Haut Conseil des Finances Publiques

Opinion n° HCFP-2022-2

on the first amending budget bill for 2022

July 4, 2022

Executive Summary

The Government referred to the High Council of Public Finance with the introductory article of the first amending budget bill (PLFR) for 2022 on June 29, 2022, expecting the High Council to issue an opinion two days later. Such a timeframe, which is in no way justified by urgency, is very tight given the complexity of the macroeconomic context and the scale of the measures contained in this PLFR. This makes it particularly difficult for the HCFP to carry out its mandate as provided for in the organic law.

The High Council considers that the Government's growth forecast for 2022 is not out of reach but is somewhat high. The inflation forecast for 2022 appears to be, on the contrary, somewhat under-estimated. The forecast for the 2022 wage bill is plausible.

The Government's forecasted public deficit is 5.0 points of GDP in 2022, which is unchanged compared to the initial finance law (LFI) but with revenues and expenditures almost €60 bn higher.

This forecast appears to carry mostly unfavorable risks.

On the expenditures side, debt interest expenditure might be higher, particularly those on inflation-indexed debt as a result of inflation exceeding expectations. Healthcare costs might end up higher as a result of recurring Covid waves. The cost of certain measures such as the cap on gas and electricity prices, which is sensitive to changes in the market price of energy, is shrouded with great uncertainty, given the volatility of these prices.

On the revenues side, the forecast assumes a growth rate of taxes and mandatory contributions at unchanged policy which is significantly higher than that of GDP. While this can be partly justified by the dynamism of the wage bill and consumer prices, the proceeds of certain taxes and mandatory contributions (duty on real property transactions, corporate income tax, domestic tax on petroleum products) are likely to be more adversely affected than expected by the unfolding downturn in the real estate market, the deterioration of corporate earnings, or a further decline in fuel consumption.

Under the terms of the organic Law of December 17, 2012, the High Council must give its opinion on the consistency of the trajectory of the structural balance adopted in the PLFR for 2022 with that of the programming law of January 22, 2018 for the years 2018 to 2022.

The structural balance presented in the PLFR for 2022 (-3.6 points of potential GDP) would improve by 0.8 point compared to 2021, exclusively as a result of the growth of taxes and mandatory contributions at unchanged policy which is much higher than that of GDP. However, it would still be 2.8 points lower than the forecast provided for in the programming law of January 2018, which the High Council recalls is now an outdated baseline.

The considerable increase of the debt interest expenditure for 2022 (+ €17.8 bn) compared with the LFI is a reminder that the greatest vigilance must be exerted to ensure the medium-term sustainability of public finances. While the economic consequences of the war in Ukraine and the Covid-19 pandemic may justify transitory support measures, it will be necessary to implement measures intending to contain public spending and reach greater spending efficiency rapidly, in order to achieve a lasting reduction of the public debt burden.

Introductory remarks

1. The High Council adopted the following opinion after deliberating at its meeting of 1 July 2022,

1- On the scope of this opinion

2. The Government referred to the High Council of public finance in application of article 15 of organic law n° 2012-1403 of December 17, 2012 on the programming and governance of public finances, with the introductory article of the first amending budget bill (PLFR) for 2022 to issue an opinion on the associated macroeconomic forecasts as well as on the consistency of this bill with the multi-year structural balance trajectory defined by the programming law of January 2018 (LPFP).

2- On the information provided and the timeline

3. On June 29, 2022, the Government referred to the High Council on Public Finance with the macroeconomic framework and information on public finances of the PLFR for 2022. This referral was complemented by detailed responses to a survey that the High Council had previously sent to the relevant administrations.

4. The High Council notes that the provisional date of referral was changed several times and that the final date of referral was communicated extremely late. The High Council was eventually referred to by the Government on June 29, 2022, and asked to issue an opinion two days later. Such a timeframe, which is in no way justified by urgency, is very tight given the complexity of the macroeconomic context and the scale of the measures included in this PLFR. This makes it particularly difficult for the HCFP to carry out its mandate defined by the organic law.

3- On the High Council's methodology

5. In order to assess the realism of the macroeconomic forecasts associated with the amending budget bill, the High Council considered the latest data and statistics available and the information provided by the Government in the referral file and in the answers to the High Council's surveys.

6. The High Council also relied on the latest forecast from other national and international organizations: the European Commission, the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD), the European Central Bank (ECB), the Institut national de la statistique et des études économiques (Insee), the Banque de France, and economic institutes such as Rexecode and the Observatoire français des conjonctures économiques (OFCE).

7. As provided for in article 18 of the organic law, the High Council held hearings with representatives from competent administrations (French Treasury, Budget Department), Insee, as well as experts and organizations from outside the finance ministry (Banque de France, Rexecode, and OFCE).

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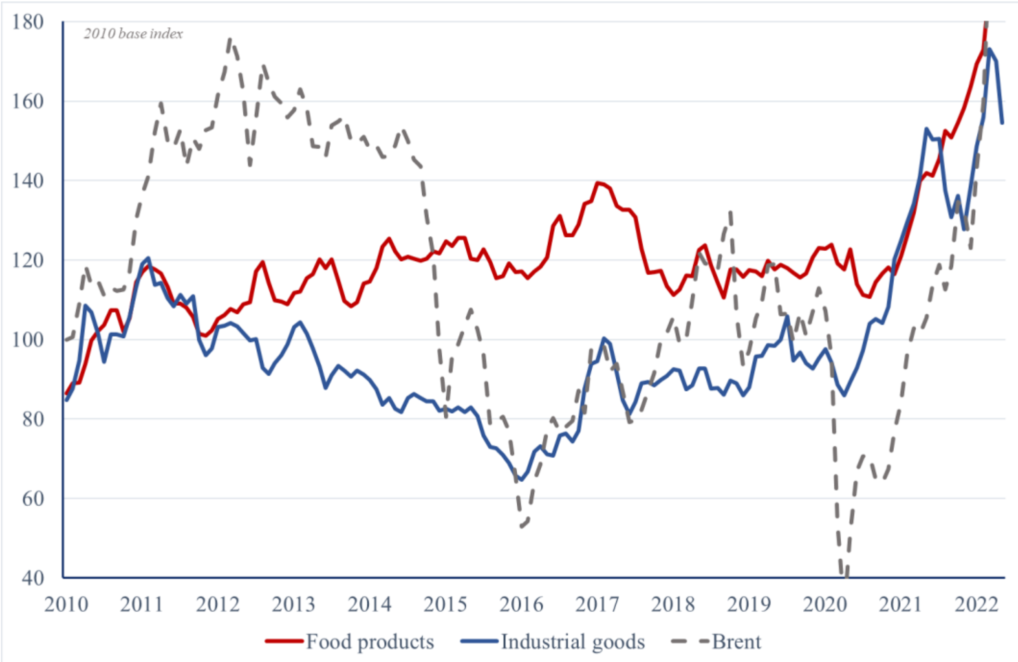
8. After a brief presentation of the general context (I), the High Council formulates its assessment of the macroeconomic forecasts upon which the amending budget bill is based (II), and on the associated public finance forecasts (III).

I- Strong inflationary tensions and tougher monetary policies depress the world' s economic growth

9. The war in Ukraine and the strict lockdowns due to China's zero-Covid policy have led to a new upheaval of the world' s supply chains and a sharp rise of commodity prices in the first half of 2022, even though the prices of some of them have slightly decreased in the spring (aluminum since March or wheat after mid-May for example).

Figure 1: commodities prices in euros



Source: Insee

10. This rise of commodity prices, particularly for energy, supports the real incomes of exporting countries, but weighs on those of importing economies, including France and its European partners. It has contributed to the almost general rise of inflation on a global scale since the beginning of 2021, triggered by the disruption of the supply chains resulting from the health crisis and the strong rebound in demand, supported by fiscal policies.

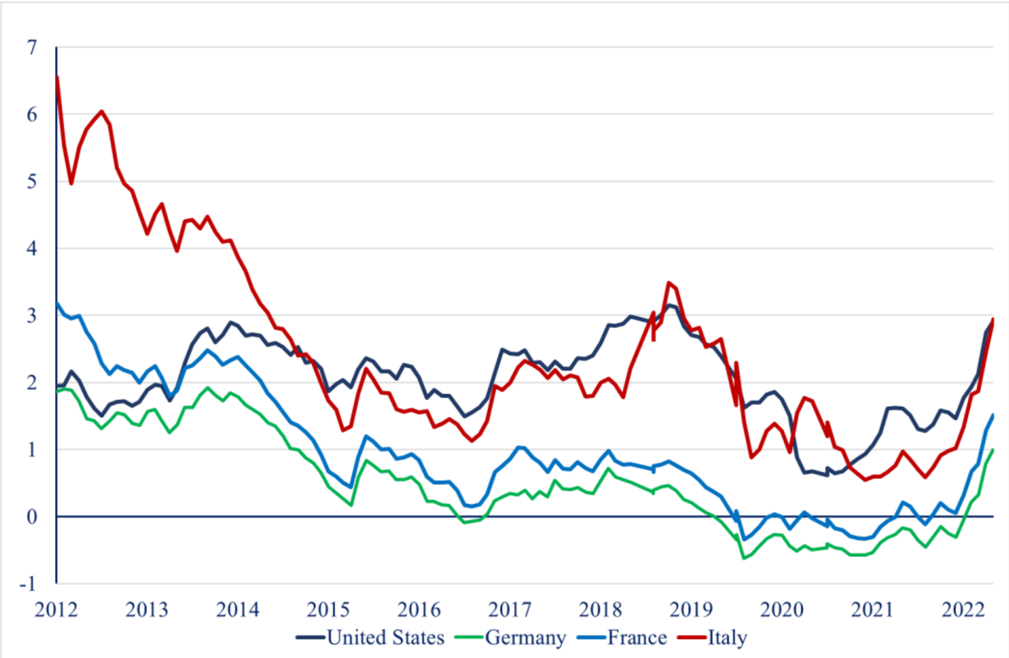
11. In the United States, the pressure on the labour market, which is close to full employment, has led to a sharp rise in wages, which has sustained the rise in consumer prices, up by +8.6% over a year in May.

12. In the euro zone, the rise in consumer prices is also very strong (+8.6% year-on-year in June). The rise of imported product prices has been strengthened by the euro's depreciation, but the transmission of inflation to wages remains contained compared to the United States, due to less pressure on labor markets as a result of a weaker economic performance during the

pandemic and a lower level of the labour mobility, which often enables employees to obtain wage increases

13. This sharp rise in inflation is holding back the rebound from the periods of reduced activity and travel, reducing households' real income and leading to a tightening of financial conditions. As a result, the Fed significantly has raised its key rates (150 basis points increase of the Fed funds rate) and started to reduce the amount of assets it holds on its balance sheet. As for the ECB, it begins more slowly the process of monetary normalization, with a halt of its net asset purchases and a first key rate increase of 25 basis points announced for July. Against this backdrop, long rates have risen sharply in most countries, reflecting the upward revision of inflation expectations and the anticipated acceleration of the rate hike schedule. In the euro zone, this has been accompanied by a revaluation of risk premiums, with a widening of spreads in countries considered as more risky (the yield of the 10-year Italian sovereign bonds has exceeded 4% over the course of June).

Figure 2: 10-year sovereign bond yields



Source: Banque de France

14. In this context, global growth forecast for 2022 has been significantly revised downwards during the first semester (by around 1.0 to 1.5 percentage points of GDP). According to the latest available forecasts, world GDP, which grew by around 6.0% in 2021 compared to 2020 on an annual average basis, is expected to increase by only 3.0 % in 2022.

Table 1: annual volume growth forecasts for world GDP (in %)

	Date of publication	2021	2022
IMF	April 19th	6.1	3.6
World Bank	June 7th	5.7	2.9
OECD	June 8th	5.8	3.0
Consensus Forecasts	June 13th	5.9	2.9
DG Treasury	June 29th	6.1	3.4

Source: IMF Economic Outlook April 2022, World Bank Economic Outlook June 2022, OECD Economic Outlook June 2022, Consensus Forecasts June 2022, PLFR1 for 2022.

15. World trade growth is expected to be lower in 2022 than in 2021. The significant slowdown in global activity and persistent disruptions in supply chains are expected to dampen world trade in goods. Trade in services, particularly tourism, could benefit from the easing of sanitary restrictions since the beginning of 2022, but is likely to suffer from the war in Ukraine.

Table 2: forecast annual growth in world trade volume (in %)

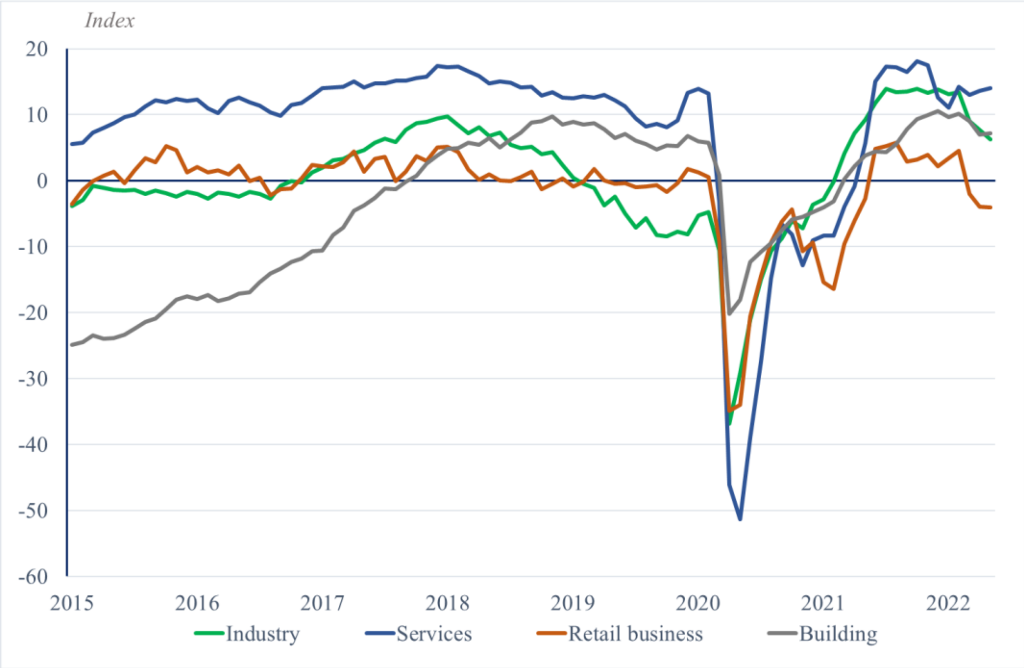
	Date of publication	2022
Trade in goods and services		
IMF	April 19th	5.0
World Bank	June 7th	4.0
OECD	June 8th	4.9
DG Treasury	June 29th	5.9

Source: IMF Economic Outlook April 2022, World Bank Economic Outlook June 2022, OECD Economic Outlook June 2022, PLFR1 for 2022.

16. Activity in the euro zone is expected to significantly slow down in 2022, after the strong rebound observed in 2021. The euro zone, which is highly exposed to the war in Ukraine as a result of its dependence on Russia for its energy imports, is expected to experience a sharper slowdown than anticipated in the fall[1]. Apart from the services sector, business surveys confirm the moderation of activity prospects since the beginning of 2022, particularly in the retail and industrial sectors.

[1] The European Commission has lowered its forecast for average annual real GDP growth in 2022 by 1.6 percentage points (from 4.3% in the fall of 2021 to 2.7% in the spring of 2022), the OECD by 1.7 percentage points (from 4.3% in December 2021 to 2.6% in June 2022), and the World Bank by 1.7 percentage points (from 4.2% forecast in December 2021 to 2.5% in June 2022).

Figure 3: business climate in the euro zone



Source: European Commission

17. In the euro zone, the negative impact of rising inflation on household real income and the continuing high savings rate, which is expected from the sharp decline of household confidence[2], should dampen consumption. At the same time, the high level of uncertainty and the tightening of financing conditions could penalize business investment spending.

Table 3: annual real GDP growth forecasts for the euro zone (in %)

	Date of publication	2021	2022
IMF	April 19th	5.3	2.8
European Commission	May 16th	5.4	2.7
World Bank	June 7th	5.4	2.5
OECD	June 8th	5.3	2.6
ECB	June 9th	5.4	2.8
Consensus Forecasts	June 13th	5.3	2.8
DG Treasury	March 31st	5.4	2.8

Source: IMF Economic Outlook April 2022, European Commission Spring Forecast May 2022, World Bank Economic Outlook June 2022, OECD Economic Outlook June 2022, ECB Macroeconomic Forecast June 2022, Consensus Forecasts June 2022, PLFR1 for 2022.

18. The factors of uncertainty surrounding these forecasts are numerous and unfavorable. The economic consequences of the war in Ukraine could be further worsened by a disruption of Russian gas supplies to the European Union, leading to a renewed rise of imported inflation. Central banks faced with the risk of persistent inflation could tighten their monetary policy

[2] Decline in the European Commission's consumer confidence indicator from -9.3 in December 2021 to -23.6 in June 2022 according to the flash survey.

further than currently anticipated, leading to a deterioration in the economic outlook with the risk of financial market turmoil and a sharp decline of risky financial asset prices. The risk of a renewed worsening of the health situation cannot be ruled out, since the proportion of the population vaccinated against Covid-19 remains very low in some emerging countries. Lastly, these countries face a number of vulnerabilities, including the risk of food shortages and capital flight, which have only been mitigated by recent increases in key interest rates. The financial and geopolitical instability that could result from the materialization of these risks would be a clear brake on global growth.

II- Observations on the macroeconomic forecasts for 2022

1- Government forecasts

19. According to the Government's referral, of June 29, 2022, *"the economic scenario of this Amending budget bill for 2022 differs significantly from the one that was used for the 2022 budget bill."* The Government has thus revised *"downward the GDP growth forecast to 2.5% in 2022, compared with 4.0% in the 2022 Budget Bill scenario."*

20. According to the government, *"inflation would reach +5.0% on average per year in 2022, after +1.6% in 2021. Energy prices would account for nearly 40% of this price increase, assuming that the price of oil is frozen at its June level of $114 (€106) by the end of the year, for an annual average of $110 (€102). »*

21. The Government states that *"the risks surrounding this forecast are significant. Developments in the Ukraine are the main risk, mainly bearish [...] A more rapid tightening of the ECB's monetary policy would have an impact on financing conditions, and could weigh on the investment projects of businesses and households. The evolution of the health situation remains a risk [...] The scenario assumes a very gradual decline in the household savings rate. A steeper decline [...] would provide additional support to consumption and thus to activity."*

2- Assessment of the High Council

22. The High Council assesses successively the assumptions for activity growth, inflation, employment and the private sector wage bill.

a) Economic activity growth

23. In the first quarter of 2022, the GDP declined by 0.2 percent, as a result of the Omicron variant outbreak and the first effects of the invasion of Ukraine. Furthermore, Insee's publication of the annual national accounts on 31 May has led to a downward revision of the growth carryover for 2022 to 1.9% at the end of the first quarter of 2022. However, the improvement of the health situation and the good performance of employment suggest that consumption and GDP will rebound in the second quarter. The high degree of uncertainty related to the international context and the continued high level of inflation would nevertheless continue to weigh on growth.

24. The government's forecast is at the level of the June 2022 Consensus Forecasts (+2.5%). It is higher than the most recent forecasts by the OECD (+2.4%), the OFCE (+2.4%), Insee (+2.3%), the Banque de France (+2.3%) and Rexecode (+2.1%).

Table 4: GDP growth forecasts for 2022 (in %)

OECD (June 2022)	2.4
Banque de France (June 2022)	2.3
Rexecode (June 2022)	2.1
OFCE (June 2022)	2.4
Insee (June 2022)	2.3
Consensus Forecasts (June 2022)	2.5
Government (Amending budget bill 1 for 2022 - June 2022)	**2.5**
For information budget bill 2022 - October 2021	*4.0*

Source: Forecasts by economic bodies and institutes

25. The shocks that occurred since autumn (the Omicron wave, the war in Ukraine, rising commodity prices, disruption of certain supply chains) led the government to revise its growth forecast from 4.0% to 2.5%. The latter is based on the assumption of a strong growth in consumption (+2.8%), driven by a moderate increase in real household income (+0.5%) and a sharp decline of the saving rate (1.9 percentage points), even though the latter would still be higher than its pre-crisis level (16.8 percentage points in 2022 compared with 15.1 points in 2019). Business investment is also expected to remain strong (+2.0%). French exports should continue to be very dynamic (+7.1%).

26. Given the 1.9% growth rate carryover at the end of the first quarter, the government's forecast assumes that the French economy will grow at a rate close to 0.4% per quarter in the following quarters. Although Insee’s business and consumer surveys suggest a deterioration of the business climate since the beginning of the year, they do not foresee a fall in activity at this stage, and the budgetary measures to support income and the good performance of employment should encourage a bounce-back of consumption after the first quarter's drop.

27. However, this forecast is weakened by several factors. A real income growth closer to the one forecast by other organizations[3] would result in lower consumption. Additionally, the drop of the household confidence indicator revealed by Insee’s business and consumer survey to a level close to the lowest levels reached in 2018 and 2020 suggests that they might decide to postpone some consumption decisions in favor of savings. Furthermore, the decline of corporate margins as a result of the sharp rise of their costs and the increase in interest rates should weigh on investment after its strong rebound in 2021, as also suggested by the downward trend of businesses’ demand outlook since March. Particularly, investment in information and communication services, which has been particularly buoyant over the past 18 months due to the needs arising from the health crisis, could run out of steam.

28. Furthermore, energy supply constraints in Europe, the recent rise of inflation in industrialized countries, and the ongoing tightening of monetary policies represent a significant threat to foreign demand for France in the second half of 2022, and could therefore weigh on exports: indeed, the Government's forecast for growth in trade in goods and services (+5.9%) is higher than that of international institutions.

[3] Insee, OFCE or Rexecode.

29. Given all the risks weighing on the international environment, the risk of a further slowdown in the French economy at the end of the year is not negligible.

30. The High Council considers that the Government's growth forecast for 2022 is not out of reach but is somewhat high.

b) The rise in consumer prices

31. The government has revised upwards its inflation forecast for 2022 to an annual average of 5.0% (compared with 1.5% expected in the initial 2022 Budget bill) for the consumer price index, a substantial increase compared with 2021 (1.6%).

32. This increase is firstly due to stronger food and energy prices, resulting from higher raw material prices (oil, natural gas, coal, wheat in particular). Secondly, the rise in raw material costs and higher input prices due to the disruptions in supply chains are gradually being passed on to the prices of manufactured goods, which have been rising more sharply than expected over the past year. Finally, services prices are also rising, driven by accelerating wages.

Table 5: inflation forecasts (CPI) for 2022

	Date of publication	Annual average in %
Government	June 2022	5.0
Banque de France	June 2022	5.1
Consensus Forecasts	June 2022	5.0
Insee	June 2022	5.5
OFCE	June 2022	4.9
Rexecode	June 2022	5.2

Source: Amending budget bill 1 for 2022, forecasts by economic bodies and institutes

33. Government's total inflation forecast is at the lower range of the forecasts available. It assumes that inflationary pressures will subside in the second half of the year, particularly in services, for which the Government forecasts an annual average increase of 3.0%, whereas the services price carryover for 2022 is already 2.6% at the end of June. Therefore, this forecast assumes a sharp slowdown in the monthly increase in services prices between now and the end of the year (which would be of about +0.2% per month on average, compared to +0.5% over the last three months and +0.4% over the last six months); this slowdown is not a given in the light of the recent and expected wage increases.

34. The High Council estimates that the inflation forecast for 2022 appears to be somewhat underestimated.

c) Employment and wage bill growth

35. The government has significantly increased its forecast for wage bill growth in the non-agricultural market sector in 2022, to +8.5%, compared to a forecast of +5.9% in the Initial budget bill for 2022, for which the High Council warned "it was subject to rather upwardly oriented contingencies". In addition, the wage bill growth for 2021, at +8.7%, was significantly higher than the Government's forecast in the Initial Budget bill for 2022 (+7.2%), which the High Council had judged "prudent".

Table 6: payroll in the non-agricultural market sector (changes in %)

	2021	2022
Workforce	2.8	2.5
Average wage	6.2	5.8
Wage bill	**8.7**	**8.5**

Source: Amending budget bill 1 for 2022

36. The forecast for non-agricultural market employment is equivalent to just under 40,000 net job creations over the remaining three quarters of 2022. This forecast is lower than those of other institutions (notably Insee and OFCE), which have lower growth forecasts than the government. In the Government's scenario, the productivity growth rate would return to a rate close to the pre-crisis level as early as the first quarter of the forecast, but without making up for the loss in level accumulated since 2019 compared with the pre-crisis trend path.

37. The growth forecast for the average wage per capita, at +5.8%, appears to be slightly higher, especially compared to Insee's projection, given the less dynamic consumer price forecasts.

38. **All in all, the 2022 wage bill growth forecast is plausible, even though the employment forecast is lower, and the per capita wage forecast is higher than those of some other institutions.**

III- Observations on public finances

1- The Government's forecasts

39. According to the Government's referral file, the public finances scenario "*leads to a general government balance forecast of -5.0% of GDP in 2022, which is stable compared to the initial budget bill (LFI) […] The structural balance is revised upwards compared to the LFI, while the cyclical balance is revised downwards […].*"

40. The Government adds that "*Since the late 2021 vote of the initial budget bill for 2022 (LFI), numerous events have affected public finances. The macroeconomic forecasts were revised substantially: the growth of GDP is forecasted at 2.5% in 2022 versus 4% in the forecast of the initial budget bill, and inflation was revised strongly upwards*".

41. *"In this context and in light of the consequences of the war in Ukraine and inflationary pressures, the Government adopted large-scale measures to limit the increase in prices and support households and companies, with a direct impact on public finances"*

42. According to the Government, "*the public expenditure ratio excluding tax credits would stand at 57.3% of GDP in 2022 and the mandatory contributions ratio would stand at 44.8% in 2022. The public debt ratio in the Maastricht terms would stand at 111.9% of GDP, compared with 113.5% of GDP in the draft budget plan revised at the end of October*."

2- Assessment of the High Council

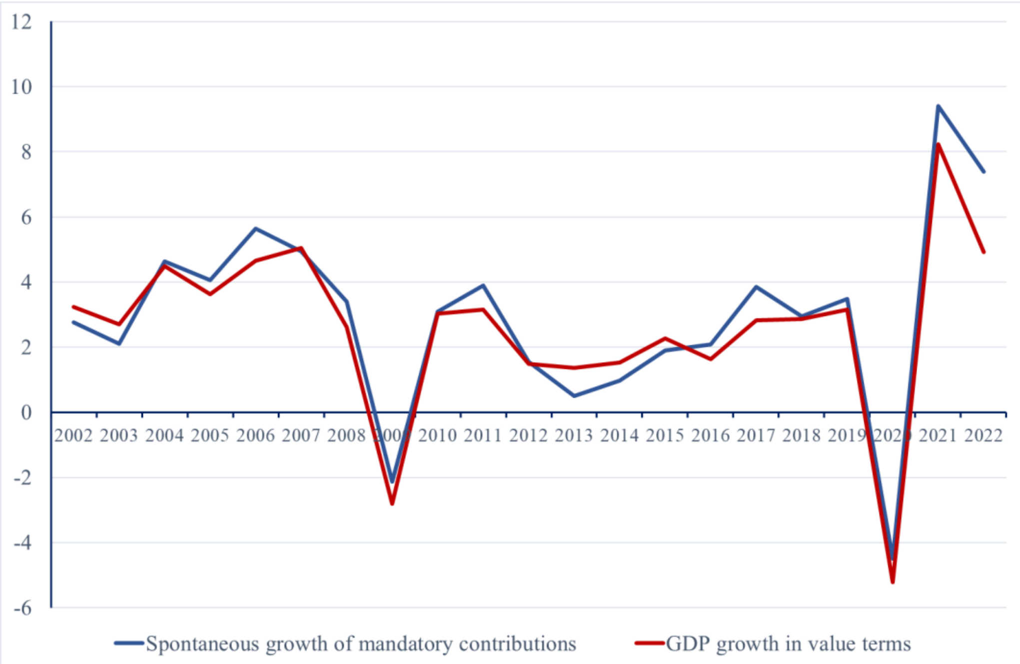
43. The High Council successively assesses the revenue, expenditure and public balance assumptions, then examines the consistency of the structural balance with the programming law and finally the evolution of the public debt.

a) Government revenues

44. Receipt of taxes and mandatory contributions would increase by €67.2 bn between 2021 and 2022 and the tax and mandatory contribution rate would increase by 0.5 point, increasing from 44.3 to 44.8 points of GDP.

45. The increase in tax revenue in 2022 would be the result of a "spontaneous" growth, which is to say, under constant legislation, of 7.4% (+€82 bn), somewhat slowed down by measures decreasing taxes and contributions by about €15 bn. The elasticity of taxes and contributions[4], standing at 1.5, would be much higher than 1, the average value assumed on the period covered by the LFI. In total, tax and contribution revenues would be about €50 bn higher than in the LFI (see box).

Graph 4: GDP growth in value terms and growth of mandatory taxes and contributions under constant legislation (in %)



Sources: Insee, Government, calculations from the High Council's Permanent Secretariat

[4] The elasticity of mandatory contributions to GDP measures the relationship between the growth rate of mandatory contributions and that of GDP, under constant legislation. It aims to measure by what percentage mandatory contributions increase when GDP in value terms increases by 1%.

46. This elasticity forecast which is much higher than 1 can be justified by some specific features of the year 2022: growth in the wage bill, which constitutes the base for a large proportion of the levies, is higher than that of GDP; growth in demand prices, and in particular consumer prices, which are a determining factor for VAT revenues, is much higher than that of GDP prices; and the impact of the very strong rebound in activity on corporate earnings in 2021, and therefore on the corporate income tax balance in 2022.

47. However, there are risks to the receipts of a number of revenues. The deterioration in the margin rate of non-financial corporations (-1.7 point compared to the initial budget bill for 2022) could lead companies to reduce their payments of corporate income tax instalments more than the Government anticipates.

48. Payroll taxes (social security contributions, social security deductions, income taxes) could also be reduced by a greater than expected use by companies of tax-exempt remuneration instruments such as the "Macron bonus", the sustainable mobility package or the fuel expenses bonus.

49. The government's assumption that revenues from the duty on real property transactions will remain at the particularly high level observed in 2021 is undermined by the decline observed in the first four months of the year compared with the average level for 2021 and the increasing signs of a decline in the number of real estate transactions, as a consequence of rising interest rates.

50. Additionally, the decrease in domestic tax on petroleum products (TICPE) revenues set by the Government in the PLFR1 for 2022 (-0.7%) could be higher due to a greater response of the volume of consumption of petroleum products to the sharp increase in the price of petroleum products that has taken place over the last year.

51. The risks from the macroeconomic scenario appear generally balanced, with the possible underestimation of inflation and the possible overestimation of growth working in opposite directions.

52. Finally, some new measures (raising the exemption ceiling for the transport bonus and the sustainable mobility package), which could be included in the bill on purchasing power, do not appear in the documents sent to the High Council: taking their cost into account should therefore reduce the forecast of tax revenues for 2022.

53. **In total, the forecast assumes a growth rate of mandatory taxes and contributions at unchanged policy which is significantly higher than that of GDP. While this can be partly justified by the dynamism of the wage bill and consumer prices, the proceeds of certain taxes and mandatory contributions (duty on real property transactions, corporate income tax, domestic tax on petroleum products) are likely to be more adversely affected than expected by the unfolding downturn in the real estate market, the deterioration of corporate earnings, or a further decline in fuel consumption.**

Box: change in the forecast of taxes and mandatory contributions (PO) between the LFI for 2022 and the PLFR1 for 2022

PO forecasts in the LFI for 2022	€1125.8 bn
2021 base effect	€31.0 bn
Lower growth of GDP in value terms in 2022	€-6.6 bn
Increase in elasticity from 1 to 1.5	€29.4 bn

Higher costs of new measures	€-4.7 bn
PO forecast for 2022	€1174.9 bn

Sources: LFI for 2022 and PLFR1 for 2022

The Government forecasts that taxes and mandatory contributions will amount to about €1175 bn in 2022, about a €50 bn increase compared to the forecast in the initial budget bill for 2022.

Part of the increase (€31 bn) would reflect the higher-than-expected level of revenue observed in 2021. This increase in revenue notably relates to corporate income tax (€9.9 bn), VAT (€4.7 bn), social security contributions (€8.3 bn) and income tax and social security levies (€3.1 bn).

For an equivalent amount, the increase in revenues reflects a higher elasticity of mandatory contributions to GDP growth. The government expects that the increase in mandatory contributions under constant legislation (+7.4%) will be higher than the increase in GDP in value terms (+4.9%), which gives an elasticity of mandatory contributions to GDP of 1.5, well above the average value for the period used in the LFI.

Conversely, tax revenues would be reduced by a lower growth of GDP in value than in the LFI and the increased costs of new measures.

b) Government expenditures

54. The government has significantly increased the public expenditure forecast (+€60 bn) compared to the LFI for 2022. The difference is due to measures taken to support households and businesses in the face of rising prices, particularly energy prices, which account for around €35 bn. The upward revision of interest expenditures (€18 bn), mainly due to the inflation-indexed bonds, also contributes to the diffeence.

55. The estimated cost of the energy price cap on electricity and gas has therefore increased by €8.9 bn and €3.5 bn respectively compared to the LFI. The 15-cent tax-free rebate at the pump, effective since April 1, will be gradually replaced by targeted aid starting at the end of the summer, would have a €7.6 bn impact on public spending. The aid set up for large energy-consuming companies would cost €3 bn. The 4% increase in social benefits and the 3.5% increase in the civil service point on July 1, 2022 would boost household income by €6.7 bn and €4.4 bn respectively. Finally, the exceptional back-to-school allowance of €100 plus €50 per child attached to the household for certain social benefit recipients would cost €1 billion.

56. The increase in the inflation forecast since the LFI has also led to a sharp increase in the debt interest expenditure on government debt indexed on French and Eurozone inflation (+€15.9 bn). In addition, the forecast for healthcare expenditure under Ondam has been increased by a little over €7 billion compared with what was voted in the LFSS, including €1.1 billion as a result of the increase in the civil service point and €5.7 billion due to additional expenditures, particularly on tests, resulting from the appearance of the Covid Omicron variant.

57. The Government's forecast is surrounded by great uncertainty. The cost of some of the measures adopted (notably the price cap on gas and electricity) is very sensitive to changes in energy market prices, which are highly volatile. The debt interest expenditure on indexed bonds could also vary significantly depending on price trends in France and in the Eurozone. As the risks affecting inflation forecasts appear to be on the rise on average, the risk affecting interest expense is also on the rise. Additionally, the cost of the aid targeted at " high mileage drivers ", which is intended to gradually replace the 15-cent tax-free discount at the pump, could also deviate from the assumption, depending on the parameters that are eventually chosen. Finally, a resurgence of the Covid 19 epidemic in the second half of the year could further increase health spending and lead to the reactivation of support expenditures for businesses and households.

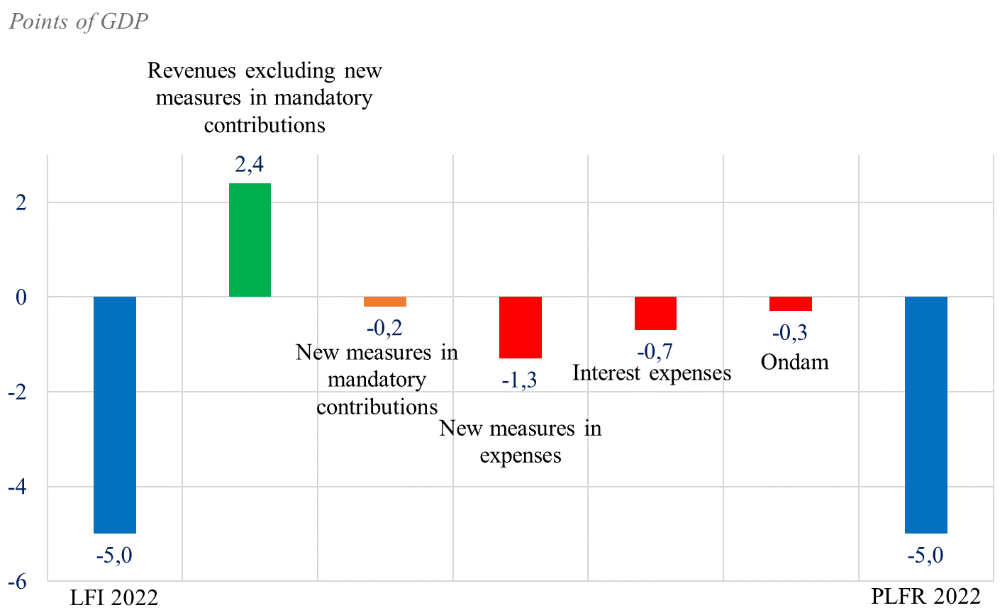
58. **The Government's public expenditure forecast is surrounded by unusual uncertainty. However, the risks of higher expenditures than forecast do appear to be prevailing. Debt interest expenditures might be higher, particularly those on inflation-indexed debt as a result of inflation exceeding expectations. Healthcare costs might end up higher as a result of recurring Covid waves. The cost of certain measures such as the cap on gas and electricity prices, which is sensitive to changes in the market price of energy, is shrouded with great uncertainty, given the volatility of these prices.**

c) The effective public deficit

59. The PLFR1 for 2022 forecasts a general government balance identical to that in the initial forecast of the LFI for 2022, at -5.0 points of GDP, an improvement of 1.4 point compared to 2021.

60. This stability of the deficit compared with to the LFI the result of a sharp increase in expenditures (+2.2 points of GDP) offset by an equivalent increase in revenues.

Graph 5: from the general government balance in the LFI for 2022 to the balance in the PLFR1 for 2022



Sources: LFI for 2022 and PLFR1 for 2022

61. The level of the government deficit in 2022 is subject to significant uncertainties. Given the risks of lower returns from some taxes and mandatory contributions and the risks of higher than forecast expenditure, the risk that the deficit will ultimately turn out to be higher than forecasted in this PLFR seems to prevail.

The Government's forecasted public deficit is 5.0 points of GDP in 2022, which is unchanged compared to the initial finance law (LFI) but with revenues and expenditures almost €60 bn higher. This forecast appears to carry mostly unfavorable risks.

d) The structural deficit

62. Under the terms of the Organic Law of December 17, 2012, the High Council must give its opinion on the consistency of the structural balance trajectory set in the PLFR for 2022 with that of the current programming law, which is that of January 22, 2018 for the years 2018 to 2022. According to the same programming law, a deviation is structural balance is considered important when it amounts to at least 0.5% of GDP in a given year or at least 0.25% of GDP on annual average over two consecutive years.

63. However, the exercise of this mandate comes in the context of the health crisis, which, at the European level, has led to the triggering of the general escape clause of the Stability and Growth Pact (see appendix 4). At the national level, the High Council of public finance considered in its opinion n°HCFP-2020-1, at the request of the Government, that the conditions mentioned in article 3 of the Treaty on Stability, Coordination and Governance for activating the clause of “exceptional circumstances” were met.

64. The High Council must base its opinion on the potential growth as included in the current programming law. The structural balance is thus calculated in the PLFR1 for 2022 under the same hypothesis of potential growth as the one included in the programming law (1.25% in 2019 and 2020, 1.30% in 2021, 1.35% in 2022).

65. Under such potential GDP hypotheses, the structural balance[5] would stand at -3.6 points of potential GDP in 2022, following -4.4 points in 2021. The structural adjustment, that is to say the variation in the structural balance, would thus stand at +0.8% of potential GDP, an improvement of 0.4 points of GDP over the LFI forecast for 2022.

Table 7: breakdown of the general government balance in the PLFR1 for 2022 and the balance in the LPFP

In points of GDP	**PLFR1 for 2022 (June 2022)**			***LPFP (January 2018)***		
	2020	**2021**	**2022**	***2020***	***2021***	***2022***
General government balance	**-8.9**	**-6.4**	**-5.0**	***-1.5***	***-0.9***	***-0.3***
Cyclical component	-4.9	-2.0	-1.3	*0.1*	*0.3*	*0.6*
Temporary and one-off measures*	-2.8	-0.1	-0.1	*0.0*	*0.0*	*0.0*
Structural balance*	**-1.1**	**-4.4**	**-3.6**	***-1.6***	***-1.2***	***-0.8***
Deviation from the LPFP	0.5	-3.1	-2.8			

Note: figures are rounded to the nearest tenth, there may be slight discrepancies in the results from computations.
**: in points of potential GDP*
Sources: PLFR 1 for 2022, programming law of January 2018.

66. The improvement in the structural balance results exclusively from the increase in tax revenues, under constant legislation, with respect to GDP growth. The structural effort, which is more representative of government action[6], is slightly negative. Thus, the structural

[5] See appendix 3 for a definition of the concepts used in this section.
[6] The structural effort is the result of the expenditure effort and new tax measures. The expenditure effort compares the growth rate of public expenditure in volume with the potential growth of the economy, a structural effort is

adjustment does not reflect government action, but is the result of favorable circumstances, external to government action, whose sustainability is not assured.

67. Furthermore, the High Council points out once again that the January 2018 programming law is an outdated reference, with respect to the macroeconomic as well as to the public finance scenarios. In particular, the calculation of the structural balance upon which the High Council is called to give its opinion is still based on the estimate of potential GDP used in this law which was adopted two years before the pandemic.

68. In its social, economic, and financial report for 2022, the Government revised downwards the potential GDP estimate by 1.75% starting in 2021 compared to the hypotheses of the LPFP[7]. This new estimate would, all else equal, lead to a decrease in the cyclical part of the deficit by 1 point in 2022 and increase the structural deficit by the same amount compared to the structural deficit estimated with the potential GDP hypotheses of the LPFP (-4.6 points of GDP instead of -3.6 points of GDP).

Table 8: breakdown of the general government balance with the updated potential GDP assumption

In points of GDP	**2021**	**2022**
General government balance	**-6.4**	**-5.0**
Cyclical component	-1.0	-0.3
Temporary and one-off measures	-0.1	-0.1
Structural balance	**-5.4**	**-4.6**

Source: PLFR1 for 2022

69. **Under the terms of the Organic Law of December 17, 2012, the High Council must give its opinion on the consistency of the trajectory of the structural balance adopted in the PLFR for 2022 with that of the programming law of January 22, 2018 for the years 2018 to 2022.**

70. **The structural balance presented in the PLFR for 2022 (-3.6 points of potential GDP) would improve by 0.8 points compared to 2021, exclusively as a result of the growth of mandatory contributions at unchanged policy which is much higher than that of GDP. However, it would still be 2.8 points lower than the estimate provided for in the programming law of January 2018, which the High Council points out is now an outdated baseline.**

71. **Furthermore, the High Council points out once again that the programming law of January 2018 is an outdated reference, whether that be for with respect to the macroeconomic as well as the public finances scenarios. The revised potential GDP estimate presented by the Government in the economic, social, and financial report for 2022 would lead, all else equal, to an even more deteriorated evaluation of the structural balance, standing at -4.6 points of GDP.**

e) Public debt

72. In 2022, the public debt ratio would decrease slightly in 2022 as in 2021 and would stand at 111.9 points of GDP, a significant decrease compared to the LFI forecast for 2022. This decrease in the debt ratio is exclusively due to GDP growth, as the government deficit for 2022 remains high, at 5.0 points of GDP in the forecast.

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positive when expenditure increases less rapidly than potential GDP. Measures to increase taxes lead to an improvement in structural effort (see appendix 3).

[7] This potential framework was notably used in the stability program 2021-2027.

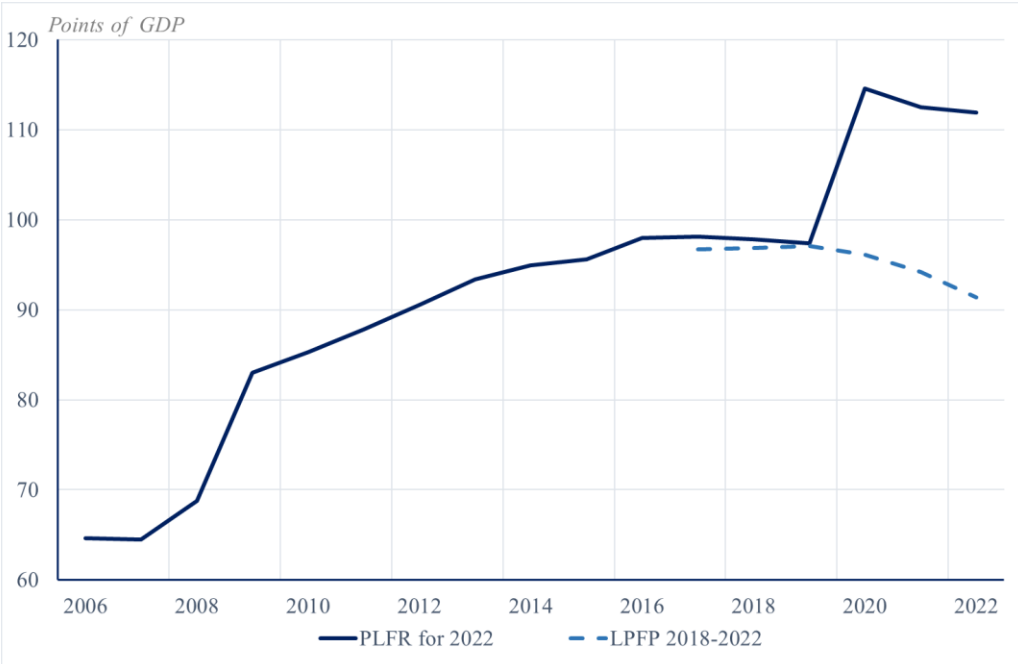
73. Contrary to an idea often put forward, the rise in inflation would not work in favor of a decline in the debt ratio in 2022 (see box).

Table 9: public debt and deficit

In points of GDP	**2020**	**2021**	**2022**
General government balance	-8.9	-6.4	-5.0
Public debt	114.6	112.5	111.9

Sources: Insee and PLFR1 for 2022

Graph 6: public debt ratio trajectory



Sources: Insee, PLFR1 for 2022 and LPFP of January 2018

74. **The considerable increase of the debt interest expenditures for 2022 (+ €17.8 bn) compared with the LFI is a reminder that the greatest vigilance must be exerted to ensure the medium-term sustainability of public finances. While the economic consequences of the war in Ukraine and the Covid-19 pandemic may justify punctual support measures, it will be necessary to implement measures intending to contain public spending and reach greater spending efficiency rapidly, in order to achieve a lasting reduction of the public debt burden.**

Box: in 2022, higher inflation increases the public debt burden

Inflation has continued to rise in the recent period. In June, it stood at 5.8 percent year-on-year, after 2.8 percent at the end of 2021 and 0.0 percent at the end of 2020. Higher inflation is commonly viewed as reducing the debt burden, by increasing the denominator of the ratio of government debt to GDP in value terms and thus facilitating the repayment of the debt inherited from the past. However, the impact of higher inflation is more ambiguous.

The trajectory of the public debt[8] depends on the extent to which interest rates and the primary balance adjust to higher inflation. In the long run, the impact of higher inflation on the public debt ratio will be either positive or negative, depending on whether interest rates rise more or less than inflation, via the adjustment of monetary policy and the evolution of risk premiums. Even in the short term, the impact is not necessarily favorable, as illustrated by the situation in 2022.

Several effects must be taken into account to assess the impact of inflation over the 2022 public debt ratio.

1. **Mechanical impact on the ratio of public debt to GDP in value terms of the revision of the inflation assumption: the revision of the GDP deflator**, which is significantly lower (0.9 point) than the increase in consumer prices, is at play; it automatically lowers the ratio of public debt to GDP by 1.0 point in 2022;

2. **Induced effect on the general government balance, via:**

o the impact of wage and price increases on the primary balance excluding employee compensation and excluding measures implemented by the Government[9]. As put forward by OFCE[10], current inflation is not homogeneous, and it is therefore necessary to distinguish between the response of government expenditures and revenues to consumer prices, wages and value-added prices. Government revenues seem to be more sensitive to wages (as in the case of income taxes, for example) than to consumer prices. They are partly dependent on value-added prices. Public expenditures excluding employee compensation and interest expenditures also depend partly on value-added prices, but, conversely, they are more sensitive to consumer prices (as for certain social benefits) than to wages. In 2022, as wages[11] and value-added prices rise slower than consumer prices, a scissor effect will limit the expected positive effect of higher inflation on the primary balance, excluding Government's discretionary measures (public sector wage increase and private sector support measures), estimated at +0.4 points of GDP.

o the discretionary measures implemented by the Government to limit the impact of inflation on revenues (3.5 points increase in the civil service point, reduction in the TICFE, 15 cent fuel rebate and targeted and increased aid for high-mileage drivers, exceptional aid for the start of the school year, early revaluation of pensions and benefits, mileage rating scale, subsidies to energy-intensive companies and sector-specific aid[12]), with an impact on the balance of payments estimated at -1.2 points of GDP in the PLFR1 for 2022 ;

o the increase in the interest expenditures[13], due to higher nominal interest rates and higher inflation (impact via interest charges on inflation-indexed Treasury bonds). The interest expenditure is thus revised upwards, with an effect of -0.5 point of GDP on the balance.

3. **Impact of lower real GDP growth (-0.6 point [14]) due to the imported nature of inflation in 2022 on the public debt ratio, via:**

o the mechanical "denominator" effect on the public debt ratio: +0.7 points;

[8] As a reminder, the public debt over GDP ratio dynamic is given by $d = (1+r) / (1+g) d_{-1}$ sp, where d is the ratio of debt over GDP in value terms, sp the ratio of the primary balance over GDP in value terms, r the effective interest rate on public debt, g the growth rate of GDP in value terms. Sustaining a constant debt to GDP ratio (in value terms), which is to say $d = d_{-1}$, implies $sp = (r-g) / (1+g) * d$.

[9] These effects are taken into account, but separately, in order to distinguish between the "usual" effect of changing assumptions on the general government balance and the effect of discretionary measures implemented by the Government.

[10] Heyer E., X. Timbeau (2022), « L'économie mondiale sous le(s) choc(s) », OFCE, May.

[11] Average wage per capita, corrected for partial activity.

[12] Excluding compensations to gas and electricity suppliers, which worsen the balance in national accounting, but do not affect cash flow and therefore do not require any additional debt (no effect in cash accounting).

[13] Measured here on a cash basis and not on a national accounting basis, because the disbursements made in 2022 affect debt in that same year.

[14] Estimated impact by Heyer E., X. Timbeau (op. cit.) of the rise in interest rates, the rise in oil prices excluding the 15 cents rebate, the rise in gas and electricity prices excluding the price shield, and the measures of the resilience plan and of the purchasing power law.

o the negative effect on the public balance: +0.3 points [15].

All in all, once all the impacts of inflation on public debt are accounted for, with the notable inclusion of the discretionary measures intended to reduce inflation, as well as its impact on growth, it appears that the extra inflation observed since the LFI for 2022 would push the public debt ratio upwards, rather than downwards, by around 1.2 points of GDP in 2022.

Table: impact of the revision of the forecasts of consumer prices, GDP prices, wage prices, on the ratio of public debt to GDP

Mechanical impact of the deflator on the public debt to GDP ratio	**-1.0**
"Induced" effect on the general government balance	**1.3**
Of which impact on the primary public balance excluding employee and measures	-0.4
Of which discretionary measures from the Government	1.2
Of which interest expenses	0.5
"Induced" effect	**1.0**
Of which "denominator" effect	0.7
Of which "general government balance" effect	0.3
Total impact	**1.2**

Source : Permanent Secretariat of the HCFP

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This opinion will be published in the *Official Journal* of the French Republic and attached to the first amending budget bill.

Paris, July 4, 2022.

[15] Élasticité des prélèvements obligatoires à la croissance du PIB retenue à 1.

For the High Council of public finance,
the First president of the Court of Auditors,
President of the High Council of public finance

Pierre MOSCOVICI

Annex 1: Macroeconomic scenario attached to the first amending budget bill for 2022

Actualized economic forecasts for France *(deviation from the amended budget bill for 2022)*						
	20201[1]		**2021[1]**		**2022**	
Goods and services in volume						
Gross domestic product (wda)	**-7.9**	(0.1)	**6.8**	(0.5)	**2.5**	(-1.5)
Households final consumption	-6.8	(0.4)	5.2	(0.8)	2.8	(-4.2)
Government final consumption	-4.0	(-0.8)	6.4	(0.0)	1.4	(2.8)
Gross fixed capital formation	-8.4	(0.5)	11.4	(-1.2)	2.9	(-1.8)
Of which : Non-financial corporates	*-6.9*	(1.2)	*11.4*	(-0.8)	*2.0*	(-3.2)
Public administrations	*-5.4*	(-1.0)	*2.7*	(-10.3)	*7.8*	(6.2)
Households (excluding individual entrepreneurs)	*-11.9*	(0.3)	*17.0*	(1.2)	*1.2*	(-2.3)
Imports	-13.0	(-0.8)	7.8	(-1.4)	6.5	(-3.9)
Exports	-17.0	(-0.9)	8.6	(0.0)	7.1	(-2.9)
Contribution to GDP growth in volume						
Private domestic demand (excluding stocks)	-5.4	(0.4)	5.3	(0.5)	1.9	(-2.9)
Public demand	-1.1	(-0.2)	1.7	(-0.4)	0.6	(0.9)
Inventories	-0.2	(0.0)	-0.3	(0.0)	0.0	(0.0)
External trade	-1 1	(0.0)	0.1	(0.4)	0.0	(0.4)
Prices and nominal aggregates						
Consumer price inflation index	**0.5**	(0.0)	**1.6**	(0.1)	**5.0**	(3.5)
Core inflation	0.6	(0.0)	1.1	(0.1)	3.9	(2.4)
GDP deflator	2.8	(0.3)	1.3	(0.9)	2.3	(0.9)
Nominal gross domestic product (wda)	-5.3	(0.4)	8.2	(1.5)	4.9	(-0.6)
Productivity, employment and wages						
Market sector excluding agriculture :						
- Effective labor productivity	-7.8	(0.3)	3.8	(-1.1)	0.6	(-3.0)
- Salaried employment (natural persons)*	-1.2	(0.3)	2.8	(0.9)	2.5	(1.4)
- Salaried employment (AA.in thousands)*	-200	(59)	470	(145)	438	(244)
- Salaried employment (y-o-y. in thousands)*	-294	(62)	780	(322)	86	(26)
- Average per capita wage (APCW)	-4.4	(0.5)	6.2	(1.1)	5.8	(1.2)
- Purchasing power of the APCW	-4.8	(0.5)	4.5	(0.9)	0.8	(-2.3)
- Wage bill	-6.0	(0.2)	8.7	(1.5)	8.5	(2.6)
Total employment (AA, in thousands)*	-0.4	(0.2)	2.1	(0.6)	1.6	(0.8)
Total employment (y-o-y, in thousands)*	-176	(87)	823	(331)	114	(13)
Non-financial corporates' accounts						
Markup rate (GOP/AV)	**31.8**	(0.0)	**34.3**	(-0.1)	**31.5**	(-1.7)
Saving rate (savings/AV)	21.9	(0.0)	26.9	(2.0)	23.8	(-0.3)
Investment rate (GFCF/AV)	24.7	(0.1)	25.6	(-0.1)	25.6	(0.1)
Self-financing rate (savings/GFCF)	88.8	(-0.3)	105.3	(8.3)	92.8	(-1.8)
Housholds' accounts						
Gross disposable income (GDI)	1.1	(0.1)	4.0	(-0.2)	5.0	(2.6)
Purchasing power of the GDI (consumption deflator)	**0.2**	(-0.2)	**2.3**	(-0.3)	**0.5**	(-0.5)
Saving rate (savings/GDI)	20.9	(-0.5)	18.7	(-1.3)	16.8	(1.7)
Operations with the Rest of the world						
Trade balance FOB-FOB (Douanes figures, in points of GDP)	-2.8		-3.4		-5.7	
Trade balance FOB-FOB (Douanes, €Bn)	-65		-85		-150	
International context						
Global demand addressed to France	-5.9		11.5		5.2	
Euro-dollar exchange rate	1.14	(-0.00)	1.18	(-0.01)	1.08	(-0.09)
Oil prices (Brent barrel in dollars)	42	(0)	71	(3)	110	(41)

Employment in the sense of employment estimations (Estel)
[1]The data presented below are the latest quarterly accounts published by Insee

Annex 2: Introductory article of the first amending budget bill for 2022

The forecasts of the structural and actual balance for all public administrations for 2021 are as follows:

In points of gross domestic product (GDP)* of the Public finance programming law potential framework	**2021 Result**	**2022 Forecast**
Structural balance (1)	-4.4	-3.6
Cyclical balance (2)	-2.0	-1.3
One-off and temporary measures (3)	-0.1	-0.1
Actual balance (1 + 2 + 3)	-6.4	-5.0

(*) The amounts in this table are rounded to the nearest tenth of point; as a result of applying this principle, the rounded amount of the actual balance may not be equal to the sum of the amounts included in its calculation.

Explanatory statements

This article presents, in accordance with the Article 7 of the Organic Law n° 2012-1403 of December 17, 2012, in its version in force on June 27, 2022, relating to the programming and governance of public finances, the forecast of the structural balance and the actual balance of all public administrations for 2022.

Since the vote at the end of 2021 of the initial budget law for the year 2022 (LFI), many events have affected public finances. Macroeconomic forecasts have been substantially revised: GDP growth is expected to be 2.5% in 2022, compared with 4% in the initial budget law, and inflation has been significantly revised upwards.

In this context and given the consequences of the war in Ukraine and inflationary pressures, the government has adopted extensive measures to limit price increases and support households and businesses, with a direct impact on public finances.

The new forecasts take into account available accounting information, and in particular the results for 2021, of which the Parliament was informed in the context of the Budget Settlement Bill for 2021, showing a 2021 deficit of 6.4% of GDP, a much lower level than expected at the end of 2021 (8.2% recorded in the second Amending budget bill for 2021), in particular because of more dynamic revenues than anticipated.

Incorporating all these factors, both on the upside and the downside, leads to a public balance forecast for 2022 of -5.0% of GDP, stable compared with the initial budget law (LFI). The forecasts are affected by significant upward and downward factors, which offset each other overall. In detail:

- The 2021 results, the revision of the macroeconomic environment, and the consideration of accounting data available to date lead to a significant increase in the tax forecast (**+2.1% of GDP**), excluding new measures. As a result, a higher elasticity of compulsory taxes to activity has been assumed in the forecast of this Amending Budget Bill, at 1.5, compared to 1.0 in the Initial Budget Bill. The dynamism of projected revenues is based mainly on (i) the forecast of the wage bill, which is clearly more dynamic than activity, supporting contributions, social security contributions and income tax (IR), (ii) the forecast of value added tax (VAT), supported by a dynamic taxable employment, notably due to the shock on consumer prices.

(iii) corporate income tax (CIT) revenues, which are expected to be boosted in 2022 by the double effect (instalments and balance) of the very sharp rise in fiscal profit in 2021 (+40%) observed in the now available tax returns, largely explaining the surprise observed at the time of the execution.

- The cost of public debt is significantly revised upwards (**-0.7% of GDP** effect on the balance), due to the effect of inflation on indexed securities and to a lesser extent to the upward revision of interest rates.
- The cost of measures already included in the Initial Finance Law to contain the effects of rising energy prices has been revised upwards due to the magnitude of the shock on the latter (in particular, revision of the cost of the tariff cap on gas and electricity prices, net of the decrease in the usual expenditure on public energy service charges due to the rise in wholesale electricity prices), leading to a deterioration of the public balance by **-0.1% of GDP.**
- Incorporating the resilience plan measures would lead to a deterioration of the public balance by **-0.4% of GDP.**
- The measures for the anticipated +4% revaluation of pensions and benefits in July, as well as the increase in the civil service index point (+3.5%), would lead to a deterioration in the balance of **-0.4% of GDP.**
- The other measures planned in favor of the purchasing power (in particular the suppression of the public audiovisual contribution, the exceptional aid for the new academic year, the targeted fuel aid) would account for **-0.2% of GDP;**
- Ondam expenditures related to the fight against the Covid-19 pandemic have been revised upwards to €10.6 billion (compared with €4.9 billion forecast in the Social security financing bill), leading to a deterioration of the balance by **-0.2% of GDP.**
- The other new information, namely the increase in local spending due to inflation, the significant fines recorded for certain companies, and other spending under the state's control standards (such as the extension of exceptional aid for apprenticeships and the ecological bonus), would lead to moderate effects on the overall forecast.

With respect to other public finance aggregates, the public expenditure ratio, excluding tax credits, is projected at 57.3% of GDP in 2022, and the tax ratio at 44.8% in 2022. The public debt ratio as defined by Maastricht would be 111.9% of GDP, compared with 113.5% of GDP in the draft budget plan revised at the end of October. Indeed, the 2021 debt has been set at a lower level than expected (112.5% of GDP against 115.3% of GDP forecast) but growth has been revised downwards (denominator effect).

The structural balance is revised upwards compared to the initial budget law, while the cyclical balance is revised downwards in similar proportions due to the downward revision of the activity level.

The potential growth used in the draft introductory article attached to this referral is the same as the one used in the 2018-2022 Public Finance Programming Law (LPFP). The one-off and temporary measures removed from the structural balance do not include the extension of the emergency support measures in 2021 and 2022, for the sake of parsimony and considering that these measures were initially intended to remain in force only temporarily.

In accordance with the Article 3 of the Treaty on Stability, Coordination and Governance of Public Finances, exceptional circumstances were activated under the conditions set out in Article 23 of the Organic Law of 2012, as noted in the High Council for Public Finance (HCFP) opinion 2020-1 of March 17, 2020 on the first draft amending finance law for 2020. In its opinion 2021-5 of October 29, 2021 on the revision of the budget and social security financing bills for 2022, the High Council considered « that the exceptional circumstances clause, triggered in the spring of 2020, may still justify deviations from the programmed path in 2022 ».

Methodological clarifications:

The magnitude of the crisis makes certain methodological issues related to the decomposition of the public deficit significant, and clarifications can usefully be made to the figures presented in this article.

The potential GDP corresponds to the path of activity that can be sustained without tensions in the economy. The assumptions relating to the calculation of potential GDP are described in the law of January 22, 2018 on the multi-year programming of public finances. The difference between the actual level of production (actual GDP) and the potential level is called the "output gap". It indicates the position of the economy in the cycle. In 2020 and 2021, due to the crisis, this gap is negative and unusually wide.

Every year, the public balance can be broken down into:

- a cyclical component (reflecting the impact of the position in the cycle on the public balance);
- one-off and temporary measures, which, because they do not affect the deficit in the long term, are excluded from the assessment of the structural balance;
- a structural component.

The public balance is expressed in relation to the actual GDP of the year 2022, i.e., €2,624 billion; it is precisely this ratio that is mentioned in article 126 of the Treaty on the operation of the EU.

The structural balance and the balance of one-off and other temporary measures are expressed in points of potential GDP in 2021, i.e. €2,682bn. Thus, the structural balance in points of potential GDP is the ratio that would be observed once GDP has returned to its potential, and after eliminating the effects of one-off and temporary measures. This property would not be verified if it were expressed in terms of actual GDP. These concepts are derived from European budgetary rules, the Stability and Growth Pact and the Treaty on Stability, Coordination and Governance, which the Organic Law of December 17, 2012 on the programming and governance of public finances applies in the domestic law.

Between the deficit expressed in actual GDP points, the structural balance and one-off and temporary measures expressed in potential GDP points, the last component is a balance: this is the cyclical component presented in the introductory article. Therefore, discrepancies between the actual and the potential GDPs play a role in the cyclical component, which is legitimate because the gap between these two values is cyclical by nature.

Annex 3: Methods for estimating the general government structural balance

Calculating the structural balance

To assess the path of public finances, it is usual to consider the structural balance, which corresponds to **the public balance adjusted from the direct effects of the economic cycle and exceptional events.** Accordingly, the public balance is broken down into two components:

- a cyclical component representing the impact of the economic cycle on the expenditures and revenues of all public administrations ;
- a structural component corresponding to what the public balance would be if the economy were at its potential level.

The identification of the cyclical and structural components of the public deficit is fundamentally based on the estimation of the potential GDP. The latter represents the level of output that the economy can sustain over the long run without putting pressure on the factors of production, namely capital and labor.

Concretely, the identification is done by calculating the cyclical shares of public revenues and expenditures. The latter are evaluated in the following way:

- **On the revenue side,** only compulsory levies are assumed to be cyclical. The cyclical level of income tax, corporate tax, social security contributions and other compulsory levies is calculated separately from the effects of the output gap on these taxes[16].
- **On the expenditure side,** only unemployment compensations are considered to be cyclically dependent[17]. The cyclical share is estimated, as for revenues, from the effects of the output gap on these expenditures.

This 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 adjustment is made to the structural balance to exclude certain events or measures which, because of their exceptional nature, do not have a permanent impact on the public balance. This adjustment was originally introduced to neutralize the effect of the sale of UMTS licenses at the end of the 1990s and the various payments received by the State (IEG, La Poste, France Télécom) which contributed to an exceptional increase in revenues. **However, there is no precise definition of exceptional measures, and their identification is partly a matter of interpretation.** While stressing that the one-off and temporary nature of the measures must be assessed on a case-by-case basis, the government is proposing a set of criteria to better understand this concept in an annex to the programming law.

The composition of the structural adjustment

[16] This effect is evaluated using the average "elasticities" of each tax category with respect to the output gap. The elasticities used are the OECD estimates.
[17] As for the other expenditures, they are either discretionary in nature or no clear and reliable link to the economic situation can be demonstrated.

The change in the structural balance from one year to the next is called the « structural adjustment».

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

- **Structural effort, which measures the share of the structural adjustment attributable to "discretionary" factors, i.e., factors that can be controlled by policymakers:**
  - **the expenditure effort,** which compares the growth rate of public expenditure in volume (deflated with the price of GDP) with the potential growth of the economy. It contributes to a positive structural adjustment when spending increases less rapidly than the potential GDP ;
  - the quantum of **new measures in compulsory levies.**

- **The "non-discretionary" part** of the structural adjustment, which takes into account:
  - effects related to **changes in revenue elasticities:** since 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;
  - **changes in revenues excluding compulsory levies.**

Annex 4: The general escape clause of the Stability and Growth Pact

In March 2020, the Covid-19 epidemic led to the entry into force of the "general escape clause" of the Stability and Growth Pact, at the initiative of the European Commission.

Introduced in 2011 as part of the reform of the Stability and Growth Pact, the general escape clause can be activated in the case of *"an unusual event outside the control of the Member State concerned which has a major impact on the financial position of the general government or in periods of severe economic downturn for the euro area or the Union as a whole"*[18]. In the case of the preventive part of the Stability and Growth Pact, "*Member States may be allowed temporarily to depart from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term*"[19]. Moreover, in the context of the corrective part of the Pact[20], the clause allows the Council of the European Union to recommend a revised path to a member state.

Therefore, since 2020, the Commission has continued to examine the Member States' budgetary situation with respect to the deficit and debt criteria as part of the Stability and Growth Pact surveillance procedures. For instance, in May 2022 the Commission adopted a report on 18 Member States, including France, under Article 126(3) of the Treaty on the operation of the European Union, but has not initiated an excessive deficit procedure.

While the Commission was still anticipating in March 2022 that the general escape clause could be deactivated in 2023, it finally decided to extend it for another year in its communication of May 23rd, 2022, in the framework of the European semester. The clause would thus be deactivated in 2024. The Commission stressed that the context of the war in Europe, the increase in energy prices and the persistent disruption of supply chains had not allowed the European economy to return to normality, as the economic situation remained affected by a high level of uncertainty, significant downside risks and the need for Member States to adopt, if required, budgetary measures to address the economic consequences of the war in Ukraine.

In this context, the Commission also indicated that it would formulate after the summer of 2022 its guidelines on possible amendments to the rules of the European economic governance.

[18] Article 5 of the Council Regulation n°1466/97 of 7 July 1997.
[19] Articles 5(1) and 9(1) of the Council Regulation n°1466/97 of 7 July 1997.
[20] Articles 3 and 5 of the regulation (EC) n°1467/97 of July 7, 1997.