# France

## A constrained budget


- In its 2017 draft budget bill, the government intends to lower the budget deficit to 2.7% of GDP in 2017, after 3.3% in 2016 and 3.5% in 2015.
- These targets, which are the same as in the April Stability Programme and also the 2016 budget bill, are based on growth forecasts which have also been maintained at 1.5% in 2016 and 2017.
- In 2017, faced with an estimated total of EUR 14 billion in new measures to finance, the government has produced as much in new savings and revenues.
- This budget complies with the European Commission's recommendation to bring back the deficit below the 3% threshold in 2017.
- Yet the execution risks are high in the light of the government's optimistic growth forecasts and intentions of keeping a tight grip on spending.


On Wednesday, 28 September, the French government presented its 2017 draft budget bill (PLF 2017). We would like to review here the key facts and figures in order to better understand how the government managed to balance its budget despite numerous constraints, notably its commitment to reduce the deficit below 3% of GDP; several downside risks to growth, and the need to finance numerous new measures…

The first big news is that the government intends to maintain the same budget deficit reduction targets as in the April 2016 Stability Programme: 3.3% of GDP in 2016 and 2.7% in 2017 (vs. 3.5% in 2015). These are also the same targets as in the 2016 budget bill. Consequently, the government's deficit trajectory complies with the European Commission's recommendation of reducing the deficit below 3% of GDP in 2017. The Commission is likely to sign off on the numbers. It should focus its analysis on the ways and means implemented to balance this budget and underline the importance to strictly execute the budget plan. It will release its assessment in November. The government also maintained its forecasts of average annual growth of 1.5% in both 2016 and 2017. The inflation outlook for 2016 is also the same, with an average annual rate of 0.1%. In 2017, in contrast, it lowered its estimate slightly to 0.8% (vs. 1%). The budget would halt the increase in the public debt ratio, which would inch down to 96.1% of GDP in 2016 and then to 96% in 2017, down from 96.2% in 2015 (see chart).

The government's decision to maintain its growth and deficit forecasts caught our attention. As to growth, we believe a downward revision would have been justified, especially in 2017, given the expected abating of several supportive factors (absence of inflation, past decline in oil prices and the euro's depreciation), while new headwinds are expected to emerge (notably, the consequences of Brexit). Yet the government esteems that the positive and negative impacts of economic developments since last April will balance each other out in terms of growth in 2017. On the negative side, Brexit's

### Public finance metrics

% of GDP

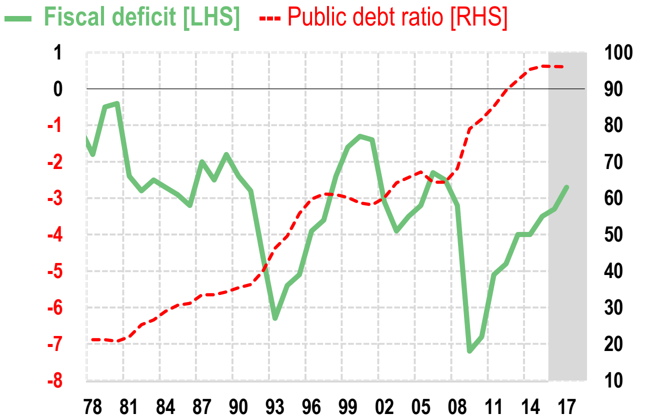


**Chart** Sources: INSEE, grey area: government forecasts

### Key figures from the 2017 budget proposal

Average annual growth rate (%) and ratios (% of GDP)

| | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|
| GDP growth | 0.6 | 1.3 | 1.5 | 1.5 |
| Potential growth | 1.0 | 1.1 | 1.5 | 1.5 |
| Fiscal balance (1) | -4.0 | -3.5 | -3.3 | -2.7 |
| Cyclical balance (2) | -1.7 | -1.6 | -1.6 | -1.6 |
| Temporary and one-off measures (3) | 0.0 | 0.0 | -0.1 | -0.1 |
| Structural balance (1)-(2)-(3) | -2.3 | -1.9 | -1.6 | -1.1 |
| Structural adjustment (change in the structural balance) | 0.3 | 0.4 | 0.3 | 0.5 |
| Of which real structural effort | 0.5 | 0.5 (0.7) | 0.4 (0.5) | 0.4 (0.3) |
| *New revenue measures** | *0.2* | *-0.1 (-0.1)* | *-0.2 (-0.2)* | *0.0 (-0.3)* |
| *Spending efforts** | *0.3* | *0.5 (0.8)* | *0.5 (0.7)* | *0.4 (0.6)* |
| Of which non-discretionary component | -0.1 | 0.0 | -0.1 | 0.0 |
| Of which tax credit key | -0.1 | -0.1 | 0.0 | 0.1 |
| Public debt ratio | 95.6 | 96.2 | 96.1 | 96.0 |
| *Public debt ratio excluding eurozone financial support* | *92.4* | *93.1* | *93.1* | *93.1* |
| Public spending ratio (excluding tax credits) | 56.1 | 55.5 | 55.0 | 54.6 |
| *Change in value of public spending (excluding tax credits)* | *1.0* | *0.8* | *1.4* | *1.6* |
| *Change in volume of public spending (excluding tax credits)* | *0.6* | *0.8* | *1.3* | *0.8* |
| Compulsory taxes/GDP ratio | 44.8 | 44.7 | 44.5 | 44.5 |

*Temporary and one-off measures notably include tax disputes. The non-discretionary component of the structural adjustment takes into account revenue elasticity effects when this elasticity differs from the historical unit value. The "tax credit key" is equal to the change in the spread between the budgetary cost and cost in the national accounts of recoverable tax credits that can be carried forward, following implementation of SEC 2010.*

** In brackets, previous figures taken from the April 2016 Stability Programme*

**Table 1** Sources: French government, BNP Paribas impact is expected to cost a quarter point of growth in 2017. Oil prices have also risen slightly since April [1] and world trade is expected to be less buoyant. All these factors would reduce growth by 0.3 points. On the positive side, the government is counting on stronger investment trends, new stimulus measures (such as the extension of the hiring bonus for SMEs and the over-amortization scheme), and fewer structural efforts in terms of fiscal savings. All these positive factors would boost growth by 0.3 points in 2017. Though realistic, we do not think this is the most likely scenario. It is clearly positioned in the upper range of forecasts[2]. The High Council of Public Finance (HCFP) also esteems that the government's 2017 forecast is optimistic, and the one for 2016 is a bit high with regard to the information available so far. The inflation forecasts, in contrast, are considered to be reasonable.

Fiscal deficit targets could be maintained in part because the growth forecasts were not changed. Yet the 2017 deficit target also depends heavily on a series of new financing measures totalling EUR 14 billion (EUR 8 billion in new revenues and EUR 6 billion in new savings), which precisely offset the new tax cuts (EUR 1.4 billion) and new spending (EUR 7.6 billion) announced by the government since the beginning of the year plus EUR 5 billion in adjustments previously identified in the April Stability Programme (to offset lower than expected inflation). These measures are outlined in Table 2. The other major news in the 2017 budget presentation is the introduction of a withholding tax, effective 1 January 2018.

According to government estimates, the reduction in the 2017 budget deficit is primarily structural (as in 2016). Indeed, despite its forecast of strong growth, there is no improvement in the cyclical balance because the government also estimates France's potential growth at 1.5%. The actual structural effort amounts to 0.4 points in 2017 (the same as in 2016) and hinges entirely on tight control over spending. As a result, fiscal consolidation should continue to strain growth, although not in a very restrictive manner.

One has to keep in mind that structural efforts are hard to evaluate by nature and must be handled with caution. It is possible that the European Commission will consider the structural efforts announced by the government to be overestimated, as was the case in previous budgets. And, aside the differences in estimations, remains the question of the execution risks of a budget during an electoral year. The risk of a fiscal slippage in the first months of the year is probably higher than usual and, whatever the outcome of the ballot, a supplementary budget act is highly likely to be voted in the summer of 2017.

### Strong critics from the High Council of Public Finances

To conclude, the 2016 target of reducing the deficit slightly to 3.3% of GDP seems reachable, even though it should not be taken for granted given the downside risks to growth and potential budget slippage on spending. In 2017, in contrast, it will be much harder to reduce the deficit to 2.7% of GDP: there are even stronger downside risks to growth and the High Council for Public Finance has identified greater upside risks for public spending than in previous years.

The High Council made several critics on that front and underlined the "unrealistic" nature of expected savings on UNEDIC unemployment insurance; the "strong uncertainty" weighing on the substantial savings planned by ONDAM, the national healthcare spending target; and the factors accelerating the total public service wage bill. Concerning government spending, it takes note of "the absence of any new clearly documented savings measures", as well as the pending accounting treatments of the announced recapitalisation of certain energy sector companies. For these reasons, the High Council esteems as "unlikely" that France will meet its nominal and structural deficit targets in 2017. It even considers it to be "uncertain" that the nominal deficit will fall below 3% of GDP next year.

By targeting a 2.7% of GDP fiscal deficit in 2017, the government benefits from a small room of maneuver to cope with negative surprises and still manage to reach the target of a deficit below 3% next year. However, a much weaker than expected growth, a likely outcome, would jeopardize even this target.

### New measures in the 2017 draft budget bill

EUR billions

| | |
|---|---|
| **New measures** | **9** |
| **New expenditures** | **7.6** |
| ■ State: emergency jobs plan; military and homeland security spending; support for education; increase in the public service wage index; increase in the wage grid | 5.7 |
| ■ Smaller decline in local government allocations | 1.2 |
| ■ Healthcare spending (easing of ONDAM, the national healthcare spending target) | 0.7 |
| **New tax cuts** | **1.4** |
| ■ Flat-rate cut in the income tax rate (-20%) targetting low-income households | 1.0 |
| ■ Reduction in the corporate tax rate targetting SMEs, from 33.3% to 28% (extension to all companies as of 2020) | 0.3 |
| ■ Reduction in charges for artisans | 0.1 |
| **Financing** | **14** |
| **New revenues** | **8.2** |
| ■ Adjustments to the Responsability Pact: transformation of the last tranche (complete elimination of C3S Solidarity Social Contribution, beginning of corporate tax reductions) by increasing the CICE tax credit (from 6% to 7%, budgetary cost postponed until 2018) | 5.0 |
| ■ Increase in proceeds from combatting tax fraud | 1.9 |
| ■ Various corporate tax measures | 1.3 |
| **New savings** | **5.6** |
| ■ Social security (unemployment insurance, health spending) | 1.5 |
| ■ Extra savings on debt servicing charges | 1.2 |
| ■ Fewer payouts for the Investment in the Future Programme (PIA) | 1.2 |
| ■ Less spending of local administrations | 1.0 |
| ■ Smaller impact of tax disputes | 0.7 |

**Table 2** Sources: French government, BNP Paribas

[1] The government does not make forecasts: it simply fixes the price at the last known price. Today, its scenario is based on oil prices of USD 45 a barrel, compared to USD 38 in April.

[2] Ecoweek 16-32, "France: growth prospects and confidence", 23 September 2016.