Flash Economics

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France: Are the second-round effects of restrictive fiscal policy properly taken into account?

The French government aims to reduce the public deficit from 5.8% of GDP in 2024 and 5.4% in 2025 to 4.6% in 2026 and 3% in 2029.

Given that tax revenues usually grow at a pace close to that of nominal GDP (which was not the case in 2024, with revenues increasing by 2.1% versus 3.4% for nominal GDP) and that public spending tends to grow faster than nominal GDP (in 2024, public spending rose by 3.9%, including 3.8% for operating expenses, 14.6% for interest on public debt, 3.0% for social benefits, and 6.1% for investments), this projected reduction in the public deficit will require a significant effort to curb spending (if this is the only lever used, public spending as a share of GDP would need to fall by 2.8 percentage points between 2024 and 2029, public spending would have to grow one percentage point less than GDP each year) or to increase the tax burden.

A reduction of the public deficit by nearly 0.6 percentage points of GDP per year will inevitably have a recessionary effect on economic activity. Since France's potential long-term growth is at best 1% in volume, and assuming fiscal policy remains unchanged, if the public deficit is reduced by 0.6 points of GDP annually, the remaining growth will necessarily be very weak.

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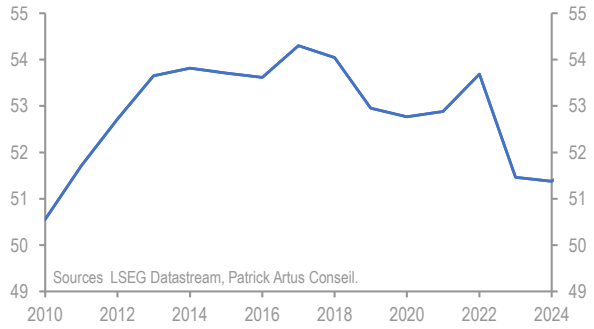
A very ambitious target for reducing the public deficit in France

The French government aims to **reduce the public deficit** from 5.8% of GDP in 2024 to 5.4% in 2025, 4.6% in 2026, and 3% in 2029.

It can be assumed that, in the medium term and under unchanged legislation:

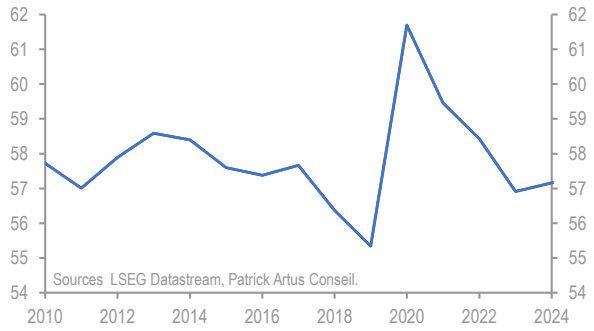
- **tax revenues will increase at the same pace as nominal GDP** (**Chart 1**);

Chart 1
France: Tax revenues
(as % of nominal GDP)



- **public spending will spontaneously grow faster than GDP** (**Chart 2**), due to demographic aging, needs in education, healthcare, and military expenditures.

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



If we make **the simplifying assumption that the spontaneous growth of tax revenues and public spending is identical to that of nominal GDP**, achieving a public deficit of 3% of GDP by 2029 will require:

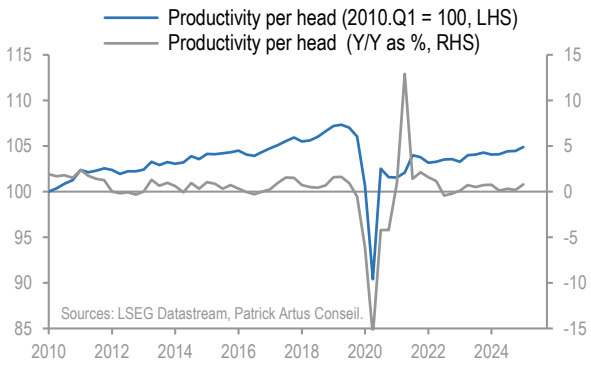
- either **a reduction of nearly 0.6 percentage points of GDP each year in the share of public spending in GDP**, meaning a decrease of 1 percentage point per year in the growth of public spending;
- or **an increase of 0.6 percentage points of GDP each year in the tax burden**.

What is France's potential growth, without measures to reduce the public deficit?

France's potential growth, in the absence of any corrective action to reduce the public deficit, can be estimated by examining:

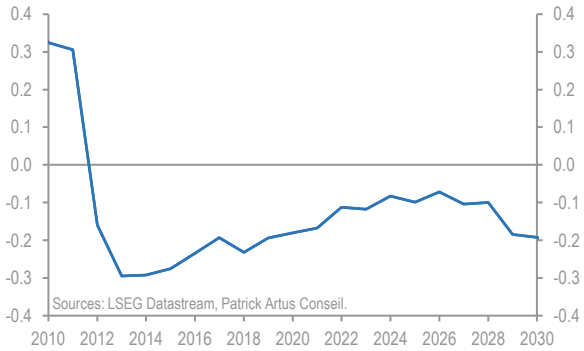
- **the growth of labor productivity**, which has been around 0.6% per year since 2022 (**Chart 3**);

Chart 3
France: Productivity per head



- **the growth of the working-age population**, which is approximately -0.1% per year (**Chart 4**);

Chart 4
France: Population aged 15 to 64 (Y/Y as %)



The unemployment rate (**Chart 5**) is probably already very low, given the low level of qualifications among the French population, and consequently cannot go lower.

Chart 5
France: Unemployment rate (as %)

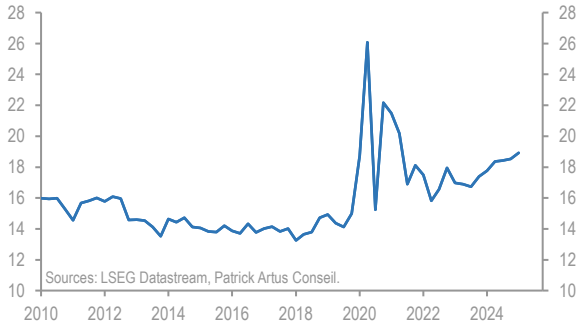


France's potential growth can therefore be estimated at best at 1% per year, thanks to a continued increase in the employment rate.

Summary: The effect of a restrictive fiscal policy in France by 2029

The reduction in public spending and the increase in the tax burden planned by the French government **will probably not be offset by a decrease in household savings rates** (there will be no Ricardian neutrality, **Chart 6**).

Chart 6
France: Gross household savings rate
(as % of gross disposable income)



Indeed, economic and geopolitical uncertainty will remain high, and the reduction in generosity of pension and health insurance schemes will encourage the French to save more.

This means there will be a recessionary effect—a reduction in growth—resulting from the deficit reduction.

We must then consider the level of the fiscal multiplier (the effect on GDP of a change in public spending or tax burden). The average of available estimates for France[1] is around 0.85, but the estimates show wide variation.

If we use this estimate of 0.85, the negative impact on France's growth from 2025 to 2029 due to the planned deficit reduction will be 0.5 percentage points per year, which is far from negligible given that the baseline growth, without deficit reduction measures, is 1% per year.

[1] See for example G. LE GARREC, V. TOUZE. « The public investment multiplier: A literature review », Revue de l'OFCE, 2021.

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