



Liberté • Égalité • Fraternité
RÉPUBLIQUE FRANÇAISE
LE GOUVERNEMENT

STABILITY PROGRAMME

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Contents

1. Overview	3
2. Keeping France's fiscal commitments to Europe	5
The Council's new recommendation	5
The chosen adjustment path	6
3. Macroeconomic outlook	7
4. Fiscal strategy	14
Overall strategy and medium-term objective	14
Outturn 2014	16
Adjustment path under the no-policy-change scenario and trend path	17
Structural balance	19
The government balance by sub-sectors	24
Government expenditure	25
General government expenditure	25
Central government expenditure.....	28
Expenditure of other central government bodies	30
Social security funds' expenditure.....	31
Local government expenditure.....	32
Government revenue	34
General government revenue	34
Central government revenue	36
Social security funds' revenue	37
Local government revenue	37
General government debt and stock-flow adjustment	38
5. Compliance with the Stability and Growth Pact	43
Excessive deficit procedure	43
Convergence towards the medium-term budgetary objective	45
6. Sensitivity analysis and comparison with previous programme	46
Sensitivity to external assumptions	46
Comparison with the previous programme	50
Comparison with the European Commission's public finance forecasts	51
7. Quality of public finances	53

Quality of government expenditure.....	53
Expenditure review.....	53
Streamlining healthcare expenditure	55
Streamlining local government expenditure.....	56
Agencies' expenditure.....	57
Quality of government revenue	58
8. Sustainability of public finances	64
Sustainability of general government debt	64
Sustainability indicator (S2)	65
Contingent liabilities.....	66
Ongoing structural reforms.....	68
9. Institutional aspects and fiscal governance.....	70
Fully operational fiscal governance	70
Statistical governance.....	71
Status of this Stability Programme under internal procedures (submission to Parliament and the HCFP)	73
10. Appendix.....	74
Statistical tables	74
In-year progress report on correction of the excess deficit and compliance with the recommendation.....	84

1. OVERVIEW

This Stability Programme outlines France's fiscal strategy for the period 2015–2018. It presents the macroeconomic scenario adopted by the government and sets out its main objectives – getting the French economy back on track and continuing its fiscal consolidation efforts.

The 2014 budget outturn was better than expected, despite a difficult economic context, and the deficit was brought down to 4.0% of GDP. Government spending, excluding tax credits, rose 0.9% in nominal terms – the lowest increase in the past few decades. In addition, for the first time since 2009, aggregate taxes and social security contributions remained stable. These figures prove that France can achieve fiscal consolidation through tighter expenditure control without increasing the tax burden.

France will carry these consolidation efforts forward, at a pace compatible with sustained economic recovery while financing government priorities.

The first months of 2015 have witnessed a confirmation of economic recovery. The rise in household purchasing power, due to weak inflation and income tax cuts, has given a strong boost to consumption. Measures were introduced to restore businesses' margins. These include the Competitiveness and Employment Tax Credit (CICE), which provided more than €10bn of support in 2014, and the first phase of the Responsibility and Solidarity Pact. Together, these schemes will account for more than €12bn in additional savings for businesses in 2015. Improved competitiveness of French businesses, underpinned by the depreciation of the euro, combined with better economic conditions among France's main trading partners, have created a more propitious environment for getting exports back on track. Moreover, an upswing in demand, the marked improvement in businesses' margins and very accommodative financing conditions as a result of ECB policy are all expected to help investment gradually recover. Measures adopted in early April should reinforce this trend.

To ensure the government will meet the targets it has set for itself, our macroeconomic assumptions are deliberately conservative. GDP growth is forecast at 1% for 2015 and 1.5% for both 2016 and 2017. The recovery may of course be more robust, particularly thanks to the initiatives and reforms underway.

As a result of the better-than-expected 2014 budget outturn, the general government deficit target for 2015 is now 3.8%, lower than that set out in the Initial Budget Act. The pace of our consolidation efforts remains unchanged. Given the sharp drop in inflation that reduces the yield of the savings measures already in place, an additional consolidation effort of €4bn will be required to achieve the 3.8% target. This will be generated by a sustained drop in government interest expenditure (€1.2bn, thanks to lower interest rates alone), a €600 million increase in revenue from fraud-fighting efforts – due to enhanced resources for the Offshore Disclosure Unit (*Service de traitement des déclarations rectificatives*, STDR) – and dividends paid out by government-owned companies, as well as €2.2bn in expenditure savings sought from central government and central government agencies, and from the country's health insurance and social security funds.

Beyond 2015, the general government deficit is expected to fall to 3.3% in 2016 and 2.7% in 2017 – below the 3% reference value. To meet this target and to offset the impact of weak inflation, a total of €5bn in additional savings measures will be put in place in 2016 across all general government sub-sectors. They will be included in the various 2016 budget bills that will be drafted in the autumn.

Stability Programme for France 2015–2018

These are ambitious but realistic targets. They will involve additional measures to keep the planned reduction in the share of government expenditure in GDP (excluding interest expenditure) on track. We will accomplish this not by stepping up our efforts but rather by maintaining our agreed-on pace, taking into account changing macroeconomic conditions, particularly sluggish prices. Failing to take such additional measures would reduce the efforts made by general government in real terms. Excluding tax credits and interest charges, i.e. within the original perimeter of the savings plan unveiled in early 2014, the share of government expenditure in GDP will, in 2015 and 2016, decrease at the pace called for in the Public Finance Planning Act (*Loi de programmation des finances publiques* – LPFP) (0.5 pp. of GDP in 2015 and 0.7 pp. in 2016).

The Council of the European Union has given France until 2017 to bring the government deficit back under 3% of GDP, while also recommending a sustained reduction of its structural deficit (0.5 pp. of GDP in 2015, 0.8 pp. in 2016 and 0.9 pp. in 2017). Since the recommendation was drafted, new information has become available. First, the deficit in 2014 actually stood at 4.0%, i.e. 0.3% lower than estimated. Second, positive economic data has been released, which reflects a brighter growth outlook for Europe as a whole, and France in particular, although the rate of recovery still needs to be bolstered.

Taking these changes into account, France's chosen adjustment path will enable it to meet the recommended headline deficit targets set with some margin, while delivering an improvement in the structural balance of 0.5 pp. a year to avoid putting a drag on the recovery. Compared to the path outlined in the Council's recommendation, this one offers three advantages: the headline deficit will be lower than recommended every year; even based on conservative assumptions, growth will be significantly more robust; and the debt dynamics will be kept under tighter control in the short run.

2. KEEPING FRANCE'S FISCAL COMMITMENTS TO EUROPE

In its Recommendation of 10 March 2015, the Council of the European Union gave France until 2017 to bring an end to its excessive public deficit. To do so, the Council recommended headline deficit targets of 4.0% in 2015, 3.4% in 2016 and 2.8% in 2017.

THE COUNCIL'S NEW RECOMMENDATION

In early March 2015, the European Commission estimated that France's government deficit for 2014 would be 4.3%. Moreover, economic growth between now and 2017 was forecast to be subdued. This was based on its Winter Economic Forecast issued in early February. At that time, the international organisations and private-sector institutes had not yet raised their growth forecasts for France. Based on these elements, the Council's Recommendation of 10 March 2015 called for the following in order for France to achieve a headline deficit of 2.8% in 2017:

- ▶ An improvement in the structural balance of 0.5% of GDP in 2015 through additional measures of 0.2% of GDP (some €4bn) ;
- ▶ An improvement in the structural balance of 0.8% in 2016 and 0.9% in 2017.

Based on assessments by the Commission's services, and factoring in the fiscal multipliers inherent to the recommended rate of consolidation, GDP growth should remain around 0.8% per year for the period 2015-2017. These growth and deficit figures would automatically lead to a marked rise in government debt, which would reach nearly 100% of GDP in 2017. Moreover, such a weak rate of growth would result in a higher unemployment through 2017.

	2014	2015	2016	2017
GDP growth	0.4	0.8	0.7	0.8
Government deficit	-4.3	-4.0	-3.4	-2.8
Structural adjustment	0.4	0.5	0.8	0.9
Government debt*	95.3	97.2	98.8	99.3

* Calculations by the Ministry for Finance and Public Accounts based on Commission document SWD(2015) 19 final underlying the Council's Recommendation of March 2015 (page 17)

THE CHOSEN ADJUSTMENT PATH

The deficit reduction targets set out in this Stability Programme are, for each year under consideration, lower than those given in the Recommendation; they are expected to be 3.8% in 2015, 3.3% in 2016 and 2.7% in 2017.

Since the Recommendation was drafted, new information has become available. First, according to statistics published in late March, the deficit in 2014 actually stood at 4.0%, i.e. 0.3% lower than estimated. Second, positive economic data has been released, which reflects a brighter growth outlook for Europe as a whole, and France in particular, although the rate of recovery still needs to be bolstered. In this new environment, France will be able to meet, and even surpass, the recommended headline deficit targets with, for 2016 and 2017, a different breakdown between improvement in the structural balance and improvement in the cyclical balance.

Turning to 2015, the adjustment path proposed by France for this year's Stability Programme is exactly the same as that given in the Recommendation, i.e. a structural adjustment of 0.5% achieved by €4bn in savings (detailed below).

In 2016 and 2017, a structural adjustment of 0.5%, based on growth assumptions that are more conservative than the Consensus forecasts, will ensure that the recommended headline deficit targets are achieved.

	2014	2015	2016	2017
GDP growth	0.4	1.0	1.5	1.5
Government deficit	-4.0	-3.8	-3.3	-2.7
Structural adjustment	0.4	0.5	0.5	0.5
Government debt	95.0	96.3	97.0	96.9

Compared to the path outlined in the Council's recommendation, this path offers three advantages:

- ▶ Every year, the headline deficit will be lower than that recommended by the Council
- ▶ Growth will be significantly more robust and thus conducive to reducing unemployment. Each year, structural efforts will be more in line with the euro area's macroeconomic situation – which continues to suffer from a slow recovery and inflation that remains well under the ECB's target. They will also meet the minimum balance threshold defined as a reference in the Stability and Growth Pact for Member States subject to the corrective arm.
- ▶ Debt levels will be kept under tighter control in the short run, and will even begin to decrease in 2017, whereas in the Recommendation of 10 March, they are forecast to continue climbing, including in 2017.

Since France's path is based on conservative macroeconomic assumptions, there are more likely to be upside risks than downside ones. Moreover, the path provides room to manoeuvre with respect to the headline deficit targets, which will prove useful should the deficit turn out to be worse than expected. Nevertheless, if this margin proves to be inadequate, i.e. should inflation fail to begin to rise once again, the government would stand ready to take the additional measures required to achieve the headline targets.

3. MACROECONOMIC OUTLOOK

In France, growth is expected to pick up starting in 2015 (1.0% in 2015, 1.5% in 2016 and 2017, and 1 ¾% in 2018). Average annual inflation should be flat in 2015, then rise to 1.0% in 2016, 1.4% in 2017 and 1 ¾% in 2018.

Economic activity should be spurred by several factors that will help growth reach and exceed its potential. These include economic policy initiatives, in particular support for businesses' competitiveness and the purchasing power of lower-income households, lower oil prices, the depreciation of the euro in effective terms, stronger growth among our trading partners and fiscal consolidation efforts that, although vigorous, will be at a more relaxed pace than in the years prior to 2014. On the downside, short-term growth is expected to suffer from a sluggish construction sector.

This growth forecast is in line with those of market economists (+1.0% in 2015 and +1.5% in 2016 in the March 2015 Consensus forecasts). **It is more conservative than that of the international organisations.** The OECD recently adjusted its forecast upward, and is now expecting 1.1% growth in 2015 and 1.7% in 2016. The IMF is also expecting growth to gain momentum: 1.2% in 2015 and 1.5% in 2016. In its Winter Economic Forecast issued in February, the European Commission projected 1.0% growth in 2015 and 1.8% in 2016, based on a no-policy-change scenario.

TABLE 1. MACROECONOMIC SCENARIO 2014–2018

Annual rate of growth, in %	2014*	2015	2016	2017	2018
GDP	0.4	1.0	1.5	1.5	1.75
Private consumption expenditure	0.6	1.5	1.5	1.5	1.7
Government consumption expenditure	1.9	1.3	0.6	0.4	0.1
Gross fixed capital formation	-1.6	-1.0	1.5	2.3	2.9
o.w. non-financial businesses	0.7	0.3	3.3	3.3	3.9
Contribution to real GDP growth of changes in inventories	0.3	0.0	0.0	0.0	0.0
Contribution to real GDP growth of external balance of goods and services	-0.3	0.0	0.2	0.2	0.2
Exports of goods and services	2.9	4.9	5.5	5.5	6.0
Imports of goods and services	3.9	4.7	4.7	4.9	5.5
GDP deflator	0.9	1.0	0.9	1.3	1.7
Private consumption deflator	0.5	0.0	1.0	1.4	1.75
Wages and salaries (non-farm private sector)	1.4	1.3	2.7	3.1	3.6
Wages and salaries per employee (non-farm private sector)	1.7	1.4	2.1	2.5	2.9
Employment, persons (non-farm private sector)	-0.2	0.0	0.5	0.5	0.7

*Insee quarterly accounts (adjusted for working days)

DESPITE UPS AND DOWNS DUE TO ENERGY PRODUCTION, GROWTH IS EXPECTED TO GAIN MOMENTUM IN THE FIRST HALF OF THE YEAR

Quarterly GDP growth remained positive although nearly flat in 2014; it is expected to average +0.3% in the first half of 2015. Recent temperature trends (the weather was milder than usual in Q4-2014, and colder than normal in Q1-2015) caused fluctuations in energy consumption and production (projected to be more robust in Q1 than in Q2), which explains in large part the quarterly growth profile expected for the first half of 2015 (+0.4% in Q1 and +0.2% in Q2).

In a context where business climate and consumer confidence indicators are improving, as shown in particular by Insee's monthly surveys, GDP growth should be fuelled by:

- ▶ Robust private consumption following the sharp upturn in December and January, which was confirmed by February's figures. This will be underpinned by fresh momentum in household purchasing power.
- ▶ Export growth, supported by the recent depreciation of the euro. They are expected to pick up only slightly in Q1 after an outstanding performance in late 2014 due to strong aerospace sales, but should bounce back in Q2.

However, construction sector investment should continue to fall in the first half of 2015, although at a slower pace than previously. Investment in other sectors is forecast to remain moderate in early 2015. However, it should pick up progressively, as confidence returns thanks to the improvement in corporate margins (via the CICE and the Responsibility and Solidarity Pact), support initiatives announced in April and favourable borrowing conditions.

A BRIGHTER INTERNATIONAL ECONOMIC ENVIRONMENT AND THE DEPRECIATION OF THE EURO ARE EXPECTED TO SPUR GROWTH

A brighter international economic environment, particularly as the euro area picks up, should be propitious to GDP growth

Recovery in the euro area is expected to be gradual and uneven across countries. Lower oil prices, the depreciation of the euro and the sharp fall-off in interest rates under the ECB's quantitative easing programme should spur growth. Germany should be able to rely on robust domestic drivers, namely consumer spending and business investment. In Spain, recovery should continue to be driven by domestic factors thanks to improving labour market conditions. The recovery in Italy is still weak, primarily driven by foreign demand and – over time – by private consumption. A rebound in investment will likely not be seen before 2016.

Outside the euro area, the United States and the United Kingdom will continue to be growth leaders among advanced economies. Following persistently high rates starting in spring 2014, growth is expected to slow in both countries. It should nonetheless remain above potential growth rates, buoyed by robust domestic demand. In Japan, growth is expected to be listless over the forecast horizon.

Growth should increase slightly in emerging economies, despite the slowdown in China's growth and likely recessions in Brazil and Russia due to falling oil prices and geopolitical tensions. The leading emerging economies should continue to experience growth rates well below the pre-crisis average.

While world growth is expected to gain little traction compared to its 2013 and 2014 levels, world trade should be more robust thanks to better-performing advanced economies and despite sluggish emerging ones.

As a result, demand for French exports is expected to pick up, growing by 4.5% in 2015 and 5.7% in 2016, following 3.3% in 2014. This scenario of gradually-improving growth in industrialised countries is widely agreed-upon. It is fairly similar to that set out in the European Commission's Winter Economic Forecast, and is consistent with the March Consensus Forecasts.

The gradual recovery in external demand and the euro's depreciation are set to boost exports

Exports are expected to pick up gradually, gaining 4.9% in 2015 and 5.5% in 2016 compared to 2.9% in 2014, as global demand recovers and the euro depreciates. The euro's depreciation against other currencies, which began in July 2014, gained traction following the ECB's announcement of a quantitative easing programme. As a result, French exporters should be more competitive abroad. The measures taken to boost competitiveness are also expected to pay off increasingly over time. Export performance should therefore remain stable up to 2016.

Imports are expected to grow by 4.7% in 2015 and 2016 in connection with the robustness of final demand. They saw strong growth in 2014 of 3.9% (1.7% in 2013) on the back of stronger domestic demand (0.7% in 2014, 0.3% in 2013) and are being buoyed in the short term by specific economic factors, including very high pharmaceutical imports in 2014.

Overall, foreign trade is not expected to hold back GDP growth in 2015 and is likely to contribute 0.2 percentage points as of 2016.

THE SHARP DIP IN OIL PRICES SHOULD RESULT IN ZERO INFLATION IN 2015 FOLLOWED BY A GRADUAL UPTICK THEREAFTER

Inflation is set to contract in 2015 to reach an annual average of 0.0%, mainly as a result of the dip in oil prices. Year-on-year headline inflation has been negative since the beginning of the year, but is expected to be back in positive territory in April.

Inflation should then pick up in 2016 to an average 1.0% for the whole year. Volatile components are likely to make a significant contribution to the uptick in headline inflation. If we assume that oil prices and exchange rates remain as is, fuel prices will remain stable and will no longer drag prices lower, while fresh produce prices are expected to push it back up, leading to growth levels similar to those recorded in the past.

Core inflation, currently weak but positive (0.1% year-on-year in February 2015), should gradually strengthen to reach an annual average of 0.8% in 2016. The positive impact of a weaker euro should come through gradually. Salaries are also expected to rise in 2016 as growth picks up, triggering increases in variable wage components. Planned price increases, such as those related to the new climate-energy tax which factors in more fully the costs of energy use, for example, should bolster inflation, while other factors are likely to have a dampening effect by lowering production costs (ramp-up of the Competitiveness and Employment Tax Credit (CICE) and the Responsibility and Solidarity Pact) or by boosting competition (Consumer Act, Growth and Economic Activity Act).

DOMESTIC DEMAND IS SET TO IMPROVE ON THE BACK OF WEAKER INFLATION, BOOSTING SHORT-TERM PURCHASING POWER AND REDUCING BUSINESS COSTS

Robust purchasing power should drive consumption

Purchasing power should continue to rally in 2015, gaining 1.3%, driven by an improvement in real wages as a result of another dip in inflation in the same year prompted by the sharp drop in oil prices against a background of lower taxes. It should continue to grow at this pace in 2016, when it is expected to be underpinned by real wages in line with productivity gains and by property income.

The household savings rate is set to decrease slightly as of 2015 (15.3% in 2015, 15.1% in 2016), which should help stimulate private consumption, expected to grow by 1.5% in 2015 and 2016. Private consumption should benefit from the improvement in purchasing power and the reduction in precautionary savings following a gradual labour market upturn and greater household confidence. The property savings rate should continue to be modest, as investment in housing recovers only moderately.

Business investment is expected to improve gradually

The recovery in investment in 2015 and 2016 (0.3% then 3.3%) is expected to be driven by non-construction investments (1.2% then 4.6% respectively, 0.3% in 2014) as the general recovery takes root. This gradual pick-up, bolstered by measures such as the very recently-announced tax incentives to be introduced mid-April and designed to encourage investment, should be boosted by a rebound in margins as a result of stronger growth, economic policy initiatives aimed at improving corporate margins, and the positive knock-on effect of the dip in oil prices that should enable businesses to cut costs. Borrowing conditions are expected to remain favourable, although interest rates are forecast to rise in line with recovering growth rates and stronger inflation. In contrast, based on non-residential construction starts at the end of 2014, business investment in construction could once again shrink in 2015 before steadying in 2016.

The construction sector's troubles are expected to dissipate slowly and are likely to put a drag on household investment in 2015

After recording a substantial decline in 2014, household investment is expected to recover little by little: it is expected to contract by a further 4.0% in 2015 after falling by 5.9% in 2014 before recording some slight progress (1.0%) in 2016.

The forecast assumes a very gradual recovery in 2015. There was still no real sign of a clear upturn in new residential housing starts in February, and the latest surveys highlight the slow rate of new individual homes coming on to the market. As well as the role played by the employment situation, household investment in housing is probably being held back as a result of the wait-and-see attitude being adopted by many due to the uncertainty surrounding house prices, while the measures introduced to boost supply (reform of the tax rules applicable to capital gains on property, the Pinel Act to promote property investment, the streamlining of administrative procedures, steps to encourage land to be released for construction purposes, funds made available to support and encourage mayors' construction projects, etc.) will gradually feed through. Consequently, forecasts are for a moderate upturn in building permits and housing starts in the second half of 2015. Households may nevertheless start spending more on house maintenance and improvements in the spring following an improvement in their purchasing power and the introduction of the energy transition tax credit (CITE).

**MARKET SECTOR EMPLOYMENT IS EXPECTED TO MAKE SIGNIFICANT PROGRESS IN 2016,
WITH SUPPORT FROM GOVERNMENT POLICIES**

The recovery in total employment is expected to be confirmed in 2015 (adding an annual 75,000 jobs on average after 50,000 in 2014) with support from the CICE and the Responsibility and Solidarity Pact. An additional 110,000 jobs are expected in 2016, driven by renewed growth and measures taken to reduce labour costs.

After contracting for three years, market sector employment should be stable on average in 2015 although it is expected to see some positive growth during the year (adding 73,000 jobs year-on-year) and into 2016 (adding 91,000 jobs year-on-year) on the back of stronger growth rates and the combined impact of the CICE and the Responsibility and Solidarity Pact. Both measures are expected to offset the negative impact on employment of the forecast improvement in productivity rates, which is forecast at 0.3% in 2014, 0.9% in 2015 and 1.1% in 2016.

Projections are for non-market sector employment to follow suit in 2015 (adding an average 55,000 jobs), as new government-sponsored employment contracts continue to offer support. The figure is expected to remain stable in 2016 as the budget for these contracts decreases progressively.

GROWTH LEVELS ARE SET TO PROGRESSIVELY GATHER PACE BY 2018

Growth is forecast to reach 1.5% in 2017 then 1 ¾% in 2018. Inflation is projected to climb to 1.4% in 2017 and 1 ¾% in 2018. Potential growth is estimated at 1.5% in 2016 and 2017. Compared to the Public Finance Planning Act, this figure was revised upwards by 0.2 percentage points for each year as of 2016, to take into account the positive impact of the structural reforms outlined in the National Reform Programme. Based on this scenario, the upswing in growth will offset only very gradually the output gap which is set to remain significantly wide throughout the period covered by the Programme. Growth should improve on the back of internal drivers that are expected to gather strength and gradually replace the role of external factors (dip in oil prices, weaker euro). Growth in consumption should slightly outpace that of purchasing power, and investment is expected to strengthen in line with more robust activity levels. Exports are expected to improve alongside global demand, which is projected to grow by around 6% a year over the forecast horizon (compared to the previous Public Finance Planning Act forecast of 6.5%).

UNKNOWN FACTORS ARE SURROUNDING THIS FORECAST

The current forecast is conservative (see earlier comparison with forecasts produced by other public and private organisations). Brighter scenarios encompassing much more robust growth rates, or more pessimistic scenarios comprising the appearance of new obstacles to closing the output gap, cannot be ruled out.

As is customary, this recovery scenario is based on oil prices and the euro exchange rate staying close to recent levels. An increase or decrease would obviously invalidate this scenario.

The performance of French exports will also depend on our partners' growth levels. They are also subject to these unknown factors. Other circumstances, such as the geopolitical situation in Russia and Ukraine, may also influence the recovery.

The behaviour of French households and businesses is also uncertain. It could be described as bullish if they decide to quickly use the gain in purchasing power generated by the dip in oil prices or if the improvement in corporate margins and higher growth expectations have a stronger-than-expected impact on investment, and conversely bearish if they continue to adopt a wait-and-see attitude.

**BOX 1 – COMPARISON WITH THE EUROPEAN COMMISSION'S
WINTER 2015 FORECAST**

In its Winter 2015 forecasts published in February of the same year, the European Commission projected GDP growth of 1.0% in 2015 followed by 1.8% in 2016 under the usual no policy change assumption.

The Stability Programme, which includes measures required to meet the target of bringing the deficit back down below 3% by 2017, forecasts growth of 1.5% in 2016 after 1.0% in 2015.

Both macroeconomic scenarios assume buoyant domestic demand under the impulse in particular of stronger private consumption supported by a steady improvement in labour market conditions. According to both scenarios, the rate of savings is expected to fall by 0.4 pp. over two years. The Commission's estimate for total investment is more optimistic than the Stability Programme's based on higher GDP growth and the ramp-up of the CICE and the Responsibility and Solidarity Pact.

The expected improvement in exports on the back of the rebound in global demand is similar in both scenarios (4.2% for the Commission compared to 4.9% for the Stability Programme in 2015, 5.5% in 2016 for both). The Commission expects healthier domestic demand accompanied by more imports (6.3% in 2016 versus the Stability Programme's 4.7%), with external trade thus putting a drag on growth.

4. FISCAL STRATEGY

OVERALL STRATEGY AND MEDIUM-TERM OBJECTIVE

The government's strategy focuses on two targets: supporting growth and employment and continuing to reduce government deficits at an appropriate pace to regain room for budgetary manoeuvre and reduce debt as a proportion of GDP. To this end, the 2014-2019 Public Finance Planning Act (*Loi de programmation des Finances publiques*, LPFP) passed in December 2014 includes implementation of the Responsibility and Solidarity Pact outlined in the 2014-2017 Stability Programme. Lower labour costs and business tax cuts will support business activity, innovation and investment, as well as boost job creation and purchasing power. Implementation of the income tax cut for low- and middle-income households will amplify the positive impact on purchasing power. The Public Finance Planning Act also includes government expenditure savings of €50 billion in order to finance the government's priorities, such as the Competitiveness and Employment Tax Credit (CICE) and the Responsibility and Solidarity Pact, and continue fiscal consolidation. This Stability Programme includes additional measures to offset the negative impact that lower-than-expected inflation has on the public finance adjustment path to ensure that the savings plan is implemented as intended.

On 8 April 2015, the government also announced the launch of an investment support programme to speed up the recovery. Under the programme, businesses' productive investments will be entitled to a one-off tax break over the next twelve months.

The outturn shows that the government lived up to its commitments in 2014. The government deficit reported by France's national statistics institute (Insee) on 26 March stood at 4.0% of GDP, compared to 4.1% in 2013, showing that government expenditure is under control. This expenditure increased by 0.9% in nominal terms, excluding tax credits, compared to average growth of 3.6% from 2002 to 2012, and 1.9% growth in 2013. This result is far lower than the 1.4% growth forecast in the 2014-2019 Public Finance Planning Act. Nominal expenditure growth was historically low in 2014, which confirms the government's responsible approach to public finance management. **The Commission and our European partners acknowledged these efforts, deeming that they complied with the 21 June 2013 Recommendation and with a revised version of the Recommendation.** Consequently, the Ecofin Council meeting of 10 March 2015 adopted a new recommendation that extended the deadline for achieving a deficit under 3% until 2017, in line with the Public Finance Planning Act, given weak growth and low inflation since the previous recommendation.

The government intends to continue its fiscal consolidation with efforts to reduce government expenditure. In line with the Public Finance Planning Act, the adjustment path set out in this Stability Programme is based on a steady reduction of government expenditure as a percentage of GDP at a pace appropriate to economic conditions and changes in France's government services. This will ensure that the deficit is brought down to less than 3% of GDP in 2017, while reducing the tax burden.

The savings plan measures, along with the revenue and expenditure adjustment measures contained in the Supplementary Budget Act passed at the end of last year, which provide an extra effort of €3.6 billion, will be fully implemented. The consolidation effort will involve all general government sub-sectors, as planned. However, current macroeconomic conditions, with low inflation, have a negative impact on France's public finances. In particular, low inflation reduces real

efforts made across general government to rein in expenditure, since administrations face lower costs. Low inflation will also reduce the yield of certain savings measures in 2015, such as the deferred adjustment of basic and supplementary pensions or the stabilisation of the civil service pay scale. Similarly, it will reduce the impact of nominal spending rules for central government in 2015, because the constraints that these rules impose will be less severe for inflation-sensitive expenditure, such as intermediate consumption and investment.

Consequently, the government presents €4 billion in additional measures for 2015 under this Stability Programme in order to meet the targets set in the Public Finance Planning Act. Almost all of these measures are on the expenditure side and offset the adverse impact of low inflation on public finances. The measures affect central government and central government agencies, as well as health and social protection expenditure. They also factor in a long period of lower interest expenditure resulting from current low yields. They will be supplemented by an expected increase in revenue produced by the Offshore Disclosure Unit (*Service de traitement des déclarations rectificatives*, STDR), thanks to an organisational review of the unit, along with increased dividends for central government (see Box 2).

With no further measures in 2016, lower-than-expected inflation would also mean that the pace of deficit reduction is slower. Therefore, the government's 2016 draft budget and draft social security budget will call for a further €5 billion in savings in order to achieve the planned savings. These measures will come on top of the €4 billion in savings in 2015 and will be confirmed in the 2016 budget acts. All sub-sectors will be called upon to contribute to the effort, which will focus exclusively on government expenditure. At this point, the savings have been apportioned to the subsectors according to their share of government expenditure.

Together, these savings measures will lead to a significant and lasting slowing of nominal government expenditure growth, while continuing to finance the government's priorities. When tax credits are excluded, government expenditure should grow by 0.9% in 2015, as it did in 2014. It should then grow by 1.1% in 2016 and by 1.7% in 2017, as inflation returns toward its long-term level. This means that government expenditure as a percentage of GDP should decrease by 2 pp. from 2014 to 2017 to stand at 54.2% of GDP in 2017 (excluding tax credits).

The measures under the Responsibility and Solidarity Pact will be phased in to restore businesses' competitiveness and production capacity, as well as boosting the purchasing power of low- and middle-income households. By 2017, the Competitiveness and Employment Tax Credit (CICE) and the Pact will save businesses approximately €40 billion. The reduction in the cost of labour stemming from the CICE will be continued, with a cut in social security contributions, especially for low-wage employees. Business taxes will be modernised with the elimination of the corporate social security contribution (*Contribution sociale de solidarité des entreprises*, C3S). Income tax for low- and middle-income households was cut in 2014 and will be cut further in 2015 by raising the taxable income threshold, thereby boosting the purchasing power of 9 million households. These measures will lower the tax burden from 44.7% of GDP in 2014 to 44.2% in 2017.

A set of measures to stimulate business investment, which is the key to renewed growth and lower unemployment, will be introduced from April 2015 with a focus on five areas. It includes a one-off enhanced depreciation and amortisation measure to increase the return on any productive investment made in the next twelve months and the tools for financing SMEs will be improved. A recasting of planning contracts between central and regional governments and measures to pre-finance the VAT Compensation Fund will stimulate local investment in development and amenities. Targeted measures will encourage households to invest in energy improvements in order to speed up the transition to cleaner energy. The final measure creates a personal activity account for certain individual entitlements that will secure wage-earners' entitlements and benefits and improve their prospects throughout their working lives.

Stability Programme for France 2015–2018

This Stability Programme calls for a structural adjustment of 0.5 points each year from 2015 to 2018. This will bring the deficit back down below 3% of GDP in 2017 and lead to a structural balance of -0.1 points in 2018, meaning that the medium-term objective will be reached. Debt will stand at 97.0% of GDP in 2016, and then start declining in the following years.

TABLE 2 ADJUSTMENT PATH

	2013	2014	2015	2016	2017	2018
Government balance	-4.1	-4.0	-3.8	-3.3	-2.7	-1.9
Cyclical component	-1.6	-1.9	-2.0	-2.0	-2.0	-1.8
One-off and other temporary measures (as a % of potential GDP)	0.0	0.0	-0.2	-0.1	0.0	0.0
Structural balance (as a % of potential GDP)	-2.5	-2.0	-1.6	-1.1	-0.6	-0.1
Structural adjustment	1.0	0.4	0.5	0.5	0.5	0.5
Nominal government expenditure growth, excluding tax credits (%)	1.9	0.9	0.9	1.1	1.7	2.2
Aggregate taxes and social security contributions rate	44.7	44.7	44.4	44.3	44.2	44.2
Government expenditure ratio (excluding tax credits)	56.3	56.0	55.4	54.7	54.2	53.5
Government debt	92.3	95.0	96.3	97.0	96.9	95.5
Government debt excluding financial support for the euro area	89.3	91.8	93.3	94.0	94.1	92.7

OUTTURN 2014

On 26 March 2015, France's national statistics institute (Insee) published the preliminary general government accounts showing a deficit of 4% of GDP in 2014 (€84.8 billion). This marks an improvement of more than €9 billion compared to the deficit forecast of 4.4% of GDP in 2014 underpinning the Public Finance Planning Act. This improvement follows an upward revision of €0.7 billion in the 2013 balance (semi-final accounts). The revision stems from the improvement of €2 billion in the central government budget balance, an improvement of €2 billion in the social security budget balance and an improvement of €3 billion in the local government budget balance, as expenditure growth slowed more sharply than expected. Nearly €1 billion less than planned was spent under the Invest for the Future programmes and accruals were also more favourable than anticipated, especially as a result of the change in the rules for recording flows under the European Union Amending Budget 6 (see Box 3).

The outturn for 2014 confirmed that government expenditure is under control. Its growth in nominal terms stood at 0.9%, excluding tax credits, compared to 1.9% in 2013. This growth rate has been revised downward compared to the Public Finance Planning Act, which called for an increase of 1.4% in nominal terms, and now stands at a historic low. The expenditure outturn testifies to responsible public finance management by the government. This outturn is the result of underspending by all general government sub-sectors and reflects the priority given to expenditure in fiscal consolidation efforts. This priority started with the Initial Budget Act for 2014, and was reinforced over the course of the year by the supplementary budget acts in the second quarter. Expenditure was controlled perfectly during the year.

After rising steadily since 2009, the tax burden stabilised in 2014 at the 2013 level of 44.7% of GDP, as called for in the Public Finance Planning Act. Aggregate tax elasticity stood at 0.6 in 2014, which is just slightly lower than the forecast of 0.7 in the Public Finance Planning Act.

Since 2014 growth matched the forecast in the Public Finance Planning Act, the improvement is entirely structural, which puts the structural adjustment at 0.4 percentage points of GDP. This result shows that fiscal consolidation efforts continued in 2014, despite a macroeconomic situation marked by low growth and inflation. This confirms that, as the European Commission anticipated in March 2015, effective actions were taken in 2013 and 2014 as required under France's European obligations (see "Excessive Deficit Procedure" page 45).

ADJUSTMENT PATH UNDER THE NO-POLICY-CHANGE SCENARIO AND TREND PATH

In accordance with the requirements of the revised Stability and Growth Pact, this Stability Programme includes a no-policy-change scenario. This is the counterfactual path that would have occurred without the measures set out in this Stability Programme. It also presents a trend government balance path based on no changes to legislation or budget practices after May 2012. The no-policy-change scenario incorporates developments stemming from existing laws and regulations, but does not factor in measures still to be implemented to meet budgetary targets.

The **trend path** of the government balance is determined by the natural growth rates of government revenue and expenditure:

- It is based on the natural growth of revenue determined by the economic situation and historic tax elasticities to tax bases, the usual pattern of local tax rates (driven by the election cycle) and index-linked taxes. The effect of measures already adopted in all of the legislation before Act 2012-958 of 16 August 2012 (second 2012 Supplementary Budget Act) has also been taken into account, but not the effects of discretionary tax measures adopted after May 2012, including those in the second 2012 Supplementary Budget Act, the Initial Budget Act and Social Security Budget Act and the supplementary budget acts for 2013, 2014 and 2015.
- Expenditure is assumed to grow in line with the usual index-linking rules and demographic changes. The ordinary changes in local government expenditure driven by the election cycle are also included, along with the natural growth of central government expenditure and health insurance expenditure that would occur without the spending rules. On the other hand, this path does not consider savings from reforms after 2012, such as the pension reform of 2014, the agreement on index-linked pensions with Agirc-Arrco in 2013 or the 2014 agreement with the unemployment insurance scheme (Unedic), or any corrective measures adopted or announced after 2012. This includes the measures in the December 2014 Public Finance Planning Act and the additional measures introduced under this Stability Programme.

This Stability Programme also presents a **"no-policy-change" scenario**, in accordance with the European Council Directive of 8 November 2011:

- Revenue under this scenario follows the same pattern as the trend path, but it incorporates all of the discretionary measures announced up to and including the 2015 budget acts.
- In contrast to the trend scenario, expenditure in this scenario assumes compliance with the spending rules for the central government budget, the national healthcare expenditure growth target (Ondam), and all of the savings measures adopted before this Stability Programme.

Stability Programme for France 2015–2018

The target adjustment path is the one in this Stability Programme, which includes the new savings measures and the measures to promote investment announced on 8 April 2015.

TABLE 3 – TREND PATH AND NO-POLICY-CHANGE PATH

(In % of GDP)	2012	2013	2014	2015	2016	2017
Trend path (before measures introduced after July 2012)	-5.6	-6.3	-6.8	-7.5	-7.6	-7.2
Expenditure savings	0.4	0.8	1.3	2.2	2.8	3.4
<i>of which lowering of national healthcare expenditure growth target compared to its trend path</i>	<i>0.1</i>	<i>0.2</i>	<i>0.4</i>	<i>0.5</i>	<i>0.6</i>	<i>0.8</i>
<i>of which lowering of central government expenditure (excluding Competitiveness and Employment Tax Credit)</i>	<i>0.3</i>	<i>0.5</i>	<i>0.9</i>	<i>1.1</i>	<i>1.3</i>	<i>1.6</i>
<i>of which other</i>	<i>0.0</i>	<i>0.0</i>	<i>0.1</i>	<i>0.7</i>	<i>0.8</i>	<i>1.1</i>
Discretionary tax measures introduced after May 2012 (including the 2015 Initial Budget Act, the Competitiveness and Employment Tax Credit, the Responsibility and Solidarity Pact, excluding tax disputes) + correction for accrual-based measurement of tax credits	0.3	1.4	1.5	1.3	1.1	0.8
No-policy-change scenario	-4.8	-4.1	-4.0	-3.9	-3.6	-3.0
Discretionary measures in the Stability Programme				0.2	0.4	0.4
Target adjustment path	-4.8	-4.1	-4.0	-3.8	-3.3	-2.7

The **2015** no-policy-change scenario forecasts a deficit of 3.9%. The target adjustment path incorporates the impact of €4 billion in savings announced to ensure full compliance with France's commitments and measures to promote investment.

In 2016 and beyond, the no-policy-change scenario, in contrast to the trend path, incorporates compliance with central government expenditure rules and with the national healthcare expenditure growth target set in the Public Finance Planning Act. It also includes the expenditure savings provided for in the aforementioned Act to finance the Competitiveness and Employment Tax Credit (CICE), along with the discretionary revenue measures in the budget acts passed since the third quarter of 2012. Under the no-policy-change scenario, the deficit would stand at 3.6% of GDP in 2016 and 3.0% in 2017. The target adjustment path incorporates additional savings measures planned for 2016 (worth some €5 billion) for a deficit standing at 3.3% of GDP in 2016 and 2.7% in 2017.

STRUCTURAL BALANCE

In 2014, the government deficit shrank by 0.1 percentage points of GDP, from 4.1% to 4.0%, but this small change in nominal terms obscures a greater structural effort. The structural effort stood at 0.7 percentage points of GDP, with sharply slower expenditure growth accounting for the bulk of the effort. The nominal expenditure growth rate slowed from 1.9%, excluding tax credits, in 2013 to 0.9% in 2014. Discretionary tax measures also boosted this effort by 0.2 percentage points of GDP, particularly the measures in the 2014 budget acts. On the other hand, the low aggregate tax elasticity to GDP growth, standing at 0.6, minimised the improvement in the structural balance by 0.2 percentage points of GDP, along with the deployment of the CICE (negative contribution of the correction for accrual-based measurement of tax credits of 0.1 pp.¹). The aggregate improvement in the structural balance stands at 0.4 percentage points of GDP. Furthermore, the persistently sluggish economy led to a deepening of the cyclical component of the deficit of 0.3 percentage points of GDP, as GDP growth of 0.4% fell short of its potential of 1.0% for 2014. The impact of one-off developments on the government balance was neutral, since the cost of settling tax disputes was offset by Eurostat's decision to treat the timing change under the European Union Amending Budget 6 as a one-off (see Box 3).

In 2015, the improvement of the government balance by 0.2 percentage points of GDP will once again rely on a major expenditure effort worth 0.8 percentage points of GDP, with nominal government expenditure growth of 0.9%. This effort will be based on savings measures passed in the Initial Budget Act, along with €4 billion in additional measures, which are primarily expenditure measures, as explained in this Stability Programme (see Box 2), to offset the impact of lower-than-expected inflation on government accounts. Revenue measures will be neutral in aggregate. Despite the negative impact of tax elasticity (-0.2 points) stemming from low inflation, which slows the natural growth of the tax base, and the persistently negative contribution of the correction for accrual-based measurement of tax credits (-0.1 points), France will still deliver an improvement in the structural balance of 0.5 percentage points of GDP. As the recovery gradually gathers strength, the improvement in the cyclical balance should remain slightly negative at -0.1 points, whereas one-off developments will reduce the headline balance adjustment by 0.2 percentage points of GDP, due to the change in timing of the recording of the European Union Amending Budget 6 after the Public Finance Planning Act was passed, and the expected cost of settling tax disputes (see Box 3).

In 2016, the government balance is expected to improve by 0.5 percentage points of GDP. All of this improvement will stem from structural adjustment. More specifically, the effort to rein in government expenditure will be stepped up, compared to the measures passed in the Initial Budget Act, with €5 billion in additional measures leading to an expenditure effort equivalent to 0.6 percentage points of GDP. As aggregate tax elasticity gradually returns to its conventional level of one within this timeframe and the CICE is fully deployed, structural adjustment will stand at 0.5 points. Economic conditions and one-off developments should have a neutral impact on the improvement in the government balance.

In 2017, the deficit is expected to fall by 0.6 percentage points of GDP. Most of the reduction should come from on-going expenditure savings equivalent to 0.6 percentage points of GDP. The Responsibility and Solidarity Pact means that taxes and social security contributions will make a negative contribution of 0.3 points in 2017, while the lag between the fiscal cost of the Competitiveness and Employment Tax Credit and its cost in the national accounts will contribute 0.1 points to the improvement in the structural balance,

¹ The cost recorded in the national accounts is the cost of the claim acquired on the government, whereas the tax expenditure recognised in the budget is the cost of the allocations and refunds. As the Competitiveness and Employment Tax Credit (CICE) is deployed, a gap emerges between these two measurements in the central government balance, which translates into a correction for central government between fiscal and national accounts.

Stability Programme for France 2015–2018

which will come out at 0.5 percentage points of GDP. The contribution of the cyclical component to adjustment will be nil.

In 2018, the headline balance adjustment is expected to stand at 0.7 points. The government is expecting an improvement in the structural balance of 0.5 percentage points of GDP. Structural reforms are also expected to boost growth to 1.75%, compared to potential growth of 1.4% in 2018. This means the cyclical component is expected to contribute 0.2 points to the improvement of the government balance in 2018. For the rest, the after-effects of the tax disputes will be favourable, contributing 0.1 percentage points of GDP (see Box 3). In aggregate, the structural balance should stand at -0.1 percentage points of GDP in 2018, which is the date when the medium-term objective (MTO) will be achieved

TABLE 4 - STRUCTURAL BALANCE ADJUSTMENT PATH AND BREAKDOWN OF STRUCTURAL ADJUSTMENT²

(In % of GDP)	2014	2015	2016	2017	2018
Government balance (1)	-4.0	-3.8	-3.3	-2.7	-1.9
Cyclical component (2)	-1.9	-2.0	-2.0	-2.0	-1.8
One-off and other temporary measures (as a % of potential GDP) (3)	0.0	-0.2	-0.1	0.0	0.0
Structural balance (as % of potential GDP) (1) (2) (3)	-2.0	-1.6	-1.1	-0.6	-0.1
Structural adjustment	0.4	0.5	0.5	0.5	0.5
Structural effort	0.7	0.8	0.6	0.3	0.3
<i>discretionary tax measures</i>	<i>0.2</i>	<i>0.0</i>	<i>0.0</i>	<i>-0.3</i>	<i>-0.1</i>
<i>expenditure effort</i>	<i>0.6</i>	<i>0.8</i>	<i>0.6</i>	<i>0.6</i>	<i>0.4</i>
Non-discretionary component	-0.2	-0.2	-0.1	0.0	0.1
Correction for accrual-based measurement of tax credits	-0.1	-0.1	0.0	0.1	0.1

² The breakdown of structural adjustment and structural effort in 2018 is a conventional one.

BOX 2 – PLANNED CORRECTIVE MEASURES

This Stability Programme incorporates €4 billion in additional corrective measures in 2015, on top of the savings measures passed in the Public Finance Planning Act. These measures are designed to offset the adverse effect of low inflation on meeting the government expenditure targets for 2015 set out in the budget acts in the fourth quarter of 2014. The expenditure savings will be made by issuing regulations or by implementing cuts during the year. The details are as follows:

- ▶ €1.2 billion on central government and central government agency expenditure. These savings will be in addition to those financing new priority measures decided at the beginning of 2015 (increased resources for fighting terrorism, development of civic service jobs for youth and government-sponsored employment contracts);
- ▶ €1 billion on healthcare and social protection expenditure. More specifically, health insurance expenditure will be regulated during the year to achieve the 2015 national healthcare expenditure growth target (Ondam) of 2.05%, compared to the 2014 outturn. This is €300 million less than the 2014 Ondam target.
- ▶ €0.4 billion in additional revenue produced by the Offshore Disclosure Unit (*Service de traitement des déclarations rectificatives*, STDR), as new decentralised processing offices are being opened.
- ▶ €0.2 billion from an upward revision of the dividends received by the central government.
- ▶ €1.2 billion less in interest expenditure due solely to the lower interest rate forecast of 1.2% at the end of 2015, versus the forecast of 2.0% in the Public Finance Planning Act.

These measures will support the fiscal consolidation effort at a time when very weak inflation minimises the improvement in the structural balance. Lower-than-expected inflation, at 0.0% as measured by the HICP (excl. tobacco), versus 0.9% projected in the 2015 Initial Budget Act, led to a spontaneous slowdown in government expenditure, but it also means losses with regard to the €21 billion in savings planned for 2015. This effect stems from the fact that certain expenditure items are capped in current euros, as is the case for central government expenditure excluding debt servicing and pensions, as well as for the national healthcare expenditure growth target (Ondam). If these caps are not revised, they increase the “purchasing power” of government when inflation falls. Furthermore, some of these expenditure items are *de facto* stabilised in current euro terms as a consequence of budget freezes or changes to index-linking rules, as is the case for pensions up until October 2015. This means that further measures are needed to meet the government expenditure objectives.

After factoring in these measures, the structural adjustment is expected to come out at 0.5 percentage points of GDP in 2015, which is the figure called for in the recommendation made to France on 10 March 2015.

The fiscal consolidation effort in 2016 will be boosted by an additional €5 billion in adjustments to expenditure exclusively. These adjustments will enable France to achieve the pace of expenditure reduction called for in the Public Finance Planning Act.

At this point, the effort is distributed according to each general government sub-sector’s share of government expenditure, as was the case in the initial savings plan:

- ▶ Central government and central government agencies will slow their expenditure growth by a further €1.6 billion;

- ▶ Healthcare and social protection expenditure growth will slow by €2.2 billion, through a reduction of the national healthcare expenditure growth target (Ondam) to 1.75%;
- ▶ Finally, local government operating expenditure growth will slow by €1.2 billion, thanks to lower inflation.

These measures will make it possible to deliver an improvement in the structural balance of 0.5 percentage points of GDP and the same pace will be maintained to bring the deficit back under 3% of GDP by 2017. The measures assume that inflation in 2016 will be lower than expected, at 1.0% as measured by the HICP (ex. tobacco), versus the forecast of 1.4% in the Public Finance Planning Act.

BOX 3 - ONE-OFF AND OTHER TEMPORARY MEASURES TAKEN INTO ACCOUNT WHEN EVALUATING FRANCE'S STRUCTURAL BALANCE

France introduced a structural balance rule to implement the Treaty on Stability, Coordination and Governance. The structural balance corresponds to the government balance adjusted for direct cyclical effects and one-off developments. This rule avoids the pro-cyclical effects produced by managing government finances on the sole basis of the nominal government balance.

On the revenue side, the timing for recognition of losses stemming from exceptional tax disputes in the national accounts cannot be foreseen because it depends on the timing and the tenor of the courts' final rulings³. These losses have been classified as one-off developments. They include reimbursements to foreign UCITS, reimbursements of withholding tax on dividends paid⁴ and, as of this Stability Programme, the De Ruyter dispute⁵.

On the expenditure side, financial flows with the European Union warrant special attention. When the Public Finance Planning Act was drafted, the adjustment path was based on a reduced contribution to the European budget in 2015 as a result of Amending Budget 6 (AB 6) invoking the ESA 2010 article in force, which was applied again in September 2014 (Article 4.140), "*VAT- and GNI-based third and fourth own resources are recorded when they are due to be paid.*" In other words, the contribution to the European

³ Expenditure and revenue are recorded on an accrual basis in the system of national accounts in compliance with the European System of Accounts of 1995. This means they are recorded, "when economic value is created, transformed or extinguished, or when claims and obligations arise, are transformed or are cancelled". Consequently, the loss or gain from disputes will be recorded in the year when the courts make their final ruling, whereas, in budgetary accounting, it will be recorded on the basis of cash flows.

⁴ Since the previous Stability Programme, France won its case before the Court of Justice of the European Union concerning taxes on electronic communications. The cost of potentially losing the case, which was recorded as a one-off when the Public Finance Planning Act was drafted, has consequently been withdrawn.

⁵ In February 2015, the Court of Justice of the European Union ruled that income from French assets of persons belonging to the social security system of another Member State cannot be made subject to French social contributions, since the contributions are used to finance social protection in France. Pending the French supreme administrative court's interpretation of this judgment, the persons concerned could be reimbursed for most of the contributions paid on their investment income. Estimated reimbursements of €0.5 billion have therefore been incorporated in the adjustment path (€0.1 billion in 2015 and €0.4 billion in 2016).

Union based on revenue is recorded when the cash payment is due. The smaller contribution payment was expected in 2015, until the countries paying the surplus make their payments so that the surplus can be redistributed to the other countries, since the European Union is not allowed to go into debt. Therefore, the transaction was recognised in 2015 in the Planning Act passed at the end of 2014, since France's contribution will diminish in 2015.

However, Eurostat issued a notice in January 2015 deeming that the standard payment schedule had been altered and that, without change, all of these payments by some countries and reimbursements to others should have occurred in 2014. Consequently, Eurostat deemed that the time of recording of Amending Budget 6 was not the time the amounts were due to be paid, but the time the Commission first notified the Member States of the consequences of the change in the ESA and in the basis for calculating contributions. This accounting change improved the adjustment path by €1.1 billion in 2014, compared to the forecast in the Public Finance Planning Act, and will be a negative contribution of €1.1 billion in 2015. All else being equal, the timing change will reduce structural adjustment in 2015 by €2.2, which is equivalent to 0.1 percentage points of GDP.

Consequently, the timing change should be neutralised. This substantial change does not alter the medium-term adjustment path and it means that structural adjustment is smaller than called for in the Public Finance Planning Act. Therefore, the pragmatic approach is to treat this change in the time of recording, which could have a major impact on structural adjustment measurements, as a one-off development. More specifically, the timing change is treated as a one-off development, and not the event itself⁶.

TABLE 5 - ONE-OFF AND OTHER TEMPORARY MEASURES EXCLUDED FROM THE STRUCTURAL BALANCE UNDER THE NATIONAL SYSTEM OF ACCOUNTS

(deviation from baseline, in € billions)	2014	2015	2016	2017	2018
Total	0.3	-3.9	-3.3	-1.2	0.0
Revenue	-0.8	-2.8	-3.3	-1.2	0.0
Withholding tax dispute (précompte mobilier)	0.0	-0.4	-0.9	0.0	0.0
UCITS dispute	-0.8	-2.3	-2.0	-1.2	0.0
De Ruyter dispute	0.0	-0.1	-0.4	0.0	0.0
Expenditure (EU AB 6)	1.1	-1.1	0.0	0.0	0.0

NB: the figures given in this table do not predict the outcome of the disputes; they merely reflect the conservative approach to multiyear public finance projections. Furthermore, the figures shown are subject to change as a result of the courts' final rulings.

⁶ The amount is much greater than Amending Budget 6 worth €0.6 billion for 2012, which was announced right at the end of the year. In contrast, Amending Budget 8 for 2013, worth €1.8 billion, was announced very early in the year. These two cases are of a different nature and do not have the same implications for planning as Amending Budget 6 for 2014.

THE GOVERNMENT BALANCE BY SUB-SECTORS

In accordance with the Public Finance Planning Act, fiscal consolidation will result from efforts to rein in expenditure shared by all sub-sectors of general government that will lead France back to a nominal deficit that is less than 3% of GDP and then to structural equilibrium. The government deficit will shrink from 4.0% of GDP in 2014 to 2.7% in 2017, when France will meet its European commitment to bring its deficit under the 3% threshold. After that, the deficit will shrink to 1.9% of GDP in 2018. The structural deficit will stand at 0.1% of GDP in 2018, which will be the year that France achieves its medium-term objective.

TABLE 6 - GENERAL GOVERNMENT LENDING CAPACITY (+) / BORROWING REQUIREMENT (-)⁷

(% of GDP)	2014	2015	2016	2017	2018
Government balance, Maastricht definition	-4.0	-3.8	-3.3	-2.7	-1.9
<i>primary balance</i>	-1.8	-1.7	-1.2	-0.5	0.4
Central government	-3.5	-3.4	-3.2	-2.8	-2.2
Other central government bodies	0.1	0.0	0.0	0.0	0.0
Local government	-0.2	-0.1	-0.1	-0.1	-0.1
Social security funds	-0.4	-0.3	0.0	0.3	0.4

The central government sub-sector (central government and other central government bodies) balance is expected to improve by 0.6 points between 2014 and 2017 from -3.3% of GDP in 2014 to -2.8% in 2017. Most of the improvement will result from a major expenditure effort, as part of the planned decrease in nominal central government expenditure, excluding debt servicing, pensions and financial support for local governments. The bulk of the savings will come from efficiency gains (pooling of procurement and IT functions, moderating central government operating expenditure, refocusing government action and stabilising the civil service pay scale); other central government bodies will see their operating expenditure and scope of intervention trimmed. Central government and other central government bodies will contribute to the additional effort of €4 billion in 2015, compared to the Public Finance Planning Act, by means of further reduction of €1.2 billion in their expenditure. In 2016, central government and other central government bodies will also do their share to implement the savings measures of €5 billion.

The social security balance should improve by 0.7 percentage points of GDP between 2014 and 2017, going from a deficit of 0.4 percentage points of GDP to a surplus of 0.3 percentage points of GDP at the end of the period. The expected surplus, stemming from the structural surplus of the Social Security Debt Repayment Fund (CADES), will be used to reduce the social security debt in nominal terms. The expected improvement will come from economic recovery and savings incorporated in the adjustment path set out in the Public Finance Planning Act: effort on the national healthcare expenditure growth target (Ondam), savings measures passed in budget acts, expected agreements between management and labour representatives on unemployment insurance and supplementary retirement schemes, pension

⁷ The breakdown by sub-sectors in 2018 is the conventional one. The expenditure effort is distributed among the sub-sectors according to their shares of government expenditure.

reform and savings achieved during the year by social protection bodies. The improvement will also stem from additional measures announced in this Stability Programme that affect social protection and are worth €1 billion in 2015, along with further savings planned for 2016 to offset the impact of lower-than-expected inflation that compared to the forecast in the Public Finance Planning Act. The cost of the cuts to taxes and contributions under the Responsibility and Solidarity Pact was made up to the social security funds in 2015 through such measures as putting some of the financing for housing benefits provided by the family allowance funds back into the budget. The social security funds will also be fully compensated for the cuts to taxes and contributions under the Pact in 2016 and 2017.

Local governments will also take part in the consolidation effort. This effort will entail a reduction of transfers from the central government by €3.7 billion each year from 2015 to 2017⁸, following a reduction of €1.5 billion under the Public Finance Planning Act. In 2016, lower inflation will mean that local governments have to make greater efforts to curb their operating expenditure in order to contribute to the additional adjustment needed. These measures will come on top of the natural impact that the election cycle has on expenditure, particularly capital expenditure, which slows down following elections. Furthermore, their current expenditure should slow down as the government's structural reforms are implemented (see "Streamlining local government expenditure", page 58). Consequently, the local government deficit is expected to be stable at 0.1% of GDP from 2015 to 2017.

GOVERNMENT EXPENDITURE

General government expenditure

The government expenditure growth figures from 2015 to 2017 reflect the government's measures to restore fiscal equilibrium. This includes the savings plan for all general government sub-sectors for the period from 2015 to 2017 that was passed in the Public Finance Planning Act (see Box 4). It also includes the additional measures set out in this Stability Programme to offset the impact of low inflation on the fiscal adjustment path. Nominal government expenditure, excluding tax credits, increased by 0.9% in 2014, which is markedly slower than the growth of 1.9% posted in 2013. Real government expenditure growth, excluding tax credits, stood at 0.5% in 2014, following growth of 1.1% in 2013. These growth figures continue the historically low rate of growth achieved in 2013. Previous government expenditure growth averaged 3.6% in nominal terms from 2002 to 2012 and 1.9% in real terms. **Nominal expenditure is expected to continue growing at a moderate pace, rising by 0.9% in 2015, 1.1% in 2016 and 1.7% in 2017. Real government expenditure growth is expected to be 0.9% in 2015, followed by 0.1% in 2016 and 0.3% in 2017.**

⁸ The figure in the 2015 Initial Budget Act is €3.4 billion. The difference with the €3.7 billion in the draft budget was financed through other appropriations.

TABLE 7 - CHANGE IN GENERAL GOVERNMENT EXPENDITURE BY SUB SECTOR

<i>(annual average, nominal terms, excluding tax credits, in %*)</i>	2012-2013	2014	2015	2016-2017
General government	2.5	0.9	0.9	1.4
Central government	1.3	-0.3	-1.2	-0.3
Other central government bodies (ODAC)	3.9	3.4	0.7	0.9
Local government (APUL)	3.5	-0.3	0.0	1.3
Social security funds (ASSO)	2.8	2.3	1.3**	1.3
<i>Memo: real expenditure, excluding tax credits (all general government sub-sectors)</i>	<i>1.1</i>	<i>0.5</i>	<i>0.9</i>	<i>0.2</i>

*Nominal expenditure, excluding tax credits and including transfers between general government sub-sectors.

** Like-for-like terms, excluding the incorporation of housing benefits (*Aide personnalisée au logement, APL*) into the budget, which reduces social security expenditure without changing aggregate government expenditure. If the incorporation of housing benefits into the budget is counted, the change would be 0.5%.

The detailed breakdown shows that nominal expenditure growth, excluding tax credits, slowed sharply from 1.9% in 2013 to 0.9% in 2014. This growth was slower than the forecast of 1.4% in the Public Finance Planning Act as savings were made across all general government sub-sectors. Nominal central government expenditure was €0.1 billion less than the level underlying the 2015 draft budget and savings were made on special account items, pensions and debt servicing. Local government expenditure also grew more slowly than expected, with a marked post-election investment pattern. Social security expenditure was lower than expected. More specifically, national healthcare expenditure growth was €0.3 billion under the target (*Ondam*) passed in the 2014 Supplementary Social Security Budget Act. The slower growth, compared to 2013, ultimately stems from the freeze on supplementary pensions and the lack of any permanent increase in basic pensions as inflation fell. Other factors include the new unemployment insurance agreement (*Convention Unédic*), savings measures in the 2014 Social Security Budget Act and the supplementary budget acts, the natural local government investment pattern and low interest rates.

Nominal expenditure growth, excluding tax credits, is expected to remain modest at 0.9% in 2015 and 1.1% in 2016, as the government's savings measures in the Public Finance Planning Act take effect and are supplemented with the additional savings announced in this Stability Programme. In combination with the provisions of the Public Finance Planning Act, the measures mentioned above will offset the impact of low inflation and maintain the planned pace of reducing government expenditure as a percentage of GDP, excluding tax credits and interest expenditure.

In 2017, the savings plan will moderate nominal government expenditure growth, which is expected to reach 1.7%, excluding tax credits. This figure will rise gradually as inflation picks up again from 1.0% in 2016 to 1.4% in 2017.

BOX 4 – 2015-2017 €50 BILLION SAVINGS PLAN

The adjustment path set out in the Public Finance Planning Act includes a savings plan worth €50 billion running from 2015 to 2017 to bring the government deficit back down under 3% of GDP in 2017.

The savings for 2015 are set out in detail in the 2015 draft budget and draft social security budget. For 2016 and 2017, this Stability Programme relies primarily on the savings set out in the Public Finance Planning Act:

- ▶ Central government expenditure, excluding debt servicing, pensions and financial support for local government, is based on the three-year adjustment path in the Public Finance Planning Act. The bulk of the savings will come from efficiency gains (pooling of procurement and IT functions, reducing central government operating expenditure, refocusing government action and stabilising the civil service pay scale); other central government agencies will see their operating expenditure and scope of intervention trimmed.
- ▶ Transfers to local government will be cut by €3.7 billion in both 2016 and 2017.

Measures in the 2015 Social Security Budget Act will produce savings in family allowance and healthcare expenditure, with a lower national healthcare expenditure growth target (Ondam). The agreements on unemployment benefits and supplementary retirement schemes that have already been signed or are under negotiation will help restore the equilibrium of these systems. Savings will also be made by trimming the management expenses of social security funds.

However, lower inflation in 2015 means that the yield of several of these measures will be smaller than expected and reduces the effort that government bodies will have to make to achieve their nominal targets. For example, some of the reforms for 2015 will produce smaller-than-expected savings. This is the case for the measures dealing with the rules for adjusting basic and supplementary pensions. The lost savings need to be offset in order to meet the targets set out in the Public Finance Planning Act. Furthermore, these savings are measured against the trend path, which is inflation-sensitive. If no corrective measures are taken, lower energy prices, and lower inflation in general, will provide government with a boost in “purchasing power”, as it does for households.

Consequently, the adjustment path in this Stability Programme supplements the measures in the Public Finance Planning Act with additional measures in 2015 worth €4 billion. Virtually all of these measures focus on expenditure to ensure that the pace of fiscal consolidation is maintained despite lower inflation (see Box 2 for details about the €4 billion in savings).

Lower inflation in 2016 will also reduce fiscal adjustment, thereby slowing structural adjustment. In order to meet the targets set under the Public Finance Planning Act, the lost savings will be offset by expenditure savings of €5 billion, on top of the 2015 measures. These savings will be set out in detail in the 2016 budget acts and all government sub-sectors will contribute to the effort.

The total reduction of government expenditure as a percentage of GDP (excluding tax credits and interest expenditure) in 2015 and 2016 will be the same as the reduction set out in the Public Finance Planning Act and cover the same expenditure as the initial savings plan. Based on the 2014 outturn of 53.8% of GDP, the share of such expenditure is expected to shrink by 0.5 percentage points of GDP in 2015 and by 0.7 points in 2016.

Central government expenditure

Article 8 of the 2014-2019 Public Finance Planning Act of 29 December 2014⁹ reaffirms the principle of a reduction in nominal central government expenditure, excluding debt servicing and pensions, which makes a major contribution to reining in central government expenditure when drafting and executing the budget.

This means that central government and central government agencies continue to make a significant contribution to fiscal consolidation. The efforts will involve the following:

- ▶ **Certain government expenditure and policies will be streamlined to make them more effective.** In this vein, the provisions of housing policy that are driving up rents and prices, thereby aggravating housing problems and increasing demand for social housing, will be recast to eliminate rent-seeking behaviour and stimulate potential growth. Housing benefits will be reformed so that they do not fuel increases in rents and government expenditure without improving the living conditions of tenants.
- ▶ **Procedures will be simplified and moved online**, which will improve service for users and produce efficiency gains, as is the case for expanded use of online tax returns.
- ▶ **The government's wage bill will be kept under control** by maintaining the stabilisation of the civil service pay scale.
- ▶ **Streamlining of local delivery of services will continue**, with pooling and improved synergy of central government and central government agencies' local networks, in line with the government's reforms of local government, including the reduction in the number of regions.

In 2014, central government lived up to its fiscal commitments since expenditure, excluding debt servicing and pensions, was down €3.3 billion compared to 2013. The very ambitious nominal expenditure target, which was tightened in the Initial Budget Act, and again in the third quarter Supplementary Budget Act, was met and final central government expenditure came in at €0.1 billion under the target.

Central government also benefited from very favourable borrowing terms (see Box 5).

New expenditure commitments in 2015, including the increase in resources to fight terrorism, were financed entirely by further savings totalling €950 million achieved either by cancelling appropriations or by setting additional appropriations aside. Central government will contribute to additional adjustment measures planned for 2015, making further cuts to its nominal expenditure, following the €2.1 billion cut in the 2015 Initial Budget Act, compared to the 2014 Initial Budget Act, excluding levies on revenue, pensions and interest expenditure. Central government will also contribute to additional savings measures planned for 2016. These measures call for savings of €5 billion, including an effort of €1.6 billion on the expenditure of central government and central government agencies (see "Expenditure of other central government bodies", page 32).

⁹ The Act defines the adjustment path in current euros for an aggregate made up of general budget appropriations, levies on revenues and earmarked revenue, excluding debt servicing and pensions ("nominal expenditure" aggregate). The annual increase in total general budget expenditure, including debt servicing and pensions (budget appropriations, levies on revenues and earmarked revenue), must be no higher than inflation ("zero real growth" rule).

**BOX 5 – CENTRAL GOVERNMENT BORROWING COSTS
AND YIELD FORECASTS**

France enjoyed very favourable borrowing terms in 2014 as a result of two successive cuts in the European Central Bank's key rates in June and September and continued investor confidence. Yields at issue for short-term securities (BTFs) averaged 0.07%, dipping to less than 0% at the end of the year. Yields at issue for securities with maturities of more than one year also started to fall in May, to reach a historically low annual average of 1.31%.

The ECB's stepped-up monetary easing, with further asset purchases, including a large proportion of sovereign securities since March 2015, should keep yields low until growth resumes and inflation picks up again.

The yield profile underlying the debt servicing forecast is conservative and based on a scenario of stable short-term yields in 2015, followed by an increase in all yields over the next two years.

TABLE 8 – YIELD FORECASTS

End of year levels (forecasts)	2014	2015	2016	2017	2018
Short-term yields (3-month BTFs)	-0.01%	-0.05%	0.25%	1.00%	1.75%
Long-term yields (10-year OATs)	0.93%	1.20%	2.10%	3.00%	3.50%

Short-term yields (3-month BTFs) are expected to be stable in 2015 and to start rising at the end of 2016, with the expected tightening of the ECB's monetary policy. After that, they are projected to rise by 75 basis points per year.

The increase to 1.20% in long-term yields (10-year OATs) by the end of 2015 reflects the early effects of resumed growth expected in 2015. These yields are expected to rise by a further 90 basis points in 2016, as the ECB phases out monetary easing, and then continue rising in 2017 and 2018 as the macroeconomic situation improves.

It should also be noted that debt servicing is also sensitive to inflation, given the proportion of inflation-linked bonds. However, the impact of this is less permanent.

Expenditure of other central government bodies

Other central government bodies, most of which are also central government agencies¹⁰ will contribute to efforts to rein in expenditure. These bodies' expenditure recently underwent a sharp increase¹¹, and is now being monitored more closely. These bodies are banned from borrowing from credit institutions and subject to restrictions on issuing debt securities, unless specifically authorised to do so. These provisions were confirmed and clarified in the 2014-2019 Public Finance Planning Act. Furthermore, central government representatives sit on the governance bodies of the vast majority of these bodies, ensuring that they adopt balanced budgets. The agencies' expenditure under the Invest for the Future programme is monitored at the central level by the General Commission for Investment, which reports to the Prime Minister in coordination with the Ministry for Finance and Public Accounts. This means that their budgets are balanced or close to equilibrium.

In 2015-2018, the government will take steps to streamline the central government agencies, one of the main thrusts of its programme. This is likely to result in a reduction in the number of these agencies and job cuts, along with a reduction in the financial resources appropriated to them in the form of subsidies for public service provision and earmarked taxes. The 2014-2019 Public Finance Planning Act¹² calls for a systematic cap on all earmarked taxes starting in 2016, or, failing that, restoration of uncapped taxes to the central government budget in 2017. Only capped earmarks that are duly justified will continue to exist, meaning earmarked taxes that are virtually fees for services, sector-specific levies or taxes financing insurance or compensation funds. At the same time, in keeping with the targets that central government will set for its own operating expenditure, the operating expenditure and scope of intervention of central government agencies will be trimmed.

Other central government bodies' expenditure was kept under control in 2014, despite the recognition of the compensation that the French Transportation Infrastructure Financing Agency (AFTIF) owes to Ecomouv. Central government bodies' disbursements under the Invest for the Future programme were maintained at the same level as 2013, except for disbursements by the Atomic Energy Commission (CEA) and the Space Agency (CNES) that were financed under the "defence industry technological excellence" initiative under the second Invest for the Future programme. Various measures to encourage these bodies to rely more on their own resources, as well as reduce earmarked taxes and levies on operating funds, have produced results.

In 2015, other central government bodies' expenditure will grow more slowly, following the recognition of the compensation owed to Ecomouv in 2014. They will contribute to €4 billion in further savings under the plan.

Expenditure growth is then expected to stabilise **in 2016** followed by increases stemming from multiyear expenditure programmes such as the Invest for the Future programme.

¹⁰ The salient features of central government agencies are that they provide public services, are mostly financed by the central government and are under its direct control. The purview of central government agencies and that of other central government bodies is not exactly the same: the former correspond to a budget-based approach while the latter are listed by INSEE each year and correspond to a national accounts-based definition.

¹¹ See, for example *L'État et ses agences*, Report 2011-M-044-01 by the *Inspection générale des finances*, March 2012.

¹² Article 16 of Act 2014-1653 of 29 December 2014, Public Finance Planning Act for 2014 to 2019

Social security funds' expenditure

In 2014, benefits paid by the social security funds grew by 2.3% in nominal terms, following growth of 2.8% in 2013. The slower growth can be attributed in part to a smaller rise in pensions, which grew by 2.3%, compared to 3.6% in 2013. This can be attributed to the absence of any adjustment to basic pensions, which was partially offset by a one-off bonus of €40 for pensioners receiving less than €1,200 a month. It can also be attributed to the freeze on supplementary pensions on 1 April 2014, under the terms of the March 2013 agreement calling for the adjustment to supplementary pensions paid by AGIRC and ARRCO to be 1 percentage point lower than inflation. Family allowance expenditure growth was limited by the small adjustment of 0.6% on 1 April 2014, stemming from low inflation, and by the measures included in the 2014 Social Security Budget Act. Finally, healthcare expenditure growth came in at €0.3 billion under the national target (Ondam) included in the 2014 Supplementary Social Security Budget Act.

Growth of social benefits paid by the social security funds in 2015 are projected to slow from 2.3% in 2014 to 1.6% in 2015. Family allowance expenditure was stable as of 1 April 2015 and basic pensions expenditure should also be stable as of 1 October 2015 as a result of flat inflation in 2015. The savings measures of €0.7 billion on family benefits in the 2015 Social Security Budget Act will also contribute to a reduction in family allowance expenditure growth. The national healthcare expenditure growth target has been set at 2.05%, which is substantially lower than the 2014 outturn.

In 2016 and 2017, growth of social benefits expenditure will be under control, averaging 1.8% per year. This will be slightly faster than the growth in 2015 due to the stronger rise in the HICP (excl. tobacco), which is expected to increase by an average of 1.2% per year in 2016 and 2017, compared to no increase in 2015. Unemployment insurance benefits expenditure will fall by an average of 0.3% in 2016 and 2017, as labour market conditions improve. The national healthcare expenditure growth target will be lowered slightly to 1.75% in 2016 and 2017.

TABLE 9 - ANNUAL NOMINAL GROWTH RATE OF SOCIAL BENEFITS

	2014	2015	2016-2017*
Social benefits	2.3 %	1.6%	1.8 %
Old age and survivor benefits	2.3 %	1.9 %	2.3 %
National healthcare expenditure growth target	2.5 %	2.05 %	1.75 %
Other	1.7 %	0.2 %	0.6 %

* Average annual growth rate

Healthcare benefits

In 2014, the controlled growth of healthcare expenditure seen since 2008 continued with spending that was €0.3 billion under the national healthcare expenditure growth target (Ondam) passed by Parliament in the 2014 Supplementary Social Security Budget Act. The governance measures for the national healthcare expenditure growth target that have been in force for several years now, including the reduced warning threshold, the monitoring committee and the increase in the number of actions taken by the early warning committee, helped meet the target for the fifth year in a row. This result is testimony to the government's efficient management of healthcare expenditure. The government has also backed this effort with structural action to improve the organisation of the healthcare system by elaborating a national healthcare strategy.

The 2015 national healthcare expenditure growth target is for 2.05% based on the 2014 outturn. More than €3.3 billion in savings measures are needed to meet this expenditure growth target. Such measures rely mainly on provisions in the 2015 Social Security Budget Act, including promotion of hospitals' expenditure efficiency (€0.5 billion), rationalisation of health product prices and promotion of generic drugs (€1.1 billion), promotion of reasonable prescriptions and use of healthcare (€1.2 billion) and development of outpatient care to ensure more appropriate and effective use of hospitalisation (€0.4 billion).

In 2016 and 2017, growth of expenditure covered by the national healthcare expenditure growth target are projected to continue to slow to 1.75% per year. Meeting this medium-term objective will rely on implementation of the national healthcare strategy and the savings plan in four areas: developing outpatient care, improving the efficiency of hospitals' expenditure, continued efforts to lower drug prices and promote generic drugs, improving the effective and appropriate use of primary care and hospitalisation.

Old-age benefits

The adjustment path presented, with growth of benefits averaging 2.3% in 2016 and 2017, includes the effects of the pension reforms of 2010 and 2014. The financial adjustment path for supplementary pensions incorporates the effect of supplementary measures now being negotiated by management and labour representatives. Based on the issues under negotiation, the government estimates that the changes will produce savings of €2 billion by 2017 and continue to restore the financial equilibrium of these retirement schemes.

Other benefits

Family allowance and housing benefits expenditure is expected to shrink in 2015, after posting slower growth of 1.9% in 2013 and 1.0% in 2014. This situation stems from the absence of any family allowance adjustment in 2015 due to the stability of the HICP (excl. tobacco) and major savings measures worth €0.7 billion passed by Parliament in the 2015 Social Security Budget Act, including €0.4 billion resulting from means-testing of family allowance benefits starting on 1 July 2015.

After posting very strong growth of 5.7% in 2013, the expenditure growth of the unemployment insurance system is projected to continue to slow down, following 1.9% growth in 2014 and a forecast for 0.9% growth in 2015, as the job market improves. The 2014 agreement between management and labour should result in savings of €0.3 billion by 2017 and additional measures under the 2016 agreement will produce further improvement in the finances of the unemployment insurance system (Unédic). These measures are expected to be worth €2 billion over the period covered.

Local government expenditure

Local government expenditure is expected to be stable in 2015, after posting slower growth in 2014. It should start picking up again in 2016. Expenditure has been made more efficient as a result of cuts in transfers to local government, local government reform, governance measures passed in the Public Finance Planning Act and the new local government expenditure growth target (ODEDEL). These factors, along with the local election cycle, could explain the slower expenditure growth.

After cuts of €1.5 billion in central government transfers to local government in 2014, and a freeze in 2013, transfers will be cut by a further €10.7 billion from 2015 to 2017, with a reduction of €3.4 billion in 2015 under the terms of the 2014-2019 Public Finance Planning Act. In this way, local governments are contributing fully to the fiscal consolidation effort. Cuts in central government transfers will give local governments an incentive to achieve efficiency gains to control their expenditure. At the same time, the structural reform of general operating grants (*dotation globale de fonctionnement*) initiated in 2015 for implementation in 2016 will produce a more equitable distribution of the grants, based on the expenses and resources of each local government.

Local government reform will also produce efficiency gains in the medium term. The creation of new metropolitan areas and direct election of inter-municipal council members through universal suffrage, which is now in force, have been powerful tools for streamlining municipal government. The reduction in the number of regions in metropolitan France from 22 to 13 as of 1 January 2016, under the terms of the Act of 16 January 2015¹³, will also streamline France's administrative structures. The proposed local administration reform act (NOTRe) to be passed in the second quarter of 2015 eliminates the *clause de compétence générale* for *départements* and regions. This clause allows local authorities to act in areas for which they are not responsible as of right and its elimination will clarify the division of powers and streamline local governments' actions.

The 2014-2019 Public Finance Planning Act creates a new governance tool in the form of a local government expenditure growth target (ODEDEL) that sets an indicative cap on local government expenditure growth. This enhances transparency and trust in the dealings between local and central government by officialising a common commitment to control the growth of local government expenditure. It is part of the determination to make all general government sub-sectors accountable for compliance with France's European commitments.

Several developments are noteworthy with regard to local government expenditure:

- ▶ **Local investment** posted weak growth during the previous cycle, averaging 1.3% per year from 2008 to 2013 in nominal terms and shrank by 9.6% in 2014. This contraction should continue in 2015, given the usual pattern of the municipal election cycle, especially since many municipalities changed their leaders in the last elections, but investment expenditure growth should pick up again in the run-up to the next municipal elections.
- ▶ **Operating expenditure** posted growth of 2.0% in 2014 according to preliminary figures, compared to 2.9% growth in 2013¹⁴. Operating expenditure growth is forecast to average 1.7% each year from 2015 to 2017, testifying to local governments' tighter control over this expenditure. More specifically, personnel expenditure growth is expected to be brought under control gradually, averaging no more than 1.8% per year from 2015 to 2017, compared to 3.5% in 2013 and 2014.

Total average local government expenditure growth over the period from 2015 to 2017 is expected to be virtually stable in real terms, in step with inflation.

¹³ Act 2015-29 of 16 January 2015 on regional boundaries, regional and departmental elections and the election calendar.

¹⁴ This covers operating expenditure, as well as current expenditure, such as social expenditure by the *départements*.

GOVERNMENT REVENUE

General government revenue

After posting a steady rise from 2009 to 2013 resulting from fiscal consolidation measures, the aggregate tax and social security contribution rate was stable in 2014 and is expected to decrease in 2015 as measures benefitting businesses and households under the Responsibility and Solidarity Pact and the Competitiveness and Employment Tax Credit (CICE) are deployed. **The rate should stand at 44.2% in 2017.**

This forecast incorporates all of the measures passed and the measures announced in the Responsibility and Solidarity Pact.

The aggregate tax and social security contribution rate is expected to decrease between 2014 and 2015, from 44.7% to 44.4%. The corresponding tax elasticity should be less than one (0.8) owing to low inflation and payroll growth that is slower than GDP growth. The aggregate tax and social security contribution rate in 2015 should be 0.3 points lower than forecast in the Public Finance Planning Act, since taxes and social security contributions growth was weaker than economic growth. The low inflation rate meant that taxes and social security contributions (the ratio numerator), particularly taxes on consumption in nominal terms (VAT) and payrolls (social security contributions), grew less rapidly than GDP (the ratio denominator), automatically reducing the ratio. The impact of discretionary tax measures on the aggregate tax and social security contribution rate is expected to be slightly negative, reducing it by 0.1 percentage points of GDP. This weak impact is expected to be the result of the implementation of the Responsibility and Solidarity Pact and Competitiveness and Employment Tax Credit, which were partially offset by measures in the second 2014 Supplementary Budget Act (including measures making several business taxes non-deductible) and the creation of a new climate-energy tax under the 2014 Initial Budget Act.

The aggregate tax and social security contribution rate is expected to decline in 2016 and 2017 to stand at 44.2% at the end of the period. Most of this decline will be the result of the Responsibility and Solidarity Pact, which will continue the movement toward lower labour costs initiated by the Competitiveness and Employment Tax Credit. The adjustment path also incorporates the impact of pension reform, green taxes, the increased contribution to the cost of public service in electricity, in accordance with the commitment to clear up the past deficits of CSPE, changes in local taxes in relation to the election cycle and disbursements for tax disputes that are expected to be lower at the end of the forecast period than they are projected to be in 2015.

The adjustment path is also based on a spontaneous growth rate for taxes and social security contributions in line with GDP growth (elasticity equal to one between 2016 and 2017).

Furthermore, non-tax revenue should remain steady at 7.6% of GDP between 2015 and 2017.

TABLE 10 – TAXES AND SOCIAL SECURITY CONTRIBUTIONS

	2013	2014	2015	2016	2017	2018
Aggregate rate as a percentage of GDP)	44.7	44.7	44.4	44.3	44.2	44.2
Elasticity	0.2	0.6	0.8	1.0	1.0	1.0

BOX 6 – THE RESPONSIBILITY AND SOLIDARITY PACT

The Responsibility and Solidarity Pact announced in January 2014 contributes to reducing taxes and social security contributions between 2014 and 2017. Many of the measures under the Pact, which were passed in the 2014 Supplementary Budget Act and Supplementary Social Security Budget Act, came into force in 2015. The measures introduced under the Pact will be deployed progressively with the aim of promoting employment, supporting businesses' capacity to invest in production and competitiveness and to make personal taxes and social security contributions more progressive for the benefit of low- and middle-income households. The cuts in taxes and contributions under the Responsibility and Solidarity Pact should come to €25 billion in 2017, including nearly €10 billion in cuts in 2015. The Competitiveness and Employment Tax Credit (CICE) and the Pact will save businesses approximately €40 billion by 2017.

The objective of the Pact and the tax credit is to promote employment and revive the competitiveness of French companies, after ten years of steady decline (see Gallois Report, November 2012), while starting to cut personal taxes and social security contributions and overhauling the incentives for taking jobs paying close to the minimum wage.

The Pact will contribute to a further reduction in the cost of labour, which started with the introduction of the CICE, through three additional measures:

- ▶ Elimination of all employers' payroll contributions on minimum-wage jobs to the collection bodies (URSSAF), except unemployment insurance, as existing cuts are enhanced, along with a 1.8-point reduction in employers' family allowance contributions on jobs paying up to 1.6 times the minimum wage as from 2015, for total cuts of €4.6 billion.
- ▶ Extension of these measures (1.8-point cut in employers' family allowance contributions) to jobs paying between 1.6 times and 3.5 times the minimum wage, starting on 1 January 2016 and producing further savings estimated at €4.5 billion;
- ▶ A €1-billion cut in family allowance contributions for self-employed workers in 2015.

These cuts will total more than €10 billion by 2017, in order to meet two objectives: promoting job creation and enhancing competitiveness.

Modernising and cutting business taxes. The corporate social solidarity contribution (C3S), which is paid by some 300,000 companies, will be phased out by 2017. A preliminary cut of €1 billion was introduced in 2015 in the form of an allowance, which means that two-thirds of the companies currently paying this tax no longer have to do so. This exemption applies exclusively to small and medium-sized enterprises. Abolishing this tax will save companies a total of some €6 billion by 2017. The exceptional corporate income tax payment for large corporations will also be eliminated in 2016, which will reduce taxes by nearly €3 billion. Furthermore, the standard rate of corporate income tax will be lowered gradually from the current 33.33% to 28% in 2020, with a preliminary cut in 2017. This tax reform will promote investment, thus boosting jobs and growth. Abolishing the corporate social solidarity contribution and avoiding a cascade of taxes on intermediate consumption should also lead to more efficient organisation of production.

Tax cuts for the least well-off households. Reform of personal income tax rates at the low end of the scale, starting with the elimination of the lowest 5.5% tax bracket, will produce major savings for taxpayers with low and medium incomes. This measure will concern 9 million households and lead to an aggregate redistribution of more than €3 billion in purchasing power in 2015.

Furthermore, the November 2014 Supplementary Budget Act eliminated the earned income tax credit (*Prime pour l'emploi*, PPE), to be replaced on 1 January 2016 by a new measure that provides a more effective incentive to find work and boosts the purchasing power of low-paid employees.

TABLE 11 – COMPETITIVENESS AND EMPLOYMENT TAX CREDIT AND RESPONSIBILITY AND SOLIDARITY PACT MEASURES THAT IMPROVE CORPORATE EARNINGS

Taxes and social security contributions (in € billion)	2014	2015	2016	2017
Competitiveness and Employment Tax Credit (tax claim)	- 10	- 16½	- 18	- 19½
Responsibility and Solidarity Pact – operating expense		- 6½	- 12½	- 16½
<i>Of which cuts in social security contributions (including those for self-employed workers)</i>		- 5½	- 10½	- 10½
<i>Of which, phasing out the C3S</i>		- 1	- 2	- 5½
Elimination of the exceptional corporate income tax payment and cut in standard rate			- 2½	- 4½
Total measures benefitting businesses	- 10	- 23	- 32½	- 40½

Central government revenue

In 2015, taxes and social security contributions assessed by central government are projected to be 0.2 percentage points of GDP lower than in 2014, primarily as a result of discretionary tax measures and transfers. Measures passed under the second 2014 Supplementary Budget Act support the growth of taxes and social security contributions paid to the central government. Indeed, the Act includes measures to fight tax fraud and aggressive tax planning, and to make some business taxes non-deductible. However, their impact is more than offset by other measures, especially measures to boost the purchasing power of the least well-off households, including the elimination of the lowest income tax bracket, the impact of the Competitiveness and Employment Tax Credit and the supplementary transfer of VAT to social security funds to offset the impact of the Responsibility and Solidarity Pact.

Assuming no change to legislation, central government taxes would grow by 2.1% in 2015, slightly outstripping nominal GDP growth estimated at 2.0%: the slow growth of VAT is more than offset by increases in other tax revenue. More specifically, revenue from the domestic tax on consumption of energy products (TICPE) and corporate income tax will naturally grow faster than GDP. Growth of TICPE revenue will stem from increased consumption of oil products as a result of lower oil prices. Corporate income tax revenue will grow as taxable earnings rebound.

In 2016, the tax and social security contribution rate assessed by central government will continue to fall, easing by 0.2 percentage points of GDP, mainly as a result of revenue transfers to social security funds to offset the impact of the Responsibility and Solidarity Pact. Aggregate tax elasticity should be slightly higher than one as economic growth picks up again.

In 2017, the tax and social security contribution rate assessed by central government is expected to decline by 0.3 percentage points of GDP. Once again, the decline will result from revenue transfers, along with corporate income tax cuts introduced by the Pact. Aggregate tax elasticity is expected to be approximately 1.

SOCIAL SECURITY FUNDS' REVENUE

In 2014, social security funds' revenue grew at a slower rate of 2.4% after posting stronger growth of 2.9% in 2013, as a result of substantial discretionary measures. The strong growth of social security contributions, at 2.6%, outstripped the growth of private-sector payrolls, at 1.5%, for employers paying into the central social security agency (ACOSS). The increase stems from the increase in contribution rate under the 2014 pension reform and the early-retirement scheme for long careers, which will add €1.1 billion. The national agreement on supplementary pension schemes (Agirc and Arrco) signed in 2013 has added €0.5 billion to contributions.

Tax revenue increased by 2.5%, driven by the transfer of an amount equivalent to the proceeds from lowering the cap on family deductions (*quotient familial*) and taxing premiums paid by employers for supplementary employee health benefits. Social security funds' revenue from investment income decreased in 2014, as interest rates and investment returns fell. Social security funds' revenue from contributions and taxes increased by 2.6% to stand at €521.3 billion in 2014.

In 2015, social security revenue is expected to grow more slowly, rising by 1.0%, following growth of 2.4% in 2014. This change stems primarily from the cuts in social security contributions under the Responsibility and Solidarity Pact. Some of the cuts will be offset by lower expenditure for the social security funds, such as €4.8 billion in housing benefits that will be put back into the central government budget. On a like-for-like basis, social security funds' revenue is expected to grow by 1.8% in 2015.

The slower growth stems from a smaller increase in private-sector payrolls, which are expected to increase by 1.3%, compared to 1.5% in 2014 and by the smaller impact of discretionary measures in 2015, compared to 2014. In 2015, social security funds' revenues will nonetheless be sustained by a transfer to the old-age solidarity fund of the additional income tax revenue of €1.2 billion from the removal of income tax exemptions for pension increases, a further €1.2 billion from the increase in the old-age pension contribution rate under the 2014 pension reform and the reform of the pension scheme for long careers and €0.5 billion from the increase in the contribution rates for supplementary pensions. Social security taxes and contributions are expected to increase by 0.9% in 2015.

In 2016 and 2017, economic recovery and the government's measures to promote job creation should sustain growth of private-sector payrolls, which should average 2.9%. The growth of social security contributions, which is expected to average 2.4% in 2016 and 2017, will be curbed by the cuts outlined in the Responsibility and Solidarity Pact, and be offset over the same period.

Local government revenue

In 2014, growth of local government tax revenue stood at 2.5%, following growth of 0.8% in 2013. This growth was sustained by increased revenue from the contribution on business value-added (CVAE) in 2014, and registration duties on property sales (DMTO), as a result of *départements'* new powers to set the duties, which increased revenue by €0.7 billion in 2014, along with stable spontaneous growth, following a major decrease in 2013. Furthermore, additional transfers of revenue from the domestic tax on consumption of energy products (TICPE) were introduced to finance reforms of apprenticeships and vocational training. According to preliminary figures, municipal tax rate increases were very small in 2014, which was an election year. Total taxes and contributions came out at €127.6 billion. With the decline in central government transfers, which shrank by €1.5 billion, after being frozen in 2013, municipalities' overall revenue increased by 1.4% in 2014, compared to 1.3% growth in 2013.

Local government tax revenue is expected to increase by 3.3% in 2015, with a larger increase in municipal tax rates than in 2014, which was an election year. However, *départements* should see little increase in their tax rate in 2015, which is an election year for them. Central government transfers to local government

should contract by €3.4 billion compared to 2014. The spontaneous growth of local tax revenue will be boosted by a 0.9% statutory increase of the tax base under the 2015 Budget Act. As inflation is now expected to be 0% in 2015, this increase in the tax base gives local governments extra revenue growth of 0.9 percentage points more than inflation. In aggregate, local government revenue is expected to increase by 1.0% in 2015.

Local government tax revenue is expected to continue its strong growth, rising by 3.3% in 2016 and 3.6% in 2017, as the central government reduces its transfers even more, for a total reduction of €10.7 billion from 2015 to 2017. The sustainability of the continued reduction in central government transfers will be underpinned by the implementation in 2016 of the reform of the general operating grant, which is the largest transfer that the central government makes to local governments. The figure for 2015 is €36.6 billion.

GENERAL GOVERNMENT DEBT AND STOCK-FLOW ADJUSTMENT

The debt-to-GDP ratio stood at 95.0 in 2014, compared to 92.3 in 2013, for an increase of 2.8 pp. of GDP. Adverse economic conditions, with nominal GDP growth of 1.3%, meant that the debt-stabilising balance remained high at 1.2% compared to 1.3% in 2013. Efforts to reduce the government deficit to 4.0% of GDP, compared to 4.1% in 2013, helped slow the increase in debt and the deviation from the debt-stabilising balance stood at 2.7 points, the same level as in 2013. The stock-flow adjustment did not contribute to the variation in the debt in 2014, after making a negative contribution of 0.1 points in 2013. The neutral stock-flow adjustment stems from a number of changes that offset each other in aggregate. More specifically, assistance for troubled European Member States and adverse changes in cash holdings were offset by large issue premiums and discounts resulting from the current low level of interest rates and the accounting treatment of tax credits. In particular, the full tax claim stemming from the Competitiveness and Employment Tax Credit (CICE) in 2014 contributes to the deficit shown in the 2014 accounts. On the other hand, the fiscal impact of CICE on government debt is spread out over the period in which the central government makes refunds to businesses. Under the terms of Article 32 of the 2014-2019 Public Finance Planning Act, the debt level, according to the Maastricht definition and notified to the European Commission stood at €2,037.8 billion at the end of 2014, or 95.0% of GDP.

TABLE 12 - BREAKDOWN OF CHANGES IN THE DEBT-TO-GDP RATIO

(percentage points of GDP)	2014	2015	2016	2017	2018
Debt ratio according to the Maastricht definition (1)	95.0	96.3	97.0	96.9	95.5
Debt ratio excluding financial assistance for euro area countries	91.8	93.3	94.0	94.1	92.7
<i>Nominal GDP growth (%) (2)</i>	1.3	2.0	2.4	2.8	3.5
<i>Debt-stabilising balance (excluding stock-flow adjustment)</i> <i>(3)_n ≈ -(1)_{n-1} × (2)_n</i>	-1.2	-1.9	-2.2	-2.6	-3.2
<i>Headline balance (4)</i>	-4.0	-3.8	-3.3	-2.7	-1.9
Deviation from debt-stabilising balance (5)=(3)-(4)	2.8	1.9	1.0	0.0	-1.3
Stock-flow adjustment (6)	0.0	-0.6	-0.4	-0.1	-0.1
Change in debt ratio (7)=(5)+(6)	2.7	1.3	0.7	0.0	-1.4

In 2015, the debt ratio should grow more slowly, rising by 1.3 points to 96.3% of GDP. The combination of a smaller deficit, at 3.8% of GDP, compared to 4.0% in 2014, and a gradual economic recovery following three years of sluggish growth will automatically curb the increase in the debt ratio, with the deviation from the debt-stabilising balance standing at 1.9 percentage points of GDP. The stock-flow adjustment in 2015 is expected to make a negative contribution of 0.6 percentage points of GDP. Most of the adjustment should stem from the debt neutralisation resulting from the correction for accrual-based measurement of tax credits, and from €4 billion in asset sales proceeds allocated to debt reduction.

The increase in the debt ratio in 2016 is forecast to be smaller still, at 0.7 percentage points of GDP, reaching 97.0%. The combination of a smaller deficit and stronger economic recovery is expected to reduce the contribution from the deviation from the debt-stabilising balance to 1.0 point, while the stock-flow adjustment should make a negative contribution of 0.4 points. As in 2015, the main reasons for these developments should be the correction for accrual-based measurement of tax credits and €4 billion in proceeds from asset sales allocated to debt reduction.

In 2017 and 2018, continuing fiscal consolidation and GDP growth approaching its potential could mean that the debt ratio starts to decline. Such a decline would be limited in 2017, bringing the debt ratio down to 96.9% of GDP, followed by a larger decrease of 1.4 percentage points of GDP in 2018, bringing the debt ratio down to 95.5%. The deficit in 2018 is forecast to be significantly lower than the debt stabilising balance of approximately -3.2%, with nominal GDP growth at 3.5%. Furthermore, the impact of the stock-flow adjustment is supposed to be neutral from 2017 on, with the exception of the national motorway fund (*Caisse nationale des autoroutes*, CNA), which will contribute to a reduction in general government debt of approximately 0.1 percentage points of GDP each year.

BOX 7 - IMPACT OF EUROPEAN FINANCIAL ASSISTANCE PLANS ON GOVERNMENT DEBT

In the wake of tensions on European markets that started in the fourth quarter of 2009, several euro area Member States in succession had to call upon Europe for financial assistance, since market interest rates had risen too high.

The impact of financial assistance for the euro area on France's government debt is estimated at €66.2 billion in 2015, or 3 percentage points of GDP, and is expected to remain stable, after standing at €68.2 billion in 2014.

TABLE 13 - DEBT ARISING FROM FINANCIAL ASSISTANCE FOR THE EURO AREA (DEVIATION FROM BASELINE)

(in € billions)	2014	2015	2016	2017	2018
Government debt (Maastricht definition)	68.2	66.2	66.2	66.2	66.2
Bilateral loans to Greece	11.4	11.4	11.4	11.4	11.4
EFSF loans to Greece	31.0	29.0	29.0	29.0	29.0
EFSF loans to Ireland	3.8	3.8	3.8	3.8	3.8
EFSF loans to Portugal	5.7	5.7	5.7	5.7	5.7
Capital endowment to ESM	16.3	16.3	16.3	16.3	16.3

(percentage points of GDP)	2014	2015	2016	2017	2018
Government debt (Maastricht definition)	3.2	3.0	3.0	2.9	2.8
Bilateral loans to Greece	0.5	0.5	0.5	0.5	0.5
EFSF loans to Greece	1.4	1.3	1.3	1.3	1.2
EFSF loans to Ireland	0.2	0.2	0.2	0.2	0.2
EFSF loans to Portugal	0.3	0.3	0.3	0.2	0.2
Capital endowment to ESM	0.8	0.7	0.7	0.7	0.7

When the European Commission and Council assess compliance with the deficit and debt criteria, the Stability and Growth Pact (Article 2 of Regulation 1467/97 as amended) explicitly calls for special attention to be given to debt incurred in the form of bilateral and multilateral assistance between Member States to preserve financial stability and debt related to financial stabilisation operations during major financial crises.

Three successive financial assistance instruments were set up:

1) **Bilateral loans:** The euro area Member States and the IMF jointly assisted Greece in the second quarter of 2010 with an initial amount of €110 billion under a bilateral loan programme that was supposed to run until mid-2013. The EU lent €80 billion¹⁵ (including €16.8 billion from France¹⁶) and the IMF lent €30 billion.

2) **European Financial Stability Facility:** The euro area Member States also created the European Financial Stability Facility (EFSF) to provide assistance to any euro area country that requests it. This facility has a capacity of €440 billion on top of the €60 billion in the European Financial Stabilisation Mechanism (EFSM), which is a European Union instrument backed by the EU budget and available to all 28 Member States. **The Member States' guarantees for EFSF loans are recognised as part of the government debt according to the Maastricht definition**, in proportion to their shares of the guarantees provided to the EFSF¹⁷ for the loans disbursed. France's share at the beginning of 2015 stood at 21.88%.

The EFSF and EFSM were activated jointly with the IMF to assist Ireland and Portugal. **Ireland** was the first to receive a total of €85 billion in assistance at the end of 2010, including **€17.7 billion from the EFSF, to which France contributed €3.8 billion**, under a programme where all of the loan tranches were disbursed before December 2013. In the middle of 2011, **Portugal** received €78 billion in assistance, including **€26 billion from the EFSF, to which France contributed €5.7 billion**, under a programme to finance Portugal's general government until the middle of 2014. Ireland exited its EFSF assistance program on 15 December 2013 and Portugal followed suit on 18 May 2014. Rigorous implementation of reforms enabled them to resume sustainable market financing of their debts.

Following a deterioration in Greece's economic and financial situation in the middle of 2011, a **second financial assistance programme** was introduced in March 2012. The euro area Member States (via the EFSF) and the IMF provided further financing of €130 billion on top of the undisbursed funds from the first EFSF programme covering the period from 2012 to 2014. At the end of 2014, the EFSF had disbursed loans of €141.8 billion to Greece, with France providing a guarantee for €31.0 billion.

The Eurogroup decided to extend the availability of the funds under the second programme until June 2015. It was also decided that Greece had to repay the €10.9 billion in EFSF loans disbursed to bail out banks that were not used, since the needs of Greek banks were smaller than foreseen. This transaction reduced the outstanding EFSF loans to Greece by €10.9 billion and means that France's guarantee has been reduced by €2.4 billion in 2015. **On the assumption that the €1.8 billion associated with the 5th Review is disbursed in 2015, the Member States will provide guarantees of €132.7 billion at the end of 2015 under the second assistance programme, including guarantees of €29.0 billion provided by France.**

France has therefore agreed to finance or guarantee €49.9 billion (equivalent to 2.3 percentage points of GDP) in financial assistance for euro area peripheral countries through bilateral loans or the EFSF by the end of 2015.

¹⁵ Later lowered to €77.3 billion after Slovakia refused to take part and Ireland and Portugal withdrew.

¹⁶ Only €11.4 billion of the €16.8 billion has actually been disbursed. The remainder was incorporated into the second financial assistance programme introduced in March 2012 and financed by the EFSF.

¹⁷ This share is based on the national central banks' shares in the ECB's capital, adjusted for the holdings of Member States benefitting from the withdrawal clause under the terms of a financial assistance programme.

None of these loans is scheduled to be repaid before the end of the period covered by this Stability Programme (2018). The average maximum maturity of the EFSF loans to Ireland and Portugal has been extended from 15 to 22 years following the decision made by the Eurogroup in March 2013. In keeping with the decisions of the Eurogroup meeting of 26 November 2012, the average maturity of loans to Greece was extended to 20 years for bilateral loans and 32.5 years for EFSF loans.

3) European Stability Mechanism: The EFSF and the EFSM are no longer granting new loans¹⁸ since they were replaced by the European Stability Mechanism (ESM), which came into force in September 2012. The EFSF was set up to be a temporary institution that cannot take part in any further financial assistance programmes after June 2013. At its December 2010 meeting, the European Council decided, therefore, to set up a permanent mechanism to safeguard the financial stability of the euro area. The ESM is designed to be permanent and to rely not only on government guarantees, but also on paid-in capital.

Eurostat issued an opinion on 7 April 2011 based on the characteristics described in the Conclusions of the European Council of 24 and 25 March 2011. **Eurostat deemed that the liabilities of the ESM will not be counted as part of the Member States' Maastricht debt¹⁹ and that only their borrowing to finance their subscriptions to the paid-in capital would be recognised as debt. This capital stands at €80.5 billion since Latvia joined the euro area on 1 January 2014 and Lithuania joined on 1 January 2015. France's 20.2% share totals €16.3 billion.**

France paid in its share of the capital in five instalments of €3.3 billion. In accordance with the Statement of the Heads of State and Government at the European Council meeting of 2 March 2011, France's Supplementary Budget Act of 8 February 2012 includes authorisation for €16.3 billion in commitments. France then ratified the ESM Treaty on 8 March 2012. The first two instalments were paid in October 2012, adding €6.6 billion to France's debt in 2012. The third was paid on 29 April 2013, the fourth on 31 October 2013 and the fifth and last instalment was paid on 29 April 2014.

The ESM made its first disbursements to Spain for its bank recapitalisation programme, which was decided in July 2012. The amount disbursed in December 2012 and February 2013 was €41.3 billion. The programme ended in January 2014. Rigorous implementation led to sustainable stabilisation of Spanish banks and Spain repaid €1.6 billion ahead of schedule in July 2014, followed by €1.5 billion in March 2015, which reduced the outstanding amount to €38.2 billion.

After approval by the Eurogroup on 24 March 2014, €10 billion in financial assistance was also granted to Cyprus. The EMS provided €9 billion and the IMF €1 billion, of which the EMS disbursed €5.7 billion at the end of December 2014. These disbursements do not add to France's debt, as explained previously.

¹⁸ The EFSF is now being managed in run-off mode, which means that the Facility will continue to manage the loans already granted until they are fully repaid and that any new financial assistance will now be provided by the ESM.

¹⁹ Since the ESM is a permanent international institution under international law with a governance structure similar to that of international financial institutions (with a board of governors, a board of directors and a managing director), and a paid-in capital of €80.2 billion. The ESM's paid-in capital must always be greater than 15% of its commitments.

5. COMPLIANCE WITH THE STABILITY AND GROWTH PACT

EXCESSIVE DEFICIT PROCEDURE

Efforts to ensure compliance with the Council recommendations

As part of the Excessive Deficit Procedure started in April 2009, on 21 June 2013, the ECOFIN Council made a recommendation to France to end its excessive deficit situation by 2015. The recommendation set headline deficit targets of 3.9% of GDP in 2013, 3.6% in 2014 and 2.8% in 2015. These targets were consistent with delivering an improvement in the structural balance of 1.3 percentage points of GDP in 2013, 0.8 percentage points of GDP in 2014 and 0.8 percentage points of GDP in 2015.

Following the passage of the 2015 Initial Budget Act and the 2014-2019 Public Finance Planning Act in December 2014, and in light of its 2015 winter forecasts, the European Commission felt that a revision of the Recommendation of 21 June 2013 to extend the deadline for France's return to a deficit of less than 3% of GDP until 2017 was warranted, because the economic conditions were worse than expected at the time the initial Recommendation was made. The Commission deemed that France's efforts in 2013 and 2014 made it possible to revise the Recommendation of 21 June 2013. The ECOFIN Council meeting of 10 March 2015 adopted the new Recommendation, which charts a new adjustment path for the headline deficit: 4.0 % in 2015, 3.4 % in 2016 and 2.8 % in 2017. The Commission stated that this path was consistent with delivering an improvement in the structural balance of 0.5, 0.8 and 0.9 percentage points of GDP respectively. It should be noted that the Commission's baseline no-policy-change scenario does not incorporate all of the consolidation measures passed for 2016 and 2017, and, more specifically, it does not include the savings measures of the Public Finance Planning Act.

The Recommendation asks France to specify, adopt and implement additional measures equivalent to 0.2% of GDP by the end of April to close the gap with the recommended improvement in the structural balance for 2015.

The 2014 deficit reported by France's national statistics institute (Insee) on 26 March 2015 stands at 4.0% of GDP. Government expenditure has grown much less quickly than the Commission predicted in its February 2015 forecasts, which confirms its finding that effective actions had indeed been implemented in 2013 and 2014.

This result shows that the government has the capacity to meet its expenditure reduction targets. As announced in January, central government expenditure, along with healthcare expenditure, was below the target set in the Public Finance Planning Act. The published statistics show that spending was reined in even more tightly (see "Outturn 2014", page 18) for local government expenditure, social security funds' expenditure and central government agencies' expenditure, and that debt servicing turned out to be less than projected in the Initial Budget Act. This tighter control of spending offset some of the decline in tax revenues since the Initial Budget Act. This revenue decline stems from three consecutive years of very weak growth as well as low inflation, and remains beyond the government's control.

This means that structural adjustment in 2014 came out at 0.4 percentage points of GDP, as measured by the Public Finance Planning Act yardstick, despite very adverse elasticity effects, which contributed -0.2 percentage points of GDP, and tax credits, which contributed -0.1 percentage points of GDP. The aggregate structural effort, as defined by the Public Finance Planning Act, reached 0.7 percentage points of GDP. Given the efforts made in 2013 as well, the measures taken ensured compliance in 2013 and in 2014 with the Council's Recommendation of 21 June 2013.

In 2015, compliance with the March 2015 recommendation will be ensured by the measures outlined in this Stability Programme. This effort will be stepped up compared to the path set out in the Public Finance Planning Act, with adjustments of €4 billion, or 0.2 percentage points of GDP (see the details of the corrective measures for 2015 in Box 2). The adjustment resulting from these measures will comply with the Recommendation of 10 March 2015, since it will be equivalent to 0.5 percentage points of GDP and the headline deficit will be brought down to 3.8% of GDP, which is lower than the target of 4.0% set in the Recommendation.

In 2016, the effort should also be greater than called for in the Public Finance Planning Act, with €5 billion in supplementary measures to be set out in detail in the budget acts. Total structural adjustment is forecast to be increased from 0.3 points to 0.5 percentage points of GDP and the headline deficit to stand at 3.3% of GDP, which is lower than the target set out in the Recommendation.

The deficit is projected to stand at 2.7% in 2017, which is lower than called for in the Recommendation of 10 March 2015. The government decided not to make an additional adjustment, which would have a negative impact on growth and jobs, while still complying with the headline targets with room to spare and achieve a structural adjustment of 0.5 points each year from 2015 to 2017. Thus, the government has confirmed the excessive deficit will be corrected by 2017, in keeping with the commitments made in the Public Finance Planning Act.

BOX 8 - FISCAL CONSOLIDATION MEASURES INTRODUCED SINCE THE PREVIOUS STABILITY PROGRAMME

Since the previous Stability Programme for 2014-2017, additional savings measures were passed in the supplementary budget acts in the second quarter of 2014 to ensure full control of expenditure in 2014. These measures, which come on top of those worth nearly €15 billion passed in the initial budget acts, slowed expenditure growth to 0.9% in 2014.

More specifically, the government put forward two supplementary budget acts in June 2014 that implemented an additional €4 billion in measures to step up the pace of fiscal consolidation. Specifically, the Supplementary Budget Act of 8 August 2014 cancelled €1.6 billion in central government appropriations, excluding debt servicing and pensions, that had been included in the target set in the 2014 Initial Budget Act. The Supplementary Social Security Budget Act included €0.8 billion in additional savings measures on expenditure covered by the national healthcare expenditure growth target (Ondam). Healthcare expenditure came in at €0.3 billion under the Ondam target and central government expenditure at €0.1 billion under the central government expenditure rule.

The savings plan for 2015 to 2017 was also passed as part of the 2014-2019 Public Finance Planning Act in order to pursue fiscal consolidation while continuing to finance the government's priorities, starting with the Responsibility and Solidarity Pact. These savings are explained in detail in Box 4.

In addition, the 2015 draft budgetary plan, which was submitted in October 2014, gives details of savings across all general government sub-sectors. These savings were stepped up following discussions with the European Commission in the fourth quarter of 2014. A plan for supplementary measures worth €3.6 billion was added to the 2015 draft budgetary plan and passed in the 2015 Initial Budget Act.

The savings plan was stepped under this Stability Programme to account for the impact of lower inflation on public finances and to uphold the adjustment path leading to a return to a deficit under 3% of GDP in 2017. Supplementary measures worth €4 billion were put forward in 2015. Most of them concern expenditure, and measures worth another €5 billion are planned for 2016 (see Box 2).

CONVERGENCE TOWARDS THE MEDIUM-TERM BUDGETARY OBJECTIVE

The 2014-2019 Public Finance Planning Act sets a medium-term budgetary objective (MTO) of a structural balance of -0.4% of potential GDP. The Act also sets out the adjustment path for achieving this objective. This path is the benchmark for this Stability Programme, which complies with the requirements of the preventive arm of the Stability and Growth Pact.

After France exits the Excessive Deficit Procedure as expected in 2017 under the current path and until the medium-term objective has been attained, the Growth and Stability Pact requires structural adjustment of at least 0.5 percentage points of GDP per year²⁰.

The structural balance adjustment path described in this Stability Programme is compatible with these requirements, since it calls for structural adjustment of 0.5 points in 2018, after bringing the deficit below 3% in 2017 (see "Structural balance" page 21). This adjustment path complies with the rules of the Stability and Growth Pact and leads to attainment of France's medium-term objective of a balanced budget in structural terms in 2018 (the structural balance is expected to reach - 0.1 percentage points of GDP).

²⁰ Article 5 of Regulation 1466/97 as amended.

6. SENSITIVITY ANALYSIS AND COMPARISON WITH PREVIOUS PROGRAMME

SENSITIVITY TO EXTERNAL ASSUMPTIONS

The pace of France's economic recovery and underlying spontaneous public finance developments will depend on world demand for French exports, oil prices, euro exchange rates and interest rates.

The international scenario underlying the projections is as follows:

- ▶ Oil prices are stable at \$59 per barrel;
- ▶ The euro exchange rate is stable at \$1.10;
- ▶ The growth rates of the global economy and world trade gradually return to their long-term average. After rising by 3.3% in 2014, world demand for French exports is expected to increase by 4.5% in 2015 and by 5.7% in 2016, followed by growth of approximately 6% in 2017 and 2018.

The assumptions about the euro exchange rate are lower than the ones in the Commission's winter forecasts. This Stability Programme assumes a rate of \$1.10 and the Commission's winter forecasts, a rate of \$1.17. The oil price assumptions are also different: at \$58 in this Stability Programme versus an average \$53 in 2015 for the Commission. The figures for 2016 are \$59 and \$61.5 respectively. The Commission also expects world demand for French exports to grow by 4.3% in 2015 and 5.4% in 2016.

In addition to providing figures about how the assumptions concerning export demand, exchange rates, oil prices and interest rates will affect growth, inflation and the headline deficit (see Tables 14 to 17), this section assesses the main upside and downside risks surrounding the forecast.

Uncertainty about the economic recovery of France's leading trading partners in the euro area

Future exchange rate movements: a continuing slide in the value of the euro could give the euro area economy an added boost and promote a resurgence of inflation. However, more volatile exchange rates also increase economic uncertainty.

Falling oil prices are stimulating growth in France and in its leading trading partners, but a rise in oil prices could reverse this trend. Continuing falls in oil prices could provide an additional spur for growth in the short and medium term, but with no certitude. On the other hand, if oil prices rebound too soon, they could slow growth.

There is still a risk of negative inflation in the euro area, even though policy mix choices seem to have made the risk of “deflation” recede. Slower price rises in the recent period stem in part from the big drop in energy prices, as well as weak demand in the euro area up until now.

Risks from trading partners outside the euro area

The timing of a return to standard monetary policy in the United Kingdom and the United States is still unclear, given the uncertainty about productivity and labour markets. This could have an impact on exchange rates.

In the emerging economies, commodity price movements are a major upside or downside risk. Geopolitical tensions in Eastern Europe around the crisis between Russia and Ukraine could also reignite. Were China’s economic growth to be lower than expected, owing to an unexpectedly severe correction of its real estate market, global growth would be hampered, especially in the case of commodity-exporting countries, such as Russia and Brazil, which have already been hit hard by falling prices. On the other hand, a stronger recovery in the developed countries or a continuation of the monetary easing seen in emerging economies at the start of the year, despite high inflation rates in some countries, are the major upside risks.

Uncertainty about business and household demand

Investment forecasts are subject to uncertainty in several areas. In addition to uncertainty about oil prices and exchange rates, there is uncertainty about their impact on the economy. Businesses could decide to make the most of lower oil prices and measures that cut labour and investment costs (Competitiveness and Employment Tax Credit, Responsibility and Solidarity Pact) by using some of the savings to boost their profits rather than passing them on in lower prices. Their price competitiveness would be lower in the short term, but healthier earnings would promote investment. Lowering prices, on the other hand, could be done more quickly and would do more to improve price competitiveness. There is also uncertainty about the pace of the recovery in investment in construction, since economic data from recent months do not yet show any tangible signs of a recovery in the very short term.

Household consumption could also defy predictions and be either stronger or weaker than expected. Purchasing power will depend on the outcome of wage bargaining, which is subject to several unknowns: employees could obtain larger pay rises, since the Competitiveness and Employment Tax Credit and the Responsibility and Solidarity Pact, along with lower oil prices, give employers more room for manoeuvre, or employers could take a harder line in wage bargaining in view of their current tight margins and their uncertainty about the economic recovery. Precautionary saving will ease more or less, depending on the labour market and confidence in the economic recovery.

**Stability Programme
for France 2015–2018**

Alternative scenarios presented in the Stability Programme:

TABLE 14 - IMPACT ON FRANCE'S ECONOMY OF A 1% INCREASE IN WORLD DEMAND FOR FRENCH GOODS (*)

<i>(deviation from the baseline scenario in %)</i>	n	n+1	n+2
GDP growth	0.2	0.2	¼
Total jobs created (thousands)	9	27	40
Household consumption deflator	0.0	0.1	0.1
Net government lending/ borrowing (in % points of GDP)	0.0	0.1	0.1

(*) Sustained 1% increase in export demand at the start of year n with no change in real interest rates

NB: An increase in world demand would boost exports, which would feed through to the rest of the economy, increasing business investment in particular.

TABLE 15 - IMPACT ON FRANCE'S ECONOMY OF A 10% DEPRECIATION OF THE EURO AGAINST ALL OTHER CURRENCIES (*)

<i>(deviation from the baseline scenario in %)</i>	n	n+1	n+2
GDP growth	+0.6	+1.0	+1.2
Total jobs created (thousands)	+30	+85	+149
Household consumption deflator	+0.5	+0.7	+1.2
Net government lending/ borrowing (in % points of GDP)	+0.2	+0.4	+0.6

(*) 10% depreciation in the value of the euro against all other currencies at the beginning of the year n, with no change in real interest rates, endogenous reaction of the rest of the world.

NB: A weak euro would boost growth in the short term by improving France's price competitiveness outside of the euro area and by stimulating the economic growth of its euro area partners.

TABLE 16 IMPACT ON FRANCE'S ECONOMY OF A \$20 INCREASE IN OIL PRICES (*)

<i>(deviation from the baseline scenario in %)</i>	n	n+1	n+2
GDP growth	-0.1	-0.2	-0.2
Total jobs created (thousands)	-3	-28	-62
Household consumption deflator	0.3	0.8	1.2
Net government lending/ borrowing (in % points of GDP)	0.0	-0.1	-0.2

(*) 20 \$ increase in the price of oil per barrel at the beginning of year n, with no change in real interest rates, endogenous reaction of the rest of the world.

NB: With no change in exchange rates, an increase in the price of oil would have an inflationary impact. The resulting increase in consumer prices and decrease in corporate profits would weaken growth.

TABLE 17 IMPACT ON FRANCE'S ECONOMY OF A 100-BASIS-POINT INCREASE IN SHORT-TERM INTEREST RATES FOR TWO YEARS(*)

(deviation from the baseline scenario in %)	n	n+1	n+2
GDP growth	-0.2	-0.3	-0.1
Total jobs created (thousands)	-10	-36	-45
Household consumption deflator	-0.1	-0.1	-0.2
Net government lending/ borrowing (in % points of GDP)	-0.1	-0.2	-0.1

(*) A 100-basis-point increase in euro area short-term interest rates lasting for two years and occurring at the beginning of year *n* that has an impact on long-term interest rates and on the value of the euro and endogenous reaction of the rest of the world.

NB: An increase in central bank interest rates would hamper growth by restricting business investment and the return on capital. It would promote savings over consumption and lead to an appreciation of the euro.

COMPARISON WITH THE PREVIOUS PROGRAMME

TABLE 18 COMPARISON WITH THE PREVIOUS STABILITY PROGRAMME

	2013	2014	2015	2016	2017
2014-2017 Stability Programme (April 2014)					
Real GDP growth (in %)	0.3*	1.0	1.7	2.25	2.25
Government balance (% of GDP)	-4.3	-3.8	-3.0	-2.2	-1.3
Structural balance (% of potential GDP)	-2.9	-2.1	-1.2	-0.8	-¼
<i>Structural adjustment (% of potential GDP)</i>	<i>1.1</i>	<i>0.8</i>	<i>0.8</i>	<i>0.5</i>	<i>0.5</i>
Government debt (% of GDP)	93.5	95.6	95.6	94.2	91.9
Government debt, excl. support for the euro area (% of GDP)	90.4	92.4	92.5	91.2	89.0
2015-2018 Stability Programme (April 2015)					
Real GDP growth (in %)	0.3	0.4*	1.0	1.5	1.5
Government balance (% of GDP)	-4.1	-4.0	-3.8	-3.3	-2.7
Structural balance (% of potential GDP)	-2.5	-2.0	-1.6	-1.1	-0.6
<i>Structural adjustment (% of potential GDP)</i>	<i>1.0</i>	<i>0.4</i>	<i>0.5</i>	<i>0.5</i>	<i>0.5</i>
Government debt (% of GDP)	92.3	95.0	96.3	97.0	96.9
Government debt, excl. support for the euro area (% of GDP)	89.3	91.8	93.3	94.0	94.1

*Change in quarterly accounts, adjusted for seasonal variations and working days

Structural adjustment in 2014 stood at 0.4 points and was smaller than the target of 0.8 points set under the 2014-2017 Stability Programme. Tax revenue elasticity is not identified as a separate cyclical factor in the usual methodology. This means that the smaller structural adjustment stems primarily from low aggregate tax elasticity of 0.6, compared to 0.9 under the previous Stability Programme. Structural efforts were also hampered by lower inflation, which reduced expenditure efforts, despite a decrease in nominal expenditure growth, excluding tax credits, from 1.4% to 0.9%. Growth was also weaker than expected under the previous Stability Programme, posting a rate of 0.4% instead of the 1.0% growth predicted in the 2014 Stability Programme. All in all, this means that the headline balance improved by only 0.1 points, instead of the 0.5 points predicted under the previous Stability Programme. Some of the deviation stems from a revision of the headline 2013 balance since it was first estimated. In aggregate, the headline balance in 2014 falls only 0.2 points short of the target set under the previous programme, coming in at 4.0% instead of 3.8%.

In 2015, the 1.0% outlook for growth is significantly lower than the 1.7% figure under the previous Stability Programme, in line with the growth forecast in the Public Finance Planning Act. In addition, as weaker inflation diminishes tax elasticity, structural adjustment is expected to be smaller than under the previous programme, standing at 0.5 points, instead of 0.8 points, despite much slower growth of nominal government expenditure, coming in at 0.9%, excluding tax credits, instead of 1.2%.

Stability Programme for France 2015–2018

The aggregate reduction of the headline deficit from 2014 to 2015 is projected to be smaller than the reduction called for under the previous Stability Programme at 0.2 percentage points of GDP instead of 0.8 points. The bulk of the deviation stems from a more adverse growth and inflation outlook.

In 2016 and 2017, the structural adjustment figures should be very similar, but the improvement in the headline balance is still expected to be undermined by weaker growth than under the previous programme.

COMPARISON WITH THE EUROPEAN COMMISSION'S PUBLIC FINANCE FORECASTS

TABLE 19 COMPARISON WITH THE EUROPEAN COMMISSION'S FORECASTS

	2014	2015	2016
European Commission's projections (winter forecasts, February 2015)			
Real GDP growth (in %)	0.4	1.0	1.8
Government balance (% of GDP)	-4.3	-4.1	-4.1
Structural balance (% of potential GDP)	-2.9	-2.6	-3.0
Structural adjustment (% of potential GDP)	0.4	0.3	-0.4
Government debt (% of GDP)	95.3	97.1	98.2
2015-2018 Stability Programme (April 2015)			
Real GDP growth (in %)	0.4	1.0	1.5
Government balance (% of GDP)	-4.0	-3.8	-3.3
Structural balance (% of potential GDP)	-2.0	-1.6	-1.1
Structural adjustment (% of potential GDP)	0.4	0.5	0.5
Government debt (% of GDP)	95.0	96.3	97.0

In its winter forecast published on 25 February 2015 before this Stability Programme was published and the 2014 deficit figure was announced by the French national statistics institution (Insee) on 26 March, the European Commission forecast that France's deficit would stand at 4.3% of GDP in 2014, 4.1% in 2015 and 2016 under a no-policy-change scenario, with GDP growth rates very similar to the ones used by the government in this Stability Programme, namely 0.4% in 2014, 1.0% in 2015 and 1.8% in 2016. However, the Commission's scenario that incorporates the supplementary adjustment measures in the Recommendation of 10 March 2015 forecasts growth of 0.8% in 2015, 0.7% in 2016 and 0.8% in 2017, which is much weaker growth than under the Stability Programme scenario.

The Commission's deficit forecast is worse than the deficit published by Insee for 2014, making it in turn more pessimistic than the government's forecast for 2015. The Commission's forecast is for a deficit of 4.1% of GDP in 2015, compared to the government's forecast of 3.8%.

In 2014, the Commission forecast a deficit that was bigger than the final figure: the Commission overestimated nominal expenditure growth, as it forecast 2.2% growth, including tax credits, as opposed to

the 1.6% growth shown in the data that Insee released on 26 March 2015. This differential between the latest Commission forecast and the outturn has an impact on the excessive deficit procedure. The underspending boosts the savings effort on expenditure, thereby raising the indicators that the Commission uses to assess effective actions on a bottom-up basis. The 2014 results uphold the judgment that French did indeed implement “effective action” for 2015.

In 2015, the differential between the Commission scenario and the Stability Programme scenario stems from the 2014 base effect and the fact that the Commission's forecasts do not factor in the additional savings recently announced by the government amounting to approximately €4 billion.

In 2016, the two forecasts are not comparable since the Commission's adjustment path under the no-policy-change scenario does not include all of the measures passed under the Public Finance Planning Act, nor the stepped up efforts announced in this Stability Programme. This explains a structural “disadjustment” in the European Commission's scenario.

7. QUALITY OF PUBLIC FINANCES

QUALITY OF GOVERNMENT EXPENDITURE

Expenditure review

The Public Finance Planning Act of 29 December 2014 institutes an annual Government Expenditure Review that is an integral part of the budget procedure (Article 22). The review should improve the efficiency of government expenditure, in the spirit of the Constitutional Bylaw on Budget Acts (*Loi organique relative aux lois de finances*, LOLF), as well as contributing to compliance with the multiyear path for public finance. The purpose of the expenditure review is to define the implementation procedures for the structural reforms underlying public finance planning.

The themes of the annual reviews are decided by the government and submitted to Parliament at the same time as the draft budgetary plan for the year. The reviews are conducted by the inspection and audit bodies. The objectives include achieving savings and may involve all general government sub-sectors to ensure comprehensive analysis of expenditure and government action. For this purpose, the scope of expenditure reviews includes tax expenditures and exemptions from social security contributions. This means that every policy can be analysed as a whole, with all of its financing instruments, whether they are based on budget appropriations or tax measures.

The new reviews follow a strict calendar. The government provides the Parliament with the findings and proposals from the reviews before the end of the February following the passage of the budget act. This gives Parliament new information before the budget procedure starts. The connection with the budget calendar means that the review is coordinated with drafting the budget, which is the responsibility of the government.

Expenditure reviews are an integral part of the budget procedure, inspired by the models used in a number of other countries. They will be used to define the measures that will achieve the savings planned as part of the fiscal adjustment path.

In preparation for the future requirements of the Public Finance Planning Act, the first reviews are already under way. They focus on the finances of universities and civil service schools, as well as housing benefits. The findings will be incorporated into the budget-making process for 2016.

BOX 9 – GOVERNANCE MEASURES IN THE PUBLIC FINANCE PLANNING ACT

In addition to presenting the fiscal adjustment path, the Public Finance Planning Act for 2014 to 2019 introduces a series of governance measures to increase the efficiency and transparency of government expenditure.

First, the Act improves the annual budget procedure by incorporating an expenditure review aimed at documenting structural savings at an early stage in the budget-making process so that they can be included when drafting the budget and giving Parliament more information about government expenditure.

Secondly, the Public Finance Planning Act introduces cross-cutting good governance measures that apply to several general government sub-sectors. For this purpose, it institutes a new instrument for governance and ownership of the fiscal adjustment path: the Fiscal Consultations, which will involve all general government sub-sectors in compliance with the fiscal adjustment path and fiscal consolidation. The use of public-private partnerships (PPPs) has also been made more secure, for central government bodies, government health institutions and local governments, through tighter central government oversight of future contracts. Other measures will also deal with new tax expenditures and exemptions from social security contributions, which will now be limited to a three-year term and require an assessment before being eliminated or renewed. The Act also extends two measures introduced under previous planning acts: first, any windfall revenue must be used entirely for deficit reduction; secondly, the principle of a social and economic assessment prior to government investments has been upheld.

Thirdly, the 2014-2019 Public Finance Planning Act includes specific rules for each general government sub-sector:

- ▶ For the central government, it raises the minimum reserve ratio to 6% for all programmes, excluding personnel expenditure; the ratio for expenditure covered by the national healthcare expenditure growth target (Ondam) is 0.3%;
- ▶ The Public Finance Planning Act rationalises the use of earmarked taxes by government agencies, which has led to additional government spending in recent years. Earmarked taxes will be systematically capped by 1 January 2016, or, failing that, will be put back into the central government budget starting on 1 January 2017. The continuing use of earmarked taxes and the creation of new earmarks will be subject to strict guidelines. Earmarked taxes must now meet one of three criteria: they must be virtual fees for services, sector-specific levies for financing mutual insurance or assistance within a given sector, or else they must have the character of insurance contributions for insurance or compensation funds that pool risks. The Public Finance Planning Act also requires all information about earmarked taxes to be submitted to the line ministries, in order to ensure better supervision of these changing resources. The Public Finance Planning Act also upholds the principle of the ban on borrowing for central government agencies²¹, and introduces rules on the compensation paid by such agencies, particularly executive pay;
- ▶ An expenditure growth target for local governments (ODEDEL) has been introduced and will include specific targets for each category of local government, starting in 2016. The target will

²¹ Nevertheless, Article 12 of the 2011-2014 Public Finance Planning Act, which was not repealed by the Public Finance Planning Acts of December 2012 and December 2014, provides an exemption for the government debt fund (Caisse de la dette publique).

supplement the supervision and planning instruments currently applying to other general government sub-sectors, such as the central government expenditure rules and the national healthcare expenditure growth target. In accordance with the constitutional principle of free administration, it will allow local governments to draft a budget compatible with the overall fiscal adjustment path;

- ▶ **Health institutions subject to a recovery plan are required to have their revenue and expenditure forecasts approved by the Managing Director of the regional health agency (*Agence régionale de Santé*, ARS).** The forecasts will not be approved if changes in the institutions' staffing levels are obviously out of line with changes in their activities.

The Public Finance Planning Act also ensures greater transparency in the oversight of public finance. For this purpose, the Act calls for several reports and accounts to be submitted to Parliament, including: a list of the government bodies and agencies created or eliminated during the year; a report on changes in health institutions' personnel expenditure; a report on the financial outlook for unemployment insurance; a report on the cost of tax expenditures and exemptions from social security contributions; an account of the execution of the Public Finance Planning Act; a presentation of the assumptions underlying the calculation of the government expenditure trend; and forecasts of cyclical, structural and headline balances.

Streamlining healthcare expenditure

The structural reforms of the healthcare system under the National Health Strategy will produce efficiencies that ensure control of expenditure without compromising quality of care.

The strategy relies on using all of the available leverage in four areas:

- ▶ Shifting the focus to outpatient care and improving the efficiency of hospital and primary care treatments. Hospitals' activities should be refocused on the most appropriate treatments; this means shortening hospital stays, while ensuring quality of care, by developing outpatient surgical procedures, using alternatives to hospitalisation, providing support for patients returning home and reducing hospital admissions and re-admissions.
- ▶ Increasing the efficiency of hospital expenditure, using the hospital performance programme for responsible purchasing and forming local hospital groups to pool resources.
- ▶ Continuing efforts to reduce drug prices, so that a fair price is paid for innovation, and to promote the use of generic drugs. The objectives of the National Generic Drug Promotion Plan launched in March 2015 are to increase the share of generic drug prescriptions by 5 points by 2017, through actions aimed at all of the private-practice and hospital doctors writing prescriptions, to conduct public information campaigns, to introduce appropriate pricing policies and to make France more attractive for foreign investors.
- ▶ Promoting the reasonable use of primary care and hospital care. This objective aims to reduce duplicate and inappropriate treatments through such means as contracts between institutions, regional health agencies and the health insurance fund, tighter supervision of doctors' prescriptions for transportation and drugs, and the reasonableness of certain treatments.

The National Health Strategy will provide support for multi-disciplinary structures with GPs at the centre to coordinate treatment by the various healthcare providers for each patient. The role of the public hospital system will be reaffirmed. At the same time, financial obstacles to access to care will be reduced through generalisation of supplementary health insurance and the expansion of the direct settlement system, which will be extended to people receiving subsidies to buy supplementary health insurance on 1 July 2015.

These structural objectives will be broken down into annual targets under the national healthcare expenditure growth target (Ondam). The latest estimates of expenditure covered by the national healthcare expenditure growth target show underspending of €0.3 billion in 2014 compared to the target set in the Public Finance Planning Act. This underspending was achieved despite the arrival of very expensive new treatments for hepatitis C, testifying to the effectiveness of the regulating mechanisms adopted in the 2015 Social Security Budget Act. For the fifth year in a row, the outturn has been lower than the initial target.

Streamlining local government expenditure

Over the period from 2015 to 2017, the government intends to continue the efforts made since 2013 to improve the quality of local public finances. These efforts are based on several measures that are already in force or in the process of being adopted.

The first measure is the reduction of €10.7 billion²² in central government funding for local government under the savings plan in the 2014-2019 Public Finance Planning Act. The aim of this measure is to generate a lasting change in local government behaviour patterns and incentivise them to rein in their expenditure growth. Tightening financial constraints should also encourage local government decision-making bodies to pool and streamline their expenditure increasingly to achieve net savings, as highlighted in a December 2014 report by the Inspectorates General of Finance and Administration on resource pooling between municipalities.

At the same time, a local government expenditure growth target (ODEDEL) was introduced by the 2014-2019 Public Finance Planning Act. This target is expected to enable local governments to take ownership of fiscal constraints and manage their expenditure growth over several years. The targets will be broken down for each category of local government in 2016 and will be adjusted as needed under the terms of Article 11 of the Public Finance Planning Act.

The reform of general operating grants will be implemented in 2016 for a simpler and more equitable distribution of central government transfers as the grants are cut back. This reform should also incite municipalities to pool their structures and their powers. For this purpose, the Prime Minister asked a Parliamentary task force to draft practical proposals and hand in its conclusions in July 2015. At the same time, the Local Finance Committee has set up working groups with the same goal. The resulting proposals for reform could then be incorporated into the draft budgetary plan for 2016.

Local government reform will continue with the passage of a bill by summer 2015.

Specifically:

- ▶ The Act on modernising local government action and strengthening metropolitan areas enacted on 27 January 2014 has already made it possible to strengthen metropolitan areas and municipal integration, and to streamline the division of powers by setting up local government consultations;
- ▶ The Act of 16 January 2015²³ redraws the boundaries of France's regions, merging neighbouring regions and reducing their number in metropolitan France from 22 to 13 in 2016. The new enlarged regions will carry more weight and make it possible to streamline expenditure through economies of scale;

22 On top of the cuts of €1.5 billion in general operating grants in 2014, following a freeze in 2013.

23 Act 2015-29 of 16 January 2015 on regional boundaries, regional and departmental elections and the election calendar.

- ▶ The proposed local administration reform act (NOTRe) currently before Parliament aims to clarify the division of powers between local governments. It eliminates the *clause de compétence générale* for *départements* and regions, which means that local governments will have to focus their expenditure on the areas for which they are responsible as of right. Regions are expected to enjoy greater power, especially in economic matters, whereas *départements* will focus on social action, and municipalities will be gradually incorporated into larger intermunicipal structures.

Agencies' expenditure

Agencies and other government bodies controlled by the central government are fully engaged in the **fiscal adjustment path**. These agencies' expenditure has grown much more quickly than central government expenditure in recent years. They will play their full part in the consolidation efforts under way since 2012.

For this purpose, the 2014-2019 Public Finance Planning Act contains many new governance rules applying to the agencies:

- ▶ Following a government decision, these agencies will be **included in the scope of the expenditure reviews** introduced in Article 22 of the Act.
- ▶ The agencies will also have to contribute to compliance with the **stabilisation of central government staffing levels** from 2012 to 2017 provided for under Article 9 of the Act.
- ▶ **The revenue appropriated to the agencies will be regulated more tightly.** The use of earmarked taxes is strictly circumscribed by Article 16 of the Act, in accordance with the findings of the Tax Policy Council (*Conseil des prélèvements obligatoires*). For this purpose, the Act provides for generalisation of caps on earmarked taxes and, where necessary, reincorporation of earmarked taxes into the central government budget. The agencies that collect the taxes themselves will also be required to submit annual reports to their line ministries so that changes in these resources can be assessed and supervised more closely.
- ▶ **The principle of banning borrowing established in 2010 has been recast** to rein in the agencies' debt with the introduction of a one-year grace period for bodies that have been newly classified as "other central government bodies" (ODAC).

The use of public-private partnerships (PPPs) is now more secure following the ban on direct contracts with agencies, which centralises contracting expertise in the line ministries.

The Public Finance Planning Act will also **improve Parliament's oversight and information with regard to central government agencies**. For this purpose, the annex on their budgets in the draft budgetary plan will be supplemented with the following:

- ▶ a list of the agencies and government bodies created and closed down during the year preceding each draft budgetary plan;
- ▶ a report covering changes in agencies' total payroll, staffing levels and financing sources (budget appropriations and earmarked taxes) over three years
- ▶ information about changes in their real property holdings;
- ▶ and the aggregate sum of the ten largest gross compensation packages of each structure for bodies with more than ten employees.

In addition, the implementation of certain provisions of the **Decree on government fiscal and accounting management of 7 November 2012 will substantially recast the fiscal and accounting framework of the agencies on 1 January 2016**. The fiscal and accounting rules for more than 1,300 bodies will be harmonised to improve the analysis of their financial sustainability. The new fiscal and accounting

framework will make more information available about the financial situation of the agencies by supplementing the accrual-basis financial accounts with cash-based budgetary accounts. Consequently, the budget authorisations passed by the boards of more than 700 bodies will distinguish between commitment appropriations and payment appropriations, as is the case for the central government budget. This will improve control of commitments covering more than one year. The adjustment of appropriations to disbursement requirements will prevent the build-up of excess cash surpluses.

QUALITY OF GOVERNMENT REVENUE

The government's tax policy focuses on four areas, with an overall commitment to a stable tax burden and certainty for businesses and individuals. The four focuses are:

- ▶ promoting investment, entrepreneurship and innovation;
- ▶ enhancing competitiveness and reducing labour costs;
- ▶ making taxes more progressive and fairer;
- ▶ enhancing the efficiency and sustainability of taxation.

Promoting investment, entrepreneurship and innovation

With a view to promoting the economic recovery, the government has committed itself to providing exceptional support for business investment for one year. Businesses that invest in production capacity in the next twelve months will receive a tax incentive to speed up modernisation of their means of production, to become more competitive and to create more jobs. The incentive will be an additional depreciation allowance for productive investment that already qualifies for declining-balance depreciation. The additional depreciation allowance will be equal to 40% of the cost price of the investment. It will entitle the eligible businesses to immediate reductions of their corporate income tax base by the same amount, spread out over the useful life of the investment. The cost of this measure is estimated at €0.4 billion in 2015 and €0.5 billion in 2016. It is part of a more comprehensive plan presented by the Prime Minister on 8 April 2015 aimed at accelerating and refocusing private and public sector investment.

The government has committed itself to promoting innovation and long-term risk-taking. The capital gains tax rules for individuals were reformed in 2014 to make them more transparent and attractive, thereby promoting long-term investment and risk-taking. Under these rules, taxes are systematically assessed using the personal income tax brackets, after deductions that vary according to how long the equities were held before being sold, with a 50% deduction after two years and a 65% deduction after eight years. Similar deductions were introduced to promote the creation and growth of small and medium-sized enterprises, with a 50% deduction after one year, a 65% deduction after four years and an 85% deduction after eight years. Furthermore, most innovative new companies qualify as innovative start-ups²⁴ (JEIs) under the reformed and enhanced rules contained in the 2014 Initial Budget Act. This qualifies them for a full exemption from corporate income tax in their first three years and a 50% allowance for the next two years' earnings. According to a recent report by the European Commission, this is seen as the most effective innovation tax incentive in the European Union.²⁵ Taxes on free distributions of shares are also being reduced to bring them into line with the rest of the tax system and make France more attractive for investors.

²⁴ Independent SMEs less than eight years old that spend a minimum amount on research can qualify as start-ups.

²⁵ "A Study on R&D Tax Incentives Final report" WORKING PAPER N. 52 – 2014

Enhancing competitiveness and reducing labour costs

The government has been committed to reducing labour costs since the fourth quarter of 2012. All of the measures to reduce labour costs through the Competitiveness and Employment Tax Credit (CICE) and the Responsibility and Solidarity Pact carry a cumulative cost of nearly €30 billion through 2016. This effort will enable businesses to restore their margins, invest and create new jobs.

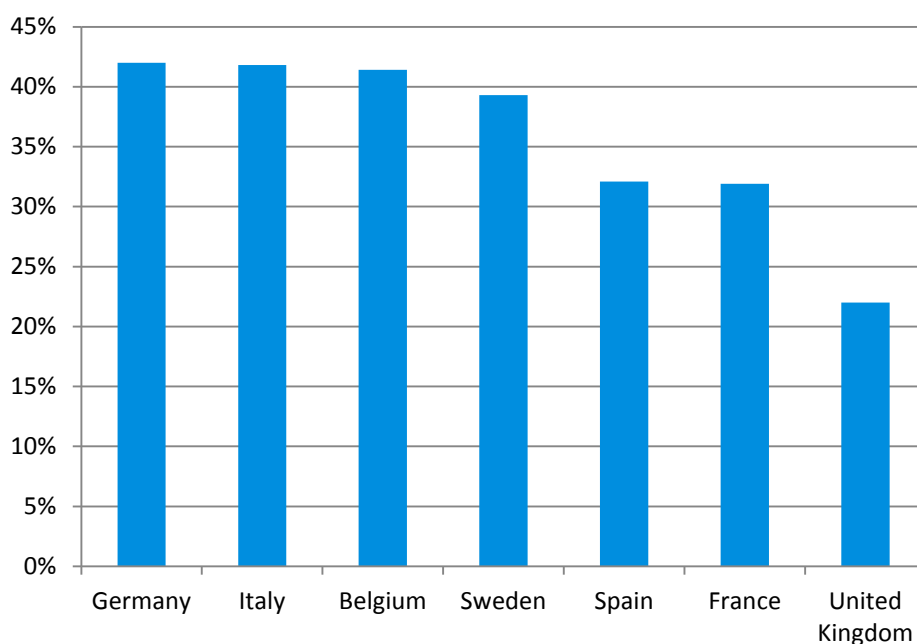
The Competitiveness and Employment Tax Credit (CICE) was introduced on 1 January 2013. The credit is based on gross payroll costs for jobs paying up to 2.5 times the minimum wage, and it was raised from 4% of this amount to 6% on 1 January 2014. The CICE is expected to result in savings of €20 billion on labour costs in 2017. On 6 November 2014, the President of the French Republic asserted his determination to make the savings on labour costs from the CICE permanent by transforming the tax credit into a general reduction in social security contributions.

The measures under the Responsibility and Solidarity Pact will produce a further €10 billion in savings on labour costs in 2016 as their application is extended to all jobs paying up to 3.5 times the minimum wage.

These two measures mean that the government's actions will concern 90% of employees, with a special effort for low-wage employees. The result will be a reduction of the tax wedge²⁶ on low-wage jobs where the impact on employment is the strongest. Moreover, this will enhance France's competitiveness. Back in 2013, the OECD reported that the tax wedge in France was relatively small (see chart below).

²⁶ The tax wedge is the ratio of taxes and social security contributions to the total labour cost paid by the employer.

CHART 1: TAX WEDGE (RATIO OF TOTAL LABOUR COST) FOR A SINGLE EMPLOYEE EARNING 50% OF THE AVERAGE WAGE IN 2013



Source: OECD

The Supplementary Budget Act of 29 December 2012 established a committee to monitor and assess the Competitiveness and Employment Tax Credit. Following implementation of the Responsibility and Solidarity Pact, a decision was made at the Social Conference of July 2014 to **expand the committee's monitoring to cover all government support for businesses**, including the cuts introduced by the Responsibility and Solidarity Pact. This decision took effect on 4 November 2014. The committee members include representatives from labour and management, representatives from the main government departments concerned, experts and Members of Parliament. On the same day, the Prime Minister initiated the establishment of regional committees to monitor government support.

Several measures have supplemented the Pact to make France more attractive for businesses, including an eventual cut in the corporate income tax rate. The Responsibility and Solidarity Pact calls for the elimination of turnover taxes, with no relation to value created. This means the corporate social solidarity contribution (C3S) will be phased out by 2017. In the same vein, the exceptional corporate income tax payment for large corporations will be maintained in 2015 before being abolished in 2016. The standard rate of corporate income tax will be lowered from its current level of 33.1/3% to 28% in 2020, with a first cut in 2017. This will bring it into line with the European average.

Making taxes more progressive and fairer

The progressiveness of personal income tax was enhanced to increase social justice and provide targeted support for the purchasing power of the least well-off. Low- and middle-income taxpayers have seen their taxes cut and these cuts will become permanent through reform of the lowest tax bracket.

Measures in the 2013 and 2014 Budget Acts, such as taxing investment income at the same rate as earned income, eliminating unwarranted exemptions (for pension bonuses paid to parents with three or more children and for employer contributions to collective supplementary healthcare schemes), have enhanced the progressiveness of personal income tax.

The Responsibility and Solidarity Pact also includes income tax cuts for households in the middle of the income range in order to boost their purchasing power. A tax cut passed for 2014 in the Supplementary Budget Act resulted in tax savings for 4 million low-income households, including 2 million that ended up being non-taxable. The 2015 Initial Budget Act extended this tax cut for low- and middle-income households and made it permanent. The reform eliminated the lowest tax bracket and raised the tax relief ceiling for low-income taxpayers (under the “*décote*” mechanism), thereby raising the minimum threshold and giving greater consideration to the situation of couples than the previous rules. The combined effects of the tax cut in 2014 and the reform of the lowest tax bracket will benefit 9 million households, including 3 million households that will then owe no tax. The reform cuts taxes by more than €3 billion and boosts the purchasing power of the households concerned by the same amount.

The November 2014 Supplementary Budget Act eliminated the earned income tax credit (PPE) so that it can be replaced on 1 January 2016 by a new measure (in-work benefit) that provides a greater incentive for getting people back to work and a greater boost to the purchasing power of low-paid employees.

Specific criteria based on taxable income for the reduced-rate general social security contribution on pensions or exemption from the contribution was implemented to limit cumulative threshold effects and changes in tax rates, particularly with personal income tax and the residence tax.

Enhancing the efficiency and sustainability of the tax system

Certain tax bases have been expanded to increase the efficiency of the tax system. For example, the intermediate rate of VAT was raised from 7% to 10% in 2014, bringing it closer to the standard rate, which had been raised from 19.6% to 20%. Meanwhile, the reduced rate was unchanged, especially for the most essential consumer goods. The base for the hotel occupancy tax has also been broadened.

In a similar vein, the “debt bias” was reduced by limiting the deductibility of loan interest to 75% in the case of businesses where net financial expenses are greater than €3 million. This measure came into effect on 1 January 2014. The announced decrease in the standard corporate income tax rate, which will be cut in stages down to 28% by 2020, will automatically reduce the debt bias as well. There is no denying that the measure restricting the deductibility of financial expense primarily concerns the largest businesses, but small and medium-sized enterprises (SMEs) have been entitled to a corporate income tax rate of 15%²⁷ since 2002, which reduces the debt bias for them.

The effort to rein in tax expenditures has also continued. As part of this effort, tax consultations (see Box 10), which were first held in 2013 to examine tax measures, with a special focus on tax expenditures, earmarked taxes and low-yield taxes, were repeated and expanded in 2014 and will be held again in 2015. The consultations take place within the framework set out by the Public Finance Planning Acts, which aims to streamline the tax system by:

- ▶ stabilising tax expenditures and tax credits in the medium term in nominal terms: the 2014-2019 Public Finance Planning Act calls for an annual cap of €80.6 billion on tax expenditures in 2015, including €24.7 billion for tax credits. The Act includes a specific new target for tax credits, to keep a tighter rein on the cost of these measures, which will now be treated as government expenditure under the new national account rules. In addition, the expenditure reviews called for in the 2014-2019 Public Finance Planning Act now cover tax expenditures.

²⁷ On profits up to the first €38,120, in the case of companies where 75% or more of the equity is owned by natural persons and turnover is less than €7.63 million.

- ▶ Tax expenditures introduced or altered since 1 January 2015 must also be assessed within the first three years and any renewal must be justified.

Other measures were taken with a view to achieving greater efficiency and social justice. Property assessments will be revised for the first time since the nineteen-seventies to take account of changes in the real estate market. As part of this revision, an experiment on residential premises was launched in 2015. The reform for commercial premises is currently being assessed and the results will be discussed in Parliament to determine the impact of the reform and the supporting measures that will be needed before its implementation following a phase of experimentation and consultations.

Green taxes will be enhanced to increase environmental sustainability. A carbon component was introduced into energy taxation in 2014 (oil, natural gas and coal taxes). It will increase in stages, starting at €7/tonne of CO₂ in 2014, followed by €14.50/tonne in 2015 and €22/tonne in 2016. Meanwhile the reduced tax rates on diesel oil, gas and fuel oil used for agriculture and construction were raised in 2014. The tax differential between diesel oil and petrol was narrowed to €0.02/litre on 1 January 2015. The total increase in the diesel oil tax will be nearly €0.04/litre in 2015, of which €0.02/litre is for the carbon component and €0.02/litre is for financing transportation infrastructures. **This will result in a proportionate narrowing of the differential between taxes on diesel oil and petrol.** In addition, the scope of the general tax on pollution-generating activities (TGAP) was extended to several heavy metals, the reduced VAT rate on fertilisers was eliminated in 2014, and the tax exemptions for biofuels will be phased out by 2016.

Tax efficiency and sustainability also requires efforts to fight tax fraud and avoidance. The resources for this fight have been increased substantially since 2012. This fight is the key to upholding the principle of equal treatment of taxpayers. Tax fraud undermines national solidarity by placing the burden of taxation on taxpayers who comply with their obligations and it undermines fair competition between businesses. More than 70 measures have stepped up this fight since 2012. This year, the fight against VAT fraud in the most vulnerable sectors (automotive and construction industries) has been stepped up through measures in the 2014 Supplementary Budget Act of 29 December 2014, and through the modernisation of the administration's investigative tools (data mining). The resources of the Offshore Disclosure Unit (*Service de traitement des déclarations rectificatives*, STDR) were increased.

In addition to fighting fraud, it is important to ensure that businesses pay their fair share of taxes in the places where they make their profits, particularly in the case of multinational firms. For this reason, France is an active participant in the OECD project on base erosion and profit shifting (BEPS), which aims to reform international rules to fight aggressive tax planning more effectively. The project team will submit its recommendations to the G20 by the end of 2015. France also supports similar work being accomplished within the European Union.

BOX 10 – TAX CONSULTATIONS

Tax consultations are meetings organised by the Ministry of Finance with other government's departments, that are held each May. The meetings examine the tax measures proposed to be included in financial legislation to be passed in the autumn. The consultations provide an innovative framework for streamlining public finance. They started in 2013, establishing a joint tax-setting procedure that is conducted in coordination with the budget procedure.

The consultations are a channel for closer consultation with ministries and prior assessment of proposed tax measures. They are part of the government's implementation of sound management principles that are the key to complying with France's European commitments regarding public finance. The total cost of tax expenditures came to €72 billion in 2013 and this cost is estimated at €82 billion in 2015, including more than €10 billion for the Competitiveness and Employment Tax Credit.

The tax consultations are also covered by the 2014-2019 Public Finance Planning Act of 29 December 2014, which provides for cost caps on tax expenditures and tax credits and an assessment of discretionary measures in their first three years of application.

The coordination of the tax consultations and the budget consultations, at which budget appropriations are worked out, was enhanced in 2014. The tax consultations were held jointly with the budget consultations for certain programmes to ensure a consolidated and coherent approach to government action. This system is to continue in 2015, with discussions between ministries based on an aggregate analysis of budget appropriations and tax expenditures in order to target areas for streamlining sector policies.

In addition to discussing tax expenditures, the 2015 tax consultations will also examine earmarked taxes and low-yield taxes that often involve complicated compliance procedures for taxpayers and high collection costs. With a view to simplifying the tax system, the objective will be to come up with proposals to eliminate taxes with inadequate yields and unproven relevance, as well as ways of transforming or merging underperforming taxes. The rationalisation of earmarked taxes will supplement the initiatives started in 2012 to cap earmarked taxes and reincorporate them into the general budget.

8. SUSTAINABILITY OF PUBLIC FINANCES

SUSTAINABILITY OF GENERAL GOVERNMENT DEBT

Impact of the ageing population on public finances

France's strong birth rate, the improvement in its older worker participation rate and the reforms it has made over the last 20 years or more, have placed France in a strong position to deal with its ageing population compared to its European partners. The financial equilibrium of France's pension system is no longer a major issue for the long-term sustainability of public finances.

The latest pension reform in 2014 enables the system to cope with the current financial challenges in the short and medium term. In the wake of the unprecedented economic crisis that affected France and in preparation for the wave of baby-boomers reaching retirement, this reform calls for budgetary measures that will be borne equally between firms, employees and pensioners. Management and labour representatives have also adopted consolidation measures, such as the national multi-sector agreement of 13 March 2013 with the supplementary retirement scheme management bodies (AGIRC and ARRCO) that reduces the index-linking adjustment of pensions from 2013 to 2015. Negotiations for a new agreement to be signed in 2015 are currently under way.

The European projections by the Ageing Working Group, which are based on Eurostat's population forecasts, are now being re-estimated. France's average fertility rate is one of the highest in Europe for the period under review, which means a strong birth rate could partially offset the ageing of the population. At the same time, bold reforms over the last 20 years or more should reduce pension expenditure as a percentage of GDP. More specifically, the increase in the number of years of service required to obtain a full pension, up to 43 years starting in 2035, which was part of the reforms passed in 2013, will enhance the sustainability of the pension system. This lengthening of the contribution period will raise the effective retirement age as life expectancy increases.

The 2014 reform enhanced governance of the pension system by setting up the Pension Steering Committee (*Comité de suivi des retraites*), which is an independent authority with responsibility for publishing an annual opinion on the situation of the pension system with regard to the statutory objectives, especially its short- and long-term financial viability. For this purpose the Committee relies on the forecasts by the Pensions Advisory Council (*Comité d'orientation des retraites*), based on the national statistics institute's population forecasts and an array of macroeconomic scenarios. In its first opinion, published in the third quarter of 2014, the Pension Steering Committee deemed that the path back to financial equilibrium presented in the Pension Advisory Council's annual report in June 2014 was still attainable by 2020. The Council's updated forecasts published in December 2014 confirmed that the pension system was expected to return to financial equilibrium by 2020 and then start generating surpluses under the baseline scenario (B).

Sustainability indicator (S2)

A country's public finances are sustainable when it is able to meet its financial obligations without having to cut expenditure or increase revenue in the long term. A public finance sustainability gap is normally assessed by estimating the immediate and lasting fiscal adjustment (in percentage points of GDP) that would be required to avoid a long-term increase in the government debt-to-GDP ratio, with no further change in the structural primary balance (meaning the structural balance excluding interest expenditure). This indicator, called the S2 indicator, is the sum of two terms:

- ▶ **The impact of the initial budget position**, which corresponds primarily to the difference between the structural primary balance and the balance that would stabilise debt in the long term.
- ▶ **The impact of the ageing population** on expenditure on pensions, healthcare, long-term care and unemployment benefits starting in 2018 based on a no-policy-change assumption. Work carried out by the Member States and the European Commission produced a harmonised estimate of this impact at the European level.

The European Commission is about to complete a cycle of updates of expenditure on pensions, healthcare, long-term care and unemployment benefits up until 2060 by the Ageing Working Group (AWG). New data is now available for updating the ageing population component of the S2 indicator from the last Stability Programme.

The previous projection of pension expenditure showed a growing share of GDP by 2060. The updated projections show a sharp drop in expenditure as a share of GDP, which explains why the S2 component related to the cost of the ageing population was lowered by nearly 2 points compared to the previous Stability Programme. The difference stems primarily from a new set of macroeconomic and demographic assumptions. It also stems in part from the impact of the 2014 reform and the use of a microsimulation model for pension expenditure at the request of the European Commission. The projections were produced by the Directorate General of the Treasury in conjunction with the national statistics institute (Insee), based on the macroeconomic and demographic assumptions defined by the Ageing Working Group, and using Insee's Destinie microsimulation model.

With no reduction in the government deficit, meaning a constant structural primary balance from 2014 to 2018, a long-term structural adjustment of 0.2 percentage points of GDP would have to be achieved in 2019 to stabilise debt in the very long term, in view of the expected trends in ageing-related expenditure (the discounted additional cost of which is estimated at -1.1 percentage points of GDP between 2019 and 2060). The expenditure savings set out in this programme would reduce the necessary adjustment stemming from the initial budget position by nearly 2.0 percentage points of GDP, leading to a substantial improvement in the sustainability indicator, bringing it to -1.8 percentage points of GDP.

TABLE 21 - FISCAL SUSTAINABILITY GAP INDICATOR S2 (PERCENTAGE POINTS OF GDP)

<i>Base year</i>	2014	2018
Sustainability gap (S2 indicator)	0.2	-1.8
o.w impact of the initial budget position	1.3	-0.8
o.w impact of the ageing population (as of 2019)	-1.1	-1.1

Note:

- ▶ *The 2014 S2 indicator is estimated on the basis of a counterfactual scenario, where the structural primary balance is assumed to be constant at its 2014 level for the duration of the Programme (2015-2018) independently of the impact of the ageing population: it corresponds to the long-term fiscal adjustment that would have to be achieved in 2018 to stabilise the very long-term debt-to-GDP ratio in view of the impact of the ageing population after 2018;*
- ▶ *The 2018 S2 indicator is estimated on the basis of the 2018 structural primary balance expected under this Programme. It corresponds to the long-term fiscal adjustment that would have to be achieved in 2018 to stabilise the very long-term debt-to-GDP ratio in view of the impact of the ageing population after 2018.*
- ▶ *The ageing-related expenditure figures (pensions, healthcare, long-term care, education, unemployment benefits) are taken from the Ageing Working Group's data published in 2015.*

CONTINGENT LIABILITIES

General government off-balance sheet liabilities cannot be evaluated with certainty and depend on future developments. If a given event occurs, the central government's liability may be invoked. These liabilities may eventually affect public finances. Therefore, they are very closely monitored by the government and Parliament. More specifically, central government off-balance sheet liabilities are described in detail in the central government's General Financial Statement (*Compte général de l'État*, CGE) that is published each year and certified by the French Government Audit Office (*Cour des comptes*). The main general government off-balance sheet liabilities are:

- ▶ liabilities for future ageing-related expenditure (pensions, healthcare, long-term care, education), where valuations depend on the demographic and macroeconomic outlook. The impact of these liabilities on the sustainability of debt is measured by calculating a sustainability gap indicator, the S2 indicator (see above).
- ▶ contingent liabilities, which are liabilities that may or may not have to be paid, depending on future events. In most cases, these relate to guarantees provided by the central government and to a lesser extent by local government.

Central government guarantees cover a wide range of actions to sustain or preserve economic activity or to provide financing for certain economic agents when market financing is inadequate. These guarantees are given under clear-cut agreements and they include in particular: central government loan guarantees, guarantees related to general interest functions (insurance mechanisms operated through the central reinsurance fund, export loan guarantees through COFACE, guarantees to protect savings, etc.), liability guarantees (e.g. for France's share of ESM callable capital) and central government financial commitments for co-financing projects and providing development assistance. Generally speaking, the risk of such guarantees being invoked is small. Furthermore, no new central government guarantees can be given other than in a Budget Act, as stipulated in the Constitutional Bylaw on Budget Acts (*LOLF*). This rule was introduced to reduce the use of such guarantees.

At the end of 2013, the aggregate outstanding central government guarantees under clear-cut agreements, meaning all central government loan guarantees, came to €203 billion²⁸ compared to €163 billion in 2012.

²⁸ Source: 2013 central government financial statements.

The guaranteed amounts for debt issuance by SFEF (*Société de financement de l'économie française*) were unchanged at €24 billion. Nevertheless, several guaranteed amounts increased in 2013, including the guarantees provided to the EFSF (European Financial Stability Facility), which increased from €58 billion in 2012 to €70 billion in 2013, to the unemployment insurance scheme (Unédic), which increased from €10 billion in 2012 to €15 billion in 2013, and to Dexia, which rose from €27 billion in 2012 to €34 billion in 2013. It should be noted that the debt of the unemployment insurance scheme, which is part of general government, is already included in Maastricht debt. Furthermore, following a decision by Eurostat on 27 January 2011, the funds that the EFSF lends to Member States in difficulty are recognised directly as part of the Maastricht debt of the Member States providing the guarantees, in proportion to the amount provided. The two main new central government loan guarantees or amendments to central government guarantees compared to 2012 concerned PSA Finance and CIF. The central government signed a memorandum of understanding with various entities in the CIF group on 27 November 2013 implementing a final guarantee for the CIF group. In 2013, the central government provided a €12-billion guarantee for 3CIF, the central refinancing unit of the CIF group. The outstanding loan amounts guaranteed for Banque PSA Finance come to €1.2 billion.

The use of this type of guarantee has increased since the crisis, particularly in developed economies, but without necessarily being a long-term arrangement. It requires the central government to be more vigilant about risks that could be transferred to the public sector. The fiscal risks that the central government incurs through these guarantees, which serve a general interest purpose, must be assessed beforehand, and be subject to ongoing monitoring and control.

France exercises this vigilance in three ways:

First, through a decision-making process, where, under the terms of Article 34 of the Constitutional Bylaw on Budget Acts (*Loi organique relative aux lois de finances, LOLF*), **Parliament's authorisation must be obtained in the Budget Act for any new guarantee scheme**. The legislation must include a precise definition of the guarantee scheme being created. When seeking authorisation from Parliament, the risks incurred must be described exactly, and, according to Constitutional Council precedent, such authorisation is not valid unless there is a guarantee limit or a mechanism to maintain financial control of the scheme. The preliminary assessments are very detailed and public information. Such vigilance and transparency is rarely matched by our OECD partners. Secondly, in conjunction with the other entities concerned during the budget-making process, **off-balance sheet liabilities are subject to centralised fiscal monitoring** at least twice a year to assess the risk of the guarantees being invoked. In addition, more specific information, which is also public, is provided as part of the various draft budgetary plans, along with many reports on specific topics submitted to the Finance Committees of both chambers of Parliament. Some of the reports are required under the terms of the Budget Act that establishes the guarantee scheme concerned.

Thirdly, the **notes to the Central Government Financial Statements (CGE) on Central Government Liabilities** provide a comprehensive inventory of guarantees given and other off-balance sheet liabilities incurred by the Ministry for Finance in conjunction with the other ministries concerned.

This inventory gives France a major advantage in terms of the materiality of its accounting compared to its partners. The inventory is audited each year by the French Government Audit Office (*Cour des comptes*), which highlighted the improvement of accounting quality in this area in its audit report on the 2012 central government financial statements published in May 2013. In its audit report on the 2013 central government financial statements published in May 2014, the French Government Audit Office withdrew its qualified opinion about the inventory. This testifies to the high-quality liability monitoring that the central government has achieved.

ONGOING STRUCTURAL REFORMS

The French economy has many strengths including its institutional framework, world-class infrastructures across its territory, its financial system, the quality and productivity of its work force and its positive demographic trends. It must implement a strategy of bold reforms, building on these strengths. These reforms cover six main areas.

Improving businesses' cost competitiveness

France's economic agenda aims to improve its businesses' competitiveness, which has been slipping since 2000. The Competitiveness and Employment Tax Credit (CICE) and the Responsibility and Solidarity Pact will cut a total of €40 billion from taxes and contributions on labour by 2017. The first effects are already being felt. Export market shares have been stable since 2013, and the cost of labour in France grew by only 0.4% in France, compared to 2.1% in the euro area. Businesses profit margins should show substantial growth in the first half of 2015, as labour costs are reined in. After being stable for three years, inward foreign investment grew by 8% in France in 2014, testifying to the country's stronger appeal for foreign investors.

Cutting red tape for businesses

Red tape (administrative procedures and unnecessary standards) generates extra costs for businesses and inefficiencies that ultimately harm consumers and undermine economic activity. In January 2014, the government set up the Administrative Streamlining Board (*Conseil de simplification pour les entreprises*), which is an independent body co-chaired by a Member of Parliament and a business leader. Every six months, the Board announces new measures to cut red tape and provides progress reports on the measures announced previously. The measures adopted so far have produced gains estimated at more than €3 billion. The measures are key steps towards freeing enterprise and supporting business growth.

Adapting regulations on the market for goods and services

Opening up the market for goods and services is a key step for business growth, competitiveness and economic activity in France. Since 2012, the government has introduced measures to make markets work better and increase competition in a large number of sectors. The Growth, Economic Activity and Equal Economic Opportunity Bill continues these efforts and aims to improve the operation of transport services, retail trade and the regulated professions. The 21st Century Justice Bill will complement this reform by strengthening the professionalism and ethical requirements of the commercial courts and by reforming contract law through ordinances, leading to sweeping modernisation of France's business law. This movement will continue with a new digital economy act to stimulate digitisation of France's economy and to develop businesses and careers based on the use of open data. The government will hold an economic and social conference in June of this year to discuss ways of supporting entrepreneurship and SMEs/VSEs, such as opening up government procurement to small businesses, tax issues and simplification of labour laws and regulations.

Investing and promoting innovation

Investment is the key to recovery in the short term and for enhancing the medium-term potential of France's economy. On 8 April, the government announced bold support measures for private and public investment to consolidate and expand the economic recovery. These measures complement existing initiatives, such as the Very High Speed Internet Plan, the creation and lending of the Banque publique d'investissement (BPI), the extension of the Invest for the Future Programme and the drafting and review of the plans that make up the New Industrial France initiative. France will also tap the full potential of the European investment plan and enhance its domestic impact through lending from the Caisse Des Dépôts and BPI.

Reforming the labour market

France has faced persistently high unemployment for the past 30 years. This situation requires a fresh look at employment policy to make it more effective. The government's action is organised around two complementary projects aimed at making career paths more flexible, ensuring greater security for employees and deepening labour and management dialogue.

The Job Security Act of 14 June 2013 marks a break with the past by instituting a French form of flexicurity. Employees have been given new rights and businesses have more adaptability through bold simplification of short-time working rules and a reform of collective layoff procedures. A review of the results is now under way and the government will soon take the necessary steps to make the Act more effective, particularly with regard to relaxing the job protection agreements. The Prime Minister has just set up a task force to determine the statutory changes needed to give collective bargaining agreements a larger role in France's labour law, particularly at the firm level. In 2016, the new unemployment insurance agreement will provide more efficient back-to-work incentives, enhance career path security and guarantee the financial soundness of the system, in line with the reforms introduced since 2014.

Fighting inequality and preparing for the future

The government's reform agenda aims to set the stage for sustainable growth. This will require a relentless fight against growing inequality that jeopardises national cohesion and tackling environmental and demographic challenges.

To fight inequality more effectively, special emphasis has been placed on education, particularly early-childhood education. In addition to commitments to create new teaching positions, access to school for two-year olds will be increased and secondary-school curricula will be reformed to increase the chances for success of the most disadvantaged pupils. Several measures for drop-outs will be implemented to ensure that they have a right to a "second chance".

The transition to clean energy will be promoted through ambitious targets and resources deployed to speed up energy-saving renovation of housing and other buildings (tax credit, third-party financing, interest-free energy-efficiency loans, etc.) and rein in energy consumption (deployment of smart electricity and gas meters).

The aggregation of these reforms enables a continuous, thorough and effective transformation of the French economy by addressing all short-, medium- and long-term challenges. In this respect, France's agenda is fully in line with the European agenda and it supports and guides Europe's action to increase growth and jobs.

9. INSTITUTIONAL ASPECTS AND FISCAL GOVERNANCE

FULLY OPERATIONAL FISCAL GOVERNANCE

The Constitutional Bylaw (*Loi organique*) 2012-1403 of 17 December 2012 radically overhauled France's domestic public finance legislation in order to bring it into compliance with European law. It has brought about changes in management, including steering based on objectives defined in structural terms, inclusion of an introductory article for budget acts, and content guidelines for Public Finance Planning Acts. Changes have also been introduced on an institutional level, with the creation of the High Council on Public Finances (*Haut Conseil des Finances Publiques*, HCFP), which is tasked with issuing an opinion on the macroeconomic forecasts contained in the Stability Programme and draft budgetary plans, and their consistency with the multiyear structural balance figures set out in the Public Finance Planning Act. The High Council also identifies potential deviation of the budget outturn from the multiyear forecast during the debate on the draft Budget Review Act. Where appropriate, it states whether there are any "exceptional circumstances" that could justify the deviation.

The creation of the HCFP now provides Parliament and outside observers with an independent assessment of the government's macroeconomic and public finance forecasts. It is fully operational and has been able to exercise its remit as stipulated in the Constitutional Bylaw. Since April 2013, it has issued 11 opinions on budget acts, draft budgetary plans, stability programmes, budget review acts and planning acts. On 23 May 2014, when examining the 2013 Budget Review Act, the HCFP observed a significant deviation between the structural balance and the government's multiyear projections as set out in the 2012-2017 Public Finance Planning Act. The government took note of this deviation when presenting, as provided for in budget acts, further consolidation measures for 2014 and beyond. The HCFP also issued an opinion on 26 September 2014 on the multiyear macroeconomic projections of the draft Public Finance Planning Act for 2014-2019, as well as on the consistency of the planned programme with France's medium-term objective and European commitments.

Concurrently with this new institutional framework, the Government has set up new public finance governance bodies. As part of efforts to prepare the Stability Programme, the Government Expenditure Strategy Council (*Conseil stratégique de la dépense publique*) was instituted by a presidential decree dated 22 January 2014. The Council's task is to "propose and monitor the structural savings programme set out in France's Stability Programme", and to "ensure France's fiscal consolidation while fostering both growth and jobs." It met again in 2015 to define the broad outlines of the additional measures for 2015-2016 approved as part of the presentation of the Stability Programme. Moreover, the introduction of budget/tax consultations has allowed for greater consistency between the examination of government expenditure and tax expenditures (see Box 10 on Tax consultations).

To direct the structural balance adjustment path based on the savings plan, and to improve public finance governance, a new Multiyear Public Finance Planning Act for 2014-2019 was passed in December 2014. Under the Act, the medium-term objective will be to achieve a structural balance of -0.4% of potential GDP. This option has also allowed France to take the implementation of the Responsibility and Solidarity Pact into account. At a time when the national accounts are making the switch

to the 2010 European System of Accounts (ESA 2010), this option comes at an opportune moment. The 2014-2019 Planning Act has also bolstered public finance governance, as it includes measures covering the entire general government sector. The Act also introduces an expenditure review (see Box 9).

Finally, national public finance governance is fully integrated within the European procedure. Since the entry into force of the "Two-Pack", each year in the autumn, the European Commission issues an opinion on Member States' draft budgetary plans (the equivalent of France's Economic, Social and Financial Report appended to the draft budget). The plans are then discussed by the Council of the European Union. In addition, the Stability Programme is submitted to the Commission in April, prior to the European Semester. At each of these European deadlines, compliance of each Member State's adjustment path with European recommendations is assessed, in accordance with the provisions of the Stability and Growth Pact.

STATISTICAL GOVERNANCE

France's national statistics institute (Insee) is responsible for publishing the national accounts, which include the main public finance aggregates in the national accounts. A new European System of Accounts (ESA), ESA 2010, is now in force, replacing ESA95. Since September 2014 it is applicable to all Member States. Insee maintains regular contact with Eurostat to ensure that its accounts are in compliance with the new ESA 2010 rules.

The **semi-final and final general government accounts**, published with lags of two years and three years respectively, are compiled on the basis of detailed accounting information. The main information source for the central government is the budget outturn, supplemented by the central government's financial statements (accrual-based financial statements, which are certified by the Government Audit Office). Restating the budget outturn as government net lending requires a series of adjustments to correct for some time lags and for the difference in treatment of certain transactions in budgetary accounting and in the national accounting system. Putting together the "Other central government bodies" account, which mainly covers central government agencies, involves posting adjustment entries in each of the agencies' individual accounts to convert them to comply with the national accounting system. The data for the local government sector (APUL) come from the individual management accounts kept by Treasury accountants. The accounts of the social security funds (ASSO) are compiled from the accounts of the various funds, public hospitals and private hospitals providing public healthcare services, the unemployment insurance agency (Unédic) and Pôle Emploi, France's public employment service agency, along with the supplementary retirement scheme management bodies (such as AGIRC and ARRCO). In September 2013 and September 2014, Insee carried out an upstream review of the ASSO accounts using additional accounting data, in anticipation of semi-final figures.

The data available for the **provisional general government account**, published three months after the end of the year, are not as exhaustive. The central government's budget cycle ends in mid-January of the following year ($y+1$) and the central government's public accounts are closed towards the middle of March of the following year ($y+1$). Consequently, the data published on 31 March of the following year ($y+1$) are virtually final and any minor revisions made later relate primarily to the adjustments required to bring them into line with the national accounts. The agencies' accounting data comprises approximately two-thirds of revenue and expenditure, with the remainder made up of forecasts. The favoured sources for local government are the data reported in the central government's accounting documents and direct, comprehensive and centralised data for the regions, *départements* and all municipalities, as well as a non-exhaustive sampling of various local government bodies. For the 31 March publication, the social security

funds' accounts are partially based on estimates as the financial statements not available on that date. Nevertheless, a large number of provisional data (e.g. from the general social security funds, public hospitals, etc.) are used. The provisional accounts provide a good estimate of the general government balance and revisions to the balance for the final accounts are fairly minor²⁹.

Government debt under the Maastricht definition is compiled using accounting data from the large majority of the general government sub-sectors, including for the provisional accounts. The debt of general government sub-sectors is consolidated based on the data gathered directly by the Public Finances Directorate General from the main holders of government securities.

The transfer of the accounting data to Insee is governed by an agreement between Insee and the Public Finances Directorate General.

France's Parliament adopted the Economic Modernisation Act in July 2008. Article 144 of this Act enshrines the professional independence of government statisticians, thus ensuring the independence of statistical output and government statisticians. The enshrinement of this principle into law was a response to the European Statistics Code of Practice adopted by the Statistical System Committee on 24 February 2005 and reiterated in the European Commission Recommendation of 25 May 2005 on the independence, integrity and accountability of national and Community statistical authorities, which was revised in September 2011. The Code's first principle on professional independence states that the independence of the statistical authorities in producing and disseminating public statistics must be specified in law. To this end, Article 144 created a Public Statistics Authority (*Autorité de la statistique publique*) responsible for ensuring compliance with the European Statistics Code of Practice. It covers all entities producing public statistics.

²⁹ France is one of the European Union countries that make the fewest revisions to their Government balance after the first release. (See European Commission survey: "How reliable are the statistics of the stability and growth pact?" L.G. Mora and J.N. Martins, Economic Papers No. 273, February 2007, European Commission).

STATUS OF THIS STABILITY PROGRAMME UNDER INTERNAL PROCEDURES (SUBMISSION TO PARLIAMENT AND THE HCPF)

The Stability Programme was presented to Parliament on 15 April 2015.

In compliance with the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, the High Council on Public Finances (HCPF) was instituted by the Constitutional Bylaw of 17 December 2012 on public finance planning and governance. Article 17 of the Constitutional Bylaw stipulates that the HCPF shall issue an opinion on the macroeconomic forecasts underpinning this Stability Programme. "The Government shall refer the macroeconomic forecasts underpinning the Stability Programme drawn up for the purposes of coordinating the economic policies of the Member States of the European Union to the High Council on Public Finances, which shall issue its opinion at least two weeks before the deadline for submitting the Stability Programme to the Council of the European Union and to the European Commission. This opinion shall be attached to the Stability Programme when it is submitted."

The High Council on Public Finances (HCPF) adopted its opinion on the macroeconomic forecasts relating to the Stability Programme for 2015 to 2018 on 15 April 2015. This opinion will be attached to the Stability Programme when it is submitted to the Council of the European Union and to the European Commission at the end of April 2015.

10. APPENDIX

STATISTICAL TABLES

TABLE 1A. MACROECONOMIC PROSPECTS

	ESA Code	2013	2013	2014*	2015	2016	2017	2018
		Level in €bn	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
1. Real GDP	B1*g	–	0.3	0.4	1.0	1.5	1.5	1%
2. Nominal GDP	B1*g	2113.7	1.1	1.3	2.0	2.4	2.8	3.5
Components of real GDP								
3. Private consumption expenditure	P.3	1169.9	0.2	0.6	1.5	1.5	1.4	1.7
4. Government consumption expenditure	P.3	509.9	2.0	1.9	1.3	0.6	0.4	0.1
5. Gross fixed capital formation	P.51	466.9	-1.0	-1.6	-1.0	1.5	2.3	2.9
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	-1.7	–	–	–	–	–	–
7. Exports of goods and services	P.6	597.8	2.2	2.9	4.9	5.5	5.5	6.0
8. Imports of goods and services	P.7	629.1	1.7	3.9	4.7	4.7	4.9	5.5
Contributions to real GDP growth								
9. Final domestic demand excluding inventories		–	0.4	0.4	0.9	1.3	1.4	1.6
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	–	-0.2	0.3	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	–	0.1	-0.3	0.0	0.2	0.2	0.2

*Seasonally and working-day adjusted data taken from the quarterly accounts, March 2015.

**Stability Programme
for France 2015–2018**

TABLE 1B. PRICE DEVELOPMENTS

	ESA Code	2013	2013	2014*	2015	2016	2017	2018
		Level	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
1. GDP deflator		–	0.8	0.9	1.0	0.9	1.3	1.7
2. Private consumption deflator		–	0.7	0.5	0.0	0.9	1.4	1.7
3. HICP		–	0.9	0.5	0.0	1.0	1.4	1¼
4. Public consumption deflator		–	0.5	0.0	0.2	0.2	0.6	0.8
5. Investment deflator		–	0.4	0.3	0.3	1.0	1.5	2.2
6. Export price deflator (goods and services)		–	-0.4	-0.8	0.9	1.8	1.7	1.7
7. Import price deflator (goods and services)		–	-1.6	-2.2	-1.7	1.4	1.7	1.7

*Seasonally and working-day adjusted data taken from the quarterly accounts, March 2015.

TABLE 1C. LABOUR MARKET DEVELOPMENTS

	ESA Code	2013	2013	2014	2015	2016	2017	2018
		Level	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
1 Employment, persons ¹		27,042	-0.3	0.2	0.3	0.4	0.3	0.5
2. Employment, hours worked ²								
3. Unemployment rate (%) ³								
4. Labour productivity, persons ⁴		–	0.6	0.2	0.7	1.0	1.2	1.2
5. Labour productivity, hours worked ⁵								
6. Compensation of employees (including employers' contributions)	D.1	1119.8	1.3	1.8	1.1	2.0	2.7	3.1
7. Compensation per employee (including employers' contributions)			1.6	1.6	0.8	1.6		

¹ Occupied population in thousands, national accounts definition

² National accounts definition

³ ILO concept

⁴ Real GDP per person employed

⁵ Real GDP per hour worked

**Stability Programme
for France 2015–2018**

TABLE 1D. SECTORAL BALANCES

% of GDP	ESA Code	2013	2014*	2015	2016	2017	2018
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-2.0	-1.5	-0.9	-0.6	-0.2	0.1
o/w. Balance on goods and services		-1.5	-1.4	-0.5	-0.2	0.0	0.2
o/w. Balance of primary incomes and transfers		-0.5	-0.2	-0.4	-0.5	-0.3	-0.1
o/w. Capital account		0.0	0.0	0.0	0.0	0.0	0.0
2. Net lending/borrowing of the private sector	B.9						
3. Net lending/borrowing of general government	B.9	-4.1	-4.0	-3.8	-3.3	-2.7	-1.9
4. Statistical discrepancy							

*Seasonally and working-day adjusted data taken from the quarterly accounts, March 2015.

TABLE 2A. GENERAL GOVERNMENT BUDGETARY PROSPECTS

	ESA Code	2014	2014	2015	2016	2017	2018
		Level in €bn	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending/borrowing (EDP B9) per sub-sector							
1. General government	S.13	-84.8	-4.0	-3.8	-3.3	-2.7	-1.9
2. Central government	S.1311	-71.8	-3.3	-3.4	-3.2	-2.8	-2.2
3. State government	S.1312						
4. Local government	S.1313	-4.5	-0.2	-0.1	-0.1	-0.1	-0.1
5. Social security funds	S.1314	-8.6	-0.4	-0.3	0.0	0.3	0.4
General government (S.13)							
6. Total revenue	TR	1141.6	53.2	53.1	52.9	52.8	52.9
7. Total expenditure	TE ¹	1226.5	57.2	56.8	56.1	55.5	54.8
8. Net lending/borrowing	B.9	-84.8	-4.0	-3.8	-3.3	-2.7	-1.9
9. Interest expenditure	D.41	47.1	2.2	2.1	2.1	2.2	2.3
10. Primary balance ²		-37.8	-1.8	-1.7	-1.2	-0.5	0.4
11. One-off and other temporary measures ³		0.3	0.0	-0.2	-0.1	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		617.1	28.8	28.8	28.8	28.7	28.8
12a. Taxes on production and imports*	D.2	336.9	15.7	15.8	15.8	15.7	15.8

Stability Programme for France 2015–2018

12b. Current taxes on income, wealth etc.	D.5	270.0	12.6	12.5	12.5	12.5	12.5
12c. Capital taxes	D.91	10.3	0.5	0.5	0.5	0.5	0.5
13. Social contributions	D.61	408.5	19.1	18.8	18.7	18.7	18.7
14. Property income	D.4	15.1	0.7	0.7	0.7	0.7	0.7
15. Other⁴ (15=16-12-13-14)		100.9	4.7	4.8	4.7	4.7	4.7
16=6. Total revenue	TR	1141.6	53.2	53.1	52.9	52.8	52.9
NB: tax burden (D.2+D.5+D.61-D612+D.91-D.995) 5		945.2	44.7	44.4	44.3	44.2	44.2
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1 + P.2	387.5	18.1	18.0	17.6	17.3	16.9
17a. Compensation of employees	D.1	278.2	13.0	12.9	12.7	12.5	12.2
17b. Intermediate consumption (including financial intermediation)	P.2	109.3	5.1	5.0	4.9	4.8	4.6
18. Social payments⁶ (18=18a+18b)		557.8	26.0	25.9	25.7	25.6	25.4
of which unemployment benefits		31.6	1.5	1.5	1.4	1.4	1.3
18a. Social transfers in kind supplied via market producers	D.6311 D.63121 D.63131	128.0	6.0	6.0	6.0	5.9	5.9
18b. Social transfers other than in kind	D.62	429.8	20.0	19.9	19.7	19.6	19.6
19=9. Interest expenditure	D.41	47.1	2.2	2.1	2.1	2.2	2.3
20. Subsidies	D.3	47.3	2.2	2.4	2.4	2.4	2.4
21. Gross fixed capital formation	P.51	78.6	3.7	3.6	3.4	3.3	3.2
22. Capital transfers	D.9	22.1	1.0	1.0	0.9	0.9	0.8
23. Other⁷ (23=24-17-18-19-20-21-22)		86.1	4.0	4.0	4.0	3.9	3.8
24=7. Total expenditure	TE1	1226.5	57.2	56.8	56.1	55.5	54.8
NB: government consumption (nominal)	P.3						

¹ Adjusted for net flow of swap-related flows, so that TR-TE=EDP B.9.

² The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

³ A plus sign means deficit-reducing one-off measures.

⁴ P.11+P.12+P.131+D.39+D.7+D.9

⁵ Including those collected by the European Union and including an adjustment for uncollected taxes and social contributions (D.995).

⁶ Includes cash benefits (D.621 and D.624) and in kind benefits (D.631) related to unemployment benefits.

⁷ D.29+D.4-D.41+D.5+D.7+P.52+K.2+D.8

*Excluding taxes collected by the European Union

NB: In the table, expenditure and revenue are presented in EDP format which differs slightly from national accounting due to the treatment of swap-related gains and losses

**Stability Programme
for France 2015–2018**

TABLE 2B. NO-POLICY-CHANGE PROJECTIONS

	2014	2014	2015	2016	2017	2018
	Level in €bn	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Total revenues with unchanged policy	1141.6	53.2	53.1	52.9	52.8	52.9
2. Total expenditure with unchanged policies	1226.5	57.2	57.0	56.5	55.9	55.2

TABLE 2C. AMOUNTS TO BE EXCLUDED FROM THE EXPENDITURE BENCHMARK

	2014	2014	2015	2016	2017	2018
	Level in €bn	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue						
2. Cyclical unemployment benefit expenditure	28.9	1.3	1.3	1.3	1.3	1.2
3. Effect of discretionary revenue measures	29.4	1.4	0.1	-0.1	-0.1	-0.2
4. Revenue increases mandated by law						

TABLE 3. GENERAL GOVERNMENT EXPENDITURE BY FUNCTION

% of GDP	COFOG code	2013
1. General public services	1	6.8
2. Defence	2	1.8
3. Public order and safety	3	1.6
4. Economic affairs	4	4.9
5. Environmental protection	5	1.0
6. Housing and community amenities	6	1.4
7. Health	7	8.1
8. Recreation, culture and religion	8	1.5
9. Education	9	5.5
10. Social protection	10	24.5
11. Total expenditure	TE ¹	57.1

¹ Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9

TABLE 4. GENERAL GOVERNMENT DEBT DEVELOPMENTS

in % of GDP	ESA Code	2014	2015	2016	2017	2018
1. Gross debt ¹		95.0	96.3	97.0	96.9	95.5
2. Change in gross debt ratio		2.7	1.3	0.7	0.0	-1.4
Contributions to changes in gross debt ratio						
3. Primary balance ²		-1.8	-1.7	-1.2	-0.5	0.4
4. Interest expenditure ³	D.41	2.2	2.1	2.1	2.2	2.3
5. Stock-flow adjustment		0.0	-0.6	-0.4	-0.1	-0.1
<i>of which</i>						
- differences between cash and accruals ⁴						
- net accumulation of financial assets ⁵						
- privatisation proceeds						
- Valuation effects and other ⁶						
NB: Implicit interest rate on debt⁷		2.4	2.2	2.2	2.3	2.4
Other relevant variables						
6. Liquid financial assets ⁸						
7. Net financial debt (7=1-6)						
8. Debt amortization						
9. Percentage of debt denominated in foreign currency						

¹ As defined in Regulation 3605/93; (not an ESA concept).

² See item 10 in Table 2.

³ See item 9 in Table 2.

⁴ The differences concerning interest expenditure, other expenditure and revenue may be posted here where material or if the debt-to-GDP ratio is above the reference value.

⁵ Liquid assets (currency), government securities, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets may be posted here where material or if the debt-to-GDP ratio is above the reference value.

⁶ Changes due to exchange rate movements and operations in secondary markets may be posted here where material or if the debt-to-GDP ratio is above the reference value.

⁷ Calculated as the ratio of gross interest expenditure to gross outstanding debt on 31 December of the previous year.

⁸ FA1, FA2, FA3 (consolidated at market value), FA511 (listed equities), FA52 (mutual fund units or shares)

TABLE 5. CYCLICAL AND STRUCTURAL DEVELOPMENTS

% of GDP	ESA Code	2014	2015	2016	2017	2018
1. Real GDP growth (in %)		0.4	1.0	1.5	1.5	1 ¾
2. Net lending of general government	B.9	-4.0	-3.8	-3.3	-2.7	-1.9
3. Interest expenditure	D.41	2.2	2.1	2.1	2.2	2.3
14. One-off and other temporary measures ¹		0.0	-0.2	-0.1	0.0	0.0
5. Potential GDP growth (as a %)		1.0	1.1	1.5	1.5	1.4
contributions*:						
- labour		0.2	0.2	0.3	0.3	0.2
- capital		0.5	0.5	0.6	0.6	0.6
- total factor productivity		0.3	0.4	0.4	0.4	0.4
- effect of structural reforms		0.0	0.0	0.2	0.2	0.2
6. Output gap		-3.4	-3.5	-3.5	-3.5	-3.2
7. Cyclical budgetary component		-1.9	-2.0	-2.0	-2.0	-1.8
8. Cyclically-adjusted balance (8=2-7)		-2.0	-1.8	-1.3	-0.7	-0.1
9. Cyclically-adjusted primary balance (9=8+3)		0.2	0.3	0.8	1.5	2.1
10. Structural balance (10=8-4)		-2.0	-1.6	-1.1	-0.6	-0.1

* The contribution of factors of production is taken from the European Commission's spring 2014 forecast. To reflect the effects of structural reform (CICE and the Responsibility and Growth Pact), potential growth has been upwardly revised by 0.2 points per year as from 2016.

¹ A plus sign means deficit-reducing one-off measures.

**Stability Programme
for France 2015–2018**

TABLE 6. DIVERGENCE FROM PREVIOUS UPDATE

	ESA Code	2014	2015	2016	2017	2018
Real GDP growth						
Previous programme (2013-2017)		1.0	1.7	2.3	2.3	
Current programme (2014-2018)		0.4	1.0	1.5	1.5	1 ¾
Difference		-0.6	-0.7	-0.8	-0.8	
General government net lending (% of GDP)						
Previous programme (2013-2017)		-3.8	-3.0	-2.2	-1.3	
Current programme (2014-2018)		-4.0	-3.8	-3.3	-2.7	-1.9
Difference		-0.2	-0.8	-1.1	-1.4	
General government gross debt (% of GDP)						
Previous programme (2013-2017)		95.6	95.6	94.2	91.9	
Current programme (2014-2018)		95.0	96.3	97.0	96.9	95.5
Difference		-0.6	0.7	2.8	5.1	

TABLE 7. LONG-TERM SUSTAINABILITY OF PUBLIC FINANCES*

% of GDP	2010	2015	2020	2040	2050	2060
Total expenditure						
<i>o/w: Age-related expenditure</i>	31.4	31.0	31.0	32.3	32.2	32.0
Pension expenditure	14.6	14.3	14.3	15.0	14.9	14.9
<i>of which Social Security pension</i>						
<i>of which Old-age and early pensions</i>						
<i>of which Other pensions (disability, survivors)</i>						
<i>of which Occupational pensions (if in general government)</i>						
Healthcare	8.0	8.3	8.5	9.3	9.4	9.4
Long-term care	2.2	2.2	2.1	2.3	2.2	2.0
Education expenditure	5.0	4.9	4.8	4.6	4.6	4.6
Other age-related expenditure (unemployment)	1.7	1.4	1.3	1.1	1.1	1.1
Interest expenditure						
Total revenue						
<i>o/w: property income</i>	0.8	0.8	0.9	0.7	0.7	0.7
<i>o/w: pension contributions (or social contributions if appropriate)</i>						

Stability Programme for France 2015–2018

Pension Reserve Fund assets						
<i>o/w: consolidated public pensions fund assets (assets other than government liabilities)</i>						
Systemic pension reforms ¹						
Social contributions paid to private compulsory pension schemes ²	:		:	:	:	
Pension expenditure paid by private compulsory pension schemes ³	:		:	:	:	
Assumptions						
Labour productivity growth	:		:	:	:	:
Real GDP growth	:		:	:	:	:
Labour force participation rate male (aged 20-64)	:		:	:	:	:
Labour force participation rate female (aged 20-64)	:		:	:	:	:
Total labour force participation rate (age 20-64)	:		:	:	:	:
Unemployment rate	:		:	:	:	:
Population aged 65 and over in the total population	:		:	:	:	:

¹ Systemic pension reforms refer to reforms that introduce a switch to a multi-pillar system, including a compulsory fully-funded pillar.

² Social contributions or other revenue received by the compulsory fully-funded pillar to cover the pension obligations it acquired in conjunction with the systemic reform.

³ Pension expenditure or other social benefits paid by the compulsory fully-funded pillar linked to the pension obligations it acquired in conjunction with the systemic reform.

*Source: The 2012 Ageing Report, 2012, European Commission Ageing Working Group, which takes into account 2013 pension reforms.

Table 7a CONTINGENT LIABILITIES

% of GDP	2013	2014
Public guarantees*	203	
<i>o/w for the financial sector</i>		

*These are guarantees granted by the government in budget acts under clearly defined agreements.

**Stability Programme
for France 2015–2018**

TABLE 8. BASIC ASSUMPTIONS

	2013	2014	2015	2016	2017	2018
Short-term interest rate (annual average) ¹	0.2	0.2	0.1	0.3	0.9	1.7
Long-term interest rate (annual average) ²	2.2	1.6	0.9	1.7	2.6	3.3
USD/€ exchange rate (annual average)	1.33	1.33	1.11	1.10	1.10	1.10
Nominal effective exchange rate (base 1995 = 100)	110.8	112.4	107.0	106.8	106.8	106.8
Global GDP growth excluding EU	3.9	3.5	3.9	4.0	4.5	4.4
EU GDP growth	0.2	1.5	1.8	2.0	2.0	2.0
Growth of relevant foreign markets	3.1	3.3	4.5	5.7	5.8	6.1
World import volumes excluding the EU	4.3	3.3	4.5	5.5	5.8	6.1
Oil prices (Brent, USD/barrel)	109	100	58	59	60	61

¹ Euribor 3-month rate

² 10-year yield France

IN-YEAR PROGRESS REPORT ON CORRECTION OF THE EXCESS DEFICIT AND COMPLIANCE WITH THE RECOMMENDATION

As part of the excessive deficit procedure, France must now provide data on in-year budget execution every six months. This data covers the period up to France's planned exit from the excessive deficit procedure in 2017. This is a new provision under the Two-Pack. Article 10 of Regulation 473/2013 in the Two-Pack states that the report must include "*the budgetary impact of discretionary measures taken on both the expenditure and the revenue side, targets for the government expenditure and revenues, and information on the measures adopted and the nature of those envisaged to achieve the targets*". The content of these reports is stipulated in detail in a delegated act (Regulation 877/2013).

This appendix has been attached to the 2015-2018 Stability Programme in fulfilment of this requirement.

In addition, the 2015 draft budgetary plan, which was submitted in October 2014, gives details of savings across all general government sub-sectors. These savings were stepped up following discussions with the European Commission in the fourth quarter of 2014. A plan for supplementary measures worth €3.6 billion was added to the 2015 draft budgetary plan and passed in the 2015 Initial Budget Act.

The savings plan was stepped under this Stability Programme to account for the impact of lower inflation on public finances and to uphold the adjustment path leading to a return to a deficit under 3% of GDP in 2017. Supplementary measures worth €4 billion were put forward in 2015. Most of them concern expenditure, and measures worth another €5 billion are planned for 2016 (see Box 2).

TABLES 1a, 1b, 3a, 3b

These tables cannot be filled out at this point in the year. No quarterly data is available yet for the first quarter of 2015.

TABLE 1c

See Tables 2a and 5.

TABLE 2

See Table 2a.

**Stability Programme
for France 2015–2018**

TABLE 3a : REVENUE

Stability Programme Measures			
	2014	2015	2016
Total	3.1	-2.3	-1.6
Measures to accelerate investment and growth		-0.4	-0.2
SECOND 2014 SUPPLEMENTARY BUDGET ACT		1.2	0.3
Central government measures		1.2	0.3
Non-deductibility of certain taxes (systemic risk, premises used as offices)		0.4	0.3
Fight against tax evasion (transfer pricing and VAT fraud)		0.4	0.1
Tax on retail floor space		0.2	
Other central government measures		0.2	-0.0
2015 Initial Budget Act / 2015 Social Security Budget Act	-0.1	-2.3	-1.0
Central government measures	-0.0	-2.3	-1.0
Lower income taxes for low- and middle-income households*		-2.8	
Introduction of an energy transition tax credit (TICE)		-0.2	-0.5
Higher rates for the domestic tax on consumption of energy products (TICPE)		0.8	-0.1
Other central government measures (including tax incentives for buy-to-let investments and interest-free loans)	-0.0	-0.1	-0.4
Social security fund measures	-0.1	-0.0	-0.1
Responsibility and Solidary Pact	-1.3	-4.5	-3.7
Central government measures	-1.3	1.8	1.8
One-time decrease in income taxes	-1.3	1.3	
Impact of lower employer contributions and the phasing-out of the corporate social solidarity contribution (C3S) on corporate and personal income tax		0.8	2.3
Elimination of the exceptional corporate income tax payment for large corporations			-2.4
Lower employer contributions: impact on the National Housing Aid Fund (FNAL)		-0.3	

**Stability Programme
for France 2015–2018**

Elimination of the earned income tax credit (PPE)			2.0
Social security fund measures		-6.3	-5.6
Lower employer contributions		-5.3	-4.6
Elimination of the corporate social solidarity contribution (C3S)		-1.0	-1.0
Competitiveness and Employment Tax Credit (CICE), including ability to use the tax credit on the advance payment of corporate income tax	-6.5	-4.4	-0.6
Offshore Disclosure Unit (STDR)	1.8	0.7	-0.8
Other measures (excl. tax disputes)	9.6	9.3	5.0
Central government measures	5.3	2.9	1.9
Higher corporate income tax for large corporations (5% and then 10.7%)	2.0	-0.9	0.2
VAT measures	5.3	0.4	0.0
Lowering of the cap on family deductions (<i>quotient familial</i>) to €1,500	1.0		
Abolition of the tax exemption for pension bonuses paid to parents with three or more children	1.2		
Removal of income tax exemptions for employer contributions to collective supplementary healthcare schemes	1.0		
Reform of capital gains tax on real estate and securities	-1.0	0.4	-0.0
Introduction of a CO2 component in the fuel tax base	0.2	1.8	1.4
Fight against aggressive tax planning that makes use of hybrid products and artificial indebtedness	0.4	-0.2	
Reform of payment facilities for settling death duties through reducing the maximum length of advances granted by the government	0.0	0.4	0.4
Taxing investment income at the same rates as labour income	-0.2	-0.4	
Limit on the deductibility of financial expenses	-1.2	1.3	-0.7
Deductions for expenses and fees from long-term capital gains calculated on the gross capital gain rather than the net	-1.0		
Increasing the quota for expenses applied to long-term capital gains on equity shares from 10% to 12%	-0.4		
Limitation of the possibility to carry forward/back losses for corporations	-0.5		
Non-deductibility of tax on excess of reserves booked by insurance companies from taxable earnings	-0.9		
Elimination of taxation of UCITS for foreign residents and creation of a 3% contribution on dividend payments	-0.8		
Taxation of overtime pay as of 1 August 2013	1.0		
Home buying reform	0.3	0.2	0.4
Stimulus package	-1.4	-0.8	-0.2

**Stability Programme
for France 2015–2018**

Zero-interest loan scheme	0.3	0.3	0.3
Other measures	0.1	0.2	0.0
Social security fund measures	3.0	3.3	1.0
Pension reform: increase in old-age pension contributions and lower family allowance contributions	0.6	0.6	0.6
"Modification of taxation rules for life insurance products	0.0	0.5	-0.3
Increase in supplementary pension scheme contribution rate	0.5	0.5	
Indirect impact of exemptions and reduced rates for the General Social Security Contribution and Social Security Debt Repayment Contribution in the 2014 Initial Budget Act		0.5	
Elimination of the right to choose for cross-border commuters working in Switzerland	0.2	0.2	0.0
Impact of higher VAT rates on the social security funds	0.4	0.0	0.0
Higher contribution rates for the National Retirement Fund for Local Government Employees (CNRACL) and the National Retirement Fund for Self-Employed Professionals (CNAVPL)	0.7		
Welfare contribution for elderly people living alone levied on retirement pensions	0.2		
Expansion of the early retirement scheme for people having started work at an early age	0.6	0.7	0.6
Other measures	-0.1	0.5	0.1
Local government	0.2	2.1	1.2
Higher local direct tax rates (impact of the electoral cycle)	0.2	0.9	1.0
Change in the cap on duties payable on real property sales (DMTO)	0.7	0.3	0.0
Adjustment of hotel occupancy tax, parking tax, property tax and residence tax		0.6	
Other measures	-0.7	0.3	0.1
Other central government bodies	1.2	1.1	0.9
Increase in the levy to compensate electricity distributors for additional costs entailed by their public service obligations	1.1	1.1	1.1
Other measures	0.1	-0.0	-0.2
Tax disputes	-0.5	-2.0	-0.5
Withholding tax dispute (<i>précompte mobilier</i>)		-0.4	-0.5
UCITS dispute	-0.5	-1.5	0.3
De Ruyter dispute		-0.1	-0.3

**Stability Programme
for France 2015–2018**

Total measures prior to transfers	3.1	-2.3	-1.6
Total central government measures prior to transfers	-1.3	-2.5	1.2
Total social security funds measures prior to transfers	3.0	-2.9	-4.9
Total local government measures prior to transfers	0.2	2.1	1.2
Total other central government bodies measures prior to transfers	1.2	1.1	0.9
Total measures including transfers	3.1	-2.3	-1.6
Total central government measures including transfers	-4.4	-4.3	-5.2
Total social security funds measures including transfers	5.6	-2.2	1.7
Total local government measures including transfers	0.6	2.2	1.0
Total other central government bodies measures including transfers	1.3	1.9	0.9

*Excluding impact of cost-of-living adjustment

TABLE 4

See Tables 4 and 1.