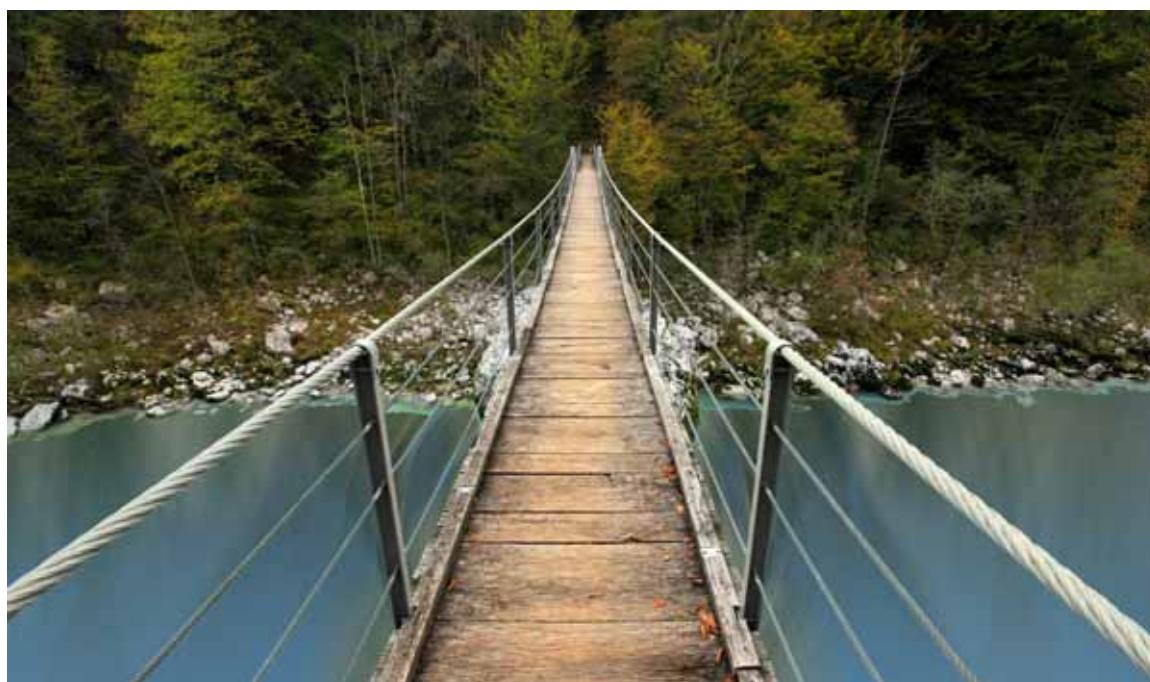


## Yearly report of audit on France's public finances situation & prospects

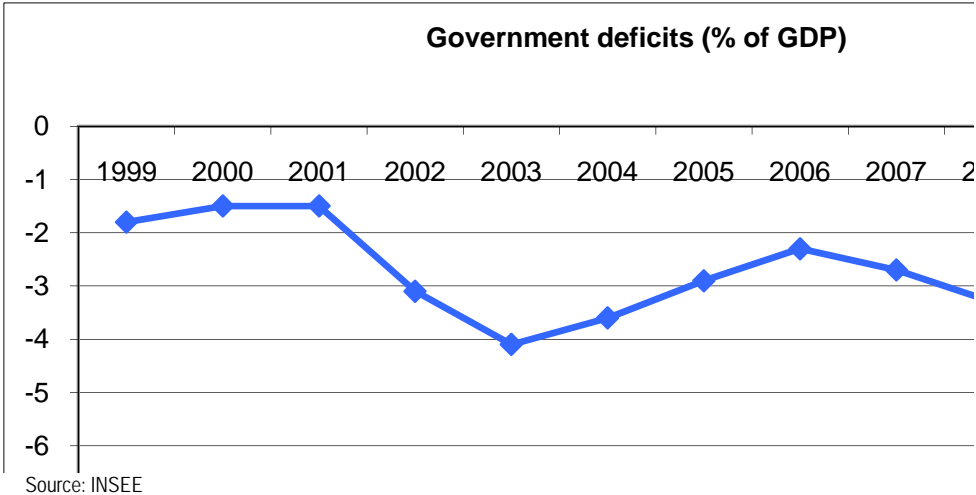


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# 1- A continued high deficit in 2010

The government deficit declined slightly in 2010, to 7.1 percent of GDP, after peaking at an exceptional 7.5 percent of GDP in 2009. The primary deficit amounted to 4.5 percent of GDP.



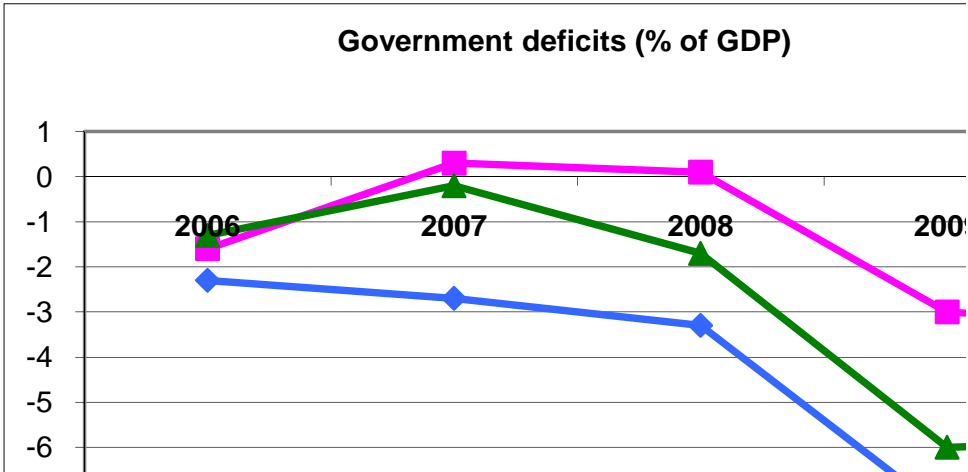
The impact of a decline in the cost of recovery measures was partly offset by the cancellation of the business tax (*taxe professionnelle*). The "Investments for the Future" (*Investissements d'avenir*) program had almost no effect on the 2010 deficit, as spending is deferred to future years.

## Factors accounting for the decline in the deficit (% of GDP)

<b>Decline in deficit</b>	<b>- 0.4</b>
Reduction in the cost of recovery measures	- 0.7
Tax cuts (mainly reform of the business tax)	+ 0.4
Investments for the Future (in national accounts)	0
Other factors	- 0.1

Source: Cour des Comptes

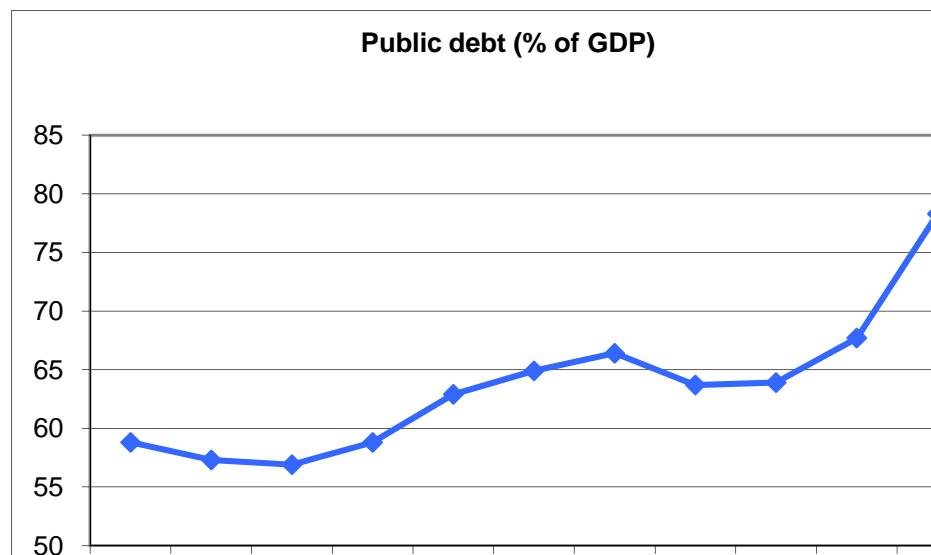
France's 2010 deficit again exceeded those of other countries in the eurozone (5.8 percent of GDP on average in other euro area countries and 3.3 percent in Germany)



Source: Eurostat, Cour des Comptes

## 2 - A growing public debt

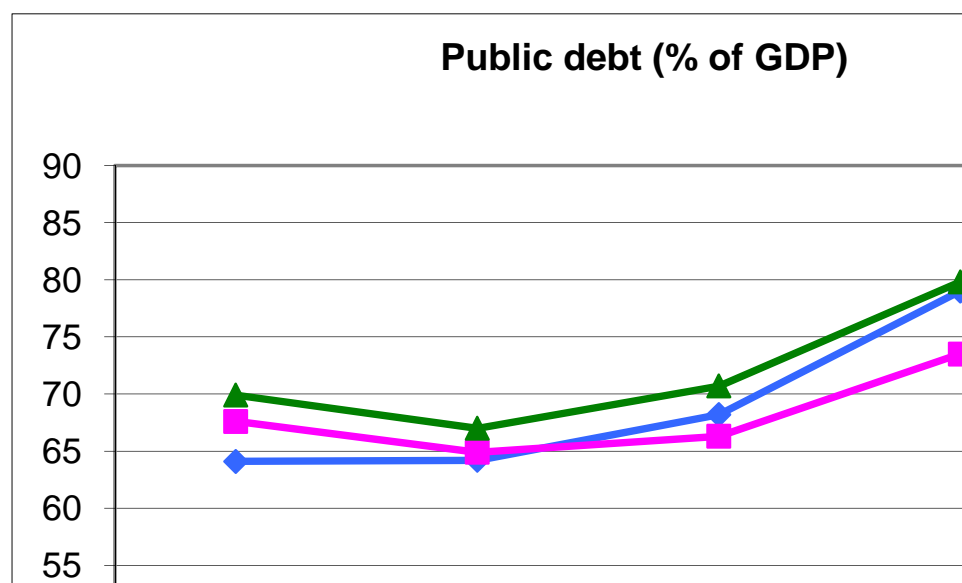
The public debt continued to increase, reaching almost 1,600 billion euros at the end of 2010 (the equivalent of **82.3 percent of GDP** or €62,000 per employed person). Interest on the debt topped €50 billion, the equivalent of the combined "defense" and "labour and employment" budgets.



Source: INSEE

The 2010 debt increase was higher in other eurozone countries than in France, even in those which had smaller deficits, as several governments borrowed heavily to support their banks (13.4 GDP points in Germany at the end of 2010, compared with 0.1 points in France).

With France's deficit expected to remain high, its debt could exceed Germany's as early as 2011.

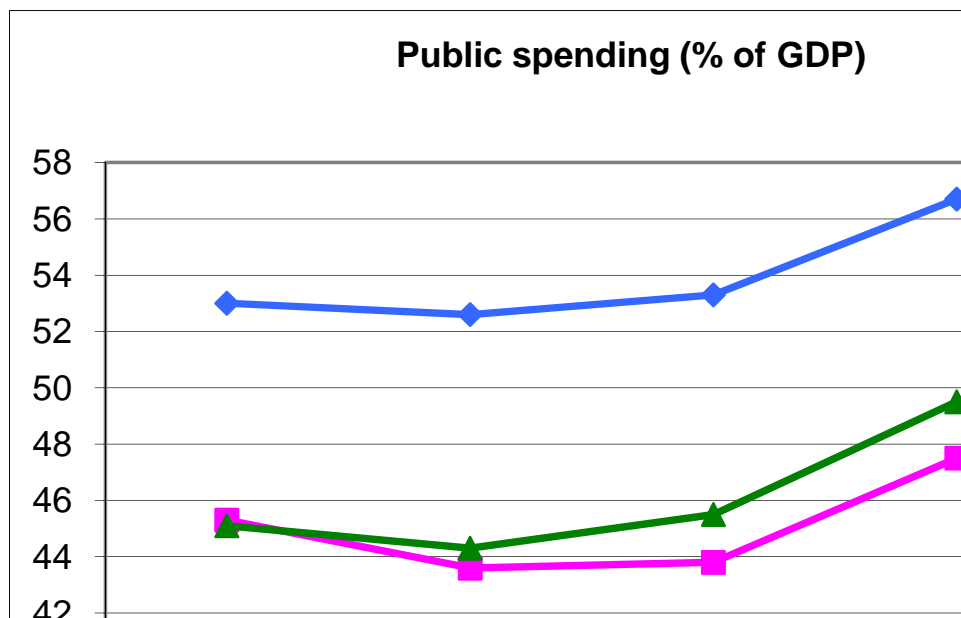


Source: Eurostat, Cour des Comptes

### 3 - Less spending but lower revenues due to tax cuts

#### Public spending

Public spending increased at a slower pace in 2010. However, it is significantly lower on average in other European countries, where spending declined more sharply in 2010.



Source: Eurostat, Cour des Comptes

Two-thirds of the slowdown in public spending in France resulted from a reduction in spending by local and regional authorities, including capital investment. Growth in spending for social security benefits was also held down.

#### Public revenues

The shortcomings of the government information system make it difficult to measure accurately the cost of replacing the business tax with other taxes, although it can be estimated at about €8 billion in 2010 for the general government.

It is still too early to measure how much the tax reform will cost once it becomes permanent and, accordingly, to estimate its extra cost for 2010 in relation to its cost over time.

The other changes in taxes and social security contributions had little or no overall impact and, in the aggregate, tax receipts fell by 0.4 GDP percentage points.

## 4 – A €100-billion structural deficit

**Structural deficit** already amounted to 3.7 percent of GDP in 2007, before the recession, reflecting the country's inability for more than 30 years to soundly manage its finances.

The **structural effort** measures how two factors over which the government has significant control contribute to structural deficits. These factors are new tax measures and increases in public spending. The effort **had a negative overall impact of 0.8 GDP points in 2008 and 2009. In 2010, that impact was virtually nil**, as the effect of a cut in spending (of 0.5 points) was almost entirely offset by tax cuts (0.4 points).

Other factors, such as the elasticity of taxes in relation to GDP or changes in non-tax revenues, further aggravated the structural deficit by 0.5 GDP points from 2007 through 2010, as that deficit is calculated by the European Commission.

In aggregate, after a further small increase in 2010, the structural deficit amounted to about **5 percent of GDP** (4.9 percent of GDP if the cost of the recovery plan is deducted and 5.2 percent otherwise).

Even considering that tax elasticity and changes in non-tax revenues depend on economic conditions, **the recession and the steps taken in its wake (recovery plan) only accounted for 38 percent of the deficit in 2010.**

### Breakdown of 2010 deficit (in % of GDP)

2010 structural deficit excl. cost of recovery plan: <b>4.9</b>	Structural deficit reported in 2007 inherited from previous years	<b>3.7</b>	Impact of recession on 2010 deficit: <b>2.7</b>
	Negative structural effort in 2008-2010	<b>0.7</b>	
	Other factors (tax elasticity, non-tax revenues, etc.)	<b>0.5</b>	
Cost of recovery plan in 2010	<b>0.3</b>		
Cyclical deficit	<b>1.9</b>		
Public deficit in 2010	<b>7.1</b>		

Source: Cour des Comptes, based on European Commission data.

France's structural deficit is higher than the average for other eurozone countries (4.2 percent of GDP) and the European Union as a whole (4.6 percent), including Germany's (2.2 percent). The size of France's structural deficit explains why its actual deficit, as well as its primary deficit, is higher than those of many other countries.

### Public deficit or surplus in 2010

	France	Germany	United Kingdom	Italy	Spain	Sweden
Actual	- 7.1	- 3.3	-10.4	-4.6	-9.2	0
Primary	- 4.5	- 0.9	- 7.4	- 0.1	- 7.3	+ 0.7
Structural	- 5.2	-2.2	- 8.2	- 2.9	-7.0	+ 1.4

Source: European Commission; recovery measures not deducted from primary deficits.

## 5 – A deteriorating trend in public sector companies

If the financial position of commercial public sector companies deteriorates, even though they are not government entities, this could expose the government, as their shareholder, to the risk that they may **need to be recapitalized or to receive reduced dividend payments**. Excluding banks and financial institutions, their total debt amounts to approximately 6 percent of GDP.

Changes in their financial position during the recession were examined on the basis of their combined financial statements prepared by the French Government Shareholding Agency (APE)<sup>1</sup>.

These show a **considerable worsening of their financial position between 2007 and 2010**.

### Combined financial statements of public sector companies

	Operating margin (%)	Return on equity (%)	Net debt / EBITDA <sup>2</sup>
2007	12.9	20.6	2.8
2010	8.2	6.8	3.7

Source: Cour des Comptes, based on data provided by the French Government Shareholding Agency (estimates for 2010).

The financial position of large private sector companies also worsened significantly between 2007 and 2009, but their results seem to have improved in 2010, whereas those of public sector companies have continued to worsen.

The equity of public sector companies is roughly equal to their debt, so that the risk of major recapitalization is limited, although this average ratio may fail to reveal more serious, individual situations.

Those companies need to turn their situation around if they are to continue to be able to invest.

They have kept paying hefty dividends to the government by distributing a growing portion of their earnings (more than 55 percent in 2010 and 2011, from less than 40 percent earlier). **If their financial position does not improve, the government cannot expect additional revenues from their dividend payments.**

<sup>1</sup> The Banque de France and the Caisse des Dépôts et Consignations are not included in the combined financial statements.

<sup>2</sup> Earnings before interest, taxes, depreciation and amortization expenses.  
Press Kit – 6/22/2010

## 6 – Most of the deficit results from the government budget and the general social security system

### Public surpluses and deficits

In national accounting, State surpluses and deficits and those of other government bodies (ODAC)<sup>3</sup>, must be combined in order to neutralize the large and extensive transfers of funds between them (including appropriations to agencies in charge of Investments for the Future in 2010). Their aggregate deficit declined in 2010, as did that of regional and local authorities. On the other hand, the funding needs of social security administrations have increased.

The public deficit resulted primarily from the State government's budget (deficits generated by other bodies being far smaller) and social security administrations (ASSO). The general social security budget deficit alone is equal to that of all social welfare administrations combined.

#### Public deficits by category of government entity in 2010 (percent of GDP)

	State + ODAC	Social security administrations	Regional and local authorities	General Government
2009	- 6.4	- 0.8	- 0.3	- 7.5
2010	- 5.8	- 1.2	- 0.1	- 7.1

Source: INSEE

### Structural surpluses and deficits

The entire structural deficit of public authorities (APU), excluding the cost of the recovery plan, is attributable to the State and the ODAC bodies.

Local public authorities (APUL) have a small structural surplus.

Social security administrations (ASSO) report a slight deficit, although that aggregate fails to show the wide disparities that exist among them. The CADES fund for the reimbursement of social security debt has a structural surplus, while the other social security administrations have deficits. In particular, the general system has a structural deficit that is equal to 0.7 percent of GDP, for which there is no justification.

#### Structural deficits by category of government entity in 2010 (percent of GDP)

APU (General Government)	State. + ODAC	APUL (local authorities)	ASSO social security administrations	<i>Of which: ASSO net of CADES</i>	<i>Of which: General Soc. Sec. budget</i>
- 4.9	- 4.9	+ 0.1	- 0.1	- 0.4	- 0.7

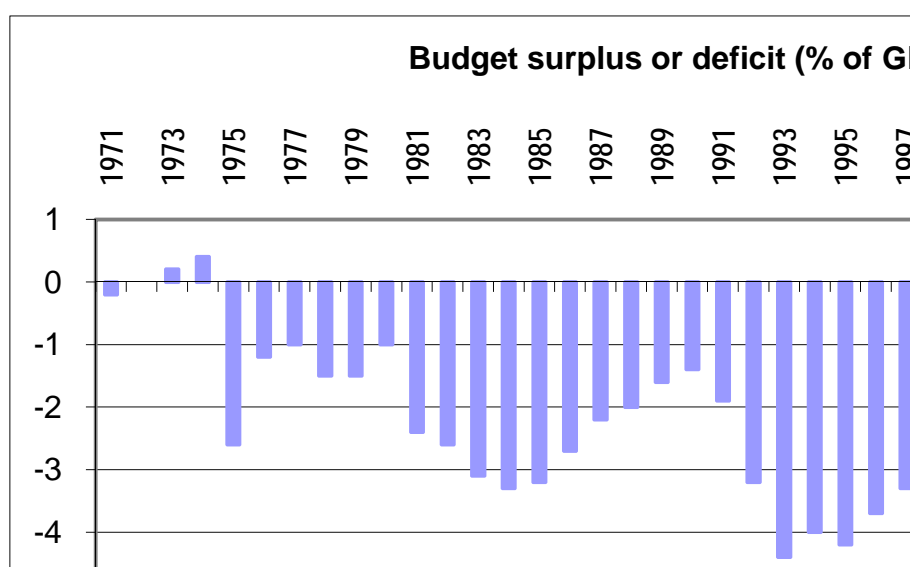
Source: Cour des Comptes

<sup>3</sup> The ODAC encompasses more than 800 bodies of various kinds, primarily non-commercial and controlled by the State.

## 7- Significantly impaired State finances

Excluding Investments for the Future, the State had a deficit of 110 to 115 billion euros, depending on the accounting system used (general accounting, budget or national accounts).

Appropriations to entities in charge of “investing for the future” added almost 35 billion euros to the 2010 budget deficit, although there were almost no actual expenditure and no new debt was incurred. The government did not include those appropriations when applying the “zero volume” norm on spending, because of their exceptionally high amount. However, the Cour des Comptes recommends that these appropriations be added back to the budget as and when expenditure occurs.



Source: Cour des Comptes, in budget accounting (exclusive of Investments for the Future in 2010).

**The spending norm was not complied with**, even though interest costs were lower than anticipated. The savings on interest costs made it possible to repay some of the government's debt, as the Cour des Comptes had recommended, but also to increase budget appropriations in other areas.

The government's total payroll, exclusive of pension funding, increased by 0.7 percent in value in 2010 and exceeded the original budget appropriation voted under the original budget by €0.5 billion.

**The cost of the recovery plan exceeded the original budget by some 20 percent over the 2009-2010 period, although it fell sharply in 2010**, especially its tax component, and the expense effectively turned out to be temporary, i.e. it was limited to the years 2009 and 2010.

**The growth in the cost of tax expenditures continued but was kept in check.** It represented 27 percent of net tax revenues in 2010, up from 18 percent in 2004. Had that ratio remained unchanged, the government would have taken in €23 billion more in 2010.

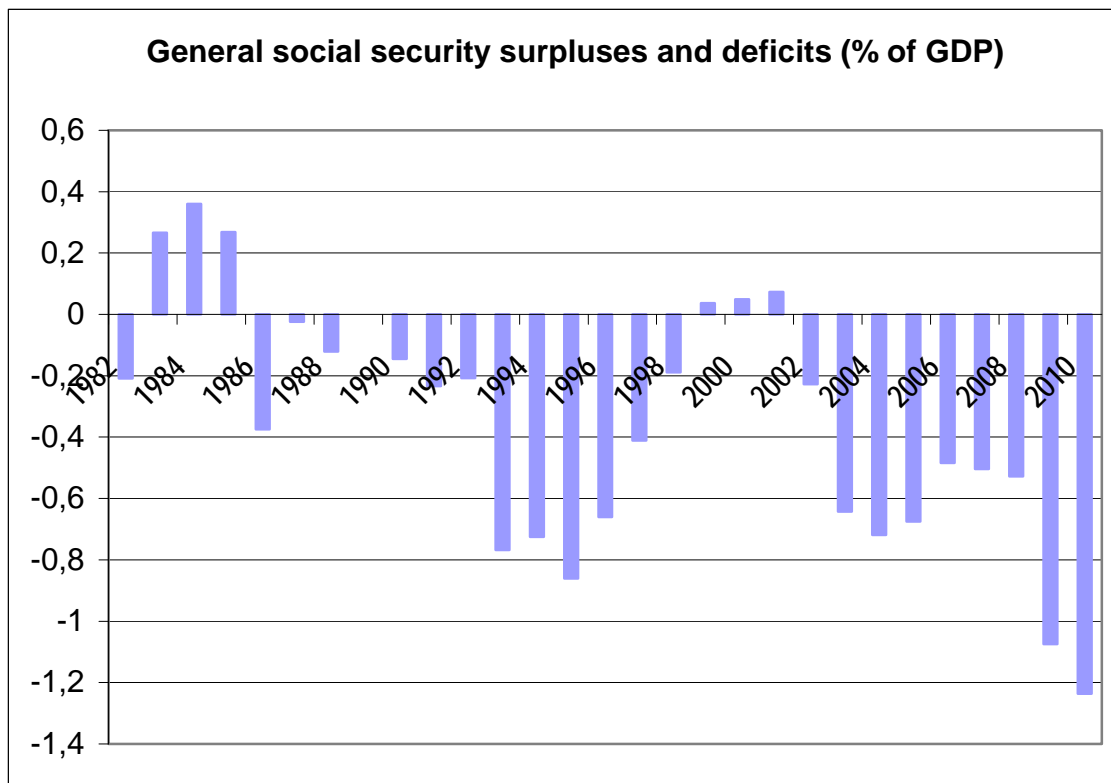
## 8 – A still growing deficit for social security administrations

The national health insurance spending target (ONDAM) was met in 2010 and the growth in social spending slowed down, partly because certain payments are tied to the inflation rate, which was close to zero in 2009. However, that slower increase was still too high to keep social security administrations from requiring additional financing, which increased by €8 billion.

The combined deficits of the basic social security systems and the old-age solidarity fund (FSV) amounted to 30 billion euros, including €23.9 billion for the general systems and €4.1 billion for the FSV old-age fund.

The unemployment compensation system had a deficit of almost 3 billion euros.

The social security administrations had an aggregate debt of €176 billion at the end of 2010, of which about half was made up by CADES. ACOSS (the Central Agency of Social Security Bodies) had a cash shortage of 50 billion euros which required extraordinary financing measures.



Source: Social Security Accounting Commission

## 9 – Improved budgets for the regional and local authorities

Aggregate spending by regional and local authorities declined by 0.5 percent in value and 2.0 percent in volume. Volume had increased by 3.6 percent a year over the 1999-2009 period, excluding the impact of services transferred by the central government.

Operating expenses grew at a slower pace (2.2 percent in 2010, down from 3.9 percent in 2009 and 5.6 percent in 2008), including payroll, although they continued to increase faster than those of the central government.

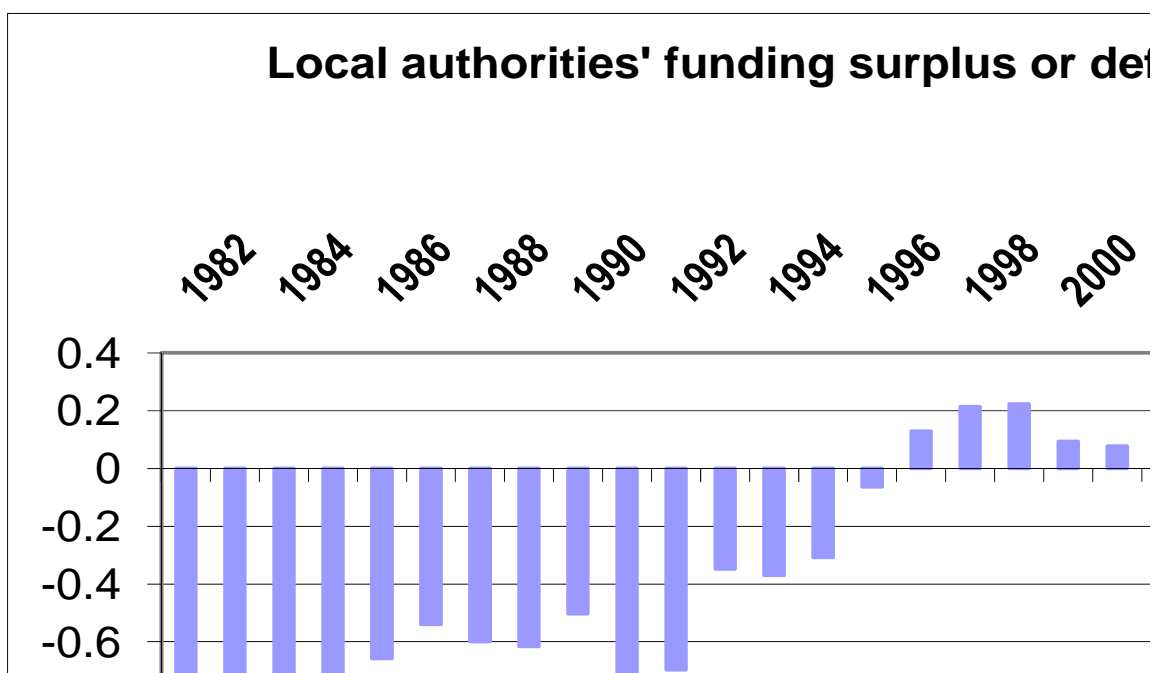
Tax revenue increased by 4 percent, thanks in part to indirect taxes (in particular real estate property transfer taxes), which rose by 9.4 percent.

Temporary offsetting payments by the central government were 1.5 billion euros higher than the revenues local authorities would have collected in 2010 if the business tax had remained in place.

The self-financing ability of regional and local authorities improved.

However, their capital expenditure fell by 8.3 percent.

Accordingly, the funding needs of regional and local authorities declined by 4.5 billion euros in 2010, as they came closer to breaking even (aggregate deficit of €1.7 billion).



Source: INSEE

## 10 - In 2011, a smaller though still very high deficit

Even if the **public deficit** were reduced to 5.7 percent of GDP, as the government seeks to do, it would be higher than the average deficit of other eurozone and European Union countries, in particular Germany. The same applies to the structural deficit.

### Public deficits: 2011 forecasts (percent of GDP)

	France	Germany	Eurozone excluding France	European Union excluding France
Actual deficit	- 5.7	- 2.0	- 3.9	- 4.5
Structural deficit	- 3.9	- 1.4	- 2.8	- 3.2

Source: European Commission (except actual deficit for France: Government estimate)

The **structural deficit** would be reduced by about 1 percent of GDP from its 2010 level, although the structural effort to reduce the deficit would in fact be lower (0.6 GDP points).

Public **revenues** will probably correspond to those anticipated by the government and could even be higher if economic conditions improve, but nothing is certain regarding the growth target for **expenditure**.

There has been additional **government spending** since the original budget. Furthermore, budget appropriations for certain areas are insufficient. Reallocations will therefore be necessary.

The discontinuation of the recovery plan and the manner in which Investments for the Future are accounted for (they were included in full in the 2010 budget) will automatically result in a steep drop in the 2011 budget deficit.

The **deficit of social security administrations** are expected to start declining in 2011, thanks to increases in payrolls, substantial new revenue and the initial impact of pension reform on spending.

Health insurance costs were lower than anticipated in 2010 and can be expected to meet the target set for 2011, which assumes an increase of slightly more than 2.9 percent.

Forecasts concerning the budgets of **regional and local public authorities** are very tentative, and those made by the government for 2010 and released in September were wrong, with the result that the public deficit for 2010 was overestimated.

The volatility of transfer taxes and uncertainties regarding local capital investments make it particularly difficult to estimate regional and local deficits for 2011. There is little doubt, however, that the situation in some of France's departments will remain problematic.

Subject to these reservations, and given the difficulties and risks in ensuing years and the efforts made by other countries, the objective should be to bring the overall **public deficit down** to less than 5.7 percent of GDP, economic conditions permitting.

# 11- The Stability Program: a combination of favorable revenue assumptions

Potential growth can be estimated at an annual 1.6 percent from 2012 through 2014.

Yet the Stability Program relies on the assumption that GDP will grow by 2.25 percent in 2012 and 2.5 percent in 2013 and 2014. While it is possible to envisage a growth rate that exceeds its potential during the upturn phase of the business cycle, that assumption seems fairly optimistic.

In addition, the Stability Program assumes that tax elasticity will be significantly greater than 1 in 2012 and 2013, and that tax revenues will increase by 0.5 points in 2013.

Although elasticity is frequently greater than 1 during the recovery phase, a lower assumption would have been more prudent. An elasticity of 1 would result in a public deficit of 3.5 percent of GDP in 2013, rather than 3 percent.

Tax elasticity in relation to GDP			
2011	2012	2013	2014
1.0	1.15	1.15	0.95

Source: Cour des Comptes calculation on the basis of the Stability Program

Lastly, the Stability Program legislation calls for new taxes generating revenues of 3 billion euros each year from 2012 through 2014. At this stage, **no measure that would generate such amounts in 2013 and 2014 has been announced.**

Accordingly the **Stability Program is largely based on a combination of favourable assumptions.**

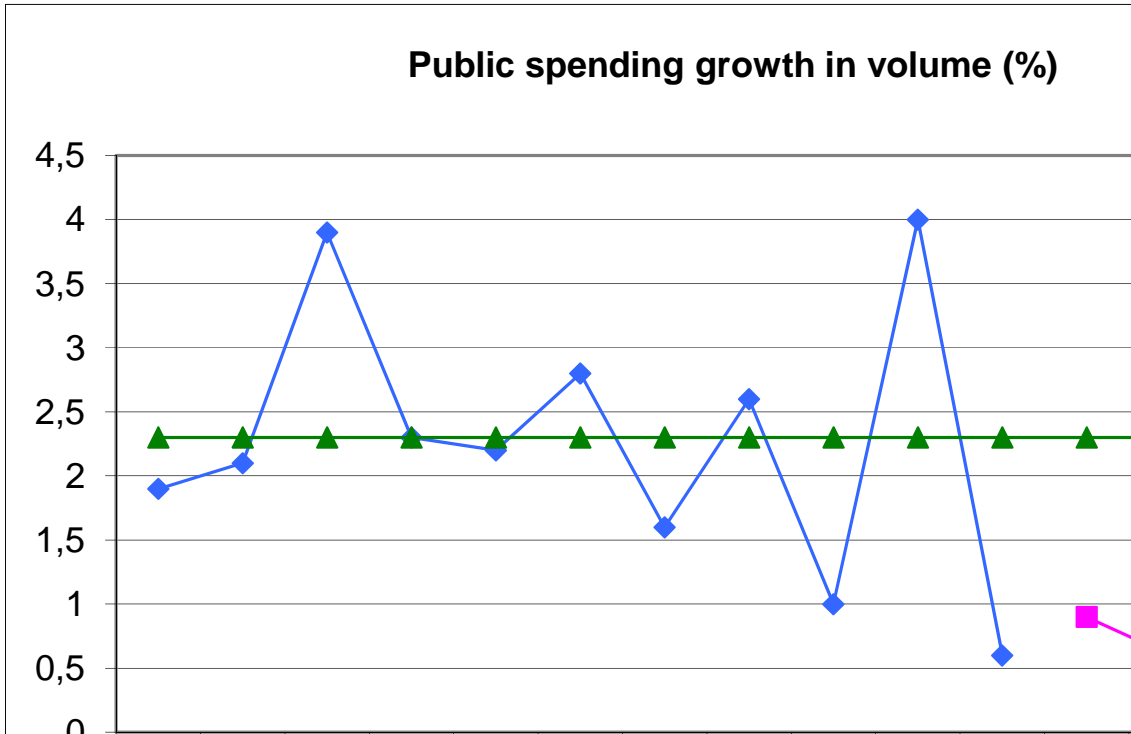
# 12 - The Stability Program: the spending slowdown and structural effort need to be documented

## A clear slowdown in the growth of spending requires new measures

The Stability Program assumes a 0.6-percent average annual growth in public spending, measured in volume, from 2012 through 2014.

It is difficult to forecast the automatic increase in spending in the absence of new savings measures. However, from 2000 through 2010, spending increased by 2.3 percent a year, which is indicative of the magnitude of the required reduction. Previously announced measures that would result in savings (pension reform, general public policy reform, etc.) are not sufficient to achieve this target.

In particular, the assumption of stable public investments, as a percentage of GDP, on which the Stability Program relies, is inconsistent with the Investments for the Future program and the government’s environmental program, unless one assumes that local authorities will again significantly curtail their capital spending on other than environmental projects.



Source: Cour des Comptes

## A more specific structural effort

Given the expenditure growth and the tax increases anticipated by the Stability Program, the structural effort would amount to almost 0.8 GDP points each year from 2012 through 2014, or slightly less than the 1-point effort needed to stabilize the debt at a rapid enough pace.

Above all, no specific information exists concerning the measures that would make such an effort possible.

## 13- Learning from other European countries' recovery programs

The recovery programs of some European countries (Germany, the United Kingdom, Italy, Spain and the Netherlands) were examined by the Cour des Comptes, based on their own national budget documents and stability programs.

That review could not be as exhaustive as in the case of France, but it reveals that, more and more frequently, public finance programs in these countries must be approved by independent budget control authorities (an "Office for Budget Accountability" was recently created in the United Kingdom, for instance, and the practice has long existed in the Netherlands).

Budgets often cover a full **parliamentary term** (as has been the case since the middle of the 1990's in the Netherlands).

**The extent of recovery measures** depends on the initial structural deficit and ranges from 1 or 2 GNP points (Germany, Italy) to 7 or 8 points (Spain, United Kingdom).

**More than half** of the recovery effort is generally aimed at **spending** (slightly less in Italy, but more than three-fourths in the Netherlands and the United Kingdom), including spending on welfare benefits (resources and benefits cease to be index-linked or become subject to new conditions, for example) in several countries, and on employment program costs in Germany. Public service staffing levels are often reduced (in Spain, only 10 percent of vacancies are filled) and salaries are frozen (Italy) or cut (Spain).

Recovery programs are complemented by **increases in revenues** that seek to combine financial return, streamlining and improvements in competitiveness (increase in VAT rates of 2.5 points in the United Kingdom and 2 points in Spain, reduction in the cost of tax expenditures).

Many countries have tightened their **budgeting procedures** at the legislative or constitutional level. In Germany, for example, a "debt brake" places a ceiling on the Federal structural deficit at 0.35 percent of GDP starting in 2016.

Even in countries where **regional and local authorities** have considerable autonomy, they are involved in the national government's efforts to limit budgets. In Germany, structural deficits of the Länder are also limited by a constitutional ceiling. In Spain, the regional authorities entered into a framework agreement with the national government on the sustainability of public finances, aimed at sharing the recovery burden.

## 14 - Bringing runaway debt under control

If the primary structural deficit (i.e. exclusive of interest costs) were to remain at its 2010 level of 2.5 percent of GDP, the public debt would increase to 90 percent of GDP by 2012, then 100 percent in 2016 and 110 percent in 2020.

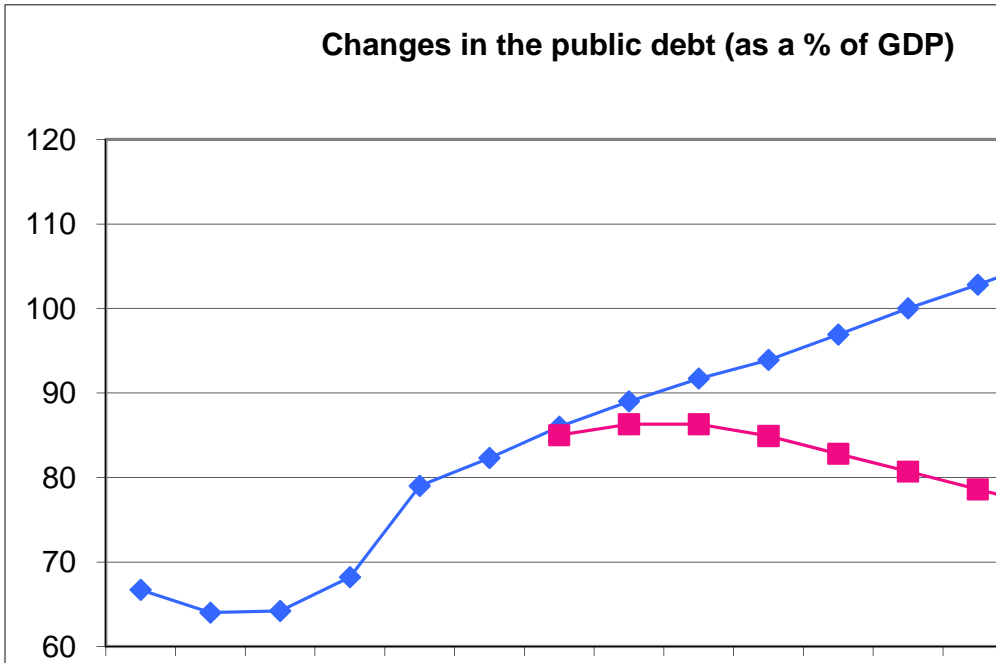
Interest costs would account for 4 percent of GDP and almost 10 percent of tax receipts in 2020, or more than the combined appropriations for the areas of education and research, assuming that the government can continue to borrow funds at close to the going market rate.

However, investors could demand much higher risk premiums. **A one-point increase in interest rates would force the government to budget an additional 2 billion euros the first year, 6 billion the third year, 9 billion the fifth year and 14 billion the tenth year.**

If the debt and its cost were to reach those levels, it would put growth and economic and social independence at considerable risk.

It is accordingly **essential to keep runaway debt under control** by quickly reducing the deficit. **The Cour des Comptes recommends a structural effort of one GDP point per year (€20 billion) to reduce the public deficit** until the structural deficit has been brought down to zero. Such an effort would prevent the debt from exceeding 86 percent of GDP and help bring it down to 72 percent in 2020.

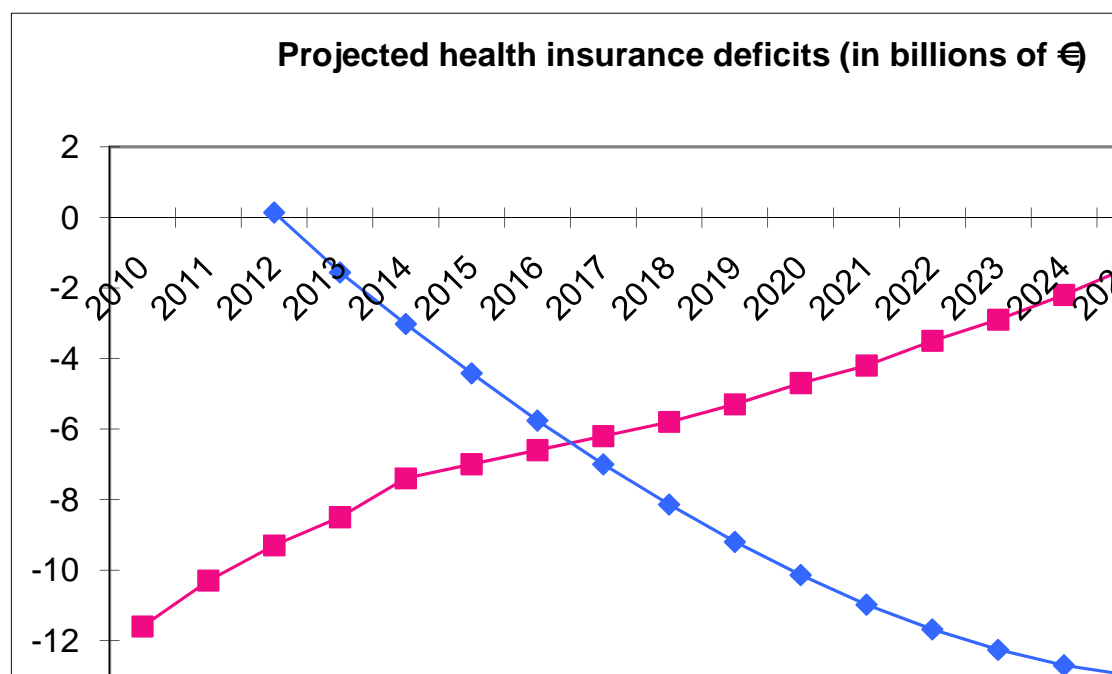
This recovery scenario resembles that of the Stability Program. The required structural effort is slightly greater (1 GDP point instead of 0.8) and continues over a longer period (until 2015 instead of 2014). It is particularly important that the measures underlying the structural effort of the Stability Program be clearly set forth.



Source: INSEE until 2010, then Cour des Comptes: normal trend scenario with unchanged 2010 primary structural deficit; structural effort scenario with 1 percent of GDP over 5 years.

## 15 – A high risk of continued social security deficits

An annual increase of 3.5 percent in total payroll, consistent with the trend for the past 12 years, and of 2.8 percent in the annual health insurance payment target, as projected by the Stability Program for 2012 through 2014, would again result in a €5-billion health insurance deficit in 2020 and in accumulated deficits of 60 billion euros after 2012. The system would not break even until 2027.



Source: Cour des Comptes

**In spite of the 2010 reform, there is still no guarantee that the pension system will break even in 2020.** The identified risks would combine to cause an annual deficit of 12 billion euros in 2020.

The Social Security Finance Act of 2011 provides for the transfer to CADES of the deficits of the general system and FSV (old-age solidarity fund) until the end of 2011 (up to a ceiling of €68 billion), and of the pension system – including the FSV – deficits from 2012 through 2018, up to €62 billion.

The risks to which the health, pension and family allowance systems are exposed could lead to a transfer of deficits twice as large as the anticipated 130 billion euros. This would be hard to reconcile with the current CADES debt repayment schedule (2025). Additional reforms are therefore indispensable.

## 16 - Unsustainable public finances over the long term

The European Commission has developed an indicator to measure the gap between the current primary structural deficit and the deficit that would be sustainable for public finances over the very long term (beyond 2060). For the purpose of the indicator, public finances are considered sustainable if, over the long term, the debt reverts to its current level (measured as a percentage of GDP).

In the computation, the two factors that explain the difference with a sustainable situation are (a) the gap between the current primary structural deficit and the level at which the debt would be stable, at current spending levels, and (b) the increase in public expenditure that will result from population ageing.

### Gap in relation to a sustainable situation (in percent of GDP)

	France	Germany	Italy	Spain	Eurozone
Total gap	4.7	4.2	1.4	11.8	5.8
Impact of the current shortfall in relation to a stabilizing balance	3.8	0.9	- 0.1	6.1	2.3
Impact of ageing on future spending	0.9	3.3	1.5	5.7	3.5

Sources: European Commission except France: Cour des Comptes based on the Stability Program

To establish a sound public finance outlook under this approach, the primary structural deficit would have to be reduced immediately and in the long term by 4.7 GDP points, including 3.8 points because of the amount by which the current deficit falls short of the stabilizing level, and 0.9 points because of the increase in spending resulting of population ageing (1.8 points prior to the 2010 reform and 0.9 points thereafter).

On average, the gap is wider in other eurozone countries, primarily due to the impact of ageing on future spending.

The situation in Germany is more sustainable than in France, in spite of a much more negative demographic outlook, because of the small size of the current deficit.

**The long-term sustainability of France's public finances is therefore under a greater threat from the current structural deficit than from the impact of population ageing.**

# 17- A threat to France's economic growth

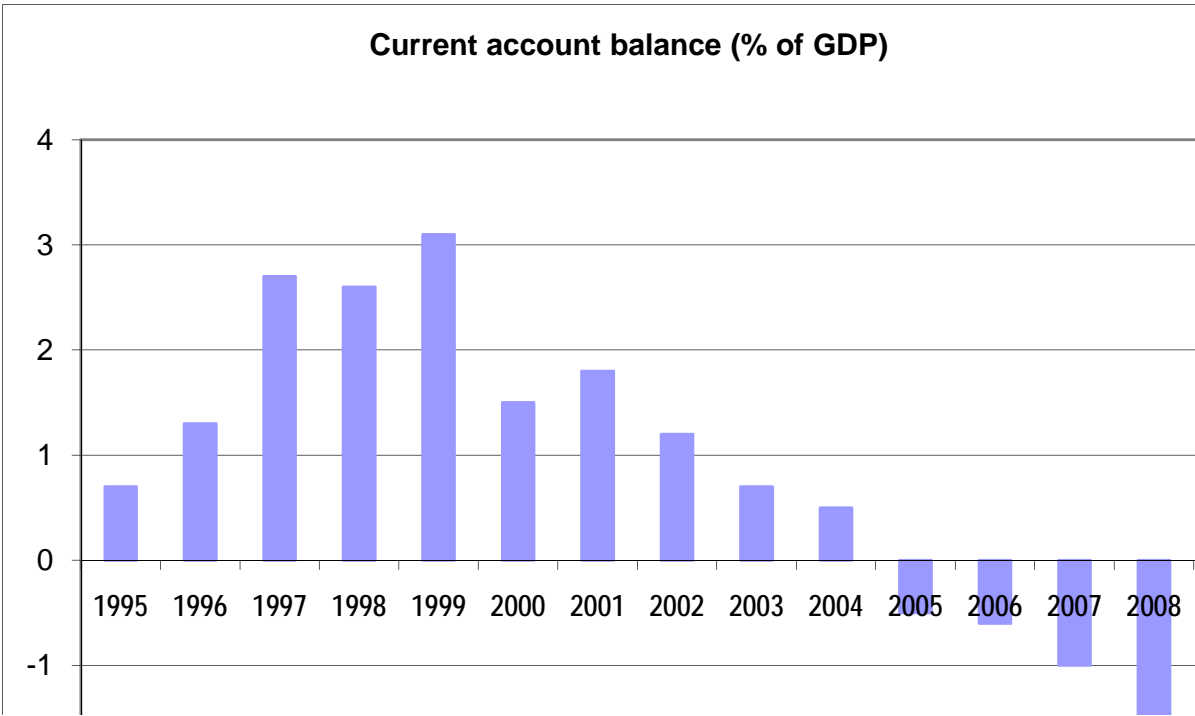
The changes that have affected public finances since 2007 in countries such as Spain have shown that standard indicators were not sufficient to measure their position. Macroeconomic imbalances can cause a recession that structurally impacts public finances. An audit of public finances must also consider those risks.

This issue is being dealt with at the European Union and G20 levels and has been the subject of academic papers (CAE Council of Economic Analysis, CAS Strategic Analysis Center, and the Stiglitz, Sen and Fitoussi Commission). Tracking systems have been developed that incorporate various indicators pertaining to public finances as well as to trade, the financing of capital investments and social cohesion.

The Cour des Comptes compared the situation of France with that of other European countries in light of several of those indicators. The outcome was that **France's position is close to or better than average, except in two areas, i.e. public finance and trade.**

While France's net foreign debt is only 13 percent of GDP, the deterioration in its current account balance over the past ten years, due to a loss of competitiveness brought to light in the Cour des Comptes report on taxes and social security contributions in France and Germany, is a reason for concern.

**The public deficit, along with the balance of trade deficit, represents the main threat to economic growth in France.**



Source: Banque de France

## 18 - Mixed results for the first Planning Act for 2009 and 2010

Although multiple-year planning acts are necessary to bring about an improvement in public finances, they cannot do so alone.

**The first Planning Act** (2009-2012) called for an annual review of its implementation. None was issued by the government for 2009 and 2010. The Cour des Comptes has prepared a partial review.

In its previous reports, the Cour des Comptes noted that **the rules that were issued had not always been complied with**. This applies to the rules requiring savings to offset tax expenditures and to protect government tax revenues, and to the "zero volume" cap on increases in government spending. Although the national health insurance target was met in 2010, this was not the case in 2009.

Because of a large increase in public spending in 2009, in 2010 it exceeded the amount that would have been permitted under the first Planning Act by 14 billion euros. The increase permitted under the second Planning Act is based on 2010 expenditure, so that the gap will never be bridged.

**The three-year government budget** forms the core of the Planning Act. By setting ceilings on budget appropriations in each area for the next three years, it specifies where budget efforts must be made and provides visibility for those in charge of planning.

**A comparison of annual ceilings under the 2009-2011 three-year budget with appropriations voted and actual expenditure indicates, however, that the latter have in fact exceeded by more than 5 percent the amounts in the three-year budget for:**

- 7 categories out of 29 in the case of 2009 expenditure;
- 11 categories out of 29 in the case of appropriations voted in the of 2010;
- 10 categories out of 29 in the case of 2010 expenditure;
- 10 categories out of 29 in the case of appropriations voted in the 2011 original budget.

**Overspending is systematic in the areas of "agriculture," "immigration," "media" and "labour and employment."**

Appropriations must inevitably be adjusted to deal with unexpected events. However, in the case of certain appropriations, the frequency, size and recurrent nature of such adjustments tend to indicate that the budgeting process is not sufficiently strict. This first attempt at a multiple-year budget provided a learning experience, and further restrictions will have to be placed on adjustments in the future, failing which the process will lose much of its usefulness.

## 19- The benefits and limitations of the new Planning Acts

The second Planning Act (2011-2014) contains some welcome new features:

- a minimum structural effort for each year;
- spending ceilings expressed in euros, so that excess spending in a given year must be offset the following year;
- a two-tiered standard (value and volume), applicable to State spending;
- debt ceilings for a large number of public agencies.

However, these provisions can be undermined by other laws, as occurred with the lowering of VAT rate on food services. A constitutional bill currently before Parliament seeks to remedy this.

Regardless of the bill's outcome, Planning Acts have certain limitations:

- they apply to all public authorities, but regional and local authorities and some social security systems currently enjoy a degree of management autonomy that allows them to make decisions that may be inconsistent with national policies;
- they do not contain any provisions to ensure key structural balance in social administrations accounts;
- forecasting tools are not perfect (in September 2010, an error of 0.7 GDP points was made concerning the deficit for the current period);
- improvements are still needed in accounting systems, monitoring and warning procedures and Planning Act implementation reports.

**While planning and rules are useful, they are not sufficient.** Sound public finances can only be achieved through ambitious reforms over time.

## 20- Curbing the growth of public spending

The Cour des Comptes recommends that the annual structural effort to reduce the public deficit be raised to 1 GDP point, with more than half of it aimed at public spending.

If 60 percent of the effort was aimed at spending, the increase in spending volume would be 0.4 percent a year.

The issue is therefore not to cut spending, but to keep it from increasing too fast.

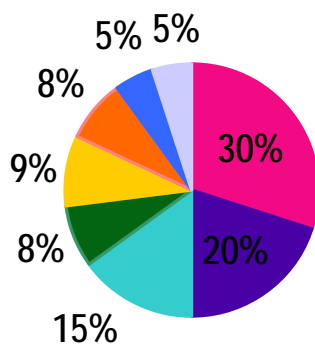
Replacing only one of every two retiring government employees generates additional savings of €800 million a year, lowered to €400 if half of the money saved goes back to the employees. **The impact on government accounts of such sensitive structural reforms should no longer be offset by costly measures such as the reduction in VAT for restaurants, the cost of which (€3.2 billion) is equal to the savings generated over eight years by replacing one out of every two retiring civil servants.**

Efforts aimed at bringing payroll and other operating expenses under control must be further developed and expanded beyond the State and its agencies, although even this will still be insufficient.

Measures in favor of business will have to be reexamined.

**Social benefits and services** account for 45 percent of public spending and it would be very difficult to improve public finances without **holding down their growth**, something that can be done without adversely affecting national cohesion by **targeting them more carefully**.

### Breakdown of public spending in 2010 (as a % of the



■ social benefits other than health care

■ staff payroll

Source: Cour des Comptes, based on national accounts

## 21 - Two examples: employment programs and health insurance

### Employment programs

Spending to improve conditions in the labour market, as defined in European statistics, amounted to 2.0 percent of GDP in France (as compared with 1.6 percent on average in the European Union). Other expenditure (tax shelters, employment incentives in certain areas and sectors) amounting to close of 1 percent of GDP can be added to the total. Savings are possible as:

- the effectiveness of tax expenditures and shelters have never been demonstrated, and they could be better targeted;
- various government measures duplicate each other, and programs should be streamlined;
- authority and funding are divided among several entities (State, regions, employers' associations and unions, etc.) and a streamlining of the system would make it more efficient.

### Health insurance

The national health insurance spending target (ONDAM) must take into account the need for the system to break even. It must be complied with every year, including:

- improving information on trends in healthcare costs;
- tightening monitoring and warning procedures;
- devising ways to deal with increased specialization and coordination of health care;
- making a greater effort to control drug reimbursements;
- devising a clear framework for negotiations with healthcare professionals;
- improving the schedules of hospital fees;
- better targeting capital investment projects.

The aim would be to balance the health insurance budget by 2014.

Given the size of its deficit (approximately 10 billion euros in 2011), cost reduction is necessary but will probably not be sufficient; health care financing will soon have to be reviewed. Consideration will have to be given to the possibility of increasing the amount contributed by insureds, without adversely affecting access to health care by the lowest income groups.

## 22 - Reducing the cost of tax shelters

Holding down the increase in spending will not be sufficient to balance government accounts and raising revenues cannot be avoided, at least until budgets are back in balance. The first requirement is to reduce the cost of tax expenditures and tax shelters.

The cost of tax expenditures, listed in an attachment to the budget, is €73 billion. However, the measures removed from the list since 2004 amount to €75 billion, although some of them could be added back in. The cost of shelters from social security contributions is at least €67 billion.

Some of the shelters from taxes and social security contributions are certainly useful, although their usefulness has seldom been assessed. However, their proliferation in recent years has had many drawbacks, including in terms of fairness, which have been pointed out in previous reports by the Cour des Comptes.

The Cour des Comptes has accordingly recommended that **the cost of tax expenditures be reduced by some 10 billion euros and that of shelters from social security contributions by the same amount.**

The 2011 original Budget Act and Social Security Financing Act include measures aimed at eliminating or reducing tax shelters and similar arrangements, which would yield additional revenues of €10.8 billion in 2012. **Current efforts must therefore be enhanced.**

Pages 167 *et seq.* of the Cour des Comptes' report set out a **list of tax expenditures, costing in aggregate €13 billion, and of tax shelters with an aggregate cost of €14 billion, which could be eliminated in whole or in part, while at the same time improving the fairness and effectiveness of tax collection.**

## 23 – A broad reform of the tax structure

In addition to increasing the tax base by reducing the cost of tax shelters, **a broader reform of the tax structure is necessary if public revenues are to increase and growth is to attain its potential**—a potential on which the increase in revenues ultimately depends.

The cost of labour in France is affected by the burden of very high income and social security taxes, which are detrimental to business competitiveness and to employment. Accordingly, these taxes should not be further increased.

Some taxes paid by employers based on their total payroll (for transportation, etc.) could be replaced by more broadly-based taxes.

The original purpose of **VAT** is to generate resources for financing public services. **Bringing the reduced rate and the sectors eligible for it into line with the German system would generate additional revenues of €15 billion.** The tax's potential degressive impact on after-tax income distribution could be offset by targeting support for low-income households.

The weight of revenues from **environmental taxes** is lower in France than the European Union average. Bringing those taxes into line with that average, as measured in percentage of GDP, would generate additional revenues of **€10 billion.**

It is necessary to balance social security accounts, and this must be done by first reducing expenses. If such measures prove insufficient, **increasing the CSG general social security contribution (health care), or the CRDS contribution for the repayment of the social security debt,** could be contemplated in order to achieve balance in public finances.

## 24 - Main avenues for the future

The oversight and planning process could be strengthened and its effectiveness improved, regardless of the outcome of the constitutional reform currently in progress, by:

1. Setting up a long-term process aimed at involving all of the “public bodies” concerned, including regional and local authorities and the separately managed social security administrations, in the process of determining and monitoring the objectives set out in Stability Programs and Planning Acts.
2. Clearly defining the nature of the policies and measures contained in Planning Acts and Stability Programs, as is the case in other European countries, so as to effectively ensure compliance with spending and revenue targets.
3. Incorporating provisions on social security into the Planning Acts, specifying measures in each area aimed at balancing budgets in the absence of extraordinary circumstances, as well as overall spending and revenue improvement objectives.
4. Improving forecasting, monitoring and warning systems, based on key relevant indicators in the consolidated general government accounts.
5. Explaining how to reconcile, for each area, the three-year budget with the appropriations approved under the original budget and subsequently utilized; charting long-run budget expenditure on a continuous basis.

A structural effort to reduce the deficit by 1 GDP point a year should be pursued on an ongoing basis by:

6. Focusing at least half of the effort on public spending:
  - by broadening the scope of the strict control of operating costs objective, established by the General Public Policy Revision (RGPP), beyond the budgets of the State and other government bodies;
  - by reexamining support policies for both business and households, including with the aim of better targeting support.
7. Complementing that effort with measures aimed at public revenue, primarily through the reassessment of tax shelters which are least justified from an economic and social standpoint.
8. Reforming the tax structure in order to boost potential growth, using the existing latitude in terms of consumption and environmental taxes.
9. Using all the revenue increases resulting from improved economic conditions to accelerate deficit reduction.
10. Putting an end in 2014 to the abnormal current-account deficits by the health-care and family-allowance systems, in the absence of extraordinary economic circumstances, in order to prevent a continued aggravation of the social security debt.

