

## WHAT CAN WE EXPECT FROM THE NEW GOVERNMENT IN 2007?

€# Over the next three months, significant tax measures are expected to be adopted, whose financial impact will hardly be felt until the end of the year. First on the list is the income- and payroll-tax exemption on overtime work. This measure is meant to increase the demand for work by companies (by lowering the cost of overtime worked by current employees and the average cost of creating a new position that is subject to overtime hours) as well as the supply of work by employees (by raising net overtime wages), in particular in sectors that are undergoing labour shortages. In addition to its structural impact, the tax relief created by this measure (which will be technically difficult to implement), will result in an income transfer to companies and, above all, to the concerned employees (including employees who would have worked overtime even without the measure). This should provide a short-term boost to demand.

€# The other measures will also boost purchasing power, including the deduction from the assessed income of mortgage interest payments on primary residences, exemptions from inheritance tax, a 50% "tax shield" (i.e., no one's taxes would amount to more than 50% of his/her income). Hence, high-net-worth individuals, who had left France or who would have been tempted to do so, will now be encouraged to stay. And the real-estate market, which was expected to slacken off, will get a short term boost.

€# Six "societal summits" will be held during the third quarter, on topics ranging from equal salaries for men and women, to the environment, to job salaries. In addition, the following measures may lead up to essential reforms in the public sector: i) the reorganisation of ministerial portfolios; ii) the financial package to boost R&D and higher education, along with a modification in governance; and iii) announced savings targets on public spending and the only partial replacement of retiring public-sector workers. All in all, this is an outline of the structural reforms needed to raise the potential growth rate and cope with the ageing of the French population.

€# As a result of the planned tax measures, particularly in the full-year 2008, and since the targeted savings will only show up gradually, public-sector deficit reduction will have to take a back seat for a while. The deficit could even approach 2.7% of GDP in 2007 and 2008, after almost hitting 2.5% in 2006. Such a shift would set France off from other major EMU countries.

### MAIN LIKELY ECONOMIC MEASURES OF THE FILLON'S GOVERNMENT

*Ex ante* impact  
on current  
account balance  
(full-year basis)

#### FIRST TAX MEASURES

Amended Finance Law (Summer 2007)	The four hours worked beyond the legal limit of 35 hours per week will be at least overpaid by 25%; they will be exempted from payroll tax (both employer-paid and employee-paid) as well as from income tax.	-€4.6bn
	Deductibility from the assessed income of mortgage interest payments on primary residences.	-€2.5bn
	"Tax shield" limiting tax bills to 50% of income at January 1st, 2008, for taxes paid in 2007.	-€3bn
	Deduction of wealth tax in 2008 up to €50,000 invested in a smaller company.	-€3bn
	Exemption from estate taxes and taxes on intra-family asset transfers for low and medium-net-worth individuals (the case of 95% of the French population).	-€3bn
	Tax exemption on student jobs.	

#### "SOCIETAL SUMMITS" IN THE COMING MONTHS

Purchasing power and salaries (June)	- Collective, sector-based bargaining of wage hikes. - Linking tax exemptions to companies' employee remuneration policies.
"Peoples' summits" (September)	1- Equal salaries for men and women. 2- Flexicurity and professional social benefits programmes: a single work contract, a new public jobs agency. 3- Improved working conditions and measures against workplace stress. 4- "Social democracy" and trade-union representation.
Environment (October)	A "green summit" aiming, among other things, at setting up a system of environmental taxation that acts as both an incentive and a deterrent.

#### MEASURES FROM 2008 ONWARDS

*Ex ante* impact  
on current  
account balance

		Timeframe	
Finance Law for 2008 and following years	- Corporate tax-relief: - Environmental taxation (green tax credit). - Expansion of research tax credit for smaller companies (SMEs and SMIs). - Research, higher education. - Education. - Non-replacement of one out of two retiring public-sector workers. - Other and non-specified savings.	2008	-€1bn
			-€0.5bn
		} Legislative session	-€9bn
			-€2.6bn
			+€5bn
Social benefits	- Family benefit payment for the first child. - Establishment of a insurance deductible for medical services. - Establishment of a fifth social benefits branch, to replace the current national autonomy and solidarity fund (CNSA). - Reform of special pension systems. - Elimination of early retirement plans.	2008 2008	-€2bn
			+€3bn
		} Legislative session	-€3.5bn
			+€3.5bn
			+€5bn

*Sources:* Presidential platform, Press release by Xavier Bertrand et Rachida Dati, February 16th, 2007; Interview with Nicolas Sarkozy in *Le Monde*, January 23rd, 2007; Interview with Eric Woerth in *Les Échos*, May 25th, 2007, Intervention of N. Sarkozy in *Le Havre*, May 29th, 2007

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