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(Resolutions, recommendations and opinions)

OPINIONS

COUNCIL

COUNCIL OPINION

of 10 March 2009

on the updated stability programme of France, 2008-2012

(2009/C 64/01)

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 10 March 2009, the Council examined the updated stability programme of France, which covers the period 2008 to 2012.

(2) In 2008, the global financial crisis amplified the deceleration of growth via lower consumer and business confidence and tighter credit conditions. Following a collapse of industrial production in the fourth quarter of 2008, annual GDP is expected to contract sharply in 2009. The main policy challenges in the downturn are to stabilise the financial sector, restore consumer and business confidence, and support investment. The downturn will have a significant impact on the public finances as the deficit has exceeded 3 % of GDP in 2008 as indicated by the French Minister of the Economy, Industry and Employment, in a letter addressed to the Commissioner of Economic and Financial Affairs on 6 February 2009, and is expected to rise above 5 % of GDP in 2009 according to the Commission services' January 2009 interim forecast. The latter also reflects the 0,8 % of GDP impact on the budget balance of the recovery plan adopted in December, the main measures of which are a frontloading of public investment and providing financial support to enterprises. The Government has implemented a number of structural reforms, which are expected to have a positive impact on the potential growth of the economy.

(3) The macro-economic scenario underlying the programme envisages that GDP growth will be positive throughout the programme period. After slowing to around 1 % in 2008 it is expected to further decelerate to a range of 0,2-0,5 % in 2009, before increasing to about 2 % in 2010 and further

[1] OJ L 209, 2.8.1997, 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

to 2,5 % for the rest of the programme period. Assessed against currently available information ([1]), this scenario appears to be based on markedly favourable growth assumptions. This assessment takes into account the severe contraction of GDP in the fourth quarter of 2008 and the gloomy economic prospects based on the low level of confidence indicators and the projected sharp contraction of investment and trade, but also the impact on growth of the recovery plan and the law on the modernisation of the economy ([2]). In the light of the latest developments in oil prices and the intensity of the global downturn, the programme's projections for inflation appear to be on the high side for 2009, but can be considered realistic thereafter. On 6 February, the French authorities informed the Commission that the macro-economic and public finance forecasts would be revised.

(4) For 2008, the general government deficit is estimated at 3,2 % of GDP in the Commission services' interim forecast, which is 0,3 % worse than the figure contained in the programme but confirmed by the above-mentioned letter on 6 February ([3]). The 0,9 % of GDP difference with the target from the previous update (2,3 % of GDP) can be largely explained by (i) a worse-than-anticipated outcome in 2007 (0,3 % of GDP); (ii) markedly weaker real GDP growth in 2008 than expected in the previous update lowering tax revenue compared to plan (by 0,3 % of GDP); and (iii) higher interest payments reflecting the impact of higher inflation in 2008 on the debt-servicing costs of inflation-linked bonds (0,2 % of GDP).

(5) The update contains a deficit target for 2009 of 3,9 % of GDP, against a projection of 5.4 % in the Commission services' interim forecast. The deterioration in the 2009 deficit reflects the working of the automatic stabilisers in response to the economic downturn but also the impact of the December 2008 fiscal stimulus package amounting to 0,8 % of GDP. More recently, the Government announced a higher deficit target of 4,4 % of GDP ([4]). The structural deficit (i.e. the cyclically-adjusted balance net of one-off and other temporary measures), according to the information provided in the updated stability programme and recalculated by the Commission services, is projected to attain 3 % of GDP in 2009, compared to 2,5 % in 2008. This fiscal stance can be considered as expansionary and can be fully explained by the fiscal impulse associated with the stimulus package.

(6) France's goal of the budgetary strategy over the medium term outlined in the programme is to reach the medium-term objective (MTO) of a balanced budget position in structural terms in 2012. According to the projections of the programme revised by the above-mentioned letter on 6 February, the general government deficit is expected to peak in 2009 at 4,4 % of GDP (from 3,9 % of GDP) and then to fall again to 3,1 % of GDP in 2010 (from 2,7 % of GDP) as the budgetary impact of the recovery plan would be phased out. This compares with the Commission services' interim forecast, which projects the general government deficit to increase to 5,4 % of GDP in 2009 and to then reach 5,0 % of GDP in 2010. According to the projections revised by the above-mentioned letter, the deficit is projected to further improve after 2010 to reach 1,5 % of GDP in 2012. The primary balance follows a similar pattern. The structural deficit is expected to bottom out at 3 % of GDP in 2009 and to improve by around 1 % of GDP in 2010 and by 0,5 % of GDP per annum in the outer years. Apart from the phasing-out of the recovery plan, this is projected to be achieved through a specified expenditure restraint. The updated programme expects the debt-to-GDP ratio to rise to 69,1 % in 2009 and to broadly stabilise at 69,4 % in 2010 before it slightly decreases in the two following years. Apart from the budgetary stance, this includes the impact of bank recapitalisations and the participation in the Strategic Investment Fund ([5]), amounting to around 0,75 % of GDP, but excludes potential contingent liabilities stemming from the guarantee scheme. According to the Commission services' interim forecast, the debt ratio would reach 72,4 % of GDP in 2009 and 76 % of GDP in 2010, the difference with the updated stability programme being explained by the divergent growth and general government deficit figures.

([1]) The assessment notably takes into account the Commission services' January 2009 forecast, but also other information that has become available since then.

([2]) On this basis, the Commission services' interim forecast projects GDP to contract by 1,8 % in 2009; GDP growth is then expected to recover to 0,4 % in 2010 as financial sector conditions and confidence improve and global demand recovers.

([3]) In view of the reported breach of the Treaty reference value, as indicated in the letter sent by the French Minister of the Economy, Industry and Employment, the Commission prepared on 18 February 2009 a report under Article 104(3) of the Treaty.

([4]) In the letter sent on 6 February, the French Minister of the Economy, Industry and Employment estimated the general government deficit at 3,1 % of GDP in 2010.

([5]) Strategic investment funds will be used to participate in the capital of firms.

(7) The budgetary outcomes are subject to downside risks throughout the programme period. First, they do not yet reflect the worse outcome in 2008 (by 0,3 % of GDP) recently confirmed by the above-mentioned letter. This outcome also reflects the fact that there has been a lack of fiscal consolidation in good/neutral economic times ([1]) and it explains part of the upward revision of the 2009 deficit target to 4,4 % of GDP (which also takes into account a downward revision of corporate taxes). More importantly, the macro-economic outlook of the programme does not include the recession now expected for 2009, implying substantial budgetary risks, even to the latest deficit target announced by the Government. Moreover, on top of the impact of automatic stabilisers, there are risks of some expenditure overruns in healthcare spending ([2]). Finally, given the past track record of local authorities, there is a risk that the planned expenditure targets will not be met. Risks to the debt scenario are also on the upside, reflecting the risks to the budget balance as well as the possible effects of financial sector stabilisation measures.

(8) 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, among which the reform of the so-called *régimes spéciaux* (special pension regimes), aimed at aligning the required contribution period with the rules of other regimes. The budgetary position in 2008, as estimated in the programme, which is worse than the starting position of the previous programme, compounds the budgetary impact of population ageing on the sustainability gap. If the 2009 budgetary position of the Commission services' interim forecast was taken as the starting point, the sustainability gap would worsen. The current level of gross debt is above the Treaty reference value. The above-mentioned schemes for the financial sector stability put in place by France, could have an impact on the long-term sustainability of public finances, if the costs of the government support would not be fully recouped in the future. Ensuring higher primary surpluses over the medium term, as already foreseen in the programme, would contribute to reducing the medium risks to the sustainability of public finances.

(9) France's past track record shows that general government expenditure overruns have not been exceptional over the past decade, indicating weaknesses in the existing budgetary rules. The reform of the Constitution adopted on 23 July 2008 introduced a general objective of balanced budgets for general government ([3]). However, the non-binding character of the balanced budget objective raises the question whether it can be effectively controlled. The reform also introduces a pluri-annual budget, adopted by Parliament, starting in 2009, for the period 2009-2012, i.e. the same length of time as in the stability programme. This reform should contribute to better management of public finances and help budgetary discipline.

Moreover, following the launch of the General Review of Public Policies in mid-2007, a number of measures were taken to increase efficiency of public spending, including a reduction of civil servants. A new debt rule applied to the social security subsector has entered into force in 2008 ([4]).

(10) In response to the financial crisis, the French Government undertook a number of measures addressed to ensure the stability of the financial sector. In order to dampen its consequences on the credit-providing capacity of French banks, the Government decided ([5]) to purchase subordinated bank debt up to EUR 40 billion without acquiring voting rights. In exchange, banks have committed to increase loans to the economy in order to guarantee a degree of financing in line with the needs of

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([1]) The assessment of whether the economy is experiencing good or bad economic times relies on the analysis of the output gap, positive in 2007 and in 2008 (which could indicate good economic times), but draws on an overall economic assessment, such as employment, private consumption, investment or external imbalances, which can modify the initial conclusions. On this basis, France would have been in good economic times in 2007 and in neutral times in 2008. Still, the structural balance deteriorated by 0,3 percentage points and 0,2 percentage points of GDP in 2007 and 2008, respectively, according to Commission services' interim forecast (see technical assessment).

([2]) When growth in healthcare expenditures in nominal terms exceeds by more than 0,75 point the objective (ONDAM) set by the Social Security Financing Act for 2009, an alert procedure is activated.

([3]) Article 34, 4th paragraph of the newly adopted Constitution: '*Des lois de programmation déterminent les objectifs de l'action de l'État. Les orientations pluriannuelles des finances publiques sont définies par des lois de programmation. Elles s'inscrivent dans l'objectif d'équilibre des comptes des administrations publiques*'.

([4]) The repayment of social debt is handled by a special fund ('*Caisse d'Amortissement de la Dette Sociale*'). A new law (adopted in 2005) finally came into force in 2008, stating that each new debt transfer to the fund has to be compensated by new revenue so as not to increase the CADES lifetime.

([5]) Of which the government has so far submitted EUR 21 billion to the Commission, which has authorised it; EUR 10,5 billion have been underwritten.

economic agents. Furthermore, a EUR 320 billion [1] line has been authorised by law to guarantee bank debts. This guarantee scheme is aimed at improving the access to finance of banks, in the context of the severe pressure the market for interbank loans has had to face since the beginning of the financial crisis. Banks will pay a premium for the Government guarantee for their loans and will provide collateral.

(11) In response to the economic crisis, the French Government unveiled on 4 December a recovery plan, which can be described as a balanced mix of revenue and expenditure instruments and is in line with the EERP. Its measures encompass public investment (mainly to public enterprises, infrastructures, research and defence), labour market measures (such as a total exemption from social security contributions by employers of small companies on new hirings), support to firms (such as sectoral aids for the housing and automobile industry as well as an acceleration of Government payments to enterprises, especially SMEs) and support to household purchasing power (mainly EUR 200 grants in April 2009 to lower-income households). The package can be considered as targeted and timely. The announced measures are temporary, therefore reversible, with no costs for public finances beyond 2010. The Government is also implementing a number of structural reforms, which are expected to have a positive impact on the potential growth of the economy, and, therefore, on public finances in the long run. As far as the goods and services markets are concerned, the above-mentioned law on the modernisation of the economy aims at raising potential growth, notably by promoting individual entrepreneurship and reducing existing barriers to competition, including in the retail sector. Also on the labour market front also new laws have been adopted, notably as regards flexicurity. The law on the modernisation of the labour market, which was adopted in June 2008 and represents the transposition of the social partners' first inter-professional agreement, aims to develop both more secure and more flexible contracts. An important reform of social dialogue procedures has also been brought in to facilitate majority agreements. These measures are related to the medium-term reform agenda and the country-specific recommendations proposed by the Commission on 28 January 2009 under the Lisbon Strategy for Growth and Jobs.

(12) Following a deterioration of public finances in 2007 and 2008 when economic conditions were more favourable, the fiscal stance is expansionary in 2009 (reflecting the response of the French Government to the EERP) when times are bad. Thereafter, public finance will be consolidated according to the programme; however, taking into account the significant risks to the budgetary targets, which imply a deficit well above 3 % in 2009 and 2010, the MTO of a balanced budget in structural terms will not be achieved by 2012.

In this context, France can reduce the risk of expenditure overruns through the implementation and further improvements of its public finance framework, in particular regarding expenditure rules. Finally, taking into account the risks to the debt projections mentioned above, the debt ratio, reflecting the expansionary stance in 2009, will be high and decisive action will be needed in the coming years to reverse this trend.

(13) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme provides all required and most of the optional data [2].

The overall conclusion is that the insufficient progress when economic conditions were more favourable and the deterioration of the economic situation, especially in the last quarter of 2008, led to a deficit slightly above 3 % of GDP in 2008. In order to counteract the strong economic downturn the government adopted a recovery plan in line with the EERP which is well targeted, temporary and timely. This temporary fiscal expansion, coupled with the strong economic downturn will lead to a further widening of the government deficit in 2009. Thereafter, the programme foresees a consolidation of public finances through a restrictive stance, especially in 2010. Risks are linked, in particular, to the markedly favourable macro-economic assumptions in the programme and the current uncertain environment, but they also reflect the non-binding character of expenditure rules. Further consolidation efforts may therefore become necessary in the outer years as the economy strengthens. The structural reforms already adopted are expected to contribute to increasing potential growth, improving competitiveness and sustaining the consolidation process.

[1] Of which the government has so far submitted EUR 265 billion to the Commission, which has authorised it.

[2] Assumptions on short and long-term interest rates are not provided.

In view of the above assessment, France is invited to:

(i) implement the fiscal measures in 2009 as planned, including stimulus measures in line with the EERP and within the framework of the SGP while maintaining the objective of avoiding a further deterioration of public finances;

(ii) in light of the forecast pick-up of economic activity, make a consolidation effort in 2010 and strengthen the pace of adjustment thereafter in order to ensure that the deficit is brought rapidly below the reference value, thereby setting the debt-to-GDP ratio on a declining path;

(iii) effectively enforce existing expenditure rules and take further steps in order to guarantee the respect of the multi-annual expenditure reduction targets of the general government by all sub-sectors and continue to implement measures in the context of the General Review of Public Policies. Implement the structural reform programme, in particular as regards the sustainability of the pension system.

Comparison of key macro-economic and budgetary projections

		2007	2008	2009	2010	2011	2012
Real GDP (% change)	SP Dec 2008	2,2	1,0	0,2– 0,5	2,0	2,5	2,5
	COM Jan 2009	2,2	0,7	− 1,8	0,4	n.a.	n.a.
	SP Nov 2007	*2– 2,5*	*2– 2,5*	*2,5*	*2,5*	*2,5*	*2,5*
HICP inflation (%)	SP Dec 2008	1,6	3,3	1,5	1¾	1¾	1¾
	COM Jan 2009	1,6	3,2	0,8	1,5	n.a.	n.a.
	SP Nov 2007	*1,4*	*1,7*	*1,6*	*1,6*	*1,6*	*1,6*
Output gap (1) (% of potential GDP)	SP Dec 2008	0,4	− 0,6	− 1,8	− 1,6	− 1.1	− 0.4
	COM Jan 2009 (2)	1,8	1,0	− 1,7	− 2,3	n.a.	n.a.
	SP Nov 2007	*− 0,8*	*− 0,8*	*− 0,6*	*− 0,5*	*− 0,3*	*0,0*
Net lending/borrowing *vis-à-vis* the rest of the world (% of GDP)	SP Dec 2008	− 2,8	− 3,4	− 2,6	− 2,5	− 2,4	− 2,4
	COM Jan 2009	− 2,8	− 3,8	− 4,0	− 3,9	n.a.	n.a.
	SP Nov 2007	*− 2,3*	*− 2,5*	*− 2,3*	*− 2,2*	*− 2,1*	*− 2,0*
General government revenue (% of GDP)	SP Dec 2008	49,7	49,8	49,6	50,0	50,0	50,2
	COM Jan 2009	49,7	49,6	49,4	49,9	n.a.	n.a.
	SP Nov 2007	*50,7*	*50,4*	*50,1*	*50,0*	*50,0*	*50,0*
General government expenditure (% of GDP)	SP Dec 2008	52,4	52,7	53,5	52,7	52,0	51,3
	COM Jan 2009	52,4	52,7	54,9	54,9	n.a.	n.a.
	SP Nov 2007	*53,2*	*52,6*	*51,9*	*51,2*	*50,6*	*49,9*
General government balance (% of GDP)	SP Dec 2008	− 2,7	− 2,9	− 3,9	− 2,7	− 1,9	− 1,1
	p.m. MoF	− 2,7	− 3,2	− 4,4	− 3,1	− 2,3	− 1,5
	COM Jan 2009	− 2,7	− 3,2	− 5,4	− 5,0	n.a.	n.a.
	SP Nov 2007	*− 2,4*	*− 2,3*	*− 1,7*	*− 1,2*	*− 0,6*	*0,0*

		2007	2008	2009	2010	2011	2012
Primary balance (% of GDP)	SP Dec 2008	0,1	0,0	− 1,1	0,1	0,9	1,7
	COM Jan 2009	0,1	− 0,3	− 2,6	− 2,1	n.a.	n.a.
	SP Nov 2007	*0,2*	*0,5*	*0,9*	*1,4*	*2,0*	*2,5*
Cyclically-adjusted balance (¹) (% of GDP)	SP Dec 2008	− 2,9	− 2,6	− 3,0	− 1,9	− 1,4	− 0,9
	COM Jan 2009	− 3,5	− 3,7	− 4,6	− 3,8	n.a.	n.a.
	SP Nov 2007	*− 2,0*	*− 1,9*	*− 1,4*	*− 1,0*	*− 0,4*	*0,0*
Structural balance (³) (% of GDP)	SP Dec 2008	− 2,9	− 2,6	− 3,0	− 1,9	− 1,4	− 0,9
	COM Jan 2009	− 3,6	− 3,8	− 4,6	− 3,8	n.a.	n.a.
	SP Nov 2007	*− 2,0*	*− 1,9*	*− 1,4*	*− 1,0*	*− 0,4*	*0,0*
Government gross debt (% of GDP)	SP Dec 2008	63,9	66,7	69,1	69,4	68,5	66,8
	COM Jan 2009	63,9	67,1	72,4	76,0	n.a.	n.a.
	SP Nov 2007	*64,2*	*64,0*	*63,2*	*61,9*	*60,2*	*57,9*

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 1,6 %, 1,4 %, 0,9 % and 1,0 % respectively in the period 2007-2010.

(³) Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0 all over the period covered (2007-2012) according to the most recent programme and are 0,1 % of GDP in 2007, 0,1 % in 2008, all deficit-reducing and 0 in 2009 and 2010 according to the Commission services' January 2009 interim forecast.

Source:

Stability programme (SP); Commission services' January 2009 Interim forecasts (COM); Commission services' calculations.