COUNCIL OF THE EUROPEAN UNION

Brussels, 12 February 2008

6317/08

UEM 61

NOTE

From:	General Secretariat of the Council
to:	Delegations
Subject:	Council Opinion on the Stability Programme of France

Delegations will find attached the Council's Opinion on the updated Stability Programme presented by France, as adopted by the ECOFIN Council on 12 February 2008.

ANNEX

COUNCIL OPINION

On the updated stability programme of France, 2007-2012

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

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(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On 12 February 2008, the Council examined the updated stability programme of France which covers the period 2007 to 2012, one year more than the required reference period to coincide with the government programme.

(2) Between 2001 and 2005, annual real GDP grew by just above 1½% on average. This was in line with average growth in the euro area, while inflation was marginally below the euro average. Since 2006, GDP growth in France has fallen below the euro area average, with evidence of structural problems and a related deterioration in competitiveness. Although the unemployment rate has improved since 2005, it remains well above the euro area average, and the employment rate and the hours worked are still low.

---

1 OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text can be found at the following website: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

In this context, the adopted measures and wide-ranging labour and product market reforms planned by the government over the coming five years would, if fully implemented, increase potential growth and competitiveness, and improve the long-term sustainability of public finances. Government deficits and debt ratios, though decreasing, remain high. While positive steps have been taken recently to curb spending, notably in social security, France has the highest expenditure-to-GDP ratio in the euro area and its deficit is still fairly close to the 3% of GDP threshold. Thus, France's plans to implement reforms to increase potential growth, improve the competitiveness of the French economy and help sustain the budgetary consolidation process as well as to forcefully restrain expenditure at all levels of government and improve its efficiency would contribute to meet the key challenges for the coming years.

(3) The programme contains two different scenarios for the macroeconomic and budgetary projections: a "low" growth scenario and a "high" growth scenario. The "low" growth scenario is considered the reference scenario for assessing public finance projections. It envisages that real GDP growth will pick up from 2% in 2007 to 2-2.5% in 2008 and to 2.5% over the rest of the programme period, which is higher than the Commission services' estimate of potential growth of just above 2%. The announced growth-enhancing labour and product market reforms will gradually contribute to a higher growth potential, the size and timing of which is subject to uncertainties. Assessed against currently available information[2], even this scenario appears to be based on favourable growth assumptions, especially for 2009. Less buoyant growth in the medium term than foreseen in the programme is therefore a risk also due to somewhat favourable assumptions concerning the international environment.

[2] The assessment takes notably into account the Commission services' autumn forecasts and the Commission assessment of the October 2007 implementation report of the national reform programme.

(4) For 2007, the general government deficit is estimated at 2.6% of GDP in the Commission services' autumn 2007 forecast, against a target of 2.5% of GDP set in previous update of the stability programme. In the new update the deficit is expected to come out at 2.4% of GDP. Revenue windfalls, which partly result from a positive base effect following higher-than-expected revenues in 2006, broadly offset the costs of the fiscal package adopted in summer aimed at supporting growth (mainly involving tax cuts) and especially the higher-than-budgeted expenditure increase (notably in healthcare despite corrective measures taken to reduce the breach in the national health insurance spending objective (ONDAM) following the detection of slippages by the "Alert Committee" in June 2007). Thus, despite the possible achievement of the budgetary objective set in the previous update, the budgetary implementation in 2007 can only be considered to be partly in line with the policy invitation included in the Council opinion of 27 February 2007 on the previous update of the stability programme[3] to "exploit the robust growth prospects and the positive base effect from stronger than previously expected 2006 outturn to frontload the adjustment towards the MTO … with a view to achieving (it) in 2010 as planned and in particular to fully and effectively implement the 2007 budget and seize any opportunity to step up the structural adjustment". The Council also notes that the budgetary implementation does not appear to be consistent with all the April 2007 Eurogroup orientations for budgetary policies since unexpected extra revenues were partially used for tax reductions and higher-than-budgeted expenditure.

(5) The main goal of the budgetary strategy in the update of the stability programme is to significantly curb public expenditure, in a context in which growth is assumed to strengthen through the adopted and announced structural reforms, in order to achieve the medium-term objective (MTO) of a balanced position in structural terms (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) in 2012 at the latest.

---

[3] OJ C 70, 27.3.2007, p. 13.

According to the reference scenario, the headline deficit would fall marginally in 2008, from 2.4% of GDP in 2007 to 2.3% of GDP, and then more rapidly, by 0.6 percentage point per year, until a balanced position is reached in 2012. At the same time, the primary surplus would improve from 0.2% of GDP in 2007 to 2.5% of GDP in 2012. Despite the background of more favourable macroeconomic growth assumptions and of a better initial budgetary position, the programme postpones the adjustment planned in the previous update, which had set 2010 as a target year to achieve the MTO. The structural adjustment is very limited in the first programme year and it is spread over a longer period. The deficit reduction is planned to be fully expenditure-based. The expenditure ratio is planned to decrease by nearly 3 percentage points of GDP. The revenue-to-GDP ratio would also decline somewhat in 2008 and 2009 and stabilise thereafter. Government gross debt, estimated at 64.2% of GDP in 2007 in the update, i.e. above the 60% of GDP Treaty reference value, is projected to decline by over 4 percentage points of GDP over the programme period and reach the reference value in 2012.

(6) The budgetary outcomes could be worse than targeted in the programme. The macroeconomic scenario, which relies upon a benign international environment, appears favourable over the entire programme period. This is to some extent linked to the fact that it relies on the implementation of structural reforms including those of the special pension regimes and the review of the labour contracts already broadly agreed, as well as reforms that are yet to be decided. In order to have their full effect on potential growth, structural measures should be implemented with determination. On the expenditure side, for the near term, there are some concrete measures to support restraint (e.g. the introduction of a minimum payment charged to patients for certain healthcare expenditures and the partial replacement of retirees in public administration).

For the medium term, when the consolidation is expected to be larger, there should be a positive effect stemming notably from the "General Review of Public Policies" which should lead to structural reforms in all fields of public expenditure, to be decided in the spring of 2008 and covering the period 2009-2011but the precise measures are not yet fully specified and hence their budgetary impact is uncertain. The extension of the state expenditure rule to cover transfers to local government could contribute towards containing expenditure. Local government and social security spending remains a risk to overall government expenditure. In view of these risks attached to the budgetary targets, the debt ratio could also turn out higher than projected in the programme.

(7) n view of the risk assessment above and the fact that the structural balance would hardly improve in 2008 and thereafter improve by close to 0.5 percentage points of GDP on average per year, the budgetary stance in the programme is not sufficient to ensure that the MTO is achieved by 2010 as planned in the previous programme and may not be sufficient to be achieved even by 2012 as envisaged in the programme. Moreover, the Council notes that the budgetary stance is not consistent with the Eurogroup's April 2007 orientations. According to the programme, a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations would be reached in 2009. In view of the risks to the budgetary targets, it could be achieved later. The adjustment implied by the programme is not in line with the 0.5% of GDP benchmark in the Stability and Growth Pact in particular due to the inadequate adjustment in 2008. The Council notes that this is not consistent with the orientations of the April 2007 Eurogroup. Taking into account the risks to the deficit projections mentioned above, the debt ratio may not be sufficiently diminishing towards the reference value over the programme period.

(8) France is at medium risk with regard to the sustainability of public finances. The long-term budgetary impact of ageing is slightly lower than the EU average, with pension expenditure showing a somewhat more limited increase, as a result of the pension reforms already enacted. The budgetary position in 2007, as estimated in the programme, albeit improved compared with last year, still constitutes a risk to sustainable public finances even before the long-term budgetary impact of an ageing population is considered. Moreover, the current level of gross debt is above the Treaty reference value. Progress with budgetary consolidation would contribute to reducing risks to the sustainability of public finances.

(9) The stability programme is consistent to some extent with the October 2007 implementation report of the national reform programme. In particular, both programmes present the government's wide ranging reform agenda, including the labour market reform, the reorganisation of the public administration, and the improvement of the competitive framework of companies. So far, the government has notably adopted a university reform, additional incentives to corporate research as well as the elimination of taxation on overtime, the reform of the retail sector (*loi Galland*) and has agreed on reforming the special pension regimes and on the merger of the ANPE (the unemployment agency) and Unedic (the unemployment benefit fund). Moreover, reforms under way cover a wide range of areas such as further reforming the pension system and the labour market including through a review of the labour contracts, as well as the modernisation of the French economy taking into account the proposals of the "Attali Commission". The implementation report covers a broader range of issues while the stability programme contains more information on recent developments. Both programmes do not provide systematic information on the direct budgetary costs (or savings) associated with the main reforms envisaged, although they are reported to underpin the budgetary consolidation of the stability programme

(10) The budgetary strategy in the programme is partly consistent with the country-specific broad economic policy guidelines and the guidelines for euro area Member States in the area of budgetary policies issued in the context of the Lisbon strategy. In particular, France is unlikely to achieve its medium-term budgetary objective by 2010 and the size of the government debt ratio remains unsatisfactorily high.

(11) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme has some gaps in the required and optional data[4].

The overall conclusion is that the pace of budgetary consolidation and debt reduction has slowed down in 2007 and is planned to be significantly less ambitious in the coming years than planned in the previous update of the stability programme, especially as concerns 2008. The envisaged consolidation is back-loaded and the achievement of the MTO through an expenditure-based adjustment is postponed from 2010 to 2012 under the more plausible of the two macroeconomic scenarios presented by the French authorities. Moreover, even this adjustment path is subject to important risks. While tax cuts adopted in summer 2007 are already impacting on public finances, the authorities have also adopted measures to curb public expenditure in 2008, notably in social security, broadened the coverage of expenditure rules for the state, and have embarked on structural reforms. Structural reforms will be crucial to increase potential growth, improve competitiveness, and sustain the budgetary consolidation process. However, measures underlying the ambitious planned reduction in the expenditure ratio over the programme period have still to be further specified and implemented. The programme objectives are also subject to risks stemming from the macroeconomic assumptions, which are favourable and the assumptions on the impact of structural reforms on growth. In view of the debt and deficit levels and the projected increase in age-related expenditure, France appears to be at medium risk with regard to the sustainability of public finances.

---

[4] In particular, assumptions on short- and long-term interest rates are not provided. Moreover, figures for 2006 are not provided in the programme, except for the table on cyclical developments.

In view of the above assessment France is invited to:

(i) strengthen the pace of budgetary consolidation and debt reduction, including through a rigorous implementation of the 2008 budget, so as to ensure that the safety margin against breaching the 3% deficit threshold is attained more rapidly and - cyclical conditions permitting - aim to reach the MTO by 2010, in order to decisively contribute to the improvement of the long-term sustainability of public finances.

(ii) effectively enforce existing expenditure rules and take further steps in order to guarantee the respect of the ambitious multi-annual expenditure reduction targets of the general government by all sub-sectors, thus leading to a reduction in the expenditure to GDP ratio.

(iii) continue and accelerate structural reforms, so as to increase potential growth and curb public expenditure.

The Council also notes that such actions would be consistent with the April 2007 Eurogroup orientations for fiscal policies.

Comparison of key macroeconomic and budgetary projections

		2006 [4]	2007	2008	2009	2010	2011	2012
Real GDP (% change)	**SP Nov 2007**	**2.0**	**2 - 2.5**	**2 - 2.5**	**2.5**	**2.5**	**2.5**	**2.5**
	COM Nov 2007	2.0	1.9	2.0	1.8	n.a.	n.a.	n.a.
	SP Dec 2006	*2.0-2.5*	*2.0-2.5*	*2¼*	*2¼*	*2¼*	*n.a.*	*n.a.*
HICP inflation (%)	**SP Nov 2007**	**1.9**	**1.4**	**1.7**	**1.6**	**1.6**	**1.6**	**1.6**
	COM Nov 2007	1.9	1.5	1.7	1.6	n.a.	n.a.	n.a.
	SP Dec 2006	*2.0*	*1.9*	*1¾*	*1¾*	*1¾*	*n.a.*	*n.a.*
Output gap[1] (% of potential GDP)	**SP Nov 2007**	**-0.5**	**-0.8**	**-0.8**	**-0.6**	**-0.5**	**-0.3**	**0.0**
	COM Nov 2007[2]	-0.2	-0.3	-0.3	-0.6	n.a.	n.a.	n.a.
	SP Dec 2006	*-0.6*	*-0.6*	*-0.5*	*-0.4*	*-0.3*	*n.a.*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**SP Nov 2007**	**-2.1**	**-2.3**	**-2.5**	**-2.3**	**-2.2**	**-2.1**	**-2.0**
	COM Nov 2007	-2.1	-2.3	-2.2	-2.2	n.a.	n.a.	n.a.
	SP Dec 2006	*-2.0*	*-1.8*	*-1.8*	*-1.7*	*-1.6*	*n.a.*	*n.a.*
General government balance (% of GDP)	**SP Nov 2007**	**-2.5**	**-2.4**	**-2.3**	**-1.7**	**-1.2**	**-0.6**	**0.0**
	COM Nov 2007	-2.5	-2.6	-2.6	-2.7	n.a.	n.a.	n.a.
	SP Dec 2006	*-2.7*	*-2.5*	*-1.8*	*-0.9*	*0.0*	*n.a.*	*n.a.*
Primary balance (% of GDP)	**SP Nov 2007**	**0.0**	**0.2**	**0.5**	**0.9**	**1.4**	**2**	**2.5**
	COM Nov 2007	0.0	0.0	0.0	-0.1	n.a.	n.a.	n.a.
	SP Dec 2006	*-0.1*	*0.1*	*0.7*	*1.7*	*2.5*	*n.a.*	*n.a.*
Cyclically-adjusted balance[1] (% of GDP)	**SP Nov 2007**	**-2.3**	**-2.0**	**-1.9**	**-1.4**	**-1.0**	**-0.4**	**0.0**
	COM Nov 2007	-2.5	-2.4	-2.5	-2.4	n.a.	n.a.	n.a.
	SP Dec 2006	*-2.4*	*-2.2*	*-1.6*	*-0.7*	*0.2*	*n.a.*	*n.a.*
Structural balance[3] (% of GDP)	**SP Nov 2007**	**-2.5**	**-2.0**	**-1.9**	**-1.4**	**-1.0**	**-0.4**	**0.0**
	COM Nov 2007	-2.8	-2.5	-2.6	-2.4	n.a.	n.a.	n.a.
	SP Dec 2006	*-2.5*	*-2.2*	*-1.6*	*-0.7*	*0.2*	*n.a.*	*n.a.*
Government gross debt (% of GDP)	**SP Nov 2007**	**64.2**	**64.2**	**64**	**63.2**	**61.9**	**60.2**	**57.9**
	COM Nov 2007	64.2	64.3	64.1	64.1	n.a.	n.a.	n.a.
	SP Dec 2006	*64.6*	*63.6*	*62.6*	*60.7*	*58.0*	*n.a.*	*n.a.*

Notes:

[1]Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2]Based on estimated potential growth of 2.0%, 2.1%, 2.0% and 2.1% respectively in the period 2006-2009.

[3]Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.1% of GDP in 2006 and 0 for the rest of the period covered (2007-2012) according to the most recent programme. According to the Commission services' autumn forecast they are 0.3% of GDP in 2006, 0.05% of GDP in 2007 and 0.1% of GDP in 2008.

[4]As the most recent programme does not provide information for 2006 (except for cyclical developments), figures were taken from the Commission services' autumn 2007 forecast.

Source:

Stability programme (SP); Commission services' autumn 2007 economic forecasts (COM); Commission services' calculations.