Cour des comptes

Chambres régionales & territoriales des comptes

LOCAL PUBLIC FINANCES IN 2020 - Pamphlet 1

[Report on] The financial situation and the management of local communities and their public facilities in 2019

In 2019, local communities incurred €250bn in actual expenditures, €186bn of which were for operational expenses and €64bn for investments. Their gross saving improved by 8.8% after +5.9% in 2018 (+ 3.2% on average per year since 2013).

This new increase in savings was mainly used to finance a new raise in investment expenditure (+ €7.1bn in 2019 and + €13.5bn since 2016).

If the local communities' overall financial situation improved again in 2019, the detailed analysis brings to light an increase in the diversity of situations between the various categories of communities and within each of these categories.

A favourable financial context in 2019 and increased investments

In 2019, the communities' enhanced savings stemmed from their buoyant tax revenues, the slight progression of State transfers and their efforts to better control their expenditure.

Dynamic local taxation

In 2019, tax revenues increased by €4.5bn to achieve €150.7bn (+ 3.1%). Excluding VAT – which was accounted for in financial transfers – the raise in local tax revenues was of €4.4bn.

This increase is in line with the average growth of previous years but, compared to past years, arose more from the strong standard upgrading of tax bases which occurred as per the initial Budget Act (+ 2.2% after + 1.2% in 2018). Its impact on the revenue of both household and business taxes is of + €1.2bn, in other words, three quarters of the increase observed in 2019 for these taxes (+ €1.6bn).

Other elements of local taxation have also increased. Consequently, the revenue of economic taxation increased by €1.3bn (+ 4.6%), mainly due to the increase in Company value-added contribution (Cotisation sur la Valeur Ajoutée des Entreprises - CVAE) (+ 6.8% in 2019).

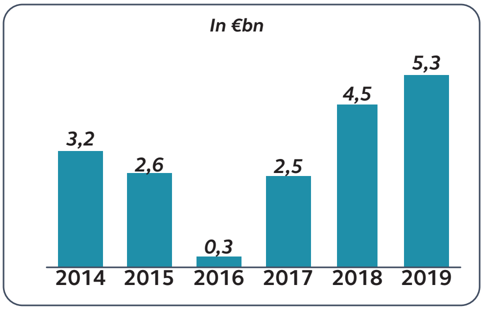
A slight improvement in financial transfers from the State to local communities

Financial transfers from the State increased again in 2019 (+ €5.5bn in comparison to 2018). As with last year, this increase mainly arose from the increase in tax relief compensations (+ €3.2bn) due to the further deployment of the housing tax reform. On a constant basis, excluding transferred taxation, financial transfers increased by €0.9bn.

Within these transfers, financial support remained predominantly stable (+ €551bn in total). However, taxation which is paid to communities to offset transfers of powers – and whose purpose, therefore, differs from other transfers – significantly increased (+ €1.5 bn), mainly as a result of the dynamism of transfer duties for valuable consideration (Droits de Mutation à Titre Onéreux - DMTO).

In total, the communities' revenues consequently increased on a constant basis by close to €5.3bn after €4.5bn in 2018. Since 2017, the last year of reductions to endowments, the increase in local community revenues has exceeded €9.8bn, an amount comparable to the reduction of financial support granted between 2014 and 2017.

Annual progress of tax revenue and financial transfers[1] (2014-2019)



Source: Cour des comptes, data from the DGFiP and DB

[1] *Excluding VAT, transferred taxation and tax relief compensations.*

Reduced impact of the State's decisions on local budgets

In 2019, the net impact of the State's decisions on the finances of local communities represented €315bn, as per the Cour des comptes' calculations, down from 2018 (€402bn). This change primarily concerns investment expenditures due to the cost of certain measures. As a result, the Decree pertaining to the accessibility of online services for people with disabilities generated, itself alone, important investments that were borne by local communities (€121bn in 2019).

Local expenditure under relative control

The supervisory scheme for local public expenditure implemented via the 2018-2022 Public Finance Programming Bill (Loi de Programmation des Finances Publiques - LPFP) hinges on a three-year financial contract with the communities whose budgets are higher. Due to the Covid-19 outbreak, the execution of ongoing contracts and orders was suspended in 2020.

Communities under contract incorporated this developmental objective in their financial guidance. Globally, during the 2018 and 2019 financial years, the progression of the actual operational expenditures for all the communities reached 1.9%, for a ceiling of 2.4% defined in the Public Finance Programming Bill.

Cumulative progression since 2017 in actual operational expenditures[2] (2018-2020)

	2018	2019	2020
LPFP progression ceiling 2018-2022	1.2%	2.41%	3.64%
Achieved	0.5%	1.9%	

Source: Cour des comptes, data from the DGFiP

Consequently, the communities' gross saving progressed by €5.1bn over this period. However, the annual financing need's national objective of progression – defined as per the law as the difference between new loans and the reimbursement of loans – remained inaccessible. The Cour des comptes had already underlined its unlikelihood in view of the cycle of local public investment.

The financial recovery scheme for communities that do not meet their contractual progression rate was first implemented in 2019. It ultimately only concerned 12 communities. It was implemented following the analysis and adjustment of the concerned communities' financial statements.

These adjustments, carried out by State services, represented nearly €3.5bn.

The health crisis led to the debate pertaining to the contents of a new generation of financial contracts due to start in 2021 to be suspended. The objectives and details of the framework for public expenditure shall most certainly be adjusted to the new economic and financial context which should encourage the streamlining of the relations between State and local government. However, the first generation of contracts revealed the pitfalls to be avoided in particular when it comes to the scope of the scheme or the lack of readability of the adjustments which have been carried out.

[2] *Budgets principaux et budgets annexes.*

An increase in the diversity of situations between communities

A favourable financial context and increased investments

Thanks to a favourable context and the relative control over their operating expenses, the financial situation of local communities again improved in 2019, in keeping with the two previous financial years.

Municipalities and their groupings enjoyed an increase in their operating revenues, in particular due to the strong standard upgrading of tax bases for residential premises. Their operating expenses remained relatively contained, with the exception of the groupings' supplementary budgets (+ 7.3%).

The communities of the municipal bloc used this surplus in savings for investments. After having significantly shrunk between 2014 and 2017, their investment expenditure thus returned to a superior level in 2013, even if the cumulated level for this period remained slightly below that of the previous cycle.

In 2019, the strong progression of the tax revenue of départements – and in particular of the revenue on transfer duties for valuable consideration (DMTO) – made possible the absorption of their social expenditure (+ 2.5%) and a major increase in their savings.

Continuing the growth momentum initiated in 2018, départements also made significant investments in 2019 (+ 13.8%) through their own capital expenditure and grants to the communities of the municipal bloc.

Finally, regions enjoyed very dynamic local taxation, thanks to the additional CVAE share that was granted to them under their new responsibilities in terms of transport as well as a share in the VAT which replaced the DGF as of 2018. This surplus in revenue led to a strong increase of their savings, despite operating expenses less under control than for other categories of local communities.

In a similar manner to départements, regions were in a position to significantly increase their investments (+ 11.3%), mostly comprising capital investments. This growth is mainly supported by merged regions (+ 17.6% equalling €931bn, which represents 86% of the progression) that therefore continue to increase their investments, more than non-merged regions (+ 3.2%).

For the other categories of communities, the situation for départements appears fragile as it depends on situational factors both in terms of expenditure and revenue – dynamics which are respectively pro-cyclic for the DMTO and contra-cyclic for social expenditure. This structural weakness is enhanced by the growing importance in their revenue of economy-related taxation. This trend shall intensify from 2021 onwards with the local tax reform and the replacement of property tax (Taxe

Foncière sur les Propriétés Bâties - TFPB) by a share on VAT, despite the fact this scheme is supported by a financial guarantee mechanism.

The départements' situation is also characterized by their considerable disparity. Local public entities representing 500,000 to 1 million inhabitants are seeing an improvement, but to a slightly lesser extent than other strata due to the faster-paced growth of their social expenditure. This is the only stratum to have borrowed more in 2019. But it is nevertheless in line with the general trend of debt reduction. Furthermore, certain resources such as DMTO, are unevenly distributed between départements and do not necessarily correlate to their level of social expenditure.

Main aggregates per category of community

(In €bn)	2013	2018	2019	2019/2018 progression	2019/2013 progression	2019/2013 average progression
COMMUNITIES AND THEIR GROUPINGS[1]						
Gross savings	20.06	22.16	23.27	***5.0%***	***16.0%***	***2.5%***
Actual investment expenditure	41.78	38.02	42.77	***12.5%***	***2.4%***	***0.4%***
Outstanding debt	107.41	115.13	116.05	***0.8%***	***8.0%***	***1.3%***
Debt reduction ratio (in years)	5.4	5.2	5.0	***-4.0%***	***-6.8%***	***-1.2%***
DEPARTEMENTS[2]						
Gross savings	6.68	7.91	9.24	***16.7%***	***38.3%***	***5.6%***
Actual investment expenditure	10.59	9.09	10.35	***13.8%***	***-2.3%***	***-0.4%***
Outstanding debt	31.32	32.10	31.35	***-2.4%***	***0.1%***	***0.0%***
Debt reduction ratio (in years)	4.7	4.1	3.4	***-16.3%***	***-27.6%***	***-5.3%***
REGIONS[3]						
Gross savings	5.16	5.41	6.08	***12.4%***	***17.9%***	***2.8%***
Actual investment expenditure	8.50	9.56	10.64	***11.3%***	***25.2%***	***3.8%***
Outstanding debt	19.72	26.25	26.45	***0.8%***	***34.1%***	***5.0%***
Debt reduction ratio (in years)	3.8	4.8	4.3	***-10.4%***	***13.7%***	***2.2%***

Source: Cour des comptes, data from the DGFiP

[1] With the financial data of the Paris département between 2013 and 2018, merged with the municipality in 2019.

[2] Excluding the Paris, Rhône, Corse-du-Sud, Haute-Corse, Guyana and Martinique départements.

[3] Excluding the Corse, French Guiana and Martinique local communities.

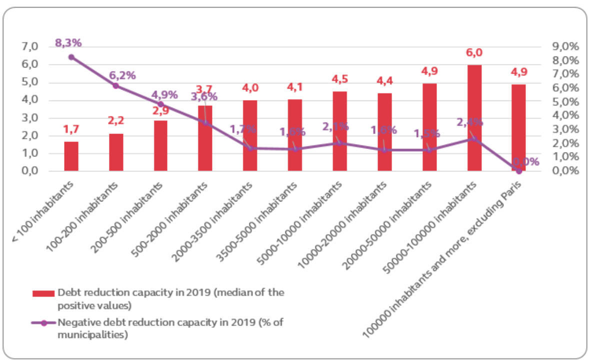
Diverse situations and structural weaknesses

The general improvement of the local sector's savings is however accompanied by increased financing requirements, driven by a resumption of the investments of the municipal bloc. In 2019, this financing requirement reached a higher level than in 2017, although under the terms of the Public Finance Programming Bill it should have dropped by €2.6bn every year.

Especially in respect to the communities of the municipal bloc, the growth in investment expenditure in 2019 was significantly higher than that of savings, thus requiring an increased recourse to loans and to the use of working capital. If the municipal bloc's capacity to reduce its debt has improved, its progression hinges on the dynamism of savings and not from debt reduction. Henceforth, this indicator could significantly deteriorate in 2020 as a result of the sharp decline in economic activity expected this year.

Furthermore, more than the other categories of local communities, the municipal bloc covers highly diverse situations. In particular, the financial situation of small municipalities is generally more favourable than that of the more inhabited municipalities, but they more frequently – on a proportional basis – presented degraded financial ratios and, as a result, a precarious state from 2019. Conversely, the situation of the most inhabited groupings is less disparate.

Debt reduction capacity of municipalities in 2019 per demographic stratum (median) and proportion of municipalities presenting a negative debt reduction capacity



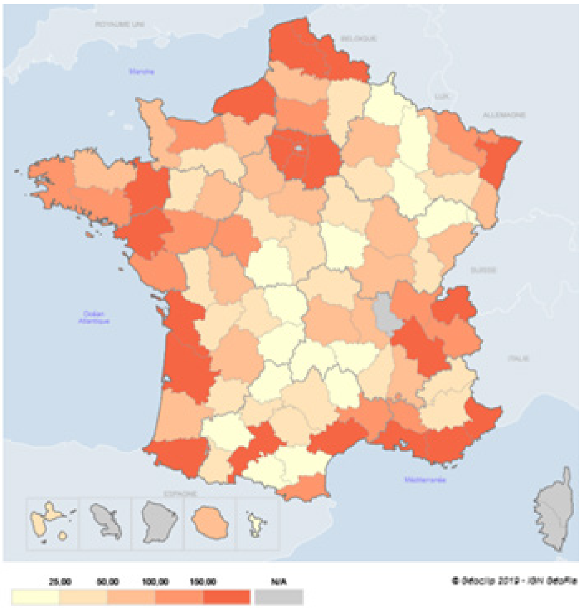
Source: Cour des comptes, data from the DGFiP

Note: For municipalities with fewer than 100 inhabitants, the median debt reduction capacity was of 1.7 years in 2019, but 8.3% presented a negative debt reduction capacity.

In 2019, the **départements'** situation was favourable but contrasted. In this way, the situation for those with 500,000 to 1 million inhabitants is improving less than that of other strata due to the faster-paced growth of their social expenditure.

Unlike communities from the municipal bloc, their finances hinge on factors which are structurally dependent on the context and are therefore fragile – dynamics which are respectively pro-cyclic for the DMTO and contra-cyclic for social expenditure. Moreover, these expenses and resources are unevenly distributed, and the degree of equalization remains modest in view of the amounts in question. This weakness could further increase from 2021 with the local tax reform and the replacement of property tax (TFPB) by a share on VAT.

Distribution of the gross DMTO per département in 2019
(In €bn)



Source: Cour des comptes, data from the DGFiP

Finally, despite dynamic savings, the increase in **the regions'** operating expenses (+ 2.1%) remains higher than for other categories of local communities (+ 2.7%), while their revenues significantly vary from one region to another. Thus, for metropolitan regions, the surplus in CVAE revenue varies from + 2.2% (+ €8bn) to + 13.5% (+ €201bn).

While the increase in savings has financially contributed to the strong rebound in investments, most regions had to increase their outstanding debt – by over 8% in four regions. No region has exceeded the 9-year alert threshold defined by the 2018-2022 Public Finance Programming Bill. However, this unfavourable situation hinges on a high level of savings in 2019 which should be significantly reduced in 2020 due to the decrease in tax revenue expected this year (decreased CVAE, VAT and TICPE [Domestic tax on consumption of energy products] revenues).

Risks foreseen for 2020

On the whole, local communities are addressing 2020 and the COVID-19 crisis from a better position than the State. Their revenue growth has accelerated since 2018 while bringing the progression of their expenditure under control, their gross savings significantly increased and contributed to the financing of local investments which increased considerably these past two years.

Given a context that is generally favourable to local finances, major disparities remain and the COVID-19 crisis should diversely affect local communities, depending on the nature of their expenses and revenue.

Départements appear particularly exposed to a downturn in the economic situation. Their finances should be affected by the COVID-19 crisis before the end of 2020, both in terms of expenditure (risk of an increase in social expenditure) and revenue (drop in DMTO revenue in particular).

Regions, whose revenues are highly dependent on the economic context, should see their savings shrink before the end of 2020 (TICPE, VAT) and even more so in 2021 (CVAE), hence fostering an increased debt ratio, unless they reduce their level of investment.

However, **the municipal bloc**, whose overall financial situation appears more favourable, is marked by great disparity. Numerous municipalities – in particular the smaller ones – are addressing the crisis in conditions that are already difficult and could see their financial situation degrade before the end of 2020. If this disparity does not support the conclusion that the entire municipal bloc is fragile, certain profiles of municipalities are more exposed due to the importance of their revenue and expenses which can be economically sensitive (touristic municipalities, overseas municipalities), even more so if their finances were already degraded in 2019.

These prospects led the Government to put forward – as part of a third Amending Finance Bill for 2020 presented on 10th June during the Council of Ministers – several support measures for the local public sector. This law provides – for the municipalities of the municipal bloc – for a partial compensation of the tax revenue (€0.75bn) and an increase in the DSIL [grant for local investment] (+ €1bn), while départements could receive an advance on their DMTO revenue within a €2.7bn limit. The idea of an account specific to crisis-related expenses should, ultimately, help better assess its short- and long-term financial consequences.

An initial analysis of the repercussions of the health crisis shall be issued by the Cour des comptes as part of the second pamphlet of its report on local public finances, published during the second semester of 2020.