Flash Economics

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The necessary budgetary adjustment in France cannot be achieved

When taking into account the fact that the long-term interest rate (around 3.5% in September 2025 for the 10-year interest rate) is higher in France than nominal long-term growth (around 2.5% - 1% in volume and 1.5% in price increases), we see that France should generate a primary budget surplus of 1.1% of GDP, whereas it has a primary budget deficit of 3.2% of GDP in 2025.

Furthermore, we know that the additional investment needed, to be borne by the public sector, as suggested by the Draghi report, amounts to around 2.2% of GDP, and that military spending (2% of GDP in 2025) would have to increase by 1 point of GDP to ensure sufficient defence capability.

In total, the budgetary adjustment required to make the necessary additional investments and stabilise the public debt ratio therefore amounts to 7.5 points of GDP (4.3 points to stabilise the public debt ratio; 3.2 points to increase investment and military spending without creating new public deficits).

It is highly unlikely that this adjustment can be achieved, as it would require an unacceptable reduction in social protection spending for the general public, and could not be achieved through an acceptable increase in the tax burden.

As a result, on the one hand, the recommendations of the Draghi report will not be implemented, and growth will hence remain weak; on the other hand, the public debt ratio will continue to rise. The question will arise (not in the short term but in the medium term) as to when the difficulties in financing the public deficit will become so great that France will have to ask the ECB for help.

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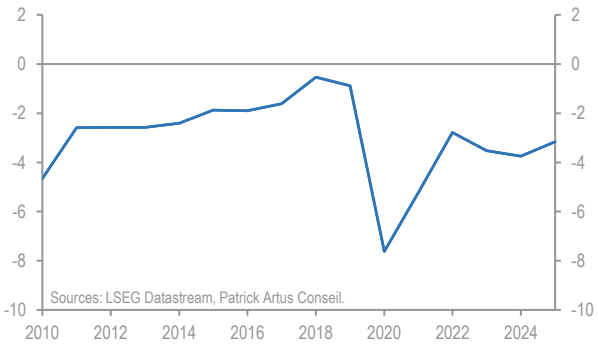
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The primary budget surplus that stabilises France's public debt ratio

Stabilising the public debt ratio requires **a primary budget surplus** equal to **the product of the public debt ratio by the difference between the long-term interest rate and nominal long-term growth.**

The latter is around 2.5% per year (1% real growth, 1.5% price increase) and the 10-year interest rate is 3.5%. This implies that a primary budget surplus of 1.1% of GDP is needed today to stabilise the public debt ratio, while a primary budget deficit of 3.2% of GDP is expected for 2025 (Chart 1).

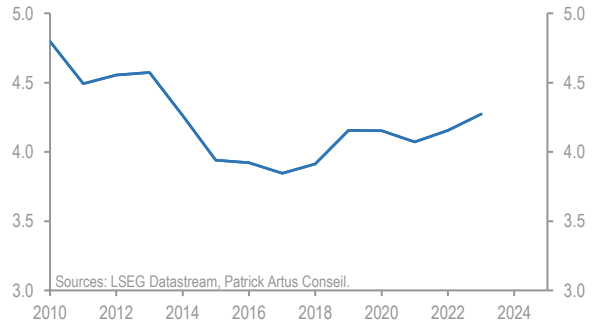
Chart 1
France: Primary fiscal deficit (as % of nominal GDP)



The need to invest more and increase military spending

The Draghi report estimates that the European Union should increase its investment by 4.5 points of GDP (in the energy transition, in the financing of disruptive innovations) to catch up with the United States. Half of this investment would have to come from the private sector, and half from the public sector.
If these figures also apply to France's need for investment, **public investment in France would need to increase by 2.2 points of GDP (Chart 2) to reach a sufficient level**.

Chart 2
France: Public investment (as % of nominal GDP)



In addition, **the level of military spending should rise from 2% of GDP**, its level in 2025 (including pensions), **to 3% of GDP**, in order to comply with the new NATO rules and ensure a sufficient defence capability.

A sizeable need for budgetary adjustment

If the objective is to, concurrently:

- **Stabilise France's public debt ratio**;
- **Achieve the increase in public investment recommended by the Draghi report; and**
- **Increase military spending to 3% of GDP, the total adjustment required is 7.5 points of GDP** (4.3 points to stabilise the public debt ratio, and 3.2 points to increase public investment and military spending without creating new public deficits).

This represents a budgetary adjustment of €230 billion (between spending cuts and tax increases), which is thus sizeable, and of which the €44 billion planned by the Bayrou government represents only a very small share.

Impossible in France to achieve a budgetary adjustment of 230 billion euros (7.5 points of GDP)

Social protection spending in France amounts to 32.3% of GDP; if we add public spending on culture, the environment, subsidies and aid to businesses and households, we reach 40.6% of GDP.

Not indexing this expenditure to inflation, assuming inflation of 1.5% per year, would therefore result in a 0.6 point fall in the weight of public expenditure in GDP, compounding each year. It would therefore take more than 12 years of no indexation of public spending to reduce the weight of public spending in GDP by 7.5 points: **it is impossible to believe that this adjustment in spending would be accepted by public opinion**.

In addition, looking at tax proceeds, we know that the Zucman tax (a 2% tax on assets in excess of €100 million, less other taxes paid) would yield between 0.5 and 0.8 points of GDP, or at best a tenth of the necessary adjustment.

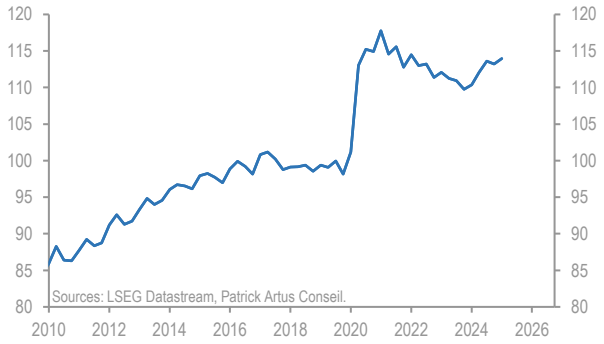
We can therefore conclude that **it is out of the question to expect a fiscal adjustment in France that would enable the public debt ratio to stabilise while the necessary public investment and military spending are carried out**.

Summary: What can we expect?

The most likely outcome is that, given the pressure of public opinion and the absence of a political consensus:

- The public debt ratio (Chart 3) will continue to rise;

Chart 3
France: Public debt (as % of nominal GDP)



- **The investments recommended by the Draghi report will not be made, which will prolong a weak GDP growth** (**Chart 4**) resulting essentially from the rise in the employment rate (**Chart5**) with insufficient investment in technology.

Chart 4
France: Real GDP growth

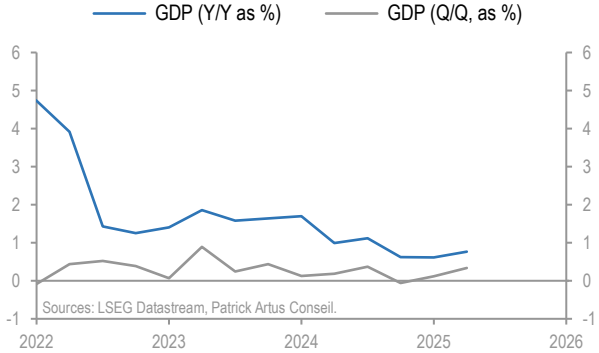


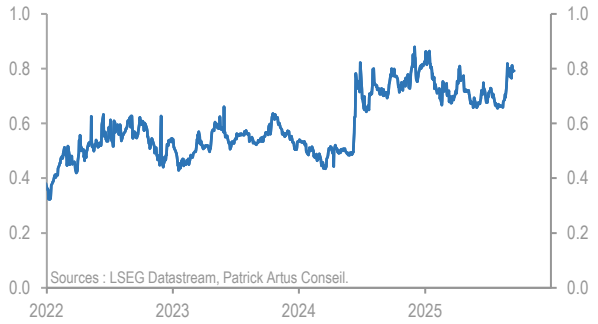
Chart 5
France: Employment rate of population aged 15 to 64 (as %)



We can therefore anticipate that the French Treasury will find it increasingly difficult to finance the public deficit and debt repayments and:

- That the OAT-Bund spread (France-Germany spread) will continue to widen (**Chart 6**);

Chart 6
France: Yield spread on country's 10-year government bonds against Germany (as % point)



- That there will come a time in the future when the Treasury will no longer be able to raise the necessary amounts. France will then have to ask for help from the ECB, which, by way of the **Transmission Protection Instrument**, can buy any quantity of public debt of a eurozone country that it deems necessary. **But this aid will be granted on condition that a credible programme to reduce the public deficit is implemented**, which will entail a major reduction in social protection spending (pensions, health spending, etc.) and substantial tax increases.

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