

Opinion n° HCFP-2016-2
on the general government structural balance presented in the budget settlement
bill for 2015

20 May 2016

Summary

The general government balance amounts to €-77,5 billion in 2015, that is -3,6 % of GDP. The structural budget balance represents -1,9 % of GDP, using the potential GDP of the public finance programming law of 29 December 2014, which has to be the reference for the High Council.

The High Council notices that this estimate of the structural deficit in 2015 (1,9 % of GDP) is lower by 0,2 GDP point than the programming law's target (2,1 % of GDP).

Nevertheless, the High Council observes that the use of the public finance programming law as a sole reference is not sufficient. Actually, the Stability Programmes of April 2015 and April 2016, which took into account the recommendations of the European Commission and of the European Council, reflect better France's European commitments. With regard to the objectives set in these Stability Programmes, the structural deficit is higher by 0,3 point. This difference comes from the revisions settled on 17 May 2016 for the GDP growth for 2014 and 2015.

The better than expected GDP growth in 2014 and 2015 results in a downwards revision of the output gap (difference between actual GDP and potential GDP). However, the High Council notes that the revised output gap submitted by the Government is still higher than most existing estimates of international organizations. According to the High Council, the output gap seems overestimated, leading to an overestimated cyclical component of the deficit and thus, mechanically, to an underestimation of the structural deficit.

In 2015, the results exemplify, once again, the fact that structural balance estimates are subject to significant variations mostly linked to the revision of GDP estimates in previous years. This variability of the structural budget balance, and its sensitivity to revisions of economic data, argue in favor of an assessment which would also take into account other indicators that could reflect better the budgetary policy, such as the structural effort.

In this regard, the High Council points out that, if the structural effort cumulated over 2014 and 2015 is in line with the structural effort targeted in the programming law (0,9 % of GDP), this effort is lower than projected in the Stability Programmes of April 2015 and April 2016 (a cumulated effort close to 1,5 % of GDP in both Programmes). These differences stem from a stronger reduction of fiscal pressure and from a reduced effort in expenditure because of a lower inflation than anticipated.

Finally, the High Council emphasizes that, with a structural deficit in 2015 wider than in the last Stability Programme (1,9 % of GDP instead of 1,6 %), the effort get back on the trajectory to structural balance of public accounts in the long run will be greater.

The High Council of public finance received the referral file from the Government on 17 May 2016, under the article 23 of the constitutional bylaw n°2012-1403 of 17 December 2012 on public finance planning and governance, to deliver an opinion on the compliance with multi-year targets concerning the structural balance in the budget settlement bill for 2015 (PLR). The High Council adopted the following opinion after deliberations on 8 and 12 April 2016.

Introduction

1- Opinion's scope

Under the article 23 of the constitutional bylaw of 17 December 2012 « [...] The High Council of Public Finance gives an opinion on significant deviations, when there are some, from the trajectory observed in execution relative to the multi-year structural balance targets defined by the public finance programming law » (LPFP).

The public finance programming law in force is the last public finance programming law voted, which is the one of 29 December 2014 for the years 2014-2019. The organic law specifies that the structural balance must be estimated with the path of potential growth submitted in the report attached to the programming law.

2- On the information submitted

The High Council of public finance received the referral file from the Government on 17 May 2016. The referral file contains the introductory article of the budget settlement bill for 2015 and in particular a summary table focusing on the actual and the structural balances for all public administrations in 2015. The referral file was supplemented with detailed answers to a questionnaire previously addressed to the relevant administrations.

Finally, the High Council organized hearings on 18 May 2016 with representatives of the Treasury General Directorate and of the Budget Directorate.

Remarks about the deviations from the planning

The opinion of the High Council deals mainly with the structural balance achieved in 2015, which is compared with the structural balances planned on the one hand in the public finance programming law for 2014-2019 and on the other hand in the later Stability Programmes. Then, the High Council assesses both the structural adjustment, corresponding to the change in the structural balance between 2014 and 2015, and the structural effort related to this change¹.

1- Deviation from the structural balance trajectory in 2015

The High Council observes that the potential growth path and the estimation method for the structural balance included in the introductory article of the budget settlement bill for 2015 are consistent with the public finance programming law for 2014-2019.

¹ These concepts are defined in annex.

According to the national accounts data published by the French National Institute of Statistical and Economic Studies (INSEE), the general government deficit is €77,5 billion in 2015, which represents 3,6 % of GDP, after 4,0 % in 2013 and 2014. The public finance programming law anticipated a public deficit around 4,1% of GDP.

The 0,6 GDP point difference on the actual balance in 2015, compared with the programming law's target, is mostly cyclical (0,4 point). The one-offs only play a marginal role in the estimation of the structural deficit for 2015.

Table 1: Differences between the budget settlement bill for 2015 (PLR) and the public finance programming law for 2014-2019 (LPFP) (in % of GDP)

	2013			2014			2015		
	LPFP (Dec. 2014)	PLR 2015 (May 2016)	Gap	LPFP (Dec. 2014)	PLR 2015 (May 2016)	Écart	LPFP (Dec. 2014)	PLR 2015 (May 2016)	Gap
Actual balance (1)	-4,1	-4,0	0,1	-4,4	-4,0	0,4	-4,1	-3,6	0,6
Cyclical balance (2)	-1,6	-1,5	0,1	-1,9	-1,7	0,2	-2,0	-1,6	0,4
One-offs (3)	0,0	0,0	0,0	0,0	0,0	0,0	-0,1	0,0	0,1
Structural balance (1)-(2)-(3)	-2,5	-2,5	0,0	-2,4	-2,3	0,2	-2,1	-1,9	0,2

Note: Figures are rounded to the nearest tenth, so that it can lead to small differences the results of the operations.

Source: The High Council on the basis of data from the LPFP of 29 December 2014 and from the PLR for 2015.

a) *A structural component of the deficit lower in the budget settlement bill for 2015 than in the public finance programming law for 2014-2019*

The cyclical component of the deficit is an estimate for the impact of business cycles on public expenditure and tax revenues.

GDP growth in 2014 and 2015 was better than expected in the programming law: 0,6 % against 0,4 % for 2014, and 1,3 % against 1,0 % for 2015. Overall, the actual GDP in 2015 is 0,6 point higher than planned in the programming law, which leads to a lower output gap² (-2,8 % in 2015 compared with -3,4 %) and lowers the cyclical deficit by 0,4 point. The cyclical component of the deficit is thus about -1,6 % of GDP in 2015 instead of -2,0 % of GDP in the programming law.

The better than expected GDP growth in 2014 and 2015 results in a downwards revision of the output gap (gap between the actual and the potential GDP). However, the High Council notes that the revised output gap submitted by the Government is still higher than most existing estimates. According to the High Council, the output gap seems overestimated, leading to a too high cyclical component of the deficit and thus, mechanically, to an underestimation of the structural deficit. Therefore, the structural deficit submitted in the budget settlement bill for 2015 appears to be a low estimate.

² Gap between actual and potential GDP.

b) A lower estimation of the one-offs' impact in the budget settlement bill for 2015 (in absolute terms) than in the programming law for 2014-2019

The one-offs, by definition, do not have a permanent impact on the public deficit. In the budget settlement bill for 2015, they are estimated at €-0,9 billion (0,0 % of GDP) against €-2,2 billion (-0,1 % of GDP) in the programming law for 2014-2019. This gap between the two legal texts mostly stems from a new time frame of the final court decisions about tax litigations, with delayed judgements compared with the programming law, particularly on the litigation related to money market funds.

c) A lower structural deficit in the budget settlement bill than in the programming law, but revised upward with respect to Stability Programmes

The structural deficit, calculated as the difference between the actual deficit and the cyclical deficit adjusted for the one-offs, is estimated at 1,9 % of GDP in 2015.

The High Council notices that this estimate of the structural deficit in 2015 (1,9 % of GDP) is lower by 0,2 GDP point than the programming law's target (2,1 % of GDP).

However, the High Council reiterates the assessment delivered in its opinion of September 2014 on the public finance programming law, that this bill was not consistent with France's European commitments, because it only planned little structural adjustments for the years 2014, 2015 and 2016. The public finance programming law voted in 2014 included further structural adjustments but they were still unsatisfactory with respect to the European commitments of France (0,1 % of GDP for 2014, 0,4 % of GDP for 2015 and 0,3 % of GDP for 2016).³

After the UE Council recommendation of 10 March 2015, the structural adjustment path has been changed in the Stability Programmes of April 2015 and April 2016, with the planning of a greater structural adjustment.

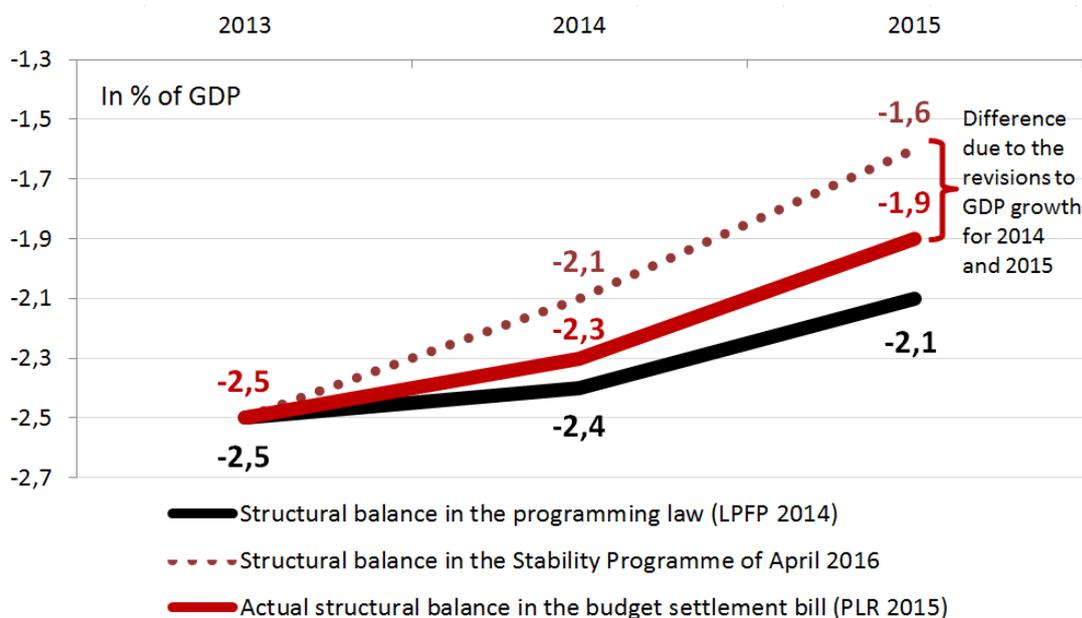
Under the organic law, the legal reference for the High Council's opinions is the public finance programming law of December 2014. Nevertheless, the High Council observes that the use of the programming law as a sole reference is not sufficient. The analysis should be supplemented by the consideration of the paths defined in the subsequent Stability Programmes.

If the structural deficit estimated in the budget settlement bill for 2015 (1,9 % of GDP) is lower than in the programming law, it is higher than in the Stability Programmes of April 2015 and April 2016 (1,6 % of GDP in both Programmes). This gap of 0,3 point is directly due to the revisions to GDP growth for the years 2014 and 2015, published on 17 May 2016⁴.

³ This structural adjustment should have been about 0,5 point at least, given the high level of public debt in France (more than 60 % of GDP). The European regulation 1466/97 defines the minimal structural adjustment: it should be higher than 0,5 point, and even greater when the debt ratio exceeds 60 % of GDP or in case of high risks on debt sustainability. The structural adjustment can, however, be modified depending on the position in the economic cycle and on the level of the output gap.

⁴ *Information rapide* n° 127 – Annual national accounts – Revision of the main aggregates for the years 2013-2015.

Structural balance trajectories



Sources: Programming law, Stability Programme of April 2016, budget settlement bill for 2015

These results for 2015 exemplify, once again⁵, the fact that structural balance estimates are subject to significant revisions, mostly linked to the revision of GDP estimates in previous years. This variability of the structural budget balance and its sensitivity to economic data revisions argue in favor of an assessment which could also take into account other indicators in order to better reflect the budgetary policy, such as the structural effort.

2- Change in the structural balance and in the structural effort in 2015

The structural adjustment, corresponding to the variation of the structural balance, represents in 2015 an improvement of 0,4 % of GDP with respect to 2014. This evolution is consistent with the public finance programming law forecast, with non-discretionary⁶ factors that compensate for a reduced structural effort.

The structural effort, which is the part of this improvement directly due to an effort in expenditure or new tax measures, represents also 0,4 % of GDP in 2015.

This structural effort of 0,4 % of GDP is explained by an effort in expenditure of 0,5 % of GDP, partially compensated by a negative impact from new tax measures (-0,1 % of GDP).

⁵ That has already been the case, in particular in the opinion delivered in May 2013 on the structural balance of 2012.

⁶ Non-discretionary factors are the effect attributable to the variation of tax levies elasticities (that is to say the quotient of spontaneous tax levies, excluding new political measures, and nominal GDP growth). In 2015, the elasticity of tax levies compared with GDP was slightly higher than expected in the programming law (1,0 instead of 0,9).

Table 2: Differences in the structural adjustment between the budget settlement bill for 2015 (PLR 2015) and the public finance programming law (LPFP 2014) (% of GDP)

	LPFP 2014		PLR 2015		Gap (PLR - LPFP)	
	2014	2015	2014	2015	2014	2015
Structural balance	-2,4	-2,1	-2,3	-1,9	0,2	0,2
Structural adjustment (a+b+c)	0,1	0,4	0,3	0,4	0,2	0,0
Structural effort (a)	0,4	0,6	0,5	0,4	0,1	-0,1
<i>New tax measures</i>	0,1	0,1	0,2	-0,1	0,1	-0,2
<i>Effort in expenditure</i>	0,2	0,5	0,3	0,5	0,1	0,0
Non-discretionary component (b)	-0,2	-0,1	-0,1	0,0	0,0	0,0
Processing of tax credits ⁷ (c)	-0,1	-0,1	-0,1	-0,1	0,0	0,1

Note: Figures are rounded to the nearest tenth, so that it can lead to small differences the results of the operations.

Source: The High Council on the basis of data from the LPFP of 29 December 2014 and from the PLR for 2015.

On the one hand, the effort in expenditure is measured by comparing the increase in expenditure excluding tax credits (0,9 % in value) deflated by the GDP price index (0,6 % in 2015, which means an increase in volume of 0,3 %) to the potential GDP growth (estimated by the Government to 1,1 % in 2015⁸). This contained expenditure (excluding tax credits) is partly due to a decrease in the interest rate burden (while the debt burden continued to increase), so it cannot really be called an *effort* in expenditure.

On the other hand, new tax measures contributed to the reduction of structural effort by 0,1 % of GDP in 2015, with tax-reducing measures (payroll tax relief and the competitiveness and employment tax credit - CICE in French) higher than tax-increasing measures (tax on petroleum products, retirement contribution, contribution on electricity consumption...).

The “non-discretionary” elements, that can contribute to the change in the structural balance (apart from new measures on taxes and expenditures) and thus create a gap between the structural adjustment and the structural effort, are small in 2015⁹.

In 2015, the **structural effort** was lower than projected in the programming law (0,4 % of GDP against 0,6 % of GDP). The effort in expenditure was consistent with the programming law, but

⁷ The cost, in national accounting, of refundable tax credits (CICE, CIR) corresponds to an obligation acquired, whereas their cost measured in terms of tax levies effort corresponds to the budgetary amount recovered or assigned. A term measuring the gap between these two measures is given in the decomposition of the structural adjustment. During the implementation of the CICE, this gap is negative because the obligation acquired is higher than the budgetary cost.

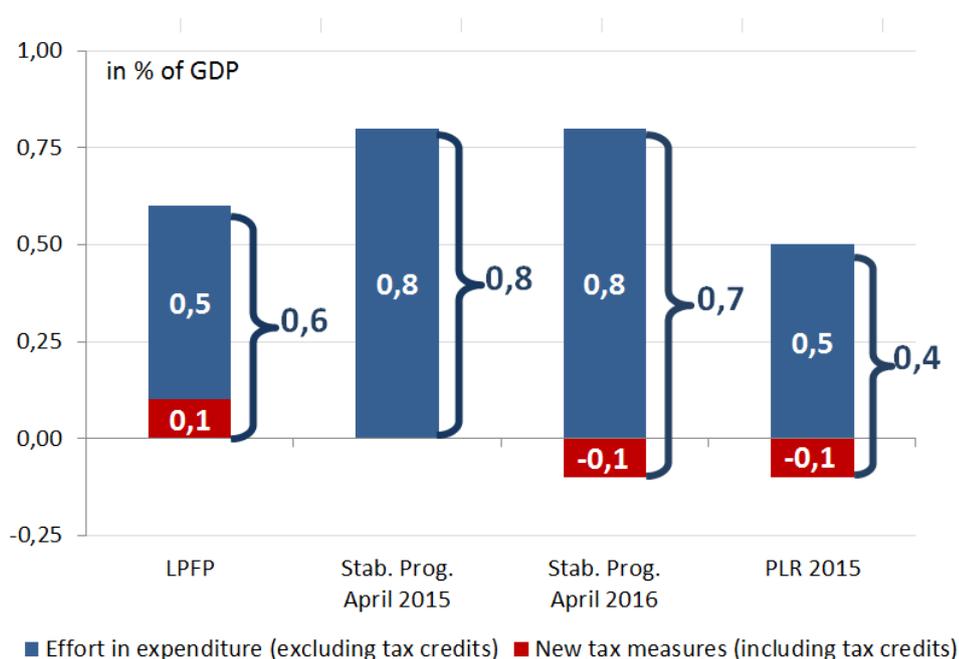
⁸ As public expenditure represents more than 50 % of GDP, the effort in terms of expenditure is close to half of the gap between the rate of growth in volume of actual and potential GDP.

⁹ Non-discretionary elements correspond to elasticity effects. However, the spontaneous evolution of tax levies (excluding new political measures) was around 1,9 % in 2015, which is similar to the evolution of nominal GDP. This means that the elasticity of GDP to tax levies is close to one.

the amount of new tax measures was higher than anticipated with the implementation of the competitiveness and employment tax credit and of new tax cuts (to support private investments and to increase revenue of low-income pensioners).

This structural effort in 2015 is significantly lower than planned in both Stability Programmes of April 2015 and April 2016 (respectively 0,8 % and 0,7 % of GDP). This is mostly due to a downwards revision of the GDP price index for 2015 (the rise of 0,6 % is smaller than the 1,1 % previously forecast). This leads to a speeding up in expenditure in volume terms (deflated by the GDP price index) and to a lower effort in expenditure.

Structural effort for 2015 in the programming law (LPFP), Stability Programmes and the budget settlement bill (PLR) for 2015 (in % of GDP)



Sources: LPFP, Stability Programmes of April 2015 and April 2016, budget settlement bill for 2015

In 2014 and 2015, the cumulative structural effort is about 0,9 % of GDP, which is consistent with the programming law's target (0,9 % of GDP), but this effort is lower than planned in the Stability Programmes (about 1,5 % of GDP in cumulative over two years). In these programmes, the effort was mostly concentrated on expenses and was calculated on the basis of expenditure evolution's targets set in nominal terms, and under the hypothesis of a rising inflation. However, since then, the inflation rate has been revised downwards with respect to the Stability Programmes, leading to an upward evolution of public expenditure in volume and thus to a diminution of the structural effort in expenditure.

The High Council points out that, if the structural effort cumulated over 2014 and 2015 is in line with the structural effort targeted in the programming law (0,9 % of GDP), this effort is lower than projected in the Stability Programmes of April 2015 and April 2016 (a cumulated effort close to 1,5 % of GDP in both programmes). These differences come from a stronger reduction of tax levies and from a reduced effort in expenditure due to a lower inflation than anticipated.

Finally, the High Council emphasizes that, with a structural deficit in 2015 wider than in the last Stability Programme (1,9 % of GDP instead of 1,6 %), the effort get back on the trajectory to structural balance of public accounts in the long run will be greater.

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This opinion has been published in the *Official Journal* of the French Republic and attached to the budget settlement bill for 2015.

ANNEX : method for estimating the structural balance

To assess the public finance trajectory, it is customary to consider the structural budget balance, which corresponds to the **public balance adjusted for direct effects of the economic cycle as well as exceptional events**. The public balance is thus separated into two components:

- A **cyclical component** that represents the impact of the economic cycle on the expenditure and revenue of the public administrations;
- A **structural component** corresponding to what the public balance would be if domestic production was at its potential level.

The identification of cyclical and structural components of the public deficit is based fundamentally on the estimation of potential GDP. Specifically, the identification takes place by first calculating the cyclical components of the public revenue and expenditure:

- **On the revenue side**, only mandatory contributions are assumed to be cyclical. The cyclical level of the income tax, corporate income tax, social security contributions and other mandatory contributions is calculated separately based on the observed levels, the estimated output gap and the elasticity of each tax category;
- **On the expenditure side**, only the unemployment compensation expenses are considered dependent on economic conditions. The cyclical share is estimated, as for revenue, based on its elasticity in relation to the output gap and the amount recognised each year.

The calculation of the cyclical component of the balance and, by difference with the actual general government balance, of the structural balance then results directly from these estimates. A simplified method helps to approach the cyclical balance. Given the fact that the mandatory contributions and expenses sensitive to the economic situation account for about half of GDP and that their average elasticity is close to one, the cyclical balance corresponds, in the case of France, to just over half the output gap.

A final correction is made to the structural balance in order to exclude certain events or actions that, because of their exceptional nature, have no lasting impact on the public balance. **However, there is no comprehensive definition of one-off and temporary measures and their identification is partly based on interpretation.**