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Minutes of Executive Board Meeting 19/67-1

9:00 a.m., July 22, 2019

1. France—2019 Article IV Consultation

Documents: SM/19/183 and Correction 1; and Correction 2; and Supplement 1; and Supplement 2; SM/19/184; SM/19/186; and Correction 1; and Correction 2

Staff: Velculescu, EUR; Das, MCM; Duttagupta, SPR

Length: 1 hour, 27 minutes

Executive Board Attendance

D. Lipton, Acting Chair

Executive Directors	**Alternate Executive Directors**
	K. Obiora (AE)
	F. Sylla (AF)
G. Lopetegui (AG)	
N. Ray (AP)	
A. Tombini (BR)	
	Z. Huang (CC), Temporary
	P. Moreno (CE)
L. Levonian (CO)	
	C. Just (EC)
H. de Villeroché (FF)	
S. Meyer (GR)	
	M. Siriwardana (IN)
D. Fanizza (IT)	
T. Tanaka (JA)	
J. Mojarrad (MD)	
	S. Geadah (MI)
A. De Lannoy (NE)	
T. Ostros (NO)	
	L. Palei (RU)
M. Mouminah (SA)	
	K.Tan (ST)
P. Inderbinen (SZ)	
	D. Ronicle (UK)
M. Rosen (US)	

C. McDonald, Acting Secretary
J. Morco, Summing Up Officer
R. Smith Yee, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
European Central Bank: K. Nikolaou, R. Rueffer. European Department: L. Antoun de Almeida, K. Cerrato Carranza, J. Decressin, Z. Jin, L. Kemoe, D. Velculescu, S. Weber. Fiscal Affairs Department: M. Aslam, J. Ralyea, A. Zdzienicka. Legal Department: J. Ams, K. Chen, K. Kao. Monetary and Capital Markets Department: V. Bacalu, Y. Chen, M. Cihak,

U. Das, N. Griffin, M. Mansilla Arrieta, J. Morsink, K. Seal, R. Stobo, T. Tressel. Strategy, Policy, and Review Department: R. Duttagupta, E. Lundback.
Executive Director: H. Beblawi (MI), L. Villar (CE). Alternate Executive Director: A. Guerra (CE), A. McKiernan (CO), M. Psalidopoulos (IT), P. Rozan (FF). Senior Advisors to Executive Directors: B. Alhomaly (SA), M. Choueiri (MI), M.Gilliot (FF), P. Pollard (US), F. Spadafora (IT), A. Tolstikov (RU). Advisors to Executive Directors: D. Andreicut (UK), D. Cools (NE), B. Jappah (AE), R. Lopes Varela (AF), P. Mooney (CO), M. Mulas (CE), E. Ondo Bile (AF), B. Parkanyi (NE), S. Yoe (ST), F. Antunes (BR), K. Lok (CC), A. Tola (SZ), A. Sode (FF).

1. FRANCE—2019 ARTICLE IV CONSULTATION

Mr. de Villeroché, Mr. Castets, Ms. Gilliot and Mr. Sode submitted the following statement:

> On behalf of our authorities, we thank staff for their report and policy discussions during the Article IV mission. Since the last review, growth remained resilient and broad based while unemployment continued to decrease, despite an environment marked by persistent trade tensions and a slow-down in many European partners. The public deficit and public expenditures declined further, allowing for the public debt to stabilize. Important structural reforms entered in application last year such as the labor market, the taxation and the vocational training reforms.
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> The sustained performance of the French economy is a sign that the reforms implemented over the past years start to bear fruits. Nonetheless, our authorities firmly believe that a continued reform effort remains warranted to tackle the simultaneous challenges of modernizing the French economy, accelerating the energy transition and enhancing equality of opportunities. In response to the social movement of the "yellow vest" that started last year, our authorities launched a Grand Débat National which confirmed the need to accelerate the transformation of France's economic and social model. Based on this conclusion, our authorities reaffirmed their strong resolve to continue the implementation of a comprehensive and far-reaching structural reform agenda and took immediate measures that have reinforced work incentives for the middle class while easing the fiscal burden on the poorest households. Going forward, three major pillars of the French system are about to be profoundly modernized. A civil service reform is about to be adopted. The details of the unemployment insurance reform have been made public and will be implemented swiftly. Importantly, the consultations preparing a systemic reform of the pension system are also already well advanced. Our authorities are committed to further reduce the fiscal deficit by gradually reducing public expenditure and to put the public debt on a continuous downward path.
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> Looking forward, while solid domestic fundamentals should allow growth to remain robust in the coming years, we agree with staff that the external environment is a source of risk. Trade tensions could affect France and its main partners' performance, through direct trade impacts and confidence effects weighing on future investment. To lower these risks, my authorities will therefore maintain their strong commitment towards multilateral cooperation, in particular as regards trade, international taxation and climate change, as well as towards enhanced European integration. In this

regard, the French economy being highly integrated within the Euro Area, the strengthening of policy coordination at the eurozone level is seen as a crucial element.

Outlook

Despite the Euro Area slowdown and rising trade tensions, growth remains robust and broad based while the employment outlook continues to improve. GDP growth in 2019 is projected at the same level than in the Euro Area (at +1.3 percent). Business climate and consumer confidence have significantly increased since the beginning of the year and are both above their long-term average levels. Tax measures targeted to the middle class and aimed at "making work pay" are increasing household's purchasing power which in turn supports private consumption. Driven by favorable financing conditions and structural reforms such as the capital taxation reform or the conversion of the CICE into a social security contribution reduction, corporate investment is still dynamic and remains one of the prime engines of growth. While exports are suffering from the weakening of external demand, competitivity gains underpinned by recent fiscal measures help to cushion the impact of this shock and export growth remains well-oriented overall. France's international attractiveness is improving significantly with inward FDI at historically high levels (France ranked second among European economies in the EY Europe attractiveness survey of June 2019). It is particularly attractive for R&D activities of multinationals and an ecosystem of innovation is building up around tech-oriented entrepreneurs. Reflecting this robust growth performance, job creations have been once again particularly dynamic during the first quarter 2019 and they are expected to remain elevated during the rest of the year. Hence unemployment is decreasing for the 4th consecutive year. The significant increase in the share of new hiring made under open-ended contracts and the long-term unemployment rate decreased are additional signs of the good health of the labor market.

The current account remains closed to balance (-0,6 percent) and the external position is broadly in line with fundamentals as highlighted by staff. Net exports contributed positively to growth in 2018. Export performance in key sectors such as aeronautics, pharmacy and luxury goods notably helped the non-energy good balance to improve while the service balance remains in positive territory. The primary income balance is largely positive reflecting the capacity of French multinationals to generate revenue abroad. Price competitiveness of French exports has been strengthened by measures taken over the last years to lower the cost of labor. Thanks to a significant rebound in their profit margins, French firms are now better able to compete internationally. Moreover, French competitiveness is also underpinned by a wage growth which is aligned with productivity dynamics over the medium term. Recent labor market reforms aiming at decentralizing further wage bargaining will reinforce the wage setting process to ensure faster wage adjustments in case of shocks. Better wage coordination at the European level, notably thanks to the European Semester and the establishment of National Councils of Productivity, should also help to balance price competitiveness within the Euro Area. In terms of non-price competitiveness, the numerous structural reforms aiming at improving the investment climate and strengthening human capital will translate into further innovation capacity and should contribute to give an edge to French firms on international markets. Higher profit margins will also help firms to invest and innovate.

We broadly agree with staff forecast that next year growth will remain resilient and that the unemployment rate will continue to decline. Supported by the various structural reforms undertaken over the last years, France growth will continue to benefit from its strong domestic demand (+1,3 percent). Increased households' purchasing power coming from tax reduction will continue to support domestic consumption. Firms will benefit from improvement in the business climate and workers from better income prospects. Nonetheless, we also agree with staff that there are several downside risks to the outlook notably stemming from a potential weakening of the external environment. An upside scenario, where activity picks-up more than expected as reforms recently implemented produce their full impact earlier than planned, cannot be ruled out.

Reform Strategy

My authorities remain strongly committed to a comprehensive reforms plan aiming at modernizing the French economy while ensuring the conditions for equal opportunity.

One can acknowledge that the pace of structural reforms, not seen for decades in France, has not abated over the past year. Indeed, since the last Article IV review, the labor market reform, additional growth-friendly tax measures, an overhaul of the apprenticeship and vocational training system and several reforms of the education system have been implemented. In the context of the yellow vests movement, a package of additional measures have been decided to reinforce the orientation of the already-implemented reforms, namely strengthening the purchasing power of the low to middle-income workers and reducing the overall level of taxation. Staff should therefore feel reassured regarding the determination of our authorities to pursue the implementation of their reform agenda. In such a context, our authorities don't consider that there is a risk of a slowdown of the reform momentum.

Moving forward, a package of additional transformative structural reforms is already well advanced in its preparatory process:

Unemployment insurance reform: while on a continued decline, the unemployment rate remains elevated. The reform, that has been made public in June 2019, will both strengthen the access of unemployed people to training and incentivize work by increasing the requirements to access to the unemployment benefits. Importantly, rules that define the possibility to cumulate unemployment benefits with wages from part-time activity will be reviewed to remove disincentives to return to full-time jobs. Additionally, the ceiling of unemployment benefits for high wage earners, that was elevated compared to other European economies, will be lowered and a bonus-malus mechanism aiming at disincentivizing abusive recourse to short term contracts in certain sectors will be introduced.

Pension reform: the existing pension system relies on a pay-as-you-go mechanism, that is effective in preventing poverty within the elderly but is complex (with 42 different pension regimes) and does not entail an automatic mechanism to ensure the financial sustainability of the system depending on demographic variations. While past parametric reforms have created the conditions for the financial sustainability of the pension system[1], some uncertainty remains due to the difficulty to predict demographic trajectories and to forecast growth over the long term. Moreover, the age of effective retirement is lower in France than in many peers. The reform under preparation would create a universal pension system with the same level of contribution giving access to the same right to pension, thus creating a major simplification of the system. The new mechanism will be calibrated so as to ensure intergenerational equity and the quasi-automatic financial stability of the system.

Civil service reform: the reform aims at modernizing the civil service to make it more agile, more open and more attractive. It will create the conditions for public administrations to adapt more flexibly and swiftly to their changing missions and new environment, notably to reap the benefits of new technologies. One of the main features of this comprehensive reform will be to facilitate the recourse to temporary contracts (rather than relying quasi

[1] Depending on the scenario, the share of the pension spending in GDP would decline from 13.8 percent in 2017 to between 11.6 percent to 13.3 percent of GDP by 2070 ; only in a scenario of very low growth productivity would the share of pension spending increase but moderately to reach 14.4 percent of GDP.

exclusively on employed-for-life civil servants) depending of the need of the different administrations. The reform will also simplify greatly the decision-making procedure for posting of civil servants with the aim to increase mobility between administrations.

Healthcare: the reform presented by staff in Box 2 will be adopted by the end of the Summer.

Competition: some precise measures have been announced to enhance competition, facilitate entry into several markets and increase the level the playing field. In the coming months, our authorities will engage reforms to combat rent-seeking behaviors in the car spare parts market, the driving license schools and the condominium associations ("syndic"). While we note staff's assessment regarding possible progress on retail distribution, sales of medicines and professional services, we feel that the PMR index should be used with caution to derive potential growth gains, as it is done in the dedicated selected issues paper. Some features of the PMR calculation have no direct relation with the intensity of competition, such as the state ownership in some companies (for example, despite a publicly-owned operator, France telecommunication sector is very competitive with a comparatively high number of competing firms resulting in low prices). While all those reforms will contribute to ensuring the financial sustainability of the social protection system, they also pursue wider objectives such as ensuring adaptation and modernization in a context of rapid socioeconomic transformation and creating the conditions for an inclusive growth model. On the latter, as highlighted in Annex V, France has one of the lowest poverty rates in the OECD and disposable income inequality has been broadly stable over time, which contrasts with the trajectory of many other advanced economies. Those positive results are the direct outcomes of a redistributive tax and benefit system and the constant attention to social cohesion. Those results could have received more emphasis in the core of the report since they are closely related to other dimensions, including the chosen fiscal consolidation path. We have doubt on the robustness of the indicator on intergenerational mobility put forward in the core of the report, since cross-border comparison of intergenerational mobility is technically difficult and some literature points to different results. France also has one of the lower genders pay gap in the world and relatively high female participation. Nonetheless, some dimensions of inequality and the differentiated impacts of reforms remain insufficiently apprehended, such as the differentiated impact of carbon taxation on households' disposable income depending of their location.

Our authorities are committed to the transition to a low-carbon economy. France's ambitions in term of climate change mitigation is defined by its Nationally Determined Contributions set in the 2015 Paris agreement augmented by the objective of reaching carbon neutrality in 2050 set in the 2017 Climate Plan. To operationalize these commitments, France has designed and adopted a multiyear strategy to reduce carbon emissions (Stratégie Nationale Bas Carbon) which defines sectoral ceiling emissions and lays out concrete measures to reach these sectoral objectives. A wide range of tools have already been deployed to reduce the carbon footprint of the economy including an already high carbon tax, participation to the European emissions trading scheme and ambitious sectoral regulation notably in the housing and transportation sectors. Following the yellow vests protest, the government has decided to maintain the carbon tax at its current level. The Grand Débat National clearly highlighted that French citizens were deeply concerned by climate change and wanted the government to act decisively to accompany the transition toward a low carbon economy while taking compensation measures to ensure a fair burden sharing among the population. With these insights in mind, our authorities are thus committed to continue to implement a strong climate mitigation agenda.

Public finance

Maintaining a strategy to contain spending growth and durably put public debt on a downward path.

A consistent strategy has been implemented since the beginning of the presidential term aiming at reducing the level of public spending growth compared to GDP growth. The choice has been made to privilege a durable containment of the rise in public spending, despite inflationary trends related to ageing and health costs. This strategy seems adequate given the findings of the updated benchmarking exercise presented in Annex VI that France has a relatively high level of spending in most expenditure areas compared to peers with potential efficiency gains in several categories. At the same time, the comparatively high level of public spending in France should be read while bearing in mind the choice made, in contrast with some of its peers, to socialize large parts of the social protection system (health, education and pensions notably). This feature of the French social model makes international comparisons somewhat difficult to interpret and does not automatically entail lower value-for-money in terms of services (health and education being good examples of sectors where public provision can prove particularly cost-effective).

The fiscal strategy is bearing fruits. The fiscal deficit has been reduced further to reach 2.5 percent and the fiscal debt stabilized at 98.4 percent of GDP at end 2018. Those results have been obtained thanks to a slow-down of the public spending increase (+0.3 percent in volume without the tax credits, compared to + 1.4 percent in 2017). Those efforts will be maintained in 2019. While the transformation of CICE into a permanent cut of social contributions will provoke a one-off increase of the public deficit to 3.1 percent of GDP, the deficit will be reduced toward 2.3 percent of GDP without this exceptional factor. The public deficit will then decline further to reach 2.1 percent in 2020, 1.7 percent in 2021 and 1.3 percent in 2022. Our authorities' projections diverge from staff's projections over the medium term given the new methodology used by staff that takes into account only the impact of legislated measures. We would insist in this regard that an increase of the public deficit after 2020 in a context of continued growth appears highly unlikely and contradicts our authorities' plan and intentions. According to our authorities' projections, the public spending ratio would decline by 2,9 points of GDP over the presidential 5-year term and the tax to GDP ratio would decline by 1,3 point over the same period. Moreover, the public debt structure, with long average maturities, is a factor of resilience to a rise in interest rates.

Clear objectives have been set for all the segments of public spending:

Central government: the contribution of the central government to fiscal consolidation efforts has been significant. In real terms, the central government spending increased by +0,5 percent in 2018 and they decreased by 1,1 percent in volume.

Local authorities: as highlighted in the selected issues paper on subnational fiscal policy, the innovative contractual relationship set up with local authorities has performed well. It created the conditions for a significant decrease of the current spending level of the local authorities (+0,3 percent in 2018 when the objective was set at +1,2 percent and when it increased by +2 percent in 2017).

Social spending: for the second year, the financing need of social security administrations were in a positive territory. This is notably due to the target for health insurance (ONDAM) being met for the ninth year in a row.

A resilient and well capitalized financial sector, serving well the economy

Our authorities share the positive assessment of the French financial system and the recognition of its robustness and resilience. Significant progress has indeed been made since the last 2012 FSAP in many key areas as reflected in the report. The French banking and insurance industries have been experiencing an increasing amount of prudential regulation emanating mainly from European ruling (CRR/CRD IV, BRRD, Solvency II). As a consequence, capital, asset quality and liquidity coverage in the banking sector as well as solvency ratios in the insurance sector have markedly improved and are at adequate levels to absorb adverse shocks, including in tail scenarios. Regulatory Tier 1 capital to risk-weighted assets reaching 15,4 percent in 2018 from 13,2 percent in 2013, Liquidity Coverage Ratio and Net Stable Funding Ratio are above 100 percent for both G-SIBs and other banks. The insurance sector reached a general Solvency Capital Requirement coverage ratio of 240 percent at the end of 2018, following an increase by 6 percentage points from end-2017.

The Financial Conglomerate (FC) business model has been effective in allowing optimization of products generation and distribution, income flows, resources allocation albeit having led to internal reorganizations when necessary. The oversight of the latest key component of the French financial system including investment service providers and asset managers has been heightened in line with the 2012 FSAP recommendations. As duly underscored by staff, the supervision by the Autorité des Marchés Financiers (AMF) over investment service providers has been stepped up across all categories through onsite inspections and macroprudential tools are available, albeit not active, for the asset management industry.

In this regard, France has strengthened its institutional arrangements for macroprudential policymaking in a context of rising nonbank financial intermediation. Reforms set out in the Loi PACTE approved in April 2019 intended to facilitate SMEs’ access to diversified financing included IPO, private equity, crowdfunding and ICO under the supervision of the AMF for the latter through the creation of a “visa”. France is also advanced in terms of resolution preparedness, less significant banking institutions, which fall within the scope of the Autorité de Contrôle Prudentiel et de Résolution (ACPR), are at an advanced stage for recovery and resolution planning cycles. Moreover, a comprehensive resolution framework has been set up for insurance institutions.

The micro and macroprudential oversight have been strongly reinforced and financial stability risks have been mitigated through preemptive measures. Reacting to the main FSAP recommendations, we would like to add the following considerations:

Preemptive Management of Systemic vulnerabilities: the recommendations referring to the use of Pillar II measures to address residual risks related to corporate exposures do not fall directly and solely within the scope of French authorities. The development of an analytical framework for borrower-based measures for corporates seems difficult to endorse in an open economy like France where companies can raise funds from foreign investors. The French authorities assess this recommendation as smacking more of factual impossibility than a challenge as presented in the report. They also recall that the use of a sectoral systemic risk buffer, which will be included in the next banking legislation under the CRR II and CRD V, is not currently allowed by CRR/CRD IV which only allows to apply the SRB on all institutions or some of them, without distinguishing between exposures. The reduction of the debt-enhancing tax bias will come in the coming years through a decrease in the corporate income tax which the authorities consider adequate while preserving the balance between public finance considerations and fair tax competition. Moreover, and as indicated above, the Loi PACTE already enlarges the long-term financing options for very small, small and medium-size companies.

Ensuring adequate liquidity management and buffers: disruptions in wholesale funding markets could cause additional costs and translate into higher risks to profitability and solvency. Still, the issues raised on USD funding only concern a couple of banks and should not be made a general issue for the French banking system as a whole. At the same time, liquidity is not a major risk for life-insurance activities and liquidity and leverage related tools already exist in France in the 2016 Loi Sapin II which namely encompasses “gates” mechanisms to cap fund repurchases.

Further integration of financial conglomerate oversight: the FC business model has acted as for now as a strong safeguard for banking and insurance groups’ profitability and risk profile through diversification effects that enable more regular revenue and economies of scale with respect to the distribution network. This model has proved to be relevant given the context of low interest rates environment and the digitalization process. However, we agree that operations of the conglomerates cannot be only contemplated from the point of view of their component bodies. Moreover, we see a link between applying a risk-based approach at the group level and removing the impediments to free circulation of capital and liquidity within the Banking Union. The integration of a conglomerate dimension in the resolution framework could be further examined in this respect and addressed from a European perspective as it would require a revision of BRRD.

Enhancing governance, financial policies and financial integrity: the institutional setup has been actively reinforced after the financial crisis and has proven to be effective in producing thorough and shared diagnostics on vulnerabilities and taking adequate actions to remedy them. The HCSF benefits from the contribution of its various members-institution and the principle of collegiality enables candid and open discussions. As regards the funding of those institutions, we do not share staff's view that they should be exempted from the constitutional and legal framework that applies to budget appropriation. As for regulated savings products, their large popularity within the French population and their important role in the saving structure for low and middle-income earners could make radical shift difficult. Transitioning to more market-based products would be politically difficult. Nonetheless, steps have already been taken to upgrade the method of calculation of the interest rates of these products such as Livret A whose new rate calculation will come into force next year. Lastly, the authorities fully agree with the need to enhance AML-CFT supervision of smaller banks rated as high-risk.

Reinforcing crisis management safety, safety nets, resolution arrangement: the authorities feel that an enhanced resolution framework for insurers should be the task of European Union supervisory and enforcement authorities and would again insist on the need to focus on France's fields of jurisdiction. Such a framework does not exist at the EU level and as said, France is clearly far more advanced in this regard.

The strengthening of the regulatory framework allows for a more effective fight against corruption.

France was pleased to volunteer to have its anti-corruption supply-side provisions reviewed by staff in partnership with the OECD's Working Group on Bribery. The Law on Transparency, the Fight Against Corruption, and the Modernization of the Economy (adopted in December 2016) has very effectively complemented the tools to better prevent, detect and sanction corruption and related offences with proportionate, effective and dissuasive sanctions. This is already being demonstrated by the resolutions of cases since the adoption of this law, whether they are resolved through trials or through settlement agreements, while enhancing cooperation with foreign authorities. Going forward, we encourage other IMF members to submit themselves to this voluntary review process.

Mr. Obiora and Mr. Nakunyada submitted the following statement:

We broadly share staff's appraisal and accompanying recommendations. Reflecting the end of a broad-based cyclical recovery and country-specific factors, France's economic activity slowed in 2018 with moderations in private consumption and investment, as well as deceleration in export growth. We are however comforted by the government's strong commitment to implement comprehensive structural reforms, which continues to create more permanent employment opportunities, and strengthen economic resilience. Maintaining this reform momentum is critical given that downside risks have risen, including uncertainties related to a disorderly Brexit, rising trade tensions, weaker than expected growth in the euro-area, and domestic pushbacks to reforms. Further policy efforts are required to raise GDP growth, reduce inequalities, and safeguard fiscal sustainability.

Although the report is quite comprehensive, we worry that it might have missed an opportunity to delve deeper into some of France's persistent economic challenges. We appreciate the work done on analyzing the country's longstanding challenges such as elevated structural unemployment, sluggish productivity growth, and stagnated wages. But we think that it could have paid better attention to others like the size of the public sector and the sustenance of the country's social safety net. France has one of the largest public sectors in the world, accounting for an estimated 57 percent of national income last year. In addition to implying some significant tax burden, we worry that the presence of such a big public sector may continue to crowd out the private sector and reduce its incentives for investments and innovation. Similarly, France has one of Europe's largest social safety nets, accounting for about a third of its economic output. While we appreciate the role of these benefits in cushioning vulnerable households, there is a likelihood that they carry a moral hazard problem that may curtail incentives for citizens to work, save and invest, potentially accounting for some of the structural rigidities in the labor market.

The reduction of public debt remains important to cushion the economy against adverse shocks. To this end, we welcome the authorities' expenditure containment measures that narrowed the primary fiscal balance and stabilized public debt as articulated in the percipient buff Statement by Messrs. de Villeroché, Castets, Gilliot, and Sode. Nevertheless, we encourage the authorities to sustain spending reforms through steady and growth-friendly consolidation efforts to meet the medium-term debt reduction objectives. In this vein, we emphasize the importance of a credible spending plan that harnesses potential efficiency gains to offset the effects of the planned frontloading of tax relief. Additional reforms are also required to bridge the spending gap between France and regional peers by improving efficiency in social expenditures. Furthermore, we urge the authorities to implement planned fiscal-structural measures including civil service reforms to improve cost effectiveness. Importantly, commitment across various government departments would be essential to ensure the success of consolidation efforts.

Addressing the remaining pockets of vulnerability remains critical to enhance the resilience of the financial system. We commend the authorities for the remarkable progress made in strengthening the institutional and policy framework to support financial stability. Nevertheless, we underscore the need for continued vigilance in the supervision of financial conglomerates with cross-border operations. Further efforts would be required to mitigate cyclical risks related to heightened corporate indebtedness. To this effect, we urge the authorities to leverage the reinforced institutional set-up and deploy appropriate micro and macroprudential tools. We appreciate progress made in the implementation of the 2012 FSAP recommendations and encourage the authorities to do the same for the 2019 FSAP recommendations including on strengthening AML/CFT supervision of high-risk smaller banks. We note the divergent views between the report and the buff Statement on the relevant institutions responsible for strengthening of crisis management, resolution and safety nets. Could staff clarify the different roles that the authorities and the EU should play in addressing these issues?

Sustained labor market reforms and further liberalization of product and service markets would be instrumental to boost growth potential. We welcome progress made in improving labour market conditions through collective bargaining, professional training, apprenticeship and unemployment benefit reforms. The authorities could now focus attention on consolidation of these gains to make the reforms more effective in improving labor force participation and intergenerational mobility, particularly among the vulnerable segments of society. We encourage the authorities to sustain efforts to fight supply side corruption, and welcome progress in strengthening the legislative framework. That said, we are encouraged by on-going product market reforms but emphasize the need to remove the remaining restrictive regulations on productivity growth. Specifically, we look forward to more efforts to reduce the administrative burden on startups and increase competition in regulated professions. While we are comforted by the notable competitiveness gains made by the authorities as outlined in the buff Statement, the report appears to be much less sanguine. In view of this, could staff clarify how the gains outlined in the buff Statement affect their overall assessment of competitiveness in France?

Mr. De Lannoy submitted the following statement:

We thank staff for their informative report and Selected Issues paper in the context of France's Article IV consultation and FSAP review. We also thank Mr. de Villeroché, Mr. Castets, Ms. Gilliot and Mr. Sode for their informative buff statement.

Structural reforms, the external environment and resilient domestic demand have supported solid growth, improved labor market conditions and facilitated a gradual reduction in the government deficit. While robust domestic demand provides an important buffer, maintaining the reform momentum is of vital importance in view of the longer-term challenges France is facing. Continued structural reforms and a growth-friendly fiscal consolidation will be needed to reduce the elevated structural unemployment and to keep the high public and growing private debt levels on a sustainable path. We commend the authorities for the steps taken in labor and taxation reforms. Going forward we encourage the authorities to further rationalize public spending at all levels of government while safeguarding the social model, to upskill labor, especially for vulnerable groups, and to comply with EU fiscal rules. We place our trust in the authorities' firm commitment, as laid down in the buff statement, to continue modernizing the French economy.
Macroeconomic developments

Growth of the French economy is gradually moderating but remains resilient. In spite of transitory domestic factors and slowing regional trends, the French economy has been growing at a relatively robust pace thanks to solid investment growth and private consumption supported by recent fiscal measures. Falling unemployment rates and modest wage growth led to favorable labor market conditions. This suggests that domestic demand will continue to support economic growth in the coming years. While the current account is broadly balanced, without continued labor market reforms the decline of labor productivity growth and high structural unemployment can create difficulties for regaining lost export market share. High public and growing private indebtedness exacerbate the need to boost potential growth through upskilling labor and innovation.

Fiscal policies

After years of deficit reduction, based on current policies France is at risk of significantly deviating from the recommended adjustment path under European fiscal rules. The headline fiscal deficit reached 2.5 percent of GDP in 2018 on the back of strong revenues. Whereas the planned breach of the

3 percent of GDP deficit threshold in 2019 has been deemed only marginal and temporary (also due to the one-off effect of converting the CICE tax credit into a social security reduction), a significant improvement in the structural balance would be needed already in 2019 to comply with the provisions of the EU fiscal rules. Moreover, the government debt-to-GDP ratio is forecast to peak at 99.0 percent in 2019 and to decline only marginally thereafter.

The growth-friendly consolidation must continue and must be underpinned by reforms to curb public spending. We commend the authorities for reducing expenditures in real terms (-0.3 percent) in 2018. At 56 percent of GDP in 2018, France’s public expenditure ratio remains the highest in the EU; it contributes to lower-than-average inequality in disposable income and good social outcomes, which in turn contributes to the resilience of domestic demand. At the same time, it restricts the government’s room of maneuver in reducing those taxes that are a burden on competitiveness. Like staff, we therefore consider a broad spending review indispensable and welcome the program “Action Publique 2022”, which is expected to identify efficiency gains and generate structural savings at all levels of the public administration. We would like to see more concrete proposals for actions on how the announced reduction in the expenditure-to-GDP ratio by some 3 percentage points by 2022 will be achieved. This exercise should be prioritized with a view to creating room for growth-enhancing expenditures, while being mindful of social sustainability. We look forward to the planned reforms of the civil service, the pension systems and unemployment benefits.

Structural policies

While we share Staff’s view that there is room for further structural reforms to reduce the French economy’s vulnerability to shocks, we would argue with staff’s assessment of a faltering momentum and note that the structural reform agenda is still on track. We agree with staff that reforms need to continue with a view to reducing structural unemployment and increasing productivity. At the same time, important reforms are being implemented in vocational education and training and a major investment plan for skills is underway. Careful monitoring is necessary to ensure that these reforms produce the desired effects. We welcome recent reforms in the areas of apprenticeship system, training system and unemployment benefits. They are important to help address structural issues such as long-term unemployment, skills mismatches and high youth unemployment. Initiated product market reforms must be pursued in order to ease restrictive regulations and remove barriers especially in the services sector. In this respect, regulated professional services are key as their costs are borne by most firms.

Financial market policies

France's financial system is overall in a stronger position since the last FSAP, but vulnerabilities persist. We welcome the increase in the capital and liquidity position of French banks and improvements in their asset quality but note that profitability has to improve for French banks. The combination of high and increasing indebtedness in both the non-financial corporate and the household sectors together with the low debt-servicing capacity at the lower tail of their distributions suggest the need for supervisory attention and, potentially, for more macroprudential measures. We welcome in this regard the authorities' recent decision to further increase the countercyclical capital buffer. This decision is in line with cyclical systemic risk indicators, such as the credit-to-GDP gap. With respect to some FSAP recommendations we note that the sectoral systemic risk buffer for the corporate sector will only be available after certain EU legislative amendments become effective, i.e. after 29 December 2020. We agree with the FSAP conclusion that oversight on financial conglomerates should to be enhanced. Here, ongoing work at the EU level, notably by European supervisory authorities, should partly address the issues identified in the FSSA. Overall, the FSSA could be clearer on articulating EU and national competences.

We would like to underline the relevance of financial stability risks stemming from the residential real estate sector. While we agree that there are mitigating factors that reduce the risks in residential real estate (e.g. the importance of fixed-rate and amortizing loans, mortgage guarantees by third parties), high household indebtedness could still act as an amplifier of shocks. Also, there are signs that lending standards have deteriorated. Against this backdrop, policies should focus on ensuring borrower resilience by providing guidance to banks to strengthen lending standards and, possibly, by introducing binding borrower-based measures. Moreover, risks stemming from commercial real estate (CRE) deserve closer attention as lending by French banks for CRE has been growing strongly, in addition to non-bank sources of finance.

We welcome the strengthening of the financial regulatory framework combatting corruption and we encourage the authorities to continue their work in this regard.

We commend the authorities for their commitment to an open and rules-based multilateral trading system and their implementation of the Paris Agreement.

Mr. Meyer and Ms. Kuhles submitted the following statement:

We thank staff for an informative set of reports and Mr. de Villeroché, Mr. Castets, Ms. Gilliot and Mr. Sode for their helpful buff statement. We broadly concur with staff's assessment and associate ourselves with Mr. De Lannoy's statement. Notwithstanding the slowdown in real GDP growth in 2018, the French economy grows largely at potential while inflation pressures remain subdued. Likely supported by the implementation of important labor market and tax reforms over the last years, employment has increased steadily. Looking ahead, staff projects the economy to more or less continue on this path, provided that regional and global growth continues. However, the economic outlook is subject to downside risks including the escalation of trade tensions, a disorderly Brexit, and vulnerabilities stemming from elevated private and public indebtedness. Against this background, we encourage the authorities to push ahead with ambitious measures to consolidate the budget, boost productivity, tackle persistent structural unemployment and facilitate corporate deleveraging.

The ongoing high deficits and the elevated public debt level could give rise to increasing sustainability concerns. Staff as well as the European Commission have advised – and continue to advise – an annual structural adjustment of 0.5 percent or 0.6 percent of GDP, respectively. In stark contrast, however, staff's baseline projects a further deterioration of the primary structural deficit over the medium term and staff notes that "the authorities are no longer planning to reach their medium-term objective by 2022". In light of growing vulnerabilities and given the currently benign economic circumstances, we call on the authorities to not further delay the necessary fiscal adjustment and commit to high quality and credibly specified structural consolidation efforts to place debt on a firm downward path and achieve the medium-term objective as required by the authorities' commitments under the Stability and Growth Pact. As staff rightly points out, such measures should especially target the exceptionally high level of public spending in some areas, backed by accompanying fiscal structural reforms to raise spending efficiency and support potential growth.

We appreciate the progress with regard to labor tax rates, the labor code, as well as training and apprenticeship reform and welcome additional labor-market reforms planned by the authorities. Against the backdrop of persistently high structural unemployment and subdued productivity growth, we echo Mr. De Lannoy's point that emphasizes that ambitious implementation and monitoring will be key to success.

With respect to the announced unemployment benefit reform, we welcome the envisioned improvement of work incentives. Concerning the desire to contain the increasing use of fixed-term contracts instead of regular contracts, the suggested bonus-malus scheme could have important benefits but might also further increase the complexity of an already complex system of labor market regulation. In this regard, we would be interested in staff's view on the additional regulatory burden imposed, especially if the reform would be expanded to all sectors of the economy, including smaller firms.

Complementary to labor-market reforms, we concur with staff that strengthening product and service market competition entails considerable potential for purchasing-power and productivity growth and encourage the authorities to enact further product market reforms as detailed by staff in the respective "Selected Issues" document.

The financial system appears overall robust and broadly resilient to stress. Still, remaining vulnerabilities related inter alia to complex interlinkages in financial conglomerates, high corporate and private indebtedness, dependence on wholesale funding, and foreign currency liquidity call for pro-active monitoring and a further build-up of bank buffers against shocks. Concerning the high level of intra-company lending, we would be interested in staff's view on potential risks and contagion channels. We welcome the increase of the countercyclical capital buffer to 0.5 percent in line with last year's staff recommendation and encourage the authorities to continue to refine their macroprudential toolkit and make proactive use of it, where appropriate.

And finally, we encourage the authorities to continue their efforts with regards to combatting corruption as suggested by staff.

Mr. Jin and Mr. Huang submitted the following statement:

We thank staff for the insightful reports and Mr. de Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode for their helpful buff statement. The French economy enjoyed a robust growth in 2018, with a strong labor market and declining fiscal deficit. Despite some social resistance, the authorities have reaffirmed their resolve to continue their comprehensive reform agenda, which is highly commendable. Looking forward, the economic outlook is facing rising uncertainties. The authorities are encouraged to continue their efforts in containing public spending, implementing labor and product market reforms, and strengthening the financial sector resilience. We broadly agree with staff's appraisal and would like to limit our comments to the following for emphasis.

Fiscal policy

On the back of the authorities' consolidation efforts, the public debt to GDP ratio has stabilized, but at an elevated level. In the meantime, the debt service to GDP ratio is at a historical low, due to the low interest rate environment. It is still a good time for the authorities to put debt on a firm downward path and preserve adequate fiscal space. In this regard, we share staff's view that the fiscal strategy should focus on spending cuts. We take positive note of the authorities' commitment to continuing their spending reforms on civil service, pension, unemployment insurance, and healthcare. Staff's granular analysis of France's public spending compared to its peers helped to identify areas where there is still room for improvement. We share staff's suggestions including streamlining tax expenditures and subsidies, increasing the efficiency of spending in health and education, and better coordination with local governments. Considering the rising debt but declining debt service, we wonder whether the high level of public debt in France is a response to the prolonged monetary accommodation in the euro area. Staff's comments are welcome.

Structural Reforms

The authorities' frontloaded labor-market reforms have begun bearing fruit. We encourage the same reform momentum in the product market. Regulations in some industries, such as professional services and retail distribution, are more stringent in France than in peer countries. In this regard, we see merit in staff's suggestions to ease restrictive regulations, reduce entry barriers, and foster competition. We share Mr. de Villeroché's view in the buff statement that the PMR index should be used with caution to estimate potential growth gains, especially if the index compilation method is opaque and the scale of index lacks straightforward economic meaning. Streamlining the administrative process for start-ups could help to facilitate entrepreneurship and innovation. We commend the authorities' firm commitment to the transition to a low-carbon economy. The authorities have decided to cancel the fuel tax increases after the "yellow-vest" protests. Could staff elaborate on how the authorities would use other tools to ensure emission reductions?

Financial Sector

France's financial sector is dominated by large financial conglomerates. We join staff in suggesting close monitoring and oversight of financial conglomerates, including better coordination among supervisory authorities, and stress testing and liquidity requirement at the conglomerate level. Banks are well-capitalized and liquid, but profitability and relatively high dependence on wholesale funding are sources of concern. The corporate leverage is rising rapidly but risks from that appears manageable. We welcome the authorities' recent macroprudential measures to manage the related risks, including lowering the exposure limit of banks to large indebted corporates and introducing a countercyclical capital buffer. We noticed that the rising corporate borrowing is mainly driven by bond issuance and intra-company lending. In this regard, the authorities are encouraged to closely monitor risks related to non-bank financing as well and take appropriate measures if necessary. The authorities have introduced a specific regulatory regime for initial coin offerings (ICOs) and crypto-assets. Staff stated that the regulatory regime appears to strike a sound balance between encouraging innovation and protecting investors. Could staff elaborate more on how this regulatory regime would strike a sound balance and how large are France's ICO and crypto-assets markets?

Mr. Tan and Ms. Yoe submitted the following statement:

We thank staff for the well-written reports, and Mr. de Villeroché, Mr. Castets, Ms. Gilliot and Mr. Sode for their informative buff statement.

Recent economic performance in France is moderating, especially against a backdrop of persistent trade tensions and a weaker-than-expected growth in Europe. The authorities' broad and ambitious structural reforms, aimed at making France's economy more dynamic, are showing early signs of paying off. Growth remained resilient with unemployment declining further. That said, longstanding structural challenges, including high structural unemployment, weak competitiveness as well as high public debt burdens, continue to persist. With the political economy posing a key risk to needed policy reform and implementation, the authorities must deliver on their commitments and build on the ongoing reforms to address these structural challenges while balancing social concerns. We broadly agree with the staff appraisal and offer the following comments for emphasis.

We encourage the authorities to press ahead with full implementation of the labor market reforms, coupled with further market liberalization, to enhance the economy's resilience and vibrancy. While the redistributive nature of its fiscal policy has helped to keep France's market income inequality relatively low and stable, France continues to lag behind peers in terms of social and income mobility. Inequality of opportunity is an impediment to long term and inclusive growth. Therefore, we support the authorities' policy agenda that is rightly focused on reforms to provide equal opportunities through employment for everyone. In this regard, we look forward to the full implementation of the labor market reforms, including additional reforms of the apprenticeship and vocational training system as well as the reform of the unemployment benefit that is underway. We also share staff's views that further liberalization of product and service markets is important to complement the labor market reforms in supporting job creation and boosting living standards. Further market liberalization would also help to enhance the competitiveness of French exports and firms, which has become more pertinent against growing headwinds in global trade.

Stronger sustained efforts to rein in public spending and increase its efficiency are needed to reverse the rising trend in public debt while the pace of fiscal consolidation needs to be carefully calibrated. Against the backdrop of growing social and political resistance to difficult reforms, the push for fiscal consolidation has become more challenging. We note that fiscal deficit is expected to increase in 2019, and hard-earned success in containing public spending will be offset by recently announced tax reliefs and expansionary fiscal measures in response to the yellow vest movement and the national debate. In particular, Box 1 points to France's mixed experience with sustaining fiscal consolidation. While we welcome the planned fiscal structural reforms of the civil service, pensions and unemployment benefits, which could help support fiscal consolidation, we note that most of the planned reforms remain to be legislated or implemented as indicated in Box 2. In this regard, can staff elaborate on the potential ramifications, if any, from the protests and ensuing national debate on the likelihood and feasibility of the planned fiscal structural reforms, and whether they see risks of further policy slippage? To put public debt on a firm downward path, the authorities must take a proactive and resolute approach towards additional spending reforms while preserving the redistributive characteristics of the French social model. The authorities agree with staff on the need to improve spending efficiencies in social protection, economic affairs, health and education through subsequent reforms. That said, further spending cuts need to be implemented with great caution amid declining support for the government's reform agenda and growing risk of a slowdown. We welcome staff's comments on whether a more gradual pace of fiscal consolidation would be more realistic and what would be the risk to fiscal sustainability by targeting a longer horizon to achieve the spending cuts?

The French financial system is more resilient than before, although continued vigilance remains essential. The authorities have strengthened the institutional and policy framework since the last FSAP, including enhancing regulation and oversight at the national and EU level as well as the proactive use of macroprudential measures to address any buildup of systemic risk. These changes have contributed to improvements in the capital positions and asset quality of the banking sector as well as the solvency ratios in the insurance sector. We encourage the authorities to further strengthen the resilience of the financial system by addressing the FSAP key findings. In particular, careful monitoring and management of risks from the concentration of exposures to large indebted corporates is warranted. We note that the authorities have expressed skepticism about the feasibility of implementing borrower-based measures. Can staff provide more details of how the measures could be developed and implemented, and share relevant experiences from other countries? We note the authorities' comment that financial conglomerates (FC) are a source of strength for the French financial system, thus it is even more pertinent to ensure that FCs operate in a profitable yet safe manner at the conglomerate-level. To better monitor and limit risks from direct and indirect exposures between entities within the conglomerate, we encourage the authorities to strengthen cross-sectoral oversight and enhance supervisory coordination for FCs.

With these remarks, we wish the authorities the very best in their reform efforts.

Mr. Ronicle and Ms. Andreicut submitted the following statement:

We thank staff for the insightful Article IV and FSAP reports and Messrs. de Villeroché, Castets, Gilliot and Sode for their comprehensive buff statement. We associate ourselves with Mr. De Lannoy's statement and would like to make the following additional comments.

The French economy has enjoyed several years of solid growth, positive labor market developments and ambitious structural reform. The resilience of the financial system has been enhanced. Productivity is high, public services are often world-leading and social outcomes are impressive. Nevertheless, the gilets jaunes protests of 2018 represented a significant political challenge. The authorities responded with a nationwide consultation and a series of fiscal measures, targeted at supporting households. Reform momentum has been sustained, with significant reforms forthcoming to the civil service, unemployment insurance and the pension system. We think France faces three principle economic challenges: high structural unemployment; slowing productivity growth, and high public debt.

Recent developments

Growth has held up reasonably well in recent months, despite the gilets jaunes protests and a slowing in neighboring economies. Labor market outcomes have been particularly robust, with employment at a ten-year high, falls in both unemployment, particularly longer-term, and underemployment, and a rise in the use of open-ended contracts. Reported labor shortages have picked up sharply, as have job vacancies, capacity utilisation is above average and staff judge the credit-to-GDP gap and output gaps to be positive – yet wage growth remains subdued and inflation is substantially below target. Could staff elaborate on why inflation is so weak? How does the French wage-Phillips curve look? Are there non-wage sources of low inflation?

Raising incomes by reducing structural unemployment

Productivity is high in France, but per capita incomes are lower than they could be because of elevated structural unemployment. As staff note, the authorities have delivered significant reforms in recent years "fostering labor market participation, flexibility and inclusiveness" and are planning more, most notably to unemployment insurance. Yet reported labor shortages have risen. Could staff elaborate on recent labor market developments? In particular, we would find it helpful: to know whether such shortages are concentrated in specific sectors? How the Beveridge Curve looks for France – has matching efficiency improved, or do staff expect it to improve, as a consequence of recent and planned labor market reforms? Have there been marked changes in labor market churn, for example hiring and separation rates? Have staff estimated the extent to which these reforms have or will lower the NAIRU?

Addressing slowing productivity growth

While productivity remains high, in recent years it has fallen behind that of peers. Reviving productivity growth will facilitate the convergence of per capita income and a reduction in the public debt burden. We therefore welcome the selected issues paper on potential gains from product market reform. We note that product market restrictions are particularly elevated relative to peers across retail and professional services, and that reducing these could bring substantial gains, though we also note some concerns from the authorities as to whether these metrics are too crude. Staff comments would be welcome. We also wonder whether there is evidence of elevated prices or profit margins in these sectors, that would be consistent with weak competitive pressures or excessive market power?

Reducing public debt

The French authorities have maintained an ambitious overall reform agenda, despite recent political challenges. The fiscal deficit has narrowed and debt is projected to fall from 2019 onwards. In that context, and noting the staff view that France has some fiscal space and that there is no "immediate risk" from high levels of public debt, we understand the authorities' concern with the appropriate sequencing of structural reforms and fiscal consolidation. That said, and as staff make clear, there are clear spending efficiencies that could be achieved, and we would encourage the authorities to pursue these, as well as consider whether regular spending reviews might support this effort. We note the differences between the authorities' fiscal projections and those of staff (p10) and would welcome some elaboration on them. We would also be interested to know whether the authorities' projections are consistent with those of the Haut Conseil des finances publiques?

Findings from the 2019 FSSA

We welcome the rich analysis on the financial sector, particularly given the number of globally significant financial institutions hosted in France, with four globally systemically important banks, one globally systemic insurer, one large global asset manager and one large global reinsurer. We also welcome staff's emphasis on the FSAP in the Article IV report, which we believe is good practice; we look forward to deeper integration of these products in the future.

We were struck by the scale of change in the financial system since the last FSAP in 2012. As the report identifies, there have been notable domestic and European reforms, across the spectrum of macroprudential policy, supervision, prudential regulation and resolution. In the context of the ongoing FSAP review, this underscores the importance of regular in-depth assessment of systemically important financial systems.

We welcome staff findings that the French financial system has made important progress since the last exercise in 2012 and that it is prudentially in a stronger position – this has allowed the financial system to support the ongoing expansion of the French economy. We commend the French authorities for their active use of macroprudential tools. We concur with staff that the authorities should focus on containing vulnerabilities and take action if systemic risks intensify.

We welcome improvements in capital and asset quality in the banking sector, as well the solid performance of French banks in the IMF stress test, though note the ongoing challenge of low bank profitability. This is not an issue confined to France, but rather a broader concern for the Euro Area as a whole. We note that the proposed actions to address low profitability, cost savings and efficiencies, are largely in the gift of individual banks; do staff have views on actions the authorities should be taking, for example fostering competition?

We take note of the rising share of non-bank assets in total financial assets (up to 40 percent in 2017) and of the fact that the insurance sector is one of the largest in the EU. This makes a strong case for an expanded macroprudential toolkit to cover non-banks as well as for an enhanced recovery and resolution framework for these entities, including bail-in powers for insurers.

Green finance

Finally, we would like to raise one issue which is not featured in the Article IV report, but which could merit further attention in future discussions, namely France’s leading role in climate finance. The requirement for institutional investors to disclose how they integrate environmental, social and governance factors into investment operations, as well the Banque de France’s important contributions to the Network for Greening the Financial System are only two examples of France’s commitment to climate finance. We look forward to France’s continued engagement in these issues.

Mr. Fanizza and Mr. Spadafora submitted the following statement:

We thank staff for an informative set of reports and by Mr. de Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode for their informative buff statement. We associate ourselves with Mr. De Lannoy’s statement and offer some additional comments for emphasis.

France’s economy has shown resilience and notable strength in the labor market, where the employment rate has reached a 10-year high. However, heightened uncertainty around the outlook, increased external downside risks, and fading support to reforms call for continued efforts to tackle long-standing structural challenges.

Fiscal Policy

We support the authorities' choice to undertake a more gradual consolidation efforts to address upfront structural challenges, which hold back growth prospects and pose threats to the country's social cohesion, as clearly shown by the "Yellow Vest" protests. However, this choice requires that fiscal and structural reforms plans remain credible. In this sense, the muted financial markets' reaction has been encouraging, despite a high government debt-to-GDP ratio that has not declined even in the presence of real interest rates below the economy's growth rate.

Staff's recommendations to improve the primary structural balance by around 2 percent of GDP over 2020-23 might prove quite difficult to achieve and risks undermining fiscal policy credibility. The authorities should thus place fiscal policy back on a gradual consolidation path in 2020, not only to lower debt vulnerabilities, but also to bring down both revenues and expenditures, which in terms of GDP are among the highest in Europe.

We share the staff's advice on the policy response graduated according to the intensity of a possible downturn and share the authorities' view on the case for a more coordinated European response should risks materialize simultaneously.

Structural Reforms

The French economy shares the challenge of reversing the slowdown of productivity growth that afflicts many of its peers and results in stagnant living standards. Efforts are also needed to assure more equal opportunities in education and training and address elevated market income inequality.

To this end, full implementation of the legislated measures is of the essence to maintaining the structural reform momentum and entirely reaping the benefits of the front-loaded reforms, notably in the labor market.

Efforts should be notably sustained in implementing the reform of apprenticeship and professional training enacted in late 2018, which is targeting more vulnerable groups; the reform underway of the unemployment benefit system is a welcome complement to reduce structural unemployment.

It is also important to monitor the effects of the reforms to assess the case for possible adjustments.

We support the staff's view that further product and service market reforms would support other ongoing efforts in fostering productivity and increase resilience.

Financial sector

The 2019 FSAP provides a useful update on France's financial system, which is complex and global in nature. We welcome the progress made since the last FSAP and the staff's overall assessment that the financial system is prudentially in a stronger position, with banks' capital and liquidity buffers judged to be adequate to withstand a sizable shock. However, the system confronts several downside risks, banks – like in other countries – face challenges in ensuring adequate profitability, and reliance on wholesale funding has decline but remains high.

We thus support the FSSA's recommendations and their focus on mitigating a further buildup of vulnerabilities, primarily in the corporate sector. In this regard, the authorities' proactive use of macroprudential measures is appropriate.

Although we acknowledged the authorities' views on the benefits of financial conglomerates, we support the staff's call for increased monitoring and oversight of these intermediaries.

Finally, we fully share the authorities' call for completing the banking union and capital markets unions to further strengthen the institutional architecture of the Economic and Monetary Union.

Mr. Tanaka and Mr. Kuretani submitted the following statement:

We thank staff for the informative sets of reports and Mr. de Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode for their insightful statement. We welcome that growth remains robust and labor market continued to improve, despite the Euro Area slowdown and rising trade tensions. We commend the authorities' determination for implementing comprehensive reforms including labor market and tax reforms. However, the country faces downside risks, stemming from a potential weakening of the external environment. Against this background, we encourage the authorities' continued efforts to advance the reform agenda aiming at addressing France's structural challenges. As we broadly concur with the thrust of the staff appraisal, we will limit our comments to the following points:

Fiscal Policy

We positively note that the fiscal deficit has declined to 2.5 percent of GDP and the fiscal debt stabilized at 98.4 percent of GDP at end 2018, owing to a slow-down of the public spending increase. In addition, according to staff's analysis, France's level of spending is relatively high compared to peers with potential efficiency gains in several categories, such as social protection, economic affairs, health and education. In this regard, we encourage the authorities to address the durable spending reforms especially in these areas. We note that the authorities favored a more gradual pace of consolidation than that recommended by staff. Could staff elaborate more on the differences of process and consequences proposed by staff?

Structural Reform

We commend the authorities' strong commitment to a comprehensive reforms plan aiming at modernizing the French economy while ensuring the conditions for equal opportunity. However, as staff insist, the reforms especially for vulnerable groups should be carefully monitored and adjusted if outcomes fall. We encourage the authorities to lower structural unemployment, address inequality of opportunity, and boost long-run growth through the progress with the ongoing reforms. In addition, we positively take note that the authorities plan to legislate a package of additional transformative structural reforms, including unemployment insurance reform, pension reform, and civil service reform.

Financial Sector

We welcome that France's financial system has progressed since the last FSAP and is broadly resilient to simulated shocks under the stress-test of 2019 FSAP. At the same time, the country faces several downside risks, including relatively high and rising private nonfinancial and public sector debt, and an uncertain earnings outlook for the banking business. In this regard, we encourage the authorities to continue to monitor the risks closely and stand ready to make further use of macro- and micro-prudential policies going forward.

Mr. Geadah and Ms. Choueiri submitted the following statement:

We thank staff for the interesting reports, which highlight France's resilient growth, higher employment, and lower fiscal deficit, relative to last year. The report also highlights the challenges associated with high public and private debt burdens, high structural unemployment, inequality of opportunity, and low productivity. The helpful buff statement by Mr. de Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode reaffirms the authorities' resolve to pursue a wide-ranging structural reform agenda, with a focus on the civil service, the unemployment insurance, and the pension system, while reducing the fiscal deficit over the medium term. We share staff's view that an important challenge is to attain social consensus on these policy priorities and commend the French authorities for their efforts in this regard, including by organizing the Grand Débat National following the Gilets Jaunes protests. France has one of the lowest poverty rates in the OECD. This reflects societal choices and comes at a fiscal cost. We believe the report could have better highlighted the policy tradeoffs involved in carrying out ambitious fiscal consolidation and wide-ranging structural reforms, while protecting social outcomes. We welcome France's strong commitment towards multilateral cooperation, in particular in the areas of trade, international taxation, and climate change, as well as towards European integration. We also compliment the authorities on having one of the lowest gender pay gaps in the world and relatively high female participation.

Staff's analysis in the Selected Issues Paper suggests that fiscal consolidation should build buffers to help France confront the next downturn. We concur with staff that a credible and sustained effort to reduce spending—the highest relative to GDP among OECD countries—in a growth-friendly manner, while increasing its efficiency, will be essential to safeguard fiscal sustainability. We also understand the authorities' preference for a gradual fiscal consolidation given their focus on addressing structural challenges upfront. We note that the planned civil service, pension, and unemployment benefit reforms could support growth and help to improve government spending efficiency, as well as the quality and fairness of social protection plans (Box 2). Social protection, economic affairs, health, and education represent three-fourths of France's government expenditure, and we welcome the authorities' intention to achieve savings in these areas (¶20). Can staff indicate whether they discussed with the authorities specific savings options in these four areas? We take positive note of recent progress in the local government contractual approach and the improved and more transparent budgeting process.

Implementation of wide-ranging structural reforms has continued since our last discussion, including labor market reforms, additional growth-friendly tax measures, an overhaul of the apprenticeship and vocational training system, and reforms of the education system. To reap the benefits of these reforms, efforts should focus on implementing them fully. Important product market reforms have been launched in transportation and with the Loi Pacte, which will simplify administrative burdens for firms, particularly smaller firms, promote entrepreneurship and innovation, support the reallocation of savings toward longer term investment, and improve the insolvency regime. We see merit in staff's advice to build on these initiatives by considering further product-market reforms (e.g., regulated professions, sales of medicines, and retail distribution).

The French financial system has made important progress since the last FSAP. Banks have strengthened their capital positions and asset quality and have adequate capital and liquidity buffers to withstand sizable shocks. The authorities share the concerns expressed in the FSAP report about the low net interest margins of the traditional banking business, given low interest rates, regulated savings, as well as competition among banks and from fintech and the need to improve IT infrastructure. We are encouraged by steps taken to address a buildup of systemic risk from corporate leverage as the authorities proactively activated macroprudential policies, including lowering the exposure limit of banks to large indebted corporates and introducing a countercyclical capital buffer. Staff and the authorities agree on the potential usefulness of further integrating conglomerate-level monitoring and oversight to help ensure that risks are promptly identified and addressed. Are there plans to discuss the proposal at the European level, including in the context of the next euro area Article IV consultation?

Mr. Tombini, Mr. Saraiva and Mr. Antunes submitted the following statement:

We thank staff for the concise report and the insightful background papers, and Mr. de Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode for the comprehensive and informative statement. The French economy continues to grow at a moderate pace, with relatively high unemployment rates and persistently low inflation. In that context, we welcome the ambitious reform agenda to raise potential growth being implemented by the French government. Going forward, fiscal consolidation will be key to guarantee long-term stability.

After peaking in 2017, economic activity has converged to potential and stabilized at moderate rates, following the dynamics of the Euro Area at large. Growth is forecasted to slow down to 1.3 percent in 2019, rising to around 1.5 percent in the following years. This result means steady if modest per capita gains in a mature economy with low population growth rates. That said, France's economic performance can be substantially improved in the long run if the government perseveres in its reformist endeavors. Therefore, we welcome the policy agenda put forward by the authorities with a view to boost growth potential, enhance competitiveness and modernize the French economy.

Unemployment is declining but remains relatively high, particularly among disadvantaged social groups. The implementation of labor-market and tax reforms in recent years partly explain the favorable trend in job creation. Unemployment rates are forecasted to reach 8.6 percent in 2019 and decline further to 8 percent in the upcoming years, in line with structural unemployment estimates. Nevertheless, unemployment among young people and non-EU citizens remain close to 20 percent, fueling social discontent. We commend the substantial investments already being made in targeted professional training for these groups. The successful integration of newer generations and non-EU immigrants into the labor market will depend not only on investment in human capital, but also on the existence of suitable job opportunities. Reducing the structural unemployment rate must, therefore, continue to be a top priority.

Inflation remains subdued despite the accommodative monetary stance of the European Central Bank and some growth in salaries. Nominal wage growth averaged 2 percent in 2018, while core inflation stood at 0.9 percent. In 2019, both inflation and core inflation are expected to remain well below the ECB's target. We take note that staff assesses wage growth in France to be subdued. Indeed, there seems to be room for a faster pace of salary increase. However, a higher cost of labor could hamper competitiveness of the French economy. Staff's comments are welcome.

A growth-friendly fiscal consolidation is the most important macroeconomic challenge for the French authorities. The accommodative monetary stance of the ECB reduces the weight of the debt service and contributes to the sustainability of French debt, despite continued fiscal deficits. We take note that, under the baseline scenario, public debt is projected to decline at a very slow pace, reaching 97 percent of GDP in 2024. Despite its low cost, we concur with staff that the public debt position remains vulnerable and subject to relevant risks. There is a sensible argument for frontloading fiscal consolidation while monetary conditions remain favorable, thereby building fiscal buffers in case downside risks materialize. That said, we understand that the French authorities face difficult tradeoffs between the implementation of the reform agenda and fiscal consolidation. Addressing legitimate concerns risen by the French society in the "Grand Débat National" also merits policy priority – ideally to be financed by reductions in subsidies and tax expenditures. All things considered, the more gradual pace of fiscal consolidation envisaged by the French authorities is warranted, as long as a clear commitment to fiscal sustainability is in place.

We commend the French authorities for relevant concessions in the context of the trade agreement between Mercosur and the EU. The agreement represents a renewed commitment of the two regions to an open and rules-based international trade system. Historically, overcoming pressures from the French agriculture sector represented one of the main difficulties for closing the deal, which has been under negotiation for almost twenty years. Although the final agreement is clearly a step in the right direction, we note that it preserves trade distorting quotas for certain agricultural products. We encourage the French authorities to embrace a more ambitious trade liberalization agenda and reassess the negative macroeconomic effects of remaining quotas and agriculture subsidies.

We welcome the institutional and policy progress since the previous Financial Sector Assessment Program (FSAP). European prudential regulation has been strengthened through a series of measures (viz., CRR/CRD IV, BRRD, Solvency II), and capital positions and asset quality of French banks have improved. Although the French financial system is generally sound, profitability remains subdued and stress tests reveal vulnerabilities associated to some banks' exposures to highly indebted corporates. We take note, however, that Pillar II measures to address bank-specific residual risks related to corporate exposure fall outside the purview of French authorities. As in other financial regulatory issues, effective coordination of several different agencies at the national and regional level is critical. The eventual completion of the banking and capital markets union could give more clarity to the diverse roles of the regulatory agencies, avoiding overlaps and filling in possible gaps. In addition, it is particularly important to safeguard the autonomy and the adequate resource provision of the Autorité de Contrôle Prudentiel et de Résolution (ACPR) and the Autorité des Marchés Financiers (AMF).

Mr. Mojarrad submitted the following statement:

We thank staff for well-written set of papers and Mr. De Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode for their insightful buff statement. We also thank staff for the excellent work on the Financial Sector Stability Assessment (FSSA). As we broadly share staff's conclusions and policy recommendations, we limit ourselves to the following points for emphasis.

The French economy is gaining resilience thanks to the authorities' bold structural reforms, already evident from the positive growth outlook and labor market gains. The authorities' engagement with social partners and the population at large through Grand Débat National is, in our view, a helpful strategy to prioritize reforms, while being mindful of the social environment. Although the consultative process may lead to a more gradual pace of reforms than that recommended by staff, it probably has better chances of success, as it allows the authorities to address the important issues of inequality and social discontent.

Public finances are challenging in France, and in view of high public debt and rising spending, we encourage the authorities to remain committed to safeguarding fiscal sustainability. Here, we welcome the indications that three important reforms—the civil service, the pension system, and unemployment benefits— are under way and agree with staff that their steady implementation will be essential to fiscal consolidation. France will clearly benefit from a strategy to contain public spending and improve its efficiency, although we agree with the point made in the buff statement that it is important to accept the country's own choices and its social model, in particular the social protection system. We welcome staff assessment of France's anti-corruption supply-side provisions and take note of the authorities' efforts to enhance the prevention, detection, and sanctioning of corruption and related offences.

The FSSA confirms that the French financial system has made important progress since the last FSAP, is more resilient, and that banks have adequate capital and liquidity buffers to withstand a sizable shock. We encourage the authorities to give due consideration to staff recommendations, in particular with regard to the need to further integrate conglomerate-level monitoring and oversight.

As emphasized by the Board on the occasion of the IEO's evaluation on IMF Financial Surveillance, we encourage staff to enhance their coordination between the FSAP and the Article IV exercises to ensure better communication and improve traction of IMF advice. We note divergences in the Risk Assessment Matrix between the FSSA and the Article IV report for three major risks (weaker-than-expected global growth, sharp tightening of global financial conditions, and weakening of domestic reform implementation), and would appreciate staff clarification.

Mr. Ostros and Ms. Karjanlahti submitted the following statement:

We thank staff for their interesting set of reports and Mr. de Villeroché, Ms. Gilliot and Mr. Sode for their informative buff statement. Despite the moderation in growth, the French economy remains resilient supported by continued strength in the labor market. The French social model produces notable results in terms of inequality and social outcomes, however the long-term fiscal imbalance has led to a path of rising debt over the past decade, which if not addressed, may threaten the sustainability of the model. Here we commend the authorities' commitment to boost competitiveness and potential growth through a broad range of structural measures and encourage increased focus on fiscal sustainability and debt reduction. We associate ourselves with Mr. De Lannoy's Gray statement, broadly agree with the staff appraisal, and provide the following comments for emphasis.

Sustaining the social model in the future will require stronger fiscal efforts and debt reduction. Acknowledging the achievements of the French social model and the preference of public provision for a broad set of social protection, we do not see the level of spending in the public sector as problem in itself. However, a long-term imbalance between spending and revenues has led to historically high public debt threatening medium-term sustainability and reducing available buffers. Furthermore, as demonstrated by the informative SIP, the fiscal stance has not been sufficiently responsive to neither debt levels nor cyclical conditions. Thus, we agree with staff's recommendation that the structural reform efforts should be combined with a more ambitious path of fiscal consolidation to meet the MTO and take advantage of the still positive cyclical position and the tax adjustment. The planned fiscal structural reforms; civil service reform, pensions reforms, and unemployment benefit reforms, as well as increasing efficiency of spending, will be important to support consolidation. Notably, the spending gap on pensions with respect to peers is large with significant opportunities for reform. Could staff elaborate on the potential fiscal effects of the pension reform and the possible timeline for implementation?

Continued strong commitment to structural reforms will be critical to boost productivity and labor force participation. We commend the authorities for their persistence in reform implementation and the additional efforts to improve social consensus and buy-in of the reform agenda through dialog. The frontloading of labor market reforms to reduce the tax wedge and broad reforms on education and training are addressing the key challenge of labor force participation. We encourage the authorities to ensure the effectiveness of these reforms, including the implementation of the recently announced changes to the unemployment benefit system. We also take positive note of strengthening competitiveness through liberalizing product and service markets. However, international rankings and staff analysis show that there is still room for improvement to bridge the productivity gap between French firms and global best-performers. Thus, we agree with staff that further efforts of service and product sector reforms, such as reducing the administrative burden for startups, improving competition among regulated professions, sales of medicine and retail distribution, would be warranted.

The resilience of the financial system has improved, but vulnerabilities remain. We appreciate the improvements in the capital and asset quality positions of the financial sector. However, risks related to funding and profitability of the banks remain. Furthermore, increasing indebtedness, especially in the non-financial corporate sectors, as well as some segments of the household sector, warrants close monitoring. In this respect, we welcome the two-step increases in CCyB and targeted measures limiting bank exposures to large indebted corporations. We encourage the authorities to go ahead with the plans to reduce debt bias of the corporate income tax deductions in support of curbing corporate leverage. In addition, we agree with staff that the authorities should stand ready to further tighten the macroprudential stance. However, as the authorities note, some recommendations related to further development of borrower-based macroprudential measures fall under EU level supervision, which could have been more clearly expressed in the report.

Mr. Mouminah, Mr. Alkhareif and Mr. Keshava submitted the following statement:

Growth in France has remained resilient and unemployment has continued to decline, including for the long-term unemployed, indicating a robust labor market. These encouraging developments are taking place against the backdrop of notable progress in advancing reforms in recent years, including those related to labor market and tax. We also take positive note of the authorities' strong resolve, as noted in the insightful buff statement of Mr. de Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode, to continue the implementation of their comprehensive and far-reaching structural reform agenda. In this context, we are encouraged by staff's baseline projections that growth is expected to remain solid in the near and medium term. At the same time, we encourage the authorities to sustain the progress on the reform agenda with appropriate prioritization and sequencing, as a number of structural challenges remain, and to continue to be vigilant as downside risks have risen.

It is important to further reduce public spending relative to GDP in a measured manner and durably put the public debt ratio on a downward path. In this connection, we take positive note of the authorities' strategy of a more gradual pace of consolidation by aiming a reduction in the level of public spending growth compared to GDP growth, which will maintain a balance between supporting growth and ensuring fiscal sustainability. At the same time, we note that the public debt-to-GDP ratio while gradually declining is expected to remain above 90 percent during the projection period. However, we are reassured to note the resilience of the public debt structure, with long average maturities. In this connection, the buff statement has brought attention to the authorities' planned reforms, including in the areas of civil service, pension, healthcare, and unemployment insurance, which should help in advancing fiscal consolidation over the medium term. Annex VI provides an interesting analysis on benchmarking spending reforms in France and we would welcome staff comments on how differences in national social models are taken into account in identifying right areas for generating efficiency gains as mechanistic comparison of spending with peer countries is unlikely to help in building social consensus.

We commend the authorities for implementing comprehensive labor and product and service market reforms and encourage sustained efforts going forward. In particular, we are impressed by the focus on reforms of apprenticeship and professional training aimed at improving opportunities and skill acquisition particularly for vulnerable groups. These are steps in the right direction to help better match training to firms' needs. To this end, we welcome the setting aside of €15 billion for the training of 1 million unemployed and 1 million low-skilled youth until 2022. We also welcome the labor-tax-wedge and labor-code reforms, the ongoing reform of unemployment insurance, and measures to further reduce gender gaps. Here, we echo staff's recommendation to monitor the effects of these reforms closely and take suitable measures if outcomes fall short of desired objectives. We take positive note of the enacted Loi Pacte - Action Plan for Business Growth and Transformation - and encourage continued reforms of product and service markets to support productivity growth.

Finally, we welcome the overall positive assessment of the French financial system and the authorities' broad concurrence with the FSAP findings. We look forward to continued reform efforts to further strengthen financial stability, including enhancing the monitoring and oversight of financial conglomerates. We also agree with staff's recommendation that the authorities should remain vigilant and stand ready to make further use of macro- and micro-prudential policies, as needed, while continuing to enhance crisis management, safety nets, and resolution arrangement. We welcome the authorities' agreement on the need to enhance AML/CFT supervision of smaller banks rated as high-risk.

With these remarks, we wish the authorities continued success.

Mr. Lopetegui, Mr. Di Tata and Ms. Moreno submitted the following statement:

We thank staff for a very interesting set of papers and Mr. de Villeroché, Mr. Castets, Mr. Guilliot, and Mr. Sode for their comprehensive buff statement.

We welcome recent developments in France, including resilient growth, continued job creation, and the adoption of important structural reforms related to the labor market, taxation, the apprenticeship and vocational training system, and the education system. We also commend the authorities for their strong resolve to continue with the implementation of a comprehensive agenda which envisages a profound modernization. In this regard, the authorities are of the view that the conclusions of the grand national debate launched after the emergence of the "yellow vests" movement are supportive of a strong reform process. In addition, we are encouraged by the authorities' commitment to fiscal consolidation through a gradual reduction in public spending to put the public debt, which remains elevated, on a downward path.

Real GDP growth slowed but remained robust at 1.7 percent in 2018, reflecting a moderation in investment and private consumption. Inflation remains subdued; the current account deficit narrowed slightly to close to balance, with the external position being assessed as broadly in line with fundamentals; and continued employment creation has led to a decline in the unemployment rate. Economic growth is projected to remain resilient at around 1.4 percent in 2019 and 2020 and to converge to its potential of 1 ½ percent in the long-run. Main downside risks include weaker than expected growth in Europe, rising trade tensions, a disorderly Brexit, and a sharp tightening of global conditions. Could staff comment on whether there are upside risks to the growth scenario assuming full implementation of the authorities' reform package?

Fiscal policy needs to reduce the deficit through durable spending reforms to put the public debt on a firm downward path. The authorities' strategy gives priority to addressing structural challenges upfront while pursuing fiscal consolidation in a more gradual manner than recommended by staff. After a reduction to 2.5 percent of GDP in 2018, the authorities envisage a decline in the fiscal deficit (corrected for one-off factors) to 2.3 percent of GDP in 2019, followed by further fiscal consolidation to 1.2 percent by 2022 supported by spending cuts that need to be further specified. Regarding the staff's baseline projections, we take note of the authorities' comments that an increase in the public deficit after 2020 in a context of continued growth is highly unlikely and contradicts their plans.

The package of additional structural reforms planned by the authorities, which includes unemployment insurance reform, civil service reform, and pension reform, is expected to support their fiscal consolidation efforts while improving equity and increasing spending efficiency. Could staff provide a rough estimate of the fiscal savings that could be achieved through these important reforms? We concur with staff that these efforts should be complemented by efficiency gains in other areas, including tax expenditures, healthcare, education, further reforms of social benefits, and an improved allocation of resources among different government levels, but would like to highlight the importance of adequate prioritization. Could staff comment on the magnitude of total tax expenditures in France as well as possible areas for improving the targeting of social benefits? We welcome recent progress in containing spending by the local administrations.

We concur with the authorities that in a downside scenario involving the materialization of external risks and a recession in the euro area, in addition to automatic stabilizers, there could be a need not only for domestic fiscal policy to support growth but also for a coordinated response at the European level. Although we agree on the need to lower public spending and improve its efficiency, we also share the view expressed in the buff statement that in assessing the high level of public spending in France, it would be important to keep in mind the choice made to socialize large parts of the social protection system, which makes international comparisons difficult. In addition, we agree that France's achievements in terms of low poverty and broadly stable disposable income inequality could have been given more emphasis in the core report. We take positive note of the fact that France has one of the lowest gender pay gaps and a relatively high female labor participation.

We welcome the recent reforms focused on the labor market, taxation, education, and training, as well as the ongoing product market reforms (such as railway reform and those envisaged in the Loi PACTE). Looking ahead, we encourage the authorities to continue with their efforts to remove restrictive regulations in product and services markets. We also acknowledge the important steps that have been taken to address corruption, including passage of Loi Sapin 2 and France’s voluntary participation in the review conducted by staff in partnership with the OECD’s Working Group on Bribery. We encourage the authorities to continue to enhance enforcement capabilities and to press ahead with their plans to enhance the AML/CFT supervision of smaller banks rated as high-risk.

We welcome the positive assessment of the French financial system made by the FSSA, which recognizes that banks have adequate capital and liquidity buffers to withstand sizable shocks, although profitability is being affected by compressed net-interest margins. We notice the positive results of the stress-test analysis as well as the advances made in strengthening the institutional arrangements for macroprudential policies within a context characterized by rising nonbank financial intermediation.

Going forward, we agree on the need for improved cooperation among supervisory agencies to enhance the monitoring and oversight of financial conglomerates; however, we acknowledge that some issues need to be addressed from a European perspective. Given that French banks are exposed to rising corporate debt, continued close monitoring is required in this area. The decision to activate macro prudential measures on banks’ exposure to large corporates is a positive step forward, but additional micro- and macro-prudential measures might be necessary if risks intensify. Some measures recommended by staff, however, do not fall directly and solely within the scope of the French authorities. We also encourage the authorities to reduce, in the context of future tax legislation, the fiscal tax bias favoring debt rather than equity financing and take positive note that the Loi PACTE intends to facilitate SMEs’ access to diversified financing sources. Could staff elaborate on possible policy responses to potential disruptions in wholesale funding as well as on the authorities’ view that an enhanced resolution framework for insurers should be the task of the EU authorities and that France is far more advanced in this area? Regarding regulated savings products, we would appreciate staff’s comments on the options available to transition to more market-based products in view of the difficulties faced by the authorities.

Lastly, we greatly appreciate the French authorities’ commitment to continue to implement a strong climate mitigation agenda.

With these comments, we wish the French authorities every success in their future endeavors.

Mr. Moreno and Ms. Mulas submitted the following statement:

We thank staff for its report and informative papers, as well as Mr. de Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode for their candid buff statement. We associate ourselves with Mr. De Lannoy's statement and will focus our comments on the following issues for emphasis:

Reforms have started to bear fruit. The reforms implemented over the past years have enhanced France's economic activity, which has remained resilient relative to peers. Against negative temporary factors and the impact of social protests, France continued to grow in 2018, although at a slower pace, and the labor market continued to improve further increasing the employment rate. The share of people at risk of poverty or social exclusion has been declining since 2013. We commend authorities for the ambitious reforms adopted and for their commitment to a comprehensive reform plan aiming at modernizing the French economy, while ensuring conditions for equal opportunity and greater social inclusion.

Going forward, reform momentum should continue as risks and challenges persist. Several challenges remain, including in the labor market (segmentation and tight labor conditions for vulnerable groups), relatively higher regulatory constraints, particularly for some services sectors and stalled private investment in research and development, which remain stable since 2015. We welcome the package of additional structural reforms to continue addressing France's challenges and welcome the authorities' determination to implement the reform agenda. We particularly welcome the frontloaded labor-market reforms fostering labor market participation, flexibility, and inclusiveness, as well as the new measures to further reduce gender gaps, such as a novel index measuring gender pay inequality.

We encourage authorities to continue with the growth-friendly fiscal consolidation strategy, including an ample spending review process. We welcome the reduction of the fiscal deficit in recent years and note that the 2019 increase of the deficit up to 3.1 percent of GDP is mainly due to a one-off measure on social contributions. We note the important difference between the staff's and the authorities' deficit projections for the next three years horizon. Staff's comments are welcome. Fiscal adjustment and compliance with the European fiscal rules are key, and we welcome the authorities' consideration of complementing ongoing efforts with additional spending reforms, as also recommended by staff. It will also be important to use any windfall gains to further reduce the general government debt ratio. We particularly welcome the spending review process under the "Action

Publique 2022" program aiming at an ambitious and coordinated overhaul of all public policies, which should yield good insights to rationalize and improve efficiency in the areas of social protection, economic affairs, health, and education, without necessarily curtailing the amount of public services provided. Could staff elaborate on the progress achieved so far in the "Action Publique 2022" program?

The health of France's financial system has strengthened notably over the last few years, but vulnerabilities persist, as adequately stressed in the FSSA. We welcome the increase in banks' capital and liquidity positions, as well as the improvements in their asset quality, which have reinforced their resilience, as attested by the positive outcomes in the solvency and liquidity stress tests. However, challenges remain, including subdued profitability and the combination of high and increasing indebtedness in both the non-financial corporate and the household sectors that warrant closer attention and, potentially, the consideration of additional macroprudential measures. We welcome in this regard the authorities' recent decision to further increase the countercyclical capital buffer, which is consistent with the signals conveyed by some cyclical systemic risk indicators—here, the FSSA could be clearer on articulating EU and national competences; for instance, the sectoral systemic risk buffer for the corporate sector will only be available after certain EU legislative amendments become effective, i.e. after 29 December 2020. We would also highlight the FSAP conclusion that oversight on financial conglomerates should be enhanced by improving cooperation among supervisory agencies and addressing data gaps. Here, ongoing work at the EU level, notably by European supervisory authorities, should partly address some of these issues.

We welcome authorities' commitment to continue implementing a strong climate mitigation agenda. France is performing well in climate mitigation policy but needs to step up its efforts with a view to reaching its 2030 targets, including increasing the pace in the deployment of renewables by fostering private investment and more investments in interconnection projects to advance in the integration of the internal energy market in the European Union.

Mr. Rosen and Mr. Shenai submitted the following statement:

France's growth has recently outperformed Euro area peers, and labor market reforms seem to be bearing fruit. Nevertheless, risks remain. Although the fiscal deficit declined in 2018, public debt remains elevated at 98 percent of GDP. Staff's detailed analysis, with which we broadly agree, shows how a sudden tightening of global financial conditions and slowing growth may exacerbate fiscal dynamics. Further, structural unemployment remains high and productivity remains low. Thus, we commend the authorities' ambitious structural reform agenda that will help boost productivity, improve the fiscal position, and raise growth prospects. We encourage the authorities to take advantage of the currently favorable economic conditions to continue to implement structural reforms while maintaining fiscal discipline and monitoring financial stability.

The buff Statement of Messrs. de Villeroché, Castets, Gilliot, and Sode underscored the scale of structural reforms implemented and planned in the years ahead. We appreciated staff's analysis of restrictive regulations that continue to hamper productivity growth and we strongly agree with staff that a sharper focus on product and service market reforms can enhance productivity. Additional information on specific measures on product and service sector reforms planned beyond those mentioned in the buff Statement, such as competition and healthcare reform, and their expected timeline for implementation would be welcome.

We appreciate staff's detailed and nuanced analysis of fiscal policy, including in the Selected Issues paper and welcome the authorities' commitment as noted in the buff statement, to contain spending growth and reduce public debt. We note, however, that there may be a potential tradeoff between the pace and scale of reforms and socio-political consensus. In this context, could staff comment on their difference in views with the authorities on the pace of consolidation? Furthermore, we were surprised that the Article IV report did not mention France's privatization efforts, particularly since revenue raised through privatization could help catalyze further productivity-enhancing reforms and yield fiscal dividends. Could staff comment on whether this process is still on track and on the estimated fiscal impact of announced privatization plans?

Staff's analysis of financial sector vulnerabilities, including in the Financial System Stability Assessment (FSSA), is timely given that external risks have risen. We agree that France is in a stronger position prudentially, with banks having implemented capital and liquidity buffers to withstand sizable shocks, while insurers' solvency ratios have been bolstered by Solvency II. We also agree that banks' reliance on wholesale funding could lead to challenges should the sector be subject to large outflows leading to cross-border liquidity fragmentation, particularly in dollar funding markets. We concur with staff's recommendations that to have additional liquidity buffers in all major currencies, the continued monitoring of insurers, and the development and inclusion of bail-in tools for resolution. Further work at harmonizing national and supranational regulatory approaches, including progress toward developing the European Banking Union and the Capital Markets Union, are welcome.

Finally, we were pleased to see the inclusion of the potential impacts from a hard Brexit on financial stability in both the staff report and FSSA.

Mr. Just and Mr. Stradal submitted the following statement:

We thank staff for their comprehensive set of reports in the context of the Article IV Consultation and the Financial System Stability Assessment. We also thank Mr. de Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode for their comparably comprehensive buff statement. French economic growth has decelerated, but easy financial conditions and robust domestic demand contributed to relative resilience. While the government has made notable progress in the implementation of some key reforms, major structural challenges remain, including a high public debt ratio; lack of external competitiveness; and stubbornly elevated rate of unemployment, especially among young people. The medium-term outlook remains highly dependent on the continued implementation of existing and planned reforms. We welcome the authorities' steadfast commitment to the reform agenda, but the recent protests showed that the political economy constraints are significant. We hope that the authorities' understanding of the "grand national debate" conclusions as supportive of a strong reform process will materialize. We associate ourselves with Mr. De Lannoy's statement and add the following comments.

Putting high public debt on a sustained downward path should be a key priority. France's public debt is projected to reach a new maximum of 99 percent of GDP this year, despite a prolonged period of historically low government bond yields across the curve. The fiscal space to react to potential shocks in the future is thus constrained. We fully agree with staff that a genuine effort to reduce debt is essential for strengthening the resilience of the economy. We are concerned that the further backloading of fiscal consolidation is expected to result in significant deviation from the recommended adjustment path towards the medium-term objective. Reaching the fiscal objective is now expected only after the end of the government's mandate. Given the highest expenditure ratio among the EU countries at 56 percent of GDP, a growth-friendly rationalization of the expenditure side at all government levels should be prioritized. Better targeting of social transfers, reforming the complex pension system, and streamlining corporate tax expenditures and subsidies are among the key ingredients.

We welcome the recent structural reforms and the authorities' commitment to continue to pursue their reform agenda. The persistently high unemployment at levels above those preceding the Great Financial Crisis points to labor market rigidities. We encourage the authorities to implement the labor code, unemployment insurance, and vocational training reforms aimed at incentivizing labor market participation and increasing labor market flexibility. We agree with staff that stepping up the efforts to further liberalize the product and service markets is a key complement with a view to increase productivity and enhance the potential growth.

We welcome the financial system's overall resilience as illustrated by the stress tests. Despite subdued profitability, the banking sector improved its capital position, as well as the asset quality and liquidity ratios. We commend the French authorities for increasing the countercyclical capital buffer and encourage them to remain vigilant to the growing private debt, as some of the manifestations, risks, and interlinkages may be veiled by the complex conglomerate structures. We take note of the banking sector's continued dependence on wholesale US dollar funding, which calls for continued close monitoring.

We commend the authorities for the significant progress in strengthening the AML/CFT frameworks.

Mr. Inderbinen, Mr. Tola and Ms. Wicht submitted the following statement:

We thank staff for the comprehensive set of reports and Mr. de Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode for their comprehensive buff statement.

Despite the global dynamics and the negative impact of the 'yellow vests' movement, growth has been resilient. Solid domestic demand has helped to offset the slowdown in exports. Moreover, unemployment has continued to decline, also thanks to recent labor market and tax reforms. Looking ahead, however, risks remain skewed to the downside. The authorities are encouraged to take advantage of the still on-going recovery and the accommodative monetary stance to advance with further structural reforms.

More decisive fiscal measures are needed to ensure long-term debt sustainability and to build buffers. We welcome the report's focus on fiscal policy, given the difficulty in consolidating the budget and the vulnerabilities associated with the high level of public debt. The authorities are encouraged to implement measures to compensate for the plans to frontload substantial tax relief. On the revenue side, tax on global technology firms is partly symbolic, in it will yield only modest revenues. Hence, rapid progress with reforms is necessary to enhance the efficiency of public spending, in particular in areas where France's level of spending is high relative to peers. In this regard, we welcome initiatives such as the planned civil service and unemployment benefit reforms, as well as the upcoming pension reform. Annex V states that redistribution policy in France comes at a relatively high fiscal cost. Could staff elaborate?

The momentum in structural reforms should be maintained, with a particular focus on the labor market and the pension system. We welcome the recent progress in improving opportunities for disadvantaged groups and enhancing flexibility and inclusiveness of the labor market. Measures to reduce the labor tax wedge and the labor-code reform of 2017 were important steps. But despite continued job creation, unemployment and labor market fragmentation remain high. Going forward, it will be key to address educational gaps and to help integrate vulnerable groups, including the youth, low-skilled workers, and non-EU immigrants into the labor market. We encourage the authorities to continue efforts to improve vocational training and apprenticeships. We commend the authorities for their ambitious goal to cut greenhouse gas emissions and achieve carbon-neutrality by 2050, in line with the Paris climate agreement. Finally, we welcome the initiatives taken to address the weaknesses in the anti-corruption framework recounted in box 3.

Despite the notable increase in the financial sector's resilience, the remaining vulnerabilities highlighted in the FSAP should be addressed. We agree with staff that complex and interlinked financial conglomerates call for enhanced monitoring and oversight. We share staff's recommendation to tackle risks stemming from the concentration of vulnerable corporate debt. The introduction of a systemic risk buffer and the reduction of the tax bias towards debt would be appropriate measures to address these risks. Furthermore, banks' considerable reliance on wholesale US dollar funding calls for additional liquidity buffers. Finally, enhanced AML/CFT supervision for smaller banks is necessary to continue to ensure financial integrity. We welcome the authorities' intention to act on this recommendation, as emphasized in the buff.

Mr. Palei and Mr. Tolstikov submitted the following statement:

We thank staff for a set of well-written reports and Mr. de Villeroché, Mr. Castets, Ms. Gilliot and Mr. Sode for their informative and helpful buff statement.

The recent performance of the French economy has been mixed. The cyclical recovery has abated, as slowing global growth and domestic social unrest weighed on demand. Growth has declined to 1.7 percent in 2018 and is expected to cool down further to about 1.3-1.4 percent in 2019-20, in line with the euro area trends. At the same time, labor market conditions continue to improve, with declining unemployment and growing share of permanent contracts. Credit to non-financial companies has remained resilient, against the background of still accommodative monetary policy. Over the past three years, fiscal deficit has been reduced to below the 3 percent of GDP threshold.

Notwithstanding the recent improvements, medium- and long-term economic prospects remain subdued, as growth in France remains constrained by weak competitiveness, sluggish productivity growth, high structural unemployment, and a high level of public and private debt. From the medium-term perspective, growth continues to be structurally weaker than in the euro area, and even more so in comparison with many other advanced economies. The medium-term outlook points to continuation of this trend. According to staff, the structural fiscal deficit has been reduced to below 3 percent of GDP, but, in response to the “gilets jaunes” demands, the French authorities introduced a number of expansionary fiscal measures in the 2019 budget. Thus, staff project a widening of the structural fiscal deficit in the medium term.

Risks to the outlook are growing, including those related to rising protectionism and trade tensions, potential Brexit disruptions, changes in investors’ attitude to sovereign debt in highly indebted countries, and tightening of the global financial conditions. At the same time, we welcome the authorities’ more optimistic view that the Grand Debat National has been instrumental in working out the agreeable modalities for continued transformation of France’s economic and social model. It is also encouraging that the authorities remain committed to their reform agenda.

In the fiscal area, putting public debt on a firm downward path remains a priority. The attempt to increase taxes had to be reversed due to the lack of broad consensus on the effects of the proposed measures. Therefore, the focus of the authorities’ strategy on public spending reduction is appropriate. Staff’s analysis shows that in many areas spending is considerably higher vis-à-vis peer countries. The authorities' projections imply the reduction of public spending ratio by 2.9 percent of GDP over 5 years since 2017, while tax-to-GDP ratio would decline by 1.3 points. Some of these spending cuts will be achieved through the planned reforms of the civil service, unemployment benefits, and pension system. We note, however that, according to staff, the fiscal effect of these reforms falls short of adjustment necessary to achieve the authorities' targets.

The recent tax reforms reduced the labor tax wedge and corporate income taxation, supporting employment and investment. At the same time, it appears that further reduction of the tax burden may not be feasible without credible progress in reducing public expenditures. We agree with staff that France has substantial room for reducing tax expenditures and improving tax collection. In addition to recommendations presented in the staff report, we recall that, according to the OECD estimates and the Fund's studies[2], France lags behind most of its peers in the effectiveness of the VAT collection. Moreover, the c-efficiency ratio remains on a gradually declining trend. The authorities should explore the ways to raise compliance, using, for example, the opportunities provided by digitalization. Could staff elaborate on the key measures likely to improve the effectiveness of tax collection? We also wonder whether a Fiscal Transparency Evaluation would be useful for the French authorities, as it has been for the United Kingdom and Finland recently.

We commend the French authorities for the continuing efforts to implement a broad structural reform agenda. Transformation of the labor market remains a priority. In addition to the first wave of reforms implemented in 2017, the apprenticeship and professional training system is modified, with the aim to enhance employment prospects of disadvantaged groups, including youth, low-skilled workers, and immigrants. Implementation of the reform of the unemployment benefits system would provide better incentives for work and to discourage frequent work-unemployment rotation.

Overall, France is ranked relatively high in the Ease of Doing Business. However, there is still room for substantial improvements in the business climate in the areas of property registration, paying taxes, protecting minority investors, and getting credit. Staff may want to comment on the key impediments to further progress in these areas. Firms are still burdened by

[2] Consumption Tax Trends 2018. VAT/GST and Excise Rates, Trends and Policy Issues, 2018, OECD. https://read.oecd-ilibrary.org/taxation/consumption-tax-trends-2018_ctt-2018-en#page57

excessive regulation in the product and services market, which contributes to lower productivity. In this respect, we welcome the recently initiated product market reforms, including the railway reform and Loi PACTE, which is aimed at facilitating firm creation and growth.

The financial sector is broadly resilient to stress, and banks' capacity to provide credit to the economy has improved. The banking sector has significantly bolstered capital positions and asset quality. However, vulnerabilities related to the complexity of financial conglomerates, dependence of French banks on wholesale funding (including in the USD), as well as exposure to indebted large corporates, require proactive monitoring of risks and stronger liquidity buffers. The financial system should also be fully prepared to Brexit-related risks. Overall, we welcome the authorities' efforts to increase financial system resilience and encourage them to achieve further progress in this area, in line with the FSAP recommendations.

Mr. Raghani and Mr. Alle submitted the following statement:

We thank staff for a comprehensive set of papers and Mr. de Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode for their informative buff statement.

We commend the French authorities for their macroeconomic achievements in recent years and for their strong reform resolve amid domestic and international challenges. Their efforts to address long-standing structural issues including labor-market and tax reforms have supported investment, growth and job creation. Though the economic expansion has slowed from 2017 to 2018 because of adverse regional and global developments compounded by domestic factors, the growth momentum still holds, and progress continues to be made in enhancing public finances and addressing unemployment. Going forward, we encourage the authorities to further the consensus with key stakeholders with the view to implementing the needed reforms for improving competitiveness, boosting growth and enhancing resilience. We broadly share staff appraisal and would emphasize the following points.

On the outlook, while growth prospects and employment figures are encouraging, we call for preparedness and measures to address downside risks. We are pleased to note that the recovery in domestic demand and the yields from recent structural reforms are giving an impetus to growth in 2019 onward. At the same time, the balance of risks presented by staff could adversely weigh on the outlook. Trade tensions between the United States and the European Union, a disorderly Brexit and associated tightening of financial conditions, the "Yellow Vests" movement and potential resistance to reforms, are risks with high potential of materialization. Could staff elaborate on the authorities' level of response preparedness? On the domestic front, we would like to learn the steps taken by the authorities with social partners to ensure adherence to reforms going forward.

Regarding fiscal policy, consolidation efforts are warranted to further reduce the deficit and put public debt on a firm downward path. We welcome the initiatives already taken to stabilize the debt, including lowering the 2018 fiscal deficit to 2.5 percent of GDP. Yet, the debt remains elevated at around 98 percent of GDP in 2017-18. The authorities are encouraged to move ahead with their fiscal structural reforms which could have a lasting impact on the debt dynamics. In this regard, we see the efforts to reverse the structurally high spending as going in the right direction. It is reassuring that legislated spending-containments measures have made the bulk of fiscal consolidation in recent period. At the same time, we welcome measures aimed at boosting households' purchasing power. Though they caused a loss in revenue worth 2.2 percent of GDP – largely offset by spending cuts -, we are of the view that this will boost demand and contribute to pave the way for reforms going forward.

We also welcome the other planned fiscal structural reforms in the civil service, unemployment and the pension system. We concur with the authorities on the priority given to those sectors which are deep-rooted sources of high spending.

The authorities should be encouraged to maintain the overall pace of far-reaching structural reforms to unleash new sources of growth. We concur with Mr. de Villeroché and his colleagues that the current pace of structural reforms was not seen in decades in France. In view of the results already observed, the authorities would be well-advised to broaden their efforts to sectors with potential high yields for the economy. In this regard, the recent Loi Pacte aimed at facilitating business creation and innovation is a welcomed step. Likewise, we appreciate all the initiatives to re-focus on training and apprenticeship, alongside reforms to ease administrative burden on start-ups. In the same vein, emphasis should be put on R&D to enhance competitiveness vis à vis peers.

We welcome the insights provided by the financial system stability assessment and the progress made since the last FSAP. While the stronger prudential position is noteworthy, the authorities should closely monitor vulnerabilities associated with rising private sector debt, which adds to the already high exposure to sovereign. In addition to the macroprudential measures taken recently, they should enhance policy tools along the FSAP recommendations.

We appreciate the steps being taken by the government to promote crypto-assets, fintech, green finance, and market entry with the view to positioning Paris as a key financial hub. In the same vein, some analysts have identified Paris among the cities which could potentially take over the role of financial center in the EU, as a consequence of the Brexit. Do staff consider such an upside risk, with possible delocalization of activities by some financial groups to Paris?

Finally, we thank the French authorities for their continued support to countries in our constituency, through financial assistance and various cooperation channels.

With this, we wish the authorities, every success in their endeavors.

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for the comprehensive reports and Mr. de Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode for their informative buff statement. Growth has slowed down in 2018 but remained resilient and is expected to stabilize at around 1.5 percent in the medium-term on the back of recovering domestic demand. Inflation has moderated, unemployment has declined and current account is broadly in balance. The fiscal deficit has reduced further, although the debt to GDP ratio has stabilized. We commend the French authorities for making progress over the last year in enacting a series of reforms to address structural challenges and improve the competitiveness of the economy. Going forward, the high rate of structural unemployment, especially among vulnerable groups, inflexible labor market, still weak competitiveness, enlarged public debt, burden and inequality in opportunity could constrain the achievement of France’s full economic potential. The rising protectionism and uncertain Brexit also remain as key downside risks. We broadly concur with the thrust of the staff’s appraisal and would like to make following remarks for emphasis.

Strengthening fiscal consolidation is important in placing public debt on a firm downward path. The large public debt of around 98 percent of GDP has reduced the available buffers. Moreover, we note that the level of spending is high in France compared to peers largely due to its social protection system, which will have to be continued. Also, the recent social unrests have highlighted the need for fully integrating the redistributive effects of reforms to support their social acceptability. In this context, we positively noted that recent front-loaded fiscal reforms are bearing fruits in terms of reducing the fiscal deficit. We also commend the number of fiscal structural reforms, covering civil service as well as pension, unemployment benefit and healthcare systems, that are planned to legislate in 2019, to generate efficiency savings, and enhance the quality and fairness of social protection plans. Additional medium-term spending reforms will be important to offset the impact of the ongoing tax burden reduction and sustain the deficit reduction efforts. As highlighted in the SI paper, aligning of fiscal policy stance at both central and subnational levels will also be helpful in achieving a sustained reduction in public debt.

French financial system remains robust and well capitalized, although some pockets of vulnerability remain. The important progress that has been made in implementing 2012 FSAP recommendations is encouraging. Given the sharp rise in corporate debt, we positively note the activation of macroprudential policies to address a buildup of systemic risk from corporate leverage. The measures to strengthen institutional arrangements for macroprudential policymaking with respect to rising nonbank financial intermediation and comprehensive resolution framework for insurance institutions are also positive developments. While welcoming the authorities' vigilance on potential risks from the financial sector and the institutional and policy framework to support financial stability, we stress the importance of staff's recommendations under the 2019 FSAP to mitigate further building of vulnerabilities and address remaining challenges in the financial system.

Structural reforms are important to address France's long-standing challenges while ensuring resilience and more inclusive growth. In this regard, we welcome the authorities' ambitious plans to advance reforms to address labor market rigidities, skills gaps, and raise competitiveness to enhance medium-term growth prospects. Frontloaded labor-market reforms implemented recently, aimed at fostering labor market participation, flexibility, and inclusiveness are appreciative developments. We concur with staff that reforms in apprenticeship and professional training as well as unemployment benefit reform should be closely reviewed and adjusted appropriately to achieve desired objectives. We praise the recent Loi PACTE, which aims to facilitate firm creation and growth, promote entrepreneurship and innovation, and support the reallocation of savings toward longer-term investment. However, we noted that the regulations remain stringent in France. Hence, competition-enhancing reforms to regulatory settings will help raise productivity. In this regard, we welcome the authorities' efforts to reform product and service markets to enhance competition and efficiency. We also commend the French authorities for their commitment to the transition to a low-carbon economy, elaborated in the buff.

With these remarks, we wish the authorities all the very best in their future endeavors.

Ms. Levonian, Mr. Ray, Ms. McKiernan, Ms. Preston and Mr. Weil submitted the following statement:

We thank staff for the insightful AIV and FSSA reports, and Mr. de Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode for their comprehensive buff statement. We generally support the staff appraisal, particularly with respect to the identified structural and the financial system priorities. However, on balance we felt that France would have benefited from more pragmatic and granular Fund advice that better accounted for the trade-offs involved, including political economy considerations and the planned sequence of reforms.

Growth remains resilient compared to peers but uncertainty around the outlook has risen. We agree with staff that growth will likely be moderate in 2019 due to the lingering transitory factors and the less favourable external environment. As the effect of one-off domestic factors fade and regional and global growth recover somewhat, growth should converge back to potential. However, an escalation of trade tensions between the U.S. and the EU and a disorderly Brexit could act as a drag on investment, weighing on employment, activity and business and consumer confidence. Domestic risks include potential resistance to the authorities' reform agenda, which could further undermine and growth.

France's economic performance continues to be hampered by long-standing structural challenges including structural deficits, relatively high structural unemployment, low labor force participation, and weak competition in product and service markets. We welcome the substantial reform agenda that has been launched, initially focusing on the labor market, and agree with staff that follow-through on these reforms, and extending to appropriately sequenced product and service market reforms, are essential to address these vulnerabilities.

France's fiscal situation leaves it vulnerable to shocks and highlights that growth-friendly fiscal consolidation should be underpinned by reductions and reforms to public spending. While the authorities had initially planned to close the deficit by 2022, we note that, on current policies, France may not meet the adjustment path recommended under the EU fiscal rules. We understand the authorities' focus on expanding and embedding structural reforms before tackling a more ambitious fiscal consolidation. If properly executed, this approach could help support a more sustained fiscal consolidation over the medium run, notwithstanding that staff have identified this as being historically challenging for France. To reduce public spending in a gradual manner, we agree that the authorities should: (i) reduce the size of the public service via attrition; (ii) achieve economies of scale by merging France's multiple public pension systems; and (iii) tighten eligibility requirements for unemployment benefits. We welcome the substantive planned structural reforms, outlined in the buff statement, relating to these areas.

Staff's estimates that the output gap is currently closed seems hard to reconcile with an unemployment rate of 8.7 percent and projected CPI of 1.2 percent in 2019. Staff might consider using confidence intervals for their output gap estimates and emphasize the implications of uncertainties around cyclical slack for their fiscal recommendations. How does the uncertainty in the measurement of the output gap factor into staff's recommendations on the pace of fiscal consolidation?

Lowering structural unemployment via labor market reforms is key to improving social outcomes and raising long-term growth prospects. With an elevated structural unemployment rate and a low participation rate for prime-age workers, recent reform priorities have rightly focused on fostering labor market participation, flexibility and inclusiveness. This has been done through reforms to facilitate labor reallocation, enhance apprenticeship and professional-training, and reduce labor taxes. We support staff's recommendation that these reforms should be fully implemented, monitored closely and reinforced if need be.

France performs strongly on gender equality but should continue to tackle pockets of income inequality. France should be commended for its strong gender equality metrics, including the gender wage gap, female labor force participation, and the share of women on the boards of listed companies. We welcome staff's stock-taking on inequality in Annex V, which suggested that, although government spending has generally been quite effective in reducing income inequality, inequality of opportunity for vulnerable groups remains a concern. Supporting labor market integration for the disadvantaged segment of the population will help make growth more inclusive, while also reducing pressures on social spending.

France, in conjunction with the relevant EU States and institutions, should continue to strengthen the oversight of internationally active conglomerates. Large internationally active and diversified financial institutions, such as France's four GSIBs, can be a source of stability but they can also be a source of risk, including spillovers to other regions. We acknowledge the complex regulatory and supervisory challenges in dealing with cross-border risks from GSIBs, including understanding the respective areas of responsibility of national and European regulators thereon. We would encourage regulators to develop a long-term approach to managing these group risks and urge staff to consider this further.

There were opportunities for greater integration between the AIV and the FSSA. We noted with interest the FSSA's observation that social safety nets play a role in containing bank credit risk stemming from household lending. Given the AIV's focus on social spending, it would have been helpful for the staff report to elaborate on the positive financial stability spillovers of French social safety nets and their role in reducing household balance sheet vulnerabilities. Similarly, while in isolation we agree that measures to reduce the corporate debt bias could address vulnerabilities stemming from increased corporate lending, we would have welcomed the analysis of associated tax policy reforms (e.g., changes to interest deductibility) in the AIV to help draw out linkages with the broader French tax strategy. We encourage future AIV consultations to consider picking-up these threads.

We commend France for agreeing to a voluntary assessment of its anti-corruption supply-side governance provisions. France has made welcome enhancements to its anti-corruption framework since the last OECD assessment in 2012 but the relevance of the baseline findings is rather limited seven years later. We look forward to the conclusions from the next assessment of France by the OECD Working Group on Bribery in 2020. We encourage other Fund members to volunteer for a review of their supply-side governance provisions.

The representative from the European Central Bank submitted the following statement:

We thank Mr. de Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode for their buff Statement and Staff for their report and selected issues paper.

We associate ourselves with the Statement of Mr De Lannoy and would like to highlight the following issues.

We broadly concur with Staff on the economic outlook and risks surrounding the baseline. Growth in France slowed in 2018, but structural reforms and resilient domestic demand supported solid growth relative to peers; looking forward, our growth projections are broadly in line with the Staff outlook. We agree with Staff that downside risks to the outlook have increased. These relate to external risks, including the possibility of a disorderly Brexit, increasing and ongoing trade tensions, and a softening of activity in the euro area. The authorities should consider carefully the potential negative spillovers from the rest of the world, against a backdrop of global growth moderation. At the same time, we agree with Staff that domestic risks related to potential reform resistance (following conflicting signals from the Grand National debate) should also be carefully considered.

Similar to Staff, we see inflation moderating in 2019 from its temporary spike in 2018 and remaining subdued in 2020 and 2021. We would like to stress that the ECB's inflation objective of "below but close to 2 percent, over the medium term" refers to the euro area as a whole and not to inflation in individual countries. Therefore, comparisons with the euro area benchmark for individual countries, as done in the report, are of limited usefulness.

We note that France's high public debt levels may create risks for debt sustainability, and therefore stress the importance of developing concrete medium-term plans to keep the debt on a sustainable path. Overall, the high debt level in combination with limited success, so far, in addressing it during economic upturns suggests a potential medium- to long-term risk for debt sustainability. Staff provides a well-balanced overview of the fiscal challenges that France has to tackle over coming years. In that respect, we welcome the related selected issues paper, which provide helpful information on the build-up of France's high debt level and the options to reduce it over time. We also note that deficit and debt will likely remain elevated. The announced tax reductions (in personal and corporate income taxes as well as social security contributions) are a welcome step to address price competitiveness gaps in the French economy compared to peer countries. However, they will inevitably weigh on the budget in structural terms. Based on current policies, France is expected to significantly deviate from the recommended adjustment path under European fiscal rules. The structural consolidation effort of around 2 p.p. of GDP during 2020-23 to reach the Medium-Term Objectives (MTO), as suggested by Staff, should help to put debt on a firm downward path. In the process of achieving a structurally sound adjustment, expenditure reductions should be carefully prioritized, and efficiency gains achieved across all subsectors of the government. In that context, we commend the authorities for achieving expenditure reductions in real terms (-0.3 percent) in 2018. However, we note that the expenditure-to-GDP ratio of 56 percent remains the highest in Europe, potentially reflecting in part inefficiencies. The elimination of such inefficiencies could allow a growth friendly reduction in spending.

France’s financial system is overall in a stronger position since the last FSAP, but vulnerabilities persist. We welcome the increase in the capital and liquidity position of French banks and improvements in their asset quality but note that the profitability of French banks has to improve. Given that the financial stability situation in the euro area has become more challenging, the need to strengthen resilience to adverse shocks has become more important. A repricing in global capital markets, a decline in income expectations or a correction in asset prices could trigger adverse shocks. The high level of private sector indebtness is an additional vulnerability in the transmission of these risks in France. In this regard, we support the authorities’ recent decision to increase the countercyclical capital buffer further. This decision is in line with cyclical systemic risk indicators, such as the credit-to-GDP gap and ECB staff early warning models. We agree that authorities should stand ready to implement additional macroprudential policy steps pro-actively. Moreover, overall, the FSSA could be clearer on articulating EU and national competences.

We would like to underline the relevance of financial stability risks stemming from the residential real estate sector. The key risk stems from the high and rising stock of household indebtedness in combination with strong loan origination. Therefore, while we agree that there are mitigating factors that reduce the risks in residential real estate (e.g. the importance of fixed-rate and amortizing loans, mortgage guarantees by third parties), high household indebtedness could act as an amplifier of shocks. Bank lending growth to the household and non-financial corporate sector has continued to strengthen gradually, while higher loan-to-income (LTI) and loan-to-value (LTV) ratios and longer initial maturities of loans suggest that lending standards have deteriorated. Against this backdrop, policies should focus on ensuring borrower resilience by, as a first step, providing guidance to banks to strengthen lending standards (on a comply-or-explain basis). As a second step, binding borrower-based measures (including debt service-to-income (DSTI), debt-to-income (DTI) and LTV limits) could be introduced.

Moreover, risks stemming from commercial real estate deserve closer attention. Lending by French banks for commercial real estate has been growing strongly in addition to non-bank sources of finance. Low yields and spreads in commercial real estate suggest that risk premia are highly compressed and prices may be overvalued. In addition to the significant exposure of banks to the relatively large commercial real estate sector, additional factors also raise concerns: Loans with high LTV ratios (>80 percent) (notably cross-border ones) have been growing in importance, although their share in the stock of total loans remains limited. Moreover, the exposure of the domestic insurance sector to commercial real estate is relatively high. Also, the outstanding stock of domestic debt securities issued by real estate companies is relatively large compared to GDP (and the main holders are domestic institutional investors). Against this backdrop, there might be room to increase resilience of banks to commercial real estate risks.

We share Staff's view that there is room for further structural reforms to reduce the French economy's vulnerability to shocks. We agree with the IMF that reforms need to continue with a view to reducing structural unemployment and increasing productivity. France has implemented a wide range of labor market reforms. Careful monitoring is necessary to ensure that these reforms produce the desired effects. This is relevant for the area of collective bargaining but also for employment protection. We welcome recent reforms in the areas of apprenticeship system, training system and unemployment benefits. They are important to help address structural issues such as long-term unemployment, skill mismatches and high youth unemployment.

Mr. De Lannoy made the following statement:

I thank staff for the interesting report that adequately highlights both the progress France has made and the challenges it faces. I have issued a gray statement also on behalf of my European colleagues, so I would like to make a few remarks here for emphasis.

In spite of transitory domestic factors and slowing regional trends, the French economy has been growing at a quite robust pace, thanks to solid investment growth and private consumption supported by recent fiscal measures. Falling unemployment rates and modest wage growth led to favorable labor market conditions. This suggests that domestic demand will continue to support economic growth in the coming years. France has had relatively robust growth and improving labor market conditions, yet structural unemployment remains elevated. It has also made progress in reducing its government deficit. At the same time, public debt is stabilizing at high levels. Lastly, France must stay competitive on the global stage while safeguarding its social model.

There has been important progress, and we commend the authorities for their ambition. They have launched labor market and education reforms, and they have advanced preparations for an unemployment insurance reform, a pension reform, a civil service reform, and health care reform. Tackling these challenges all at once is challenging, and I understand from Mr. de Villeroché's buff statement that the government is considering how to best sequence its comprehensive reform plans. The growth-friendly fiscal consolidation must continue to bring the deficit in line with EU fiscal rules and to put public debt on a downward path. Moreover, further labor and product market reforms are needed to reduce the French economy's vulnerability to shocks, while already implemented reforms need to be monitored to ensure that they deliver the expected results.

Finally, we take note of staff's warning about the increasing level of private indebtedness, especially in the non-financial corporate sector, and we encourage the authorities to contemplate additional macroprudential measures if they become necessary. We welcome the authorities' recent decision to further increase the countercyclical capital buffer. With this, we wish the authorities success in following through with their reform plans.

Mr. Mouminah made the following statement:

We issued a detailed gray statement. I will be brief and confine my remarks to a few issues.

The implementation of the ambitious structural reform agenda has supported growth and robust labor market conditions. We also take positive note of the staff projections that growth is expected to gradually return to potential. At the same time, the current positive outlook is subject to increased downside risks. In this context, we encourage the authorities to continue pursuing a growth-friendly fiscal consolidation and sustain the structural reform momentum with appropriate prioritization and sequencing to address the remaining structural challenges.

Notably, continued fiscal adjustment in a growth-friendly manner will be essential to durably put the public debt ratio on a downward path. In this connection, the authorities should take the recommendations of the commission of the independent experts, *Action Publique* 2022, to help realize the efficiency gains while improving the quality of public services.

We are encouraged to note that some of the recommendations are being used to guide the number of reforms within each ministry, especially on healthcare, employment, and education. We look forward to the planned fiscal structural reforms in the areas of pension, unemployment benefits, and civil service. In this context, it is important that the authorities pursue previously announced plans to increase the effective retirement age starting in 2020 to maximize the pension reform's medium-term saving potential.

Maintaining the structural reform momentum will help reduce structural unemployment and enhance productivity growth. In particular, we are impressed by the authorities' focus on the reform of apprenticeship and professional training aimed at improving opportunities and skills acquisition, particularly for vulnerable groups. These are steps in the right direction to help better match labor supply and demand. In addition, the experience of France in providing training to 1 million unemployed and 1 million low-skilled youth in a relatively short period of time will provide useful lessons to many Fund members that face similar challenges. We agree with staff that the full implementation of the labor market reform coupled with a sharper focus on product and service market reforms that support competition will be important to support inclusive long-term growth.

On corruption, we commend the French authorities for volunteering to have France's anti-corruption supply-side provisions reviewed by the Fund staff in partnership with OECD. In this context, we look forward to sustained efforts to enhance enforcement capabilities. Finally, we welcome the overall positive assessment of the French financial system and the authorities' broad concurrence with the Financial Sector Assessment Program (FSAP) findings. Indeed, France has made a notable progress since the last FSAP in strengthening financial stability, and the authorities should build on this progress in line with the findings and recommendations of the 2019 FSAP. With this, we wish the authorities all the best and success.

Ms. Levonian made the following statement:

We issued a gray statement jointly with Mr. Ray, and so I simply want to draw out a few points. In our gray statement, we said that the staff report could have been a bit more helpful, and what I mean by that is that Mr. Rosen put his finger on the issue when he wrote in his gray statement about potential tradeoffs between the pace and scale of reforms and sociopolitical consensus.

It would have been helpful to draw those tradeoffs out a bit more clearly. However, there is no doubt that France's fiscal position has left it vulnerable to potential future shocks. The rate of increase in public spending has to come down to put public debt on a sustainable downward path and tackling the efficiency of public spending is incredibly important. Like Mr. Jin, we see the frontloaded labor market reforms as beginning to bear fruit, and we encourage the same degree of commitment to be carried over to the product market, which remains over-regulated in places. Going forward, it will be important to support greater job opportunities for vulnerable groups, including the youth and low skilled workers.

Turning to the FSAP, our takeaway is that the French financial system is stronger today than it was five years ago. In particular, the increases in the countercyclical capital buffer and the other macroprudential measures have helped to limit vulnerabilities, including those stemming from increasing corporate debt, and we would highlight the need to keep corporate debt vulnerabilities under continued close monitoring.

Our key concern from the FSAP is the issue of conglomerate supervision. This is an area of shared responsibility between France and the European Central Bank (ECB), and we felt, like Mr. De Lannoy, that the division of responsibility could have been more clearly delineated in the report, on this and other financial sector issues, but staff seem to be using this example of France to draw attention to a much broader issue. There are gaps in surveillance of large internationally active financial conglomerates, and the international community should aim to better understand this area in the interests of global stability. This is an area in which we believe the Fund could play a stronger role in coordination and cooperation with regulators worldwide and with standard setters.

In closing, we commend the authorities for their leadership in gender equality and their commitment to the transition to a low carbon economy. Lastly, we want to recognize France for agreeing to a voluntary assessment of supply-side governance and encourage other members to do the same. With that, we wish the authorities well.

Mr. Rosen made the following statement:

We thank staff for their report and Mr. de Villeroché for the buff statement, which provided helpful additional details on the authorities' reform agenda. We strongly support the structural reforms undertaken by the French authorities, especially considering some challenging domestic political conditions. These reforms are already bearing fruit, and we wish the authorities the best of success in their efforts. The reforms are critical for the health of the French economy. Although government spending has declined by about 0.8 percent of GDP since 2015, expenditure remains elevated at about 56 percent. That means that France has one of the world's largest public sectors. We concur with staff in their supplementary paper that a fiscal consolidation needs to take place in France, and we also agree with Mr. Obiora and others that reducing the size and scope of the state, including through rationalizing social spending, privatizations, deregulation, and the broad tax reductions that France is undertaking will address structural rigidities, increase incentives to work, and enhance productivity and lead to faster growth.

As the report suggests, fiscal consolidation should be driven by spending reductions while continuing to lower the tax burden. However, as other chairs noted in their gray statements, authorities should take a consistent but gradual approach to fiscal consolidation. Faster-than-necessary consolidation may reduce the authorities' political space to achieve needed structural change, and rising risks to growth further underscore the need for the gradual approach.

While we encourage and support action by France to reduce its fiscal spending, we also join France and many others in calling on other euro area members to use their available fiscal space far more than they are now to preserve the euro area's recovery.

We were pleased to see staff's analysis of the potential impacts of a hard Brexit on financial stability in both the staff report and the Financial Sector Stability Assessment (FSSA). While Brexit is a risk for Europe and the global economy, we encourage France to remain vigilant against asymmetric risks in the financial sector. Further harmonization of national and supra-national regulatory approaches would be welcome.

Mr. Di Tata made the following statement:

We thank staff for a very interesting set of papers and Mr. de Villeroché, Mr. Castets, Ms. Gilliot, and Mr. Sode for their comprehensive buff statement. We welcome recent developments in France, including resilient growth, continued job creation, and the adoption of important structural reforms. We also commend the authorities for their strong resolve to continue with the implementation of the comprehensive reform agenda, which envisaged a profound modernization.

The authorities are of the view that the conclusions of the Grand National Debate launched after the emergence of the yellow vest movement are supportive of a strong reform process. Real GDP growth slowed but remained robust at 1.7 percent in 2018, reflecting a moderation in investment and private consumption. Inflation remained subdued. The external position is broadly in line with fundamentals, and continued employment creation has led to a decline in the unemployment rate. Staff expects economic growth to remain resilient and converge to a potential of 1.5 percent in the long run. We issued a comprehensive gray statement, but I would like to emphasize a few points.

First, fiscal policy needs to reduce deficits through durable spending reforms to put the public debt, which remains elevated, on a firm downward path. The authorities' strategy gives priority to addressing structural challenges up front while pursuing fiscal consolidation in a more gradual manner than recommended by staff. The package of additional structural reforms employed by the authorities, which includes unemployment insurance reforms, civil service reform, and pension reform, is expected to support fiscal consolidation while improving equity and increasing spending efficiency.

We concur with staff that these efforts should be complemented by efficiency gains in other areas, including tax expenditures, health care, education, and social benefits, but would like to highlight the importance of adequate prioritization. We agree with the authorities that in the downside scenario involving the materialization of external risks and a recession in the euro area, there could be a need not only for domestic fiscal policy to support growth but also for a coordinated response at the European level.

Second, we welcome recent reforms focused on the labor market, taxation, education, and training, as well as ongoing product market reforms such as labor reform and those envisaged in the *Loi PACTE*. Looking ahead, we encourage the authorities to continue with their efforts to remove restrictive regulations in products and services markets. We also acknowledge the important steps that have been taken to address corruption, including passage of the *Loi Sapin II* and encourage the authorities to continue to enhance enforcement capabilities.

Third, we welcome the positive assessment of the French financial system in the FSSA. Going forward, we agree on the need for improved cooperation among supervisory agencies but acknowledge that some issues will need to be addressed from a European perspective. The decision to activate macroprudential measures on banks' exposure to large corporates is a positive step, but additional micro and macroprudential measures might be necessary if risks intensify. We also encourage the authorities to reduce the fiscal tax bias favoring debt rather than equity financing, avoid potential disruptions in wholesale funding, and conduct a technical review to consider transitioning to a more market-based saving product.

Lastly, we greatly appreciate the French authorities' commitment to continue to implement the strong climate mitigation agenda. With these comments, we wish the authorities every success in their future endeavors.

Mr. Tan made the following statement:

We have two comments to add for emphasis following our gray statement.

First, like other Directors, we would like to reiterate the importance for the authorities to keep up the pace of reforms to address longstanding structural challenges facing the country. Clearly, the downside risks to growth have increased on both fronts. Externally the environment is challenging with trade tensions, weaker-than-expected growth in Europe, and the growing threat of a disorderly Brexit. Domestically, the yellow vest protests have also introduced greater uncertainty. This has led to delays in the fiscal consolidation process and raises further questions about public support for future reforms.

In response to these economic challenges and uncertainties, the authorities should press on with the implementation of existing and planned reforms aimed at making the French economy more competitive. Particularly, we agree with staff that further liberalization of the product and service markets will complement ongoing labor market reforms, enhancing economic competitiveness and boosting potential growth.

Staff has set out useful analysis in its selected issues paper on the key regulatory restrictions. Moving forward, we would call on staff to go further and work with the authorities on identifying specific reforms and the appropriate sequencing that will foster more successful implementation by the authorities.

Second, we encourage the authorities to rein in public spending through increasing spending efficiency in order to support much-needed fiscal consolidation. Like Mr. De Lannoy and Mr. Ostros, we emphasize that stronger durable efforts are needed to ensure the long-run sustainability of the social model. Recognizing that high social spending in France reflects its policy choice with respect to social protection and that political economy considerations are particularly relevant in the domestic context, nonetheless, high social spending combined with the fiscal deficit constrains the room for policy maneuver and reduces the buffer against shocks.

We welcome that staff recommended spending reforms that are centered on increasing expenditure efficiency. If implemented effectively, these reforms would serve to bolster fiscal consolidation while supporting social objectives. Hence, successful execution will be the key challenge ahead for the authorities. To this end, staff has done well in identifying a risk of social spending with room for efficiency gains.

Policy development and implementation are not done in a vacuum. Hence, it is encouraging that staff tailored policy advice to country-specific circumstances and policy choices in this consultation, and we would encourage you to continue to do so for France and the rest of the membership. On this note, we wish the French authorities the very best in their reform efforts.

Mr. Tombini made the following statement:

Alongside Mr. de Villeroché, the French Chair has been competently represented by Mr. Castets over the last three years. I would like to take this opportunity to wish him the best of luck in his new position at the World Bank.

We issued a gray statement, so I will be brief today. First and foremost, we must recognize that the French authorities are engaged in an ambitious reform agenda to modernize the economy, enhancing its competitiveness, inclusiveness, and sustainability. In and of itself, this is great news. We commend the authorities for daring to propose such a bold structural reform agenda in a mature, complex, and systemically important economy.

Nevertheless, the reform agenda involves many tradeoffs. I will highlight three of them. First, the modernization of the French economy depends on well-planned investments, particularly in human capital. On the other hand, as many Directors mentioned in their gray statements, debt levels are high, and fiscal consolidation is needed. All in all, the more gradual pace of fiscal consolidation envisaged by the authorities seems adequate under the prevailing circumstances. It is paramount to remain vigilant, however, and be ready to act if risks materialize.

Second, many Directors also mentioned the importance of the labor market reform to reduce structural unemployment and increase productivity. We fully agree. Nevertheless, we recall that partly as a result of previously undertaken reforms, unemployment is already falling; wages are growing in real terms and in line with productivity, while flexibility of adjustment to shocks has been enhanced. At the same time, core inflation remains subdued. In such a situation, a too-fast implementation of additional labor reforms could undermine the support to the broader agenda while not addressing the most pressing issues from a macroeconomic perspective. Properly calibrating and pacing the labor market reform may be key to reconcile short-term and long-run goals in a consistent way.

Third and finally, France has given repeated proof of its commitment to a free and rules-based international trade system. The new trade agreement between Mercosur and the EU is certainly a step in the right direction. At the same time, the French authorities continue to insist on residual trade-distorting measures such as quotas on agricultural subsidies. Fulfilling the potential of the agreement may require a more ambitious stance of removing artificial protection to less competitive sectors. With these remarks I wish all the best for the authorities.

Mr. Inderbinen made the following statement:

As we state in our gray statement, growth has been quite resilient in the face of external developments and the bouts of social unrest. We welcome the focus of the report and the selected issues papers on fiscal policy. We note from the buff statement that reducing the level of public spending relative to GDP has been the authorities’ ambition from the inception of the current presidential term. We also take good note of the measures taken so far, including the ceilings on public wages, social expenditure, and health spending, included in the 2019 budget.

These savings have largely been offset by the recent tax cuts, and overall the staff emphasize that efforts have so far not yielded an adjustment of the primary balance that would be sufficient to meet the medium-term objective and to get the trajectory of debt-to-GDP on to a downward trend.

From the answers to Directors’ technical questions, we learned that the authorities seem to be revisiting some of the plans of the pension reform and also that the envisaged head count reduction of the civil service reform no longer seems feasible, so maybe staff could elaborate on this.

Given the difficulties in consolidating the fiscal position and the limited achievements to this end during the upswing, could staff offer some comments on how the selected issues paper on the appropriate fiscal stance and the international experience with successful consolidations was received by the authorities, and also on how staff perceive the traction of Fund advice on fiscal policy more broadly.

On the financial sector, we note the considerable increase in resilience. Like others, we emphasize the need for heightened liquidity requirements given banks' significant reliance on foreign currency wholesale funding, and along with others, we agree with staff that the complex and interlinked financial conglomerates call for enhanced monitoring and oversight.

On financial integrity, we note the recommendations to improve Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) supervision of the smaller banks, and we welcome the authorities' readiness to act on this, as mentioned in the buff statement.

Finally, we welcome the initiatives taken by the authorities to address the remaining weaknesses identified in the OECD Working Group on Bribery, as laid out in Box 3 of the report, and we join Mr. de Villeroché and his colleagues and Ms. Levonian, in encouraging more countries to volunteer to have their governance frameworks assessed under the Fund's enhanced engagement policy.

Mr. Just made the following statement:

We thank staff for the technical answers to questions and associate ourselves with Mr. De Lannoy's remarks.

The French authorities continue to implement a series of structural reforms with the aim of modernizing the economy. There are also some notable structural fiscal measures announced to address the high public debt. However, in reaction to the *gilets jaunes* protests, the authorities opted for a less ambitious consolidation path also with the objective to minimize the distribution consequences for lower and middle incomes. Of course, this shortened policy reaction is permissible. It will give the authorities time to rethink their overall policy strategy. Still, high debt remains. Hence, the medium-term objective cannot be met, which does not contribute to strengthening the European fiscal framework.

Given the overall state of our fiscal framework, we would expect our larger member states not to risk undermining our fiscal governance further. This brings me to a broader concern, which the *gilets jaunes* have brought into sharp focus. France, as well as many other countries in Europe, will need to find an answer on how to move to a carbon-neutral economy and how to finance the welfare state, which faces a challenge from digitalization. Decarbonization can be achieved by different policy paths but needs to take into consideration the distributional consequences so that the impact on low-income households is minimized and the social and political backlash against decarbonization is avoided. In addition, there will be spillovers and interconnected issues that the Fund could look at. They will increasingly have to assess also the high carbon content of imports and may have to take measures. Going forward, there is a reasonable chance that decarbonization will have a negative impact on growth, which implies that more effort on fiscal sustainability today would be required.

France has a very extensive welfare state. Even small reforms require substantial political capital, which is not only an issue in France but in all other EU countries. Welfare states tend to be financed by taxes on employment. Technology will increasingly disrupt the funding of the welfare states, as well as the right of employees to welfare. Again, we think this is an angle that needs to be included, especially from the perspective of risk-based surveillance.

France, as well as the EU, will face difficult political choices in the years ahead, which opens up the possibility for the Fund to contribute to the debate and help us manage these transitions in a manner that preserves the central tenets of the social models in Europe and in a way that is least disruptive for our own economy as well as the global economy. For this, the Fund would need to intensify its internal conversation on how to integrate carbon neutrality and digitalization in its surveillance.

Briefly on the Financial Sector Assessment Program (FSAP), the majority of banking assets in France are under direct supervision of the Single Supervisory Mechanism (SSM). This is covered by the euro area FSAP. The non-bank financial sector in France is significant. However, the Fund does not have yet the analytical tools or the framework to assess this market segment effectively. This does not leave much for the Fund to assess in a country like France. We therefore think that the forthcoming FSAP review needs to have a fresh look how the FSAP can continue to be relevant for euro area member countries. One area that might have merited more analysis, however, would have been the interconnectedness of French banks with other euro area financial sectors. This is mentioned in the FSSA, but possible spillovers would have merited more analysis.

Mr. Moreno made the following statement:

Like Mr. Tombini, I also would like to express my appreciation for Mr. Castets's work. The buff statement is quite detailed and reassures the reader about the authorities' commitment to the reform agenda. We have issued a gray statement, and I associate myself with the comments and the remarks made by Mr. De Lannoy. I would like to focus on three areas.

First, on the fiscal adjustment, we highlight the importance of complying with the EU fiscal rules. Staff concurs with the European institutions on the importance of a fiscal structural adjustment of around half a percentage point of GDP. In order to meet these goals, the authorities could consider complementing ongoing efforts with additional spending reforms and using any windfall gains to further reduce the general government debt ratio.

Much of the adjustment will be gained from the spending review process. We look forward to the lessons learned from this spending review, which has been applied across a number of countries. There is scope for the European Department (EUR) and for the Fiscal Affairs Department (FAD) to engage in best practices with the spending review. I will also highlight that the efforts cannot only be done on expenditures per se, such as social protection, health, and education, but also on tax expenditures. I would welcome staff's comments on what is being done in this area. Of course, the key element of this exercise is efficiency and effectiveness without curtailing the amount and quality of public services provided.

Second, on the pace of the reform agenda, the authorities should be commended for the ambitious reforms adopted and for the commitment for a comprehensive reform plan aimed at modernizing the French economy. The reform agenda, which is already bearing fruits in terms of resilience of the economy, will also allow improvement in inclusion indicators.

Going forward, the reform momentum should be maintained. As stressed by the staff, the authorities should closely monitor the impact of reforms and stand ready to adjust them if needed. Here, I would like to echo Ms. Levonian's comments on the tradeoffs, which were also stressed by

Mr. Tombini and Mr. De Lannoy's comments on the sequencing. We will highlight following up on the impact of inclusion and addressing the sense of displacement and dissatisfaction on the part of the French population. Here the reforms in the labor market fostering participation, flexibility, inclusion, and wage increases are a step in the right direction. We look forward to the novel index measuring gender pay inequality, which can also be useful for other countries as well.

We also highlight the climate mitigation agenda and the authorities' commitment to the 2030 target. Following Mr. Tombini's comments, the commitment to the multilateral agenda should be extended to the EU given that we have a common commercial policy. I welcome the comments, not the full comments, but most of them.

Finally, on the financial sector, the FSSA rightly focuses on remaining challenges, including good profitability and the combination of high and increasing indebtedness in both the non-financial and corporate and household sectors, which warrant closer attention and eventually considering additional macroprudential policy measures.

We welcome the authorities' recent decision to further increase the countercyclical capital buffer, and we would also highlight the FSSA recommendation to enhance oversight of financial conglomerates, including by implementing cooperation among supervisory agencies and stressing data gaps. Here I would also like to echo Ms. Levonian's comments on the scope for the Fund to play a greater role on conglomerates.

Mr. Sylla made the following statement:

This buff statement is the last one for Mr. Castets as an Alternate Executive Director. He and his colleagues have put their best effort in this one, and we can see it. Thank you for that.

First, the French authorities are to be commended for taking on longstanding and key structural reforms over the past period. Based on what we have learned from past Article IV consultations, we concur with Mr. de Villeroché that the current pace of structural reform has not been seen for decades in France. The achievements in terms of growth and employment clearly demonstrate the reform effort and effectiveness of measures taken in the labor market.

Civil service and training of unemployed people are to be noted. Going forward, the authorities should be encouraged to maintain the reform momentum. To this end, the dialogue with social partners and the general public as recently initiated should be pursued to avoid derailing the reform agenda.

Our second point is related to the public debt. We acknowledge the authorities' efforts, and we join many other Directors in calling for further steps to sustainably reduce this debt. The action underway, including running lower fiscal deficit and reversing the structurally high public spending are welcome steps. The authorities are encouraged to move ahead with their spending containment measures while protecting growth-friendly expenditure and key social spending, which characterize the French model.

Lastly, like Mr. Mouminah, we encourage the authorities to further their initiatives aimed at supporting innovation and entrepreneurship among the youth. In the same vein, we welcome the government action to promote financial innovation and to position Paris as a key financial hub. This will also open new employment opportunities. With this, we wish the French authorities every success in their endeavors.

Mr. Meyer made the following statement:

We also thank staff for their insightful and very well-focused set of reports and Mr. de Villeroché and colleagues for their helpful buff statement. We mostly share staff's analysis and policy recommendations. We also associate ourselves with Mr. De Lannoy's gray statement and oral remarks. Let me just highlight some points for emphasis.

First, we welcome that notwithstanding the slowdown in growth last year, economic activity has remained resilient relative to peers and is expected to return to potential. We also commend the French authorities for the steady increase in employment, supported by the implementation of important labor market and tax reforms over the last years. At the same time, external and domestic risks have increased. Against this background, we encourage the French authorities to take advantage of the still overall benign environment to make further progress in strengthening resilience and tackling structural challenges. In this context, let me underline again, we welcome the implementation of important structural, fiscal, and economic reforms in recent years, but we see a need for further reforms that address longstanding structural challenges. The authorities agreed to this, as highlighted by Mr. de Villeroché in his buff statement.

In particular, tackling the still-high structural unemployment, strengthening potential growth, and putting public debt firmly on a downward trend are important. We would also like to echo Mr. De Lannoy's point that an ambitious monitoring of the implementation of legislated structural reforms and readjustments as necessary will be key for success. However, the yellow vest protests have clearly complicated this task, and the authorities had to take a breather to reflect on how to best move forward in transforming France's economic and social model, as Mr. de Villeroché has put it. Fiscal policy is one important example in this regard. The authorities, probably sensitively so, decided to give some room, incentives to work, and relief to the poorest households. Achieving the targets, especially on spending reduction as set out by the government, might be challenging, and both staff and the *Haut Conseil des Finances Publiques* make this point.

We call on the French authorities to be steadfast in their goal to achieve the spending reductions and to achieve the structural fiscal adjustment in line with the common EU fiscal rules and also in line with staff's recommendations. Pension reform and civil service reform seem to be key in this regard. Most Directors agree on this direction. The divergence is on the speed of how to get there. With a closed output gap, with ongoing windfalls of low interest rates, and with proven difficulties to keep up fiscal consolidation efforts over a long period of time, we come to the conclusion that the authorities should use the anchor of fiscal rules, which are also helpful to keep up the credibility of EU fiscal rules overall, as indicated by Mr. Just. We believe this structural adjustment of roughly 0.5 per year is the right order of magnitude.

Let me finish with a point on the financial sector. It appears to be overall robust and resilient to stress. This said, pockets of vulnerabilities remain that warrant continued supervisory vigilance, including complex interlinkages of financial conglomerates, as well as rising private sector indebtedness. We encourage the French authorities to further refine their macroprudential toolkit and make proactive use of it where appropriate. With this, I wish the French authorities all the best.

Mr. Ostros made the following statement:

I thank staff for a very rich set of reports, which I read with great interest. I also thank Mr. de Villeroché and his colleagues for the nice buff statement, and I associate myself with Mr. De Lannoy's statement this morning and his gray statement.

It is important to commend the French authorities for what they are doing. They have a strong reform agenda that they are pushing through, not always in an easy environment, but it is worth commending, and we see signs of the reforms paying off. That is a very good step forward. But the set of reports make a very strong case that France has to improve fiscal sustainability and turn the debt trajectory around to build buffers. I totally agree with that conclusion. But I would like to complicate the discussion a bit because there is flavor in the report—I know that is not staff's intention—suggesting that the problem is high public expenditure per se, and I do not believe that that is the case here. Of course, if you have high public expenditure, there is plenty of room to make efficiency gains, and I think the French government and authorities have that ambition, and I welcome that. Of course, with high taxes, there is plenty of room to also look at the tax structure to increase efficiency; but the level of public expenditure should not be seen as an indicator of a country's growth potential going forward. There is evidence that countries that are open to the world economy actually have higher public expenditure to be able to deal with the structural challenges that come with strong international competition, and I think that is the case for many European economies. There is plenty of evidence that public expenditure rightly used can boost potential growth, as we discussed here many times. If we look at the social outcomes of the French model, it is an outcome that many countries would like to reach. Also the quality of the public sector, the quality of health care for instance, in France, would outperform most health care systems around this table.

While I am very much supportive of the strong call for fiscal consolidation, it is important to acknowledge that high public expenditure can deliver results that are crucial in this development period that we are in.

All in all, I agree with Mr. Tombini that finding a growth-friendly path of fiscal consolidation is probably the biggest macroeconomic challenge for the authorities, and I would encourage the authorities to combine structural reform efforts with a more ambitious path for fiscal consolidation to take advantage of the still-positive cyclical position. I wish the French authorities well in that endeavor.

Mr. Ronicle made the following statement:

I will associate myself with Mr. De Lannoy's comments. We issued a detailed gray statement, so let me just underline a few key points. In Britain, we have tended to look somewhat enviously across the channel at our French neighbors. We see a country of high living standards, world-leading health care, fast trains, and fine food. That picture has become a little more nuanced in recent years with growing awareness of social issues and protests, most recently the gilets jaunes. France's economic and social model has delivered impressive outcomes but today faces some important challenges, so it is to the authorities' credit that they have pushed through such extensive reforms, reforms which eluded their predecessors. They deserve credit for acting decisively in the face of recent protests and for maintaining an ambitious reform agenda going forward.

I have a lot of sympathy for the authorities' concern with getting sequencing of reforms right. I grew up in the Britain of the 1980s, a period of dramatic structural reform, accompanied by fiscal consolidation and tight monetary policy. In the medium term, those reforms had significant benefits, but the period was one of rapidly rising inequality, joblessness, and heightened political tension. France's situation today is not as troubled as Britain's was then, but I still think it is right to focus on the most effective way to deliver change. We think France faces three major challenges: high structural unemployment, slowing productivity growth, and high public debt, and we would prioritize them in that order.

High structural unemployment seems to be the biggest challenge. French output per hour ranks alongside the most advanced major economies, yet GDP per capita is somewhat lower. Raising employment will be critical to tackle this. The authorities' reforms here are very welcome, but I was disappointed that there was not a deeper assessment of the labor market in the report and would encourage the team to explore this issue more deeply in next year's Article IV consultation.

As I said earlier, productivity in France is as high as the best performing major advanced economies, but productivity growth has been slowing. Raising it again will help incomes to grow and help deal with France's high public debt. The report's analysis here was helpful and I would encourage the authorities to look at ways of further liberalizing markets and services, particularly retail and professional services.

France's public debt is high, but as staff note, it poses no immediate risk. On current plans, it is set to level off and then fall. On that basis, we sympathize with the authorities' desire to use their political capital to deliver structural reforms. That said, staff point out a number of clear inefficiencies in public spending, and we would encourage the authorities to tackle these as well as to adhere to European fiscal rules.

Our reading of France's FSSA was largely positive. Corporate and household balance sheets are in good health. The banking system is well capitalized and could withstand an adverse scenario. We were struck by the degree of change that has happened since the previous assessment. For us, that underscores the importance of maintaining the frequency of FSAPs for systemic jurisdictions, not least since the notion of 5-year frequency can in practice mean 6½ years between reports. That is a crucial consideration for the forthcoming FSAP review.

Mr. Jin made the following statement:

I would like to thank staff for the insightful report and Mr. de Villeroché and his colleagues for their buff statement. On the back of the authorities' reform efforts, France has achieved solid growth in 2018 with declining unemployment and a narrowing fiscal deficit. We commend the authorities' commitment to continuing their comprehensive reform agenda following the yellow vest movement. We have already issued a gray statement and would like to add some points for emphasis.

France's public-debt-to-GDP ratio is reaching a historically high level, but the debt-service-to-GDP ratio is historically low. From the perspective of debt management, it seems that the French government has made a good use of the low interest rate environment to manage borrowing. Their debt repayment burden does not increase but actually decreases after the borrowing. In this regard, can staff elaborate more on France's public debt sustainability. Is the current debt level of nearly 100 percent of GDP really too high for France if we do not consider the fiscal rule of 60 percent of GDP?

We would like to associate ourselves with Mr. Ronicle in commending France's commitment to green finance, especially its work on the network for greening the financial system. We appreciate France's great contribution and its leading role in this area.

Mr. Fanizza made the following statement:

I thank the staff for the nice work done on the papers. I would like to thank also Mr. de Villeroché and his colleagues for their statement, and I will associate myself with Mr. De Lannoy's statement.

I want to make three points. The first is a general one, which has already been raised, but I believe it is the crux of the problem. France's experience in the past year has been telling, has highlighted the tradeoff between fiscal consolidation and structural reforms. France needs structural reforms, like many other countries in the region, and also needs fiscal consolidation to improve its medium- and long-term outlook. Thus, the government took important step in an ambitious program with structural reforms and also in fiscal consolidation. It could not make it. It ends up with substantial social discontent that could have taken a turn for the worse. They did exactly the right thing in that circumstances. They took a more gradual path toward fiscal consolidation, and it seems to have worked, while redoubling their effort to explain to the public what they were doing and build up social cohesion. This is important. That is an important lesson that we need to take since many countries have similar problems. That is important.

Second, I appreciate the analysis of the staff on the output gap, but what I got from that—independent of the impact it had on creating the deficit bias of France—is that it seems like beating a dead bird. The output gap has never been a useful metric for policy decisions in the short-term. We have heard that so many times; we have repeated it; we should stop using it. I think many Board members agree on that.

Finally, let me reiterate that we fully share the authorities' call for accelerating the completion of the European banking union and establishing the capital markets union. Making the link to my first point, this would improve the tradeoff, because it would eventually reduce the vulnerability stemming from high debt levels; so it would be easier to move forward in the direction of structural reform and fiscal consolidation.

With that, I would like to wish the French authorities the best.

Mr. Tanaka made the following statement:

We thank staff for the informative set of reports and Mr. de Villeroché for the comprehensive, insightful statement. We welcome that growth remains robust and labor market continues to improve despite the euro area slowdown and rising trade tensions.

First, let me touch upon the structural reforms. We commend the authorities' strong commitment to comprehensive reforms aimed at modernizing the French economy, including labor market and tax reforms. Reforms should be monitored, especially for vulnerable groups like young, low-skilled, and non-EU born immigrants. We encourage lowering structural unemployment and addressing inequality of opportunity. We further encourage additional transformative structural reforms, including unemployment insurance, pension, and civil service. Pension reform might take a long time, but it is essential for every country.

Second, let me touch upon the fiscal policy. We positively note that the fiscal deficit has declined to 2.5 percent of GDP, and the fiscal debt stabilized, albeit at a relatively high level.

Finally, on the financial sector, we welcome that the French financial system has progressed since last FSAP and is broadly resilient to simulated shocks under the stress test of 2019 FSAP, but we should also note downside risks, namely relatively high rising private non-financial and public sector debt. We encourage the authorities to continue to monitor the risks closely and stand ready to make further use of macro and microprudential policies.

Mr. Mojarrad made the following statement:

We issued a gray statement and would like to emphasize the following points.

First, like other Directors, we welcome the indication that the French economy is gaining resilience thanks to the authorities' courageous structural reform agenda. This is already evident in the gains achieved in the labor market and the indication that growth is expected to remain solid in the near and medium term.

Second, we appreciate the French authorities' efforts to listen and communicate with social partners and the population at large. This strategy is very helpful to prioritize reforms while taking account of the social environment. Such a consultation process may lead to a more gradual pace of reform than that recommended by staff, but it probably has a better chance of success as it allows the authorities to address the important issues of inequality and social discontent while at the same time continuing their far-reaching structural reforms agenda.

Third, we agree with other Directors that public finances in France continue to face important challenges, including high public debt and rising spending, and we agree with the staff that sustained implementation of reforms of the civil service, the pension, and employment benefits will be helpful in supporting the authorities' growth-friendly fiscal consolidation.

Finally, we are comforted by the findings of the FSAP/FSSA, which shows that the French financial system has made important progress since the last FSAP, is more resilient, and that banks now have adequate capital and liquidity buffers to withstand sizeable shocks. We encourage the authorities to give due consideration to staff's recommendations, in particular with regard to the need to further integrate conglomerate-level monitoring and oversight. With these comments, we wish the French authorities all success.

Mr. Geadah made the following statement:

We thank staff for the interesting reports and Mr. de Villeroché and his colleagues for the helpful buff statement. We welcome the authorities' commitment to carry out a wide-ranging structural reform agenda with a focus on civil service reform, unemployment insurance, and the pension system, while reducing the fiscal deficit over the medium-term. We see merit in staff's advice to build on these initiatives by considering further product market reforms.

We also welcome the efforts in seeking to reach social consensus on these policy priorities. France has one of the lowest poverty rates in the OECD, as well as lower gender pay gaps and relatively high female labor force participation. These outcomes, together with the provision of health and education services, reflect society's choices and come at fiscal cost, as suggested by Mr. Ostros. Nonetheless, the authorities remain attached to pursuing growth-friendly fiscal adjustment to reduce debt, and we look forward to the outcome of these efforts in future years.

As we noted in our gray statement, and as Ms. Levonian noted this morning, we would have welcomed more of a discussion of the tradeoffs involved in carrying out ambitious fiscal consolidation and wide-ranging structural reforms while protecting social outcomes. We welcome the FSAP and are pleased to note that the French financial system has made important progress since the last FSAP. Banks have strengthened their capital positions and asset quality and have adequate capital and liquidity buffers to withstand sizeable shocks. We agree with staff's advice on further integrating conglomerate-level monitoring and oversight to help ensure that risks are properly identified and addressed, and we welcome the authorities' openness to consider it.

Mr. Ray made the following statement:

We issued a joint gray statement with Ms. Levonian, and I came this morning expecting I would not intervene, but given the conversation, I thought that I could not resist.

On fiscal policy, we agree with both staff and the authorities that fiscal consolidation is needed to contain spending growth and put public debt on a downward path, because without action, France's fiscal situation would leave it vulnerable to shocks.

I look at both the staff's view and the authorities' consolidation trajectory, and I do wonder what the debate is about. Staff seem to want debt-to-GDP to be 95 percent of GDP in 2022, where the authorities are merely getting it down to 97 percent of GDP in 2022. The pace of consolidation post-2020 is the same in both views, and really in that world, I just wonder whether or not we are trying to fine-tune things too much. If I was in the French *Tresor*, I would be more concerned that staff think that the output gap is closed, and unemployment has an 8 in front of it than the fiscal path should get debt down a mere 2 percentage points of GDP further in four years' time.

In that context, I tend to agree with Mr. Ronicle that given the authorities' rather remarkable reform objectives, that their priority should be to use what I might call political space to continue to try to embed those reforms, which would bring long-lasting structural benefits to the economy rather than spend the political capital on what is a modest difference in the fiscal path.

Lastly, Mr. Fanizza touched on a topic that is dear to me, and that is the measures of the output gap. I tend not to agree that we should throw the concept out, but that we should be highly conscious of how difficult these things are to estimate and the error bands around them when we are working with them.

Mr. Palei made the following statement:

The French economy appears to be well balanced, particularly in the external sector, and given the situation, the French policies could be an example to follow for many countries in the euro area. However, the weakness of the authorities' position is the fiscal situation in the country, and with the public debt approaching 100 percent, we have heard clearly that many countries in the euro area want it to be reduced. Mr. Meyer was explicit that this is the main priority for the authorities going forward. At the same time, we understand that it may be politically and socially difficult for the authorities to reduce fiscal deficit today given the wave of protests that took place in the country over the past year, which still continue.

This statement makes me think about several issues in the fiscal area. First, the very large footprint of the state is an important factor in this discussion, and it adds to the complexity of the fiscal consolidation in France. A few years ago, Fund staff wrote a paper about the C-efficiency in advanced economies and they considered the efficiency of VAT collection. Surprisingly for me, France was positioned relatively poorly, together with some of the southern countries in Europe that did have challenges during the European crisis. This combination of a very large role of the state and low C-efficiency, and even the decline in C-efficiency over the years, makes it important for staff to explore this topic in more detail. When questioned about it, staff expressed the intention to look into this topic deeper, maybe by the time of the next Article IV consultations. We appreciate it, and we look forward to this exercise, maybe a selected issues paper.

I also believe that the fiscal transparency evaluation could benefit the French authorities from the point of view of social acceptance of additional fiscal reforms and fiscal consolidation, because during the protests, the accountability and transparency of the government was one of the demands of the protesters. Here I note the staff report focused only on the supply-side of corruption, but we should not forget the governance issues and related corruption issues within the country, and the very high role the state and state-owned enterprises (SOEs), also the lack of efficiency in tax collection and maybe some tax expenditure fuel these perceptions of lack of good governance, or better governance, and this is something the authorities may benefit from. Thank you.

Mr. Meyer made the following statement:

Picking up on Mr. Ray's point, as I tried to indicate, in the direction of consolidation, all Directors seem to agree, and I tend to agree with Mr. Ray's question of what is the fuss about point one, point two more or less. The point for the Europeans is more about the fiscal framework, the fiscal rules that we have in Europe, and against that background, there is an importance for credibility, not only for France but for the overall framework for other countries. This gives confidence to markets, and we can have a discussion of those fiscal rules, the right ones, and these discussions are ongoing. But as long as we have those ones, there is a premium for us and for the euro area and the EU overall to stick to those rules.

On the output gap, I could not agree more. I am also thinking that we should use output gaps. By the way, they are used within the fiscal framework in the EU, so it is not that all Directors would like to throw them out the window.

Mr. Moreno echoed Mr. Ostros's comments cautioning against questioning the authorities' level of expenditure. He remarked that this sentiment could apply to other countries as well.

The staff representative from the European Department (Ms. Velculescu), in response to questions and comments from Executive Directors, made the following statement:[3]

> We thank Directors for their comments and questions, both in the gray statements and in the Board. Let me focus my few remarks on two key policy issues of broader interest which are interlinked, fiscal policy and structural reforms, the tradeoffs, the pace, and the sequencing of them.
>
> On fiscal policy, I would like to make two points. First, France has a social model that is based on highly redistributive tax and social policies, and this model has served France very well in reducing income inequality. But it is clear that this model is becoming socially and economically unsustainable. From a social point of view, after successive governments relied on repeated tax hikes to finance ever-rising social spending, a limit appears to have been reached, prompting the government to legislate significant tax cuts in the short and medium run. This was perhaps unavoidable, but economically this means that the economy's capacity to generate revenues to finance the large spending needs on which the social model is based is no longer tenable, and this has repercussions on public debt. In fact, we have seen this over the last four decades, with debt having risen almost uninterruptedly to close to 100 percent of GDP now.
>
> This brings me to the second point. Can France continue on this path, and if so, for how long? Some have argued that with interest rates at record lows, France could afford to take its time and only very gradually reduce its deficit spending and its debt. We do not agree with this view. Market sentiment can change rapidly, particularly in the current global context, where tensions and risks abound, and this can have repercussions on the cost of debt. Moreover, if activity slows further, France may need to undertake procyclical tightening to maintain its deficit below the Maastricht limit of 3 percent given the European rules, which would affect vulnerable groups disproportionately. The case of a very severe recession, however, would require exhausting

[3] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

France’s relatively limited fiscal space, which would increase debt even further and raise long run intergenerational inequality concerns. Such an outcome may also raise broader questions about the sustainability of the European fiscal framework, given the growing discrepancy between debt paths among the largest euro area members. Thus, the time to act is now when, as the previous Managing Director has said, “the sun is still shining,” the output gap in France is closed, and before risks materialize.

In this regard, we have recommended a balanced, not a frontloaded, structural adjustment of about half a percent of GDP per year starting next year in line with the European rules, which balances the cyclical and sustainability concerns while preserving the credibility of fiscal policy.

On structural reform issues, there is no question that the Macron government has made remarkable progress with key labor market reforms frontloaded early in the mandate, including an unemployment benefits reform being rolled out as we speak. We have welcomed these reforms and the early focus on them, and agreed with this sequencing. We consider that they are essential to support a reduction in the still very high level of structural unemployment in France. But we know that reform effects come only very gradually, and only time will tell if these reforms will be able to produce the necessary transformation in the French economy to generate sustainable long-term gains and prepare the economy to withstand the next downturn with sufficient flexibility. Thus, the authorities will need to monitor their effects carefully and stand ready to deepen the reforms as needed.

In sum, as many Directors have highlighted, both structural and fiscal reforms are essential to address France’s structural problems of high public debt and high unemployment. These reforms mutually reinforce each other, as lower unemployment boosts revenue and reduces pressures on social spending, while a leaner public sector can help a more efficient allocation of resources. Both are thus necessary to bolster the economy’s resilience to shocks. Having made a strong down payment on the structural front, the authorities must now turn to fiscal policies and deliver on their commitments to bring down spending and debt ambitiously and sustainably.

The staff representative from the Monetary and Capital Markets Department (Mr. Das), in response to questions and comments from Executive Directors, made the following statement:

I will make comments on two issues that came up in the gray statements and the discussion, one dealing with the issue of financial conglomerates and interconnectedness, and the second dealing with macroprudential tools for non-bank sector. Both issues are extremely complex, and the first issue has been shorted for quite a while now. We had brought this issue up to the Board in the context of the Belgium FSAP a year and a half back. In the case of France, these are much bigger entities; for example, the global systemically important French banks are all sitting within these conglomerates, and are operating in over 60 member countries as subsidiaries. The scale of French financial conglomerates is much wider and larger.

Fortunately, we had good discussions on this topic with the ECB, with the European Insurance and Occupational Pensions Authority, with the European Securities and Markets Authority and the French authorities, and we were able to garner consensus that more work is needed urgently on the conglomerate matter, especially in the case of groups that have non-financial interlinkages and are actively undertaking cross-border financial intermediation. Conglomerates exist everywhere, but this is where a lot more work is needed, and we have written in the context of the FSAP a technical note that will be a big contribution to this debate if, and when, it gets published.

On the macroprudential side, clearly in the case of France, systemic vulnerabilities are nested not in the banks but in the corporate sector, the insurance sector, the asset management sector; and the toolkit is again incomplete. We have had discussions with the European Systemic Risk Board that development of a macroprudential framework for corporate and nonbanks needs to be accelerated. We again have a technical note coming out in the context of the FSAP, which the French authorities have agreed to publish, and hopefully staff will be providing many more specific details on how member countries could approach a policy response in the nonbank areas.

Mr. de Villeroché made the following concluding statement:

Let me first thank staff for the Article IV and the FSSA, as well as for the dialogue with my authorities. I would like to thank Directors l for their gray statements and this very interesting debate that we had today. Since the last Article IV consultation, growth has been resilient in France, driven by strong investment and domestic demand consumption. Unemployment has declined further. The external position remains broadly balanced, and the 12 months have just passed but they were also rich in political events, to say the least.

The main message from my authorities is that they will maintain their strong resolve to implement a far-reaching and comprehensive package of structural reforms. This presidential term started with priority on reforms starting with labor market and capital taxation, with the aim of strengthening the dynamism of our economy, increasing its attractiveness, and rewarding work. These reforms were immediately followed with a reform of the training and apprenticeship system, the objective of which is to improve the skills of the workforce and workers' employability. These reforms, combined with those implemented in the previous years, are bearing fruit, and we expect them to contribute to strengthen productivity, competitiveness, unemployment, further in the coming years.

Then we had to react to the yellow vest protests, and my authorities organized a large consultation, the results of which were clear: reforms need to be pursued, and the government will do it. Immediate measures were taken to make work pay even more and to reinforce the protection of the most vulnerable. Going forward, major reforms will be finalized in the coming months, which will transform our country and our social model. We have the unemployment benefit system, which will be reformed soon, and the announcement has already taken place. The pension system will get a systemic reform—again, an announcement had been made—including moving forward the age for getting a full pension, and we have civil service organization as well.

These reforms will increase further the competitiveness of our economy. They will reinforce the productive nature of our social protection system and make public administration more efficient. It should as well contribute to enhanced competitiveness of the external economy. The external sector is an aspect that might have deserved more coverage in the report. We just say it is balanced, but there is very little here, and that was a regret from my authorities.

The determination is there, but I listened carefully to comments on the questions of tradeoffs and sequencing, the question of prioritization, and I will come to fiscal policy, but definitely this question is very much in our minds. I regret a bit that the report lists more reforms without addressing these tradeoffs. I do not think we can do more fiscal consolidation than we are currently doing, and at the same time increase the questions of redistribution and address inequalities. Doing them on top of new structural reforms could be challenging, so this question of sequencing and political economy for us has been a missing part of the discussion with staff.

Coming to fiscal policy, my authorities remain firmly committed to putting debt on a downward path. In 2018, the deficit declined, and it will be just above 2 percent this year without the large one-off effect due to the transformation of a tax credit into a social contribution reduction.

Public spending will continue to be reduced at all levels of government in order to put the government debt on a downward path. I would like to highlight that 2019 will be the fourth consecutive year of a decrease of the public-expenditure-to-GDP ratio and that my authorities made the commitment to reduce this ratio further until the end of the political mandate. It is therefore highly unlikely that it will increase further in the context of consistent growth projected in the baseline of staff, and this is something on which my authorities have reservations on the way it is calculated.

Let me now turn to the FSSA, which rightly underlined that much has been done since 2012 in cooperation at the European level to enhance the solvency, liquidity, and supervision of the financial system. I have three points on the real estate sector for households. My authorities' assessment, and I think it is convergent with staff assessment, is that the risk remains contained for commercial real estate. It is something which is closely monitored by the authorities, and risks remain limited with a slowdown in prices last year, the decrease in the vacancy rate, and limited exposures for institutional investors.

On corporate debt levels, in net terms the corporate debt is at a comparable level with European peers. Nonetheless, my authorities are monitoring its rise and will take appropriate measures if needed.

Third, and related to the previous points, France has been a fast mover on the development of a macroprudential toolkit. We are more advanced than other countries. We had been using the countercyclical buffer, and its level has been increased. The high limit exposure to corporate debt has been enforced, and my authorities stand ready to act again if risks arise.

Several Directors mentioned in their gray statements the efforts by France to mitigate greenhouse gas emissions. France is already among the countries where carbon taxation is at the highest level, but we think that more could be done. We would therefore appreciate if staff could cover that issue in the upcoming surveillance exercise.

The Acting Chair (Mr. Lipton) noted that France is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They noted that France's growth slowed last year but remained relatively resilient compared to peers, while labor market conditions continued to improve. The growth outlook remains solid, but downside risks have risen, related to global trade tensions, an uncertain Brexit outcome, and weaker-than-expected growth in Europe. In this context, Directors commended the authorities for their continued progress with structural reforms over the last year supporting jobs and growth. Looking forward, they recommended pursuing and building on the authorities' reform agenda to address France's remaining structural challenges: high public and private debt, still high structural unemployment, sluggish productivity growth, and inequality of opportunity. In prioritizing the recommended reforms, Directors highlighted the importance of carefully assessing the tradeoffs and the proper sequencing of structural reforms and fiscal consolidation.

Directors called for a sustained, growth-friendly consolidation effort to reduce the deficit and put public debt on a firm downward path. In this context, many Directors considered that a strong adjustment would be appropriate to rebuild buffers and not delay achievement of the medium-term objective under EU fiscal rules. A number of other Directors, however, supported a more gradual consolidation. Directors noted that France has some fiscal space that could be used in a sharp downturn but stressed the importance of carefully balancing the need to support growth and safeguard sustainability.

Directors urged the authorities to anchor their fiscal strategy in durable medium-term reforms to reduce public spending. In this context, they supported the authorities' planned civil service, pension, and unemployment benefit reforms, which could help generate some fiscal savings while also improving the efficiency of the public sector. Directors called for complementing these reforms with additional spending measures to reconcile the government's objectives of frontloading tax relief, making space for priority investment, and putting debt on a sustained downward path.

Directors welcomed recent labor market reforms, including revamping vocational training and professional development and overhauling unemployment benefits, in order to foster labor market participation and enhance opportunities for vulnerable groups. They encouraged the authorities to implement these reforms resolutely, monitor their effects 2 carefully, and stand ready to deepen them if outcomes fall short of objectives. Directors also welcomed the recent reforms that led to an improved business environment and recommended complementing them with further efforts to liberalize regulated professions, retail trade, and the sale of medicines. Directors welcomed France's voluntary participation in the Fund's enhanced governance framework on the supply and facilitation of corruption. They also took positive note of the authorities' commitment to transition France to a low-carbon economy.

Directors commended the authorities' progress in bolstering the financial system's resilience, as reflected in the FSAP review, including by taking a proactive macroprudential response to the buildup of systemic risk from corporate leverage. Directors emphasized the need to continue to monitor systemic risks closely and stand ready to deploy additional macro- and micro-prudential policies as needed. Given the global significance and complexity of France's financial system, Directors called for further integration of monitoring and oversight at the conglomerate level, strengthening liquidity-risk management within conglomerates, and ensuring adequate liquidity buffers. Enhanced AML/CFT supervision of smaller banks will also be important.

It is expected that the next Article IV consultation with France will be held on the standard 12-month cycle.

APPROVAL: May 13, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Recent Developments, Outlook, and Risks

1. ***Could staff comment on whether there are upside risks to the growth scenario assuming full implementation of the authorities' reform package?***

- Staff-s medium term growth projections already assume some gains from recent and ongoing structural reforms (including labor market and product market reforms legislated in recent years) However, there is large uncertainty surrounding these estimates, with risks balanced both on the upside and downside.

2. ***How does the uncertainty in the measurement of the output gap factor into staff's recommendations on the pace of fiscal consolidation?***

- Staff estimates that the output gap is largely closed, in line with capacity utilization rates and the share of firms stating that labor shortage is a key factor limiting production. Staff recognizes that estimates of the cyclical position of the economy are subject to important uncertainty. However, as the analysis in last year's Article IV consultation indicates, in the past, staff has consistently overestimated the magnitude of a negative output gap in France. Thus, also in view of the high level of debt and need to build fiscal buffers, staff considers that the recommended steady pace of fiscal consolidation remains appropriate.

3. ***Could staff elaborate on why inflation is so weak? How does the French wage-Phillips curve look? Are there non-wage sources of low inflation?***

- Price and wage inflation remained relatively subdued despite staff estimates of a closed output gap and other activity indicators, such as the rate of capacity utilization and the level of job vacancies. Existing studies for France and the euro area suggest that the Philips curve fits relatively well, especially after accounting for persistence and long-term inflation expectations (also see IMF WP 2018 "Understanding Euro Area Inflation Dynamics: Why so Low for so Long"; and Trésor-economics 2018 "Relation between inflation and the cycle in the past five years").

- Some factors that may have contributed to the relatively weak wage and price inflation in France over the recent past include the introduction of measures to reduce labor costs (e.g., the CICE tax credit); increased competition in some sectors (e.g., telecommunications), including due to the increased use of digital platforms.

4. ***We take note that staff assesses wage growth in France to be subdued. Indeed, there seems to be room for a faster pace of salary increase. However, a higher cost of labor could hamper competitiveness of the French economy. Staff's comments are welcome.***

- Wage growth in France has evolved broadly in line with productivity in recent years. To the extent that recent structural reforms can help improve productivity, a somewhat higher level of wages could be sustained. But in the absence of a notable improvement in productivity, increasing wages could indeed hamper the competitiveness of the French economy.

5. ***Trade tensions between the United States and the European Union, a disorderly Brexit and associated tightening of financial conditions, the "Yellow Vests" movement and potential resistance to reforms, are risks with high potential of materialization. Could staff elaborate on the authorities' level of response preparedness? On the domestic front, we would like to learn the steps taken by the authorities with social partners to ensure adherence to reforms going forward.***

- The authorities have taken steps to contain the impact of external risks, notably in terms of preparedness for a disorderly Brexit scenario (including by passing an enabling act, which allows the government to take measures by ordinance to prepare for the consequences of a no-deal Brexit regarding, for instance, the emergency construction of the necessary infrastructure for restoring border checks and enabling the continuity of certain financial activities to be ensured once the UK loses its financial "passporting" rights). But as risks have increased, staff emphasizes the need to build buffers against shocks, especially by reducing debt.
- Regarding the domestic front, the authorities have taken proactive action to engage with social partners and the general public, notably through organizing a grand national debate after the "yellow vest" protests. But support for the government's agenda among the general public has declined compared to the start of the mandate, and the possibility of it faltering going forward, given the scope of the agenda, remains a distinct risk.

6. ***Some analysts have identified Paris among the cities which could potentially take over the role of financial center in the EU, as a consequence of the Brexit. Do staff consider such an upside risk, with possible delocalization of activities by some financial groups to Paris?***

- Paris could benefit from some reallocation of financial sector activity within the EU as a consequence of Brexit. But uncertainty about the implications of Brexit for the reallocation of financial activities is large and staff does not currently have an estimate of the potential impact of this upside risk. In particular, the relocation of activity from the UK will likely benefit several EU27 financial centers rather than any single country or city.

Fiscal Policy

7. ***We note the differences between the authorities' fiscal projections and those of staff (p10) and would welcome some elaboration on them. We would also be interested to know whether the authorities' projections are consistent with those of the Haut Conseil des finances publiques?***

- Staff's medium-term fiscal projections are based on measures that have been legislated or sufficiently specified, as detailed in the text table on page 9 of the staff report. In contrast, the authorities' projections included in the 2019 Stability Program embed spending reduction objectives that still require a specification of measures behind them.
- The Haut Conseil des Finances Publiques does not make independent fiscal projections but provides an assessment on how realistic the government's macroeconomic projections are. In the latest report they have stressed the risk that the government's medium-term fiscal targets for spending reduction may not be achieved.

8. ***We note the important difference between the staff's and the authorities' deficit projections for the next three years horizon. Staff's comments are welcome.***

- See response to question number 7.

9. ***The authorities agree with staff on the need to improve spending efficiencies in social protection, economic affairs, health and education through subsequent reforms. That said, further spending cuts need to be implemented with great caution amid declining support for the government's reform agenda and growing risk of a slowdown. We welcome staff's comments on whether a more gradual pace of fiscal consolidation would be more realistic and what would be the risk to fiscal sustainability by targeting a longer horizon to achieve the spending cuts?***

- With the annual structural adjustment consistently below the recommended pace of 0.5 percent of GDP over the last two years, achievement of a fiscal effort of this magnitude going forward—which is in line with the European rules—is essential to preserve the credibility of fiscal policy and rebuild fiscal buffers, in view of the increased downside risks. A more backloaded fiscal consolidation would risk the need for procyclical tightening should a softening in activity bring the deficit above the limit of 3 percent of GDP.

10. ***Annex VI provides an interesting analysis on benchmarking spending reforms in France and we would welcome staff comments on how differences in national social models are taken into account in identifying right areas for generating efficiency gains as mechanistic comparison of spending with peer countries is unlikely to help in building social consensus.***

- The analysis in Annex VI acknowledges the difficulty of benchmarking public spending when there are cross-country differences in national social models. It also recognizes that the higher level of spending in France compared to peers may reflect, in part, the social choice to rely more on public rather than private insurance.

- At the same time, given that France has reached a limit with how much tax rates can be increased to support this social model, there is a clear need to reduce spending in the medium run to achieve France's medium-erm objective and put public debt on a sustained downward path. In this regard, the analysis highlights some areas where despite spending more than peers, outcomes in France are mixed, pointing to scope for improving efficiency while generating much needed fiscal savings.

11. ***The package of additional structural reforms planned by the authorities, which includes unemployment insurance reform, civil service reform, and pension reform, is expected to support their fiscal consolidation efforts while improving equity and increasing spending efficiency. Could staff provide a rough estimate of the fiscal savings that could be achieved through these important reforms?***

- Staff estimates the unemployment benefit reform could lead to savings of around 0.04 percent of GDP per year in the next few years.
- The authorities have not indicated a savings objective from the pension reform. Staff estimates that fiscal savings of up to 0.4-0.6 percent of GDP in the medium term could be obtained from accelerating the increase in the effective retirement age. However, recent indications are that the authorities have abandoned these plans.
- The authorities have also not indicated a savings objective from the planned civil service reform. Staff estimates that halving the replacement ratio of retiring government workers (from 1¼ over the last five years to ¾) could yield about 0.1–0.2 percent of GDP in savings. But recent indications are that the target announced at the onset of the presidential mandate for reducing public employment by 120,000 by 2022 may no longer be feasible.

12. ***In this regard, we welcome initiatives such as the planned civil service and unemployment benefit reforms, as well as the upcoming pension reform. Annex V states that redistribution policy in France comes at a relatively high fiscal cost. Could staff elaborate?***

- France is among the countries in Europe with the largest difference between market income Gini and disposable income Gini. This good performance in terms of disposable income inequality is largely due to its high social protection spending which, at 24 percent of GDP in 2017 is about 20 percent larger than peer average (see chart).

13. ***We note that the authorities favored a more gradual pace of consolidation than that recommended by staff. Could staff elaborate more on the differences of process and consequences proposed by staff?***

- See response to question number 9.

14. ***We appreciate staff's detailed and nuanced analysis of fiscal policy, including in the Selected Issues paper and welcome the authorities' commitment as noted in the buff statement, to contain spending growth and reduce public debt. We note, however, that there may be a potential tradeoff between the pace and scale of reforms and socio-political consensus. In this context, could staff comment on their difference in views with the authorities on the pace of consolidation?***

- See response to question number 9.

15. ***Social protection, economic affairs, health, and education represent three-fourths of France's government expenditure, and we welcome the authorities' intention to achieve savings in these areas (¶20). Can staff indicate whether they discussed with the authorities specific savings options in these four areas?***

- The mission discussed the upcoming reform unifying social benefits, health reform, and ongoing education reforms, as well as the potential for further measures to reduce tax expenditures. However, specific details regarding potential fiscal and efficiency savings from these reforms had not yet been finalized, as they are still subject to social dialogue. Some are expected to be included in the 2020 budget and staff expects to discuss them further in the next staff visit this fall.

16. ***Could staff comment on the magnitude of total tax expenditures in France as well as possible areas for improving the targeting of social benefits?***

- Total tax expenditures amounted to about 3.4 percent of GDP in 2018 (excluding the CICE tax credit, which is being replaced with a social security contribution cut). The authorities had announced their intention to reduce tax expenditures by about 0.06 percent of GDP to compensate for tax cuts planned for the 2020 budget but have more recently trimmed those plans to about 0.03 percent of GDP.

- Possible areas for improving the targeting of social benefits include family and housing benefits. For instance, the share of family and child benefits that are means-tested in France is lower than in peer countries (Annex VI). Some administrative cost savings may also be possible in the context of the upcoming reform unifying some social minima under a universal activity benefit.

17. ***We particularly welcome the spending review process under the "Action Publique 2022" program aiming at an ambitious and coordinated overhaul of all public policies, which should yield good insights to rationalize and improve efficiency in the areas of social protection, economic affairs, health, and education, without necessarily curtailing the amount of public services provided. Could staff elaborate on the progress achieved so far in the "Action Publique 2022" program?***

- A commission of independent experts, Comité Action Publique 2022 (CAP 2022), conducted a spending review to improve the quality of public service while also finding fiscal savings and presented a report to the government in July 2018.
- While the authorities have not published this report, it reportedly contains a number of recommendations that could generate savings of around 1.5 percent of GDP in the medium term. Staff's understanding is that some of the recommendations in the report are being used to guide a number of reforms within each ministry, especially on health, employment, and education.

18. ***According to the OECD estimates and the Fund's studies[1], France lags behind most of its peers in the effectiveness of the VAT collection. Moreover, the c-efficiency ratio remains on a gradually declining trend. The authorities should explore the ways to raise compliance, using, for example, the opportunities provided by digitalization. Could staff elaborate on the key measures likely to improve the effectiveness of tax collection?***

- Staff can explore this topic in more detail in an upcoming Article IV consultation.

19. ***Considering the rising debt but declining debt service, we wonder whether the high level of public debt in France is a response to the prolonged monetary accommodation in the euro area. Staff's comments are welcome.***

- As stressed in the report, public debt has been increasing almost uninterruptedly since the early 1980s. Thus, this trend predates the recent period of monetary accommodation in the euro area and is primarily due to persistent overall and primary fiscal deficits.

20. ***While we welcome the planned fiscal structural reforms of the civil service, pensions and unemployment benefits, which could help support fiscal***

consolidation, we note that most of the planned reforms remain to be legislated or implemented as indicated in Box 2. In this regard, can staff elaborate on the potential ramifications, if any, from the protests and ensuing national debate on the likelihood and feasibility of the planned fiscal structural reforms, and whether they see risks of further policy slippage?

- Following the protests and the national debate, the authorities reiterated their commitment to move ahead with three key fiscal-structural reforms (pensions, unemployment benefits, and the civil service).
- The details of the unemployment benefit reform have already been announced and no further legislation is required, while the reform on the civil service is already in parliament and is expected to be legislated over the summer.
- As to the pension reform, some details have been made public recently, but the reform may take longer to agree with social partners and legislate. Moreover, previously announced plans to accelerate the increase in the effective retirement age starting in 2020 appear to have been abandoned, which would minimize the reform's medium-term savings potential.
- Thus, downside risks remain with regards to further reduced ambition of reforms, which could compromise fiscal objectives.

21. ***Could staff elaborate on the potential fiscal effects of the pension reform and the possible timeline for implementation?***

- See response to question 11. The reform is expected to be legislated in 2020, with implementation starting in 2025.

22. ***We were surprised that the Article IV report did not mention France's privatization efforts, particularly since revenue raised through privatization could help catalyze further productivity-enhancing reforms and yield fiscal dividends. Could staff comment on whether this process is still on track and on the estimated fiscal impact of announced privatization plans?***

- The Loi PACTE, enacted in early 2019, included some privatizations efforts. The largest privatization plan, of Paris airport (ADP), is however on hold, as the opposition initiated a referendum process (référendum d'initiative partagée) against this privatization that could take a long time to resolve.

Structural Reforms

23. ***While we are comforted by the notable competitiveness gains made by the authorities as outlined in the buff Statement, the report appear to be much less***

sanguine. In view of this, could staff clarify how the gains outlined in the buff Statement affect their overall assessment of competitiveness in France?

- Staff assesses France's external position to be broadly in line with fundamentals, and the authorities share this view. Recent measures to lower the cost of labor should improve French firms' competitiveness. And the improvement in the service and non-oil goods trade balances in 2018 is reassuring. Other measures, including the education reforms and the labor market reforms, can help bolster labor allocation productivity growth going forward. But it is still early to assess effect of recent reforms on France competitiveness.

24. ***With respect to the announced unemployment benefit reform, we welcome the envisioned improvement of work incentives. Concerning the desire to contain the increasing use of fixed-term contracts instead of regular contracts, the suggested bonus-malus scheme could have important benefits but might also further increase the complexity of an already complex system of labor market regulation. What is the staff's view on the additional regulatory burden imposed, especially if the reform would be expanded to all sectors of the economy, including smaller firms?***

- The bonus-malus scheme applies to firms above a given size (firms with 11 workers or more) and only in selected sectors (accommodation and restauration; food; transport and storage; water and sanitation; rubber and plastic; wood, paper, and printing; and certain specialized activities).

- The incentives of the scheme, which is based on comparing each firm's use of short-term contracts with the sector average over the past few years, can indeed prove difficult to interpret for some firms. While the authorities do not intend to extend the scheme to lower firms or other sectors, staff recommended close monitoring of reforms, including this scheme, to ensure that its application does not prove excessively burdensome.

25. ***The authorities have decided to cancel the fuel tax increases after the "yellow-vest" protests. Could staff elaborate on how the authorities would use other tools to ensure emission reductions?***

- France has increased carbon taxes on fuel over the past few years but, following the "yellow-vest" protests, opted to cancel plans to increase those taxes further over 2019-22.

- The authorities reiterated their commitment to reduce emissions further and are still assessing policy alternatives in this area.

26. ***Could staff elaborate on recent labor market developments? In particular, we would find it helpful: to know whether such shortages are concentrated in specific sectors? How the Beveridge Curve looks for France – has matching efficiency improved, or do staff expect it to improve, as a consequence of recent and planned labor market reforms? Have there been marked changes in labor market churn, for example hiring and separation rates? Have staff estimated the extent to which these reforms have or will lower the NAIRU?***

- There is evidence of shortages in some sectors (e.g. ICT, health, and construction), as a result of skills mismatches. In this regard the recent apprenticeship and training reform should help improve skills and better match labor supply and demand. Staff has not conducted analysis on the recent evolution of matching efficiency in France, including as a result of reforms. Evidence in an earlier study (IMF 2016 Selected Issues Paper "Structural Unemployment—Causes and Potential Remedies") suggested that the Beveridge curve appeared to have shifted outward since the crisis, pointing to a possible deterioration in matching efficiency. A more recent study (ECB 2019 "The euro area labour market through the lens of the Beveridge curve") pointed to a steepening of the curve (meaning that more vacancies are needed for a small decrease in unemployment to occur) in recent years.

- Staff projects a gradual decline in the NAIRU of around one percentage point over the medium run, including on account of recent reforms. But uncertainty around these estimates is large.

27. ***We note that product market restrictions are particularly elevated relative to peers across retail and professional services, and that reducing these could bring substantial gains, though we also note some concerns from the authorities as to whether these metrics are too crude. Staff comments would be welcome. We also wonder whether there is evidence of elevated prices or profit margins in these sectors, that would be consistent with weak competitive pressures or excessive market power?***

- The OECD product and service market regulation (PMR) index is useful in that it is comparable across countries. But it also has limitations and should be interpreted with caution.

- One concern with the use of PMR indices is that a more stringent regulation (as defined in the index) may not always imply lower intensity of competition. This concern may be more valid for some PMR sub-indices (as the prevalence of state-owned enterprises, as pointed in the buff Statement) than for others (and, in particular, seems to be less of a concern for areas in which the selected issues paper focuses, such as retail distribution, sale of medicines, and some professional services, and further easing regulation for start-ups).

- There is indeed evidence of elevated prices or profit margins in some sectors, which has prompted the authorities to adopt measures aimed at increasing competition, for instance on driving schools and auto parts.

28. ***Additional information on specific measures on product and service sector reforms planned beyond those mentioned in the buff Statement, such as competition and healthcare reform, and their expected timeline for implementation would be welcome.***

- The Prime Minister announced this March a series of measures aimed at increasing competition in different areas to be implemented over 2019-20: auto parts; driving schools; condominium associations ("syndic"); health insurance (currently in parliament); laboratories of medical analysis; online sale of medicines.

29. ***Overall, France is ranked relatively high in the Ease of Doing Business. However, there is still room for substantial improvements in the business climate in the areas of property registration, paying taxes, protecting minority investors, and getting credit. Staff may want to comment on the key impediments to further progress in these areas.***

- Some recent reforms, such as the recently adopted Loi PACTE, included measures that should lead to improvements in the Ease of Doing Business (for instance, by improving financing option for SMEs). Further progress is possible, and prioritization of reforms is key to ensure that efforts focus on reforms with the "biggest bang for the buck." Staff's Selected Issues paper offers some suggestions in this regard.

Financial Sector

30. ***We note the divergent views between the report and the buff Statement on the relevant institutions responsible for strengthening of crisis management, resolution and safety nets. Could staff clarify the different roles that the authorities and the EU should play in addressing these issues?***

- The area of insurance resolution is a new one and remains a work in progress in the EU. In the absence of an EU Directive to guide the homogenization of insurance resolution frameworks, France is among the first major jurisdictions to have reformed their resolution framework for insurers. While recognizing that for competitiveness and level playing field reasons, the authorities prefer to wait for agreement at the EU level before further strengthening the regime, the authorities do not need to wait, strictly speaking, for an EU Directive to adopt FSAP recommendations to strengthen their crisis management arrangements. Staff agree that a concerted effort would be needed to reach agreement at the EU level and think that the French authorities are extremely well placed to lead such an effort. Similar considerations apply to the issues related to conglomerates.

31. ***Concerning the high level of intra-company lending, we would be interested in staff's view on potential risks and contagion channels.***

- The potential risks and contagion channels arising from intra-company lending are not yet fully clear due to data gaps. While theory suggests that credit chains among corporates could create vulnerabilities, more empirical work is needed to fully grasp potential risks and contagion channels.

32. ***The authorities have introduced a specific regulatory regime for initial coin offerings (ICOs) and crypto-assets. Staff stated that the regulatory regime appears to strike a sound balance between encouraging innovation and protecting investors. Could staff elaborate more on how this regulatory regime would strike a sound balance and how large are France's ICO and crypto-assets markets?***

- It is important to note two points at the outset. First, the work carried out on the new regime on ICOs and crypto-assets was a stock-taking exercise rather than an in-depth assessment. Secondly, the framework referred to in the FSSA was in the process of being developed during the FSAP. The primary legislation has now been adopted, but the full regime will not be in place until the end of 2019. As such, it was not possible to assess how the regime is functioning in practice. Notwithstanding the above, the high-level analysis carried out allowed staff to reach the conclusion that the regime appeared to strike a sound balance between encouraging innovation and protecting investors. This is because the approach introduces, on the one hand, an optional licensing regime for certain virtual assets service providers (e.g. crypto exchanges and crypto broker-dealers). In order to obtain a license, entities will have to demonstrate that they adhere to certain standards and have proper internal controls and organizational structures. Creating a pool of entities with such licenses should allow potential investors to have more confidence in the services that will be provided. It should also make it easier for these entities to interact with other financial services providers e.g. banks. At the same time, the fact that the license is voluntary means that other crypto-asset providers can continue to test innovative approaches and products without the additional constraints of regulation. Regarding the size of the ICO and crypto-assets markets, as noted above, the new voluntary licensing regime will only be operational around the end of 2019 so there is no data for the moment, and it is difficult at this stage to gauge the potential appetite among market participants for this new regime. What is clear is that there has been a high level of engagement in the consultation process carried out by the French authorities thus far and strong support from market participants for the development of the new regime.

33. ***We note that the authorities have expressed skepticism about the feasibility of implementing borrower-based measures. Can staff provide more details of how the measures could be developed and implemented, and share relevant experiences from other countries?***

- The analytical framework for borrower-based tools in the corporate sector is still at its infancy and there are several considerations that should go into its design. In general, unlike households where the borrowers and loans are fairly homogenous, several layers of heterogeneity exist in the case of corporates calling for differentiated limits across corporates. Staff will provide relevant country experiences bilaterally.

34. ***We welcome improvements in capital and asset quality in the banking sector, as well the solid performance of French banks in the IMF stress test, though note the ongoing challenge of low bank profitability. This is not an issue confined to France, but rather a broader concern for the Euro Area as a whole. We note that the proposed actions to address low profitability, cost savings and efficiencies, are largely in the gift of individual banks; do staff have views on actions the authorities should be taking, for example fostering competition?***

- The French banking sector is already quite competitive. It is adjusting to the profitability challenges by cutting costs and refocusing business lines wherever possible. The authorities are engaged and are in proactive dialogue with the banking industry; they are promoting opportunities in the domestic financial markets, including via green finance and financial digitalization. The efforts could potentially help banks grow into new areas. The movement towards a capital markets union would also help expand the range of market options; opportunities will arise in the process for further consolidation of branch networks and business lines, reaping the benefits of network optimization and operational efficiencies. A closer authority-industry partnership thus appears essential to keep the banking system sustainable.

35. ***Staff and the authorities agree on the potential usefulness of further integrating conglomerate-level monitoring and oversight to help ensure that risks are promptly identified and addressed. Are there plans to discuss the proposal at the European level, including in the context of the next euro area Article IV consultation?***

- Currently staff is not aware of any plans to discuss the proposal at the European level.

36. ***We note divergences in the Risk Assessment Matrix between the FSSA and the Article IV report for three major risks (weaker-than-expected global growth, sharp tightening of global financial conditions, and weakening of domestic reform implementation), and would appreciate staff clarification.***

- The risks are now aligned. It must be noted the FSAP risk matrix focuses on disruptions to financial stability and is used in developing stress scenarios for testing the resilience of banks or insurers.

37. ***Could staff elaborate on possible policy responses to potential disruptions in wholesale funding as well as on the authorities' view that an enhanced resolution framework for insurers should be the task of the EU authorities and that France is far more advanced in this area?***

- On the issue of potential disruptions in wholesale funding, possible policy responses include ensuring the availability of liquidity support in times of stress and coordinating with other central banks on availability of swap lines (see April 2018 GFSR). On the issue of resolution framework for insurers, please see staff's response to question 30.

38. ***Regarding regulated savings products, we would appreciate staff's comments on the options available to transition to more market-based products in view of the difficulties faced by the authorities.***

- Given the long-standing role and popularity of regulated savings products in France, this matter would require a detailed analysis especially on how they affect liquidity management of banks and financing needs of social housing projects. The FSSA has therefore suggested that, as an extension of steps already initiated by the French authorities, a full technical review be undertaken at an appropriate time for further reform including the desirability of introducing a market-based mechanisms.