ECO FLASH

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France's 2019 fiscal deficit: right at the 3% threshold

Hélène Baudchon

- **In 2019, according to the preliminary INSEE estimate, France's fiscal deficit came to 3% of GDP, which is good news, if only slightly better than the government's target of 3.1% of GDP.**
- **The deficit widened by 0.7 points compared to 2018, the first increase since 2009.**
- **Attributable to the one-off fiscal cost of the transformation of the CICE tax credit into reduced employer contributions, the swelling deficit was expected to be only temporary, and would be followed by a substantial improvement in 2020. In the draft budget bill for the current year, the government was forecasting a deficit of 2.2% of GDP.**
- **Yet the Covid-19 pandemic has radically changed the situation. In the amended draft budget bill for 2020, presented on 18 March, the government is now forecasting a deficit of 3.9% of GDP, a preliminary estimate that is considered to be on the low end.**

In 2019, according to the preliminary INSEE estimate, France's fiscal deficit came to 3% of GDP, which is good news, if only slightly better than the government's target of 3.1% of GDP. France's deficit came right up to – but did not exceed – the 3% threshold. Although the deficit is slightly smaller than expected, it deteriorated slightly more compared to 2018 (by 0.1 points to -0.7 points) due to the concomitant downward revision of the 2018 deficit (to 2.3% of GDP, from 2.5% previously).

Widening of the fiscal deficit to 3% of GDP in 2019, the first increase since 2009

The increase in the deficit is due to the sharp decline in public revenues as a share of GDP (down 0.8 points to 52.6%; while the share of taxes and social security contributions declined by 0.7 points to 44.1%). This is largely, but not solely, due to the transformation of the CICE tax credit into reduced employer contributions. But numerous other tax cuts were included in the 2018 and 2019 budget bills, as well as in later amendments announced in response to the "yellow vest" crisis. The weight of spending remains virtually flat (down 0.1 points to 55.6%), but this figure masks contrasting trends depending on the type of expenditure (for example, debt servicing charges declined by 12%, while investment by local administrations surged by 15%, reflecting the municipal electoral cycle)[1]. One last key figure to keep in mind in this rapid review of France's 2019 public finance situation is the debt ratio: it levelled off at 98.1% of GDP after an imperceptible 0.2 point decline in 2018.

The increase in the 2019 deficit is the first since 2009. It brings to an end 9 years in a row of deficit reduction, during which the deficit gradually narrowed by a cumulative total of

France: fiscal deficit and public debt

% of GDP

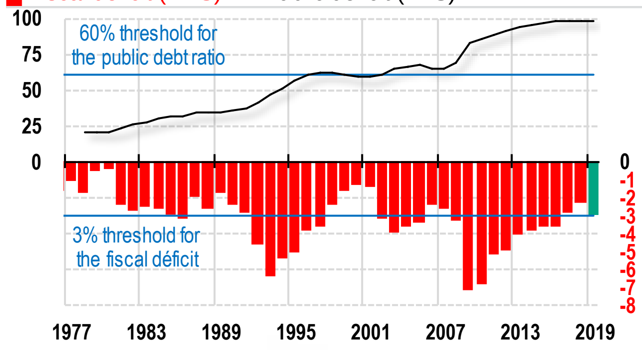

Chart Source: INSEE, BNP Paribas

[1] For further details: https://www.insee.fr/en/statistiques/4470956

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4.9 points. Last year's swelling deficit is essentially due to the one-off fiscal cost of the transformation of the CICE tax credit (without this impact, the deficit would have been only 2.1%). It was expected to be only a temporary increase followed by a big improvement in 2020, although the narrowing would be just as misleading as the widening of 2019. In the 2020 draft budget bill presented on 27 September 2019, the government was targeting a deficit of 2.2% of GDP this year, based on a GDP growth forecast of 1.3%[2].

A deficit below the 3% threshold in 2020 is yesterday's news

In the meantime, however, the outbreak of the Covid-19 pandemic has radically changed the situation from an economic and fiscal perspective. French GDP is now expected to contract sharply and abruptly, although the exact size of the plunge is still hard, if not impossible, to quantify. The massive recessionary shock is likely to be short lived, but the profile of the ensuing recovery is still shrouded in uncertainty. The government has announced a series of fiscal and financial support measures and the ECB has launched several monetary policy measures that aim to limit the shock as much as possible, while putting into place the conditions for a rapid recovery.

In the 2020 amended draft budget bill presented on 18 March, the government now expects the deficit to swell to 3.9% of GDP. This forecast is based on a 1% contraction in GDP and takes into account EUR 11.5 bn in stimulus measures out of the total of EUR 45 bn. These include EUR 8.5 bn for partial unemployment, EUR 2 bn for additional healthcare expenditures, and EUR 1 bn for the self-employed compensation fund. It excludes EUR 32 bn in deferred fiscal and social charges that the government eventually intends to recover. Note that the government reports the stimulus measures as one-off measures, which mean they do not worsen the structural deficit. The 1.7-point deterioration in the deficit forecast between the 2020 draft budget bill and the 2020 amended draft budget bill can be broken down as follows: 1.4 points for the downward revision of the GDP growth forecast and 0.3 points for support measures (see table).

The decline in GDP, like the swelling of the fiscal deficit and the amount of the stimulus package, are preliminary estimates and they are presented as being minimums. For example, based on our GDP growth forecast (-3.1%) and including all of the stimulus plan (1.9 points of GDP), the fiscal deficit would rise to 6.2% of GDP. We wish we were able to claim that this theoretical figure was at the upper end of the forecast range, but there is a real risk that the situation could deteriorate even further. Moreover, a recovery plan to follow on the back of the stimulus package is already being mentioned for the post-crisis period, amidst rising fears that a rapid rebound in growth no longer seems to be the most likely scenario. Note that during the Great Recession of 2009, French GDP contracted by 2.8%, and the fiscal deficit soared to 7.2% of GDP.

The expected deterioration in France's 2020 deficit falls well outside of the European fiscal guidelines, but it is not problematic. What is alarming is the underlying economic situation. It corresponds to the "exceptional circumstances" presented in Article 3 of the Treaty on Stability, Coordination, and Governance (TSCG). On 20 March, the European Commission went so far as to propose triggering the general waiver clause, or purely and simply suspending – temporarily – fiscal discipline rules.

France: previous and new forecasts for the 2020 fiscal deficit

		2018	2019	2020
2020 draft budget bill	Growth	1.7	1.4	**1.3**
	Headline fiscal balance	-2.5	-3.1	**-2.2**
	Cyclical balance	0.0	0.0	**0.1**
	One-off measures	-0.2	-0.9	**-0.1**
	Structural balance	-2.3	-2.2	**-2.2**
2020 amended draft budget bill	Growth	1.7	1.4	**-1.0**
	Headline fiscal balance	-2.5	-3.1	**-3.9**
	Cyclical balance	0.0	0.0	**-1.3**
	One-off measures	-0.2	-0.9	**-0.4**
	Structural balance	-2.3	-2.2	**-2.2**

Table Sources: Government, BNP Paribas

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[2] See EcoFlash, *France: 2020 budget offers more stimulus, less austerity*, 22 October 2019

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