

Overview

This stability programme sets out the major policy lines of France's public finances strategy for the years 2015-2018. It specifies the economic framework chosen by the Government and sets the main goals of its work: the recovery of the French economy and continuing to improve the health of the public accounts.

The fiscal outcome of 2014 was slightly better than expected, despite a difficult economic context. That helped reduce the deficit to 4.0% of GDP. Tax credits excluded, public spending grew by 0.9% in value terms, which is the slowest rate of increase in recent decades. And, for the first time since 2009, taxes and fiscal contributions were stable. These results show France's ability to improve the health of its public finances through greater control of spending, without increasing taxes and fiscal contributions.

This momentum in the restoration of the public accounts will continue at a pace that will consolidate the economic recovery and fund the Government's priorities.

The economic recovery is consolidating now, in early 2015. Improved purchasing power of households, linked to low inflation and reduced income tax, is leading to revitalized consumption. The policies implemented to support businesses are improving their margins. The Competitiveness and Employment Tax Credit (CICE), worth €10 billion in 2014, is one example; the first component of the Responsibility and Solidarity Pact is another. Together they total more than an additional €12 billion or so in 2015. The improved competitiveness of businesses, also strengthened by the weakened euro, is combined with the recovery of France's main trading partners, creating a favourable environment for exports to restart. Moreover, the recovery of demand, the very clear increase in business margins, and the very accommodating financial conditions created by the action of the European Central Bank (ECB) should help investment to resume gradually. The latest measures adopted by France in early April are set to amplify that trend.

In order to ensure that the goals the Government has set itself are met, the selected macroeconomic projections are deliberately prudent. Expected growth is thus 1.0% for 2015, and then 1.5% for 2016 and 2017. That hypothesis clearly does not exclude a recovery that could be even more powerful, particularly thanks to the measures France has taken and the reforms undertaken.

For 2015, the general government deficit target has been lowered compared to the initial finance act, to 3.8%, taking into account the effects of the better performance in 2014. The expected pace of improvement has not been adjusted. Achieving it requires finding additional resources of around €4 billion because of the very clear fall of inflation, which reduces the yield of the savings measures already adopted. In addition to the sustained fall in the cost of the interest on government debt (€1.2 billion only due to the fall in interest rates) and a greater yield than expected from combating tax evasion – linked to improved conditions for the processing of corrective declarations from taxpayers who have undeclared accounts abroad – and increased dividends paid by State-owned companies (worth a total of €600 million), it has been decided to slow spending by the government and its operators and by the health and social protection sectors by €2.2 billion.

Beyond 2015, deficit projections are also improved, as it is expected to diminish to 3.3% in 2016 and fall below 3% in 2017, to 2.7%. In 2016, meeting that target will require additional measures to slow the spending of public administrations, saving a total of €5 billion so as to compensate for the effects of low inflation. Those measures will be enshrined in finance acts for 2016, from autumn this year.

The targets are demanding but realistic. They involve additional measures to keep to the planned path of reducing expenditure (excluding interest costs) compared to GDP. These measures will not lead to an

acceleration of efforts, but rather to maintaining the planned pace, taking into account macroeconomic developments, including sluggish inflation which, in the absence of measures to compensate, would mean reducing the real effort made by public administrations. Excluding tax credits and interest costs – so within the initial scope of the savings plan announced in early 2014 – the scale of public spending compared to GDP thus falls to the pace planned for in the spending bill in 2015 and 2016 (0.5 points in 2015, then 0.7 points in 2016).

The Council of the European Union has given France until 2017 to bring its general government deficit below 3%, also recommending a sustained cut in its structural deficit (0.5 points in 2015, then 0.8 points in 2016 and 0.9 points in 2017). Since the drafting of that recommendation, new information has become available. Firstly, the 2014 deficit is, in the end, of 4.0%, 0.3 points below forecasts. Secondly, favourable economic conditions have improved growth prospects across Europe and particularly in France, although the recovery still needs consolidation.

In this new context, France has set itself a path that will enable it to keep to the recommended nominal deficit target with room for manoeuvre, supported by a structural adjustment of 0.5 points per year so as to avoid damaging the recovery. This path has three advantages compared to that indicated in the recommendation: Every year, the nominal deficit will be below that recommended; although prudent, growth will be much stronger; and the pattern of debt will be better controlled in the short term.

Implementation of France's European fiscal commitments

In its recommendation of 10 March 2015, the Council of the European Union gave France until 2017 to correct its excessive general government deficit. The recommended nominal deficit path to achieve that goal is as follows: 4.0% in 2015; 3.4% in 2016; 2.8% in 2017.

THE NEW COUNCIL RECOMMENDATION

In early March 2015, France's 2014 general government deficit was estimated at 4.3% by the European Commission, and growth prospects up to 2017 were very moderate. Indeed, the Commission's recommendations are based on its winter economic forecasts, published at the beginning of February when the international organizations and private institutes had not yet raised their growth forecasts for France. In that context, to meet the nominal target of 2.8% in 2017, the recommendation of 10 March 2015 calls for:

- ▶ a structural adjustment of 0.5% in 2015, obtained through additional savings of 0.2 GDP points (i.e. around €4 billion);
- ▶ a structural adjustment of 0.8% in 2016, then of 0.9% in 2017.

Based on the assessments of the Commission's departments, effective growth would be expected to stay around 0.8% annually for the 2015-2017 period, given the fiscal multipliers inherent to the recommended pace of consolidation. Such a growth and deficit dynamic would mechanically lead to a significant growth of debt, reaching nearly 100% of GDP by 2017. Moreover, with such weak growth, the unemployment rate would continue to increase into 2017.

| | 2014 | 2015 | 2016 | 2017 |
|----------------------------|------|------|------|------|
| Growth | 0.4 | 0.8 | 0.7 | 0.8 |
| General government deficit | -4.3 | -4.0 | -3.4 | -2.8 |
| Structural adjustment | 0.4 | 0.5 | 0.8 | 0.9 |
| Public debt* | 95.3 | 97.2 | 98.8 | 99.3 |

* French Ministry of Finance and Public Accounts (MFCP) calculations based on working document SWD(2015) 19 final, underpinning the new recommendation of March 2015 (page 17)

THE FISCAL PATH PRESENTED HERE PROVIDES FOR A LOWER GENERAL GOVERNMENT DEFICIT THAN IN THE RECOMMENDATION EVERY YEAR

The general government deficit path presented in this stability programme is each year lower than the path indicated in the recommendation, at: 3.8% in 2015; 3.3% in 2016; and 2.7% in 2017.

Since the recommendation was drafted, new information has become available. Firstly, the 2014 deficit, which was published in late March, actually totals 4.0%, which is 0.3 points lower than forecasted. Secondly, the favourable economic environment has improved growth prospects across Europe, and especially in France. In this new context, it is therefore possible to meet, and even go beyond the nominal deficit targets in the recommendation, with a different balance in 2016 and 2017 between structural adjustment and cyclical adjustments.

As far as 2015 is concerned, the path proposed by France in this stability programme is very much identical to that of the recommendation: a structural adjustment of 0.5% through €4 billion of savings (specified further in the document).

Concerning 2016 and 2017, a structural adjustment of 0.5%, along with prudent growth hypotheses compared to the current consensus of forecasters, will enable France to meet the recommended nominal deficit targets.

| | 2014 | 2015 | 2016 | 2017 |
|----------------------------|------|------|------|------|
| Growth | 0.4 | 1.0 | 1.5 | 1.5 |
| General government deficit | -4.0 | -3.8 | -3.3 | -2.7 |
| Structural adjustment | 0.4 | 0.5 | 0.5 | 0.5 |
| Public debt | 95.0 | 96.3 | 97.0 | 96.9 |

This path has three advantages compared to that indicated in the recommendation:

- ▶ the nominal deficit will each year be lower than that provided for by the recommendation to France;
- ▶ growth will be considerably stronger and therefore compatible with a fall in unemployment. The structural effort made every year will be better adapted to the eurozone's macroeconomic context, which remains marked by a slow recovery and a rate of inflation far below the mandate of the ECB. At the same time, it will of course comply with the minimum level set as a benchmark in the Stability and Growth Pact for the Member States placed in the corrective arm;
- ▶ the dynamics of the debt will be better controlled in the short term; it will even begin to fall in 2017, whereas in the recommendation of 10 March, it continues to grow, including in 2017.

As the path is based on a prudent underlying macroeconomic framework, upside risks are more likely than downside risks. In addition, the path offers a margin of safety with regard to the nominal deficit targets, which will help absorb any unpleasant surprises on the deficit during implementation. However, if that margin of safety were to prove insufficient, such as if inflation was slow to restart, the Government would be prepared to take the additional steps required to ensure the nominal targets are met.