Prospects

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The point of view

The long-term impact of slippage in the public finances

In 2019, on the eve of the public health crisis, France's general government deficit had fallen back below 3% of gross domestic product (coming in at 2.4% in 2019), while public debt as defined in the Maastricht Treaty stood at less than 98% of GDP. As a result of the public health crisis, the public deficit widened to 8.9% of GDP in 2020 as economic activity slowed and various forms of government support kicked in, including in particular short-time working. Public debt surged to nearly 115% of GDP. As the economy recovered from the Covid pandemic in 2021-2022, nominal GDP rose sharply, with the result that the debt ratio fell, with public debt ending 2022 at less than 112% of GDP. This was the easy part of the consolidation process.

Last week, French statistics institute INSEE published the first results of the general government national accounts for 2023. They are less than stellar – far from the targets set out in last autumn's Budget Bill for 2024 – and suggest that the public finances will have even less room for manoeuvre over the coming years. The public deficit rose to 5.5% of GDP (up from 4.8% in 2022), compared with a government forecast last autumn of 4.9%. While there were already rumours that this target – included in the Budget Bill for 2024 – might not be met, this figure is a setback for the government, whose public finance trajectory out to 2027 was already found to be "unambitious" by the High Council of Public Finance last September and by the European Commission in November. As a result, public debt only fell to 110.6% of GDP at end 2023 (from 111.9% at end 2022), whereas the government had forecast last autumn that it would fall below 110% (to 109.7%).

The main surprise was government revenue, which slowed more sharply than spending in 2023 and, unlike in the previous year, rose much less than nominal GDP. In particular, VAT revenue slowed sharply, corporate income tax was well down and personal income tax rose only slightly, mainly because of the way personal income tax thresholds have been linked to inflation. The rate of tax and social security contributions was similar to what it had been during the pre-Covid period, at 43.5% of GDP (lower than in 2022). **Meanwhile, spending did not keep pace with inflation in 2023, which means it declined both in real terms and as a proportion of GDP (to 57.3%), even though the latter ratio was still higher than in the pre-Covid period (2019: 55.2% of GDP).** Looking at the detail, operating expenditure rose significantly as a result of the sharp increase in intermediate inputs, including in particular energy prices, while there was only a modest increase in the government wage bill. The social benefits bill increased, in particular for inflation-linked benefits, chief among them pensions, while health benefits held steady (with some increases offset by a decline in Covid-related expenditure). Subsidies slowed, notably as a result of the withdrawal of Covid-related help for businesses. Spending to help businesses and households cope with higher energy prices (price caps) stabilised. Despite recommendations from the European Commission that these measures be withdrawn as soon as possible, France – unlike other European countries – opted to keep this safety net (or at least part of it) in place. The phasing out of these measures should help reduce the public deficit in 2024. **Moreover, public investment remained buoyant in 2023 and the debt interest burden eased (to 1.8% of GDP) as the cost of servicing inflation-linked bonds fell.**

This recent information about the public finances is bad news for all economic agents. The government is going to have to find the "right" savings for the next few years, failing which it will have to rely on the revenue side of the equation, which will mean raising taxes (an option which thus far appears to have been ruled out), if France is to have any chance of bringing its finances back into line with European rules (probably not until current finance minister Bruno Le Maire has left office). **In the short term, this slight slippage is unlikely to have much of an impact on the cost of financing France's public debt, and in particular on the spread to the German Bund (Germany currently has other issues to contend with), though it appears increasingly plausible that France's credit rating could be downgraded.**

The impact will be felt in the long term. At a time when financing the green transition and climate change adaptation (as well as the digital transition, which could generate productivity gains in France) must become a priority and will also have to be paid for out of the public purse (notably because of the existence of externalities), the amount of room for manoeuvre is shrinking ever further. And let's not forget that debts are meant to be repaid, which means today's households and businesses (and, no doubt, tomorrow's even more so) are the ones who will have to shoulder the cost. ■

Marianne Picard
marianne.picard@credit-agricole-sa.fr

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