

Opinion n° HCFP-2018-2
on the general government structural balance presented in the budget
settlement bill for 2017

18 May 2018

The Government referred to the High Council of Public Finance on 16 May 2018 in accordance with Article 23 of the organic law 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 2017 (PLR). After its deliberations on 18 May 2018, the High Council delivered the following opinion.

Summary

The nominal general government deficit stood at 2.6% of GDP in 2017 compared with 2.9% in the Public Finance Programming Law (2018-2022 LPFP) and after 3.4% of GDP in 2016. The 0.3-point deviation from the programming law entirely relates to the cyclical component of the deficit. It is explained by the upward revision of GDP growth in 2017 (2.2% in the budget settlement bill against 1.7% in the programming law).

The High Council notes that the estimated structural deficit for 2017 is identical to the one contained in the January 2018 programming law. It points out, however, that the gap between this structural balance and the one posted for the same year in the new programming law prepared and adopted only a few months earlier could only be small.

Based on the estimation of potential growth of the 2018-2022 Programming Law, the structural deficit was reduced by 0.3 percentage points of GDP in 2017. The structural effort, which aims to measure the share of this improvement resulting from government action, is slightly negative. The reduction of the structural deficit stems from a particularly high elasticity of compulsory levies to GDP.

The High Council thus points out that the reduction of the general government deficit below the 3% of GDP ceiling, which should enable France to emerge from the excessive deficit procedure, was achieved without any discretionary budgetary effort in 2017.

The High Council stresses that non-compliance with the expenditure path will not always be offset by positive revenue surprises, whether directly related to the economic cycle or to a high revenue elasticity to GDP. Consequently, compliance with the public finance path will require the implementation of the efforts announced in the programming law, in particular on public expenditure.

I- Introduction

1- On the subject of this opinion

Under the Article 23 of the organic law of 17 December 2012, *“the High Council of Public Finance gives an opinion on significant deviations, if any, from the trajectory observed in execution relative to the multi-year structural balance targets defined by the public finance programming law”* (LPFP). A deviation is considered significant if it is at least 0.5% of GDP for a given year or at least 0.25% of GDP per year on average for two consecutive years. If the High Council were to identify such a deviation, this would trigger the *“correction mechanism”* within the meaning of Chapter IV of the constitutional bylaw. The constitutional bylaw further specifies that the structural balance must be estimated with the potential growth path submitted in the report attached to the programming law.

For the three previous years, 2014, 2015 and 2016, the deviations were assessed relative to the structural balances set out in law n° 2014-1653 on public finance programming for 2014 to 2019 enacted at the end of 2014. This law was repealed in January 2018 by the new law n°2018-32 on public finance programming for 2018 to 2022 (LPFP). This law provides new structural balance estimates as from 2016 in the report attached thereto.

This series of texts means there is a choice in terms of which reference may be used. Referring to the LPFP for 2014 to 2019 would allow the High Council to compare a forecast with the implementation but is hampered by the fact that this LPFP has been repealed. The High Council had also considered, in its June 2017 opinion on the budget settlement bill for 2016, that the 2014 programming law *“no longer provides a relevant framework for a fair assessment of the public finance trajectory”*, as *“the potential GDP assumptions have become highly implausible”*.

The High Council therefore refers in this opinion to the programming law in effect for 2018 to 2022. It faced this situation previously in May 2015, and had also selected the most recent LPFP in its opinion n° HCFP-2015-02 on the 2014 budget settlement bill. The High Council, however, underlines the limitations of the comparison for the first year of the new public finance programming law. The gap between the structural balance presented in the budget settlement bill for 2017 and the one posted for the same year in the new programming law prepared and adopted only a few months earlier could only be small.

2- On the information transmitted and the time frames

The High Council of Public Finance received the referral file from the Government on 16 May 2018. This file contained the introductory article of the budget settlement bill for 2017 and in particular a summary table focusing on the actual and structural balances for all public administrations in 2017 (Annex 1). The referral file was supplemented with detailed answers to a questionnaire previously addressed to the relevant administrations on 26 April 2018.

Finally, the High Council organised hearings on 16 May 2018 with representatives of the Treasury General Directorate and of the Budget Directorate, as provided for by Article 18 of the aforementioned organic law.

II- Remarks about deviations from the programming law

The High Council notes that the method for calculating the structural balance set out in the introductory article of the budget settlement bill for 2017 and the potential growth path are both consistent with those of the January 2018 LPFP¹. The structural balance in 2016 and 2017 is estimated using the output gap presented in the new programming law that the High Council deemed “*realistic*” in its September 2017 opinion². The steps involved in estimating the structural balance are presented in annex 2.

The High Council notes that, after INSEE's rebasing in May 2018, the Government did not re-estimate potential growth or the output gap before 2017. In light of the minimal revisions to GDP growth observed in the last ten years, this is a reasonable decision (Annex 3).

According to INSEE, the public deficit stood at €59 billion in 2017, or 2.6 percentage points of GDP, after 3.4 percentage points in 2016. The deficit observed in 2017 is 0.8 percentage point lower than in 2016, and 0.3 percentage point lower than forecast for 2017 in the January 2018 programming law (2.9 percentage points of GDP).

According to the Government's estimates, this positive 0.3 point of GDP difference relative to the LPFP on the 2017 balance relates solely to the cyclical component of the deficit. This is estimated at -0.3 percentage point in 2017 compared with -0.6 percentage point in the LPFP.

One-off and temporary measures have a negative impact on the public balance of 0.1 point of GDP, as estimated in the LPFP. This estimate includes the reimbursement of the 3% tax on dividends (€4.7 billion) as an expenditure and the exceptional corporate income tax payment related to this dispute (€4.9 billion) as revenue. These exceptional and temporary measures also include repayments of tax claims related to smaller disputes (UCITS, €0.6 billion; Stéria, €0.4 billion; CVAE (value-added contribution), €0.3 billion; De Ruyter, €0.1 billion), as well as the penalty interest (€0.7 billion) associated with all the disputes. The High Council notes that taking these measures into account as one-off and temporary measures is consistent with the principles defined by the Government in the report attached to the LPFP.

The structural deficit, which is the difference between the actual deficit and the sum of its cyclical component and one-off and temporary measures, is thus estimated at 2.2 percentage points of GDP in 2017, i.e. identical to the level set out in the January 2018 LPFP.

¹ Law n° 2018-32 of 22 January 2018 on public finance programming for 2018 to 2022.

² Opinion n° HCFP-2017-3 on the public finance programming bill for the years 2018 to 2022.

Table 1: Differences between the budget settlement bill for 2017 (PLR) and the public finance programming law for 2018-2022 (LPFP)
(as % of GDP)

	2016			2017		
	LPFP (Jan. 2018)	2017 PLR (May 2018)	Diff.	LPFP (Jan. 2018)	2017 PLR (May 2018)	Diff.
Actual balance (1)	-3.4	-3.4	0.0	-2.9	-2.6	0.3
Cyclical component (2)	-0.8	-0.8	0.0	-0.6	-0.3	0.3
One-offs (3)	-0.1	-0.1	0.0	-0.1	-0.1	0.0
Structural balance (1)-(2)-(3)	-2.5	-2.5	0.0	-2.2	-2.2	0

Note: Figures are rounded to the nearest tenth, which can lead to small differences in the results of the operations.

Sources: Law n° 2018-32 on public finance programming of January 2018 and budget settlement bill for 2017.

The High Council notes that the estimated structural deficit for 2017 is identical to the one contained in the January 2018 programming law. It points out, however, that the gap between this structural balance and the one posted for the same year in the new programming law prepared and adopted only a few months earlier could only be small.

III- Remarks on the change in the structural balance and on the structural effort

The estimated structural deficit declined from 2.5 points of GDP in 2016 to 2.2 points in 2017, i.e. a 0.3-percentage-point reduction.

In 2017, as estimates currently stand, this **improvement in the structural balance** can be attributed entirely to “non-discretionary” factors and, in particular, for 0.5 percentage point, to a spontaneous increase in compulsory levies (before new measures), which is well above nominal GDP growth³. The social security administrations’ revenue, driven by a more dynamic wage bill than GDP in 2017, the corporate income tax and VAT, contributed to this strong elasticity of compulsory levies to GDP (1.4).

The **structural effort**⁴, which is the part of the improvement in the structural balance directly due to an expenditure effort or to new compulsory levy measures, and thus to government actions, is slightly negative (-0.1 percentage point).

The **expenditure effort**⁵ is close to -0.2 point of GDP in 2017 compared with 0.0 point of GDP in the January 2018 LPFP. This effort is measured by comparing the 1.5% increase in public expenditure excluding tax credits in volume terms⁶ with the potential growth of GDP (estimated at 1.25% in volume terms in 2017 according to the January 2018 LPFP). This growth in public expenditure is higher than that expected in the programming law.

³ The spontaneous growth in levies is estimated at 4.0% for nominal GDP growth of 2.8%.

⁴ This effort is also called “discretionary” as opposed to “non-discretionary” changes in the structural balance, largely attributable to the variation in the elasticities of compulsory levies and to non-tax revenue.

⁵ As public expenditure represents 56.4% of GDP, the expenditure effort is close to half of the gap between the rate of growth in volume terms of public expenditure and of potential GDP.

⁶ Which results from nominal growth of 2.1% less the GDP price increase of 0.6%. Growth in nominal expenditure is calculated excluding the reimbursement of the 3% tax on dividends recognised in exceptional and temporary measures. Taking this reimbursement into account, expenditure increased by 2.5%.

The new tax measures are virtually neutral in terms of the structural effort in 2017⁷ (the exceptional corporate income tax payment is excluded as it is classified as a one-off and temporary measure).

Table 2: Breakdown of the change in the structural balance (as % of GDP) with the potential growth assumptions in the LPFP

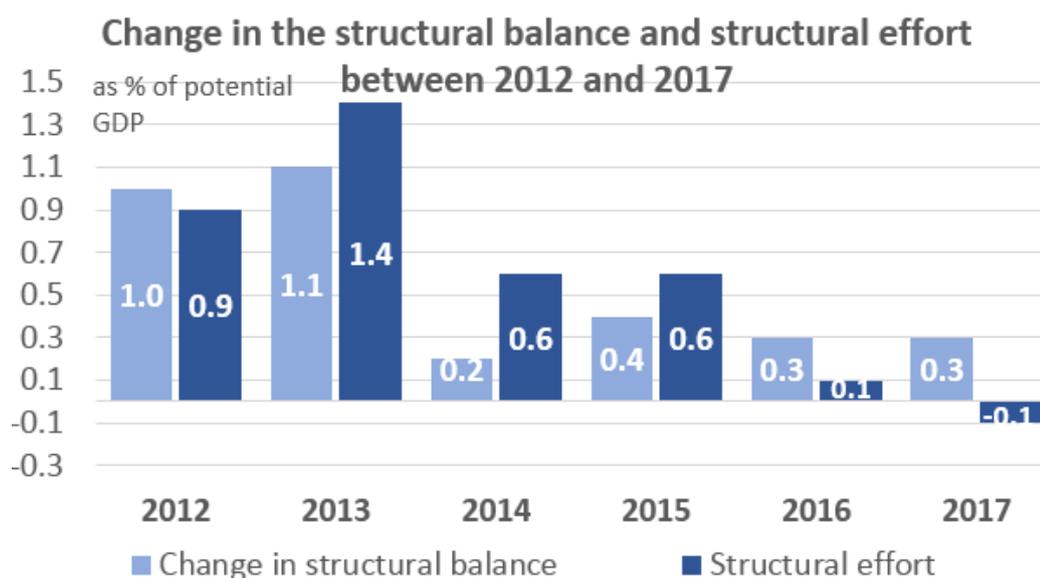
	2018-22 LPFP		2017 PLR		Difference (PLR - LPFP)	
	2016	2017	2016	2017	2016	2017
Structural balance	-2.5	-2.2	-2.5	-2.2	0.0	0.0
Change in structural balance	0.2	0.3	0.3	0.3	0.1	0.0
Structural effort	0.2	0.0	0.1	-0.1	-0.1	-0.1
New tax measures	-0.1	-0.1	-0.1	0.0	0.0	0.1
Expenditure effort	0.1	0.0	0.2	-0.2	0.1	-0.2
Treatment of tax credits	0.1	0.1	0.0	0.1	-0.1	0.0
Non-discretionary component	0.1	0.2	0.2	0.4	0.1	0.2
Non-tax revenue	-0.1	-0.2	-0.1	-0.1	0.0	0.1
Effects of compulsory levies elasticity	0.2	0.4	0.3	0.5	0.1	0.1

*Note: Figures are rounded to the nearest tenth, which can lead to small differences in the results of the operations.
Source: Law n° 2018-32 on public finance programming of January 2018 and budget settlement bill for 2017.*

The other components offset each other in terms of the change in the structural balance (-0.1 percentage point for revenue excluding compulsory levies, +0.1 point for the treatment of tax credits).

The difference between the change in the structural balance (+0.3 percentage point of GDP) and the structural effort (-0.1 point) is particularly high in 2017. Most of this difference can be attributed to elasticity effects.

⁷ Of these measures, the decline in the income tax helped reduce compulsory levies by nearly €2 billion. Green taxes (TICPE, the domestic consumption tax on energy products) increased by nearly €2 billion.



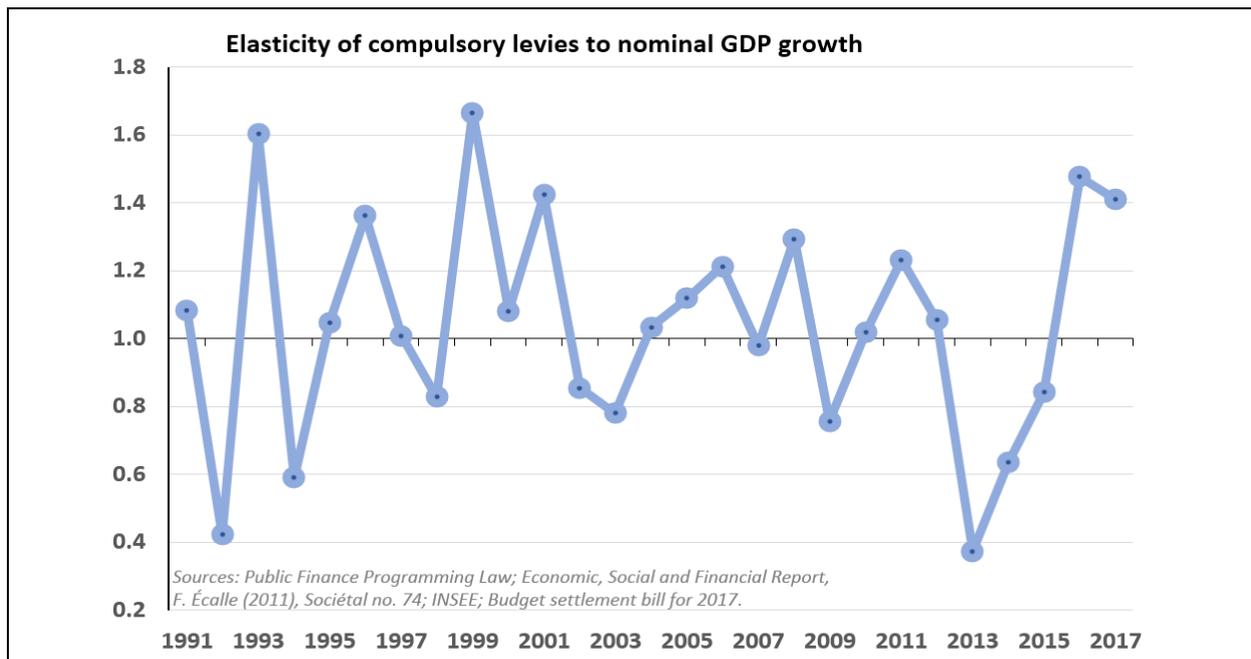
Source: Law n° 2018-32 on public finance programming of January 2018 and budget settlement bill for 2017.

Note: From 2013 to 2015, the change in the structural balance was less than the structural effort and this gap reversed starting in 2016.

The structural effort: an indicator of discretionary measures that is not affected by compulsory levy elasticity effects

The elasticity of compulsory levies corresponds to the ratio of their growth rate to the rate of nominal GDP growth. The elasticity of compulsory levies to GDP fluctuates around its historical average, close to one. The calculation of the structural balance is based on a conventional assumption of unitary elasticity. The difference between actual elasticity in a given year and unitary elasticity therefore has an impact on changes in the structural balance. This difference is therefore taken into account in the structural balance even though it is a non-discretionary component that is beyond the control of policy-makers and that is rather cyclical in nature — significant elasticity is generally seen in periods of steady growth.

An indicator such as structural effort is better able to reflect the discretionary measures decided by the public authorities and thus to reflect the fiscal stance. It can be broken down into an expenditure effort and a revenue effort. The structural effort in terms of revenue (defined as the amount of new tax measures), which is part of the structural effort calculation, is not affected by elasticity effects.



Based on the estimation of potential growth of the 2018-2022 Programming Law, the structural deficit is reduced by 0.3 percentage point of GDP in 2017. The structural effort, which aims to measure the share of this improvement resulting from government action, is slightly negative. The reduction of the structural deficit stems from a particularly high elasticity of compulsory levies to GDP.

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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 2017.

ANNEX 1

Introductory article of the budget settlement bill for 2017 Structural balance and actual balance of the public administrations in 2017

The structural balance and the actual balance of the public administrations resulting from implementation for 2017 are as follows:

	2017 implemented	2018-2022 LPFP		2017 Initial Budget Act (LFI)	
		2017 forecast	<i>Difference</i>	2017 forecast	<i>Difference</i>
Structural balance (1)	-2.2	-2.2	0.0	-1.0	-1.1
Cyclical balance (2)	-0.3	-0.6	0.3	-1.6	1.3
One-offs (3)	-0.1	-0.1	0.0	-0.1	0.0
Actual balance (1 + 2 + 3)	-2.6	-2.9	0.3	-2.7	0.1

Explanatory statement

The nominal public balance implemented in 2017 of the public administrations was, according to INSEE, -€59 billion, whereas it was forecast at -€62 billion in the 2017 initial budget act (LFI). Relative to the 2017 LFI, the actual balance is therefore better than expected (-2.6% of GDP according to INSEE compared with -2.7% of GDP in the 2017 LFI).

The 2018-2022 LPFP offered an opportunity to substantially revise potential growth and the output gap, which translated into an unchanged actual balance due to an improvement in the cyclical component and a decline in the structural component.

The new Government called for this change of framework when it came into office to ensure the prudence and probity of the 2018-2022 LPFP through the use of assumptions close to those of the European Commission.

Thus, this article compares the actual public balance achieved in 2017 within the meaning of the national accounts with the forecasts included in the initial budget adopted under the previous administration (law no. 2016-1917 of 29 December 2016 on the initial budget for 2017 (hereinafter the “2017 LFI”)) and with the forecasts of the current 2018-2022 LPFP.

According to these new assumptions and given INSEE’s most recent growth estimate, the economy is likely to be closer to its potential than previously expected: the output gap in 2017 is projected at -0.6% of potential GDP, compared with -2.9% in the 2017 LFI forecast.

This article also takes into account INSEE’s revisions to economic activity in its 15 May 2018 publication which covers the entire post-war period. To maintain the output gap assumptions for 2016 and for potential growth in the 2018-2022 LPFP, which the High Council of Public Finance deemed reasonable in its opinion of 24 September 2017, potential activity has therefore been recalculated.

	2017 implemented	2018-2022 LPFP		2017 Initial Budget Act (LFI)	
		2017 forecast	<i>Difference</i>	2017 forecast	<i>Difference</i>
Output gap	-0.6	-1.1	0.5	-2.9	2.3
Potential growth	1.25	1.25	0.0	1.5	-0.2
Real growth	2.2	1.7	0.5	1.5	0.7

Relative to the 2018-2022 LPFP, the nominal balance is 0.3 percentage point of GDP higher in 2017: forecast at -2.9% of GDP, it is -2.6 % of GDP according to INSEE. This upwards revision is due solely to higher-than-expected growth (2.2% compared with 1.7% in the LPFP). This translates into a 0.3-percentage-point improvement in the cyclical balance (-0.3% of GDP instead of -0.6%). Exceptional and temporary measures did not change in 2017 compared with the 2018-2022 LPFP. The structural balance in 2017 is the same as that included in the 2018-2022 LPFP (-2.2% of potential GDP) and there was no significant deviation from the path within the meaning of Article 23 of the organic law n° 2012-1403 of 17 December 2012.

Compared with 2016, the public deficit declined by 0.8 percentage point of GDP to 2.6% from 3.4%. This change is the result of a structural adjustment of 0.3 point of GDP, driven mainly by strong elasticity of compulsory levies (for 0.5 point of GDP), estimated at 1.4 in 2017.

ANNEX 2

Method for estimating the structural balance

The structural balance calculation

To assess the public finance trajectory, it is customary to consider the structural 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 divided 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 the economy were at its potential level.

The identification of cyclical and structural components of the public deficit is based fundamentally on the estimate of potential GDP. Potential GDP is the level of production that the economy can sustain over the long term without creating pressure on the capital and labour factors of production.

Specifically, the identification takes place by calculating the cyclical components of public revenue and expenditure. They are estimated as follows:

- **On the revenue side**, only compulsory levies are assumed to be cyclical. The cyclical level of the income tax, corporate income tax, social security contributions and other compulsory levies is calculated separately based on the effects of the output gap on these taxes⁸.
- **On the expenditure side**, only the unemployment compensation expenses are considered dependent on the cycle⁹. The cyclical component is estimated, as for revenue, based on the output gap's effects on these expenditure.

That is how the cyclical component of the deficit is calculated. **This component is deducted from the actual balance to obtain an estimate of the structural balance.**

A final correction is made to the structural balance in order to exclude certain events or measures that, because of their exceptional nature, have no lasting impact on the public balance. This adjustment was originally introduced to offset the impact of the sale of UMTS licences at the end of the 1990s and the various cash payments received by the State (IEG, La Poste, France Télécom) which led to an exceptional increase in revenue. **However, there is no specific definition of exceptional and temporary measures and their identification is partly based on interpretation.** While stressing that the one-off and temporary nature of the measures must be assessed on a case-by-case basis, the Government proposes a set of criteria to better understand the concept in an appendix to the programming law.

The composition of the structural adjustment

The change in the structural balance from one year to the next is called the “structural adjustment”.

⁸ This impact is estimated based on average “elasticity” of each tax category relative to the output gap. The elasticities used are those estimated by the OECD.

⁹ As regards other expenditure, either they are discretionary or no link to the cycle can be clearly and reliably demonstrated.

To analyse the fiscal stance, **the change in the structural balance can be broken down** as follows:

- **The structural effort, which measures the share of the structural adjustment attributable to “discretionary” factors, i.e. that can be controlled by policy-makers:**
 - **the expenditure effort**, which compares the real public expenditure growth rate (adjusted by the GDP price deflator) with potential growth in the economy. It contributes to a positive structural adjustment if expenditure increases more slowly than potential GDP;
 - the amount of **new tax measures**.

- **The “non-discretionary” component** of the structural adjustment, which takes into account:
 - effects related to **changes in revenue elasticity**: as the cyclical component is calculated with average elasticities, the structural balance includes any fluctuations in elasticities in a given year if they differ from their long-term average;
 - **the change in revenue excluding compulsory levies**.

ANNEX 3

The impact of the change in the national accounts base on GDP growth and the general government accounts

In accordance with the European system of national and regional accounts, INSEE developed a new national accounts base (2014 base to replace the 2010 base), which includes a number of methodological changes to GDP and the general government accounts. This change in base resulted in retroactive adjustments to the national accounts for the entire period that they cover. Along with those adjustments, the national accounts were also affected, for 2015 and 2016, by updates to the data as part of the normal account production process.

The revisions to GDP, resulting mainly from the incorporation of drug trafficking and revised rent estimates, were nevertheless minimal: nominal GDP for 2016 was virtually unchanged at €2 228.6 billion compared with €2 228.9 billion in the 2010 base. For 2015 and 2016, there were almost no revisions to real GDP growth.

The general government accounts¹⁰ were also subject to methodological changes, most notably: spreading the sales of over-the-air licences over the period the frequencies are used (previously recorded in the sale year); reclassifying loans from the State to the French Development Agency and their repayment as State expenditure and revenue; including the construction costs for the Tours-Bordeaux high-speed rail line in the public deficit; reclassifying *Société de financement de l'économie française* as a general government entity (SFEF had previously been classified in the banking sector); and reclassifying the television licence fee as a tax (previously considered non-tax revenue).

In total, the net impact of these revisions on the government balance is limited. It is almost always less than 0.1 point of GDP in absolute value terms, except in 2012 (-0.2 percentage point) and slightly negative. It was almost zero in 2015 (-0.05 point) and in 2016 (0 point).

Breakdown of revisions to the general government balance

(In billions of euros)	2015	2016
Revisions of the general government balance between bases 2010 and 2014	-1.0	-0.1
Of which recalculations following rebasing	-3.2	-1.6
of which spreading out the sales of over-the-air licences	0.3	-0.3
of which reclassification of loans to the French Development Agency	-1.1	0.2
of which revised non-collection estimates	-1.2	-0.2
of which debt write-offs	-0.8	-0.7
of which Tours-Bordeaux high-speed rail line	-0.8	-0.6
Of which source data revisions	2.2	1.5

Source: Ministry of Economy and Finance

¹⁰ Eurostat expressed two reservations on the reporting of the public finance aggregates for 2017 but the reported figures were not invalidated or revised.