



# IMF Working Paper

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## France: Lessons from Past Fiscal Consolidation Plans

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#### Abstract<sup>2</sup>

This paper analyzes past fiscal consolidation plans and their outcomes in France. It covers the early attempts at fiscal consolidation in the 1970s and the 1980s (*Plan Barre* and *Virage de la Rigueur*), the first episode of medium-term fiscal consolidation in 1994–97 ahead of joining the European Economic and Monetary Union, and the fiscal consolidation under the corrective arm of the European Stability and Growth Pact in 2003–07. These experiences offer important lessons for the future, suggesting that binding constraints help focus policymakers’ attention and justify their actions; spending restraint needs to be shared and coordinated across all levels of government; and appropriate deficit targets could help in enforcing budgetary discipline in good times.

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<sup>1</sup> This working paper is a revised and expanded version of the chapter on France in the book “Chipping Away at the Public Debt—Sources of Failure and Keys to Success in Fiscal Adjustment” (edited by Paolo Mauro and published by John Wiley and Sons, 2011).

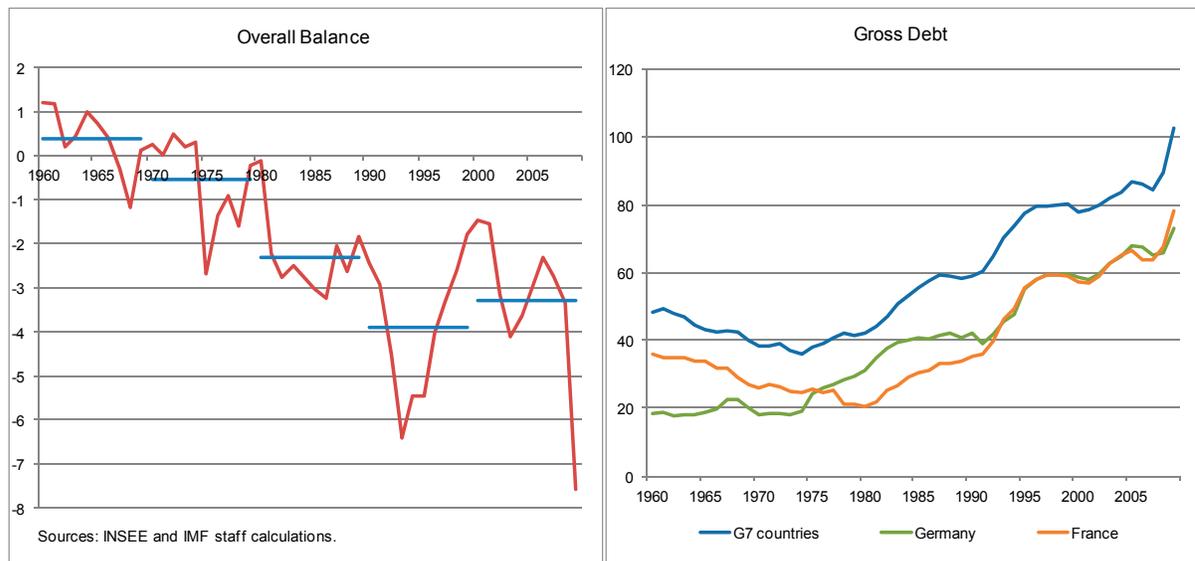
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## I. INTRODUCTION: FACTORS UNDERLYING THE NEED FOR FISCAL CONSOLIDATION

1. **Fiscal consolidation attempts have been motivated by continuous fiscal deficits and sustained increases in public indebtedness over the last 35 years** (Figure 1). The thirty years following World War II (“The Glorious Thirty” in the parlance of French economic history) were characterized by strong economic growth, broadly balanced budgets or small surpluses, and declining debt-to-GDP ratios. However, deficits averaged about 2 percent of GDP during the late 1970s and 1980s, and exceeded 3 percent of GDP on average in both the 1990s and 2000s. These continued deficits have contributed to an almost uninterrupted increase in debt ratios, from a post-war low of 20 percent of GDP in 1980 (when France had the lowest gross debt-to-GDP ratio among G7 countries) to more than 80 percent of GDP today.

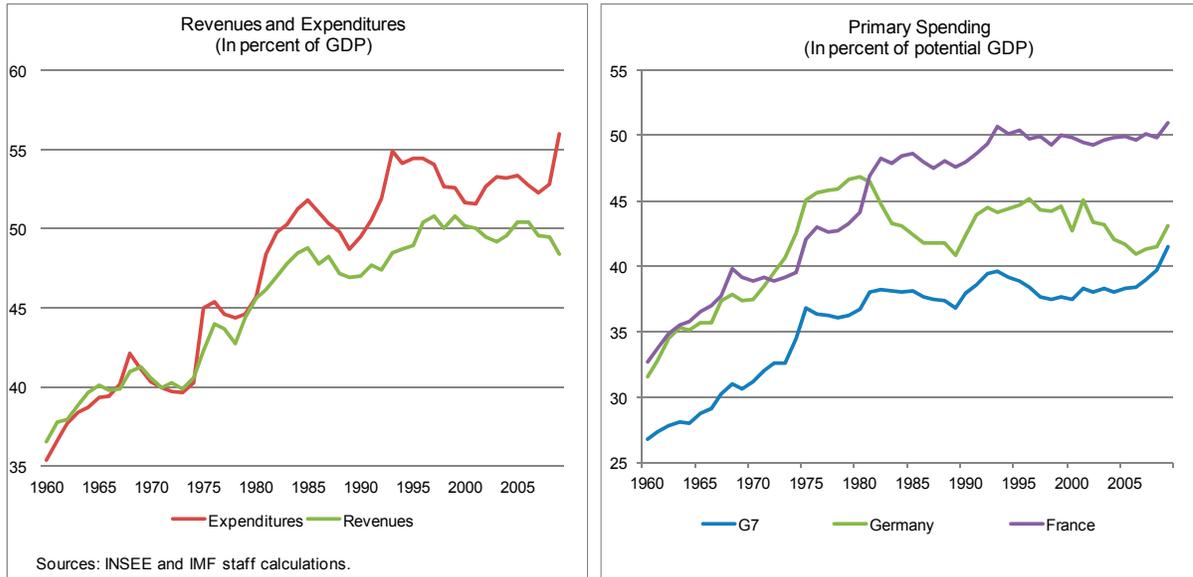
Figure 1. France: General Government Balance and Gross Debt, 1960–2009  
(In percent of GDP)



2. **France’s deficits and rising debt reflected a steep increase in general government expenditures not matched by higher revenues** (Figure 2). From the early 1960s to the mid 1990s, the spending-to-GDP ratio increased from 35 to 55 percent. While similar trends were at play in other G7 countries,<sup>3</sup> France had both the highest starting point in 1960 and largest increase in primary spending through the mid 1990s. As a result, in 1993 its primary spending-to-potential GDP ratio was, at 51 percent, 11 percentage points higher than the average of G7 countries. After more or less keeping pace with spending until the late 1970s—essentially through continued increases in social contributions—revenues then slowed down, before stabilizing at around 50 percent of GDP in the mid 1990s.

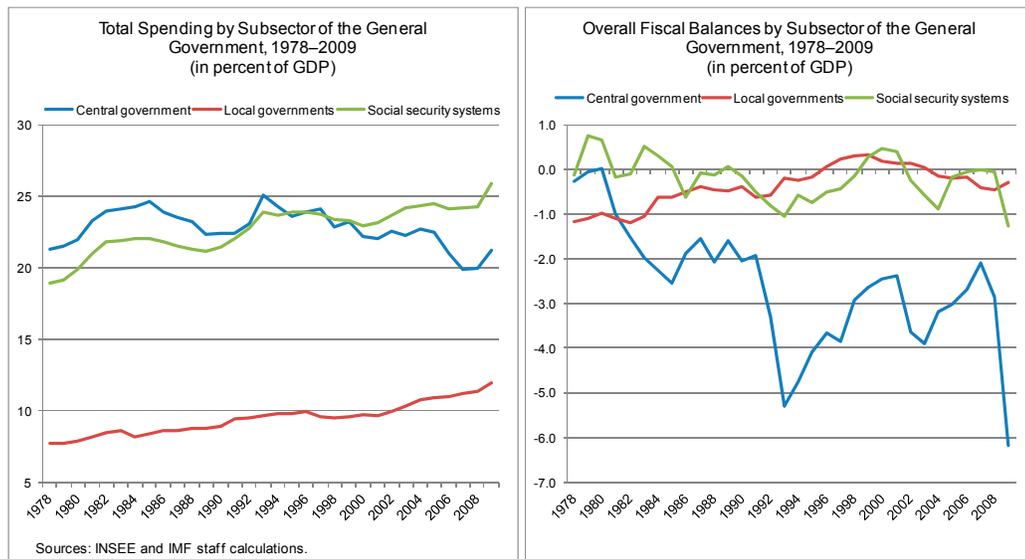
<sup>3</sup> For a recent reference, see Cottarelli and Schaechter (2010).

Figure 2. France: General Government Revenues and Expenditures, 1960–2009



3. **The rapid growth in general government spending reflected, in large part, rising expenditures by the social security administrations and by local governments.** The social transfers-to-GDP ratio doubled between the early 1960s and the mid 1990s, from 11½ to 23 percent, as a result of significant extensions of the social insurance system and a sustained increase in unemployment. Starting from the early 1980s, France embarked on a massive fiscal decentralization that shifted an increasing amount of responsibilities to the subnational levels of government (Box 1). Partly as a result, both the social security administrations and local governments have been operating under rather soft budget constraints and have relied on the growing amount of resources transferred from the central government. Consequently, their spending grew even as their deficits remained relatively contained (Figure 3).

Figure 3. France: Spending and Balances by Subsector of the General Government, 1960–2009



### **Box 1. Central Government, Social Security, and Local Governments**

France is often perceived as having a very centralized government; yet, from a budgetary perspective, the social security administrations and the four layers of local governments are quite independent from the central government. Indeed, by the Constitution, the social security administrations and local governments are given financial autonomy over their revenues and expenditures. These entities also follow budgetary processes separate from those of the central government, with annual budget laws for the social security administrations voted by parliament during separate sessions (until FY2011) and an independent budgetary process for local governments with a different timeline.

Since the early 1980s, France has implemented an important fiscal decentralization, shifting a large number of responsibilities from prefects representing the central state to the 22 regions, 96 departments, and over 36,000 communes and inter-communal cooperation establishments. As a result, local authorities have become responsible for an important share of public service provision, including three quarters of public investment. New responsibilities boosted the number of civil servants employed at the local level without any significant reduction of the central government size. (Only recently has the policy of nonreplacing every other retiring central government civil servant started to bear fruit, but the estimated elimination of about 30 thousand posts a year will take more than a decade to offset the additional 340 thousand hirings by local governments between 1995 and 2005.) Local governments are subject to a golden rule that requires funding all their operating expenditures out of their own revenue, about half of which comes from the central government in the form of financial transfers and various grants. The golden rule has proven effective to limiting local governments' indebtedness; however, this rule alone has not been sufficient to constrain the overall growth of public spending.

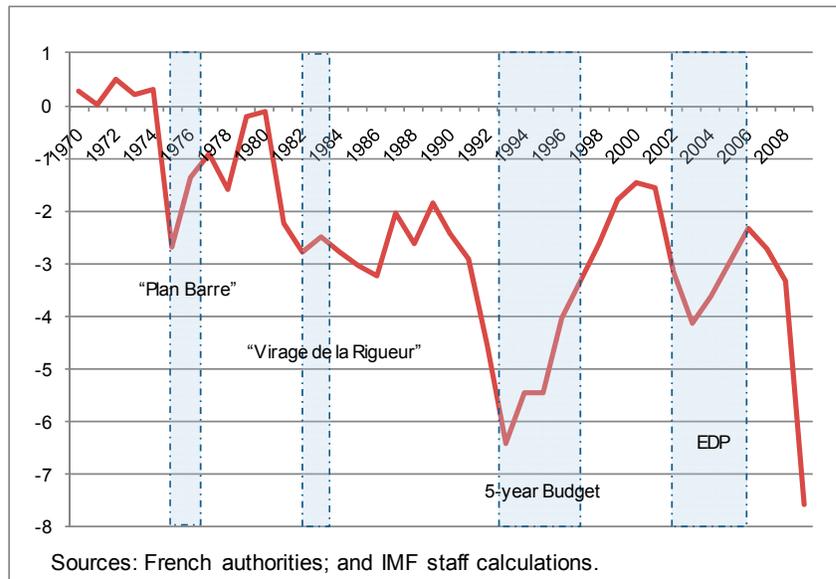
The French social security system—larger than the central government since 1998—includes 15 different administrations that manage four different regimes. The general regime covers about 80 percent of French citizens and divides up into four branches: retirement, health insurance, family income support, and workplace accident assistance. Retirement has become the biggest expenditure branch, at 12.5 percent of GDP in 2010; and health insurance spending amounts to over 11 percent of GDP, of which the social security system covers about three quarters. The complicated public-private ownership structure of the health insurance system severely limits the scope of the government control over healthcare spending. Social security spending is funded by a mixture of payroll contributions and earmarked taxes, the latter effectively shifting some of the funding costs to the central government. Since the early 1990s, a rapidly increasing share of different taxes (VAT, excises on alcohol and tobacco, and several others) saw their proceeds fully or partially earmarked for social security.

#### **4. Several fiscal consolidation attempts over the past three decades sought to stem the increase of public spending and help ensure macroeconomic sustainability**

(Figure 4). The most prominent plans, which usually followed sharp deteriorations of the fiscal balance, included the “*Plan Barre*” of 1976, the “*Virage de la Rigueur*” of 1983, the first five-year budgetary plan of 1993–97 prepared for EMU accession, and the Excessive Deficit Procedure (EDP) of 2003–07 under the Stability and Growth Pact (SGP). This paper will discuss briefly the first two episodes, and will focus on the two most recent ones, as they were cast in a multi-year budgetary framework.<sup>4</sup>

<sup>4</sup> Between 1986 and 1991, successive governments aimed at reducing the fiscal deficit. Those consolidation efforts were more limited (aiming on average at a structural adjustment of 0.2-0.3 percent of GDP a year) and did not result in a significant reduction of the deficit.

Figure 4. France: Attempts at Fiscal Consolidation 1970–2008  
(in percent of GDP)



5. The rest of the paper is organized as follows. Section II reviews the early attempts of fiscal adjustment. Section III analyzes the implementation of the 1994 Guidance Law for the Public Finances. Section IV assesses the implementation of the stability programs in the mid 2000s. Lastly, Section V draws some lessons from the consolidation attempts.

## II. EARLY ATTEMPTS AT FISCAL ADJUSTMENT

6. The first two prominent attempts at fiscal consolidation—*Plan Barre* of 1976 and *Virage de la Rigueur* of 1983—followed increases in fiscal deficits triggered by counter-cyclical policies in response to an economic slowdown. While partly reflecting fiscal sustainability considerations, these early adjustment plans were primarily motivated by demand management concerns in face of high inflation and deteriorating external current account balances. The impact of these early fiscal consolidation attempts, however, was limited in size and duration. Formalized medium-term fiscal consolidation attempts would begin only a decade later, in the first instance as part of the Maastricht process.

### A. The *Plan Barre*

7. **Counter-cyclical fiscal policies implemented to help the French economy recover from the 1974–75 recession led to a significant deterioration of the fiscal balance.** In 1974–75, the French economy, along with most OECD countries, experienced its first serious recession since the end of World War II. After giving priority to the fight against inflation during the first months of 1975, the authorities gradually geared the policy mix toward a more expansionary stance. In budgetary terms, this translated into successive plans to

stimulate the economy, including transfers to the least privileged social groups and to companies, subsidized loans to SMEs and exporters, incentives for investment (e.g., VAT deductions) and job creation, and increases in public investment and employment. These stimulus measures, combined with a cyclically induced decline in revenue, contributed to a significant deterioration of the fiscal balances in 1975 and the first half of 1976.

8. **Faced with higher inflation and a sharp deterioration in the external current account balance, the government adopted in September 1976 an austerity package, the *Plan Barre*.** On the fiscal side, this package aimed at ensuring that the initial 1976 budget objective of reducing the fiscal deficit would be met while providing for drought-related outlays. The plan also included a temporary surcharge on personal and corporate income taxes as well as increases in registration and fuel taxes. The budget for 1977, which aimed at bringing the central government balance back to equilibrium, provided for a further tightening of the fiscal stance, mainly through current and capital spending cuts partly offset by a cut of the VAT rate (from 20 percent to 17.6 percent).

9. **While not bringing the budget fully back to equilibrium, these efforts were effective in reducing the deficit.** Despite an increase in spending relative to GDP, the general government deficit declined from 2.7 percent of GDP in 1975 to 0.9 percent of 1977, mainly due to a significant increase in taxes and social security contributions. While consolidation efforts were suspended in 1978, they were renewed momentarily in 1979, when significant revenue measures—increase of the taxation of oil products and of social security contributions—contributed to a further reduction of the general government deficit in 1979 (to 0.2 percent of GDP).

### B. *The Virage de la Rigueur*

10. **Strongly expansionary domestic policies implemented in 1981 coupled with consolidation efforts carried out by partner countries led to a rapid increase in France's public debt, a large deterioration of its current account, and continued inflationary pressures** (Figure 4). France entered the 1980s in a relatively strong fiscal position, as fiscal surpluses in the early 1970s had been followed by limited deficits later in the decade. As a result, its fiscal deficits and public debt levels were significantly lower than in Germany and in the rest of the European Community. The government elected in mid-1981 carried out a strongly expansionary fiscal policy aimed at reducing unemployment. This policy combined counter-cyclical elements with a sizeable expansion of social programs and tax relief for lower income groups. The combination led in France to a sharp deterioration of the external current account and fiscal balances and to continued inflationary pressures, while failing to deliver the sought after reduction in unemployment. (France's fiscal stance contrasted with austerity programs implemented by its partner countries that were trying to deal with relatively high public debt levels.)

11. **Facing internal and external imbalances, the French authorities opted for a radical shift in policies in late 1982 and early 1983.** Reforms aimed at bringing the social security and unemployment insurance back into balance adopted in late 1982 and in the 1983 budget embodied a change in the fiscal policy stance. This was reinforced by measures announced in March 1983 as part of a broader adjustment program aimed at eliminating the trade deficit within two years and avoiding a further deterioration of the fiscal balance.<sup>5</sup> These measures included increases in taxes on households and oil products, the introduction of a new levy on personal incomes to finance the social security system, increases in public service charges, a compulsory savings scheme, and expenditure cuts. These efforts were pursued also in 1984, notably through the extension of revenue-raising measures and further spending restraint.

12. **Although these policies proved effective in reducing inflationary pressures and improving external balances, their impact on the fiscal deficit was more limited.** Reflecting in part the impact of the measures on domestic demand, the external current account deficit was virtually eliminated in 1984, from a deficit of 2.1 percent of GDP in 1982; and inflation declined from 12 percent to 7.7 percent over the same period. At the same time, the fiscal deficit declined only slightly because the structural improvement of the fiscal accounts was blunted by the adverse impact on revenue of the economic slowdown. Also, higher interest payments on the rapidly growing public debt more than offset modest consolidation efforts made by the local governments and social security administrations.

### III. A FIRST ATTEMPT AT MEDIUM-TERM FISCAL CONSOLIDATION, 1994–97

#### A. The 1994 Guidance Law for the Public Finances

13. **In response to a deterioration of the fiscal situation in the early 1990s, the authorities adopted in 1994 a five-year Guidance Law on Public Finance Control.** This law constituted an implementing tool of the convergence program presented jointly by France and Germany to the European Council (EC) in November 1993. In the case of France, this envisaged a reduction of the general government deficit from a projected 5½ percent of GDP in 1993 to 2 percent of GDP by 1997. The adoption of this law was triggered by: (i) a significant increase in the central government deficit from 1.4 percent of GDP in 1990 to 3.2 percent of GDP in 1992<sup>6</sup>; and (ii) an increase in the public debt to 30 percent of GDP in 1992 and in the debt service burden to 16 percent of government revenue in 1992 (compared to 12 percent in 1990).

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<sup>5</sup> The program also included a devaluation of the French franc, restrictions on spending abroad by French tourists, and the elimination of existing exchange control loopholes.

<sup>6</sup> In this section, “central government” refers solely to the portion of the central government that is covered by the budget laws and does not include other, off-budget central government units, whose spending amounts to roughly 3½ percent of GDP.

14. **The 1994 Guidance Law placed, for the first time, the central government budget in a multi-year framework and set the stabilization and then reduction of the public debt as the main objective of fiscal policy.** Meeting this objective was expected to deliver several benefits by: (i) creating fiscal space through debt service reduction; (ii) avoiding crowding out effects on private investment; (iii) allowing further declines in interest rates and eliminate the interest rate differential with Germany (setting fiscal policy in a medium-term framework was expected to increase investor confidence in government efforts to put its finances on a sustainable path); (iv) smoothing out the necessary accommodation of the projected increase in age-related spending from 2005 onward; and last but not least (v) putting France on a path toward meeting the fiscal criteria set forth under the Maastricht treaty for becoming a member of the European Monetary Union (overall budget deficit of less than 3 percent of GDP and public debt of less 60 percent of GDP in 1997).

15. **To help meet its overarching goal, the 1994 Guidance Law set a number of quantitative medium-term objectives** (Table 1). The central government deficit was to be brought back to 2½ percent of GDP by 1997. In turn, to help meet this objective, overall spending was projected to remain unchanged in real terms (given the expected increase in interest payments, this was consistent with a 0.4 percent annual decline in real primary spending).<sup>7</sup> Revenues (including privatization receipts) were projected to grow in real terms by 2.8 percent per year over 1995–97, on average, in line with real GDP.<sup>8</sup> Any additional revenues from better-than-expected economic developments were to be saved or used for a reduction of the tax burden. To ensure that the Maastricht fiscal deficit criteria, which relate to the general government, would be met, the law also provided for a gradual improvement in local government and social security financial positions, whose accounts were projected to be balanced by 1997. Finally, the law also called for future central government budgets to be set in a multi-year framework, with annual draft budget laws to be accompanied by five-year budgetary projections.

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<sup>7</sup> In line with French budgetary accounting rules, the transfer of resources to other government subsectors and to the EU are not included in the spending targets but rather are netted out from gross revenue.

<sup>8</sup> These projections were somewhat more optimistic than the consensus forecast, which, in the fall of 1993, expected real GDP growth to average 2½ percent per year over 1995-97.

Table 1. France: Quatitative Objectives of the 1994 Guidance Law

	1993 Suppl. budget	1994 Init. Budget law	1995 Proj.	1996 Proj.	1997 Proj.
(in current FF billion in 1993-94, and 1994 FF billion thereafter)					
Total spending	1,432	1,448	1,448	1,448	1,448
Debt service	176	185	193	198	201
Primary spending	1,256	1,263	1,255	1,250	1,247
Revenue (net)	1,114	1,148	1,181	1,215	1,248
Overall balance	-317.6	-299.7	-266.7	-232.9	-199.8
(in percent of GDP)	-4.5	-4.1	-3.5	-3.0	-2.5
Memorandum items:	(growth rates, in percent)				
Total spending		1.1	0.0	0.0	0.0
Debt service		5.1	4.2	2.7	1.5
Primary spending		0.5	-0.6	-0.4	-0.2
Revenue (net)		3.0	2.9	2.8	2.7

Source: 1994 Guidance Law for the Public Finances.

### B. A Mixed Start: 1994–95

16. **The 1994 budget law was consistent with the objectives set forth in the 1994 Guidance Law.** The annual budget law called for a ½ percent of GDP decline in the central government deficit, to be attained by restraining spending, which was projected to decline in real terms on account of a reduction in the number of civil servants, wage moderation, a substantial decline in investment spending, and a reduction in the growth of transfers to local governments. The annual budget also envisaged a slight decline of the tax burden, primarily through a reform of personal income taxation. Lastly, privatization receipts, which were at that time accounted for as revenue, were projected at FF 50 billion (0.7 percent of GDP).

17. **The 1994 deficit turned out to be in line with budgetary objectives, but underlying spending was significantly higher than planned.** Contrary to what was stipulated under the 1994 Guidance Law and in line with a supplementary budget adopted subsequently, additional revenues resulting from higher-than-projected growth were used for additional expenditures, including increases in school allowances, social spending, labor market measures, and peace-keeping operations.

18. **The pattern of ex-ante expenditure restraint and ex-post spending overruns continued in 1995.** The annual budget law provided for a further decline in the deficit to 3½ percent of GDP (including privatization receipts), based primarily on expenditure restraint and increases in excises. Spending was expected to stay flat in real terms on account of real declines in transfers to local governments, unemployment benefits (owing to a recovering labor market), and capital spending. However, the Alain Juppé government

formed after the May 1995 presidential elections adopted a supplementary budget with additional spending in support of employment, the social housing sector, and small and medium enterprises. These outlays, along with spending overruns observed during the first half of the year, were to be offset by temporary increases in taxes (mainly the VAT, CIT and wealth tax) and savings on non-priority spending. But an economic slowdown in the second half of 1995 further weakened revenue collections, and the original fiscal deficit target was met only by the undertaking of new measures, including expenditure cuts and the mobilization of additional nontax revenue, as part of another supplementary budget adopted in November.

### C. Expenditure Restraint, at Last: 1996–97

19. **The 1996 budget law was accompanied by an updated medium-term budget plan, which reiterated the government’s commitment to deficit reductions through expenditure restraint.** The updated plan covered 1996-99 and, in line with the original plan, aimed at a gradual reduction of the deficit, from 4.1 percent of GDP (excluding privatization receipts) in 1995 to 3 percent in 1997 and 2 percent in 1999.<sup>9</sup> Again, the adjustment was to be achieved by keeping spending constant in real terms and maintaining the tax-to-GDP ratio unchanged.

20. **Expenditures were successfully restrained in 1996.** The authorities contained expenditure growth through a mix of further declines in capital spending, a stability pact with local governments aimed at moderating central government transfers, a freeze of the pay scale of public sector employees, and cuts in defense spending and social transfers.

21. **However, to meet the Maastricht fiscal deficit criterion, the authorities had to take corrective measures in 1997.** Faced with a cyclical shortfall in revenue and difficulties in meeting the annual budget law objective of keeping spending unchanged in nominal terms, the Lionel Jospin government formed after the May 1997 parliamentary elections commissioned a public finance audit. This audit projected the general government deficit at 3½–3¾ percent of GDP based on unchanged policies. Consistent with its strong commitment to meet the Maastricht fiscal deficit criterion, the government adopted a corrective plan providing for an exceptional increase in the corporate income tax, the abolition of the preferential rate on long-term corporate capital gains, and additional expenditure cuts.

### D. Overall Performance

22. **Although significant fiscal consolidation was accomplished, the central government deficit was not reduced as much as envisaged** (Table 2 and Figure 5). Including privatization receipts, the fiscal deficit declined by 1.2 percent of GDP between

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<sup>9</sup> Unlike in the original plan, which recorded privatization receipts as above-the-line revenue, the updated plan included privatization receipts as part of financing in line with the Maastricht definition.

1993 and 1997, some 0.8 percent of GDP less than initially planned.<sup>10</sup> This underperformance resulted from higher-than-planned increases in spending, both primary spending (about 0.7 percent of GDP) and interest payments (0.4 percent of GDP),<sup>11</sup> lower nontax revenue (0.2 percent of GDP), and lower-than-expected economic growth (which contributed to an increase in the deficit-to-GDP ratio of 0.2 percent). These spending slippages were only partly offset by an increase in central government tax revenue (0.5 percent of GDP), which reflected both an increase in taxes collected by the central government and a decline in the share of tax revenues redistributed to other levels of government. Higher-than-projected deficits and real interest rates well above economic growth led the debt-to-GDP ratio to increase more than planned, to 44 percent of GDP in 1997 (instead of the targeted 42 percent of GDP).

Table 2. France: 1994 Guidance Law Targets and Outcomes  
(In percent of GDP)

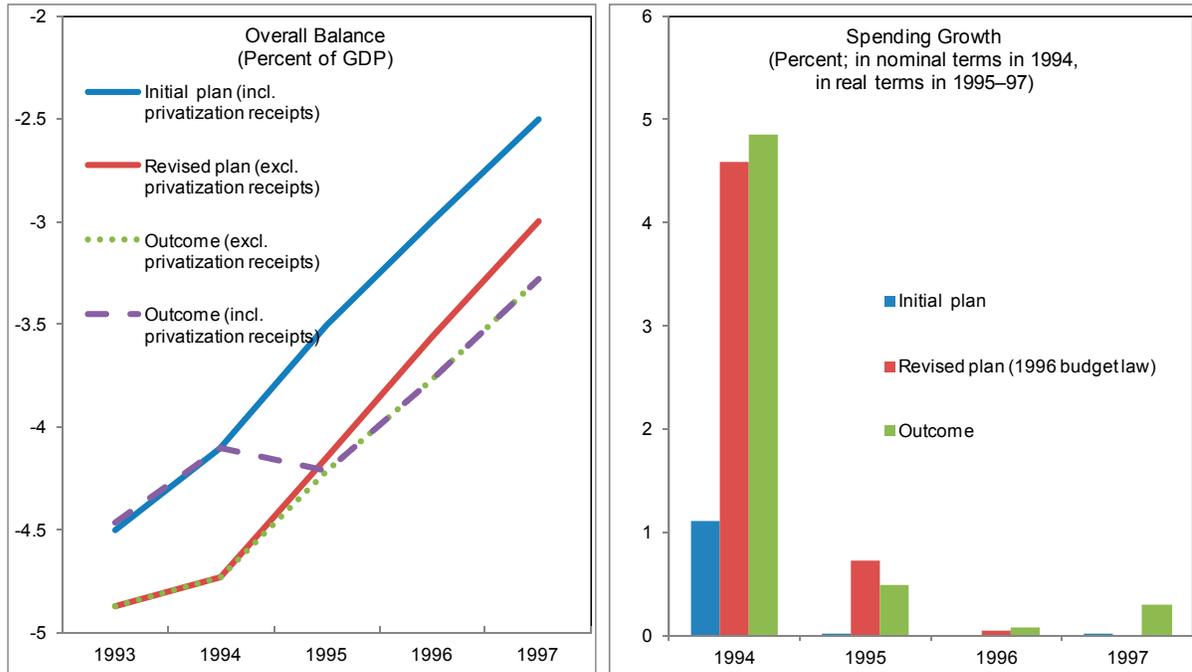
	Plan(p)			Actual(a)			Overperformance (actual relative to plan)		
	1993p	1997p	$\Delta p$	1993a	1997a	$\Delta a$	1997a-1997p = 1997 actual <i>minus</i> 1997 planned	$\Delta a - \Delta p$ = Actual improvement <i>minus</i> planned improvement	1993a-1993p = 1993 actual <i>minus</i> 1993 preliminary estimate from plan ("base effect")
Revenues	15.7	15.7	-0.1	15.7	16.0	0.3	0.4	0.4	0.0
Cyclical	-0.7	-0.5	0.2	-0.6	-0.5	0.1	0.0	-0.1	0.1
Structural	16.5	16.2	-0.3	16.4	16.6	0.2	0.4	0.5	-0.1
Expenditures	20.2	18.2	-2.0	20.2	19.3	-0.9	-1.1	-1.2	0.0
Primary	17.7	15.6	-2.1	17.9	16.6	-1.4	-0.9	-0.7	-0.2
Interest	2.5	2.5	0.0	2.3	2.7	0.5	-0.2	-0.4	0.2
Overall balance	-4.5	-2.5	2.0	-4.5	-3.3	1.2	-0.8	-0.8	0.0
Primary balance	-2.0	0.0	2.0	-2.2	-0.5	1.7	-0.6	-0.4	-0.2
Structural primary balance	-1.3	0.5	1.8	-1.6	0.0	1.6	-0.5	-0.2	-0.3

Sources: 1994 Guidance Law for the Public Finances; French Ministry of Finance; and IMF staff estimates.

<sup>10</sup> Excluding privatization receipts, the deficit declined by 1.6 percent of GDP.

<sup>11</sup> Higher-than-expected primary spending reflected primarily the dynamism of the compensation of employees, pensions, and economic transfers; capital spending declined significantly.

Figure 5. France: 1994 Guidance Law Targets and Outcomes for the Central Government



Sources: French government; and IMF staff calculations.

23. **The general government deficit was under 3 percent of GDP and the Maastricht fiscal deficit criterion was met in 1997.** Four main factors contributed to this success. First, the initial plan aimed at a reduction of the general government deficit to 2 percent of GDP, thus leaving significant margin for meeting the Maastricht target. Second, the improvement of local government accounts was larger than expected, and they registered a surplus of 0.2 percent of GDP in 1997. Third, last-minute mobilization of one-off payments from France Telecom contributed to additional revenue of about ½ percent of GDP. Lastly, some statistical changes, introduced primarily to bring the French accounting system in line with European standards, contributed to a further reduction of the estimated deficit. At the same time, the far-reaching reform of the social security system adopted in 1996 contributed to a 0.6 percent of GDP reduction of its deficit, but this improvement was insufficient to bring the social security accounts to balance as initially envisaged.

24. **The comparison above of plan targets with outcomes illustrates both the usefulness of and institutional limits to France's first attempt at medium-term budgeting** (Box 2). As the quantitative objectives of the 1994 Guidance Law were not legally binding, there was considerable discretion in the conduct of fiscal policy (at least as long as the overall deficit stayed on a declining path). Moreover, in the absence of binding limits on spending growth, the government did not fully embrace expenditure restraint, especially when revenues were higher than envisaged. At the same time, the French government spared no efforts to comply with Maastricht pre-requisites for Euro entry.

## **Box 2. From Economic Planning to Multi-Year Budgeting**

**During the post-war period, five-year economic plans provided a framework for setting medium-term policies.** These plans, required under the Constitution, set a number of economic and social objectives, as well as an overall strategy ensuring the consistency of the policies of different economic actors. While these plans were indicative and had no binding legal status, the main actors of the private and public sectors were involved, as part of the national planning commission, in their preparation, ensuring broad ownership of their objectives.

**The connection between five-year plans and annual budgets was, however, somewhat loose.** In budgetary terms, the five-year plans primarily focused on setting priorities for public investment and fiscal incentives, which represent only a small share of government spending. Also, as these plans were only indicative, short-term considerations often took precedence over the attainment of longer-term objectives, as became notably the case when the economic outlook deteriorated in the 1970s. A 1982 law on economic planning tried to strengthen the linkage between five-year plans and annual budgets through better monitoring and reporting of the implementation of the plans and the budgetary resources allocated to the attainment of their objectives, but limited progress was made toward linking planning and budgeting in practice.

**In the context of the Stability and Growth Pact (SGP) and the 2001 Organic Budget Law, the introduction of a medium-term budget framework (MTBF) provided a credible link between medium-term planning and short-term fiscal policy making.** In line with SGP guidelines, since 1998 the government has prepared annual MTBFs comprising: (i) a medium-term target for the general government balance; (ii) an annual path toward this objective, which has to be consistent with a ½ percent of GDP annual improvement in the structural balance (as long as the medium-term target has not been met); (iii) key economic assumptions; (iv) a description of fiscal and structural measures envisaged; and (v) a sensitivity analysis. The 2001 Organic Budget Law also calls for the inclusion of MTBFs in the Economic, Social, and Financial Reports annexed to annual budget laws.

**Yet, the existence of medium-term targets did not prove to be a binding constraint.** A 2007 report by the *Inspection Générale des Finances* concluded that multi-year programming had not been respected, notably because of slippages on the spending side, and identified two major contributing factors: (i) MTBFs were prepared mainly to satisfy the SGP requirements and had no direct link with annual budget preparation procedures; and (ii) MTBFs were not supported by operational targets that would allow the achievement of public finance objectives. The report also noted that spending norms only applied to the state budget, representing about 40 percent of the general government spending.

**To tackle these weaknesses, the government introduced multi-year budgeting in 2008.** This new model of budgeting, which started being implemented with the 2009 budget, drew heavily upon the [UK Spending Review](#). It was characterized by: (i) a “2+1” approach, according to which expenditure ceilings are set for three years but reviewed every two years; (ii) the fact that only central government spending is covered; (iii) the breakdown of the overall three-year ceilings into 32 sub-ceilings along with an indicative ceiling on tax expenditures; and (iv) contingency reserves amounting to 1 percent of central government spending by the third year of programming. In addition, the legal status of medium-term budgeting was strengthened: multi-year budgets are presented to parliament for discussion and approval, along with the annual budget laws.

#### IV. A MORE SYSTEMATIC APPROACH TO MEDIUM-TERM BUDGETING: CONSOLIDATION EXPERIENCES UNDER THE SGP

25. **France issued a total of twelve annual stability programs (SPs) over 1998–2009, of which six envisaged reductions in the overall fiscal deficit of more than ½ percent of GDP per year in the context of excessive deficit procedures (EDPs).** The first episode of significant planned fiscal consolidation included the five SPs submitted from 2003 to 2007 that aimed to reduce the general government deficit below 3 percent of GDP, thus terminating EDPs. The second episode is ongoing and includes the recent SP submitted in January 2010 that targets a large reduction in the overall fiscal deficit under EDPs opened in February 2009. Both planned consolidation episodes followed economic downturns and significant deteriorations in the public finances. As the second episode is still unfolding, in what follows the focus will be on the 2003–07 episode.

##### A. The Fiscal Consolidation Experience of 2003–07

26. **SP targets were occasionally missed during this period, but France ultimately succeeded in reducing the fiscal deficit below 3 percent of GDP.**<sup>12</sup> The 2003 SP was submitted on December 11, 2003, shortly after the excessive deficit statement from the Council on June 3. It constituted the key fiscal adjustment plan during this episode.<sup>13</sup> The fiscal deficit dipped only slightly below 3 percent of GDP by 2005 thanks, in part, to one-off receipts. It then remained just below the SGP ceiling during the global economic boom of 2005–07, before the recent global financial crisis put France’s public finances under severe pressure again (Figure 6 and Table 3).

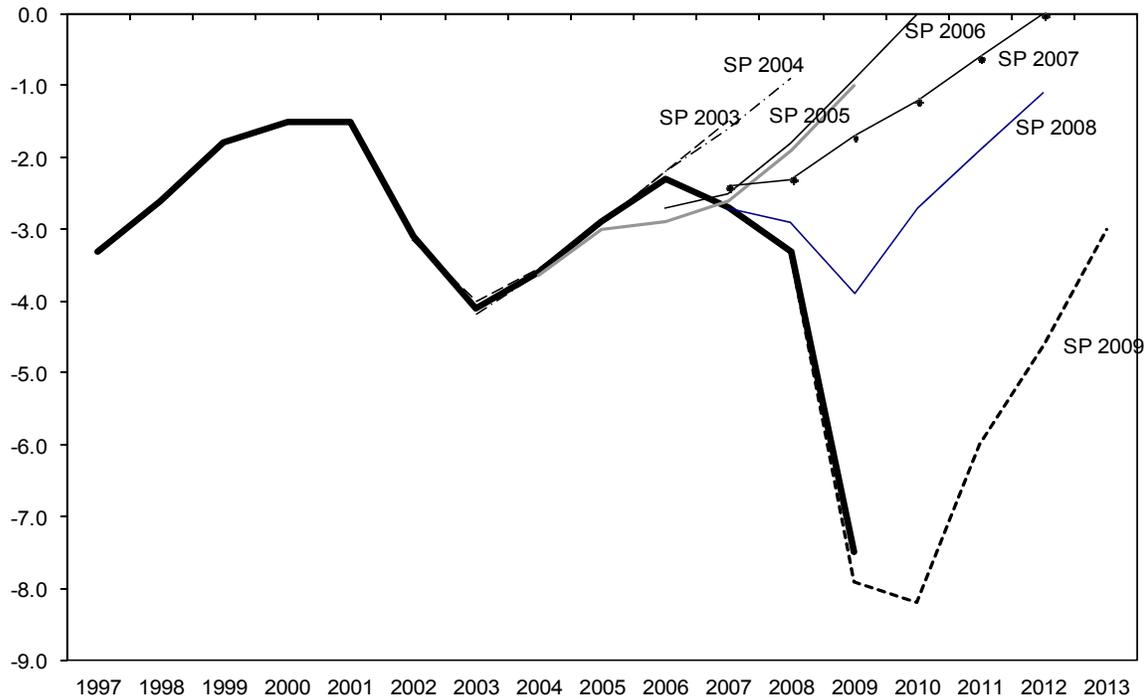
27. **Fiscal adjustment focused on expenditure control, with revenue-to-GDP ratios targeted to remain broadly stable, so as not to constrain GDP growth.** Key adjustment measures included a legally binding zero real growth rule for central government spending (Box 3), as well as significant health and pension reforms. To help meet the requirement of bringing the deficit below 3 percent of GDP in 2005, the 2003 SP set more ambitious spending targets than its predecessors. Yet, the program envisaged reducing the deficit only marginally below the Maastricht fiscal deficit target and, therefore, was vulnerable to adverse macroeconomic and budgetary developments.

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<sup>12</sup> Note, however, that SP targets were frequently missed in many countries (see Moulin and Wierds, 2006 and European Commission, 2007).

<sup>13</sup> The 2003 SP was followed by SPs in 2004 and 2005 that contained updated fiscal targets for the outer years of this consolidation episode.

Figure 6. France: Central Government Balance—Stability Program Targets and Outcomes  
(In percent of GDP)



Sources: Stability Programs, WEO database, and IMF staff calculations.

Table 3. General Government Balance: Targets and Outcomes  
(In percent of GDP)

	2004	2005	2006	2007	2008	2009
<b>Actual</b>	<b>-3.6</b>	<b>-2.9</b>	<b>-2.3</b>	<b>-2.7</b>	<b>-3.3</b>	<b>-7.5</b>
SP 2003	-3.6	-2.9	-2.2	-1.5		
SP 2004		-2.9	-2.2	-1.6	-0.9	
SP 2005			-2.9	-2.6	-1.9	-1.0
SP 2006				-2.5	-1.8	-0.9
SP 2007					-2.3	-1.7
SP 2008						-3.9

### Box 3. The Evolution of Fiscal Rules in France

Until the early 1990s, the French authorities relied mainly on a simple budgetary rule, defining a nominal deficit target on a year-ahead basis, independently of the subsequent performance of the economy and, therefore, independently of revenues. This rule required, in effect, expenditures to be reduced in line with falling revenues in a downswing, and increased expenditure (or tax cuts) during an upswing of the economy. From 1998 onward, medium-term expenditure targets were set at the general government level as part of the stability programs. These initial targets were missed due both to the lack of consistency between the annual budget laws and these medium-term objectives and to spending slippages in the implementation of the budget laws (Moulin, 2004).

The authorities adopted in 2003 a “zero volume growth” spending rule in annual budget laws. This rule essentially states that central government expenditures (until 2008, excluding transfers to other government subsectors and the EU) should remain constant in real terms. This rule was instrumental to restraining central government spending. But it did not prevent slippages at the local government and social security levels. In fact, some argue that this may have contributed to a loosening of the local government budgetary constraint (Champsaur, 2010).

Trying to address this issue, the government recently broadened the scope of the zero volume growth spending rule to encompass revenue transfers to local governments and the EU, as well as earmarked revenue for quasi-fiscal activities by nongovernmental entities. Implementation of this rule in 2009 was mixed, even abstracting from stimulus measures (*Commission des Finances du Sénat*, 2010).

The focus of the fiscal rules on spending rather than revenues has contributed to the proliferation of tax exemptions leading to an erosion of the tax base. The government recently committed to a sizable reduction in excessive tax deductions and strictly limited the introduction of new tax exemptions.

28. **Spending overruns were partly offset by favorable economic developments and one-off receipts.** To assess the relative contributions of economic developments and fiscal effort to the overall fiscal adjustment performance, implementation relative to SP targets is decomposed into: (i) cyclically-adjusted revenues and primary expenditures; (ii) interest spending; and (iii) cyclical balances (Box 4). This decomposition shows that underperformance in the 2003 SP was associated entirely with structural shortfalls (Table 4, and Figure 8). Indeed, the 2007 structural primary balance fell short of target by 2.5 percent of GDP (1.8 percent excluding base effects), while the overall balance underperformed by 1.2 percent of GDP (1.1 percent excluding base effects), with the difference reflecting overperformance of cyclical revenues and interest expenditures owing, respectively, to strong growth and low interest rates during the program period (Box 5).

### Box 4. A Method of Decomposing Program Implementation

Implementation relative to SP targets can be decomposed into components corresponding to cyclically-adjusted revenues and primary expenditures, interest spending, and cyclical balances, as follows:

$$(b_t^A - b_t^T) = (r_t^A - r_t^T) - (g_t^A - g_t^T) - (i_t^A - i_t^T) \\ = [(r_t^{A,S} - r_t^{T,S}) - (g_t^{A,S} - g_t^{T,S})] + [(r_t^{A,C} - r_t^{T,C}) - (g_t^{A,C} - g_t^{T,C})] - (i_t^A - i_t^T),$$

where b, r, g, and i stand, respectively, for the overall balance, revenues, primary expenditures, and interest spending (all relative to GDP), superscripts refer to actual (A), target (T), cyclical (C), and cyclically-adjusted (S), and subscripts denote years. Cyclically-adjusted revenues and primary expenditures are expressed as:1/

$$(r_t^{A,S} - r_t^{T,S}) = [r_t^A(1 - gap^A)^{\varepsilon_r} - r_t^T(1 - gap^T)^{\varepsilon_r}] \cong [r_t^A(1 - \varepsilon_r gap^A) - r_t^T(1 - \varepsilon_r gap^T)] \\ (g_t^{A,S} - g_t^{T,S}) = [g_t^A(1 - gap^A)^{\varepsilon_g} - g_t^T(1 - gap^T)^{\varepsilon_g}] \cong [g_t^A(1 - \varepsilon_g gap^A) - g_t^T(1 - \varepsilon_g gap^T)]$$

where  $gap^A = \frac{Y^A - Y^*}{Y^A}$  and  $gap^T = \frac{Y^T - Y^*}{Y^T}$  refer to, respectively, actual and target output gaps relative to GDP, while  $\varepsilon_r$  and  $\varepsilon_g$  denote elasticities of revenue and primary expenditure, respectively. For France, the standard revenue elasticity of 1 and the primary expenditure elasticity of 0 are appropriate, in line with recent estimates by the OECD and the European Commission. 2/

1/ See Fedelino, Ivanova, and Horton (2009) for a description of the cyclical adjustment methodology.

2/ See European Commission (2005) and Girouard and André (2005).

Table 4. France: General Government Targets and Outcomes—Stability Program 2003  
(In percent of GDP)

	Plan(p)			Actual(a)			Overperformance (actual relative to plan)		
	2003p	2007p	$\Delta p$	2003a	2007a	$\Delta a$	2007a-2007p = 2007 actual minus 2007 planned	$\Delta a - \Delta p$ = Actual improvement minus planned improvement	2003a-2003p = 2003 actual minus 2003 preliminary estimate from plan ("base effect")
Revenues	50.3	50.3	0.0	49.2	49.6	0.4	-0.7	0.4	-1.1
Cyclical	-0.3	-0.3	-0.1	0.1	0.5	0.5	0.8	0.5	0.3
Structural	50.6	50.6	0.1	49.1	49.0	0.0	-1.6	-0.1	-1.5
Expenditures	54.3	51.8	-2.5	53.3	52.3	-1.0	-0.5	-1.5	1.0
Primary	51.2	48.7	-2.5	50.4	49.6	-0.8	-0.9	-1.7	0.8
Interest	3.1	3.1	0.0	2.8	2.7	-0.1	0.4	0.1	0.3
Overall balance	-4.0	-1.5	2.5	-4.1	-2.7	1.4	-1.2	-1.1	-0.1
Primary balance	-0.9	1.6	2.5	-1.3	0.0	1.2	-1.6	-1.3	-0.4
Structural primary balance	-0.6	1.9	2.6	-1.4	-0.6	0.8	-2.5	-1.8	-0.7

### Box 5. Macroeconomic Assumptions

French SPs have typically included two scenarios: a cautious, or low, reference scenario with real GDP growth of 2¼ - 2½ percent per year, and a favorable, or high, scenario with real GDP growth of 3 percent per year. In most of the past SPs, even the reference scenario was somewhat optimistic in comparison to the consensus forecast (CF) published ahead of SPs and covering similar time horizons. That said, reference growth assumptions in the 2003 SP were close to CF and those in the SPs of 2004 and 2005 were only marginally higher. In practice, growth was somewhat underestimated in 2004 and overestimated in 2005, while over 2006-07 projections turned out close to actual growth rates.

Real GDP Growth: SP Targets, CF Forecasts, and Outcomes  
(In percent)

	2004	2005	2006	2007	2008	2009
Actual	2.3	1.9	2.4	2.3	0.1	-2.5
CF 2003	1.6	2.4	2.6	2.5		
SP 2003	1.7	2.5	2.5	2.5		
CF 2004		2.2	2.2	2.3	2.3	
SP 2004		2.5	2.5	2.5	2.5	
CF 2005			1.8	2.1	2.1	2.1
SP 2005			2.3	2.3	2.3	2.3

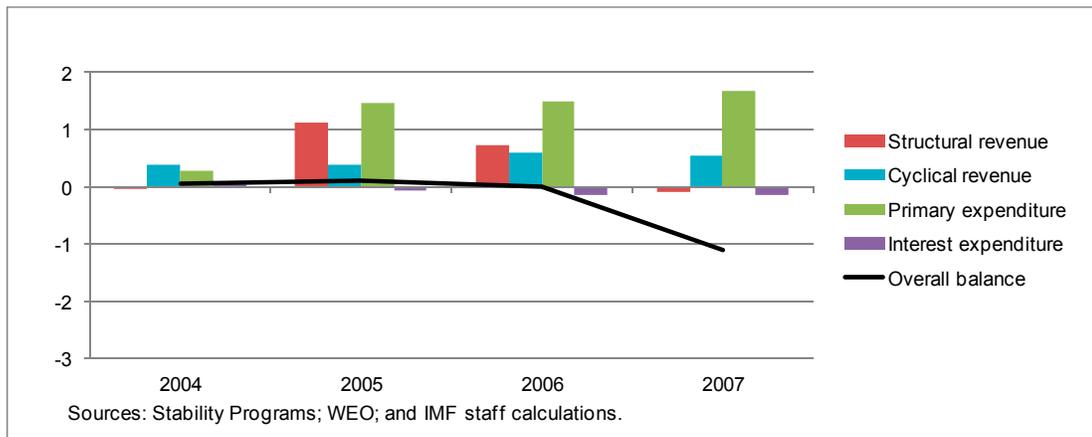
Although consolidation efforts under the 2003–07 EDP did not rely on very conservative growth assumptions, they benefited from the favorable economic environment at the time. Notably, while the SPs of 2003–05 assumed negative output gaps throughout the program periods, actual output gaps were positive over 2004–07.

<sup>1/</sup> Optimistic biases in growth assumptions that underlie fiscal projections have been identified in a number of countries under the SGP (Jonung and Larch, 2004, and Strauch, Hallerberg, and von Hagen, 2004).

29. **Although the deficit fell substantially short of target only in the last year of the program, spending overran targets also in the preceding years.** Prior to 2007 spending overruns happened to be offset by buoyant cyclical revenues and low debt service costs, as well as temporarily higher cyclically-adjusted revenues in 2005 and 2006 (Figure 7). In these two years, tax elasticities turned out somewhat higher than usual thanks to the buoyant economy and sizable one-off receipts. Notably, to meet the Council requirement of reducing the deficit under 3 percent of GDP in 2005, the government utilized one-off receipts from the electricity and gas industries in the amount of ½ percent of GDP. At the same time, a number of tax cuts were implemented in 2006 and 2007, most notably within the framework of the income tax reform of 2007. As for spending, the primary expenditure ratio was close to target (net of base effects) only in 2004, the first program year also covered by the concurrent budget law.<sup>14</sup>

<sup>14</sup> SP2004, while broadly similar to SP2003 in terms of the overall deficit goals and implementation, contained somewhat less stringent spending targets, but set higher targets for revenues. SP2005 relaxed the deficit targets considerably, presumably because by then the requirement of bringing the deficit below 3 percent of GDP in 2005 was essentially met.

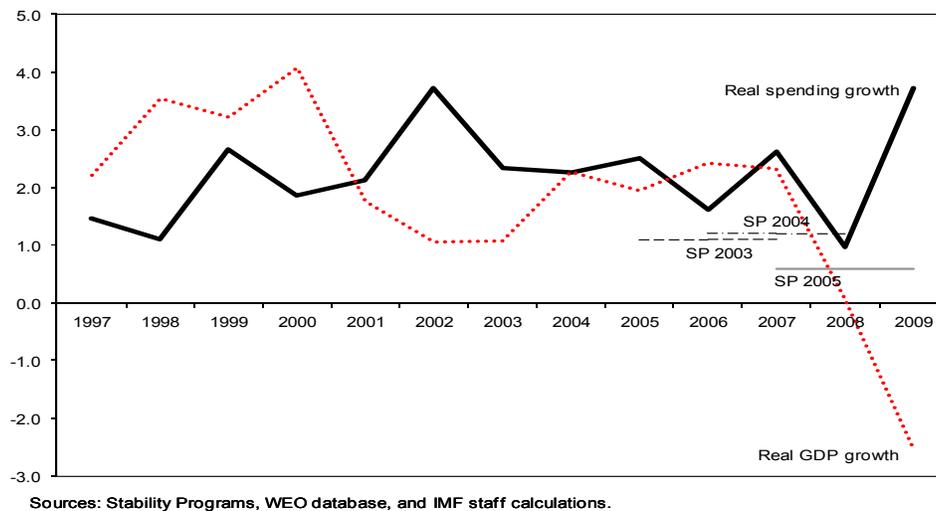
Figure 7. General Government Program Implementation: Actual minus Target ,  
Stability Program 2003  
(In percent of GDP, net of base effects)



### B. A Closer Look at Spending by Levels of Government

30. **Spending overruns at the general government level were the main obstacle to successful consolidation under the 2003–07 EDP.** The rate of growth of general government spending showed few signs of diminishing during this consolidation episode (Figure 8). As noted above, spending overruns would have been even more detrimental, if not for strong GDP growth. Indeed, although real spending growth of the general government exceeded SP targets, it remained close to or even dipped below real GDP growth from 2004 to 2007.<sup>15</sup>

Figure 8. France: General Government Real Spending Growth: Stability Program Targets and Outcomes (In percent)



<sup>15</sup> Real spending growth is obtained from nominal expenditures using CPI minus tobacco as deflator.

31. **Spending overruns mostly reflected slippages by local governments and social security administrations** (Table 5). SPs targeted average annual real spending growth at all government levels.<sup>16</sup> During the 2003–07 EDP consolidation episode, central government (CG) spending and social security (SS) spending each accounted for close to 40 percent of general government (GG) expenditure, with local government (LG) spending taking up 20 percent. Both local governments and social security administrations spent in excess of their respective targets during this episode, with overruns by local governments being especially large. However, since the share of local governments in general government expenditure was lower than that of social security administrations, their overruns accounted for broadly similar shares of the total general government overspending over the SPs of 2003, 2004, and 2005, on average. In contrast, spending restraint by the central government helped compensate a portion of these overruns, although these comparisons are complicated by inter-governmental transfers.

Table 5. Real Spending Growth by Levels of Government: Targets and Outcomes (In percent)

	GG	CG	LG	SS
SP2003 Targets for 2005-07	1.1	0.3	2.0	1.7
<b>SP2003 Outcomes for 2005-07</b>	<b>2.2</b>	<b>-1.5</b>	<b>4.3</b>	<b>2.6</b>
SP2004 Targets for 2006-08	1.2	0.2	1.8	1.7
<b>SP2004 Outcomes for 2006-08</b>	<b>1.7</b>	<b>-1.9</b>	<b>3.6</b>	<b>1.8</b>
SP2005 Targets for 2007-09	0.6	0.0	0.5	0.9
<b>SP2005 Outcomes for 2007-09</b>	<b>2.4</b>	<b>0.7</b>	<b>3.3</b>	<b>2.8</b>

32. **The central government was bound by a zero real spending growth rule and managed to slow down and eventually reduce its spending in real terms** (Figure 9). That said, the rule is set in budgetary accounting terms, which exclude the bulk of transfers to local governments that are part of central government spending in national accounting terms. Overall, transfers to other levels of government account for over 20 percent of central government spending and reflect, in part, transfers of responsibility from the central government to other administrations.

33. **Local government spending grew rapidly and always exceeded SP targets over the course of the 2003–07 EDP.** Approximately half of the total local government spending was taken up by operating expenditures, a quarter went into various transfers, and another quarter consisted of investment—a key responsibility of local administrations. According to the golden rule imposed on local governments, they must fund operating expenditures out of

<sup>16</sup> The average annual real spending growth targets were set for three years. Specifically, in the 2003 SP, targets were set for 2005-07, in the 2004 SP for 2006-08, and in the 2005 SP for 2007-09. Outcomes are computed for the corresponding years. The central government targets are reported in national accounting terms, as different from real spending growth rules set in budgetary accounting terms (*Commission des Finances du Sénat*, 2010).

their own revenue, about half of which comes from the central government in the form of financial transfers and various grants.<sup>17</sup>

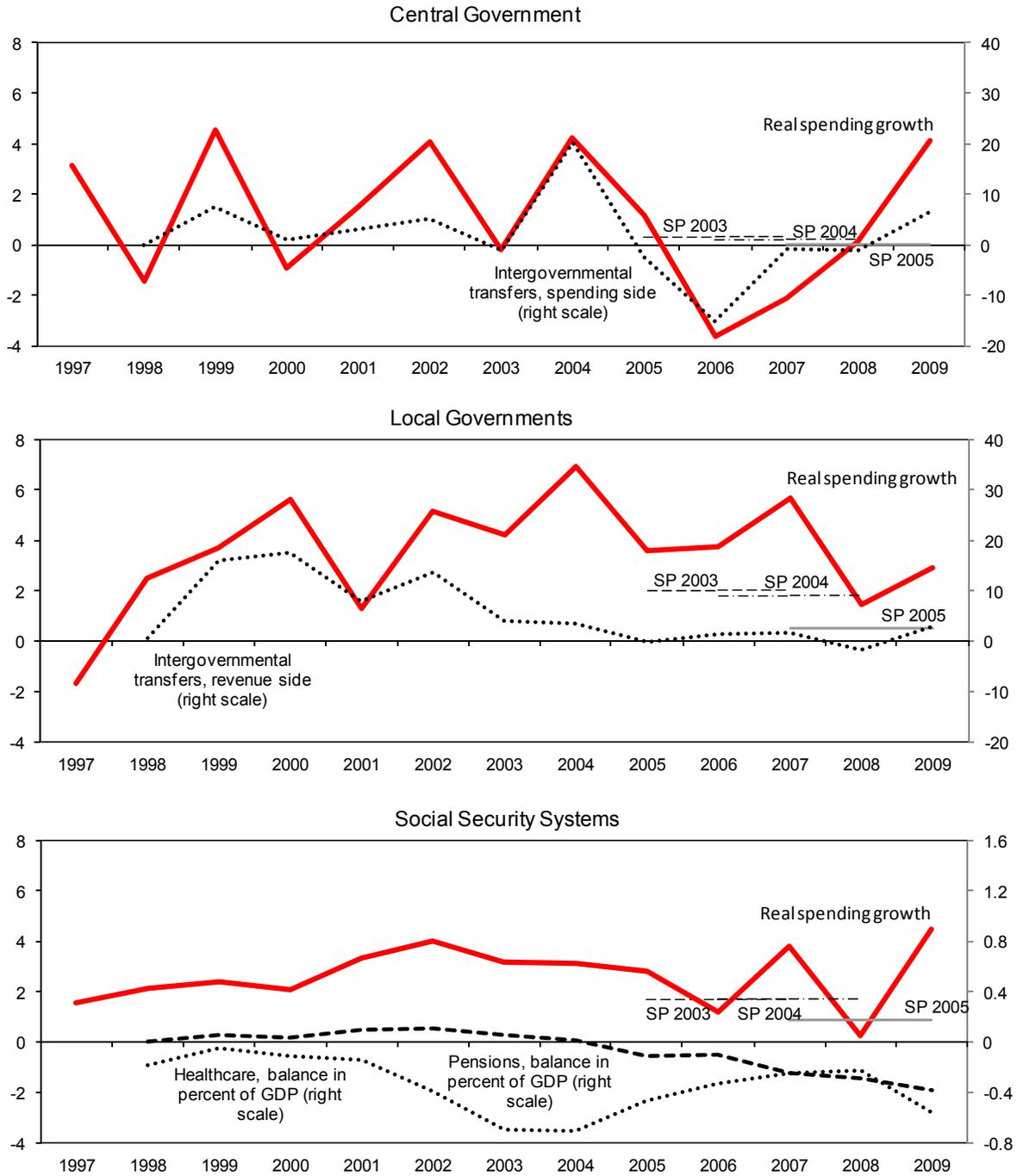
34. **Social security spending also frequently overshoot SP targets.** About half of the total social security spending goes into pensions, a third is allocated to healthcare, and the rest is split up among unemployment, family, and housing support. The healthcare branch was in chronic deficits during the past decade, and the retirement branch moved into deficit over the last five years (see Figure 9). That said, social security spending overruns were associated also with other branches of the system, notably unemployment support.<sup>18</sup>

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<sup>17</sup> Transfers to local governments shown in Figure 10 are a subset of total transfers.

<sup>18</sup> See, for example, *Commission des Finances du Sénat* (2010).

Figure 9. Real Spending Growth by Government Levels: Stability Program Targets and Outcomes (In percent)



Source: Stability Programs, INSEE, Direction de la Sécurité sociale, and IMF staff calculations.

## V. CONCLUDING REMARKS

35. **This study assessed past fiscal consolidation plans and their outcomes in France.** First, it discussed the early attempts at fiscal consolidation in the 1970s and the 1980s (*Plan Barre* and *Virage de la Rigueur*) that were primarily motivated by demand management needs and suffered from the lack of medium-term budgetary planning. Second, the study analyzed the first episode of medium-term fiscal consolidation in 1994–97 that allowed France to meet the fiscal criteria of the Maastricht treaty and to join the European Economic and Monetary Union. Although significant consolidation was accomplished during this episode, institutional limits—the absence of binding quantitative objectives and limits on spending growth—hindered the implementation of the plan. Third, the study assessed the fiscal consolidation under the corrective arm of the European Stability and Growth Pact in 2003–07. Although, as a result of this consolidation, France succeeded in terminating the excessive deficit procedure, the absence of binding constraints on spending of local governments and social security administrations was a key obstacle along the way.

36. **The analyses of past fiscal consolidations in France suggest the following lessons:**

- Binding constraints help focus policymakers' attention and justify their actions vis-à-vis the public at large. In successful fiscal consolidation episodes, the authorities were ready to do what it takes in order to meet Maastricht fiscal criteria or exit from excessive deficit procedures. In this vein, the recent introduction of multi-year budgeting bodes well for the future.
- Fiscal consolidation is facilitated when spending restraint is shared and consolidation efforts are coordinated across all levels of government. In the fiscal adjustment episodes studied in this paper, the inability of the government to fully meet its objectives resulted primarily from higher-than-planned increases in spending, often by local governments and social security administrations even when progress was made at the central government level.
- Appropriate binding deficit targets could help in enforcing budgetary discipline in good times. Under the SGP, the 3 percent of GDP requirement for the fiscal deficit was viewed as a target when it should have been seen as a ceiling. In light of this misplaced emphasis, France missed a very good opportunity to consolidate the fiscal accounts further in the boom years of 2005–07 which, in turn, would have given the authorities more fiscal room to deal with the recent global financial crisis.

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