COURT OF ACCOUNTS

Budget situation and outlook

June 2013

Warning

The purpose of this summary is to facilitate the reading and comments of the report on the budget situation and outlook adopted by the Court of Accounts, which exclusively holds jurisdiction.

Contents

Introduction

As in previous years, this report on the budget situation and outlook was prepared in accordance with Article 58-3° of the LOLF (Organic Law Governing Finance Acts). The purpose of the report is to inform Parliament's discussions on budget guidelines.

Chapter 1 focuses on the budget situation in 2012. The Court of Accounts examines the trend in public spending, revenues, deficit and debt, demonstrating how France is positioned with respect to other European countries. More specifically, it presents the financial statements of the French State government, social security administrations and local public administrations.

Chapter 2 covers the 2013 fiscal year. Based on the information available at 24 June, the Court analyses the risks surrounding the achievement of the stability programme's revenue, spending and balance targets for all public administrations. In 2012, the Court obtained internal forecasts from the Finance Ministry divisions on the fiscal year in progress. These forecasts have not been provided this year.

Chapter 3 covers the outlook for 2014 to 2017. After reviewing the structure of the Public Finance Programming Bill of December 2012 and the Stability Programme of April 2013, the Court examines the structural effort in terms of revenues and spending needed to lower the public deficit to under 3.0% of GDP by 2015, with an adequate safety buffer. This report also presents the fiscal consolidation programmes of a number of European countries.

This year, in Chapter 4, it describes the long-term financial outlook for the overall social security scheme and all pension schemes.

In Chapter 5, the Court gives a more comprehensive and specific presentation compared to previous years of the potential sources of savings resulting from its analyses on public spending efficiency, in order to highlight the choices subject to the authority of the Government and Parliament. These sources of savings include measures with immediate impact affecting all public administrations, and more structural measures specific to each category of public administration.

1 Situation in 2012

Despite a major structural effort to reduce the public deficit, it dropped by only 0.5 point in 2012 to 4.8% of GDP, i.e. 0.3 point higher than expected. Growth of economic activity was nil and public spending increased more than expected. The deficit was higher than the average of other European countries and also too high for public debt to be stabilised.

Slightly higher-than-expected deficits

The public deficit declined in 2012 (4.8% of GDP versus 5.3% in 2011), but was slightly higher than the Government's target of 4.5%.

Although it slowed in relation to the average for 2008-2011, growth in spending (1.0% in volume terms and 0.9% excluding exceptional measures) was stronger than expected (0.4%), only half of which can be attributed to unexpected payments to Dexia and the European Union at fiscal year-end. While the standards on State and social security spending were met, the least well-controlled government spending such as local authority expenditures grew faster than expected.

Increased spending was also too strong to contribute to the structural deficit reduction effort. This effort was very significant (1.1 GDP point), but only due to the strength of measures aimed at increasing mandatory tax and social security contributions, some of which were taken over the course of the year and yielded €22bn in 2012.

This brought the structural deficit down to 4.0% of GDP, according to the HCFP (National Budget Council), i.e. 0.3 point more than expected in the 2012-2017 Public Finance Programming Bill on an identical calculation basis.

Situation in 2012

Breakdown of the public deficit (% of GDP)

	2011	2012
Budget balance	-5.3	-4.8
Cyclical component	-0.3	-0.8
One-off and temporary component	+0.1	0
Structural component	-5.1	-4.0

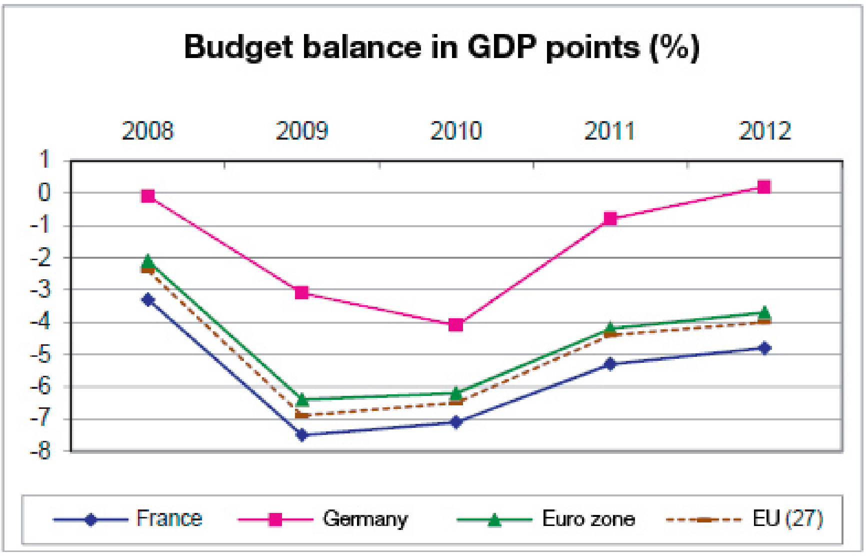
Source: Budget Settlement Bill for 2012 and opinion issued by the HCFP.

This structural effort was offset by the impact of nil economic activity growth, which undercut the cyclical component of the deficit by 0.5 point, to the extent that the public deficit dipped by a mere 0.5 GDP point relative to 2011, remaining close to €100bn.

This deficit level was still very far from where it needed to be to help stabilise public debt, near 1.3% of GDP in the 2012 economic environment. Consequently, public debt continued to rise, reaching 90.2% of GDP at year-end, compared to 85.8% at the end of 2011. However, the interest expense of public administrations fell 0.8% in 2012 on the back of particularly favourable borrowing conditions.

Harsher conditions than in other European countries

The fall in public deficit was virtually the same in France and, on average, in the euro zone and the European Union, where the deficit in 2012 remained at lower levels than in France (respectively 3.7% and 4.0% of GDP).



Source: Eurostat

On average, the economic climate was better in France than in other European countries, and particularly in euro zone countries, but the structural balance showed greater improvement. On average, other countries did a better job of controlling the increase in their spending and relied less on raising tax and social security contributions. In 2012, France's structural deficit (4.0%of GDP) averaged higher than the euro zone and European Union (2.1% and 2.8% according to the European Commission).

Debt rose at the same magnitude in France, the euro zone and the European Union. French debt remained between the averages of the euro zone and EU at end-2012.

Germany set itself apart as the only European company to post a budget surplus (0.2% of GDP in 2012) following a 1.0 point improvement . Its structural balance was also in the black (0.3% of GDP) and its debt more than 8 GDP points below France's at the end of 2012, despite being the same at the end of 2010.

Situation in 2012

Varying trends for different public administration categories

The central government deficit declined little in 2012[1]. While some tax revenues were stable on a constant legislation basis, with VAT even dipping slightly for reasons still only partially explained, they were shored up by substantial new measures. Government spending decreased slightly in terms of the volume-based norm, which is unprecedented and due in large part to a fall in interest expenses, but increased somewhat in a broader scope.

Local public administration expenditures picked up 1.2% in volume terms in the national accounts. A ramp-up in operating expenditures, particularly the total wage bill, was also observed. Despite growth in their tax revenues significantly exceeding GDP growth, their total revenues, including value-stabilised government allocations, increased at a slower pace than total spending. As a result, their deficit climbed in 2013 and their debt along with it. Based on their financial situation, local *communes* and inter-municipalities were able to continue increasing their investment, unlike the regions and particularly unlike the *départements*.

The reduction of the social security administration deficit marked time in 2012. Spending targets on health insurance and basic mandatory schemes were observed, but unemployment benefits rose sharply and, despite stronger growth in the total wage bill than in GDP, revenues were undermined by the deterioration of the economic environment.

(1) €7.7bn in the national accounts and €3.5bn in the fiscal accounts.

2 Situation and outlook in 2013

There is a significant risk surrounding the revenue forecasts for the stability programme in 2013. Depending on the trend in local spending, however, the targets for public spending growth should be met.

Forecasts already revised

The forecasts on economic growth and changes in public revenues and spending for 2013, on which the Initial Budget Act, the Social Security Finance Act (LFSS) and the Public Finance Programming Bill were based, have been significantly revised within the framework of the April 2013 stability programme. The main revisions are focused on revenues.

Based on the stability programme forecasts, the budget deficit is expected to hit €68.3bn in 2013 versus €62.3bn under the Initial Budget Act; the deficit of the overall social security scheme and the old-age solidarity fund is expected to reach €17.3bn versus €13.9bn under the Social Security Finance Act. The estimate for the public administration deficit is 3.7% of GDP versus 3.0% under the Public Finance Programming Bill.

Significant risk on revenue forecasts

The biggest risk relates to the macroeconomic assumptions for the stability programme. The stability programme is based on GDP growth of 0.1%, but this growth is actually liable to be negative in 2013, which points to weaker-than-expected revenues. If, for example, GDP growth was -0.1% instead of +0.1%, in line with INSEE forecasts, revenues would be down by about 0.1 GDP point compared to the assumption taken by the stability programme.

Besides GDP growth estimates, additional risks also weigh on the trend in certain public revenues estimated under the stability programme, as shown in the following table. Lost revenues could represent up to 0.3% of GDP. There is also some grey area surrounding the quantification of new measures and the cost of tax-related disputes, however these can go both ways.

Uncertainties were still running high in mid-June regarding the revenues expected from certain taxes, traditionally the corporate tax but also VAT this year. The forecasts determined starting in July by the administration will be based on more accurate data making it possible to better assess this risk.

Risks, excluding revision of GDP growth, weighing on stability programme revenues (€bn)

VAT	**0 - 1.5**
Corporate tax	0 - 2.5
Total State	**0 - 4**
Property and residence taxes	0 - 0.25
Corporate value-added tax	0 - 0.5
Non-tax revenues from local authorities	0 - 0.15
Total local public administrations	**0 - 0.9**
Various central administration bodies	**0 - 0.1**
Taxes in favour of social security administrations	0 - 1.0
Total public administration	**0 - 6**

Source: Court of Accounts

Government spending standards that can and must be observed

The Government has aimed to stabilise public spending in terms of value-based standards. After taking into account margins on under-use of available budget allocations, the risk of exceeding the target represents €1.1bn to €2.1bn of the overall budget. Part of this risk is linked to the total wage bill (about €0.5bn).

Evaluation of risks on government spending

In €bn	**Estimated risk for 2013**	
	Low assumption	*High assumption*
Total overall budget (1)	1.9	2.9
Margin linked to under-use of available budget allocations (2)	-0.8	-0.8
Total overall budget after taking the margin into account (1+2)	1.1	2.1
Risk linked to levy on government revenues (PSR) in favour of the European Union	0.8	2.6
Total based on «zero-value» standard	1.9	4.7

Source: Court of Accounts

The precautionary reserve, plus the additional budget allocation freeze of €2bn in January 2013, should be enough to cover these risks if, like last year, the budget allocations are not freed up too early.

It may not be enough, however, if the PSR (€0.8bn to €2.6bn) is added to the risk on the overall budget levy on government. The total risk would then be €1.9bn to €4.7bn in terms of the value-based standard, while the amount of budget allocations is unlikely to reach, much less exceed, the 2012 level (€3.7bn).

In any event, there is no leeway left to finance unexpected exceptional expenditures.

Finally, in terms of the volume-based standard, savings of approximately €0.7bn in interest expenses and €0.8bn in pensions, relative to the Initial Budget Act, were incorporated in the stability programme. These savings will probably be greater (by about €0.5bn) in interest expenses.

Subject to the amount of the European levy, government spending in 2013 should either be in line with the stability programme targets and possibly below them due to the decline in interest expenses.

A plausible target for public spending growth

On the social security front, the stability programme includes events subsequent to the Social Security Finance Act, such as the indexing of benefits on a lower inflation forecast. It also raises the overly optimistic unemployment benefits forecasts of the Public Finance Programming Bill.

With strict management, it should be possible to generate savings in health insurance spending of about €0.5bn compared to the 2013 National Health Insurance Spending Target (ONDAM).

These savings can help partially offset the under-estimation of local public administration expenditures, particularly investments, under the stability programme. Forecasts in this area are intrinsically very fragile, but local spending could be around €1.0bn higher.

The forecast on public spending growth included in the stability programme appears plausible overall, subject to sometimes significant and unexpected changes in spending by local authorities and some central administration bodies.

Deficit targets liable not to be met despite a very significant structural effort

While the targets for stability programme spending can undoubtedly be met, a risk of 0 to 0.3 GDP point weighs on revenues, for GDP growth of 0.1%, and the risk of another downturn in the economic environment must also be taken into account. The public deficit may therefore exceed the target of 3.7% of GDP in 2013.

The Public Finance Programming Bill calls for a structural deficit equal to 1.6% of GDP in 2013 and the stability programme 2.0%. This deficit may be higher for two reasons in particular: 1) the upward revision of 2011 GDP by INSEE after the stability programme was submitted, meaning that the structural component of the deficit should be raised for all years starting with 2011; 2) revenue losses in 2013, likely due to lower-than-expected elasticity. It could therefore range from 2.15% to 2.45% of GDP.

However, the drop in revenues that might result from GDP growth of less than +0.1% would have no impact on the structural balance.

3 Outlook for 2014 to 2017

Given the budget trend revisions, the question is whether an adjustment needs to be made to the Public Finance Programming Bill. The structural effort called for by the stability programme in 2014 and 2015 is based on very substantial savings and is necessary to return the public deficit to 3% of GDP by 2015, with a sufficient safety buffer. The fiscal adjustment programmes of other European countries could offer some potential ideas for reforms.

Clarification needed on the budget trend

The Public Finance Programming Bills include estimated targets, which may or may not be met depending on developments in the economic environment, such as the actual deficit and more restrictive provisions, including in particular structural balance trends.

Outlook for 2014 to 2017

Stability Programme and Public Finance Programming Bill

		2012	2013	2014	2015	2016	2017
Actual public deficit	Public Finance Programming Bill	-4.5	-3.0	-2.2	-1.3	-0.6	-0.3
	Stability Programme	-4.8	-3.7	-2.9	-2.0	-1.2	-0.7
Structural deficit	Public Finance Programming Bill	-3.6	-1.6	-1.1	-0.5	0	0
	Stability Programme	-3.7	-2.0	-1.0	-0.2	+0.2	+0.5
Structural effort	Public Finance Programming Bill	1.4	1.9	0.5	0.5	0.4	0.1
	Stability Programme	1.3	1.9	1.0	0.6	0.5	0.3
Increased revenues	Public Finance Programming Bill	1.1	1.6	-0.1	-0.2	0	-0.3
	Stability Programme	1.1	1.5	0.3	0	0	-0.2
Increased spending	Public Finance Programming Bill	0.4	0.9	0.4	0.2	0.7	0.8
	Stability Programme	1.0	0.9	0.4	0.2	0.4	0.6

Source: 2012 Public Finance Programming Bill and April 2013 Stability Programme. Key : amounts expressed as a % of GDP for deficits, debt, structural effort and increased revenues; expressed as a growth rate for spending.

The actual deficit targets under the Public Finance Programming Bill were pushed back in the Stability Programme and will be again if the Council of the European Union follows the Commission's proposal concerning the budget trend.

The structural effort called for by the Stability Programme for 2013 to 2015 is greater than or equal to the effort required by the Public Finance Programming Bill, and the targets for limiting spending growth are equally strict for 2014 and 2015.

However, the Public Finance Programming Bill's structural balance targets, which were not met in 2012, may not be met in 2013 either in light of the Stability Programme, and it is far from certain they will be achieved in 2014.

The question is whether or not the Public Finance Programming Bill should be adjusted to include the new budget trends that became apparent in the first half of 2013 and thus establish a more relevant reference framework for the coming years.

The structural effort called for by the Stability Programme is still necessary

The Stability Programme's aim of bringing the actual deficit down to 2.9% of GDP by 2014 is based on overly optimistic assumptions on GDP growth and public revenues.

Given the exacerbated growth outlook, the aim of reducing the actual deficit to under 3.0% of GDP was pushed back to 2014 under the Stability Programme, and will be pushed back to 2015 if the Council of the European Union follows the Commission's proposal.

Based on more conservative assumptions on GDP growth and public revenues, the structural effort called for by the Stability Programme for 2014 and 2015 (1.6 GDP point in two years, i.e. the equivalent of €32bn) is necessary to bring the public deficit back down to 3.0% of GDP by 2015 with a sufficient safety buffer. The additional period proposed by the European Commission does not authorise any relaxation of the structural deficit reduction effort.

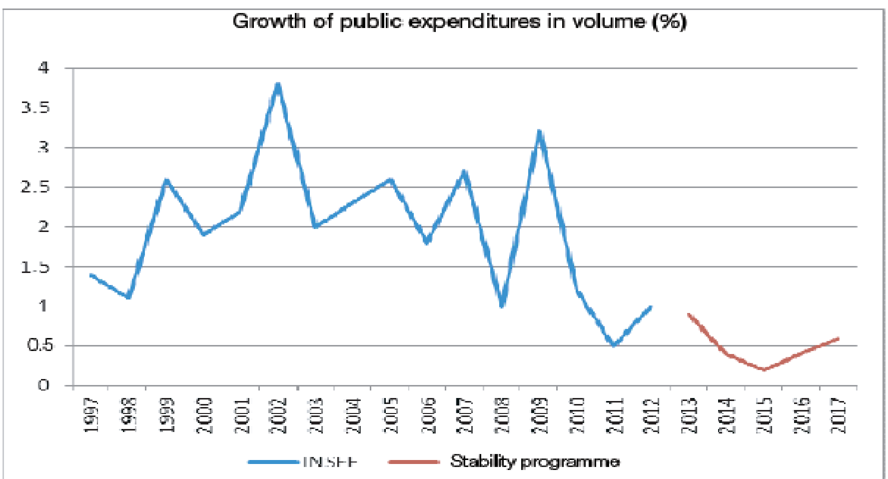
Budget trend in a conservative baseline scenario (% of GDP)

	2012	2013	2014	2015
GDP growth	0	-0.1	+0.8	+1.5
Cyclical component of the balance	-0.8	-1.5	-1.9	-1.9
Structural effort	1.3	1.9	1.0	0.6
Structural component of the balance	-4.0	-2.3	-1.4	-0.9
Time component	0	-0.1	-0.1	-0.1
Actual balance	-4.8	-3.9	-3.4	-2.9

Source: Court of Accounts

Very substantial savings needed and an increase in social security contributions in the works

On average for 2014 and 2015, 80% of the structural effort planned by the stability programme is linked to public spending. Specifically, the programme calls for growth of public spending in volume terms to be reduced to 0.4% in 2014 and 0.2% in 2015. This reduction represents a major difference compared to previous years and requires savings of some €13bn and then €15bn, spread out among all public administrations. At this point, however, the savings provided for under the stability programme still need to be clarified at the State level and are somewhat hypothetical at the local authorities level.



Source: Court of Accounts based on INSEE data (adjusted for the impact of the 2009-2010 stimulus plan) through to 2012 and based on the stability programme after 2012.

Furthermore, new measures aimed at increasing mandatory social security contributions, set to yield at least €12bn, are expected to be voted into the Finance Acts and Social Security Finance Acts for 2014: €5bn to offset the lower returns generated by certain measures and the cost of the CICE (tax credit for competitiveness and employment); €7bn to implement the structural effort provided for under the stability programme in terms of revenues.

These new resources would have to be allocated to social security, for which re-establishing financial balance is a priority, or to the State, rather than to local authorities.

Outlook for 2014 to 2017

Budget trend in a conservative baseline scenario (% of GDP)

2008	2009	2010	2011	2012	2013	2014
-10	-2	-7	18	22	33	7

Source: Court of Accounts according to the reports appended to the draft Finance Acts and the stability programme; excluding the impact of the 2009-2010 stimulus measures and community tax-related disputes.

Examples of other European countries

Setting aside the measures that have been approved, the European Commission has projected a deficit of 4.2% of GDP for France in 2014, compared to averages of around 3.0% for the euro zone and the European Union. The structural deficit is expected to remain higher in France relative to the average for other countries and France is also expected to see a greater increase in debt.

While past reforms carried out in Germany and the results of these reforms led to a slight decrease in its budget balance, the fiscal consolidation programmes of other countries demonstrate their ability to take (or plan to take) sometimes highly challenging measures to balance their budgets.

According to a review of the fiscal consolidation programmes in Spain, the United Kingdom, Italy and the Netherlands, the changes in the structural balance were relatively close from 2011 to 2013 (averaging around 1.0% of GDP per year, with the exceptional case of the Netherlands, which started off with a better budget situation). There are common factors in the measures implemented since 2010 :

- VAT hikes, particularly increases in the normal rate, ranging from 1 to 3 points;
- an effort to limit the change in the total wage bill through staff cuts and/or multi-annual pay freezes, or even the elimination of certain bonuses;
- fast-track implementation of pension reforms, calling in particular for an increase in the retirement age;
- determination to limit the expenditures of local authorities.

4 Long-term outlook for social security schemes

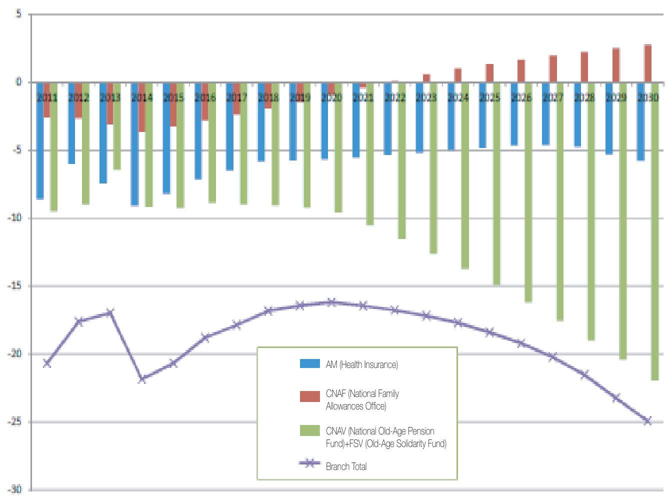
The long-term financial outlook for the overall social security scheme and all pension schemes looks highly unfavourable based on updated economic assumptions.

A deficit of more than €15bn in the overall social security scheme for the entire 2013-2030 period

As the stability programme was being drafted, the projected changes in the total wage bill were revised, resulting in a decline of nearly €10bn in the estimated balances for the overall social security scheme on a 2017 horizon. According to the more or less material impact of the current crisis on long-term growth, the overall scheme could post a deficit of €15bn to €20bn by 2020, building up an equivalent debt of 8% to 12% of GDP on a 2030 horizon in the least favourable scenarios. The majority of this debt is expected to stem from the accumulated deficits of the pension branch, but the healthcare branch is also expected to maintain an average deficit of about €5bn per year over the period.

Long-term outlook for social security schemes

Balances of overall social security scheme branches based on the economic assumptions of the 2013-2017 growth stability pact and an average increase of 3.5% in the total wage bill from 2013 to 2030.



Source: Court of Accounts

In order to secure the re-absorption of social security debt by 2025, only compatible with the probable term of CADES (Social Security Debt Redemption Fund), re-balancing measures must be taken immediately with an impact of at least €20bn on the annual balance of the overall scheme on a 2017 horizon, i.e. new efforts totalling €5bn per year for 4 years. In addition, reforms would have to be implemented to sustainably reduce spending, particularly in the healthcare and old-age branches.

A more unfavourable pension scheme outlook compared to Pensions Advisory Council scenarios

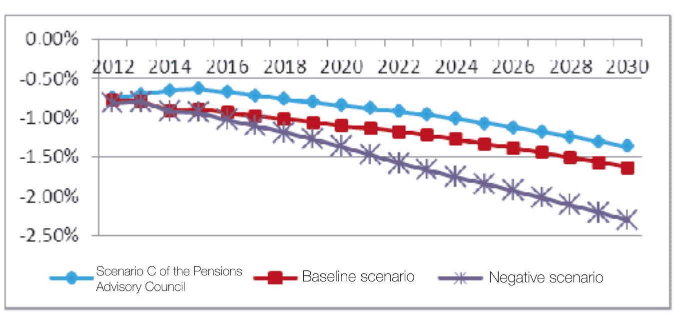
The Court of Accounts also analysed the risks weighing on the balances of the overall pension system and on the main pension schemes on a 2030 horizon.

As regards the overall pension system, based on the macroeconomic assumptions of the stability programme for 2013-2017 and the Pensions Advisory Council's scenario C (i.e. a historic increase in the total wage bill of +3.5% per year), after 2017 the annual pension system deficit is likely to reach 1.6% of GDP by 2030. Cumulative deficits from 2013 to 2030 would thus generate funding requirements exceeding 17% of GDP . Growth in the total wage bill of less than 0.25 point per year would result in a deficit of 2.3% of GDP, bringing cumulative deficits to more than 22% of GDP by 2030.

These projections highlight the fact that pension schemes cannot be sustained over the long term, on a constant legislation basis, and underscores the extreme sensitivity of balances to even a small change in economic growth assumptions over an extended period.

Pension scheme balances are set to decline significantly across the board by

Change in overall balance of pension system
(as % of GDP)



For ARRCO and AGIRC, assuming constant returns and taking into account the agreements of 13 March 2013

Source: Court of Accounts

2030. By 2030, pension system deficits should be predominantly concentrated in the overall pension scheme (36%), ARRCO-AGIRC complementary schemes (28%) and civil servant/ government agent schemes (34%).

Their accumulation would push social security debt above the redemption capacities of the CADES fund for the overall pension scheme and would drain the reserves of the ARRCO and AGIRC complementary schemes.

Based on this outlook, re-balancing measures are urgently needed alongside more structural reforms to be implemented on a more gradual basis.

5 Potential sources of savings

While public spending growth in volume terms averaged 1.7% from 2007 to 2011, stood at 1.0% in 2012 and is estimated at 0.9% in 2013 according to government forecasts, the stability programme calls for public spending growth to be reduced to 0.4% in 2014 and 0.2% in 2015. To achieve this target, savings estimated up to €13bn in 2014 and €15bn in 2015 would have to be generated relative to the estimated trend in public spending growth (1.5% per year).

To meet its commitments, France would have to divide up the spending reduction effort between all public administrations.

In addition to the projected budgetary impacts, the savings effort must be perceived as a leverage used to initiate more extensive reforms, ranging from the adaptation of public policies to governance and institutional organisation. The effort begun in 2012 to modernise government initiatives should work toward this objective.

Cross-disciplinary measures to slow public spending in the short term necessary to meet the 2014 and 2015 public spending reduction targets

The measures taken under the RGPP (general revision of public policies) will have no new impact on spending in 2014 and the main decisions expected to arise from the modernisation programme of the Governmentwill have little impact on the budget before 2015. Consequently, in order to meet the stability programme commitments for 2014 and 2015, immediate cross-disciplinary measures may be called for to slow down the key determining factors in public spending, such as a freeze on the civil servant wage index, the temporary sub-indexing (excluding minimum social security benefits) of family allocations, pensions, housing aid, the benchmark salary for unemployment insurance, or the reduction of the rate of change in the national health insurance spending target (ONDAM).

Potential sources of savings

The total wage bill for public administrations, including employer contributions, came to €268bn in 2012, i.e. 13.2% of GDP, after climbing 2.2% per year on average since 2007. About one-fifth of this rise can be attributed to a headcount increase and about four-fifths to the increase of the average gross salary per person. In the short term, slowing the total wage bill for all public administrations can only be achieved by a reduction of the value of the civil servant wage index, which is the only reference point common to all three public functions (State, local and hospitals). A 1% increase in the value of the civil servant wage index automatically increases the total wage bill by nearly €1.8bn, including €750m for the State, €600m for local administrations and €400m for public hospitals. In the short term, without addressing the other determining factors analysed later in this document, maintaining the freeze on the civil servant wage index in 2014 and 2015 is the only instrument that can be quickly and technically used to partially slow the rising trend in the total wage bill.

The rate of change in social protection spending is largely determined by the revaluations established each year. For family benefits and basic pension schemes for example, the annual revaluation at 1 April 2013 (1.2% and 1.3%, respectively) resulted in a €3.2bn increase in overall pension scheme expenditures. A cross-disciplinary measure aimed at sub-indexing family benefits and pensions (including special schemes) by 1 point in 2014 and 2015, which would not affect minimum social security benefits, would reduce expenditures by €3.8bn. This measure could be adjusted according to the beneficiaries' financial situation. Applied to housing aid (individual aid) this same measure would prevent an additional expenditure of about €170m, while the impact would be €165m for the sub-indexing of the benchmark salary used to determine the job-seeker's allocation.

Given the slower change in expenditures reimbursed by health insurance currently observed, and the downward revision of inflation forecasts, it may be possible to **achieve a 0.2-point reduction in the annual growth of health insurance expenditures currently used as a target** (ONDAM[(2)]) in the multi-annual programming, i.e. reducing this increase to 2.4% in 2014 and 2.3% in 2015 and 2016. Taking into account the savings that can be generated in 2013 (about €500m relative to the target), health insurance spending would decline by about €900m in 2014 and €1,200m in 2015. In addition to

(2) National health insurance spending target

the health insurance spending reduction measures that can be taken, the moderation of regulated rates applied to certain healthcare professions, which are little exposed to the economic environment, could contribute to this target through a freeze or sub-indexing, to prevent them from receiving more favourable treatment in a period when changes in civil servant wages and social security benefits would be subject to such measures.

In the medium term, freezing or sub-indexing measures are not a sustainable solution, from an economic and social point of view, to the imperative need to reduce public spending. More structural saving measures are needed, focused on the operations and actions of all public administrations, their institutional and territorial organisation, civil service management methods, oversight of local authority expenditures, and of course savings efforts that need to be continued in order to help reduce administration management costs.

Structural saving measures at the State level

Controlling the State total wage bill is critical

The increasing trend in the State total wage bill (22% of total expenditures, 33% with pensions) observed in recent years averaged €1,300m per year on a constant-headcount basis, subject to the impact of category-specific measures (€650m), individual advancement measures (€1,200m - positive age and job-skill coefficient), the «Noria effect» (impact of changes in compensation due to hiring and departures) (-€1,050m linked to the higher salary cost of departing employees). To reduce this annual increase to the €300m target set by the government for 2014 and 2015, adjustment measures need to be considered for these various determining factors. Four scenarios presented in the report apply alternately to efforts on category-specific measures, individual advancement measures, the value of the civil servant wage index and on headcount.

According to these scenarios, based on a stabilised headcount, limiting the increase in the State total wage bill to €300m per year calls for the implementation of a very strict salary policy combining various degrees, such as a freeze or low revaluation of the value of the civil servant wage index, a sharp reduction in category-specific measures, a significant slowdown in career advancements (positive age and job-skill coefficient).

A freeze on the value of the civil servant wage index cannot be considered as a permanent application measure. Focusing the adjustment on the determining factors of civil servant compensation, by pushing back career advancements and reducing category-specific measures, is an option which, though it should not be ruled out, should not be exclusive, otherwise the State would be deprived of considerable leverage on its human resources management policy. Undoubtedly, the best way to go would be a balanced «mix» of the measures on the value of civil servant compensation and on the headcount. A headcount reduction, divided up entirely or partially among State administrations, could be accompanied by an option aimed at increasing staff working hours in order to limit the adverse consequences on the quantity and quality of services rendered.

Contribution to savings by government intervention expenditures

Government interventions, which account for one-third of government spending, could in the future contribute to the public spending reduction effort by exploring three different avenues.

Better targeting of intervention mechanisms with respect to their effectiveness. A few recommendations from recent Court of Accounts' reports illustrate the possible options that can be explored in the area of financial aid for the press, emergency farming aid, subsidies for the main athletic federations or in the ongoing professional training sector.

The **reduction of similar programmes** by different public bodies is another avenue: joint intervention by the State and local authorities in certain sectors, such as culture, could be better coordinated, while in employment («RSA-Activité», «Allocation de solidarité spécifique») or land development planning, the number of programmes has accumulated, making it harder to understand the different policies developed and increasing the associated management costs.

The third potential source of savings is by **revising the foundations of certain intervention mechanisms** of questionable utility or whose financial sustainability can no longer be ensured. The evaluations of public policies launched by the government should help identify these mechanisms. Recent controls performed by the Court of Accounts have provided a few examples, including certain forms of housing aid, aid for tobacconists, or increases in statutory annuities.

It is also important to continue improving the efficient management of the government and its operators. Both the purchasing policy, subject to ambitious saving targets of €2bn for the State by 2015 as established by the Inter-Ministerial Committee for the Modernisation of Public Initiatives on 2 April 2013, and the management of government real estate, could be expanded. The reduction of the operational management costs of State operations is another avenue of improvement, which could be applied for example to management of taxes and pensions or keeping military equipment in working order. Finally, operators should be encouraged to develop their own resources in order to finance their development without requesting State subsidies, which are already being cut in many sectors.

Several Court of Accounts' reports recommend **simplifying the organisation of decentralised services in France and abroad.** The topical public report on «the territorial organisation of the State government», published in summer 2013, will offer several recommendations aimed at simplifying and modernising the State's territorial services and enhancing the consistency of their presence and operations with those of the local authorities services. The organisation of services abroad could also stand improvement.

However, State investments offer little opportunity for savings due in large part to their low percentage in government spending (3.5%), their positive impact on short-term activity and, where relevant, on long-term potential growth. Nevertheless, the latest White Paper on national defence published in April 2013 calls for a significant decrease in military equipment orders. The corresponding savings will depend, however, on the outcome of contract renegotiations between the State and its public- and private-sector suppliers. Looking at civil-sector investments, most expenditures are made by local authorities (€52bn in 2012, i.e. 70% of the total), with the State coming in second with €3.9bn in 2012. Most discussions on the State's civil-sector investments concern transport, within the framework of the SNIT (national transport infrastructure scheme), and in particular the need for a prior evaluation of the socio-economic profitability of the projects and their prioritisation.

Even if the approach selected in this report is focused on potential savings in public spending, it is also recommended **to continue cutting tax-related spending**, as illustrated by examples drawn from the Court of Accounts' observations regarding various State intervention sectors.

Potential sources of savings

Structural measures within the scope of social security organisations

The concerning situation of social security finances and the bleak outlook in the short, medium and long terms reviewed in Chapters 3 and 4 of the report call for radical measures from the government authorities. In its reports on the situation of the Social Security Finance (RALFSS) and on the budget situation and outlook (RSPFP), the Court of Accounts developed proposals to reduce the growth rate of social security spending (see above), **to re-examine the legitimacy of certain mechanisms, to reduce the social niches eating into social security revenues, to reduce the management costs of social security funds and to better manage unemployment insurance expenditures.**

Various potential savings proposals are listed and illustrated in the report. For the **healthcare branch**, the report addresses the potential savings that can be generated in the medical transport sector, in respect of the coverage of the social security contributions of independent medical practitioners or in terms of calculating daily indemnities. Altogether, the potential savings identified for the health insurance sector represent potential savings of nearly €1.5bn.

Looking at **family allocations**, aside from the government's recent decisions to reduce the ceiling on the family quotient, the Court of Accounts pointed out that the redistributive nature of certain benefits was uncertain: this is particularly the case for the CMG (childcare supplement) component of the PAJE (early childhood benefit) which is of greater benefit to wealthier families. Similarly, the rapid rise in social security expenditures, averaging +7.5% per year from 2009 to 2012, calls for an evaluation of the utility of these measures, currently accounting for €4.5bn or 7% of family allocation benefits.

Looking at the **old-age branch**, and without prejudice to decisions that might be taken following the working group chaired by Ms. Yannick Moreau, the Court recommended reducing family benefits allocated to pensioners, in particular the 10% increase in pensions for raising three or more children, or at least taxing this benefit, as the current tax exemption costs the State about €900m.

The reduction of social niches, which eat into the bases on which social security contributions are based, need to be systematically re-examined, in accordance with the 2012-2017 Public Finance Programming Bill. There are three possible avenues worth considering:

- the conditions for applying the CSG (general social security contribution) to pensions (exemption for low-income earners, 6.6% for high-income earners, versus 7.5% for wage earners) could be reviewed. An alignment of the percentage of taxable pensioners with the percentage of wage earners would bring in another €1.2bn to the social security system.

- the exoneration of social security contributions benefiting individual employers over 70 years of age added to the tax reductions associated with the compensation of employees working from home. The elimination of this exemption would reduce the corresponding tax expenditure by about €370m;

- the social security contributions paid in respect of collective healthcare and personal protection policies are subject to a tax of 8% allocated to social security, while the top-up and employer contribution are subject to a normal rate of 20%. Harmonisation of the normal rate would boost social security revenues by €1.2bn.

While the majority of national social security funds will negotiate their target and management contracts in 2013, the Court of Accounts recommends that the supervisory authorities set ambitious spending targets on personnel and administrative management, estimating the potential savings at €1bn over five years.

The rapid deterioration in the financial position of the unemployment insurance scheme reflects the environment in which the renegotiation of the unemployment insurance agreement will take place between management and union representatives in the second half of 2013. The recent report published by the Court of Accounts in January 2013 on the «job market: undermined by high unemployment, calling for better targeting of policies», identifies a few expenditure reductions to clarify the search for leeway.

Structural measures at the local administration level

Among local public administrations, spending has increased the most over the past 30 years, climbing from 8.6% in 1983 to 11.7% of GDP at the end of 2011, representing average volume-based growth of 3.1% per year. The high level and momentum of local spending cannot be exclusively attributed to the impacts of skills transfers resulting from decentralisation laws: only 1.67 points of the 3.1-point increase in GDP from 1983 to 2011 was due to this impact. The rest of the increase in local spending, i.e. 1.38 GDP points, occurred on a constant skills basis.

The 2012-2017 Public Finance Programming Bill calls for local authorities to contribute to the effort to restore the budget balance, with the first goal being to stabilise the budget for State financial aid paid in 2013, followed by a decrease of €750m per year in 2014 and 2015. This budget was established at €1.5bn per year, resulting from the terms of the April 2013 stability programme, which also calls for the signing of a trust and responsibility pact negotiated between the State and local authorities in order to get them more involved in public spending policy. The contribution of local authorities to the effort to restore the budget balance is also expected to increase, meaning that local authorities will need to find a new financing model that does not undermine the relative structural balance of their budget.

Given the momentum of local spending, **a twofold objective is in order**.

Firstly, it is important to prevent the decrease in State financial aid from automatically leading to local tax hikes, given the already high level of overall mandatory taxes and social security contributions. Against this backdrop, a total reduction of €4.5bn in State financial aid over two years would make it necessary to focus primarily on identifying potential savings in local spending.

Secondly, it is also important to identify areas in which savings could be generated, in order to avoid makingadjustments solely to the investment cash flows of local authorities and their organisations, or through the increased use of debt. Potential sources of savings are primarily the responsibility of the local authorities, even though the State also has regulatory leverage at its disposal.

State regulatory leverage on local public spending

One source of regulatory leverage is the reduction of State allocations already under way. The distribution of the effort between the various levels of local authorities, currently under discussion by the Local Finance Committee, should take into account the financial leeway each category of local authority has at its disposal. If they were to receive new fiscal resources, the decrease in State allocations would no longer serve as an incentive to reduce local spending and thus total public spending; rather it would merely reduce the State's budgetary expenses.

Given the reduced resources allocated by the State to the vertical equalisation of the different categories of local authorities and the impacts of the new economic tax scheme, **horizontal equalisation** between a given level of local authorities should improve, based on the model of the FPIC (inter-*commune* and *commune* equalisation fund), transfer duties for the *départements* or equalisation funds for the CVAE (tax on corporate added value) received by the regions and *départements*.

The effort to reduce the cost of standardisation, which is weighing on local spending, must be significantly stepped up in the wake of the recent Lambert-Boulard Report (March 2013). The measures adopted by the Inter-Ministerial Committee for the Standardisation of Public Initiatives are headed in this direction. Savings of €500m on flows of normative provisions and existing normative provisions, which had an estimated net impact of €1.3bn in 2012, are not out of reach.

Increased pooling of services is one of the aims of the bills targeting the modernisation of territorial public initiatives and development of territorial solidarity and local democracy. In particular, these bills call for a transfer as of right, to the public institution for inter-*commune* cooperation, of *commune* personnel providing the services subject to a skills transfer, and for a broader definition of the jobs that can be done by a given service provider. These positive objectives, which are in line with the suggestions made by the financial jurisdictions, could be enhanced by making it mandatory for each inter-*commune* group to achieve a quantified resource-pooling target (expressed as a percentage of the limit on the increase in aggregated operating expenditures) and by subjecting the portion of State financial aid to the condition of meeting these targets. This is already being considered, by basing 10% of the inter-*commune* allocation on an inter-*commune* resource-pooling fund as from 2015.

France's administrative organisation can also be described as an overlapping of skills and multiple structures that generate excess costs for local public initiatives. **Clarifying skills and improving the coordination of local public authorities,** which the Court of Accounts has often identified as a necessity, could also generate considerable savings.

Local investment accounts for over 70% of civil public investment in France. In its annual public report for 2013, the Court of Accounts recommended avoiding *département*-region co-financing of investments and suggested establishing a limit on subsidies for projects conducted by other local authorities. Furthermore, for all local authorities, it is possible to define an obligation to carry out a multi-annual impact study of operating expenses generated by investments exceeding a limit to be defined, as called for by the above-mentioned bill targeting the development of territorial solidarity and local democracy.

Potential sources of savings

Savings subject to the responsibility of local authorities

Potential savings must be capable of offsetting the drop in State financial aid.

Management of personnel costs represents a major issue for the budget outlook of local authorities, given its high percentage of their operating expenses (35% on average) and how fast this percentage is rising (+3.5% in 2012, i.e. +€1.6bn, after +2.4% in 2011). If the *communes* alone had maintained their expenditures at their 2011 level in 2012, they would have generated savings of €850m. The sources of savings are the same as those described earlier for the State: slowering career advancements, moderating category-based measures, and regulating staff headcounts and working time. In autumn 2013, the Court of Accounts will publish a topical report on local finances which will examine these aspects in greater detail.

Streamlining management of the considerable cultural heritage belonging to the local authorities is an avenue well worth exploring, as it chalks up more than €3bn per year in maintenance expenses. The Court of Accounts' 2013 annual public report demonstrated that management of the real estate belonging to local authorities is still underdeveloped. More efficient management could generate potential savings of around €150m.

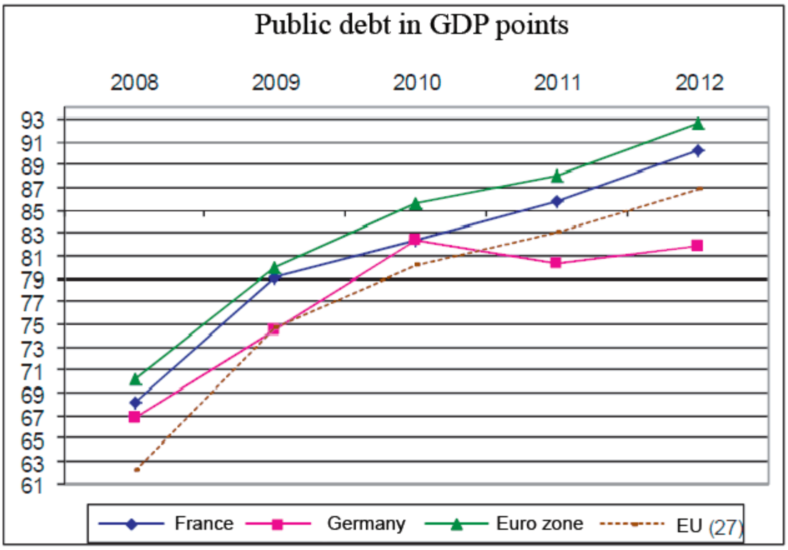
Similarly, **a more efficient purchasing policy** could contribute savings in the area of recurring purchases, estimated at €29.7m in 2012, carried out internally or outsourced. The «Advertising and public relations» line alone accounts for €1.5bn and «Travel and Receptions» €308m (2012).

Economic intervention policies represented an overall expense of €5bn in 2012, including €2.3bn for the regions and €1.7bn for the *départements*. In its 2007 topical report focused on economic decentralisation, the Court of Accounts observed a lack of consistency and coordination in local authorities' initiatives in this matter. Without prejudice to enhancing the role of «regional leader» which could lead to the adoption of the bill aimed at mobilising the regions for growth, employment and promotion of equality in the territories, the re-examination of all the aid mechanisms, the streamlining of structures and development of the evaluation of their effectiveness could be a potential source of savings for all local authorities, estimated at around 10% of the total cost of economic interventions, i.e. potential savings of €500m.

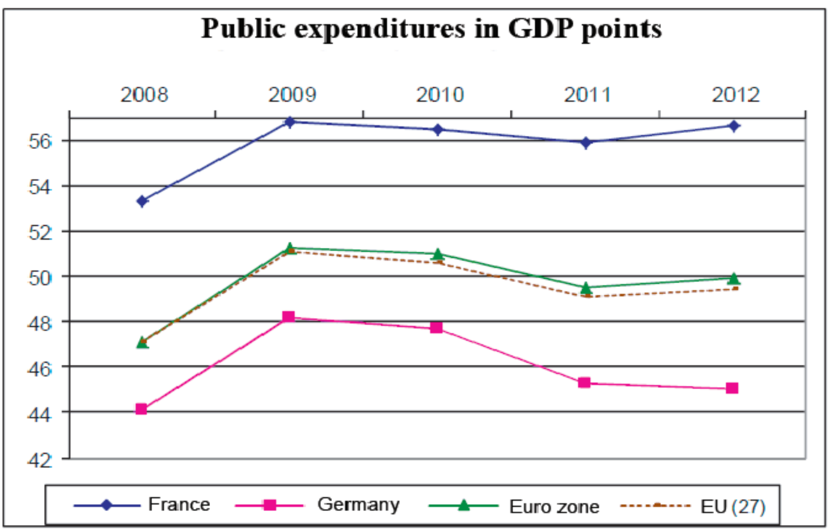
Optimising the management of local public services is another avenue, through the establishment of oversight tools appropriate to the multiple contributors working in a sometimes poorly coordinated manner in the electricity distribution, household waste management and sorting, water and sanitation sectors. Another way to optimise these services would be to strengthen the responsibilities of certain categories of local authorities, such as the management of social intervention mechanisms by the *départements*. Improved overall efficiency could be sought and overseen by the local authorities and their decision-making bodies, through the establishment of quantified, prioritised targets whose implementation is carefully monitored. The transmission and consolidation of the most significant performance indicators at the national level would offer useful reference points for this optimisation effort.

Appendices

Additional charts and tables



Source: European Commission



Source: European Commission

Potential risks in terms of «zero-value» standards in 2013

In €bn	Estimated risk for 2013	
Operations	Low assumption	High assumption
Agriculture, fishing, food, forestry and rural affairs	0.1	0.3
Defence	0.8	1.2
Education	0.2	0.2
Solidarity, social integration and equal opportunity	0.1	0.1
Work and employment	0.3	0.5
Equality of land, housing, cities	0.2	0.3
CAS (special allocation account) subsidy for green vehicles	0.1	0.1
Other assignments	0.1	0.2
Total operations excluding debt and pensions (1)	**1.9**	**2.9**
Margin linked to under-use of budget allocations (2)	*-0.8*	*0.8*
Total operations excluding debt and pensions after taking the margin into account (1+2)	**1.1**	**2.1**
LFI (Initial Budget Act) amendment on PSR (levy on government revenues in favour of the EU)	0.8	0.8
European Union PSR risk	0	1.8
Total based on "zero-value" norm	**1.9**	**4.7**

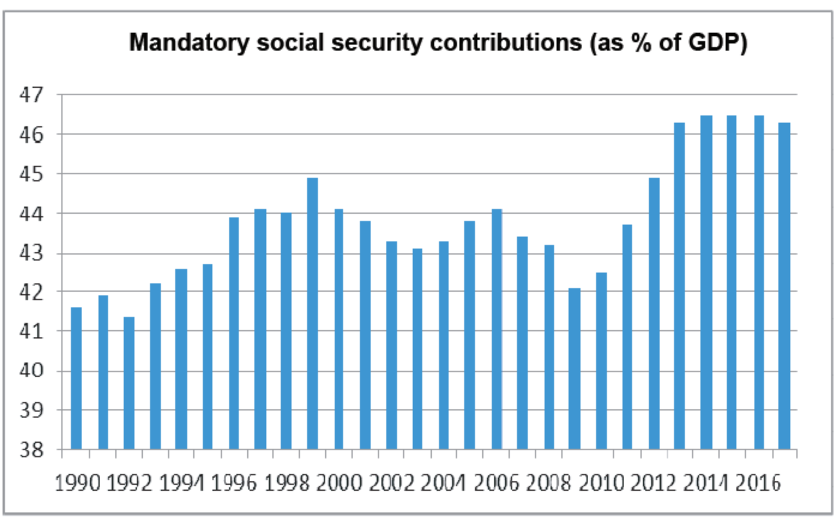
Source: Court of Accounts

Appendices

Local public administration expenditures under the stability programme

(Change in %)	Changes in 2012	**Estimates for 2013**
Total expenditures	+3.1	**+2.6**
Total wage bill	+3.1	**+2.8**
Intermediate consumption	+3.7	**+2.6**
Social expenditures	+3.2	**+4.3**
Investments	3.5	**3.0**

Source: INSEE (2012) and stability programme (2013)



Source: INSEE through to 2012 and stability programme thereafter

Stability programme assumptions in France and Germany

Growth rate		2013	2014	2015	2016	2017
GDP (volume)	France	0.1	1.2	2.0	2.0	2.0
	Germany	0.4	1.6	1.5	1.5	1.5
Potential GDP	France	1.4	1.5	1.5	1.6	1.6
	Germany	1.3	1.3	1.1	1.1	1.2
Total wage bill	France	1.3	2.4	4.0	4.0	4.0
	Germany	2.4	2.9	2.8	2.8	2.8

Source: Court of Accounts according to the stability programmes

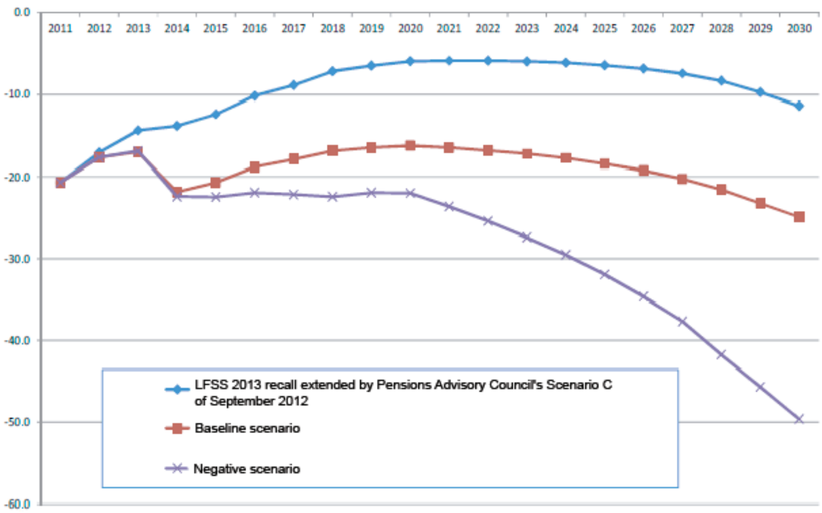
Budget trend in Germany

(as % of GDP)	2012	2013	2014	2015	2016	2017
Public administrations	+0.2	-0.5	0	0	+0.5	+0.5
State	-0.4	0	0	0	0	+0.5
Local administrations and länders	-0.1	+0.5	+0.5	+0.5	+0.5	+0.5
Social security	+0.6	0	0	0	0	0

Source: German stability programme

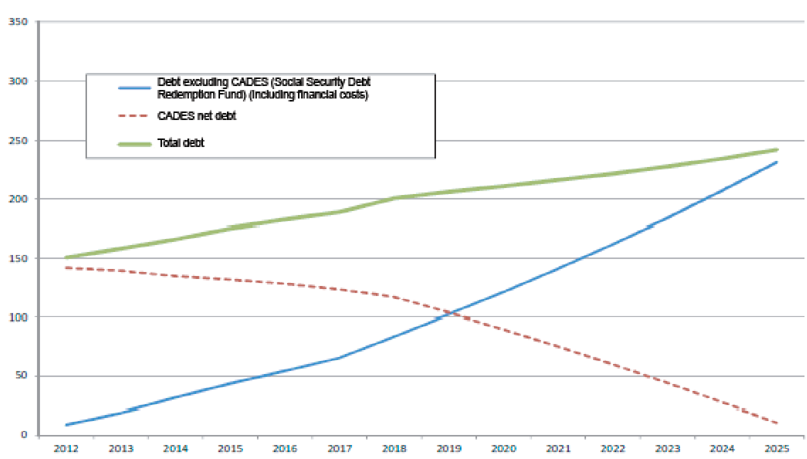
Appendices

Change in overall social security scheme and in old-age solidarity fund under different economic assumptions



Source: Court of Accounts

Change in CADES net debt and social security debt excluding CADES



Source: Court of Accounts