Cour des comptes

PUBLIC FINANCES AND ACCOUNTS

THE SITUATION AND OUTLOOK OF PUBLIC FINANCES

Summary

June 2016

AVERTISSEMENT

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

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

The response of the Ministry of Finance and Public Accounts and the Minister of State for the Budget 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 by-law relating to finance 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 debate on the guidelines for public finances (article 48 of the LOLF).

This first chapter is devoted to the situation of public finances in 2015 and its development compared with previous years. The Court examines the development of the expenditures, revenues, deficit, and debt of all public administrations. It then more specifically analyses the accounts of each of the major categories of public administrations: central government, social security administrations, and local public administrations. This chapter also compares France's situation with that of other countries of the European Union.

The second chapter covers fiscal year 2016. The Court, on the basis of the information available in mid-June 2016, assesses the risks to achieving the projected revenues, expenditures, and balances of the Stability Programme for all public administrations.

The third chapter assesses the risks weighing on the public finance trajectory incorporated into the Stability Programme for 2017 to 2019. It also examines the measures to reduce the structural deficit at this horizon.

In the fourth chapter, the Court provides a critical analysis of the methods of assessing the Government's savings plan over the 2015-2017 period. For 2015, it compares the savings achieved with those published and measures the effort made.

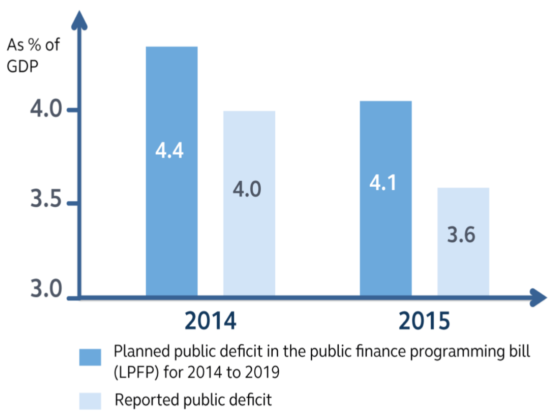
Lastly, the final chapter is devoted to the lessons that may be learned from implementing the fiscal governance rules introduced following the 2008-2009 financial crisis in the Member States of the European Union (rules of structural balance of public finances, mechanism for automatic correction of the public finance trajectory, independent fiscal institutions, etc.).

1 The situation in 2015

A scaled-down deficit

The deficit of public administrations in 2015 was 0.5 points lower than projected in the public finance programming bill (LPFP) and 0.4 points lower than the 2014 results[1]. Although this was an improvement, it remained high at 3.6% of GDP.

LPFP forecast of public deficit and reported deficit



Source: Cour des comptes on the basis of INSEE data and the LPFP

A reduction of the deficit due to local authorities for nearly two-thirds

The reduction of the public deficit compared with 2014 stemmed from local public administrations for two-thirds and from social security administrations for a smaller proportion.

Financing capacity (+) or need (-) of public administrations by sub-sector (in €bn and % of GDP)

	Central administrations		Social security administrations		Local public administrations		Public administrations	
	€bn	% GDP	€bn	% GDP	€bn	% GDP	€bn	% GDP
2012	-84,2	-4,0	-12,7	-0,6	-3,5	-0,2	-100,4	-4,8
2013	-68,2	-3,2	-8,8	-0,4	-8,3	-0,4	-85,4	-4,0
2014	-72,4	-3,4	-7,9	-0,4	-4,6	-0,2	-84,8	-4,0
2015	-72,4	-3,3	-5,8	-0,3	0,7	0,0	-77,5	-3,6

Source: Insee

The central government's deficit, which accounts for most of the deficits of the public administrations (3.3% of GDP out of a total of 3.6%) decreased only slightly. The spontaneous growth in revenues was close to GDP growth for the first time since 2011, and interest expenditure once again decreased. The measures to reduce mandatory levies cut revenues slightly, whereas expenditures within the "value rule" (excluding debt and pensions) increased (by €2.1bn) compared with the target passed in the initial finance act (LFI) for 2015.

For the first time since 2003, local communities generated in 2015 a financing capacity in the national accounts sense. This positive balance resulted from the slowdown in operating expenditure (+1.0% in 2015 after +2.7% in 2014), but especially from the pronounced decline in investment

1 The public deficit was also 0.2% of GDP lower than the forecast associated with the 2016 finance act (-3.8% of GDP).

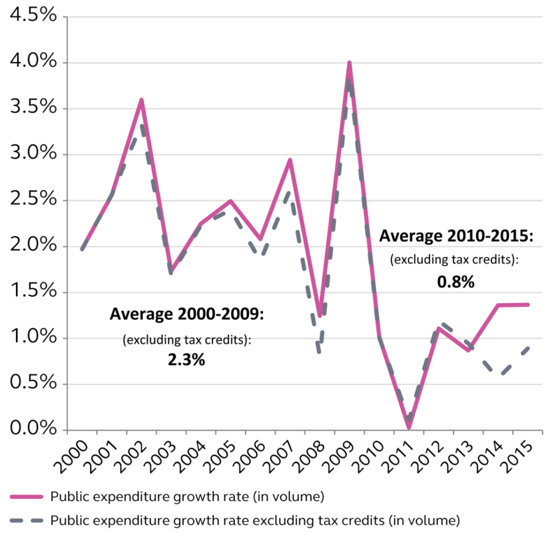
expenditures for the second consecutive year. Although the decrease in allowances exerted real pressure, for the second year, on local finances, its impact was in part lessened by the dynamism of their fiscal resources.

The balance of social security administrations also contracted in 2015 to -0.3% of GDP. This improvement is attributable in particular to the general scheme, the CADES (social debt redemption fund), and hospitals.

An improving structural balance

The reduction of actual (3.6% of GDP) and structural (1.9% of GDP) deficits of around 0.4% of GDP between 2014 and 2015 primarily resulted from a "structural effort2" on expenditures: their growth in volume remained close to 1% in 2015, whereas they grew by more than 2% in the 2000s. However, all the factors contributing to the moderation of expenditures will not be renewable, such as the decrease in local investment and the further decline in interest expenditure. Since 2012, nearly half of the reduction of the public deficit has resulted from the decrease in interest expenditure: the reduction of the primary balance, i.e., excluding interest expenditure, was nearly half of the reduction of the actual balance (0.7 points versus 1.3 points).

Growth of public expenditures between 2000 and 2015 (in %, in volume)



Source: Cour des comptes on the basis of INSEE data

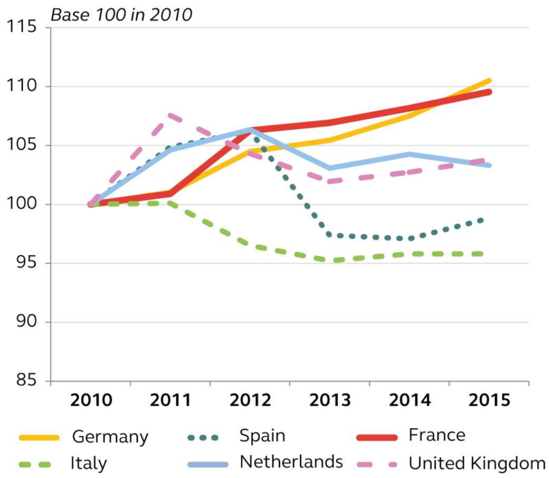
France's persistent lag behind its European neighbours

Compared with other countries, France presents a more degraded public finance situation: only four EU countries maintain a more degraded actual deficit than France (Greece, Spain, Portugal, and the United Kingdom), and four have a higher structural deficit (United Kingdom, Spain, Slovenia, and Belgium).

Between 2010 and 2015, public expenditures in volume continued to increase more in France than in most other EU countries (except for Germany).

[2] The structural effort measures the discretionary portion (new revenue measures and expenditure efforts) of the change in the structural balance.

Change in public expenditures in volume (base 100 in 2010)



Source: Cour des comptes on the basis of Eurostat data

France's debt trajectory now diverges not only from that of Germany, but also from that of the average of eurozone countries: as a proportion of GDP, public debt continued to rise in France in 2015 (+0.4% of GDP), while it declined in Germany (-3.5% of GDP) like on average in the eurozone (-1.3% of GDP). At 96% of GDP, it exceeds that of Germany by nearly 20 points and that of the eurozone's average by 5 points.

2 The situation in 2016

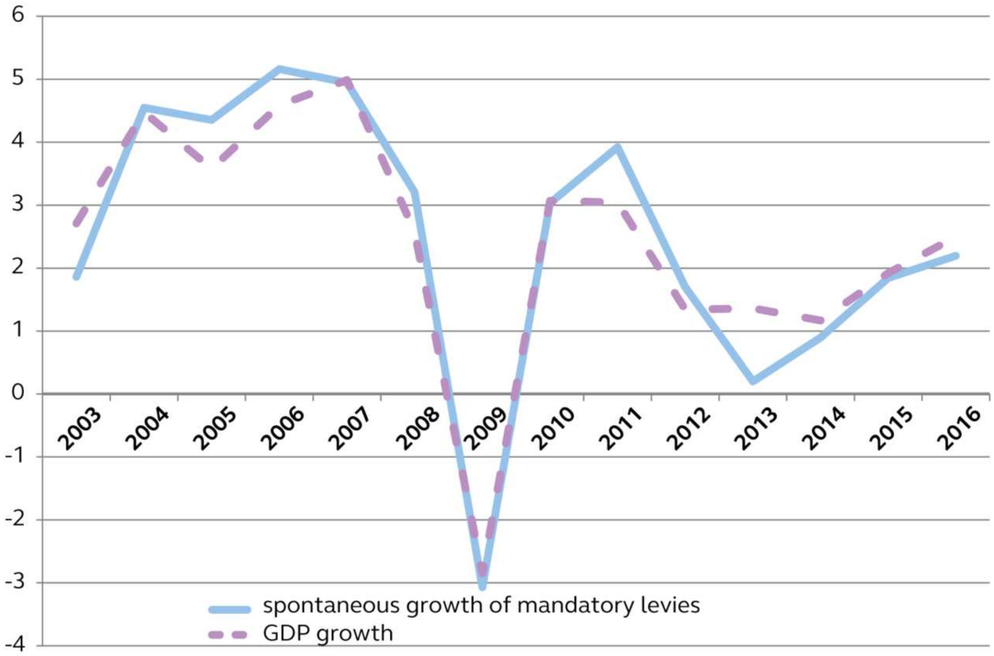
The April 2016 Stability Programme projects a deficit of 3.3% of GDP for 2016, a decline of only 0.3 points compared with the 2015 result, although a further improvement in growth is anticipated.

Despite increased risks compared with 2015 of exceeding the central government's expenditure objectives, the deficit forecast of 3.3% of GDP in 2016 can be achieved. However, this deficit reduction, both actual and structural, would be limited and still would not bring down the weight of public debt in GDP, which would therefore remain above 95% of GDP in 2016.

A plausible public revenue forecast

The revenue forecast is based on a scenario of GDP growth and inflation considered realistic by the High Council of Public Finances and does not include significant risk of over-valuation.

Growth of mandatory levies and GDP in value



Source: Cour des comptes, on the basis of INSEE and the economic, social, and financial report of 2003 to 2016

Significant risks concentrated on expenditures of the central government and Unédic

On the other hand, the central government's ability to meet the expenditures value rule already appears to be compromised. Pressures on appropriations are greater than they were in 2015 at the same time: compared with the credits of the 2016 initial finance act, the risk of overrun is thus estimated at between €3.2bn and €6.4bn, i.e., amounts significantly higher than those estimated by the Court last year at the same time (between €1.8bn and €4.3bn). Although the precautionary reserve is high (particularly with the freezing of carryovers of appropriations), only some of the appropriations thus placed on reserve will ultimately be able to be cancelled: in 2015, only €4bn of the €11bn in appropriations placed on reserve at the beginning of or during the year had been cancelled, and the finalisation in June 2016 of the first of the three supplemental appropriation decrees expected during the year has already led to difficult choices, the Government having renounced some initially planned cancellations.

Risks in expenditures on the scope of the value rule, deviation from the 2016 initial finance act (in €bn)[3]

Missions	Low assumption	High assumption	Central estimate
Work and employment	1.7	2.4	2.0
Defence	0.5	0.8	0.7
Agriculture, food, forestry, and rural affairs	0.7	1.1	0.9
Solidarity, insertion, and equal opportunities	0.4	0.6	0.5
Equality between regions and housing	0.2	0.4	0.3
Schooling	0.1	0.4	0.25
Ecology, sustainable development and mobility	0.0	0.5	0.25
Security	0.1	0.3	0.2
General and territorial administration of the central government	0.1	0.2	0.15
Immigration, asylum, and integration	0.1	0.2	0.15
Healthcare	0.0	0.1	0.05
Public service	0.1	0.25	0.2
A. TOTAL	**4.0**	**7.2**	**5.6**
B. Margin related to under-consumption of credits, or statistical allowance*	-0.8	-0.8	-0.8
C. (=A-B) TOTAL incl. statistical allowance	**3.2**	**6.4**	**4.8**

* An assumption is made, as in previous years, of a statistical margin of under-consumption of credits, estimated at €0.8bn in 2016, which allows some of the observed overshoots in the management process to be secured.

Source: Cour des comptes

3 This table shows overspending compared with the 2016 initial finance act, after unfreezing of the precautionary reserve.

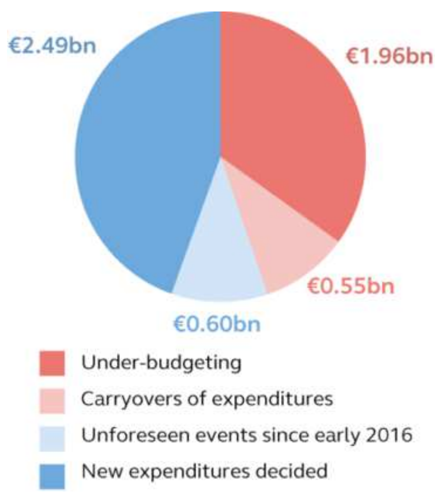
The new expenditures decided and announced since the beginning of 2016 represent the biggest source of deviation from the 2016 initial finance act, amounting to nearly €2.5bn in risks for central government expenditures for fiscal year 2016 alone. They correspond mainly to the emergency employment plan and measures intended for ranchers and farmers. The increases in the workforce, the index point, and the categorical measures for officers of the Security and Schooling missions will also drive up the wage bill, whose total growth is expected to exceed 1.0% at constant scope (after +0.5% in 2015), for the first time since 2009.

Under-budgeting represents approximately €2.0bn, near the 2015 level, and expenditures carryovers from 2015 to 2016 represent around €0.6bn. The management contingencies and bad surprises seen since the beginning of the year represent only a marginal share of the identified risks (around €0.6bn)[4].

Risks of lesser magnitude also influence the expenditures of social security administrations. The €800m in savings expected in 2016 from the renegotiation of the Unédic agreement will not be achieved because this negotiation failed.

All in all, meeting the deficit objective will require very strict management of expenditures and leaves no room for new decisions leading to expenditure increases. Although public revenues appear properly calibrated and are expected to grow in 2016 at the pace of improving economic growth compared with 2015, the successive announcements of new public expenditures, which are neither funded nor secured by sustainable savings, pose a risk on public finances in 2016 but even more in subsequent years. Among the additional expenditures announced during 2016, those pertaining to the wage bill will weigh essentially on 2017 and will continue to increase in subsequent years.

Distribution of government expenditure overrun risks in 2016 by category, deviation from the 2016 initial finance act



Source: Cour des comptes. This graph, produced on the basis of the average of the two low and high assumptions of over-expenditures, does not take into account the margin related to the under-consumption of appropriations or statistical allowance (€0.8bn). These are therefore gross overruns.

[4] In practice, this mainly involves Agriculture, food, forestry, and rural affairs and Ecology and sustainable development and mobility missions.

3 Outlook for 2017 to 2019

In the public finance programming bill of December 2014, the Government made a commitment to return to structural balance and a public deficit below 1% of GDP in 2019. The public balance trajectory applied for 2017 to 2019 in the April 2016 Stability Programme is less ambitious, even though the 2015 deficit was half a point below the LPFP forecast: the better-than-expected result was not utilised to cut the public deficit more quickly and significantly change the course of the debt trajectory.

Successive forecasts of actual public balance for 2015 to 2019 (as % of GDP)

	2015	2016	2017	2018	2019
Programming bill	-4.1	-3.6	-2.7	-1.7	-0.7
April 2015 Stability programme	-3.8	-3.3	-2.7	-1.9	
April 2016 Stability programme	-3.5	-3.3	-2.7	-1.9	-1.2

Source: Public finance programming bill of December 2014, Stability programmes of April 2015 and April 2016

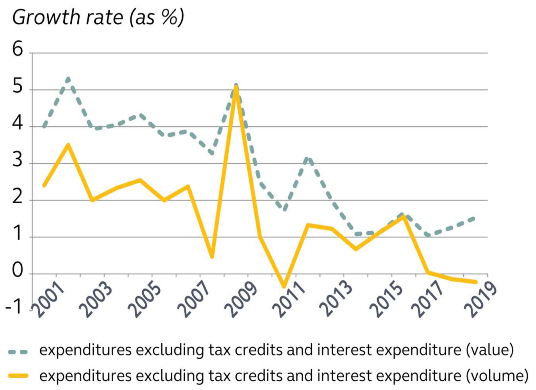
A public finance trajectory not ensuring a return to structural balance

Starting from the April 2015 Stability Programme, the Government has revised potential growth upwards. It is now at a substantially higher level than the level accepted by international organisations. It thus allows the Government to post a structural balance in equilibrium in 2019 despite an actual deficit still amounting to 1.2% of GDP. However, with the potential GDP estimates of international organisations, such a deficit would still leave a structural deficit above 1% of GDP. A more ambitious public finance trajectory would be required to meet, in 2019, the medium-term objective of structural balance of 0.4% of GDP by the programming bill and 0 in the April 2016 Stability Programme.

A trajectory that also assumes an unprecedented decline in public expenditures

The analysis of the Stability Programme also shows that achieving a deficit target of 1.2% of GDP in 2019 assumes unprecedented control of public expenditures: with the macroeconomic scenario of the Stability Programme and the continued decline in the mandatory levies ratio to GDP of 0.2 points per year, a reduction of public expenditures in volume, excluding interest expenditure, between 2016 and 2019 would be required, whereas it increased by 1.1% on average between 2010 and 2015 and 2.6% between 2000 and 2009.

Growth of public expenditures (as %)



Source: Cour des comptes on the basis of the national accounts of the INSEE and the April 2016 Stability Programme

A significant risk of not meeting the deficit objectives starting in 2017

The Stability Programme does not present the necessary reforms to achieve the public deficit and expenditure control objective for 2017, and the policies implemented in recent years hardly carry the promise of medium-term savings. On the contrary, the planned increase in military expenditures, the measures announced at the beginning of the year concerning employment, the measures young people, the mitigation of the effort requested from cities and inter-city bodies, and especially the growth of civil service wage bill will push expenditures up, by around 0.3% of GDP in 2017.

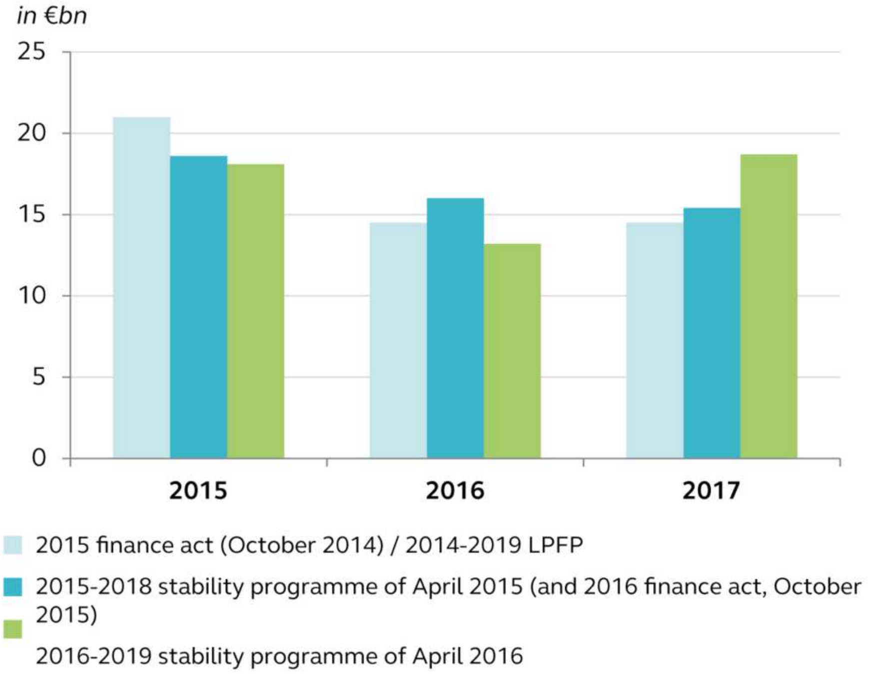
The wage bill of administrations, representing almost a quarter of government expenditures, will increase starting in 2017 at a pace marking a divergence from the trends observed for 10 years: none of the three levers – workforce stability, freezing of the index point, and limitation of categorical measures – that had allowed the growth of the public wage bill to be controlled over the last decade will be at work any longer. Over 2017 alone, the wage bill could grow more quickly than over the entire period of 2009 to 2015. The protocol on professional development, careers, and wages, which will begin to take effect in 2017, is also expected to ramp up in the coming years.

The risks weighing on achieving the expenditures and balance trajectory of the Stability Programme are therefore very significant, even though this trajectory would not be enough to restore the situation of public finances beyond the Stability Programme horizon.

4 Measurement of expenditure savings between 2015 and 2017

The Government announced a €50bn savings programme over 2015 to 2017, including €21bn in savings in 2015, then €14.5bn in savings in 2016 and 2017. This distribution was modified during the April 2016 Stability Programme (see graph below): the amount of savings was revised down to €18.1bn for 2015 and €13.2bn for 2016, with the greatest effort being postponed to 2017 (€18.7bn).

Timing of the €50bn savings plan (in €bn)



Source: Cour des comptes on the basis of the information report of the Finance Committee of the National Assembly on the Stability Programme for 2016 to 2019 and the national reform programme

Measurement of expenditure savings between 2015 and 2017

A significantly lower amount of savings in 2015 than the amount reported by the Government

The calculation of these savings is based on the assessment of trend growth in expenditures, i.e., “no policy change”.

The assessment of trend growth of public expenditures is based on various and sometimes questionable methods. Although “no policy change” growth can be defined rather naturally for expenditures like welfare benefits, which are very largely determined by the legislation, this definition cannot be applied to other expenditure items more directly controlled by the public authorities, like investments or operating expenditure.

The review of the assumptions used by the Government reveals that they result in a rather high evaluation of trend growth and therefore an overestimation of the reported savings, which are calculated on the basis of this trend.

Even with the assumptions made by the Government, the Court considers that the savings effort made in 2015 (€12bn) is real, but significantly lower than that reported in the Stability Programme (€18.1bn), essentially because of the central government.

Review by the Court of the savings measures for 2015 of the €50bn plan presented by the Government (in €bn)

Category of public administrations	Measurement	Government Assessment (Stab. P. of April 2016)	Court Estimate
Central administrations (Central government + other central government agencies) (A)	Central government: Decrease in appropriations of ministries, reduction of the value rule	7.4	3.3
	Investing for the Future programme (PIA): Slowdown in PIA expenditures compared with the initially planned trajectory	1.0	0
	Sub-total Central administrations	**8.4**	**3.3**
Local administrations (B)	Local public administrations: Increased effort in expenditure of local authorities under the effect of decreases in central government allocations	**3.5**	**3.5**
Social security administrations (C)	ONDAM	3.2	3.2
	Unédic: measures on transferable accrued rights and accumulated wages/allocations	0.4	0.4
	Other social security administrations	2.6	1.6
	Sub-total Social security administrations	**6.2**	**5.2**
TOTAL (A+B+C)		**18.1**	**12.0**

Source: Cour des comptes on the basis of the tables and data presented previously and the Stability Programme (Stab. P.) of April 2016

A structural effort in expenditures less than 0.5% of GDP

Although the construction of a trend on expenditures is helpful for decision-making and the formalisation of a fiscal consolidation strategy in the form of a savings plan, its realisation does not allow the sustainability of the policy for public finances to be judged. It is the structural effort in expenditures, built on the difference between the growth of public expenditures and the potential growth of the economy, that permits it.

In 2015, the structural effort in expenditures was around €6bn less than the minimum adjustment effort of 0.5% of GDP required by European rules from a country that, like France, has not achieved its medium-term objective of structural balance. This difference is equivalent to the difference between the amount of savings actually achieved in 2015 and the Government's objective in its savings plan.

The savings effort made in 2015 is therefore less than the Government's ambition and less than what would have been necessary to ensure the sustainability of the fiscal policy over the medium term.

5 New European rules on the governance of public finances: an initial assessment

The 2008 financial crisis, then the sovereign debt crisis, forced the Member States of the European Union, and particularly those of the eurozone, to strengthen their fiscal governance. Several texts were adopted in this sense between 2012 and 2013: the Treaty on Stability, Coordination, and Governance (TSCG), the "six-pack", and the "two-pack", which refer to a set of directives and regulations to strengthen the rules of the Stability and Growth Pact (SGP). These texts provide for three main innovations: a structural balance rule, the establishment of an automatic correction mechanism, and the creation of independent fiscal institutions.

The structural balance rule: a procedural constraint more than a legal constraint

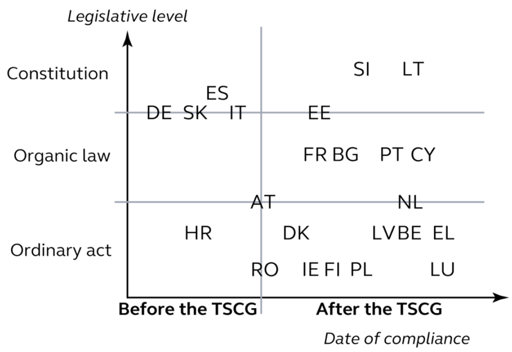
European texts now require setting a medium-term objective (MTO), defined in structural terms. Under the TSCG, the corresponding structural deficit cannot exceed 0.5% of GDP. The steering of fiscal policy on the basis of a structural balance objective, rather than nominal, is economically desirable: it limits the risk of an overly relaxed fiscal policy in a period of strong growth or overly rigorous growth in a recession period.

The TSCG requires that the MTO be transcribed through "permanent and binding" provisions. Only a few States, including Germany, Italy, and Spain, have chosen to adopt constitutional "golden rules", often even before the signing of the TSCG. Most other countries have transposed this rule in ordinary laws.

France transposed this requirement in the organic law of 17 December 2012 on programming and governance of public finances. The organic provisions leave it to the multi-year public finance programming bills (LPFP) to the OMT and define the fiscal trajectory. The structural balance objective must be included in the introductory article of the finance acts. The achievement of this objective is evaluated in the finance review act. The LPFP currently in force was adopted in December 2014 and sets the OMT to -0.4% of GDP.

However, the organic law imposes only a procedural constraint and not a legal constraint, to the extent that the LPFPs can be revised at any time and do not bind the financial legislator.

Compliance with the provisions of the TSCG



Source: Cour des comptes

The "correction mechanism": an alert function more than an automatic mechanism

The automatic correction mechanism supports the structural balance rule by imposing a correction in case of a significant deviation from the trajectory (i.e., a difference between actual and forecast deficits of 0.25% of GDP two years in a row or 0.5% in one year).

Most countries have translated this rule by providing for a simple obligation to explain deviations from the trajectory under the "comply or explain" principle.

In France, the organic law provides that, where the High Council of Public Finances (HCFP) triggers the correction mechanism, the Government is obliged to explain the reasons for the deviation in a report to Parliament setting out, where appropriate, the corrective measures envisaged. This mechanism was triggered in spring 2014, during the HCFP's examination of the 2013 finance review act, following a deterioration of more than 1.5% of GDP of the deficit[5]. The Government, rather than go back to the LPFP in force, chose to change the public finance trajectory by introducing a new multi-year programming[6].

The establishment of independent fiscal agencies: real progress

The new governance rules required the creation of independent fiscal agencies with a dual mission: ensure the unbiased and realistic nature of macroeconomic and public finance forecasts and perform an ex-post assessment of compliance with the financial trajectory. Governments must comply with their opinions or publicly explain themselves if they decide to depart from them.

[5] This deviation is noted in relation to the trajectory provided for in the multi-year public finance programming bill for 2012-2017 of 31 December 2012.

[6] See multi-year public finance programming bill for 2014-2019 of 29 December 2014.

All Member States have established such agencies, usually by creating *ad hoc* structures. Their mandates are quite variable: some build the macroeconomic projections themselves (Austria, Belgium, Netherlands, United Kingdom) or public finance forecasts (Austria, United Kingdom) themselves, while others make fiscal policy recommendations (Portugal) or advise on structural reforms (Italy).

In France, the High Council of Public Finances, backed by the Cour des comptes, is responsible for giving a public opinion when the finance acts are filed.

Possible developments

Without revisiting the choice made in 2012 not to amend the Constitution, it appears possible to strengthen the governance of public finances within the current institutional framework.

First of all, the objectivation of the potential growth assumption appears necessary to avoid biasing the structural balance targets. Like for the macroeconomic forecasts, it seems desirable to plan for an independent, transparent body to rule on the potential growth assumptions, particularly in connection with the presentation of the Stability Programme, which is the first public reference of the process of developing the finance acts for the year. Parliament's control should also be strengthened, prior to forwarding the Stability Programme to the European Commission.

Then, the debate in favour of simplified fiscal governance is currently emerging in the European bodies. Although the reference to structural balance, which ensures the long-term sustainability of fiscal policy, must be retained in principle, it deserves to be supplemented by an expenditure rule, easier to explain ex ante and verify *ex post*.

It could take the form of an expenditure objective adapted annually for all general public administrations, fixed in current euros, on the basis of a structural balance target compatible with meeting the medium-term structural objective. Such a scheme requires considering a mode of governance that involves the central government, social security administrations, and local governments in its definition and monitoring.

Conclusion

Although improved over 2014, the public deficit remained high in 2015 at 3.6% of GDP, and France's public finance situation is not as good as its European partners.

The public balance trajectory applied for 2016 to 2019 in the April 2016 Stability Programme, less ambitious than the one indicated in the December 2014 programming bill, projects a return to structural balance of public finances in 2019. This outlook is very uncertain because it is based on inflated assumptions of growth potential and very ambitious assumptions of public expenditure control. However, even though the announced ambition of expenditure control has never been stronger, decisions taken since the beginning of the year have instead led to an increase in expenditures, which began in 2016 but is expected to grow significantly in 2017 and beyond.

The expenditure control policy pursued so far has aimed more at containing it than improving its effectiveness. The action to be taken must now be based on explicit choices, address key sources of inefficiency in expenditures, review the missions of public administrations overall, and better target intervention expenditures.