 2015, 1.4 % in 2016 and 2.7 % of GDP in 2017.

ANNEX – STANDARD TABLES

Table 8 – Adjustment of apparent structural effort for the revision in potential growth - details of calculations

	Potential GDP growth underlying the 2013 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
2013	0.9	1.0	0.0	56.1	0.0
2014	1.0	1.0	0.0	56.1	0.0
2015	1.1	1.0	0.2	56.4	0.1

Table 9 – Adjustment of apparent structural effort for the expected revenue windfalls/shortfalls - details of calculations

	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 assessment	Correction coefficient β (% of nominal GDP)
	recom. (1)	assessment (1')	recom. (2)	assessment (2')	recom. (3)	assessment (3')	recom. (4)	assessment (4')	recom. (5)	assessment (5')			
											(6)=[(1')-(2)-[(3)+(ε-1)*(4)/100]*(5)]-[1-(2)-[(3)+(ε-1)*(4)/100]*(5)]	(7)	(8)=100*(6)/(7)
2013	43.6	36.1	27.4	25.9	1.3	1.1	-1.0	-0.7	1045.7	1077.6	-3.9	2113.7	-0.2
2014	23.6	21.9	-8.2	12.4	2.8	1.1	0.1	-0.6	1089.3	113.7	-4.4	2137.7	-0.2
2015	35.2	20.4	0.0	2.5	3.6	1.8	0.7	0.0	1112.9	1135.6	1.9	2176.5	0.1

*revenue elasticity (ε): 1.0

Table 10 – Forecast of key variables for the computation of the fiscal effort under the baseline scenario

		2014	2015	2016	2017		
Enters top-down	α						
		Structural expenditure (% of potential GDP)	56.4%	56.4%	56.4%	56.4%	
		Potential GDP growth (%)	1.0%	1.0%	1.1%	1.2%	
	β		Current revenue (national currency)	1135.6	1156.0	1181.8	1216.5
			Discretionary measures with impact on current revenue (national currency)	12.4	2.5	-2.9	-4.3
			Nominal GDP growth (%)	1.1%	1.8%	2.8%	3.3%
		p.m Elasticity on current revenue	0.8	0.9	0.9	1.0	
	p.m Output gap (% of Pot. Output)	-2.3%	-2.3%	-1.6%	-1.1%		
Enters bottom-up		Discretionary measures with impact on total revenue net of one-offs and other temporary measures (national currency)	15.9	4.4	-2.0	-4.3	
		Total expenditure net of one-offs and other temporary measures (national currency)	1234.7	1252.5	1281.9	1321.0	
		Interest expenditure (national currency)	46.8	47.4	49.8	53.3	
		Total unemployment	3021.3	3054.3	3012.0	2847.8	
		Unemployment benefits (national currency)	40.8	40.5	40.0	37.8	
		Investment expenditure matched by EU funds (national currency)	0.0	0.0	0.0	0.0	

Source: Commission calculations based on Winter 2015 forecast