FOR AGENDA

SM/13/209
Correction 1

July 26, 2013

To: Members of the Executive Board

From: The Secretary

Subject: **France—Selected Issues**

The attached corrections to SM/13/209 (7/15/13) have been provided by the staff:

Evident Ambiguity

Page 30, text chart: replaced because the bars that should have been translucent were solid.

Typographical Error

Page 29, paragraph 1, line 6: for “the strucutural imbalance” read “the structural imbalance”

Questions may be referred to Mr. Gardner (ext. 35394), Mr. Hallaert (ext. 39969), Ms. Poirson Ward (ext. 37072), and Ms. Perez Ruiz (ext. 38326) in EUR.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (2)

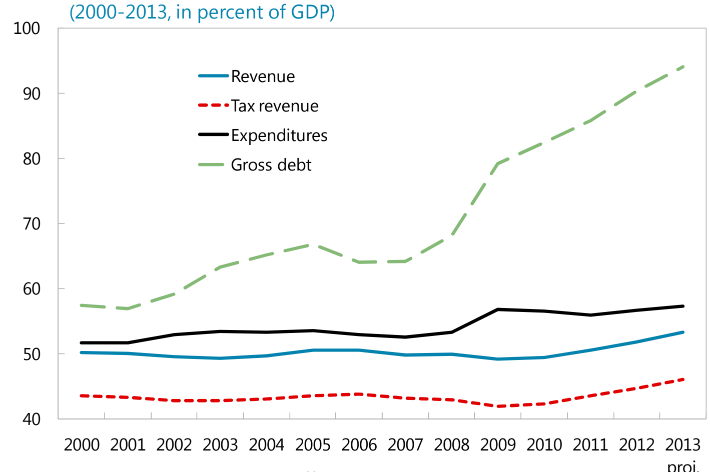
Other Distribution:
Department Heads

WHICH EXPENDITURE SAVING TO SUSTAIN MEDIUM-TERM FISCAL CONSOLIDATION?[1]

1. **Much of the fiscal imbalance that was opened during the crisis has been corrected, but the structural fiscal deficit still stood at 3.5 percent of GDP in 2012**.[2] France's fiscal deficit widened markedly during the crisis (from 2.7 percent of GDP in 2007 to 7.5 percent of GDP in 2009). Automatic stabilizers contributed to about 2/3 of this deterioration, with the rest coming from a discretionary fiscal stimulus. Thus, over the same period, the structural fiscal balance widened by 1.5 percent of GDP. The fiscal consolidation undertaken since 2010 reduced the structural imbalance by just over 2 percentage points of GDP by 2012, with an additional adjustment of nearly 2 percentage points projected for 2013. An additional adjustment of 1.7 percent of GDP will be needed to meet the government medium term objective of a balanced structural position.

2. **The Stability Program of April 2013 envisions that fiscal consolidation, which has so far relied mostly on revenue measures, will shift to expenditure containment**. The tax-to-GDP ratio increased by 3 points over 2009-12 and is projected to increase by one additional point in 2013. In contrast, the expenditure-to-GDP ratio, which had increased by over 4 points between 2007 and 2009, has remained at its peak level of close to 57 percent of GDP and is the largest in the euro area (Figure 1)[3]. The increase in the expenditure ratio during the crisis is not fully cyclical as almost 1/3 is due to structural spending increases. Going forward, the authorities intend to shift from revenue-based consolidation to expenditure-based consolidation. The share of revenue measures in the structural adjustment should decline from 85 percent in 2012 to 79 percent in 2013 and to 33 percent in 2014. In 2015 and 2016, the structural adjustment would come entirely from expenditure containment.

Figure 1. France: Main Fiscal Indicators
(2000-2013, in percent of GDP)



Sources: INSEE and IMF Staff projections.

[1] Prepared by Jean-Jacques Hallaert.

[2] In this paper, structural numbers are in percent of IMF estimated potential GDP.

[3] Averaging 2.2 percent per year in 2008-09, real expenditure growth outpaced its trend growth of 1.5 percent (average real structural spending was 2.0 percent). Stabilizing the nominal and structural expenditure ratios required limiting real expenditure growth to 0.6 percent per year in 2010-13 (0.4 percent for structural spending).

3. **The purpose of this paper is to identify the areas of expenditure saving that could sustain medium term fiscal consolidation**. The first section discusses the size of the fiscal adjustment needed to meet the objective of a balanced budget. The second section draws lessons from international experience with fiscal consolidation for the design of an expenditure-based consolidation in France. The last section identifies possible areas of expenditure saving.

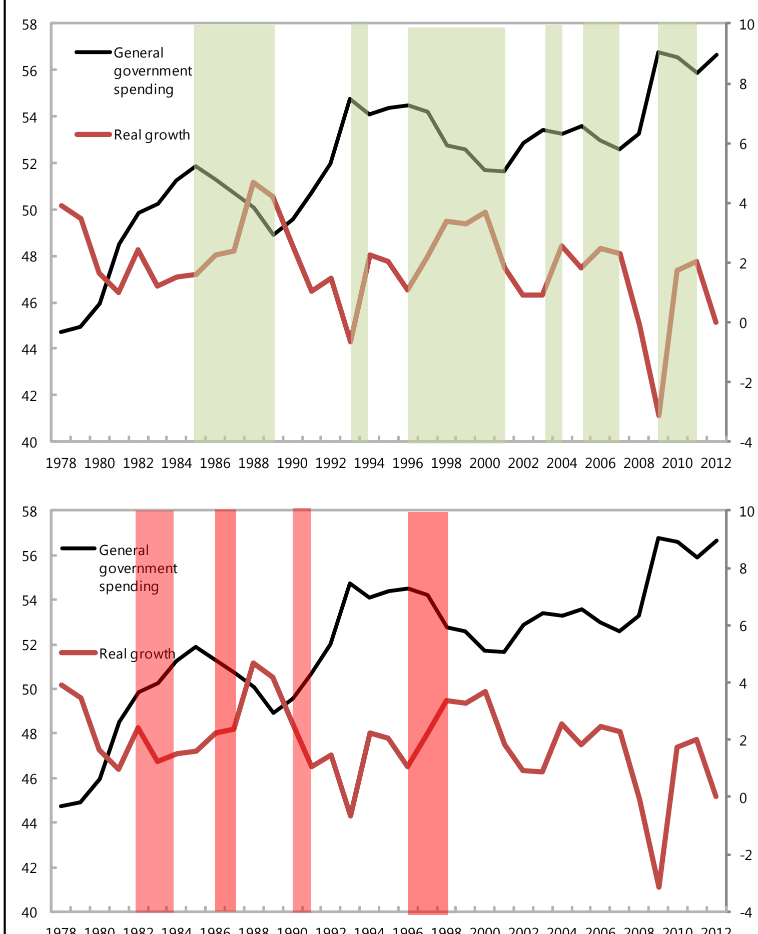
A. A Historically Large Adjustment

4. **To reach their medium-term fiscal objective, the authorities estimate that they will have to reduce the spending-to-GDP ratio by about 3 percentage points during 2013–17** (République Française, 2013). Under the authorities' macroeconomic projection, such reduction in the expenditure ratio implies a structural adjustment of close to 2½ percent of GDP and would deliver a structural surplus of 0.5 percent in 2017. Under IMF staff's macroeconomic framework and potential growth, the same reduction in the expenditure ratio would balance the structural budget and would require a structural adjustment of close to 2 percent of GDP.

5. **Such a reduction is large by historical standards**. Figure 2 shows periods of declining expenditure-to-GDP ratio shaded in green. In the past 35 years, the largest reduction in the expenditure-to-GDP ratio reductions amounted to 3 points between 1986 and 1989 and 2.8 points between 1996 and 2001.

6. **More than in the past, the reduction in the expenditure ratio will have to come from discretionary expenditure saving**. The red shaded areas of Figure 2 show that policy measures were short lived. They explain only 0.76 point of the 3 points reduction in the expenditure ratio during 1986-89 and 0.56 points of the 2.8 point reduction in 1996-2001. In other terms, the drop in the expenditure ratio was achieved without substantial expenditure containment: real structural primary expenditure grew on average by 2.0 percent a year in the two periods

Figure 2. France - General Government Spending (left axis, in percent of GDP) and Real Growth (right axis, in percent)



Sources: INSEE, Devries *et al.* (2011), and Author's calculation.
Note: Shaded in green are periods of decline in the expenditure-to-GDP ratio, in red are the periods of policy-driven spending cuts.