Haut Conseil des Finances Publiques

Opinion n°HCFP-2016-4 of the High Council of public finance on the amending budget bill for 2016

November 14, 2016

Main conclusions of the HCFP's opinion:

In accordance with Articles 15 and 16 of the Organic Law of 17 December 2012, the High Council of public finance (HCFP) received the referral file from the Government. The referral file contains the introductory article of the amending budget bill for 2016 and the "economic and financial framework of the amending budget bill for 2016" including "updated macroeconomic forecasts" and "updated public finances forecasts in 2016 and 2017". The HCFP chooses to treat the referral based on those two articles in one opinion.

Regarding 2016

The High Council notes that the Government's growth forecast, revised downwards from 1.5% to 1.4% for 2016, is still in the upper range of available forecasts. Nevertheless, it considers that this forecast is achievable.

Given the information published since its previous opinion, the High Council regards the Government's inflation, employment and private-sector wage bill forecasts for 2016 as realistic.

The High Council notices that the structural balance for 2016 complies with the objective set out in the public finance programming law (LPFP) of 29 December 2014. The structural deficit estimate, of 1.6% of GDP with the potential growth assumptions from the LPFP, lies below the objective of 1.8% of GDP in that law. However, the structural adjustment in 2016 is less than the objective set out in the Stability Program of April 2016 and the minima set out in the European regulation n°1467/97.

The High Council is of the opinion that the deficit forecast of 3.3% of GDP in 2016 is realistic. It depends on the strict management of public expenditure at the end of the year.

Regarding 2017

As was done in the previous opinion on the budget bill for 2017, the High Council observes that the unaltered growth assumption made by the Government for 2017 (1.5%) remains above the "Consensus Forecasts" (1.2% in November) and the forecasts of international governmental organizations (1.3% for the IMF, 1.4% for the European Commission).

As regards public finances, the High Council confirms the assessment made in its previous opinion on the budget bill and the social security financing bill forecasts for 2017.

In accordance with Article 15 of the Organic Law of 17 December 2012 on programming and governance of public finances, the High Council delivers an opinion on the macroeconomic forecasts which the amending budget bill (PLF) for 2016 is based on, and on the consistency of this amending budget bill vis-à-vis the multi-year structural balance targets. In accordance with Article 16, the HCFP also delivers an opinion on changes to the overall scenario associated to the budget bill (PLF) for 2017.

The High Council chooses to treat the referral based on those two articles in one opinion. This opinion follows the opinion n°HCFP-2016-3 on the budget bill and the social security financing bill for 2017 delivered on 24 September 2016.

Introductory observations

1- On the scope of the opinion

In accordance with Articles 15 and 16 of the Organic Law of 17 December 2012, the High Council of public finance (HCFP) received the referral file from the Government. The referral file contains the introductory article of the amending budget bill for 2016 and the "economic and financial framework of the amending budget bill for 2016" including "updated macroeconomic forecasts" and "updated public finances forecasts in 2016 and 2017" (cf. annexes).

<u>In accordance with Article 15</u>, the High Council delivers an opinion on:

- The macroeconomic forecasts which the amending budget bill for 2016 is based on,
- The consistency of the introductory article of the amending budget bill (PLFR) vis-à-vis the multi-year structural balance targets set in the public finance programming law (LPFP).

<u>In accordance with Article 16</u>, the High Council pronounces on revisions to the macroeconomic forecasts presented by the Government during the Parliament's review of the budget bill for 2017.

The High Council chooses to treat the referral based on those two articles 15 (I of this opinion) and 16 (II of this opinion) simultaneously and in one opinion.

2- On the information submitted

The High Council of public finance received the referral file from the Government on 4 November 2016. The referral file contains the introductory article of the amending budget bill for 2016 and updated macroeconomic and public finances forecasts for 2016 and 2017. The referral file was supplemented with answers to two questionnaires previously addressed to the relevant administrations. The High Council had access to information about the end of the budget year only on Saturday 12 November 2016.

3- On the method of the High Council

The High Council analyzed the referral file as well as the answers of the Government to its questionnaires.

It organized hearings with representatives of the relevant administrations on 7 November 2016.

The High Council also took into consideration all the forecasts and analyzes available, especially those of the OECD (Interim Economic Outlook – 21 September), IMF (World Economic Outlook – 4 October), INSEE (point de conjuncture – 6 October), European Commission (Automn Economic Forecast – 9 November) and “Consensus Forecasts” (November).

As concerns public finances, it took note of the evolution of revenue and expenditure of the central government until the end of September, as well as a set of analyzes and forecasts, especially the updated forecasts for the Unédic (mid-September), the report of the Commission of Social Security Accounts (23 September), the last opinion of the Alert Committee on the evolution of health insurance expenditure (8 October) and the conjuncture note of La Banque Postale on local finances (3 November).

I. Remarks about 2016 forecasts

A – Remarks about economic forecasts

The Government has slightly decreased its growth forecast for 2016, which is now 1.4% GDP instead of 1.5% in the budget bill for 2017 and in the Stability Program of April 2016.

The growth forecast for 2016 was no longer compatible with the national accounts published at the end of October for the 3rd quarter. Indeed, GDP growth was only of 0.2% for that quarter after -0.1% in the second quarter of 2016.

According to the Government, “activity would accelerate in the 4th quarter, with a growth rate of 0.5%. Business climate, evaluated by the INSEE, remains a bit above its long-term average, which is historically associated with quarterly growth of about 0.3-0.4%. A slightly greater progression is expected since domestic consumption and corporate investment should rebound after a 3rd quarter affected by temporary factors”. Considering the positive calendar effects in 2016, growth over the year would be 1.3% in a quarterly accounts sense and 1.4% in an annual accounts sense[1]. This revision is in line with the assessment of the High Council in its September 2016 opinion on the budget bill for 2017, which stated that “the Government’s growth forecast (1.5%) was slightly high in view of the information known so far”.

The High Council notes that the Government’s growth forecast of 1.4% for 2016 is still in the upper range of available forecasts. Nevertheless, it considers that this forecast is achievable.

The Government’s revision to the growth assumption goes along with a change in its composition: consumption is revised downwards (1.6% instead of 1.8% in the budget bill for 2017), private investment is significantly increasing (1.5% instead of 0.3%); the contribution of external trade to growth is more strongly negative than it used to be in the budget bill for 2017 (-0.6 instead of -0.4 point); that of inventories is positive and greater than before (0.3 instead of 0.1 point).

The forecast consumer **price inflation** is revised slightly upwards in terms of annual average for 2016 (0.2% instead of 0.1%), while the GDP price inflation is marginally revised downwards (0.8% instead of 0.9%)[2]. GDP in value, used to compute the ratios on public finances, is forecast to grow by 2.2% in 2016 instead of 2.4% as stated in the budget bill for 2017.

Employment and private-sector wage bill forecasts are unchanged. The High Council described them as “credible” in its opinion on the budget bill for 2017.

Given the information published since its previous opinion, the High Council regards the Government’s inflation, employment and private-sector wage bill forecasts for 2016 as realistic.

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[1] INSEE projections are elaborated in the framework of quarterly national accounts in the working-day adjusted form to neutralize quarterly evolutions that depend only on calendar effects. In contrast, this adjustment is not applied to annual national accounts published every year in May, which relate to production in gross terms over the year regardless of the number of working days. Year 2016, a leap year with three holidays on Sunday, displays a great number of working days and a positive calendar effect on growth estimated to lie around 0.1 GDP point. Quarterly accounts are adjusted by -0,1 % and thus indicate a slightly lower growth than annual accounts will do.

[2] Consumer price and GDP price cover very distinct fields: the former concerns imported goods and is particularly sensitive to oil prices; the latter reflects the price of value added on the national territory whose uses are consumption as well as investment, export and stocks. Their developments differ and revisions can occur in opposite directions.

B – Remarks about public finances

Decomposition of the general government balance									
	Amending budget bill 2016 (Nov. 2016)			Programming law reminder (Dec. 2014)			Stability Program (Apr. 2016)		
	2014	2015	2016	2014	2015	2016	2014	2015	2016
General government balance *(GDP points)*	-4	-3,5	-3,3	-4,4	-4,1	-3,6	-4	-3,5	-3,3
Cyclical component	-1,7	-1,6	-1,7 (-1,6)	-1,9	-2	-1,7	-1,9	-1,9	-1,8
One-off and temporary measures	0	0	-0,1	0	-0,1	-0,1	0	0	-0,2
Structural component	**-2,3**	**-1,9**	**-1,5 (-1,6)**	**-2,4**	**-2,1**	**-1,8**	**-2,1**	**-1,6**	**-1,3**

Note: figures are rounded to nearest tenth, which can result in small discrepancies in the results.
Between brackets are the estimates calculated using the potential growth assumptions from the programming law of December 2014.
Sources: Amending budget bill 2016, programming law of December 2014, Stability Program of April 2016 for 2016-2019

The general government deficit forecast for 2016 (3.3 % of GDP) remains unchanged with respect to the budget bill for 2017. In contrast, due to the change in the growth scenario for 2016, its breakdown is slightly modified. The cyclical component is deteriorated by 0.1 GDP point and the structural deficit improved by the same amount with respect to forecasts associated to the budget bill for 2017.

1) Consistency of the annual structural fiscal balance targets with the public finance programming law (LPFP) and the Stability Program

Deviation from the adjustment path

In accordance with the Organic Law of 17 December 2012, the High Council deliberates on the consistency of structural balance targets set out in the amending budget bill (PLFR) with those set out in the last programming law (LPFP), in this case, law n°2014-1653 of 29 December 2014 for years 2014 to 2019.

In order to compare structural balance targets, the Organic Law makes imperative the use of the same assumptions as in the programming law, especially those about potential growth (1.3% in 2016 instead of 1.5% in this amending budget bill as well as in the Stability Program of April 2016 and in the budget bill for 2017). Computed with the potential growth assumptions from the public finance programming law (LPFP) 2014-2019, the structural deficit is estimated to stand at 1.6% of GDP in 2016.

The High Council notices that the structural balance for 2016 complies with the objective set out in the public finance programming law (LPFP) of 29 December 2014. The structural

deficit estimate, of 1.6 GDP point with the potential growth assumptions from the LPFP, lies below the objective of 1.8 GDP point in that law.

However, the structural deficit does not comply with the targets set out in the Stability Program of April 2016. It is 0.2 point greater than the objective set in this program (1.5 instead of 1.3 point with the same potential growth assumptions). Nevertheless, this gap can be explained by revisions to GDP growth in previous years, subsequent to the publication of the Stability Program[3].

The High Council recalls that the Government's structural deficit estimate is substantially lower than estimations provided by international governmental organizations, due to a significantly higher output gap estimate. The High Council criticized on several occasions the output gap assumptions maintained by the Government, which lead to underestimate the structural deficit. Thus, the European Commission expects the structural deficit for 2016 to amount to 2.5% of GDP[4] in November 2016, that is to say one point more than the Government's estimate. The difference with the OECD and IMF estimates is about ¾ and ½ point respectively.

Evolutions in structural terms

Structural adjustment and structural effort

% of GDP	Amending budget bill 2016 (Nov. 2016)		Programming law (Dec. 2014)		Stability Program (Apr.2016)	
	2015	**2016**	**2015**	**2016**	**2015**	**2016**
Structural adjustment	**0.4**	**0.3** **(0.2)**	**0.4**	**0.3**	**0.4**	**0.4**
Structural effort	**0.5**	**0.4** **(0.3)**	**0.6**	**0.2**	**0.7**	**0.5**
expenditure restraint (excluding tax credits)	0.5	0.55 (0.4)	0.5	0.4	0.8	0.7
new revenue measures	- 0.1	- 0.15	0.1	-0.1	-0.1	-0.2
Elasticity effects	0	-0.1	-0.1	0	-0.2	-0.2
Treatment of tax credits [5]	-0.1	0	-0.1	0	-0.1	0

Note: figures are rounded to nearest tenth, which can result in small discrepancies in the results.
Between brackets are the estimates calculated using the potential growth assumptions from the programming law of December 2014.
Sources: Amending budget bill 2016, programming law of December 2014, Stability Program of April 2016 for 2016-2019

[3] National accounts published in May 2016 entailed significant revisions to GDP growth for 2013, 2014 and 2015 (see opinion HCFP-2016-2 of 20 May 2016 on government structural balance in 2015). These revisions resulted in GDP increased by 0.6 point in 2015, reduced output gap and the structural deficit for 2015 and subsequent years deteriorated by 0.4 point.
[4] This forecast is consistent with an output gap of -1.4% instead of -2.8% according to the Government.

Structural adjustment in 2016 is less than the objective set out in the programming law (0.2 instead of 0.3 point with comparable potential growth assumptions) and in the stability program (0.3 instead of 0.4 point).

Structural effort is estimated to be 0.4 point (0.3 using the assumptions from the LPFP). It stands below the objective set out in the stability program of April (0.5 point) but above that in the programming law (0.2 point) of September 2014, which did not comply with France's European commitments according to the High Council.

Both are lower than the minima set out in the European regulation n°1467/97[6].

All in all, the High Council notices that the structural deficit path complies with the targets defined in the public finance programming law but the structural adjustment in 2016 is less than the objective set out in the Stability Program of April 2016 and the minima set out in the European regulation n°1467/97.

2) Revenue and expenditure forecasts

The general government deficit forecast of the Government for 2016 remains unchanged at 3.3% of GDP. The same holds true for the forecast evolution of public expenditure (1.6%). Only minor adjustments are made to revenue and expenditure forecasts with respect to those presented for 2016 at the end of September in the budget bill for 2017.

a/ Revenue

- The adjustment to the economic scenario and measures of the amending budget bill result in net tax revenues for 2016 being revised downwards by 0.6 €B with respect to the budget bill for 2017. VAT revenues decrease by 0.2€B, linked to the reduced increase in consumption (1.6% instead of 1.8% in the PLF). This loss is compensated for by additional receipts on free transfer tax (donations) and other miscellaneous revenues. Furthermore, the amending budget bill increases the share of VAT revenue allocated to the social security by 0.5€B as compensation of the central government for the decrease in health insurance contributions of farmers. Other measures bring about a reduction in the domestic consumption tax on energy products (TICPE).

[5] The cost of reimbursable tax credits (CICE, CIR) in national accounting corresponds to the acquired obligation, whereas their cost in terms of new compulsory contributions is the amount charged or returned. The gap term between the two measures thus appears in the decomposition of structural adjustment. This gap was negative during the ramping up phase of the CICE; it is roughly neutral in 2016.

[6] Structural adjustment should be greater, or even far greater than 0.5 point a year as stated in the European regulation n°1467/97 which applies in all States subject to an excessive deficit procedure (case of France). This regulation states that "in its recommendations, the Council invites the State Member to comply with annual budgetary targets in order to improve by at least 0.5% of GDP each year the cyclically adjusted balance net of exceptional and temporary measures (i.e. the structural balance)".

- These forecasts are broadly in line with tax recoveries recorded by the end of September. Nevertheless, great uncertainty affects the last advance corporate tax payment like every year[7].

- The downward revision to tax revenues with respect to the budget bill is offset by additional non-fiscal revenues of 0.8€B, of which 0.5€B –unsustainable- is a repayment from the Coface (French export-credit guarantee company).

- Projections of revenues from social contributions are based on a private-sector wage bill growth assumption (2.6%) which is consistent with observed data and the last projections of the French Social Security Agency (ACOSS).

- Local taxes forecasts are in line with information available at the end of September, perhaps cautious for transfer duties.

Overall, the High Council considers that public revenues forecasts for 2016, which remain subject to uncertainty on the last advance corporate tax payment like every year, are consistent with available information.

b/ Expenditure

- Compliance with the objectives of budget implementation for 2016 is made difficult by additional measures announced throughout the year and by the extent of under-budgeting in the initial budget act, which reached an unprecedented level in 2016 (requiring more than 2.5€B new appropriations). These measures lead in particular to increase the public-sector wage bill, (general increase, category-specific measures...), which should grow by about 1.3% over the year according to the HCFP, and to raise many other expenditures (emergency employment plan, measures to benefit farmers, external affairs and internal security, emergency funds for the departments...).

  However, compliance with the expenditure objective for the central government in 2016 will be facilitated by reduction in the transfers to the European Union and to local authorities (1.2€B and 0.7€B respectively).

  All in all, appropriations net of cancellations and expected savings on the transfers (PSR) would amount to 0.9€B, partially offset by three special levies for 0.2€B. According to the Government, supplementary savings on implementation, resulting from the careful monitoring of the consumption of budgetary commitments in the end of the period, would allow compliance with the central government's expenditure objective (excluding the debt burden and pensions). This situation is pretty close to what was observed last year about

[7] For companies with a turnover over €250M, the last advance payment of 15 December depends on the projected increase in the results of the current financial year. The impact can be high: in 2013 and 2015, the gap between the amending budget bill and the implementation amounted to about €2B.

the end of the period 2015 (0.7€B net appropriation in the PLFR 2016, compared with 0.4€B in the PLFR 2015).

Regarding the larger „spending norm in volume" (i.e. including the debt burden and pensions), compliance with the objective is facilitated by the reduction in interest expenses, which should lie 2.9€B under the level set out in the initial budget act, as was already projected in the budget bill (PLF) for 2017.

- Health insurance expenses are also under great strain. In its opinion of 12 October 2016, the Alert Committee identifies likely overspending of 500€M on the national healthcare expenditure target (ONDAM) for public hospital service, and of 245€M on non-hospital treatments. The Committee notices that significant risks affect this forecast due to the vigorous growth in expenditure, notably related to non-hospital treatments.

  This overspending may be offset by reducing the objectives on medical-social expenditures and healthcare abroad, for about 220 M€, and by cancelling appropriations put in reserve of 558M€.

  By contrast, the resources mobilization strategy made by two agencies[8] for an amount of 200M€ will only contribute artificially to compliance with the national healthcare expenditure target (ONDAM) and should not improve the public balance.

- Based on accounting information at the end of September, the Government revise downwards local government expenditures. They should increase by 0.7% instead of 0.8% as forecast in the budget bill for 2017. This forecast is cautious even though it remains subject to risks, especially on investment with a significant part usually contracted at the end of the year.

All in all, the High Council is of the opinion that the deficit forecast of 3.3% of GDP in 2016 is realistic. It depends on the strict management of public expenditure at the end of the year.

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II. Remarks about 2017 forecasts

The Government had to revise downwards its 2016 forecast due to new information from national accounts for the 3rd quarter. However, it decided to keep its assumptions for 2017 unchanged. The main assumptions are a 1.5% GDP growth rate, a 0.8% increase in the consumer price and a 2.7% expansion in the wage bill.

Under unchanged economic developments, forecasts for 2017 in level will be slightly modified by a “base effect”. The nominal GDP for 2017 is thus reduced by 0.2 point like the GDP for 2016, due

[8] Fund for hospital employment and the National Association for in-service training of hospital staff.

to adjustments in volume and price for 2016. This minor revision may negatively affect government revenues. For this reason, the Government foresees lower corporate tax revenues in 2017, for an amount of 0.2€B. Nevertheless, this is offset in their scenario by a downward revision to the debt interest burden, associated with the assumption of a more gradual rise in short-term rates with respect to forecasts for the PLF 2017. Therefore, the public deficit forecast remains unchanged at -2.7% of GDP.

The adjustment to 2016 forecast also leads to slight changes in the breakdown of public balance between its cyclical component and its structural component. In Government's forecasts, the former is reduced by 0.1 point in 2016 and 2017 because of a lower GDP level, which results in improving the structural deficit forecasts by 0.1 point in both years.

A third consequence is the marginal increase in public finance ratios expressed as a percentage of the GDP, due to its slight nominal decrease. Thus, for unchanged nominal amounts of expenditure and compulsory levies, the ratio of these quantities to the GDP is increasing a bit in 2017 with respect to the budget bill for 2017.

As was done in the previous opinion on the budget bill for 2017, the High Council observes that the unaltered growth assumption made by the Government for 2017 (1.5%) remains above the "Consensus Forecasts" (1.2% in November) and the forecasts of international governmental organizations (1.3% for the IMF, 1.4% for the European Commission).

Regarding public finances, the European Commission forecasts for France, published in the economic outlook at the beginning of November, predict a 2.9% of GDP deficit for 2017 instead of 2.7 in the Government projections.

As regards public finances, the High Council confirms the assessment made in its previous opinion on the budget bill and the social security financing bill forecasts for 2017.

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