The overall situation of public finance (at the end of January 2019)

PRESENTATION

According to the Government's latest forecast, the public deficit should stand at 2.7 GDP points in 2018, as it did in 2017. Measured in structural terms, i.e. neutralising the impact of exceptional factors and the economic situation, the structural balance should also be stable compared with 2017.

The Projet de Loi de Finances *(PLF –Draft Budget Bill) for 2019 provided for an increase in the deficit, to 2.8 GDP-point, mainly due to the transformation of the* Crédit d'Impôt pour la Compétitivité et l'Emploi *(CICE – Tax Credit for Competitiveness and Employment) into a cut in social contributions that increases the deficit in exceptional temporary fashion.*

Substantial measures supporting household purchasing power were taken at the very end of 2018. They led to a deterioration of the public deficit, now forecast by the Government as standing at 3.2 GDP points in 2019. At best, the structural deficit sho be stable and the public debt-to-GDP ratio increase once again, in contrast to the provisions of the Loi de Programmation des Finances Publiques *(LPFP – Public Finance Programming Act).*

Perspectives for public finances in 2019 are particularly fragile. Only some of the measures to increase household purchasing power were incorporated into the Finance Act. Compliance with the Government's public balance forecast therefore assumes that the measures contained in the Act introducing economic and social emergency measures passed at the end of 2018, which increases the deficit by €3.7 billion, are compensated by the savings and extra revenue that the Government has announced but which still need to be expressed in legislative or regulatory provisions. Furthermore, the Government's macroeconomic scenario, which remains unchanged from the one presented in September 2018 when the PLF was tabled, takes no account of the macroeconomic impact of the measures taken at the end of the year or, conversely, of the deterioration in cyclical conditions that has since come about in Europe.

This Chapter first of all analyses the public finance situation in 2018 (I), and then the forecast for 2019 (II).

The Court's observations are based on information available at 22 January 2019.

I - In 2018, headline and structural deficits remained high

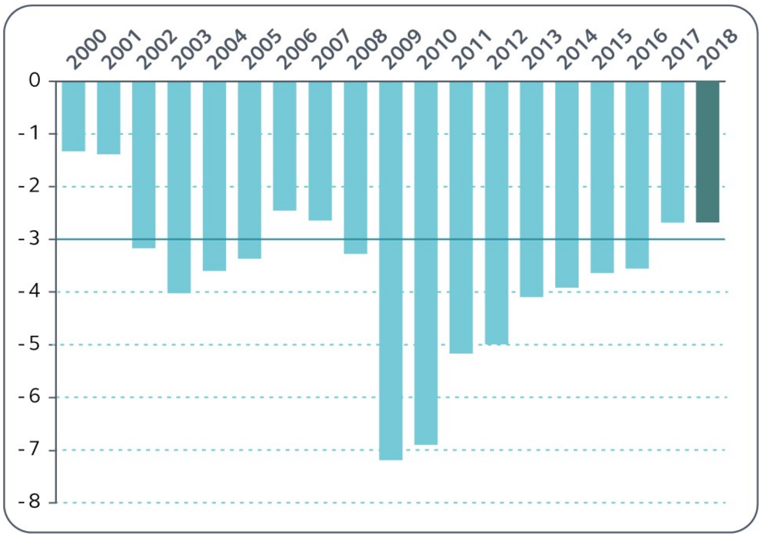
In its most recent forecast, which went alongside the *Loi de Finances Initiale* (LFI – Initial Budget Act) for 2019, the Government forecasted a public deficit of 2.7 GDP points in 2018. This forecast, which came very close to the PLF's, is 0.4 GDP points lower than the updated version produced by the Government in the Stability Programme introduced in April 2018. It is also 0.1 GDP points higher the PLF's, due to a downward adjustment of forecasts of tax and social contribution revenues.

A - The headline deficit should be close to that of 2017

According to the Government's latest forecast, after eight years of uninterrupted reduction, the public deficit in 2018 should stand at 2.7 GDP points, the same level as in 2017.

Information available at 22 January 2019 suggests that this forecast should be achieved. The budgetary execution results communicated by the Government are even more positive that the one incorporated in the forecast. Their expression in the national accounting system will not however be available before the end of March 2019. In addition, the partial accounting results available on regional and local authorities are consistent with the Government's forecast, although, given the data yet to be collected, the final result is still uncertain at this point in the year. The same is true with regard to the accounts of all social security administrations, for which (incomplete) data available on the general regime is also consistent with the Government's forecast.

Graph 1: the Government budget balance from 2000 to 2018 (in GDP points)



Source: Cour des Comptes, based on Insee data up to 2017 and the Government's forecast for 2018.

B - There should be no reduction in the structural deficit

The headline balance and its evolution are partly linked to the economic situation. They are also affected by exceptional factors that modify a single year's balance without having any consequences on the government balance over the long term. 2017 saw the reimbursement of the 3% tax on dividends, following the Constitutional Council's invalidation of the tax, and the surtax on companies introduced to compensate the cost for public finances. The same thing will happen in 2019, with Tax Credit for Competitiveness and Employment (CICE) being replaced by a reduction in social contributions, expressed over 2019 alone by major CICE payments on salaries for 2018 and previous years, and by the reduction of contributions on 2019 salaries.

The structural balance would be that recorded excluding exceptional factors and if economic activity lives up to its "potential" (see inset).

The cyclical and structural components of the Government balance

Annual variations of the general government headline balance are affected by new measures, usually enacted by Parliament in finance laws or via other legislative provisions, as well as by fluctuations in economic activity. In order to better assess the public finance situation, the effect of such fluctuations must be deducted from the headline balance in order to obtain the "structural" balance, calculated in practice by following the steps below:

- estimation of the "potential" GDP, i.e. the one that would have been recorded in the absence of cyclical fluctuations of the GDP, and calculation of the output gap, i.e. the difference between the headline GDP and the potential GDP;
- estimation of the headline balance's cyclical component, which essentially results from the gain or loss of revenue associated with the gap, assuming that government revenues evolve in almost the same way as the GDP (elasticity[1] close to 1); given the public expenditures-to-GDP ratio (a little over 50 points), the cyclical balance is roughly equal to half the output gap;
- evaluation of exceptional temporary factors affecting the headline balance;
- estimation of the structural balance by the difference between the headline balance and the sum of these exceptional temporary factors and its cyclical component.

When there is an unfavourable economic situation (as in the late 2000s), there is less deterioration in the structural balance than in the headline balance; conversely, when it is favourable (as in the late 1980s and the 1990s), there is more deterioration in the structural balance than in the headline balance.

[1] The elasticity of government revenue to its base measures the growth of such revenue in %, when its tax base increases by 1%. If a 1% increase in the base increases government revenue by 2%, its elasticity will therefore be 2. An apparent elasticity for the general government revenues to the GDP can be computed by assessing how much they evolve when the GDP varies by 1%.

According to the Government, the structural deficit would be 2.3 GDP points (see table below).

Table 1: breakdown of the government balance in 2016, 2017 and 2018

In % of the GDP	2016	2017	2018
Headline balance	- 3.5	- 2.7	- 2.7
= Cyclical component	- 0.9	- 0.3	- 0.1
+ One-off temporary measures	- 0.1	- 0.1	- 0.2
+ Structural balance	- 2.6	- 2.3	- 2.3

Source: Cour des Comptes based on the LFI for 2019 and information provided by the Ministry of Economy and Finance.
Note: As figures have been rounded to the nearest tenth, there may be slight disparities in operation results.

According to the Government's assessments, there should be no decrease in the structural deficit since 2017. Generally referred to as "expenditure effort", expenditures' contribution to reduction of the structural balance would be to the tune of 0.2 GDP points. It would be compensated by measures reducing mandatory levies by an equivalent amount.

Once the increase in the Consumer Price Index excluding tobacco (+1.6%) has been deducted, public expenditure in volume should have stabilised: an evolution significantly below the 0.6% provided for in Public Finance Programming Act (LPFP). This result was obtained by strict management of State expenditures and of the *Objectif National de Dépenses d'Assurance-Maladie* (ONDAM – National Health Insurance Expenditure Target). It should nonetheless be seen in relative terms as it was not obtained from a slower evolution in expenditures than forecast in the LPFP but rather from a higher-than-expected rise in consumer prices.

In addition, this increase in inflation is almost entirely due to the rise in petroleum product prices (on average over 2018 compared with 2017). Consequently, when GDP prices are used (with a more moderate 0.9% increase in 2018) to measure the evolution of public expenditure in volume, it has risen by 0.7%. The expenditure effort, which is based on this latter definition of growth in expenditure volume, is therefore limited to 0.2 GDP points, lower than that provided for in the LPFP (0.4 GDP points).

In this respect, it is worth noting that increased inflation due to petroleum product prices is generally unfavourable to public finances from the first year on (see inset).

Impact of increased inflation on public finances

A uniform price rise is of short-term benefit to the general government budget balance. It is expressed almost at once by an increase in numerous tax and social revenues along with the Consumer Price Index, while public expenditures are little impacted over the short term, as expenditures, on the part of the State in particular, are generally constrained by budgets passed. Interest payments are an exception however, due to inflation-indexed obligations. The positive impact on the general government balance is then reduced, largely owing to indexation mechanisms applicable to a number of expenditure items (including social benefits and pensions) and to greater or lesser adjustment of other expenditures to the price rise. Over the medium term, this impact, which depends in particular on the role played by expenditure indexation mechanisms and tax scales, is uncertain.

In contrast, an increase in inflation originating in a rise in oil prices generally has a negative impact on the government budget balance in the first year. Although such price rise leads to a direct increase in certain revenues (in particular from VAT on petroleum products), it nonetheless weighs on revenues from the *taxe intérieure de consommation sur les produits énergétiques* (TICPE – domestic consumption tax on energy products) due to lower household consumption of petroleum products. In addition, revenues from corporate tax are penalised by the fall in profits resulting from the rise in prices of petroleum products purchased by companies. It finally leads to an increase in interest payments.

A rise in oil prices continues to have a negative impact on the general government balance over the years that follow: although revenues increase due to the general price rise, they are nonetheless penalised by the resulting reduction in activity, and the increase in expenditure due to increased inflation weighs on the balance. According to Insee's and Treasury's MÉSANGE (*Modèle Économétrique de Simulation et d'ANalyse Générale de l'Économie /* Econometric Model of Simulation and General Analysis of the Economy), this impact is significantly greater compared with that recorded over the first year.

With a structural deficit of 2.3 GDP points, France is still far from reaching its medium-term budgetary objective (MTO), set at -0.4 GDP points by the 2014 and 2018 Public Finance Programming Acts (LPFPs), in application of the European rules adopted in 2012 (which impose a structural deficit less than 0.5 GDP points).

Furthermore, the forecast stability in the structural balance diverges from our European commitments, which require that countries which, like France, are part of the Stability Pact's "preventive arm" (as they record a headline deficit below the 3 GDP-point threshold, a debt exceeding 60 GDP points and a structural deficit greater than its medium-term budgetary objective) to reduce their structural deficit by 0.6 GDP points a year[2]. This strict rule nonetheless allows for a measure of leeway: a lesser reduction, of only 0.1 points over a year or an annual average of 0.35 points over two years is permitted. With the stability forecast in 2018, the structural balance would not meet European rules, even when the permissible leeway is taken into account.

C - The public debt-to-GDP ratio should increase slightly unlike in other European countries

According to the forecast for 2018 alongside the Budget Bill, the public debt-to-GDP ratio will increase once again to reach 98.7 GDP points. Social security administrations' and local governments' debts would be reduced, unlike the State's (Table 2).

Table 2: public debt by public administration subsector (in % of the GDP)

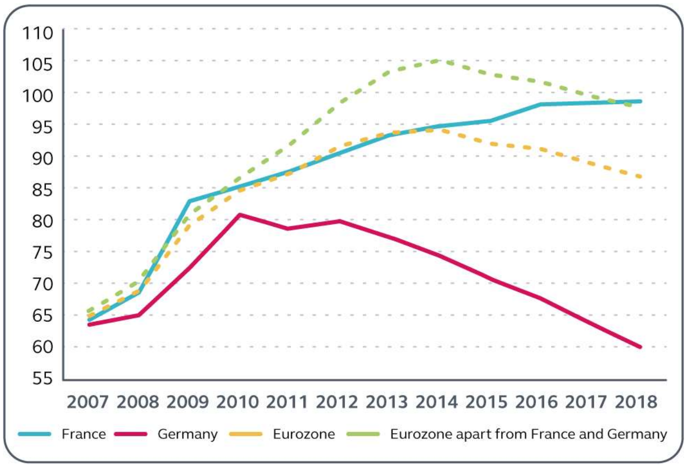
	2016	2017	2018
Central public administrations	79.1	79.9	81.1
Local public administrations	9.0	8.8	8.5
Social security administrations	10.1	9.9	9.1
All public administrations	**98.2**	**98.5**	**98.7**

Source: Economic, Social and Financial Report for 2019.
Note: As figures are rounded, subtotal sums may differ slightly from totals.

Hence, in 2018, France's public debt stayed on a trajectory that diverged from Germany's and the Eurozone's: the German public debt, which, when divided by the GDP, has decreased continuously since 2012, should be back to the 60 GDP-point threshold in 2018; the rest of the Eurozone's debt has been diminishing since 2015 and will have fallen below France's in 2018.

[2] European texts stipulate that the change in the structural deficit must exceed 0.5 GDP points, which, according to the Commission's and European Council's interpretation, requires an adjustment at least equal to 0.6 GDP points.

Graph 2: public debt (in GDP points)



Source: Cour des Comptes, based on Insee and Eurostat data up to 2017, and the Government and European Commission forecast for 2018 (Ameco database).
Note: Insee's reclassification of SNCF-Réseau as a public administration in September 2018 increased the public debt ratio by 1.6 GDP points as from 2016.

⁂

In total, despite still relatively favourable GDP growth (1.7% according to the Government and 1.5% according to Insee), higher than existing estimations of potential growth (1.25% according to the Government), neither the public deficit nor the structural deficit will be reduced in 2018. The debt-to-GDP ratio will have continued to increase, unlike the trajectories observed among the great majority of our partners.

II - In 2019, a headline deficit of more than 3 GDP points, and particularly fragile public finance forecasts

For 2019, the public finance trajectory provided for in the Draft Budget Bill (PLF) was substantially corrected following the emergency measures announced in response to the “yellow vest" movement. Forecasts for the public balance and debt have been downgraded compared with 2018, highlighting the fragility of our public finances and the partial nature of the turnaround recorded.

A - Measures decided on at the end of 2018 modify the public finance trajectory

The Draft Budget Bill (PLF) for 2019 forecast a moderate increase in the public deficit (+0.2 GDP points, to 2.8 GDP points), along with an equally moderate reduction (-0.3 GDP points) in the structural deficit.

Since the PLF was tabled, tax and social measures to the tune of €11 billion in support of purchasing power have been decided on, partly compensated by increases in revenues and decreases in expenditures. They have led the Government to bring its deficit forecast up to 3.2 GDP points.

1 - A draft Budget Bill in line with the January 2018 Public Finance Programming Act

The PLF, which is globally consistent with the Public Finance Programming Act (LPFP) of January 2018, presented a 0.2 GDP-point deterioration in the public deficit, from the 2.6 GDP points initially forecast in 2018 to 2.8 GDP points in 2019. Apart from the one-off 0.9 GDP-point decrease in revenues connected with the CICE's transformation into a cut in social contributions and from the fall-out of 2018 reimbursements of the 3% tax on dividends, the deficit should fall by 0.5 GDP points.

The impact of turning the Tax Credit for Competitiveness and Employment (CICE) into a cut in contributions

In national accounting, the CICE (tax credit on the corporate income tax to compensate partially wages paid by businesses) is recorded the year that corporate income tax receivable is declared[3]. Hence, the CICE for remunerations paid in 2018 is essentially recorded in 2019. The decrease in social contributions on remunerations paid as from 1 January 2019 will have an impact from 2019 onwards. The 2019 deficit will therefore be impacted by CICE declarations for 2018 as well as by the cut in social contributions in 2019.

This operation reduces mandatory levies on companies by a total of €20.4 billions: a €24.1 billion decrease in social contributions, partly compensated by the effect of lowering the CICE rate from 7% to 6% on 2018 salaries (for €1.7 billion) and by the mechanical impact of the cut in contributions on business results and therefore on corporate tax (€2 billion for 2019).

[3] Conversely, company accounting records the CICE for the year in which salaries are paid (i.e. in 2018 for salaries paid in 2018).

This expected improvement would be a partial expression of an economic growth (+1.7%) that is higher than potential growth (+1.25%): the cyclical deficit would fall by 0.2 GDP points. It also reflected a structural improvement, with the structural deficit falling by 0.3 GDP points in the Government's forecast.

Such improvement was nonetheless not enough to ensure compliance with France's European commitments: given the low level of the structural adjustment carried out in 2018, they required a reduction of the structural deficit of at least 0.6 GDP points[4]. It only just enabled stabilisation of the public debt-to-GDP ratio, despite a major asset disposal programme. It was nonetheless consistent with the budgetary consolidation trajectory set by the LPFP. This is no longer the case with the Finance Act that was finally passed, which incorporates the cost of measures in support of household purchasing power implemented at the end of 2018.

2 - Measures decided on at the end of the year with major consequences for public finances

The measures decided on at the end of the year in support of household purchasing power represent close to €11 billion and are mainly constituted of cuts in mandatory levies and a few increases in expenditures. The cuts in mandatory levies result from cancellation of the increase in the tax on energy products provided for in the PLF (€3.9 billion), non-imposition of income tax and exemption from social contributions on overtime hours from 1 January, a move initially planned for 1 September 2019 (€2.4 billion), and cancellation of the increase in the *Contribution Sociale Généralisée* (CSG – General Social Contribution) for less well-off retirees (€1.3 billion). Increases in expenditures essentially correspond to those on the *Prime d'Activité* (Wage Bonus – €2.8 billion) and extending the scope of the "energy cheque" and *prime à la conversion* (vehicle replacement bonus – €0.4 billion).

The Government has also encouraged businesses to pay their employees a *prime exceptionnelle* (extraordinary bonus) by exempting it from contributions and taxes, and considers that the measure will have no impact on the government balance. Yet this bonus may well act as a partial substitute for the pay rises that will have taken place in any case, which would decrease tax and social revenues. The measure may therefore finally weigh on public finances, though how much so is difficult to estimate at this point.

In order to limit the increase in the public deficit, a tax niche on intra-group profits was abolished in the LFI (+€0.4 billion).

[4] In order to reach the minimum required 0.7 GDP points over two years, taking account of an adjustment estimated at 0.1 GDP points for 2018.

The Government has also announced its intention to postpone the decrease in corporate income tax from 33.3% to 31% initially planned for businesses with turnovers not exceeding €250M (making an increase in revenues of €1.7 billion) and to create a new tax on major actors in the Internet world (€0.5 billion).

Finally, measures designed to cut back on State expenditures (and which may save as much as € 1.5 billion) have also been announced.

These measures to increase revenues and decrease expenditures, which are yet to be expressed in legislative or regulatory texts, would reduce the deficit increase by €3.7 billion, bringing it down to 3.2 GDP points.

According to the Government, all these measures put together will increase the deficit forecast in the PLF by over €7 billion (see Table 3), i.e. to the tune of 0.3 GDP points.

Table 3: impact on the government balance of the main measures announced since the 2019 PLF and Social Security Finance Bill (PLFSS) (in € billions)

Measures	Total
Measures taken in the Social Security Finance Act (LFSS)	**- 0.4**
Restoration of a number of social exemptions	- 0.4
Measures adopted in the LFI following parliamentary debate	**- 7.0**
Increase in the energy cheque and vehicle replacement bonus	- 0.4
Upward revision of *aides personnelles au logement* (APL – Personal Housing Assistance), due in particular to their not taking present-day incomes into full account	- 0.3
Cancellation of the rise in energy taxes	- 3.9
Increase in the employment bonus	- 2.8
Increase in the imposition on intra-group transfer of capital gains	0.4
Measures taken in the law bearing on economic and social emergency measures	**- 3.7**
Tax exemption and early implementation of exemptions from social contributions on overtime hours	- 2.4
Cancellation of the increase in the CSG for less well-off retirees	- 1,3
Exemption from income tax and social contributions on the extraordinary bonus for private-sector employees	0
Measures announced but yet to be adopted	**3.7**
Tax on major actors in the Internet world	0.5
Postponement of the decrease in corporate tax for businesses with turnovers exceeding €250M	1.7
Savings on State expenditures	1,5
Total	**- 7.4**

Source: Cour des Comptes based on the Finance Act and its appended documents and the law bearing on economic and social emergency measures.

The LFI's base effect of the loss of revenues for 2018 compared with the PLF's forecasts (0.1 GDP points) and the measures taken at the end of 2018 (0.3 GDP points) would deteriorate the public deficit forecast by the Government by 0.4 GDP points, increasing it from 2.8 to 3.2 GDP points. Apart from one-off measures (turning the CICE into a cut in contributions in 2019 and reimbursement of the 3% tax on dividends in 2018), there would be a slight decrease in the headline deficit (-0.2 GDP points) between 2018 and 2019.

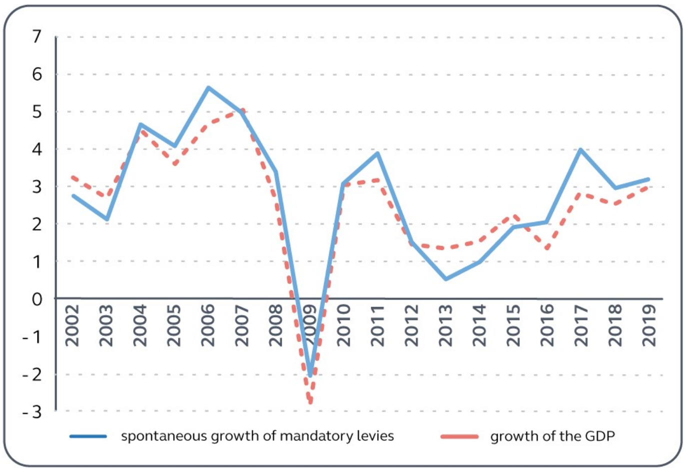
Similarly, the structural deficit forecast would deteriorate by 0.3 GDP points to reach 2.3 GDP points (as against the 2.0 forecast in the PLF), the same level as in 2018.

3 - Extensive measures to lower mandatory levies and an increase in expenditures equivalent to that in 2018

Mandatory levies would be practically stable at constant scope. Barring changes in legislation, the increase in mandatory levies (+€34 billion) would be substantially compensated by the reduction measures decided on (-€31 billion).

Barring changes in legislation, the Government forecasts a 3.2% growth in mandatory levies (also referred to as their "spontaneous" growth"), very close in value to the GDP's (3.0%): mandatory levies' elasticity to the GDP would therefore be slightly higher than 1, its average value between 2000 and 2017. Given the economic scenario selected this elasticity forecast is plausible.

Graph 3: spontaneous growth rate of mandatory levies and the GDP (in %)



Source: Cour des Comptes, based on budget documents and Insee data from national accounts.

Measures to decrease mandatory levies (by €31 billion) would be to the tune of around €11 billion for households (€5 billion included in the PLF plus almost €6 billion decided on at the end of the year) and €20 billion for businesses (but would be close to 0 for these latter apart from the effect of turning the CICE into a cut in contributions).

Under other PLF hypotheses (economic scenario and growth of mandatory levies if there were no change in legislation) that the Government has left unchanged, the forecast rate of tax and social security contributions would fall by 1.3 GDP points at constant scope (1.1 points at current scope).

Apart from tax credits and exceptional factors, public expenditures' growth in value would be almost stable (+1.7% in 2019 as against +1.6% in 2018)[5]. In the absence of an updated inflation scenario that takes account of the measures taken since the PLF was tabled, and the steep drop in oil prices since then, any reliable assessment of how public expenditure will evolve in volume is as yet impossible.

Compared with the 2018 execution, the 2019 PLF initially assumed that State expenditures would increase by +€2.8 billion with regard to standard controllable expenditures[6] and by +€6.4 billion with regard to the State's overall expenditure objective. The measures taken in late December 2018 will lead to an estimated €3.5-billion increase in expenditures, which the Government means to compensate to the tune of €1.5 billion by savings that have been announced but are as yet non-documented.

Furthermore, the forecast increase in expenditures by social security administrations is a little lower for 2019 than it was in 2018 (+2.0% as against +2.2%): it would be brought about by the speeding up of the ONDAM, which has increased from +2.3% in 2018 to +2.5% in 2019), but slowed down by the weakness of measures for revaluing social expenditures (which would increase by 0.3% in 2019 instead of the usual indexation on inflation, enabling savings of €3.3 billion). Finally, the Government forecast has local public administrations' expenditures increasing in 2019 at the same pace as in 2018 (+2.6%).

---

[5] 1.5% forecast in the 2019 PLF + 0.2 points associated with the measures taken in late December 2018 (corresponding to €2.8 billion in employment bonuses + €0.4 billion in energy cheques and vehicle replacement bonuses + €0.3 billion on personal housing assistance, partly compensated by €1.5 billion in budgetary savings).

[6] The State's "controllable" expenditures comprise the State's general budget expenditures excluding contributions to the *Pensions* special appropriation account, interest payments on the debt and the "Investments for the Future" mission, to which are added expenditures on the part of supplementary budgets, expenditures by a number of the Treasury's "controllable" special account programmes, and the capped taxes and charges involved. They do not, however, include interest payments and revenues to the profit of the European Union and local and regional authorities.

Deterioration of the government balance compared with 2018 would weigh on the State, subjected to the dual impact of the CICE's transformation into a cut in contributions and the new measures taken to increase household purchasing power. Conversely, the social security administrations' balance should show a slight improvement and the local public administrations' balance-to-GDP ratio remain stable between 2018 and 2019.

Table 4: government balance by public administration subsector (in % of the GDP)[7]

	2017	2018	2019
State	- 2.8	- 3.1	- 4.0
Central administrations bodies	- 0.1	- 0.1	- 0.1
Local public administrations	0	0.1	0.1
Social security administrations	0.3	0.6	0.8
Government balance	**- 2.7**	**- 2.7**	**- 3.2**

Source: Economic, Social and Financial Report for 2019, updated using information supplied by the Ministry of Public Action and Accounts.
Note: as figures are rounded, subtotals may differ slightly from totals.

B - Major uncertainties regarding the 2019 balance

There are a number of major uncertainties with regard to the government balance forecast for 2019 that was finally incorporated in the LFI: first of all, those to do with the fact that the macroeconomic scenario has not been updated despite an international and budgetary context that has evolved considerably since the PLF was tabled; secondly, those to do with assessment of the measures to reduce mandatory levies decided for 2019, and the forecast for various expenditures.

[7] It is assumed that the measures reducing the CSG and bringing forward the exemption of overtime hours from social contributions, enacted in the law bearing on emergency economic and social measures, are fully compensated to Social Security bodies by the State. If the provisions of the Social Security Finance Acts provided for the State's not compensating social security administrations for reductions in contributions, this could lead to a deterioration of up to 0.1 GDP points in the social security administration balance and an improvement of the State's to the same total.

1 - A weakened macroeconomic scenario

The *Rapport Économique, Social et Financier* (RESF – Economic, Social and Financial Report) appended to the initial PLF for 2019 had incorporated the hypotheses of 1.7% GDP growth in 2019 as in 2018, a 1.3% rise in consumer prices apart from tobacco in 2019 following 1.6% in 2018, and 3.5% growth in the private sector payroll in 2019, as in 2018.

This scenario, which was based on data available at the beginning of September 2018, has not been modified and therefore forms the basis for the LFI. Yet a number of major new factors have come into play since then, both as regards measures taken since the PLF was tabled and the evolution of the macroeconomic environment, internationally in particular.

In relation to the PLF scenario, the measures taken since the autumn amounts to an increase in household purchasing power by 0.8 points, which should support their consumption and France's economic growth in consequence, even if part of the resulting increase in demand is expressed by additional imports.

Conversely, such support to purchasing power has come about at a time when our partners' growth prospects are weakened, above all in Europe, in particular due to a greater-than-forecast slowdown in the German economy, financial tensions in Italy, the effect on the United Kingdom's economy, as well as on those of its European partners, of continuing uncertainties regarding the conditions under which the UK will leave the European Union, the rise in American and Chinese customs tariffs, and the sharp fall in stock markets since summer 2018.

It is uncertain what impact the measures taken at the end of 2018 and the contrasting slowdown of our partners' economic activity will have on French growth, but the rapid deterioration of the global economic environment, highlighted in business and consumer surveys, has created a risk that it will fall below the Government's forecast. In its December 2018 forecast, which took account of the most recent cyclical information and, for the most part, the measures announced by the Government in December 2018, Insee predicted carryover growth[8] of only 1.0% at the end of the first half of the year. With this figure, achieving the Government's annual growth forecast in 2019 would require high quarterly growth rates in the GDP, to the tune of 0.9% per quarter in the second half of 2019, something that has not happened since the first half of 2006.

[8] Carryover growth is the growth figure that would be recorded over the whole year if GDP growth were zero over the course of the remaining quarters.

Given the evolutions that have come about since the PLF was tabled, the Finance Bill's inflation forecast would seem too high. Cancellation of the increase in energy tax and the freeze on gas and electricity prices will automatically lead to reduced inflation. In addition, oil prices fell sharply in November and December 2018: if they continue to stay at the level reached in early 2019, they should bring down petroleum product prices compared with the PLF forecast. Finally, the rise in core inflation (i.e. excluding volatile product prices, mainly corresponding to fresh food products and energy prices) expected in the PLF (annual average of +1.2% in 2019 as against +0.8% in 2018) cannot be taken as granted, given its moderation observed in the second half of 2018.

Although the drop in energy prices should be favourable to the 2019 government balance, prospects of lower core inflation would be unfavourable to it (see inset: "impact of increased inflation on public finances") as the results of the two effects are uncertain.

The LFI's macroeconomic scenario emerges significantly weakened as it does not taken account of the new measures decided on at the very end of the process or of the rapid evolution of the economic environment since the PLF was tabled. Although the French growth forecast (1.7%) on which the LFI is based is not altogether out of reach, there is a serious risk that it will not be achieved.

2 - Uncertainties on forecasts of revenues and expenditures increased by the measures taken at the end of 2018

There are major uncertainties with regard to forecasts on revenues from mandatory levies as well as on expenditures. Some are already present in the PLF and have been increased due to the measures decided on at the end of 2018.

Introduction of PAYE has created an unaccustomed uncertainty as regards the yield from income tax, which the Court had estimated at €2 billion upwards or downwards[9].

The forecast expenditures on unemployment benefits assumes that savings to the tune of €0.5 billion will be made for 2019. Even with the hypothesis of a new savings plan being decided in the near future, there is a major risk that its implementation will not be expressed by such savings in 2019, given the usual time it takes for such measures to take full effect.

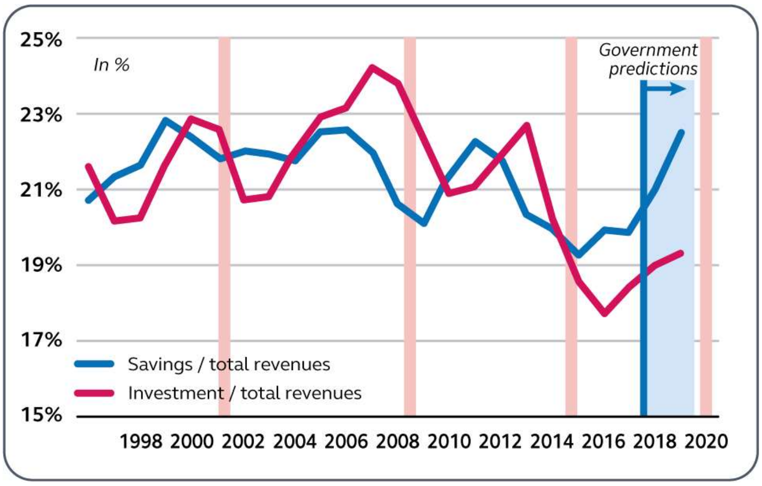
---

[9] Cour des Comptes, *La situation et les perspectives des finances publiques* (Public Finances: situation and perspectives). La Documentation Française, June 2018, 181 pp., available on www.ccomptes.fr.

Similarly, the increase in investments on the part of Local Public Administrations may well be greater than forecast by the Government. The Government forecasts that expenditures on investment will rise by 6.3% in 2019. They would be spurred in particular by the mounting importance of the Société du Grand Paris (SGP)[10]. Nonetheless, leaving aside the SGP, forecast public investment growth is still high, although a little more moderate: +4.9% in 2019 as against +5.8% in 2017 and 2018.

Yet the sharp rise in savings that Government forecasts see as resulting from local authorities' compliance with their operating expenditures objective is likely to lead to a significantly higher increase in investment than forecast. All the more so as, during previous municipal electoral cycles, the year preceding elections generally saw a greater increase in local public administrations investments than might have been expected from the level of their savings (see Graph 4).

Graph 4: local public administrations' savings and investments compared with total revenues (in %)



Source: Cour des Comptes based on data from national accounting and the State's financial transfers to local authorities under budgetary annexes
Note: The impact of transfers connected with decentralisation and creation of the Société du Grand Paris has been neutralised. Municipal election years are marked by vertical lines.

Initial uncertainties have been reinforced by those surrounding the impact of the measures announced at the end of 2018.

[10] Regarded as a public administration in national accounting.

The cost of the extension of the Employment Bonus decided on at the end of the year is affected by distribution of salaries and the rate of recourse by employees concerned, and by its very nature remains surrounded by major uncertainties.

In addition, the measures deferring the decrease in the corporate income tax rate for large companies (+€1.8 billion) and the tax on large digital companies (+€0.5 billion) have yet to be made the subject of legislative provisions and cannot therefore be taken as granted.

Similarly, the €1.5-billion savings plan on the State's controllable expenditures announced by the Government has not been included in the LFI and its content still needs defining. Furthermore, such savings would add to those already needed to compensate the tensions already weighing on the State's budget (in particular on the *Defence* mission's external operations and domestic missions, despite the continued improvement of such operations' budgeting) in the context of the PLF, or those that may emerge in the course of execution, like the wage measures decided on in December 2018 on behalf of the domestic security forces.

⁂

All in all, the forecast of a public deficit of 3.2 GDP points in 2019 is a fragile one: among other things, it assumes that growth will not slow down in 2019, contrary to what the most recent cyclical information suggests, that the impact of the measures adopted in the context of the law bearing on emergency economic and social measures will be fully compensated by the savings announced, and, finally, that the expenditure objectives contained in the 2019 Finance Acts will be strictly complied with.

C - Marked deterioration in the public balance and debt that highlights the fragility of our public finances' recovery

Perspectives for public finances in 2019 testify to the fragility of the recovery made so far: the emergency measures aiming to respond to the social crisis were enough to bring the public deficit forecast above the 3 GDP-point threshold, limit the structural adjustment forecast for 2017, 2018 and 2019 to 0.2 GDP points and once again increase the public debt-to-GDP ratio, even though growth over the course of the three years in question should be higher than its potential. This finding only goes to confirm that, due to incomplete consolidation of its public finances, France has little fiscal room to face up to an economic downturn or crisis situation.

1 - Marked deterioration in the government balance

After two years below the 3 GDP-point threshold, the headline deficit would therefore once again be above it in 2019 (3.2 GDP points). However, return to a deficit above 3 GDP points will not necessarily lead to new implementation of the excessive deficit procedure if the deficit is only just above the 3 GDP-point threshold, as in the Government's current forecast, and if its return below the threshold in 2020 is considered as credible by European bodies, given the one-off effect of turning the CICE into a cut in social security contributions.

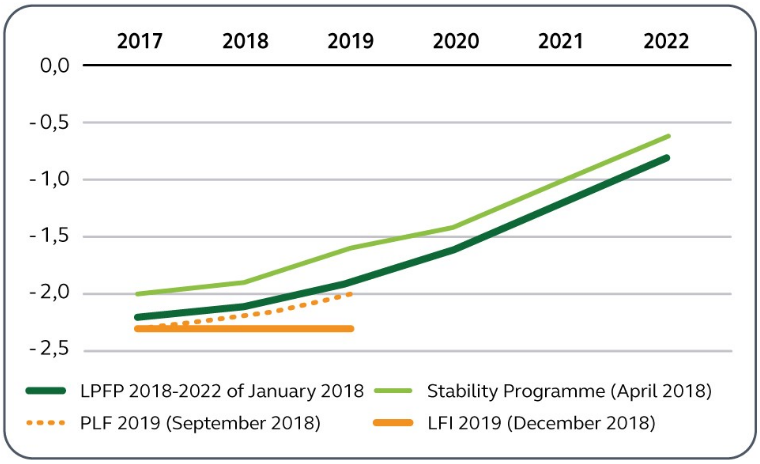
However, the fact that there is no improvement in the structural balance now forecast for 2019, following a similar evolution in 2018, runs altogether contrary to our European commitments.

Even before taking account of the measures announced at the end of 2018, the forecast reduction in the structural balance was already below that required by our European commitments. In its letter of 19 October 2018 to the French Government, the European Commission had therefore emphasised the possibility of a "risk of deviation" with regard to the budgetary adjustment recommended in 2019 and a "significant risk of deviation" with regard to the budgetary adjustment recommended for 2018 and 2019 taken together. The measures decided on at the end of 2018, leading to forecast stability in the structural balance in 2019, have made it even less likely that France will be able to comply with its European commitments.

In the coming spring, during its examination of France's Stability Programme, the European Commission will be revising its assessment of French public finances, along with those of other countries.

The forecast structural deficit now also differs markedly from the target set in the Public Finance Programming Act (LPFP) of January 2018 (Graph 5), the ambition of which was nonetheless limited, with an improvement of only 0.4 GDP points in total over 2018 and 2019.

Graph 5: successive structural balance forecasts (in GDP points)



Source: Cour des comptes

2 - A growing misalignment with other European countries

In the forecasts for 2019 made by the European Commission in November 2018, the Eurozone showed a headline deficit of less than 1 GDP point, slightly more than in 2018 (0.8 GDP points in 2019 as against 0.6 GDP points in 2018), in a context in which most countries are already well on the way to consolidating their public finances. In this particular forecast, France's deficit stood at 2.7 GDP points, higher than any of its Eurozone partners except for Italy (2.9 GDP points).

In these forecasts, the Eurozone's structural balance (at -1.0 GDP points), albeit deteriorated by 0.3 GDP points, was still markedly less deteriorated than France's (-2.3 GDP points in the Commission's and Government's forecasts), and the only Eurozone countries showing a structural deficit higher than France's were Spain and Italy.

Since these forecasts were published, however, France has taken measures, which, all things being equal, should lead to significant deterioration of the deficit forecast for 2019. Conversely, Italy has reduced the cost of a number of measures included in its draft Budget Bill following exchanges with the European Commission, which had observed in its opinion of 21 November 2018 that the Italian Budget Bill did not comply with the Stability and Growth Pact's requirements.

With respect to the Commission's November 2018 forecast, all things being equal, taking the most recent factors into account would lead to further deterioration in France's position in the Eurozone, both as regards the headline deficit, which would exceed Italy's and therefore become the highest in the Eurozone, and the structural deficit, which would come close to Spain's and Italy's.

3 - A public debt that would continue to increase, leaving little room for manoeuvre

The government balance for 2019 forecast in the Economic, Social and Financial Report (RESF) was slightly lower than the balance stabilising the debt ratio: higher than in 2018, the GDP's expected growth in value (3.0% as against 2.5%), which automatically reduced the weight of the past debt in the GDP, compensated the increase attributable to the high deficit in 2019. De facto, the public debt-to-GDP ratio was expected to decrease slightly, by 0.1 GDP points, in the PLF forecast, to bring it to 98.6 GDP points in 2019. The Government has not revised its public debt forecast since the PLF was tabled, but as the measures announced at the end of 2018 increased the deficit forecast for 2019, the public debt-to-GDP ratio should also be revised accordingly, to show an increase over this year. Such rise would increase further if growth proved to be weaker than forecasted by the Government, as the most recent cyclical evolutions suggest, or if the deficit were higher than forecast. The State's financing needs for 2019 have been updated, however, leading the *Agence France Trésor* (AFT – French Treasury Agency) to announce a provisional total of medium- and long-term emissions (OATs – *Obligations Assimilables du Trésor* / Fungible Treasury Bonds), net of repayments, of €200 billion instead of the LFI's €195 billion.

At the same time, according to the European Commission's forecasts, Germany's public debt should fall considerably below 60 GDP points while the Eurozone's, excluding Germany and France, would decrease once again, to 95.7 GDP points, so falling well below France's.

France is now one of Europe's most debt-ridden countries, after Greece, Italy, Portugal and Belgium. Yet following the 2008-2009 financial crisis, these countries recorded tensions on their interest rates and even experienced problems refinancing their debts[11], leading them to implement rigorous budget adjustment programmes without being able to absorb the macroeconomic shock by policies in support of activity. Even though France's situation is not totally comparable to these countries', the high levels of public debt and public deficit in France leave little room for manoeuvre, in particular in the event of an economic downturn or crisis situation.

CONCLUSION

Public deficits remained high at the end of 2018. According to the Government, headline and structural deficits were stable, while economic growth remained higher (1.7% according to the Government's latest forecasts and 1.5% according to Insee's Report of December 2018) than its potential (1.25% according to the Government). The public debt-to-GDP ratio should increase again, whereas it is falling in all other European countries.

In its 2019 Draft Budget Bill, France presented a slight improvement in the structural balance, in compliance with the trajectory set out in the Public Finance Programming Act of January 2018, but already below its European commitments.

The measures decided on at the end of 2018 modified this trajectory and the deficit forecast in the Initial Budget Act (LFI) now stands at 3.2 GDP points in 2019. This forecast does not take account of the emergency measures enacted in the law bearing on emergency economic and social measures. The Government has announced its intention to adopt measures increasing mandatory levies and reducing State expenditures by an equivalent amount over the course of 2019, in order to keep the forecast deficit at 3.2 GDP points.

[11] Similarly, a number of countries, including Spain and Ireland, although less in debt than France, have also been faced with such problems.

Hence, after two years of deficit below 3 GDP points, the forecast headline deficit would exceed the threshold once again in 2019, under the effect of the CICE's transformation into a cut in social security contributions and substantial reductions in mandatory levies in favour of households, with no supplementary effort on expenditures compared with 2018. Leaving aside the one-off measures (turning the CICE into a cut in contributions in 2019 and reimbursement of the 3% tax on dividends in 2018), there should nonetheless be a slight decrease (-0.2 GDP points) in the headline deficit between 2018 and 2019.

The structural deficit would remain stable at best, standing at 2.3 GDP points, nowhere near the Medium-Term Budgetary Objective (MTO) for the structural deficit (set at 0.4 GDP points for France), which half the Eurozone countries have already achieved. Finally, the public debt-to-GDP ratio should increase once again in 2019.

This worrying public finance scenario is also affected by a whole range of weaknesses. In particular, the underlying macroeconomic scenario does not take account of recent cyclical information, which is overall unfavourable to French growth, or, conversely, of the impact of the measures adopted at the end of 2018, and various measures announced to limit the increase in the deficit, to a total of €3.7 billion, are yet to be enacted.

In these conditions, the Court deems it essential that the Government loses no time in presenting amending finance bills, for the State and social security, exhaustively and openly incorporating all announced measures as well as the consequences of the evolution in the macroeconomic situation. It will also have to update the public finance trajectory set out in the Programming Act of January 2018. The trajectory should act as the basis for in-depth recovery of our public finances, which is more than ever necessary as recent events have demonstrated the inadequacy and major fragility of the recovery made so far.

Sustained reduction of headline and structural deficits is essential in order to finally make a start on reducing the public debt-to-GDP ratio and find room for budgetary manoeuvre enabling France to face up to an economic downturn or crisis situation.

Given the high levels of mandatory levies, such consolidation, a fortiori *if it is to be accompanied by a reduction in mandatory levies, must be achieved by greater control of public expenditures.*

Replies

JOINT REPLY FROM THE MINISTER OF ECONOMY AND FINANCE AND THE MINISTER OF PUBLIC ACTION AND ACCOUNTS

We should like to thank the Court for its work, which has helped clarify citizens on France's situation with regard to public finances, and which spurs us on to continue with their improvement. This has been the Government's constant objective since 2017.

To start with, we should like to draw attention to the results obtained by the Government since 2017. Following achievement of a public deficit below 3% of the GDP in 2017, France was able to free itself from the excessive debt procedure implemented since 2009. This result was above all due to a major effort on expenditure, well beyond what the Court judged achievable in its audit of June 2017. Similarly, the control of the 2018 State budget evidences the Government's determination and ability to restore balanced public finances over time.

The Public Finance Programming Act for 2018-2022 expresses this ambition, which relies on a reduction of more than 3 points of public expenditure's weight in national wealth. The new measures taken by the Government last December in response to the economic and social emergency have certainly led to an adjustment of the public finance trajectory but in no way call into question the Government's determination to comply with its commitment to control public expenditure.

In this context, the analyses presented by the Court call for two series of observations, firstly on the public finance situation in 2018 and secondly on perspectives for 2019.

1- Regarding the public finance situation in 2018

The execution of the 2018 budget proves that the Government's change of method vis-à-vis the role of the State is both effective and appropriate. Substantial efforts were made in the matter of initial budgeting. The major increase in appropriations as well as introduction of provisions for the unexpected have helped improve the State budget's sincerity, as has been regularly remarked by observers, including the Haut Conseil des Finances publiques *(HCFP – High Council of Public Finances). The consequent reduction of the reserve rate from 8% to 3% on appropriations excluding payroll has resulted in increased accountability among public managers.*

Management of the 2018 budget was therefore carried out on a new footing, enabling avoidance of any major movements in management and so constituting a real break with previous practices. For the first time in over thirty years, the Government did not open or cancel appropriations by advance decree. All openings and cancellations on the general budget will therefore have been decided by Parliament, both in the context of the Finance Bill and the Amending Finance Bill, henceforth anticipated and recentred on single management, making appropriations opened in the Amending Finance Act available as from 11 December.

Such budgeting and management efforts should enable consolidation of a public deficit below 3% for the second year running. The nominal balance forecast in the Amending Finance Act in November was set at -2.6% of the GDP, a forecast that was reset at -2.7% in the 2019 initial Finance Act in order to take account of the new risks anticipated at the end of December when a text integrating the measures announced by the President of the Republic for 2019 had to be tabled for a second reading. The most recent factors available on the situation regarding execution of the State budget – a €4-billion improvement in the budget balance in comparison with the figures forecast in the Amending Finance Bill – are an unexpected stroke of fortune vis-à-vis a forecast that is still subject to the traditional uncertainties at this point in the year. In addition, as regards local public administrations, the most recent accounting feedback available indicates that their operating expenditures would be contained and lower than 1.2%, which would suggest that the contractualisation introduced in the LPFP is producing the desired effects.

The Court considers that there was no reduction of the structural deficit in 2018. It should be borne in mind, however, that stabilisation of the structural deficit is the result of a significant expenditure effort (0.2 GDP points) whose impact on public finances is nonetheless alleviated by the major reduction in mandatory levies (-0.2 GDP points) undertaken by the Government in the context of a strategy designed to support our enterprises' competitiveness and French citizens' purchasing power. In any event, these results confirm the Government's determination and ability to keep to its objectives as regards control of public finances.

2- As regards 2019

With regard to 2019, the Finance Bill initially forecast a public deficit standing at 2.8% of the GDP, in line with the Government's public finance strategy. With only a very short time at its disposal, the Government reviewed the public finance trajectory in order to take account of implementation of the measures reducing mandatory levies and increasing expenditures announced by the President of the Republic last December in response to the economic and social emergency. The government balance is now forecast to stand at -3.2% of the GDP for 2019. Although 2019 should see the public deficit rise above 3% of the GDP once more, this deterioration will only be a one-time occurrence, limited and exceptional, mainly due to the CICE's transformation into long-term reductions in contributions and the consequent temporary dual cost (-2.3% without this one-off effect).

The Court asks the Government to lose no time in implementing all the recovery measures required to reduce the emergency measures' impact on public finances. Yet such recovery has already been partially implemented following the initial Finance Act, with abolition of the tax niche on intra-group profits, and all planned measures have been announced and will be implemented in 2019.

In addition to the implementation of emergency measures and compensation of their impact on public finances, the Court is worried by various tensions on the State budget which should nonetheless be put in perspective. Once again regarding the Ministry for the Armed Forces' external operations and, as the Court emphasises, the dedicated provision has been increased by €200M compared with 2018, marking a new stage in the State budget's increasing openness.

Finally, as previously emphasised, the procedure undertaken with the 322 local authorities concerned in the field of contractualisation has produced the desired effects of keeping operating expenditures below 1.2% in 2018. The control of operating expenditures observed and the encouragement provided by the financial recovery mechanism in the event of overspending reinforces our forecast of the evolution in operating expenditures among local and regional authorities as included in the LPFP.

In conclusion, as regards the public finance trajectory after 2019, we agree with the Court's analysis on the need to continue reduction of nominal and structural deficits. The light that the Integration project has shed on the public debt demonstrates the need to do so, and it is an updated trajectory of this kind that is set to be put forward on the occasion of the presentation of the next Stability Programme, with the aim of ensuring a decrease in the gross public debt ratio over the course of the programme's implementation.