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Statement by Mr. Buissé and Mr. Rozan on France
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The French authorities would like to underline their appreciation for the work conducted by staff for this Article IV consultation, made under particularly difficult circumstances. They strongly valued this engagement and exchange on the diagnosis, risks and policy priorities. This highlights the importance of the resumption of Article IV consultations in this recovery phase. The article IV report and the two selected issues papers represent a particularly valuable contribution to the policy debate in France, and more generally in advanced economies.

France has been hit by the crisis after several years of strong reform implementation that were bearing fruits, with a notable improvement of economic fundamentals. The crisis was met with decisive and comprehensive policy actions to contain the spread of the virus, protect livelihoods and limit economic scarring. The tools implemented to support firms and households were designed in consultations with all stakeholders, and their efficiency is being monitored on an ongoing basis. This fiscal response was articulated at the European level, with an unprecedented coordination and the negotiation of new tools, to ensure maximum effectiveness and solidarity, and strongly complemented by the ECB's accommodative monetary policy.

As the crisis evolves, France's response, in particular through the *Plan de Relance* (Recovery Plan), will continue to be at the same time swift, flexible and ambitious, to support the short to medium term recovery, and to align it with France's long term economic transformation needs, continuing the strong reform drive at the heart of the Government's action, while adapting its implementation to the current context. The priority remains to (i) protect the most vulnerable, and the Government will continue to rebuild the social protection system for a fairer society; (ii) deepen and accelerate the effort towards climate transition; (iii) make the French economy even more competitive, resilient, and innovative and develop skills ; (iv) and modernize public administration and public services, conscious of the need to contain public spending in the medium term and to enhance its efficiency.

The crisis has impacted the French economy at a time when growth was robust, and unemployment was down to a ten-year low. Indeed, over the past three years, France has embarked on an ambitious reform path, which has made France a more competitive and attractive place for investors.

(i) The labor market was made more dynamic, thanks to a simpler labor code, a renovated vocational training system, and the implementation of a massive investment plan in skills. Results are already showing, and the new tools are being taken up at a rapid pace, with increased and improved collective negotiation at the firm level, and a rising number of apprenticeships. The macroeconomic effects of these structural reforms combined with measures aimed at reducing labor costs were already visible before the crisis, with very dynamic job creations, unemployment falling to around 8.1% at end 2019, and improvements in job quality through a greater use of long term contracts and full-time employment. Growth in France reached 1.5 % in 2019, above the 1.3 % average of the Euro Area;

(ii) The social model, already strongly redistributive, has been renovated to ensure stronger equality of opportunity. Reforms have been undertaken to tackle the lack of social mobility. Schemes targeted to support people furthest from the labor market have been reinforced and rationalized to increase their effectiveness. Measures in the field of public education have been taken to ensure more equal opportunities, including expanding daycare capacity to accommodate 30 000 additional children until 2022, lowering the mandatory school age to 3-years-old, and halving class sizes in sensitive areas. Finally, some statutory minimum social benefits (“*minimas sociaux*”) have been significantly increased (minimum old-age pension, adult disability allowance) and dental and optic health benefits have been enhanced;

(iii) Continuous efforts have been made to contain labor costs and support the cost-competitiveness of the French economy, by permanently reducing social contributions on labor (€20 billion of employee contributions cut offset by an increase in the generalized social contribution (CSG) with a broader base, conversion of the CICE tax credit into a permanent reduction in employer social security contributions). The business environment was simplified through the Action Plan on the Growth and Transformation of firms (*PACTE*) and the ESSOC Law has further simplified the regulatory environment for firms. Thanks to these measures, competitiveness is improving: since 2012, unit labor costs in France have risen more slowly than in the euro area. French market shares have stabilized over the period. Competitiveness has consequently greatly improved, as shown by the results of the international rankings;

(iv) Support has been deployed to stimulate corporate investment, in particular in innovation, to support productivity. Capital and capital income taxation have been reformed so as not to deter productive investment. Corporate taxation has been adapted, with a gradual path of reduction of the corporate income tax rate until 2022, reducing both firm-level tax burden, and the debt bias. Innovation has also been supported through several financing mechanisms (in particular, an important investment plan has been launched in 2017 with €13 billion earmarked for innovation, and the Fund for innovation and industry has strengthened its support to breakthrough innovation by €250 million annually). Amortization rules for productive investment in the digital sector and robotization by SMEs have been adapted. All of these measures have supported a very dynamic corporate investment in the recent pre-crisis period. The deindustrialization process appears to have halted, with 30 000 additional industry jobs since mid-2017.

<u>The pandemic has triggered an unprecedented economic crisis, with a massive impact on output. A rebound is expected for 2021 thanks to support measures.</u>

The Budget bill relies on a -11 % recession in 2020. This prudent assumption was made in October, in view of the restrictions to be implemented at the end of the month to curb the pandemic, but the latest data suggest the cost of the second lockdown has been smaller than expected. The shock is highly differentiated across sectors. Although activity has only slightly decreased in the agricultural sector, as well as in IT and financial sectors, it has drastically fallen in sectors that were directly affected by the containment measures, for instance hotels and restaurants. The automobile and aerospace industries and transport services also experienced significant drops in their activity. Domestic demand has plummeted because of the drop of household consumption and corporate investment, although investment is estimated to have decreased less than in the EA. Production was strongly impacted by the disorganization of supply chains and the containment measures. The crisis has taken a particular toll on external trade, due to the exposure of French exports to aeronautics and tourism.

The *Plan de Relance*, announced in September, supported by the EU's Recovery and Resilience Facility, as well as the massive action of the ECB, will contribute to the rebound of the activity in 2021, though uncertainty is high. Thanks to the support measures taken by the Government, household incomes as well as the productive capacity have been largely preserved in 2020. The Government expects a rebound in activity for 2021, at 6 %, thanks to the progressive lifting of sanitary restrictions, and the implementation of the *Plan de relance*. The level of uncertainty is however particularly high. The evolution of the health situation will be crucial, both on the downside (worsening pandemic) and the upside (treatment and vaccine). Trade tensions could also become more acute, even if the Brexit deal has reduced the immediate level of risks. Financial markets should be monitored. There is also high uncertainty about household consumption: given the large savings accumulated in 2020, and the push provided by the *Plan de relance*, the recovery of consumption could be more dynamic than expected.

<u>A massive public reaction has proven effective to face the short-term shock linked with the pandemic, amounting to around €500 billion</u>.

To preserve jobs, skills and household income, the Government has taken unprecedented strong measures. It put in place a series of massive emergency measures to protect companies and workers, notably through the Solidarity fund, state-guaranteed loans and a short-time unemployment scheme. As noted by staff in the report, the take-up of these schemes has been high. It is estimated that about 2/3 of the 2020 shock to national income has been absorbed by the public sector, through both automatic stabilizers and emergency measures.

The short-time work scheme (*dispositif d'activité partielle*) has been strongly reinforced and has been very effective in helping companies cope. At its peak in April, over 8 million workers were benefitting from this scheme. While the generosity of this scheme was fully warranted during the containment phase, the scheme has been recalibrated and tightened for the recovery phase (in June 2020 and starting from February 2021) to balance the financial support to the most affected sectors with the need to provide an incentive to resume activity in sectors that do not directly suffer from the containment measures. The take-up diminished quite in line with the rebound in activity observed in Q3. The current state of the scheme appears appropriate, and the government will continue to assess its efficiency going forward, along the evolving situation.

Strong additional measures have been taken to support the purchasing power of workers and specific attention has been paid to the most vulnerable. Unemployment benefits were extended and adapted during the lockdown. The implementation of some parts the unemployment insurance reform has been delayed. Automatic renewal of rights to certain social benefits have been decided. Exceptional financial assistance has been dedicated to the most fragile.

Companies have received unprecedented support. A €300 billion guaranteed loan scheme has been put in place, with a take-up of around €130 billion at end 2020. The deferral of social contribution and tax payments, and an accelerated refund of tax credits also provided significant liquidity to firms. Beyond liquidity support, direct financial support has been provided to SMEs, independent workers and micro-companies, given their fragility, to help cover fixed expenses during periods of stopped or reduced activity. A Solidarity Fund, credited with €20 billion for 2020, has been created to that effect.

After the end of the first lockdown, sectoral support plans have been adopted to help specific sectors particularly affected by the crisis. A first set of measures has extended emergency measures to take into account the specific situation of sectors affected by prolonged social distancing, for instance tourism, hotels, restaurants, culture, publishing, retail stores. In addition, a second set of measures has provided equity support and support to structural transformation to sectors facing solvency issues in a difficult economic environment, in particular the automotive, aerospace, tourism sectors, and technological startups.

To support both the short-term recovery and the medium-term transformation of the French economy, a recovery plan, the "Plan France Relance", was unveiled in September and started being implemented at the end of 2020. The €100 billion Recovery Plan will be partly funded by €40 billion of direct subsidies from the European Union, following the historic European agreement in July. It is designed to sustain the growth potential of the French economy, support employment creation, social and territorial cohesion, and speed up the greening of the economy. It will support French companies and industries' competitiveness and invest in technologies to maintain France among the most competitive and innovative countries. **By supporting both supply and demand, it supports job creation and aims to help restore the pre-crisis level of economic activity in 2022**. It has been designed and calibrated to have a lasting impact on growth.

- **Along its first pillar, a strong emphasis has been placed on the green transition, to reach France's climate objectives**. €30 billion are dedicated to this effect. The recovery plan will include investments for energy-retrofitting, for sustainable mobility, for decarbonation of the industry and for the development of green technologies (hydrogen, biofuels, recycling).

  More generally, policies developed throughout the crisis have made sure the pursuit of climate objectives is not postponed but accelerated. As noted in the latest Fiscal monitor, France is leading the way in terms of greening its COVID-19 fiscal package. Green budgeting is being implemented, and the budget voted for 2021 has been fully climate-tagged and analyzed expenditure by expenditure through an environment and climate lens. This is a landmark achievement to be able to closely follow and monitor the impact of the recovery plan on climate and the environment. Going forward, the Government will continue to implement policies compatible with reaching climate commitments at the domestic and at the European level. The Selected Issues paper on climate policies was a very useful contribution to take stock of the already robust climate mitigation policies in France, as well as highlighting useful policy debates to be held at the domestic or EU level. More specifically on carbon pricing, European coordination is necessary for an effective climate action. The European Commission is exploring, as part of the European Green Deal, a reform of the EU's Emission Trading System, and to possibly extend its perimeter. Due attention will have to be paid to the social acceptability of this going forward.

- **The second pillar will provide €34 billion to reinforce the competitiveness and resilience of the French economy**. Measures will include cut in distortive production taxes (€10 billion per year on a permanent basis, the first two years being part of the France Relance Plan for a total amount of €20 billion), measures to reinforce corporate balance sheets and investments in innovation, in the digitalization of SMEs and in the resilience of the French industry, especially to secure critical supplies.

  One key objective is to strengthen corporate balance sheet, to secure a strong and long-lasting recovery. Going beyond broad-based liquidity support, the Government is putting in place a publicly supported scheme of participatory loans and subordinated bonds to SMEs and mid-size companies, allowing for quasi-equity financing up to €20 billion (consistent with estimates of the equity gap due to the crisis). This scheme will provide medium to long-term financing to firms with a viable business model but which need equity or quasi-equity to continue investing and growing due to their current indebtedness. The public support will consist of a portfolio guarantee granted to investments funds which invest in quasi-equity instruments, in order to address the current market failure regarding access to quasi-equity. This mechanism has been discussed with all stakeholders to ensure its adequate take-up, both on the side of beneficiaries, financial sectors and investors. The massive participation of the private sector was necessary to quickly scale up this equity support. The design of this instrument was carefully assessed to ensure market-led selectivity, adequate pricing, and time-bound support. The Government will closely monitor the implementation of the mechanism to ensure the success of this strategy.

  More generally, while we agree with staff that it will be important to shift support from providing broad-based emergency support to targeted support for the most dynamic parts of the economy, the general design of the public support to the granting of participatory loans and subordinated bonds, which is time-bound and relies on a market-based mechanism to determine the conditions of the support, is appropriate. Close monitoring will of course be necessary to ensure the intended effects are reached.

  In addition, a significant and permanent cut in production taxes will be implemented, amounting to €20 billion over the next two years. France is characterized by the large number and high level of production taxes, which weigh on the competitiveness of French companies, and particularly the industry. **Three production taxes are concerned (CVAE, TFPB, CFE): this combination of measures better targets the competitiveness of industrial companies, and SMEs in particular, than a cut in C3S would have done**. CVAE has been shown to weigh heavily on companies that need to regularly renew their productive equipment, and therefore creates distortions at the detriment of capital-intensive sectors. The reform of real estate property taxes (TFPB and CFE) will directly benefit industrial companies since it corrects the calculation of the tax base which penalized them considerably compared to other types of business premises.

- **The third pillar will provide €36 billion for skills, social and territorial cohesion**. The significant means devoted to scaling up employment support measures and investment in skills and competences will help safeguard jobs, improve the employability of the most vulnerable, especially the youth, and strengthen productivity. Among the key measures, €1.6 billion is dedicated to training young people in strategic and dynamic sectors, €1 billion to lifelong training, €1.1 billion to subsidizing new hires under the age of 26 and €7.6 billion are dedicated to preserve employment through a long duration short time work scheme (along with support to training).

  The long duration short time work scheme has been designed to be targeted and provide the right incentives, without impeding factor reallocation. Its use is conditioned on signing a collective agreement, and it has been designed to target companies that should return, over the medium to longer term, to a level of activity similar to that of the pre-crisis-level. Moreover, only up to 40 % of usual working hours (50 % in exceptional cases) can be covered by the scheme, in order to avoid skills obsolescence.

More generally we will welcome further exchanges with staff on their ideas on how to ensure an efficient reallocation of labor in the recovery phase.

Specific attention is paid to the timely implementation of the recovery plan, as well as its efficiency. In order to be timely, the recovery plan should be implemented as quickly as possible to secure the recovery. A comprehensive monitoring and evaluation framework has been set out by law. The budgetary design of the plan enables the Government to shift the allocation of credits whenever the implementation of an action is deemed unsatisfactory. There has been a heavy involvement of relevant stakeholders, both at national and local levels, in the preparation of the plan, and the governance has been designed to ensure swift and flexible implementation.

The crisis response measures required a substantial mobilization of fiscal tools and a deepening of the deficit. While 2019 was marked by a reduction of the deficit to 2,1% of GDP (not counting the temporary effect of the replacement of the tax credit for employment and competitiveness (CICE) by a permanent cut in social security contribution), in 2020, the public deficit is estimated to reach -11,3 %, while debt is estimated to reach 119,8 %, given the drop in activity and the sizable and fully justified public intervention to offset the effects of the crisis.

The normalization of the situation of the public finances, helped by the rebound in activity and the implementation of structural reform, will be done progressively, so as to preserve the recovery. The deficit will be reduced to 8,5% in 2021, and public debt should stabilize around 122,4%. The COVID related debt will be ring-fenced, and public resources will be dedicated to its amortization, with a credible trajectory and calendar. **More generally, while the consolidation of public finances should not be engaged too promptly to preserve the recovery, the Government is fully committed to maintaining the sustainability of public finances in the medium term,** based on the growth recovery, improved spending efficiency, and strict control of the evolution of expenditure volumes. It will be able to rely on a high level committee, chaired by Jean Arthuis, former Finance minister and former chair of the Senate finance committee, which is expected to deliver its recommendations at the end February 2021 in order to help redefine a fiscal trajectory and improve the governance of public finances.

We generally share staff's assessment of the financial sector. In the current context, vigilance on the build-up of risks in the financial sector is critical, given the impact of the crisis on corporate balance sheets. The banking sector appears to be adequately capitalized, and it entered the crisis with comfortable capital buffers and low NPL ratios. However, we do not fully share the results of the Solvency Stress Test undertaken by staff, as it does not take into account the prudential filters on expected loss provisions recommended by the Basel Committee and implemented into EU law in June. Finally, the banking and insurance sector profitability in the low-interest environment requires monitoring, and supervisory authorities will remain vigilant regarding the possible build-up of risks in the commercial real-estate sector.

More generally, the crisis has emphasized the need for continued reforms, following the strong reform drive of the first three years of the mandate.

The reform agenda will continue to be implemented, while adapting it to the changing circumstances, along the following four directions:

- **First, efforts to rebuild the welfare state for a fairer society will continue**: the **health system** will receive additional funding to enhance its long term resilience ("*Ségur de la Santé*" agenda), while work is being undertaken to limit the growth of spending related to outpatient care. The **reform of unemployment benefits** will be implemented. The objectives remain unchanged (support job creation, fight precarity by incentivizing work and limit excessive use of short-term contract). Some measures are already in place, but the implementation modalities of the rest of this important reform are currently being adapted to ensure they fit the current economic and social context. In addition, the discussions with social partners on the **pension reform** will resume, with the goal of moving towards a single universal retirement regime. Reforms aimed at **fighting inequalities** will continue, with the implementation of the Plan Pauvreté to protect the most vulnerable, and new initiatives will be implemented in 2021 to fight inequalities of opportunities;
- **Second, beyond the climate agenda highlighted in the *Plan de relance*, and the green budgeting exercise that started this year**, the Government is preparing a **new Law on climate and the environment**, that will implement part of the proposals made by the Citizens' Convention for Climate. The objective is to build a credible trajectory, compatible with reaching climate neutrality by 2050;
- **Third, scaled-up support will be provided for innovation and the development of a knowledge-based society**, in particular through a Multiannual Program Law on Research, which will invest €25 billion in public research over the next ten years, and through the fourth *Programme d'investissement d'avenir,* which will target support to advanced technology;
- **Fourth, the authorities will continue the modernization of public services**: the housing policy reform started in 2017 will be deepened; the law on the acceleration and simplification of public action ("ASAP" Law) is being rolled out to enhance the relationship between citizens and the administration, and make administrative structures and procedures more efficient.