Cour des comptes

FINANCES AND PUBLIC ACCOUNTS

THE SITUATION AND OUTLOOK OF PUBLIC FINANCES

Summary

June 2018

DISCLAIMER

This summary is intended to help understanding and using the report prepared by the Cour des comptes.

Only the report is legally binding on the Cour des comptes.

The responses of the Ministry for the Economy and Finance and the Ministry of Public Action and Accounts appear after the report.

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Introduction

This report on the situation and outlook of public finances is prepared, as in every year, pursuant to Article 58-3 of the bylaw on budget acts (LOLF).

Filed jointly with the Government's report on the development of the national economy and the guidelines for public finances, it is intended to contribute to the Parliament's annual budgetary orientation debate (Article 48 of the LOLF).

In this report, the Cour des comptes first examines the situation of public finances in 2017 and how it has changed in relation to previous years, as well as the situation of each of the major categories of public administrations : central government, social security funds (ASSO), and local governments (APUL). It then looks at the main differences between the initial forecasts in the 2017 budget act and the actual results, and subsequently examines France's position in 2017 relative to that of other European countries.

The Cour des comptes then examines changes in expenditure and revenue over the last 10 years. This review makes it possible to analyse the impacts of the economic crisis on public finances.

The Cour des comptes then analyses the information available before 19 June relating to fiscal year 2018 and identifies the risks to achieving the projected revenues, expenditures, and balances of the stability programme for all public administrations.

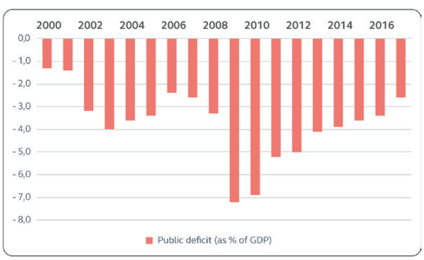
Lastly, the Cour des comptes assesses the risks weighing on the public finance trajectory incorporated into the stability programme for years 2019 to 2022 and the measures proposed in this programme to reduce the structural deficit.

1 2017 : a sharp reduction in the deficit due to spontaneous growth in compulsory levies

Deficit back below 3% of GDP in 2017 despite expenditure overruns

The public deficit declined sharply in 2017 (by 0.8% of GDP) to 2.6%, after reaching 3.4% in 2016. It is 0.1% below the projection in the initial budget act (LFI) for 2017 and 0.6% below the level the Cour des comptes had expected in its audit conducted in June 2017, given the growth forecasts available at the time and assuming no corrective measures were implemented.

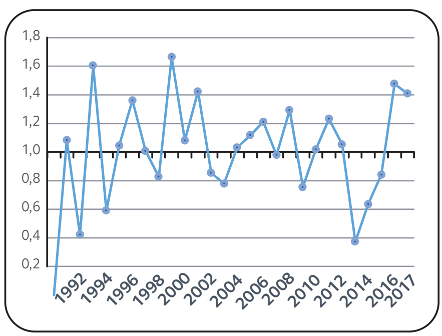
Public balance



Source : Insee (France's national institute of statistics and economic studies)

The similarity between the balance projected in the LFI and the actual balance nonetheless masks major differences between the drafting of the LFI and its execution. The LFI had very significantly underestimated both the expenditure and revenue of public administrations, but for different reasons: revenue because the improvement in economic conditions had truly become visible only gradually over the second half of 2017, and thus after the Cour des comptes had conducted its public finance audit; and expenditure because many of the sources of increased expenditure had been underestimated from the beginning.

Elasticity of compulsory levies to GDP growth



Source : Public finance programming bill; Economic, Social, and Financial Report; F. Écalle (2011), Sociétal no. 74; Insee; Cour des comptes calculations

2017 : a sharp reduction in the deficit due to spontaneous growth in compulsory levies

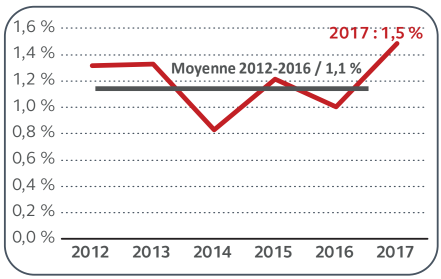
The reduction in the structural balance (0.3% of GDP in 2017) thus stemmed entirely from the higher elasticity of revenue to GDP while the effort on expenditure, which corresponds to the structural change in the ratio of expenditure to GDP, was zero.

Expenditure up significantly compared with the average pace in recent years

Despite the measures taken to curb spending during the year in the central government's budget, expenditure excluding interest expenditure and levies on revenue earmarked for the European Union increased to a much greater extent in 2017 (+1.5% in volume) than in previous years (+1.0% in 2016, +1.1% on average between 2012 and 2016) and at a faster pace than potential growth (1.25% according to the Government). The Cour des comptes had actually shown, in its June 2017 public finance audit, that many of the sources of increased expenditure had been underestimated from the beginning.

However, the decline in the deficit and the return to more sustained economic growth were still not sufficient to reduce the public debt to GDP ratio, which rose from 96.6% of GDP in 2016 to 96.8% of GDP in 2017.

Growth rate in volume of public expenditure that can be controlled by the public authorities



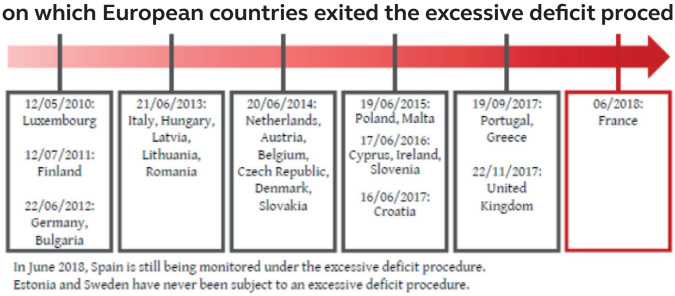
Source : Cour des comptes, based on data from Insee

Note : public expenditure that can be controlled by the public authorities was determined by subtracting the following from total public expenditure: tax credits, the amount of refunds of the 3% dividend tax, interest expenditure and levies on revenue earmarked for the European Union

Actual and structural deficits still high relative to France's European partners

France is expected to exit the excessive deficit procedure at the end of June 2018. This procedure, initiated on 27 April 2009, thus lasted for more than nine years. France was one of the last countries still in the procedure (only Spain remains).

Dates on which European countries exited the excessive deficit procedure



Source : Cour des comptes, based on the European Commission's website

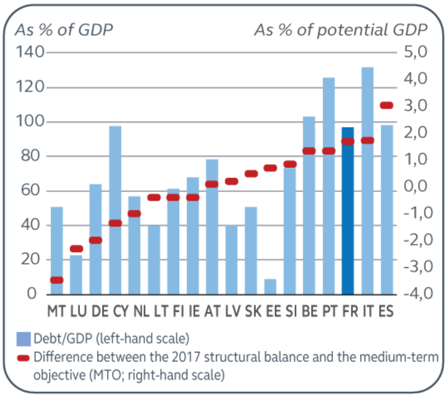
2017 : a sharp reduction in the deficit due to spontaneous growth in compulsory levies

France's actual and structural public deficit remains significantly higher than that of most of its European partners, as several of them (including Germany) even have surpluses. The structural deficit, at 2.1% of GDP according to the European Commission's estimates, remains well above the medium-term objective for France pursuant to the Treaty on Stability, Coordination and Governance (a structural deficit that is less than or equal to 0.4% of GDP).

The difference between the structural balance observed (-2.1% of GDP) and the medium-term objective (-0.4% of GDP) is therefore 1.7%, which puts France in third place among countries that have to reduce their structural balance to meet their medium-term objective.

The situation of public finances at the end of 2017 therefore leaves no room for complacency.

Distance to the medium-term objective in 2017 and public debt ratio in 2017



Source : Cour des comptes, based on the European Commission (AMECO), May 2018 forecasts

2 Public finances 10 years after the 2008 financial crisis: the situation has deteriorated; trends differ by sub-sector

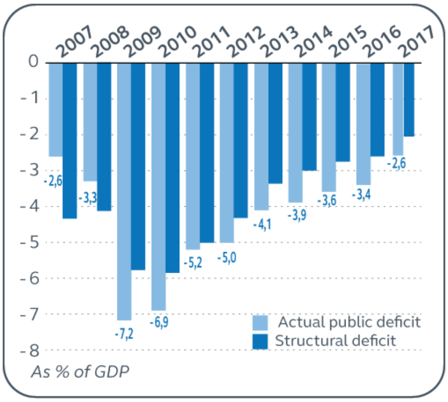
While in 2017 France's deficit fell back below 3% of GDP, for the first time since 2007, and the country embarked on a new public finance trajectory characterised by a more favourable economic climate, the Cour des comptes has analysed the changes in public finances over the last 10 years.

Deficit back to its 2007 level, but with a significant deterioration in the overall public finance situation

After nine years above 3% of GDP, the public deficit fell back to its 2007 level (2.6% of GDP).

This return to the 2007 level nevertheless took place with a three-point increase in compulsory levies and expenditure (excluding tax credits) relative to GDP, while public debt, which was barely above the 60% of GDP limit in 2007, increased by 32.3%, to 96.8% of GDP in 2017.

General government balance between 2007 and 2016



Source : Cour des comptes, based on data from Insee and from the European Commission (AMECO), May 2018 forecasts

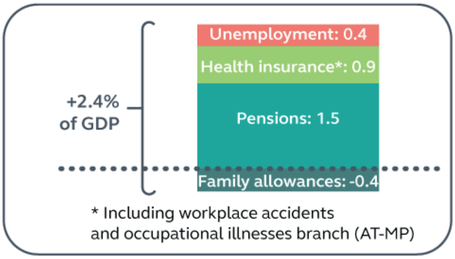
Furthermore, France's situation has deteriorated relative to that of its European partners, which have increased the weight of their revenue and their expenditure in GDP by only 1.1% and that of their debt by 25.6%. France (along with Luxembourg, whose debt is barely more than 20% of GDP) is the only country in the eurozone where public debt continued to grow in 2017, nearly 10 years after the 2008-2009 financial crisis.

Public finances 10 years after the 2008 financial crisis: the situation has deteriorated; trends differ by sub-sector

Differing impacts of the crisis across public administration sub-sectors

Over the last 10 years, substantial efforts have been made to control social expenditure, in particular on pensions and health insurance, but they have proved insufficient to prevent a sharp increase in the ratio of expenditure of the social security funds (ASSO) to GDP (+2.4% of GDP).

Variation between 2007 and 2017 in the different categories of social security administration expenditure (as % of GDP)



Source : Cour des comptes, based on financial accounting data (Social Security Accounts and UNÉDIC (French agency responsible for managing unemployment insurance) Accounts Committee)

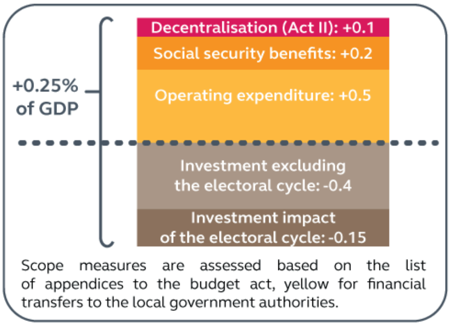
The revenue of the social security funds was less affected by weakening economic growth than that of the rest of the public administrations, due to the combination of a more dynamic base, measures to increase compulsory levies, and central government transfers.

The social security funds thus experienced the largest increase in expenditure among public administrations, but they also benefited from the largest increase in revenue and their balance returned to its 2007 level.

After having increased their expenditure between 2007 and 2013 (well beyond the mere impact of Act II of the decentralisation), the local governments began to curb their spending in 2014 as they were constrained by the decline in central government allocations.

These spending curbs focused more on investment expenditure, down nearly 0.5% of GDP between 2007 and 2017 (0.4% excluding the impact of the electoral cycle), than on operating expenditure, which was 0.5% of GDP higher in 2017 than in 2007.

Variation between 2007 and 2017 in the different categories of local public administration expenditure (as % of GDP)



Source : Cour des comptes, based on Insee data and the "yellow" document "financial transfers from the central government to the local government authorities", appended to the 2018 budget act

Despite the reduction in financial assistance from the central government, revenue of local governments rose more quickly than GDP over the period due to the strength of the base of their compulsory levies.

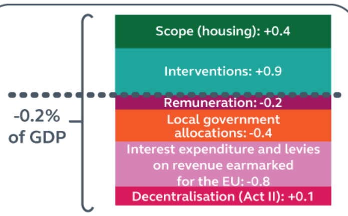
Consequently, because the spontaneous growth in their revenue was greater than that of GDP and because their investments fell sharply, local governments improved their balance relative to 2007.

Public finances 10 years after the 2008 financial crisis: the situation has deteriorated; trends differ by sub-sector

On the surface, expenditure by the central government and its agencies was under better control: measured at constant scope, it fell by 0.5% of GDP.

However, appearances can be deceiving: excluding interest expenditure and levies on revenue, which were sharply down, their expenditure increased by 0.7% of GDP.

Variation between 2007 and 2017 in the different categories of central public administration expenditure (as % of GDP)



Scope measures are assessed based on the budget act lists for housing benefits (2015 and 2016, with the budgeting of personal housing assistance (APL) and family housing benefits (ALF)) and based on the "yellow" (appended to the 2018 budget act) "financial transfers from the central government paid to the local government authorities".

Source : Cour des comptes, based on Insee data and the scope measures presented in the budget acts

Moreover, central government revenue was sluggish due to a less favourable base for its levies and to revenue transfers to the social security funds, only partially offset by measures to increase its compulsory levies.

All in all, it was the central government that bore the brunt of the impacts on its revenue of weakening growth following the 2008-2009 financial crisis, and its balance deteriorated by 0.5% of GDP over the period. Conversely, the favourable trend in their revenue played an important role in the emergence of surpluses for the local governments (in 2016) and the social security funds (in 2017).

3 An achievable 2018 deficit forecast, but with a moderate risk of slippage

The April 2018 stability programme forecasts a public deficit of 2.3% of GDP in 2018, only a 0.3% of GDP improvement on the 2017 result.

This forecast is achievable, although the adverse factors have tended to strengthen since the stability programme was published.

A plausible, albeit somewhat high, revenue forecast

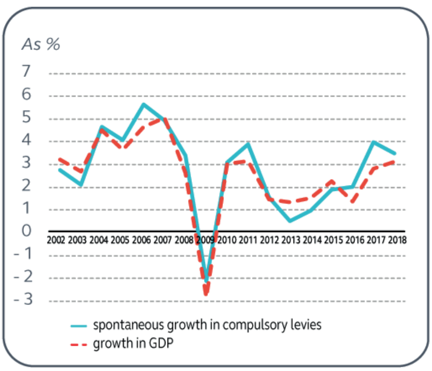
The stability programme projects 2.0% growth in GDP in 2018, which now appears to be somewhat high in light of the economic data that have been published since April. Insee, in its most recent forecasting report, for instance forecasts 1.7% growth in 2018.

The stability programme also assumes spontaneous growth in compulsory levies will be just above growth in GDP in value, consistent with a GDP elasticity of 1.1, after 1.4 in 2017.

It is possible that the projected elasticity, which is close to its historical average and below that of 2017, will be achieved. However, it assumes that the factors that led to the very strong growth in 2017 in VAT and corporate tax revenue, which have not yet been fully explained, will continue to influence their growth in 2018. But there are no guarantees this will be the case in the context of weaker economic activity.

The revenue forecast for 2018 could thus prove to be somewhat high.

Spontaneous growth in compulsory levies and growth in GDP



Source : Cour des comptes, based on Insee data, the reports on compulsory levies for years 2008 to 2011, the economic, social, and financial reports for 2012 to 2017 and the 2018-2022 stability programme

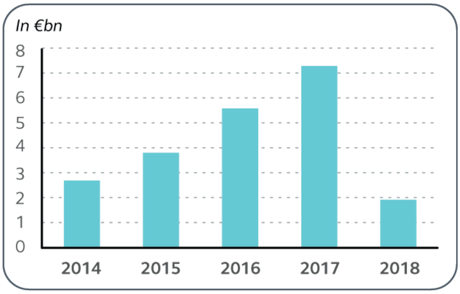
An achievable 2018 deficit forecast, but with a moderate risk of slippage

A plausible expenditure forecast, with a high degree of uncertainty concerning the local government authorities

The April 2018 stability programme projects a change in public expenditure excluding tax credits of 0.6% in volume in 2018 after 1.1% in 2017. This forecast is achievable.

In particular, the more accurate budgeting of appropriations for the central government's general budget categories in the initial budget act is reflected in risks of significantly smaller slippage (less than €2 billion) than in the last two years (more than €5 billion): subject to very strict management through the end of the year, it should be possible to offset this slippage by savings that can already be identified or, as is the case every year, by savings that will gradually be identified during the budget implementation, as well as by the cancellation of some of the appropriations placed in reserve.

Estimate of the average risks of overruns by the ministries in June of each year



Source : Cour des comptes, Situation and outlook of public finances reports from 2014 to 2018

The forecast for expenditure by the social security administrations is realistic.

The main uncertainty with respect to expenditure relates to the local governments. The forecast in the stability programme assumes a sharp slowdown in operating expenditure (+0.4% in value after +1.6%), due to a new contracting mechanism between the central government and the 322 largest local governments, implemented pursuant to the 2018-2022 public finance programming bill (LPFP). This growth, which is below the average target of 1.2% set for these authorities, does not appear to be out of reach, as indicated by the Cour des comptes' analysis of the initial budgets of a large sample of local governments. However, it remains subject to the high degree of uncertainty surrounding the implementation and impact of this contracting on expenditure by the local governments.

A very small reduction in the actual and structural deficit

Even if it were achieved, the deficit reduction would be small in 2018 (-0.3% of GDP).

It would, moreover, result almost entirely from economic conditions. The Government is thus expecting the reduction in the structural deficit to be limited to 0.1% of GDP, which diverges from European rules. This decrease in the structural deficit reflects a slightly higher, but still modest (0.3% of GDP), effort on expenditure, mostly offset by measures to reduce compulsory levies.

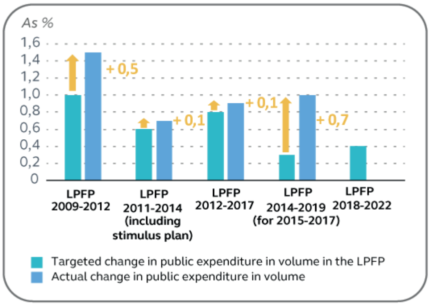
4 Risks to achieving the 2019-2022 public finance trajectory

A new programing bill for 2018 to 2022 came into force in January 2018. The stability programme submitted in April 2018 follows on from that bill, and updates its macroeconomic assumptions and its public finance trajectory. The programming bill nonetheless lacks ambition and the 2019-2022 trajectory in the stability programme has a number of weaknesses.

A programming bill that lacks governance innovation

The public finance programming bill (LPFP) for 2018 to 2022 moves away from France's European commitments, in particular with respect to the improvement in the structural balance (expected improvement of 0.3% on average per year compared with more than 0.5% per year required), even though the results of the programming bills have, until now, systematically fallen short of the commitments set by the European rules.

Targeted average annual change in public expenditure (excluding tax credits) in each LPFP and the actual result



Source : Cour des comptes, based on national accounting data (Insee) and the LPFPs

Furthermore, the LPFP does not contain any major governance innovations, beyond the introduction of the contracting mechanism between the central government and the 322 largest local government authorities.

In fact, it sometimes retreats from the most recent LPFPs: the maximum total amount of tax expenditure is so high that it will not be restrictive for the LPFP's timeframe and the objective of extending the scope of the cap on the earmarked taxes has been abandoned.

Risks to achieving the 2019-2022 public finance trajectory

Strengthening the governance of public finances could, however, lead to better compliance with the objectives of the programming bills.

As the Cour des comptes regularly recommends, this strengthening could involve, among others, expanding the scope of the social security financing acts to all social protections and creating financing acts for the local governments, which would set out the objectives of the programming bills. Such a change would allow for more effective adoption of these objectives by all public stakeholders.

Supplementing the structural balance objective with an expenditure objective that concerns the amount of expenditure for all public administrations set out in all subsequent budget acts would also likely facilitate the Parliament's adoption of, and thus compliance with, the objectives in the programming bills.

Lastly, regularly holding a national public finance conference would make it possible to involve all stakeholders in controlling public finances.

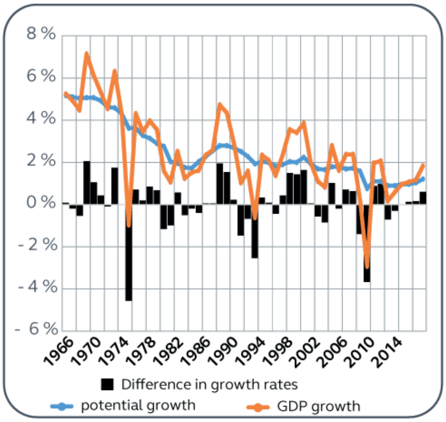
A 2019-2022 trajectory that has a number of weaknesses

The stability programme, which updates the public finance programming bill's trajectory, forecasts a return to a public finance surplus in 2022 and a structural balance close to the medium-term objective of equilibrium that France has set under the Treaty on Stability, Coordination and Governance.

This trajectory has four major weaknesses.

It relies on an optimistic growth assumption, one that is higher for the entire 2017 to 2022 period than the potential growth; this has never happened over such a long timeframe. There is a real risk of a slowdown in growth, which could make it more difficult to implement the announced curbs on spending.

GDP growth and potential growth



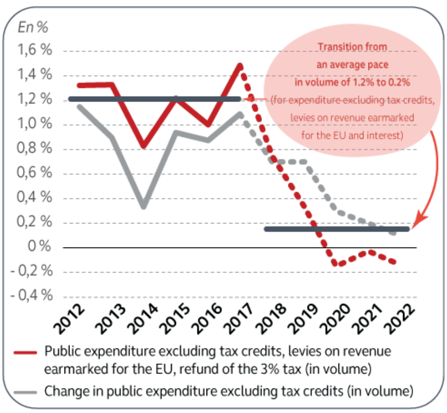
Source : European Commission; AMECO database

The mandatory levy trajectory takes into account only some of the announced measures, and notably does not incorporate the full elimination of the residence tax that has been announced. Implementing this measure while complying with the stability programme's trajectory will therefore entail postponing or abandoning some of the compulsory levy reduction measures that are currently scheduled to start in 2020 or increasing expenditure-relating savings.

Risks to achieving the 2019-2022 public finance trajectory

The programming assumes in particular a sharp decline in growth in expenditure: expenditure, excluding interest expenditure and levies on revenue earmarked for the EU, would need to stabilise, and then decline in volume, between 2020 and 2022 to meet the expenditure objective in the stability programme, while this growth, which narrowly exceeded 2% in the 2000s, still stood at just over 1% between 2012 and 2017.

Change in public expenditure excluding tax credits, excluding levies on revenue earmarked for the EU and excluding interest expenditure for the last five years and within the timeframe of the LPFP (as %, in volume)



Source : Cour des comptes, based on national accounting data (Insee) and the LPFPs

The pace of the change in central government expenditure, with a decline projected in "controllable" expenditure in volume starting in 2020, appears challenging. In light of the health insurance spending target (ONDAM) and because no savings measures would be taken before the structural pension reform, achieving the trajectory would require a particularly significant effort on the rest of the social expenditures. Lastly, the stability programme forecast assumes that the local governments will meet a strict operating expenditure control target (+1.2% in value per year, reflected in a 0.5% decline in volume as from 2020).

Achieving the expenditure target is a key element of the trajectory, but the drivers for controlling public expenditure that would make it possible to meet this goal have so far not been specified. In particular, the proposals of the "Public Action 2022" committee have not been made public and the Government has not disclosed how it intends to act on them.

Lastly, the projected improvement in the balance of all public administrations relies on a cap on the surpluses of the social security funds, to the benefit of the central government balance, and the creation of increasingly large surpluses for the local governments.

The forecast in the stability programme assumes that the surplus of the social security funds is capped at the level reached in 2019 through transfers of revenue to the central government. However, the procedures for implementing these large transfers (about 1% percent of GDP at the end of the period), still need to be clarified, even though CADES (the social debt redemption fund) will, in principle, be exempted and the central government does not directly manage the balances of UNÉDIC and AGIRC-ARCCO (supplemental pensions for private-sector employees).

Risks to achieving the 2019-2022 public finance trajectory

Most importantly, the forecast in the stability programme assumes that the local governments will generate a continuously growing surplus that reaches 0.7% of GDP in 2022. However, even if they meet their operating expenditure growth target, they could choose to increase their investment or lower their taxes rather than allowing their surpluses to grow.

Securing the public administrations' headline balance objective therefore requires a review of the actual revenue- and cost-sharing between the central government, the social security funds and the local governments.

Conclusion

The situation of France's public finances has deteriorated in the last decade. In 2017, it was more fragile than that of most of its European partners. The return to a deficit below 3% of GDP in 2017, made possible by a sharp improvement in economic conditions, cannot mask this structural fragility.

Restoring the long-term sustainability of France's public finances means not relying on the recently observed improvement in the economic situation but rather taking purposeful action on public spending. This can be done by rectifying the remarkable lack of efficiency weighing too often upon public management and major public policies.

The public finance programming bill and the stability programme set ambitious targets for controlling public expenditure, but how they will be achieved has for the most part yet to be defined.

The necessary and possible achievement of these targets requires a collective effort to raise awareness of public expenditure, clear political choices, and accountability on the part of all stakeholders.