

Opinion n° HCFP-2017-4

On the budget bill and the social security financing bill for the year 2018

24 September 2017

On 15 September 2017, the Government referred to the High Council of public finance its macroeconomic forecasts and information on public finances, on which are based the budget bill and the social security financing bill for the year 2018. After its deliberations, the High Council delivered the following opinion on 24 September 2017.

Main conclusions

The High Council considers the Government's macroeconomic scenario (GDP growth, inflation, employment and private sector payrolls forecasts) to be cautious for 2017 and reasonable for 2018.

With regard to the public finance scenario, the structural adjustment (i.e. the variation of the structural balance) would be small in both 2017 and 2018 (respectively 0.2 and 0.1 % of GDP). The High Council notes that these adjustments are lower than the minimum provided by European rules.

The High Council is of the view that the compulsory levies collected in 2017 could be higher than anticipated by the budget bill. For the year 2018, subject to the uncertainties regarding the valuation of new measures, the High Council considers the foreseen compulsory levies' receipts to be prudent.

The High Council notes that the objectives concerning the control of public expenditure in 2018 are more demanding than in the previous years. It also notes that an effort has been made in order to budget Government's expenses in a more realistic way. However, it emphasizes that there are significant risks to the realization of the planned reductions in public spending.

Since the structural deficit in 2018 is high and its planned reduction small, the High Council emphasizes the need to respect the spending objectives, even in the event of better than expected revenues.

Introductory remarks

1- On the opinion's scope

Under article 14 of the constitutional bylaw of 17 December 2012 on public finance planning and governance, the High Council gives an opinion on:

- the macroeconomic forecasts which the budget and social security financing bills are based on;
- the consistency of the budget bill's introductory article with the multi-year targets for public finances set in the public finance programming law.

This opinion is transmitted jointly with the opinion on the public finance programming bill for the years 2018-2022.

2- On the information submitted

The Government referred to the High council of public finance on 15 September 2017, its macroeconomic forecasts and information about public finances, which the budget and social security financing bills are based on. The file was supplemented with detailed answers to questions addressed in advance by the High Council to the relevant administrations.

3- On the methodology used by the High Council

To assess the realism of the macroeconomic forecasts and public finance content of the budget and social security financing bills, the High Council analyzed the Government's assumptions as well as the evolutions anticipated within the forecast period. It considered the last available statistics and information provided by the Government about its economic policy measures.

The High Council also paid attention to all available forecasts and analysis.

As permitted by article 18 of the constitutional bylaw, the High Council held hearings of the relevant administrations' representatives – Treasury, budget and social security departments. It also held hearings of representatives of the European Commission, the OECD, the Banque de France, the CEPIL, COE-Rexecode and the OFCE.

The High Council heard the European commissioner for economic and financial affairs, taxation and customs.

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After a brief presentation of the global and European economic situation (I) the High Council exposes its remarks on the macroeconomic forecasts attached to the budget and social security financing bills for 2018 (II) and on the public finance scenario (III).

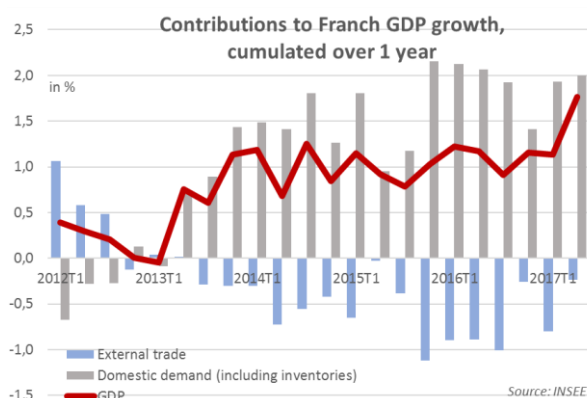
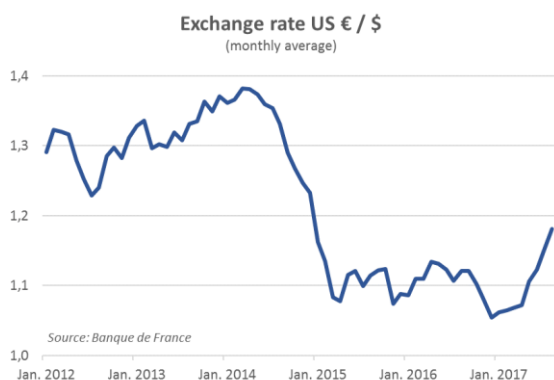
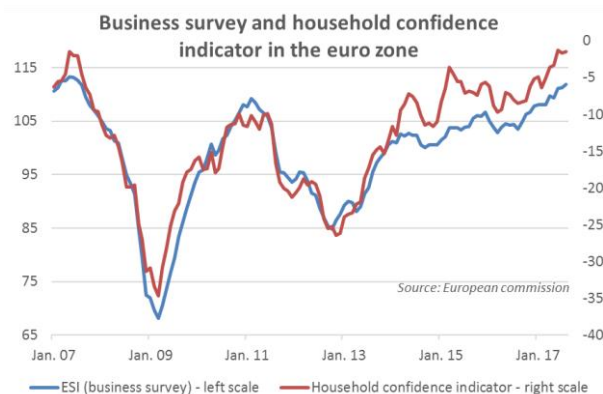
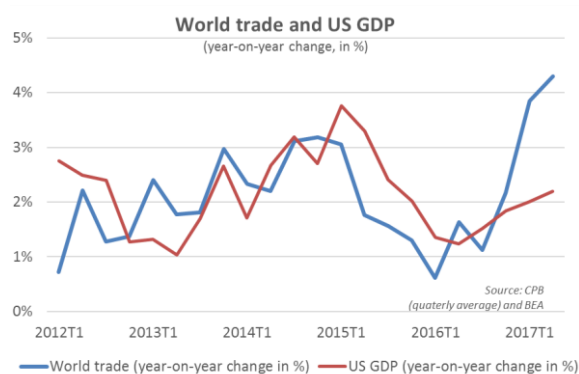
I- A favorable global and European economic environment

1- Global growth increased in the beginning of 2017

Global growth is supported by improvements in advanced as well as emerging countries' economic conditions. The strengthening of growth in the United States, after the 2016 slowdown, the surge of European recovery and the better economic situation of developing countries (upturn in Russia and Brazil, persistent dynamism in China, rebound of imports by oil-exporting countries due to the oil price increase...) contributed to this upward shift. Global trade significantly picked up.

2- The euro zone recovery strengthens

The global environment is favorable for European growth, despite the recent euro appreciation. Consumer and business surveys show a quasi-sustained improvement in the euro zone activity since more than one semester, supported by domestic demand as well as external demand. Euro area growth is fostered by high consumer confidence and large job creations, supporting purchasing power. Fiscal stance in the euro zone is now neutral, if anything slightly supportive, given the recent consolidation efforts.



3- France's recovery firms up

In this favorable European environment, France's economic activity significantly strengthened (0.5 % in all three last available quarters) thanks to domestic demand, driven by businesses' investment and consumer spending, and to the less negative contribution of external trade to growth. This recovery, based on all components of demand in a balanced way, is fostered by large job creations. Also, the high capacity utilization rate upholds investment. The results of consumer and business surveys, steadily improving, show favorable activity prospects on the short term.

4- Risks remain

Besides geopolitical tensions and their possible consequences, several risks remain. In particular, debt levels are still high in many countries and the expected monetary policy normalization in large economies could prove destabilizing for some markets and for the financial position of some countries' economic agents, both public and private. A further euro appreciation, initiated in spring 2017, could weigh on euro zone countries' and France's competitiveness. In addition, uncertainty is still high concerning the conditions of *Brexit* and its impact on British and its key partners' economies.

However, on the short term, the cyclical indicators' sustained improvement could lead to revise upwards the euro zone's and France's growth prospects.

II- Remarks on macroeconomic forecasts for 2017 and 2018

1- The Government's scenario

According to the Government's referral file, *"growth would increase significantly in 2017 to 1.7 % from 1.1% in 2016 (working days adjusted) and then stabilize in 2018"*. [...]

"The sustained recovery in the euro zone and the sharp increase in global demand in general would support the upturn in France's activity. Nevertheless this would be gradual given the disappointing external trade in the 1st semester." [...]

"The improvements on the job market – about 300 000 job creations in one year –, the profit margin recovery since 2013 and the upturn in consumers' and businesses' optimism observed in surveys would foster private domestic demand. Households' investment would support activity and business investment would remain high." [...]

"Inflation would be 1.0 % in 2017 (after 0.2 % in 2016) thanks increased energy prices, and then rise slightly in 2018."

2- The High Council's assessment

a) Activity growth

For the year 2017, along with the Government, most forecasting institutes revised their growth forecasts for the euro zone and France.

For the euro zone, the European Central Bank's forecast is 2.2 % in September (from 1.9 % in June), the OECD's is 2.1 % (from 1.8% in June).

For France, the carry-over growth from the second quarter of 2017 is 1.4 %, as measured by the French National Institute of Statistics and Economic Studies (INSEE). The most recent forecasts for 2017 are 1.7% by the OECD and COE-Rexecode and 1.6% for the IMF. The forecast mean calculated by *"Consensus forecasts"*, of which some have not been recently updated, is 1.6% in September 2017.

For the year 2018, the Government's scenario anticipates the maintained dynamism of the global environment and a sustained increase in domestic demand.

The assumptions on global trade (4 % growth in 2017 and 2018) are along international organizations' forecasts (IMF, WTO, OECD). Concerning external trade, the Government's scenario anticipates a neutral contribution to growth. Still, the recent underperformance of French exporters shows it remains difficult for production to benefit from the sustained global trade growth. To this respect, the Government's assumption seems optimistic.

As for 2017, the Government's growth forecast is close to those of international organizations (1.8% for the IMF and 1.6% for the OECD) and of the "Consensus forecasts". Despite uncertainties weighing on external trade, this forecast is reasonable, given the recent growth trend and the indicators' persistent improvement.

The High Council considers the growth forecasts (1.7 % for both years) to be cautious for 2017 and reasonable for 2018.

b) Employment and private wage bill

The Government forecasts a sharp increase in market-sector employment in 2017 (235 000 per year on average after 170 000 in 2016). In 2018, market-sector employment would slow down (160 000 per year on average).

The assumptions on the average wage growth are 1.7 % for 2017 and 2.1 % for 2018.

Hence, the private wage bill would grow 3.3 % in 2017 and 3.1 % in 2018 in nominal terms. The forecast for 2017 has been revised 0.5 percentage point upwards from the April 2017 Stability Program (2.8 %).

Market-sector payrolls have been very dynamic in the 1st semester of 2017 (135 000). The slowdown in some measures' effects, in particular the end of the "Embauche PME" measure ("Hiring in SMEs"), as well as cyclical indicators point to a slowdown in employment. The Government anticipates a sharp slowdown, which makes its forecast rather cautious.

The same remark stands for the private wage bill prospects. It has grown significantly since the beginning of the year (2.1% for the 1st semester of 2017). This reflects a surge of employment, but also the average salary's upward trend lately (2 % per year on the 2nd quarter).

The High Council considers the employment and wage bill forecasts for 2017 and 2018 to be cautious.

c) Inflation

The Government's forecast for the consumer price rise in 2017 is 1.0 %. The oil-price increase (16 % per year on average compared with 2016) and the rise of taxes on energy would lead to a 0.4 point contribution of energy prices. This forecast is consistent with indicators available until summer.

For 2018, the forecast is 1.1 %, as in the April Stability Program. Energy prices would contribute to inflation through tax increases, with oil price assumed stable at €44 per barrel.

State-ruled prices would contribute up to 0.2 point (of which 0.1 point for tobacco).

The inflation would get closer to its core rate, which would be 0.8 % high thanks to the rise of manufactured product prices (supported by the past rally of industrial commodities' imported prices) and private services' prices (impacted by the nominal wage growth increase and increase in rents).

These forecasts for 2017 and 2018¹ are along the "Consensus forecasts" means of September (respectively 1.0 % and 1.1 %).

¹ The GDP deflator forecasts are 0.8 % for 2017 and 1.1 % for 2018. It would rise slower than consumer prices in 2017 because of the oil price increase (which immediately affects consumer prices). In 2018, it would rise like consumer prices, as there is no specific assumption on the terms of trade. The trends in prices and volumes would

The High Council considers the inflation forecasts for 2017 (1.0 %) and 2018 (1.1 %) to be reasonable.

III- Remarks on public finance forecasts for 2017 and 2018

The High Council analyzed the consistency of the budget bill’s introductory article with the multi-year structural balance targets. It then weighed the risks on revenues and expenditure.

1- The consistency with the multi-year structural balance targets

Under the constitutional bylaw of December 17, 2012, the High Council gives an opinion on the consistency of the budget bill’s structural balance path with the targets set in the programming law.

a) *The consistency with the 2014 programming law in force*

Before the promulgation of the 2018-2022 programming law, the 2014-2019 programming law is still in force. This framework has nevertheless largely lost its relevance. The High Council highlighted in its last opinion in June, about the 2016 budget settlement bill that “the 2014 programming law no longer provides a relevant framework for a proper assessment of the public finance trajectory” in particular because of the “unlikely” potential GDP assumptions.

Components of the public balance

<i>In points of GDP or potential GDP</i>	2018 budget bill (Sept. 2017)			<i>Programming law (Dec. 2014)</i>		
	2016	2017	2018	<i>2016</i>	<i>2017</i>	<i>2018</i>
Public balance	-3.4	-2.9	-2.6	-3.6	-2.7	-1.7
Cyclical component	-0.8	-0.6	-0.4	-1.7	-1.4	-0.9
One-off and temporary measures	-0.1	-0.1	-0.1	-0.1	0	0
Structural balance	-2.5	-2.2	-2.1	<i>-1.8</i>	<i>-1.3</i>	<i>-0.8</i>

*Note: figures being rounded to the nearest tenth, sum totals can be slightly different
Source: 2018 budget bill, December 2014 programming law.*

These assumptions have been sharply revised in the 2018-2022 programming bill. The structural balance estimate for 2017 is now -2.2 % of GDP, by comparison with the -1.3 % target of the 2014 programming bill. However, the comparison is not relevant, since this new estimate mechanically results from a very different assumption on the output gap.

The High Council nevertheless notes that the structural adjustments presented for 2017 and 2018 – whose calculation does not depend on the level of the output gap but on the potential GDP growth – are below the 2014 programming law targets. This adjustment is only 0.2 point of GDP in 2017 and 0.1 in 2018, rather than 0.5 for each year in the 2014 programming law.

b) *The consistency with the 2018 – 2022 programming bill*

The consistency of the introductory article of the budget bill with the programming bill multi-year structural balance targets holds by construction, since both bills have been drafted and presented simultaneously.

result in a sharp increase in nominal GDP. After 1.6 % in 2016, it would grow 2.5 % in 2017 and 2.9 % in 2018, building a favorable frame for public finance rebalancing.

2- The structural adjustment and structural effort in 2017-2018

Structural adjustment and structural effort

<i>In points of potential GDP</i>	2018 budget bill (sept.2017)		
	2016	2017	2018
Structural adjustment	0.2	0.2	0.1
Structural effort	0.1	0.1	0.2
of which expenditure restraint (excluding tax credits)	0.2	0.1	0.4
of which tax credit key	0.1	0.1	0.0
of which new tax measures	-0.1	-0.1	-0.3
Non-discretionary component	0.1	0.1	-0.1

*Note: with 1-digit round figures, sum totals can be slightly different
Source: 2018 budget bill, December 2014 programming law.*

The structural adjustment (i.e. the variation of the structural balance) would be small in 2017 and 2018 (respectively 0.2 point and 0.1 point). In 2018, it would result from significant expenditure restraint (+ 0.4 point of GDP) quasi offset by new tax cuts (- 0.3 point of GDP).

The same holds for the structural effort (0.1 then 0.2 point of GDP), which is the part of the structural adjustment directly due to expenditure restraint or new tax measures.

The High Council notes that the planned structural adjustments for 2017 and 2018, which will be assessed by the European Commission, do not comply with Article 5 of European Regulation 1466/97², which provides a structural adjustment higher than 0.5 point of GDP per year.

3- Risks on revenues and expenditure

a) *The Government's scenario*

According to the Government's referral file, "*the budget and social security financing bills anticipate a [general government] nominal deficit of 2.9 % in 2017 and 2.6 % in 2018.*

In 2017, public spending excluding tax credits would rise 0.8 % in real terms, notably driven by the public wage increases, cyclical local investment and Areva's recapitalization.

In 2018, public spending excluding tax credits would slow down (+0.5 % in real terms). This slowdown would chiefly be due to local public authorities and the State. Whereas the social security branches would contribute to the upward trend, notably because of the 2017 inflation-linked surge of pension spending."

² Article 5 of Regulation 1466/97: "For Member States faced with a debt level exceeding 60 % of GDP or with pronounced risks of overall debt sustainability, the Council and the Commission shall examine whether the annual improvement of the cyclically-adjusted budget balance, net of one-off and other temporary measures is higher than 0,5 % of GDP."

In 2017, “*elasticity of compulsory levies to GDP growth [would be] higher than one (1.3) thanks to the speed-up of growth.*” In 2018, elasticity of compulsory levies would be equal to one. The sum total of new measures would be € - 6.7 billion (-0.3 point of GDP in 2018).

b) *The High Council’s assessment*

The High Council considered the risks on the revenue and expenditure forecasts for 2017 and 2018, on the basis of the information it had access to.

i) Revenues

In 2017, revenue forecasts attached to the 2018 budget bill have been revised in order to take into account the available information on ongoing execution. They correspond to a 1.3 elasticity.

More favorable developments cannot be excluded concerning social contributions and VAT. VAT revenues, with a 5 % growth over the seven first months of the year, seem more dynamic than the 2017 forecast attached to the 2018 budget bill (3.5 % over the year in national accounting terms).

In 2018, revenues should grow further thanks to sustained growth. The government anticipates a spontaneous revenue growth – i.e. excluding new measures – close to the growth of activity (which implies an elasticity of compulsory levies to growth equal to one). This assumption can be considered as cautious given the elasticity observed in 2016 (1.2) and the estimate for 2017 (1.3).

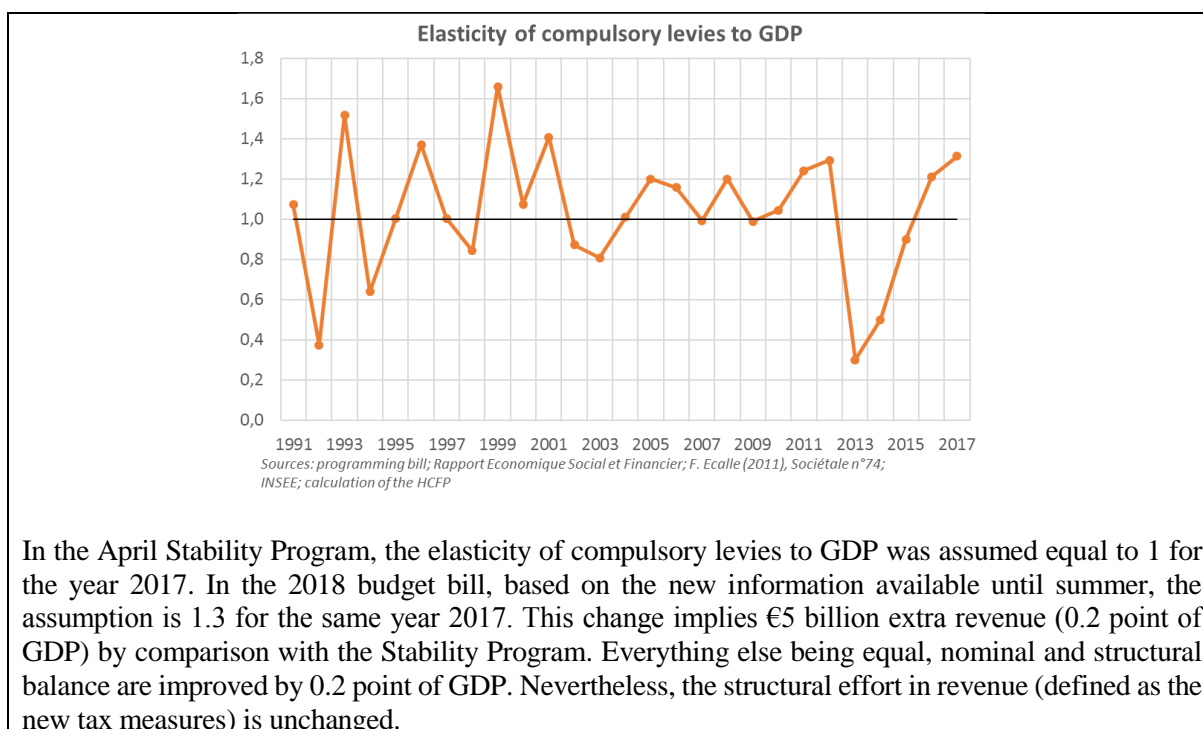
In the 2018 budget bill, new measures account for about €7 billion in net tax cuts. These measures are the sum total of decisions made by the previous Government having an impact in 2018 and decisions of the current Government in the 2018 budget bill: CICE rate increase, corporate tax cut, local tax exemption, wealth tax change... They are partly offset by tax increases (on energy, tobacco, social contribution shift).

The High Council does not have the means to give an opinion on the valuation of these measures.

Elasticity of compulsory levies

The elasticity of compulsory levies is the ratio between their “spontaneous” growth (excluding discretionary tax measures) in % and the GDP nominal growth. On the long term, it is close to 1. However, on the short term it can fluctuate around this value. The structure of economic growth can explain these deviations. Indeed, not all components of GDP are taxed, so if growth is driven by exports, revenues will be less than if it is driven by domestic demand. Furthermore, some taxes have their own trend. Financial and housing markets dynamics can generate revenues with no direct link to macroeconomic activity. Even the wage bill growth, which is linked to GDP growth, can be different sometimes, causing specific developments in social contributions.

The figure below shows the elasticity of all compulsory levies to GDP. It is close to 1 on average (1.03 over 1991-2016), and its fluctuations around this value are large. It can be different from 1 for several years in a row. From 1999 to 2001, elasticity stayed higher than 1 for three years in a row. Conversely, compulsory levies’ growth stayed below the growth of GDP from 2013 to 2015.



Overall, the High Council is of the view that the compulsory levies collected in 2017 could be higher than anticipated by the budget bill. For the year 2018, subject to the uncertainties regarding the valuation of new measures, the High Council considers the foreseen compulsory levies' receipts to be prudent.

ii) Expenditure

In the recent years, there has been a significant effort to control public expenditure. The growth of spending has slowed down: 1.7 % in nominal terms and 0.8 % to 0.9 % in real terms per year (excluding tax credits) on average from 2011 to 2016, from 4.0 % in nominal terms and 2.2 % in real terms from 2000 to 2008.

In 2017, the aggregate growth of spending (excluding tax credits) presented in the 2018 budget bill is 1.8 % in nominal terms and 0.8 % in real terms. This increase takes into account the expenditure restraint measures decided by the Government mid-2017, following the audit on public finances by the “Cour des Comptes”. Respecting this spending growth target will require a lot of caution in execution until the end of the year.

In 2018, the general government spending growth target (excluding tax credits) is stricter than in 2017: 1.6 % in nominal terms from 1.8 % in 2017 and 0.5 % in real terms from 0.8 % in 2017.

The State spending target includes an increase in the budget of Ministries of about €4 billion and a €1.5 billion rise of the contribution to the EU budget (vis-à-vis the 2017 budget bill). The State expenditure increase includes a 1.7 % wage bill growth (€1.5 billion).

The target includes an effort in order to budget more realistically some expenses (benefits for disabled adults, in-work benefit, emergency housing, State medical aid...). Yet, some expenses are still under budgeted (military actions – despite a €200 million increase from the 2017 budget bill –, EU contributions...).

Areva's recapitalization will weigh on the State's spending in 2017, but not anymore in 2018.

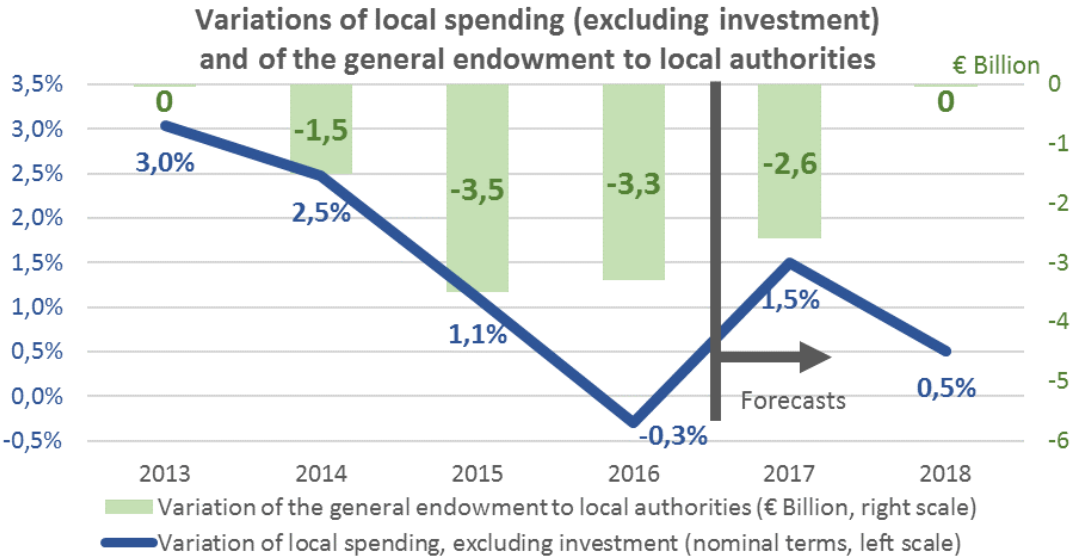
The Government’s spending targets are based on some substantial downsizing, in particular concerning housing benefits (€ -1.7 billion in the 2018 budget bill by comparison with the 2017 budget bill) and subsidized contracts (€ -1.5 billion in the 2018 budget bill by comparison with the 2017 budget bill).

The social security branches’ spending would slightly speed-up in 2018 from 2017 (2.0 % after 1.9 % in nominal terms – national accounting measure), mainly due to the surge of pension spending (2.5 % after 1.8 %).

The national healthcare expenditure growth target (ONDAM) has been revised upwards for 2018, to 2.3 % (after 2.1 % in 2017). In 2018, according to the 2018 budget bill, the spontaneous growth of ONDAM spending should rise, from 4.2 % in 2017 to 4.5 % in 2018: impact of the recent agreement with health professionals, ongoing implementation of the PPCR career pact in public health institutions and upcoming advanced treatments. The target implies greater cuts than in the recent years (€4.2 billion from €4.05 billion in 2017 and €3.4 billion in 2016).

The Unedic expenditure scenario presented in the 2018 budget bill seems more optimistic than the forecasts published by the Unedic in June 2017, despite identical unemployment rate assumptions.

The spending of local authorities would slow down from 1.8 % in 2017 to 1.2 % in 2018, thanks to contracts passed between the State and the biggest local authorities’ representatives. This objective is based on the wager that the contractual approach will lead to a sharper slowdown in local authorities’ spending than in 2017. In fact, in contrast with the four previous years, the 2018 budget bill does not include endowment cuts (see figure below).



Source: HCFP, from the Cour des comptes June report of each year and INSEE data

The High Council notes that the objectives concerning the control of public expenditure in 2018 are more demanding than in the previous years. It also notes that an effort has been made in order to budget Government’s expenses in a more realistic way. However, it emphasizes that there are significant risks to the realization of the planned reductions in public spending.

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The High Council considers the assumptions on revenues to be prudent. The spending targets are more demanding than in 2017. Since the structural deficit in 2018 is high and its planned reduction small, the High Council emphasizes the need to respect the spending objectives, even in the event of better than expected revenues.

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This opinion has been published in the *Official Journal* of the French Republic and attached to the budget bill for 2018.

Annex 1: the macroeconomic scenario attached to the 2018 budget bill

Economic forecasts for France			
	2016	2017	2018
Goods and services, real terms	%, annual average		
Gross domestic product	1.1	1.7	1.7
Final consumption of households	2.3	1.3	1.4
Final public consumption	1.3	1.2	0.0
Gross fixed capital formation	2.8	3.0	3.9
<i>of which: non-financial corporates</i>	3.6	3.7	3.7
<i>public administrations</i>	-0.1	-1.1	5.4
<i>households (excluding individual entrepreneurs)</i>	2.4	4.2	3.4
Imports	4.2	3.6	3.6
Exports	1.8	2.5	3.9
Contributions to real GDP growth	in points of GDP		
Private domestic demand (excluding inventories)	1.8	1.4	1.4
Public demand	0.3	0.2	0.2
Inventories	-0.1	0.4	0.1
External trade	-0.8	-0.4	0.0
Prices and nominal aggregates	%, annual average		
Consumer prices inflation	0.2	1.0	1.1
Core inflation	0.6	0.4	0.8
Gross domestic product deflator	0.4	0.8	1.1
Nominal gross domestic product	1.6	2.5	2.9
Productivity, employment and wages	%, annual average		
Market-sector (excluding agriculture):			
- Productivity	0.1	0.3	1.1
- Payrolls	1.1	1.6	1.0
- Average salary	1.2	1.7	2.1
- Wage bill	2.4	3.3	3.1
Total employment	0.8	1.0	0.5

Source: ministère de l'économie et des finances (September 15, 2017)

Annex 2: introductory article of the 2018 budget bill

Article liminaire

La prévision de solde structurel et de solde effectif de l'ensemble des administrations publiques pour 2018, l'exécution de l'année 2016 et la prévision d'exécution de l'année 2017 s'établissent comme suit :

(En points de produit intérieur brut)

	Exécution 2016	Prévision d'exécution 2017	Prévision 2018
Solde structurel (1)	-2,5	-2,2	-2,1
Solde conjoncturel (2)	-0,8	-0,6	-0,4
Mesures exceptionnelles (3)	-0,1	-0,1	-0,1
Solde effectif (1 + 2 + 3)	-3,4	-2,9	-2,6

(*) L'écart entre le solde effectif et la somme de ses composantes s'explique par l'arrondi au dixième des différentes valeurs.

Exposé des motifs

A l'occasion du projet de loi de programmation des finances publiques (LPFP) pour les années 2018 à 2022 et dans la lignée du rapport préparatoire au débat d'orientation des finances publiques de juillet 2017 le Gouvernement a revu ses hypothèses de croissance potentielle et d'écart de production qui sont désormais cohérentes avec celles des principales organisations internationales et observateurs des finances publiques. Ainsi la croissance potentielle en 2017 et en 2018 est désormais estimée à 1,25%. Cette estimation repose notamment sur le constat d'une productivité qui a ralenti par rapport à la période d'avant crise. En parallèle le Gouvernement retient une hypothèse d'écart de production plus réaliste (-1,5%) que lors de la précédente LPFP (-3,1%).

Ces révisions conduisent à un niveau de déficit structurel plus important que celui présenté à l'occasion de la loi de règlement pour 2016. Selon ces nouvelles estimations, en 2016, le solde public s'est élevé à -3,4% du PIB résultant d'un déficit structurel important (-2,5% du PIB) et d'un déficit conjoncturel de -0,8% du PIB.

En 2017, le solde public atteindrait -2,9% du PIB, un niveau qui, combiné avec la perspective d'un solde public 2018 inférieur à -3,0% du PIB, permettrait à la France de sortir de la procédure pour déficit excessif dans le calendrier prévu par la recommandation du Conseil de mars 2015. Cette évolution serait portée par une amélioration du solde structurel qui passerait de -2,5% à -2,2% du PIB. Le solde conjoncturel s'améliorerait aussi, passant de -0,8% à -0,6% du PIB, du fait d'une croissance supérieure à son potentiel (1,7% contre 1,25% en volume), permettant une réduction de l'écart de production (de -1,5% du PIB potentiel en 2016 à -1,1% en 2017). Les mesures ponctuelles et exceptionnelles pèseraient quant à elles sur le solde nominal à hauteur de 0,1 point de PIB en 2017 et 2018 (du fait des contentieux OPCVM, Stéria et sur la cotisation sur la valeur ajoutée), si bien que leur effet serait nul sur l'ajustement structurel.

En 2018, le déficit public serait de -2,6 %, soit une amélioration de 0,4 point de PIB par rapport à 2017. Cette amélioration serait portée en partie par la conjoncture (pour 0,2 point) et par une amélioration du solde structurel de 0,1 point. L'amélioration structurelle serait portée par un effort en dépense de 0,4 point, en partie compensé par l'impact des baisses de prélèvements obligatoires prévues en faveur des ménages et des entreprises (0,3 point de PIB potentiel) et par la prise en compte de la composante non discrétionnaire, qui pénaliserait l'ajustement structurel à hauteur de 0,1 point de PIB potentiel, principalement en raison du faible dynamisme des recettes hors prélèvements obligatoires.

Appendix 3: estimating the general government structural balance

The structural balance estimate

To assess the public finance path, the structural budget balance is usually considered. The structural balance is the **public balance adjusted for the direct impact of the economic cycle and exceptional events**. The public balance is thus divided into two components:

- A **cyclical component**, which reflects the impact of the economic cycle on public administrations' expenditure and revenue;
- A **structural component**, being what the public balance would be if domestic production were at its potential level.

The calculation of the cyclical and structural components of the public balance is based on the potential GDP estimate. Potential GDP is the “sustainable” output, i.e. the quantity that can be produced without having positive or negative impacts on inflation. The cyclical component of the public balance results from the cyclical variations in public revenue and expenditure, considered as follows:

- **On the revenue side**, only compulsory levies are assumed to be cyclical. The cyclical parts of the income tax, corporate income tax, social security contributions and other mandatory contributions are calculated separately based on the observed levels, the estimated output gap and the elasticity of each tax category to GDP growth³;
- **On the expenditure side**, only the unemployment compensation expenses are considered dependent on economic conditions⁴. Their cyclical share is estimated, as for revenue, based on their elasticity to the output gap and the amounts observed.

The structural balance is calculated as the difference between the nominal public balance and the cyclical component estimate. Given the fact that compulsory levies and cyclical expenses account for about half of GDP and that their average elasticity is close to one, the cyclical component of the public balance is equal to just over half the output gap (for France). **A final correction is made to the structural balance in order to exclude certain events or actions** that have no lasting impact on the public balance. **However, there is no comprehensive definition of one-off and temporary measures and their assessment is partly based on interpretation.**

The components of the structural adjustment

The variation of the structural balance is known as “structural adjustment”. A positive structural adjustment reflects a budgetary policy directed towards the medium term objective (-0.4 % for France as set by the programming law), when there initially is a deficit. Conversely, a negative structural adjustment reflects an expansionist budgetary policy, increasing the structural deficit.

In order to assess more sensibly the budgetary policy, the **structural adjustment is divided into two components.**

- **The structural effort, which measures the discretionary part of the structural adjustment, i.e. controlled by public decision makers, is made of:**
 - **the expenditure restraint**, which compares the public spending real growth (calculated with the GDP deflator) to the economy's potential growth. It has a positive contribution to the structural adjustment when public spending grows slower than potential GDP;
 - **the new measures on compulsory levies.**
- **The non-discretionary part** takes into account:
 - the impacts of **changes in revenue elasticities**: since the cyclical component of the public balance is based on average elasticities, the structural balance includes the effects of elasticity fluctuations around the long-term average value;
 - the **changes in revenues other than compulsory levies.**

³The elasticities used in the calculation are the OECD's estimates.

⁴Other expenses are either discretionary, or not clearly linked to GDP.