Haut Conseil des Finances Publiques

Opinion n° HCFP-2018-3

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

19 September 2018

On 12 September 2018, the High Council of Public Finance (HCFP) delivered an opinion concerning the budget bill and social security financing bill after deliberating on the realism of macroeconomic forecasts and the consistency of annual structural fiscal balance forecasts vis-à-vis the multi-year structural balance targets.

Main conclusions

The High Council of Public Finance considers that a growth of 1.6% - 1.7% for 2018 is likely and that the Government's forecast – 1.7% - is therefore credible. Moreover, the growth forecast of 1.7% for 2019 is deemed plausible. However, the international context in which it takes place bears high uncertainties.

The High Council considers that the forecasts of employment and private wage bill for 2018 are consistent with the information available as of today and that the forecasts for 2019 are plausible. It is of the opinion that the inflation forecasts for 2018 and 2019 are reasonable.

For 2018 and 2019, the High Council notes that the forecasts of compulsory levies are realistic given the selected macroeconomic scenario. It observes that the forecast of the evolution of public expenditure, which implies restraint measures from public administrations, is achievable.

Overall, the High Council considers that the forecast of nominal public deficit for 2018 and 2019 (respectively 2.6 and 2.8 points of GDP) is plausible.

The High Council notes that there is no major gap between forecasts of structural budget balance associated to the budget bill for 2019 and the path planned by the public finance programming law for 2018 to 2022.

It underlines however that the structural adjustments planned for 2018 (0.1% of GDP) and 2019 (0.3% of GDP), which will be submitted to the European Commission, are not compliant with the rules of the "preventive arm" of the Stability and Growth Pact. In its opinion regarding the public finance programming law of January 2018, the High Council had already pointed out that the planned path of public finances was moving away from France's European commitments.

Furthermore, the High Council notes that the structural adjustment presented for 2019 benefits from the fact that the raise of the fifth down payment of the corporate tax, limited to 2019 fiscal year, was not taken into account as a one-off measure. This questionable choice improves the structural adjustment presented by the Government by nearly 0.1 point of GDP in 2019.

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The nominal deficit is likely to remain close to 3.3% of GDP by 2019. Once the impact of the transformation of Competitiveness and Employment Tax Credit into cuts in social contributions is taken out, the deficit would fell sharply between 2017 and 2019. Nonetheless, more than half of its reduction is of cyclical nature because of an anticipated growth superior to the potential growth at this time.

The French structural deficit remains at a high level. It would only decline slowly regarding European rules and France would not yet have begun the reduction path of its GDP to debt ratio, as opposed to almost all of the European countries.

The High Council underlines that this ongoing situation is likely to leave little or fiscal policy stimulus in case of recession

Introductory remarks

1- On the opinion's scope

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

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

2- On the information submitted

The Government referred to the High Council on 12 September 2018 its macroeconomic forecasts and information about public finances, on which are based the budget and social security financing bills of 2019. To this file were added detailed answers to questions addressed in advance by the High Council to the relevant administrations.

3- On the methodology used by the High Council

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

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

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

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

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After a brief presentation of the global and European economic situation (I) the High Council exposes its remarks on the macroeconomic forecasts attached to the budget and social security financing bills for 2019 (II) and on the public finance scenario (III).

I- A global and European economic environment less favorable than in 2017

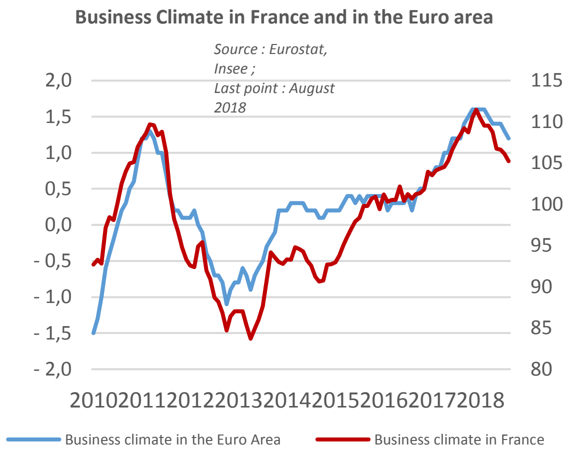
1- A slowdown in the first semester of 2018

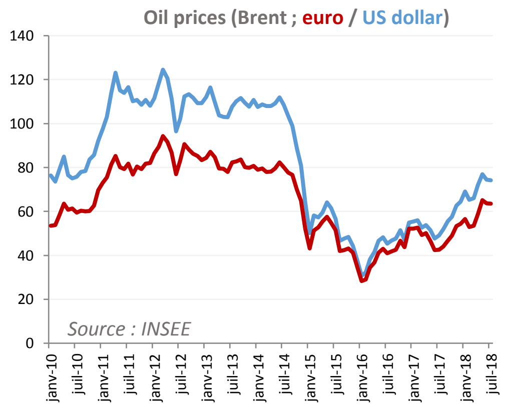
Global growth has slowed down over the last period. Its geographical dynamic has slightly changed: while it strengthened in the US, it slightly faltered in Europe and in Japan, even more so in some developing countries.

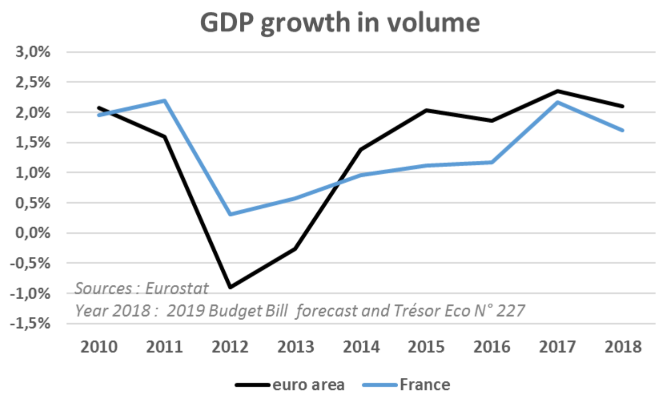
European growth moved from a quarterly basis of 0.7% in 2017 to 0.4% on the first semester of 2018. This downturn reflects a less buoyant international environment since summer 2017, with the increase of gas prices, the appreciation of the euro and the rise of economic and political uncertainties.

Business climate drawn from European cyclical surveys took a step back in the first semester of 2018 after reaching high levels in December and January. However, in summer 2018, it remains higher than its long-term average. European growth is encouraged by a still accommodative monetary policy, as well as slightly expansionary budgetary policies.

The slowdown was more pronounced in France than the average of the euro zone, with a subdued GDP growth settled at 0.2% over the two first quarters of 2018. The gap is primarily due to households expenditure, especially consumption that has stagnated in France over the first semester (+0.1%) while the annual pace of consumption growth in the euro area remained close to 1.5%. It could be explained, in particular, by the impact of fiscal measures implementation weighing on households purchasing power (rise in CSG not fully offset by the cuts on employee contributions over the period, rising taxes on tobacco and oil products). Several temporary factors including transport strikes have also contributed to this consumption downturn.







2- Global prospects: moderate growth, intensified downside risks

a) Slowing growth

Most of the available forecasts describe a global growth still underpinned by the dynamism of the American economy whereas growth in the euro area is set to stabilize following the slowdown seen in the first half of 2018.

Among other things, these forecasts assume the pursuit in 2019 of the long American economic expansion cycle notably through a still very expansionary budgetary policy and a gradual monetary tightening. In the second half of 2018, growth in the euro area is set to stabilize to an annual pace close to 2%, which is consistent with information drawn from business surveys.

This context reflects a high capacity utilization rate. Core inflation would continue to rise slowly in developed countries.

b) Growing risks

Prospects for 2019 are marked by heightened uncertainties leading to substantial economic risks: rising trade tensions, the outcome of negotiations on Brexit, Italy's situation, financial imbalances in China, the vulnerable situation of several emerging countries (Turkey, Argentina, South Africa, Brazil…).

Furthermore, against the background of a gradual tightening of monetary policies, the high public and private debt level involves additional risk. Those risks could be intensified if the very expansionary American budgetary policy induced a higher-than-expected rise in inflation triggering thereby a faster monetary policy tightening than the one currently anticipated by the economic actors.

II- Remarks on macroeconomic forecasts for 2018 and 2019

1- The Government's scenario

According to the Government's referral file*, "the ongoing upturn since the autumn of 2016 is set to continue in 2018 and 2019 but would ease mildly compared to 2017, reflecting a less buoyant international environment. (...). After having reached 2.3 % in 2017, growth is set to ease at 1.7 % in 2018 and would remain stable at the same level in 2019. After having picked up at 1.0 % in 2017, the inflation is set to reach 1.8% in 2018 and would finally weaken at 1.4 % in 2019"*

The Government's scenario is embedded in a context of a gradual slowdown of world trade (5.2 % in 2018 and 4.6 % in 2019 after 5.5 % in 2017).

In France, with the subdued growth seen in the first half of the year, it assumes an upturn as of the third quarter of 2018. It relies most notably on a consumption recovery boosted by purchasing power gains arising from compulsory levies easing (second step of the transformation of social security contributions into general social contribution which has a broader assessment basis), reduction of housing tax and lower inflation.

For the year 2019, the scenario assumes a quarterly growth of roughly 0.4 % extending the expected upturn in the second semester of 2018. On the one hand, the economy is projected to be still bolstered by international trade growth; on the other hand, stronger household's consumption and growing business investment are set to support the domestic economy. Household's purchasing power would benefit from compulsory levies easing (full impact of contributions cuts, housing tax) and the anticipated reduction of inflation. The saving rate is likely to stabilize after having increased in 2018.

2- The High Council's Assessment

a) Activity growth

After a higher-than-expected growth in 2017 (2.3% against 1.7% in the 2018 budget bill and 1.8% in the Stability Program), the Government anticipates a real GDP growth of 1.7% in 2018 as in 2019 (see annex 4)[1]. These growth forecasts are identical to those retained a year ago in the programming bill 2018-2022. These are however inferior to those of the stability program of last April (respectively 2.0% for 2018 and 1.9% for 2019).

Given the carry over in growth at the 2nd quarter, estimated at 1.3% as of today, the achievement of an annual average of 1.7% growth in 2018 would require a substantial acceleration of economic activity in the second half of this year, to a pace of at least 0.5% for each semester.

In the light of available information on the early summer (industrial production of July, economic environment surveys until August), an upturn of growth rate in the 3rd quarter can be anticipated, though its scale cannot be precisely predicted yet.

The Government's growth forecast for 2018 is in line with those of the international organizations and forecasting institutes, which predict 1.6% - 1.7% for the most part.

The High Council of Public Finance considers that a growth of 1.6% - 1.7% for 2018 is likely and that the Government's forecast – 1.7% - is therefore credible.

For the year 2019, the High Council considers that the assumptions retained by the government on household demand (rise in consumption at the same pace as purchasing power, stabilization of investment in housing) and business demand (still dynamic investment but decelerating) are plausible.

The Government's growth forecast for 2019 is, as for 2018, in line with the average available forecasts. Most of them present an increase in activity for 2019 close to 2018's.

GDP Growth forecasts for 2018-2019

	France		**Euro area**	
	2018	**2019**	**2018**	**2019**
European commission (July 2018)	1,7	1,7	2,1	2,0
IMF (July 2018)	1,8	1,7	2,2	1,9
OECD (September 2018)	1,6	1,8	2,0	1,9
Bank of France / ECB (September 2018)	1,6	1,6	2,0	1,8
OFCE (September 2018)	1,7	1,8	-	-
Rexecode (September 2018)	1,6	1,3	2,0	1,6
Consensus (September 2018)	1,7	1,7	2,1	1,8
Government (2019 Budget Bill; September 2018)	**1,7**	**1,7**	**2,1**	**2,1**

Source : HCFP from different institutions forecasts

The High Council observes however that this forecast is affected with a level of uncertainty higher than in previous years'. As mentioned above, it is essentially the international environment

[1] Overall, given a higher than expected growth in 2017, GDP level in 2017 and for the years following is about 0.5 point higher than projected a year ago, triggering therefore a stronger narrowing of the output gap and a more favorable cyclical component of the output gap. Thus, the output gap in 2018, which was forecast at -0.7% of GDP a year ago is now estimated at -0.2% by the Government. It is set to be +0.2% in 2019 (against -0.2% in the programming law).

that carries those risks (rising trade tensions, the outcome of negotiations on Brexit, Italy's situation, financial imbalances in China, the vulnerability of several emerging countries…)

The High Council considers the Government's growth forecast for 2019 to be plausible. It points out, however, that the international context in which it takes place bears particularly high uncertainties.

b) Employment and private wage bill

According to the Government's forecast, the wage bill of the non-farm market sector would rise by 3.5% in value in 2018 and 2019, after 3.5% in 2017. Employment growth would progressively falter from 2017 to 2019.

The weaker growth of the number of employees is the consequence of the gradual impact of the economic activity's deceleration in 2018 and the lessened support of employment policies compared to the previous years (end of the rise in Competitiveness and Employment Tax Credit and Responsibility Pact, end of recruitment subsidies).

Market sector wage bill (evolution in %)

	2017	**2018**	**2019**
Market employee payroll	1.8	1.5	1.0
Average wage	1.7	2.0	2.5
Wage bill	**3.5**	**3.5**	**.5**

Source : Government's forecast

Employment in the non-market services would substantially ease under the effect of the reductions of Stated-aided contracts from the 2nd semester of 2017.

The wage bill forecast for 2018 is revised down compared to the Stability Program (3.9% at the time) since data from the first semester are taken into account. The last known evolution, on a year-on-year basis at the 2nd quarter of 2018, is a 3.6% increase of the wage bill including 1.5% for the payroll and 2.1% for the average salary.

The High Council considers that the employment and private wage bill forecasts for 2018 are consistent with the information available as of today and that the forecasts for 2019 are plausible.

c) The rise in consumption prices index

The consumer prices index is likely to increase by 1.8% in 2018 on annual average according to the Government (1.6 % without tobacco). The rise would be higher than the 2018 budget bill forecast (1.1%) a year ago. The gap is essentially buoyed by energy's prices (an overall upward contribution of 0.7 point against 0.1 point planned in the 2018 budget bill). This rise in inflation was not anticipated and has limited households' purchasing power progression.

Core inflation (excluding volatile prices) is gradually recovering. It is projected to settle at 0.9% in 2018 (after 0.4% in 2017) mostly supported by the rebound of services prices relative to wages.

This forecast is consistent with the index seen until august (a core inflation settled at 0.9% year-on-year) and the assumption of an oil price stabilization at 73$/63€ per barrel of Brent.

For 2019, under this oil price assumption, the forecast is 1.4% on annual average (1.3% excluding tobacco). The lower contribution of energy's prices (0.3 point) and administered prices

(0.2 point against 0.4 point) are likely to account for the inflation downturn whereas core inflation is projected to rebound (1.1%) without fully reflecting wages acceleration.

These forecasts for 2018 and 2019 are slightly below the "Consensus Forecasts" averages in September (1.9 % and 1.6 % respectively).

The High Council considers that the inflation forecasts made for 2018 and 2019 are reasonable.

III- Remarks on public finances forecasts for 2018 and 2019

Insee's revisions of public administrations accounts, the significant amount of refund of 3% dividends taxes and the transformation of Competitiveness and Employment Tax Credit into social contributions reductions make the analysis of public finances complicated for the recent years and in anticipation (1).

The High Council analyzed the consistency of the budget bill with the multi-year structural balance targets (2). Then it weighed the risks on public revenues and expenditure (3).

1- Revisions of accounts and large one-off operations make difficult the analysis of the public finances path on the current period

The budget bill and the social security financing bill forecast a public administrations' (APU) deficit of 2.6 points of GDP in 2018 and 2.8 points in 2019, after 2.7 points in 2017. It includes Insee's revision of public administrations accounts for 2016 and 2017 and the refund of the 3% dividends tax, as well as the transformation of Competitiveness and Employment Tax Credits (CICE) into charges reduction.

a) Insee's revisions of public administrations accounts in September 2018

Insee published on 6 September 2018 revised estimates of public administrations accounts for 2016 and 2017. This revision takes into account methodological modifications concerning SNCF Réseau reclassification within public administrations and the accounting treatment of the Government's recapitalization of Orano (ex Areva) as well as an update of "data sources" relative to March notification in 2018.

General Government balance revision between March and September 2018 of Insee reporting

In billion €	2015	2016	2017
Balance notified in March 2018	-79.7	-75.9	-59.5
Sources data revisions			+2.8
Impact of SNCF Réseau reclassification		-3.2	-2.2
Impact of the new treatment of Orano's recapitalization			-2.5
Balance notified in September 2018	**-79.7**	**-79.1**	**-61.4**
Balance notified in September 2018 (points of GDP)	**-3.6**	**-3.5**	**-2.7**

Source: Insee

Overall, the nominal public deficit and the structural deficit are depressed by 3.2 billion (i.e. 0.2 point of GDP) in 2016 and by 1.9 billion (i.e. 0.1 point of GDP) in 2017. The impact of SNCF Réseau reclassification being essentially offset by the improvements relative to the social security administrations and the special account allocated to *Energy transition* CAS, the deficits in both 2017 and 2018 are marginally affected.

b) The impact of 3% dividends tax invalidation and the transformation of Competitiveness and Employment Tax Credits into charges reduction

The last three years are marked by two substantial one-off measures: on the one hand, the refund of the 3% tax on dividends in 2017 and 2018 following its invalidation by the Constitutional Council and its offset in 2017 by an exceptional surtax on corporate tax; on the other hand, the transformation of the CICE into contributions reduction in January 2019.

The refund of dividends tax (9.3 billion in expenditure) is distributed between 2017 and 2018. An exceptional surtax on corporate tax which return is estimated at 5.1billion has offset this refund in 2017. The remaining part weighs on the 2018 deficit to the tune of 4.2 billion namely 0.2 point of GDP. The transformation of CICE into contributions reduction has a net cost slightly higher than 20 billion in 2019, namely 0,9 point of GDP (after taking into account additional revenues from corporate tax relative to contributions cuts).

If those two operations that will not have a long-term effect on public accounts are neutralized, the Government's scenario reflects a public deficit reduction of around 0.3 point in 2018 and around 0.5 point in 2019.

Other one-off measures complete those two high magnitude measures (see infra).

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

Under the organic law of December 17, 2012 the High Council gives an opinion on the consistency of the structural balance path presented in the 2019 budget bill with the latest programming law targets i.e. the one of January 2018 for the years 2018 to 2022.

In particular, the High Council has to identify potential substantial deviations between the structural deficit target defined on the programming law and the current structural deficit. Such a deviation is deemed significant once it exceeds 0.5 point of GDP a year or 0.25 on average over two years.

a) A structural deficit close to the programming law path

The structural budget balance[2] is calculated with the same potential GDP assumptions as in the programming law. In its September 2017 opinion on this programming law, the High Council deemed that the Government's potential growth estimate (1.25% in 2018 and 2019) "*was a reasonable basis to implement the mid-term public finances planning"*.

The level of structural balance related to the 2019 budget bill slightly differs (0.1 point of GDP) from the path defined in the programming law for 2018 and 2019.

The High Council notes that the Government has not recorded as a one-off the 2019 increase of the corporate tax fifth deposit, the effect of which will be temporary. This measure, which return is estimated at 1.5 billion is, therefore, considered as a contribution to the structural balance improvement. The High Council is of the view that it would be logical to classify its impact, limited to the 2019 fiscal year, as a one-off. As a result, the structural deficit would be revised upward it would be settled at 2.1 points of GDP in 2019 rather than 2.0 as presented by the Government.

[2] Cyclically adjusted balance net of one-off and other temporary measures.

Decomposition of the general government public balance

In points of GDP	2018 Budget bill (Sept. 2018)			Programming law (January 2018)		
	2017	2018	2019	2017	2018	2019
Nominal balance	**-2.7**	**-2.6**	**-2.8**	**-2.9**	**-2.8**	**-2.9**
Cyclical component	-0.3	-0.1	0.1	-0,6	-0.4	-0.1
One-off measures	-0.1	-0.2	-0.9	-0,1	-0.2	-0.9
Structural balance	**-2.3**	**-2.2**	**-2.0**	**-2.2**	**-2.1**	**-1.9**

Note: Figures being rounded to the nearest tenth, components may not add to the total

Source: 2019 budget bill, January 2018 programming law

Despite the upward revision, the gap between the structural deficit presented within the framework of the budget bill and the structural deficit path set by the public finance programming law would not be relevant under the constitutional bylaw of 17 December 2012.

b) **The structural adjustment and the structural effort in 2018 and 2019**

The structural adjustment and the structural effort in 2018 and 2019 as presented by the government

In points of potential GDP	2018 Budget bill (sept. 2018)			Programming law (January 2018)		
	2017	2018	2019	2017	2018	2019
Structural adjustment	0.3	0.1	0.3	0.2	0.1	0.3
Structural effort	-0.2	0.0	0.3	0.0	0.1	0.3
Of which expenditure restraint (excluding tax credits)	-0.1	0.2	0.4*	0.1	0.4	0.4
Of which tax credit key	-0.1	-0.2	-0.2*	-0.1	-0.3	-0.1
Non-discretionary component	0.4	0.1	0.0	0.2	-0.1	0.0
Key on credit tax**	0.1	0.0	0.1	0.1	0.0	0.0

Source: 2019 budget bill, January 2018 programming law.

Note: Figures being rounded to the nearest tenth, components may not add to the total.

** Those data neutralize the impact of the creation of France Compétences (annex 6) resulting from the fact that public administrations now provide missions previously borne by other actors. On a constant field, expenditure restraint would be 0.2 point of GDP while other receipts measures are set to be equal to 0.0 point of GDP.*

*** In national accounts, credit taxes are recorded according to demands deposited and do not depend on refunds from the budgetary balance. The gap between tax credit deposited and tax credit refunded is called "credit tax key". It has an impact on the structural adjustment measure.*

The structural adjustment (i.e. the variation of the structural balance) is set to be limited in 2018 and 2019 (respectively 0.1 point and 0.3 point). In 2017, while the structural effort was negative, the dynamic of compulsory levies being significantly higher than GDP growth accounted, in full, for the structural balance improvement. In 2018, the structural adjustment is likely to benefit again from an elasticity effect but its magnitude is much lower than in 2017. In 2019, it is set to strictly rely on the structural effort.

The structural adjustment in 2018 and 2019 is practically similar to the one determined in the public finance programming law of January 2018.

The structural effort (0.0 point of GDP in 2018 then 0.3 point in 2019) is the part of the structural adjustment directly due to an expenditure restraint or new tax measures. The effort on expenditure being offset by the impact of fiscal easing, the structural effort is projected to be equal to zero in 2018. In 2019, it is forecast to settle at 0.3 point. The effort on expenditure (0.4 point of GDP in a constant field) is set to outweigh the compulsory levies cuts (0.2 points of GDP excluding one-offs, and -0.1 point in national accounting after taking into account "key in tax credit"[3] (see table)).

If the limited-to-2019 increase of the corporate tax 5th deposit was recorded as a one-off, the structural effort as well as the structural adjustment would fall by roughly 0.1 point of GDP compared with the Government's presentation.

The High Council notes that there is no major deviation between forecasts of structural budget balance related to the budget bill for 2019 and the path planned by the public finance programming law for 2018 to 2022.

It underlines, however, that the structural adjustments planned for 2018 (0.1% of GDP) and 2019 (0.3% of GDP), which will be submitted to the European Commission, are not compliant with the rules of the "preventive arm" of the Stability and Growth Pact. In its opinion regarding the public finance programming law of January 2018, the High Council had already pointed out that the planned path of public finances was moving away from France's European commitments.

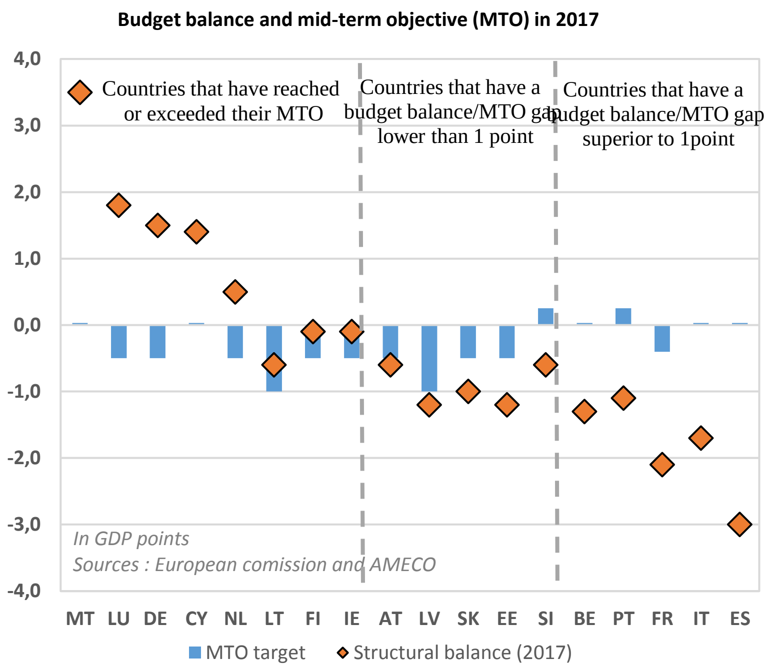
Furthermore, the High Council notes that the structural adjustment presented for 2019 benefits from the fact that the raise of the fifth down payment of the corporate tax, limited to 2019 fiscal year, is not taken into account as a one-off measure. This questionable choice improves the structural adjustment presented by the Government by nearly 0.1 point of GDP in 2019.

[3] Once neutralized France Compétences and the effect of the refund of the 3% dividends tax which net contribution on the structural effort is equal to zero, expenditure restraint is 0.4 point in 2019 reflecting a rise in public spending of 0,6% (1,9% in value for an increase of 1,3% in GDP price) inferior to the potential GDP growth (1,25%). The 0.65 point gap (=0.25-0.6) is then multiplied by the expenditure weight in percentage of GDP (55%) corresponding to 0.65 x 0.55 =0.36 point of GDP. Overall, the structural effort on expenditure is roughly 0.4 point of GDP, France Competences excluded. Furthermore, the compulsory levies contribution is set to be -0.2 point of GDP corresponding to the net effect of measures marking the year 2019 (excluding the transformation of Competitiveness and Employment Tax Credits -contribution in those one-offs). In 2019, as well as in 2018, measures that reduce levies would outweigh increasing measures with a net effect on the balance estimated at -4.1 billion (0.2 point of GDP) excluding CICE-contributions transformation (see detail infra in the third part).

The level of the budget balance and the evolution of the debt-to-GDP ratio in France compared to other euro zone countries

Bringing its deficit below 3 points of GDP, France removed from the excessive deficit procedure in June 2018 moving, thus, into the preventive arm of the Stability and Growth Pact. France is one of the countries that are the furthest away from their medium-term objective(MTO)(-0.4 points of GDP) with a structural balance estimated by the Commission at 2.1 points of GDP in the spring of 2018. According to the European Commission's forecast in Spring 2018, 8 countries have a structural balance that has reached or exceeded their MTO in 2017, 5 countries have a structural balance less than 1 point below their MTO and the 5 countries which have the largest structural balance have a negative deviation of more than 1 point from their MTO (see chart)[4].

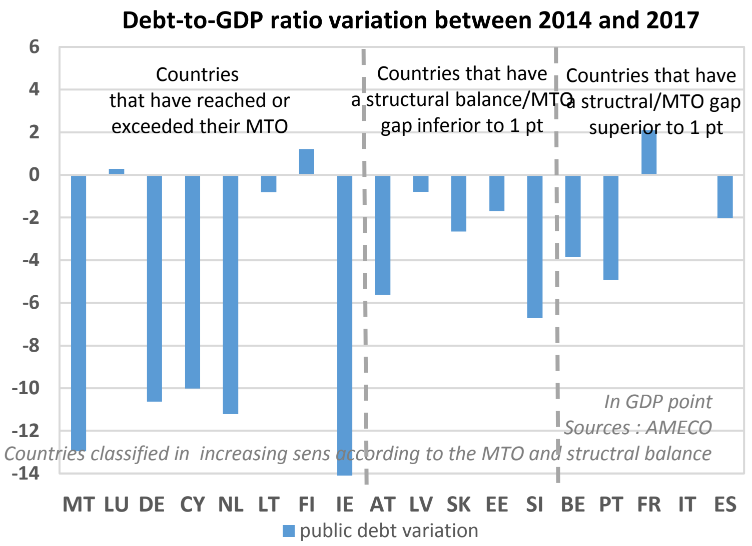
In the "preventive arm", member countries have to ensure their convergence toward their MTO, defined in structural terms. MTOs are set to provide convergence toward a debt ratio of 60 points of GDP.



Note : MT = Malte ; LU = Luxembourg ; DE = Germany ; CY = Cyprus ; NL = Netherlands ; LT = Lithuania ; FI = Finlande ; IE = Irlande ; AT = Austria ; LV = Latvia ; SK = Slovakia ; EE = Estonia ; Sl = Slovenia ; BE = Belgium ; PT = Portugal ; FR = France ; IT = Italy; ES = Spain

Countries that have not reached their MTO have to make sure they are heading towards it at a sufficiently rapid pace whilst taking into account the position in the economic cycle, public debt as well as sustainability risks in medium term. In the absence of particular factors, a structural adjustment of at least 0.5 point of GDP per year is required until the MTO's achievement.

[4] Greece is not taken into account in this analysis



5 over the 8 countries that have met or exceeded their MTO have seen their debt-to-GDP ratio decline by over 10 points between 2014 and 2017. A reduction also holds for countries that have a deviation of less than 1 point from their MTO, although at a lesser extent (3.5 points of GDP in average over the period 2014-2017). Countries with a deviation of more than 1 point from their MTO in 2017 have also reduced this ratio by 1.7 points over the period. Bucking this trend, France increases its public debt by roughly 2.2 points of GDP over the period (3.6 points when SNCF Réseau is included).

3- Risks on revenue and expenditure

a) The Government's scenario

According to the Government's referral file, *" the compulsory levies rate is projected to decline, from 45.3% in 2017 to 45.0 % in 2018 then 44% in 2019 on a constant field*[5] *(44,2% when compulsory levies related to France Compétences are taken into account) as a result of the 10 billion cut on compulsory levies in 2018 then 20 billion in 2019 , as well as the dual effect on public finances of the transformation of Competitiveness and Employment Tax Credits into contributions reductions this year.*

Public expenditure control accounts for tax reductions. In 2018, despite the rise in inflation (price index excluding tobacco) at 1.6% (after 1% in 2017)[6]*, public expenditure growth excluding tax credits is set to remain moderate (progression of 1.6 % in value). As a result, expenditure in volume is projected to stabilize, that is a sharp downturn with respect to 2017 (1.4 % in volume).*

In 2019, public expenditure excluding tax credit is set to increase by 0.3 % in volume on a constant field and by 0.6 % in volume[7] *if the impact of the anticipated reclassification of France Competence, a new public institution created by the free-to-choose its professional future law, is taken into account. This progression is set to remain moderate thanks to Government's measures*

[5] Even if Insee has not ruled yet on the treatment of this operation in national accounting, the Government forecasts that expenditure and receipts relative to professional formation from France Compétences will be recorded in the public administrations field, which would have a symmetric impact of 4.8 billon on both public expenditure and revenues.
[6] The Government uses price index excluding tobacco (1.6 % in 2018) to assess the evolution of public spending in volume and not GDP price (0.9 %in 2018), used to calculate the structural effort.
[7] Using price index excluding tobacco (1.2%) and not GDP price (1.3%)

such as the contained increase of some social and welfare benefits that will be upgraded by 0.3 % as well as the return impact of the 3% dividend refunds.

b) The High Council's assessment

Based on the information it had access to, the High Council considered the risks on receipts and expenditure forecasts for 2018 and 2019.

i) Receipts

In 2018, receipts forecasts attached to 2018 budget bill have been revised in order to take into account the available information on the ongoing execution. The amount of new measures is -9.9 billion (2019 budget bill and social security financing bill's measures or previous measures affecting the year 2018).

Compulsory levies spontaneous growth is likely to be slightly faster than GDP growth in value : the ratio between those trends - the elasticity of compulsory levies to GDP – would settle at 1.1 in 2018 according to the Government. This higher-than-one elasticity would be essentially due to a wage bill growth stronger than GDP growth, a great part of social contribution being based on wage bill. Furthermore, corporate tax and income tax are set to remain more dynamic than the activity.

Government's receipts forecasts are in line with the available information. In particular, the State's fiscal net revenue forecast is consistent with the fiscal receipts collection in September.

For 2019, excluding new measures, the Government forecasts a spontaneous receipts growth close to the activity's (corresponding to a compulsory levies elasticity equal to one). This assumption seems reasonable given the position in the economic cycle.

Within the framework of the 2019 budget bill, new measures account for -19.4 billion (-4.1 billon excluding the transformation of the Competitiveness and Employment Tax Credits into contributions cuts). Those measures correspond, most notably, to the full year effect of the transformation of contributions into CSG (-4.2 billion) and the pursuit of housing tax reductions as well as corporate tax (-2.4 billion), already initiated in 2018. Conversely, compulsory levies are heightened with the rise in energy taxation (3 billion), the pursuit of the rise in tobacco taxation (1.3 billion), the temporary growth of the corporate tax 5th account (1.5 billion) in 2019, the increase in Arrco-Agirc contributions (1.9 billion).

Overall, for 2018 and 2019, the High Council is of the view that the compulsory levies forecasts are realistic regarding the macroeconomic scenario.

ii) Expenditure

In 2018, the overall rise in expenditure excluding credit tax stated in the 2019 budget bill is 1.6% in value and 0.0% in volume if the consumer prices index is set as deflator, as the Government usually does. Corrected by GDP price, expenditure growth is 0.7% in volume. This presentation corresponds to the one selected for the structural effort measuring

In 2019, public administrations expenditure (excluding tax credit) growth target is 1.5% in value and 0.2 to 0.3% in volume (excluding *France Compétences*), deflated by consumption or GDP prices – those two index prices evolutions being very close in forecast. However, it is worth pointing out that the 2018 basis is marked by an exceptional expenditure corresponding to the refund of the 3% dividends tax (for an amount estimated at 4.2 billion in 2018). This expenditure neutralized, public spending growth in 2019 is set to strengthen by 0.4% and would reach 1.9% in value, France Compétences excluded (namely 0.6% in volume).

The evolution of public spending (excluding tax credits) in value and in volume

In %	2018	2019		
		France Competences included	France Compétences excluded	France Compétences and the 3% dividend tax excluded
In value	1.6 %	1.9 %	1.5 %	1.9 %
In volume (IPC)	0.0 %	0.7 %	0.3 %	0.7 %
In volume (GDP price)	0.7 %	0.6 %	0.2 %	0.6 %

Source: HCFP from Government's data

For 2019, State expenditure objective includes a 2 billion rise in ministries credits as well as a 1.6 billion increase in receipts levy for the benefit of the European Union with respect to the initial 2018 budget bill. Among other things, this State credits expansion includes a 1.5% raise in staff expenditure (i.e. 1.4 billion).

A significant proportion of the savings anticipated in 2019 on State budget are enrolled in the pursuit of the savings initiated since the initial 2018 budget bill, and concern most notably housing benefits, recruitment subsidies in SME's and State-aided contract. Those arrangements would partially offset credits increases on other State projects.

The High Council points out that efforts aiming at more realistic budgeting on State spending have been made since the 2018 budget bill, especially on external operations and internal missions (whose credits are growing by slightly more than 250 million relative to the initial 2018 budget bill under the military programming law). However, tensions risks on the execution of the year 2019 remain. Within the framework of a maintained reserve rate at 3% in the 2019 budget bill, excluding staff spending, those risks require a rigorous execution of the overall State controllable expenses.

Conversely, as seen in recent years, interest charge[8] and receipts levy in favor of the European Union are likely to be lower than the forecast.

Social security administrations' spending are likely to falter slightly in 2019 relative to 2018 (1.8% after 2.0% in value in national account).

The ONDAM (National Healthcare Expenditure Target) is set to increase by 2.5% in 2019 after 2.3% in 2018 (and 2.1% in 2017). In 2019, the trending pace of expenditure in the scope of ONDAM is likely to remain as dynamic as in 2018, around 4.5%: the effect of the recent agreement with health professionals, the ongoing implementation of the career path protocol, careers and remunerations (PPCR) in public health institutions as well as the arrival of several innovative drugs. Achieving this target implies a quantum of economies of the same magnitude as last years' (3.8 billion against 4.2 billion in 2018, 4.05 billion in 2017 and 3.4 billion in 2016).

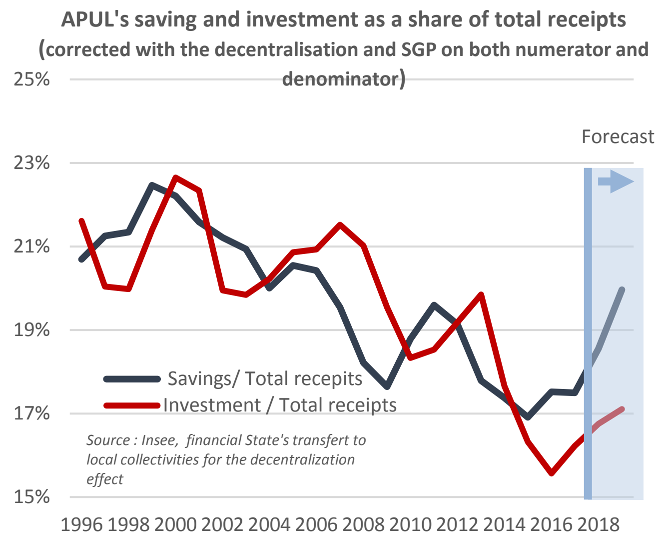
Expenditure concerning pensions or some social and welfare benefits[9] (excluding benefits for the lowest income) are projected to be moderate by a revalorization level lower than the inflation's.

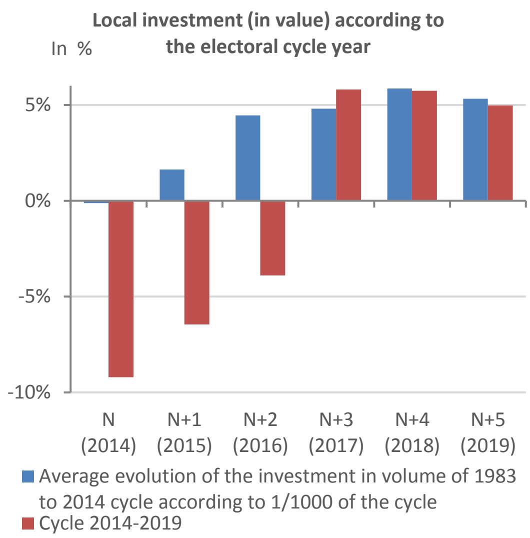
Local public administrations spending (APUL), essentially composed of local collectivities, are set to increase by 2.3% in 2018 and 2019 (after 2.5% in 2017). As a result, APUL financing capacity

[8] The Government assumes 1.6 point rise in interest rates (State's bond at 10 years) between the end of 2017 and the end of 2019 to reach 2,2% at this horizon, a level sharply superior to "Consensus forecasts" estimate for the end of September 2019 (1.2%).

[9] Indexed on family allowances monthly basis.

would continue to grow. The Government assumes to comply with the local spending path target, which operation is partly declined in a contractual framework. The information currently available reveals a moderate growth in 2018 with a pace close to the one expected by the Government[10]. Given the room for manoeuver delivered[11], uncertainty remains concerning the local investment strength in 2018 and 2019 (respectively 5.8% and 4.9% expected by the Government[12]) at this stage of the electoral cycle.





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In 2018 as well as in 2019, the High Council is of the view that the forecast of public spending evolution, that involves control efforts from all public administrations, is achievable.

Given the macroeconomic scenario selected and the tax reductions decided for 2019, the High Council deems plausible the public deficit forecast for the year 2019, subject however to the strict respect of the expenditure planned path.

The nominal deficit is likely to remain close to 3 % of GDP by 2019. Once the impact of the transformation of Competitiveness and Employment Tax Credit into social contributions reductions is taken out, the deficit would fell sharply between 2017 and 2019. Nonetheless, more than half of its reduction would be of cyclical nature because of an anticipated growth superior to the potential growth at this time.

The French structural deficit remains at a high level. It would only decline slowly regarding European rules and France would not yet have begun the reduction of its debt to GDP ratio by 2019, as opposed to almost all European countries.

The High Council underlines that this ongoing situation is likely to leave little room for fiscal policy manoeuver in the event of a sharp economic slowdown.

10 Regarding execution data from the public finances general direction DGFIP, operating spending would have increased by roughly 0.9% over the first semester of 2018 relative to the first semester of 2017 while investment spending was accelerating (+7 %).
11 Local public administrations spending (APUL) is set to be 7.4% excluding "Société du Grand Paris" (SGP) and 6.3% when SGP is included.
12 The Banque Postale forecasts an increase of 7.1% of local collectivities investment in 2018 (note of September 2018)

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This opinion has been published in the Official Journal of the French Republic and attached to the budget bill for 2019.

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

Economic forecasts for France			
	2017	2018	2019
Goods and services, real terms	%, annual average		
Gross domestic product	**2,3**	**1,7**	**1,7**
Final consumption of households	1,0	1,1	1,7
Final public consumption	1,3	1,0	0,8
Grossed fixed capital formation	4,5	3,3	2,1
Of which : Non-financial corporates	*4,1*	*3,7*	*2,7*
Public administrations	*1,4*	*4,6*	*3,1*
Households(excluding individual entrepreneurs)	*5,6*	*1,5*	*0,2*
Imports	4,0	2,5	3,1
Exports	4,5	3,7	3,6
Contributions to real GDP growth	In points of GDP		
Private domestic demand (excluding inventories)	1,5	1,2	1,3
Public demand	0,4	0,4	0,3
Inventories	0,2	-0,2	0,0
External Trade	0,1	0,3	0,1
Prices and nominal aggregates	%, annual average		
Consumer prices inflation index	**1,0**	**1,8**	**1,4**
Core inflation	0,4	0,9	1,1
Gross domestic product deflator	0,7	0,9	1,3
Nominal gross domestic product	2,8	2,5	3,0
Productivity, employment and wages	%, annual average		
Market-sector (excluding agriculture) :			
- Productivity	0,7	0,4	1,1
- Payrolls employment	1,8	1,5	1,0
- Average salary	1,7	2,0	2,5
- Wage bill	3,5	3,5	3,5
Total employment	1,1	0,9	0,6

Source : ministry of economy and finance (September 2018)

Annex 2: introductory article of the 2019 budget bill

La prévision de solde structurel et de solde effectif de l'ensemble des administrations publiques pour 2019, l'exécution de l'année 2017 et la prévision d'exécution de l'année 2018 s'établissent comme suit :

(En points de produit intérieur brut)

	Exécution 2017	Prévision d'exécution 2018	Prévision 2019
Solde structurel (1)	-2,3	-2,2	-2,0
Solde conjoncturel (2)	-0,3	-0,1	0,1
Mesures exceptionnelles (3)	-0,1	-0,2	-0,9
Solde effectif (1 + 2 + 3)	-2,7	-2,6	-2,8

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

Exposé des motifs

Cet article présente, conformément à l'article 7 de la loi organique n° 2012-1403 du 17 décembre 2012 relative à la programmation et à la gouvernance des finances publiques, la prévision de solde structurel et de solde effectif de l'ensemble des administrations publiques pour 2019. Il présente également ces mêmes soldes pour les années 2017 (exécution) et 2018 (prévision d'exécution).

Le retour du déficit public sous 3 % du produit intérieur brut (PIB), opéré en 2017 et qui a permis à la France de sortir en 2018 de la procédure pour déficit excessif ouverte à son encontre depuis 2009, est confirmé en 2018 comme en 2019.

Par rapport à la loi de règlement pour 2017, publiée le 25 juillet dernier, le déficit pour 2017 est revu à -2,7% du PIB, reflétant notamment l'intégration dès 2016 de SNCF Réseau dans le périmètre des administrations publiques, qui a été récemment annoncée par l'Insee.

En 2018, le solde public s'améliorerait de 0,1 point de PIB, passant de -2,7 % à -2,6 %, notamment du fait d'une amélioration du solde structurel de 0,1 point. La croissance de l'économie, à 1,7 %, supérieure à son potentiel, expliquerait une amélioration de 0,2 point du solde conjoncturel, et contrebalancerait ainsi l'effet négatif des mesures ponctuelles et temporaires sur le solde nominal en 2018. L'ajustement structurel de 0,1 point est porté par l'effort en dépense, dont la croissance en volume est nulle, et par la dynamique spontanée des prélèvements obligatoires. Ces effets sont partiellement compensés par les baisses de prélèvements obligatoires (-0,2 point de PIB potentiel).

En 2019, le solde nominal se dégraderait de 0,2 point de PIB, pour atteindre -2,8 %, uniquement sous l'effet des mesures ponctuelles et temporaires. Corrigé de cet effet ponctuel et transitoire, le déficit public s'améliorerait en 2019, tant s'agissant du solde conjoncturel (pour 0,3 point) que du solde structurel, dont l'amélioration de 0,3 point est en ligne avec les orientations fixées par le Parlement dans la loi de programmation des finances publiques pour les années 2018 à 2022.

L'ajustement structurel serait principalement porté par l'effort en dépense qui s'élèverait à 0,4 point (en neutralisant le classement dans les administrations publiques du nouvel opérateur France compétence, 0,2 point en l'y incluant), permettant une diminution supplémentaire des prélèvements obligatoires (pour 0,2 point, hors France compétence) conformément aux objectifs du Gouvernement de maîtriser les dépenses, afin de réduire à la fois les prélèvements obligatoires et le déficit.

Les hypothèses ayant servi au calcul du solde structurel et notamment l'estimation de la croissance potentielle de l'économie sont inchangées par rapport à celles de la loi de programmation des finances publiques pour les années 2018 à 2022. La chronique de solde structurel est très proche de celle de la LPFP (-2,2 % en 2017, -2,1 % en 2018 et -1,9 % en 2019), l'écart s'expliquant principalement par le reclassement de SNCF Réseau dans les APU (-0,1 % PIB en 2017).

Pour mémoire : solde public en Md€

en Md€	**Exécution 2017**	**Prévision d'exécution 2018**	**Prévision 2019**
Solde effectif	-61,4	-60,6	-66,7
PIB nominal	2291,7	2349,8	2420,1

Annex 3: estimating the general government structural balance

The structural balance estimate

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

- A **cyclical component,** which reflects the impact of the economic cycle on public administrations' expenditure and revenue;

- A **structural component,** being what the public balance would be if domestic production were at its potential level.

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

- **On the revenue side**, only compulsory levies are assumed to be cyclical. The cyclical parts of the income tax, corporate income tax, social security contributions and other mandatory contributions are calculated separately based on the observed levels, the estimated output gap and the elasticity of each tax category to GDP growth[3];

- **On the expenditure side**, only the unemployment compensation expenses are considered dependent on economic conditions[4]. Their cyclical share is estimated, as for revenue, based on their elasticity to the output gap and the amounts observed.

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

The components of the structural adjustment

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

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

- **The structural effort, which measures the discretionary part of the structural adjustment, i.e. controlled by public decision makers, is made of**:
  - **the expenditure restraint**, which compares the public spending real growth (calculated with the GDP deflator) to the economy's potential growth. It has a positive contribution to the structural adjustment when public spending grows slower than potential GDP;
  - the new measures on compulsory levies.

- **The non-discretionary part** takes into account:
  - the impacts of **changes in revenue elasticities**: since the cyclical component of the public balance is based on average elasticities, the structural balance includes the effects of elasticity fluctuations around the long-term average value;
  - the **changes in revenues other than compulsory levies.**

Annex 4: Macroeconomic assumptions from 2018 budget bill to 2019 budget bill

In the 2018 budget bill (September 2017), growth assumptions were 1.7% for both 2017 and 2018. The programming law presented the same time also retained 1.7% growth level for 2019.

These assumptions have been revised upward in the PSTAB stated in April 2018 related to the years 2018 to 2022. GDP growth in volume was predicted to 1.8% in 2017, 2.0% in 2018 and 1.9% in 2019. In May 2018, the release of Insee's accounts has led to increase GDP growth to 2.3% for 2017. In September 2018, in the 2019 budget bill, the Government's GDP growth forecasts for 2018 and 2019 have been revised downward (1.7% for these two years).

	2018 Budget Bill and 2019-2022 programming law (September 2017)			**PSTAB 2018-2022** (April 2018)			**2019 Budget Bill** (September 2018)		
	2017	**2018**	**2019**	**2017**	**2018**	**2019**	**2017**	**2018**	**2019**
GDP growth	1,7	1,7	1,7	1,8	2,0	1,9	2,3	1,7	1,7
Consumption price	1,0	1,1		1,0	1,4	1,2	1,0	1,8	1,4
Core inflation	0,4	0,8		0,4	0,7	0,9	0,4	0,9	1,1

Thus, these 2019 budget bill assumptions are the same as those retained a year ago. However, in the interval, GDP growth for 2017 has been sharply revised upward (2.3 % rather than 1.7 %). Overall, cumulated growth at the end of 2017 is higher than the one retained a year ago of roughly 0.6 point, being therefore, the highest GDP level over the three last years. As a result, the output gap closure is more pronounced, the cyclical component of the deficit is more favorable and public revenues are higher.

Inflation forecast for 2018 has also been revised up. It was settled at 1.1 % in the 2018 budget bill. It has been increased at 1.4 % in April 2018 and at 1.8% in September. Above all, this revision concerns energy prices and results from the pursuit of the increase of oil prices in 2018. Core inflation forecast for the year 2018 in the 2019 budget bill (0,9 %) is close to the one retained in the 2018 budget bill (0,8%).

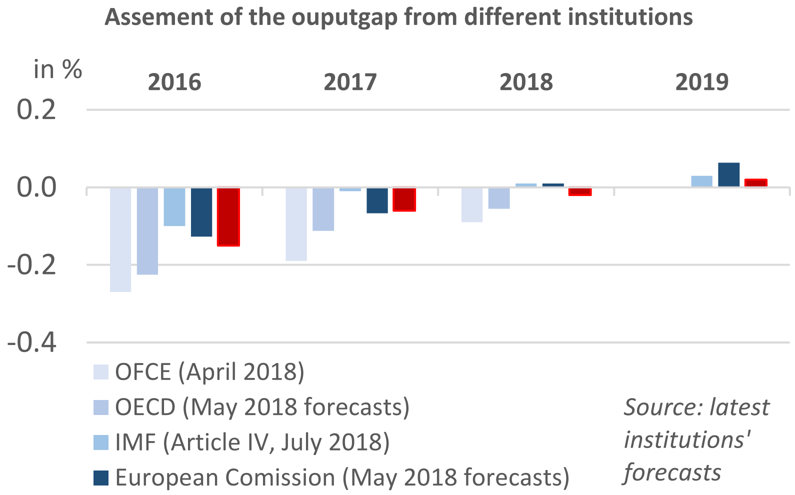
Annex 5: the assessment of the output gap in France

The output gap is the difference between GDP and potential GDP which is the maximum level of output consistent with no pressure in the economy. The analysis of the output gap is a way to assess the rebound capacity of the economy or on the contrary, the risk of an economic slowdown.

The output gap is a non- observable measure and has to be assessed with statistical tools. Therefore, measures of the output gap may differ across institutions.

The output gap in 2017 is estimated within a range of -1.1 point of GDP (OECD, forecast of May 2018) to -0.1 point of GDP (IMF, July 2018 forecast). The government's assessment lies at -0.6 point of GDP, close to the European Commission's assessment (-0.7 point of GDP).

For 2018, the output gap is estimated within a smaller range than 2017's (see graphic). The European commission, the IMF and the Government consider the output gap as almost closed (+0.1 point of GDP according to both international institutions, 0.2 point of GDP again according to the Government). The output gap would be still negative according the OECD (of 0.6 point of GDP).



According to the forecasts presented by the Government, the structural deficit, which is estimated with the programming law assumptions on potential growth, is set to be close to the nominal deficit in 2018 (after taking out one-offs), the cyclical component being very low. The European Commission and the IMF estimates of the structural balance would also be calculated with a very low cyclical component. The cyclical component is set to remain higher for the OECD (roughly –0.3 point of GDP). However, the revisions of the output gap could be substantial and could lead to analyze *a posteriori* the position in the economic cycle[13]. Those revisions can have various causes: the revisions of the effective GDP growth data as well as potential GDP growth's.

The output gap estimate could be confronted to other indicators showing a relationship with the economic cycle such as the capacity utilization rate, production bottlenecks, recruitments difficulties[14]. Those indicators can lead to consider that the French economy is closer to the closure of its output gap than estimated so far, or even already positive as the Minister of Finance suggested

[13] See HCFP Opinion-2017-3
[14] See HCFP opinion-2018-1

in a recent publication (Trésor eco n°223 - June 2018). Furthermore, in the past, the update of the European Commission and the IMF output gap estimates has generally headed toward its closure in 2017.

Overall, those indications lead to consider that the output gap could be more positive in 2018 than the Government's estimates.

ANNEX 6: France Compétences [15]

France Compétences is a public national institution which has a legal personality and a financial autonomy, placed under the authority of the Ministry in charge of the professional formation who will take back the essential part of the missions previously wielded by four institutions of professional formations : the national Council of employment, formation and professional orientation (CNEFOP), the national joint committee for employment and formation (COPANEF), the joint Funds for the career path safeguarding (FPSPP) and the national commission for professional certification (CNCP). Besides an overall competency relative to "every other actions concerning both continuous vocational training and apprenticeship", *France Compétences* will ensure several missions of funding, regulation and recommendation:

- Fund skills operators in order to provide additional support for apprenticeship and professionalization contracts under the inter-sector fair distribution
- Support areas in order to provide funds for apprenticeship and formation centers under the territorial fair distribution
- Ensure the division and the financial support from the unique contribution
- Organize and fund professional development counselling for working population
- Ensure the monitoring, the observation and the transparency of costs and bearing costs rules when the provider perceives public funds
- Contribute to the monitoring and the quality assessment of actions relative to formation
- Define a national directory for professional certifications
- Issue recommendations relative to apprenticeship funding and education quality

In its public finances forecasts attached to the 2019 budget bill, the Government includes *France Compétences* within public administrations in order to anticipate the treatment that is likely to be retained by Insee subsequently.

[15] Annex written from the answer n°9333 of the Ministry of Labour Valérie Petit (La République En Marche – Nord)