

**FOR
AGENDA**

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October 18, 2000

To: Members of the Executive Board

From: The Secretary

Subject: **France—Report on Observance of Standards and Codes—
Fiscal Transparency Module**

The attached report on the observance of standards and codes on fiscal transparency module by France has been prepared in the context of the 2000 Article IV consultation with France (SM/00/217, 9/22/00), which is tentatively scheduled for discussion on Friday, October 27, 2000.

It is expected that following the Board discussion, this report will be published on the Fund's external website.

Mr. Hemming (ext. 38543) and Mr. Allan (ext. 38542) are available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

FRANCE

**Report on the Observance of Standards and Codes (ROSC)
Fiscal Transparency Module**

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October 17, 2000

EXECUTIVE SUMMARY

This report provides an assessment of fiscal transparency practices in France in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency—Declaration on Principles* based on the authorities' response to the IMF fiscal transparency questionnaire and other documents provided by the authorities.

France has achieved a high level of fiscal transparency and has introduced a number of improvements in coverage and presentation of fiscal information in recent years. Notable areas of progress include the development of the final accounts publication to include more complete information on government assets and liabilities as well as disclosure of contingent liabilities. Accounting standards have been changed to reflect accrual principles in a number of areas and these standards are clearly explained in the report. Further developments to improve transparency of the budget presentation are under consideration.

Noting that steps have been taken to reduce quasi-fiscal activity by public utilities, the staff suggested that further steps could be taken to identify and report remaining QFAs in the budget presentation. The staff also suggested that a more consolidated picture could be given of fiscal activity outside the appropriation process and that reconciliation of stated policies with outcomes at the general government level could be improved.

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ACRONYMS

CGAF	Rapport de présentation du compte général de l'administration des finances
CNIS	National Council for Statistical Information
ECB	European Central Bank
ECOFIN	Economic and Financial Committee (of the EU)
ESA 95	European System of Accounts
EU	European Union
INSEE	Institut National de la Statistique et des Etudes Economique
MEFI	Ministry of Economy, Finance, and Industry
RESF	Rapport économique, social, et financier
SGP	Stability and Growth Pact

I. INTRODUCTION¹

1. This draft report provides an assessment of fiscal transparency practices in France against the requirements of the IMF *Code of Good Practices on Fiscal Transparency—Declaration on Principles*. The authorities have completed the fiscal transparency questionnaire prepared by the IMF staff. The assessment has two parts. The first part is a description of practice, prepared by the IMF staff on the basis of the questionnaire response and additional information provided by the authorities or from public sources. The second part is an IMF staff commentary on fiscal transparency in France.

II. DESCRIPTION OF PRACTICE

A. Clarity of Roles and Responsibilities

2. **The boundary between general government and the rest of the economy is well defined.** The European System of Accounts (ESA 95) standard is observed in defining the general government sector and all reports on government fiscal activity. There are clear laws determining the relationship between government and the rest of the economy. However, public enterprises (particularly the public utilities) have been involved in quasi-fiscal activities, although these are being substantially reduced through privatization and regulatory reform.² In this regard, there are some continuing concerns with the slow rate of implementation of European Union (EU) directives regarding deregulation of electricity and gas distribution. Regulation of interest rates on savings schemes also involves a significant subsidy through such instruments, and the extent of these subsidies (and the distribution of benefits) has not in the past been clearly revealed in budget discussions. However, indicative rules that limit the deviation of regulated rates from market rates have reduced the scope for subsidies.

3. **Government equity holdings are reported.** Equity holdings through public enterprises are subject to government approval and are reported in annual reports of the enterprises. Financial flows from direct equity sales or acquisitions by the government are recorded in a special account. The new *Rapport de présentation du compte général de l'administration des finances* (CGAF report) also provides additional information on equity holdings using accounting standards that are close to business practices (see below).

4. **Independence of the central bank is assured by law.** The Bank of France's independence to conduct monetary policy has been specified in law since August 1993 (*Law No. 93.980 August 4, 1993*). In January 1999 this authority was transferred to the European

¹ Fiscal transparency discussions with the authorities were led by Ms. Selma Mahfouz, (Economist, FAD) on the basis of a draft prepared by Ms. Mahfouz and Messrs. William Allan and Jérôme Fournel with input from the staff of EU1 and PDR Departments.

² Some quasi-fiscal activities are also being replaced by explicit subsidies. For example, airlines are explicitly contracted on a competitive basis to maintain some noncommercial routes and the cost of maintaining postal services in rural areas is now explicit.

Central Bank (ECB). In the context of EMU, the Bank of France is responsible for supervision of the money market and the proper functioning and security of payment systems. It serves as the treasury account holder and, on behalf of the treasury, is responsible for the logistical organization of treasury security auctions.

5. **Responsibilities of different branches and levels of government are clearly defined.** The constitution guarantees the separation of powers between the executive, legislative, and judicial branches of government. The constitution also specifies that local authorities (and other territorial entities) shall freely govern themselves under conditions stipulated by legislation.³ The principles of distribution of responsibilities were given in the Decentralization Act of 1982 and subsequent legislation, which designate specific and shared responsibilities among levels of government. Local taxes are collected by the state on behalf of subnational governments. Taxes are established at the national level, but subnational councils have discretion in setting tax rates. Since 1990, local authorities have been free to borrow (including abroad and in foreign currency, although the approval of the minister of finance is required for foreign currency bond issues). State transfers are now given mainly in the form of block grants, which account for around 30 percent of local authority revenues. Deconcentration of administration within state service agencies has strengthened the powers of the prefects of administrative districts to coordinate all services of the state within their districts, as well as to coordinate with local authorities.

6. **Budget management is governed by a clear legal framework.** As required by the constitution (Article 47), finance bills are governed by a law (*Loi organique*),⁴ which has a near-constitutional status. The law requires that all commitments and disbursements of public funds must comply with the budget appropriation law. It specifies, among other things, that budgeting must be on a gross basis, that appropriations are to be classified according to the required budget nomenclature, that strict limits are applied to appropriations (but some appropriations, such as social welfare payments or interest payments, are estimated, and others are provisional and subject to future events), and that moving appropriations between chapters be strictly limited. The law requires the budget to be comprehensive and this requirement is monitored by the Constitutional Council. As a consequence, many expenditures formerly treated as extrabudgetary (such as postal pension expenditures) are now incorporated in the budget.

7. **All taxes have a clear basis in law and the tax code is accessible to the public.** Tax laws are clearly defined in the general tax code and its appendices (*Code Général des impôts*) which constitute the legal basis for taxation. Changes to the tax legislation are

³ The constitution of the Fifth Republic specifies communes (municipalities), and departments and overseas territories, as the units of subnational government. The former constitute the first level of local government, the latter units are an intermediate level. The *Decentralization Act* of 1982 introduced regions (there are 22 metropolitan regions) as another tier, generally covering several departments and immediately below the State level. It should be noted that State administrative districts, broadly coincident with subnational government boundaries, are used for regional administration by the national government.

⁴ *Ordonnance No. 59-2* of January 2, 1959.

discussed in parliament each year in connection with the budget laws (initial and supplementary). Specific tax laws (such as those in the area of corporate tax and value added tax in recent years) are also introduced periodically. Approved changes are incorporated in the tax code or appendices. The code and basic reference material are accessible to the public (see <http://www.finances.gouv.fr/reglementation/codegen/>), photocopies of any material required are available from the territorial tax centers, and tax summaries are published every year to explain the tax system and, in particular, new measures. A taxpayers' charter is available on the website of the ministry of finance. This provides comprehensive information regarding administrative, conciliatory, and judicial means to challenge tax administration decisions.

8. **Public servants are subject to a clearly defined code of behavior.** Several laws provide assurance of ethical behavior of public servants, particularly in relation to handling of public funds. First, there are general laws applying to all public servants. Law 83-634 of July 13, 1983, among other things, prohibits public servants from engaging in any private professional activity of any kind for remuneration, unless under a special waiver (Article 25). Law 94-1040 of December 2, 1994 (establishing the Code of Financial Jurisdictions) and Law 95-851 of July 24, 1995 (on the Court of Budget and Financial Discipline) give specific rules on proper use of public funds and sanctions against breaches of financial regularity. Long-standing special regulations apply to civil servants serving as authorizing officers and accountants. Under Decree 62-1587 of December 29, 1962, public accountants are required to provide professional guarantees and must take an oath of office. The decree also stipulates that the roles of authorizing officers and accountants are incompatible and prohibits either from engaging in certain activities.

B. Public Availability of Information

9. **Budget documents provide a comprehensive coverage of general government.** The annual budget reflects all expenditures of the central government and, as noted, now incorporates many expenditures previously treated as extrabudgetary. Estimates are also provided for cost sharing contributions (*fonds de concours*) in an Annex (*jaunes budgétaires*) to the budget but these estimates are not yet consolidated in budget projections. Each year, the National Economic Commission prepares a Spring report which shows the deficits for the two preceding years, the year in progress and the coming year for all subsectors of general government. Consolidated figures on debt, expenditures and taxes are also shown for these years. These data are updated in the *Rapport économique, social, et financier* (RESF) presented in Autumn with the budget law. Moreover, France presents a set of forecasts, in principle by the end of each year, for the budget year and three following years including the major aggregates of the general government sector in accordance with the requirements of the EU Stability and Growth Pact (SGP).

10. **Budget documents include reports on government guarantees and tax expenditures.** For the first time, the 1999 accounts included a statement of off-balance sheet items such as contingent liabilities from government guarantees and pension liabilities. Tax

expenditures are shown in an annex to the draft budget law (*Evaluation des voies et moyens, tome II*) with an estimate of cost.

11. **Government's debt and financial assets are regularly reported.** Debt data are published in a timely and regular way through the treasury website (<http://www.francetresor.gouv.fr/>) and published documents.⁵ Monthly data on negotiable debt are available approximately 15 days after month-end and nonnegotiable⁶ debt around 35 days after month-end (at year-end, data on non-negotiable debt are available after about two and a half months). Annual data on debt guaranteed by the state is published in summary in the CGAF report, approximately three and a half months after year-end and later in detail in the *Compte de la dette publique*, which is published about nine months after year-end. Data on government financial assets are available monthly in *Situation résumée des opérations du Trésor*, covering liquid and quasi-liquid assets, loans, advances, and investments. Data on investments are classified into market or nonmarket sector, with further breakdowns in each category. Annual data are published in the CGAF report.

12. **There is a public commitment to produce regular fiscal reports.** France subscribes to the Special Data Dissemination Standard and from the beginning of 2000 has issued a calendar of dissemination dates for publication of short-term indicators. Dates for the following month's release are accessible to the public on the website of the Institut National de la Statistique et des Etudes Economique (INSEE) (<http://www.insee.fr>).

C. Open Budget Preparation, Execution, and Reporting

13. **The budget preparation process is open and clearly documented.** The Spring report to parliament sets the basic policies and framework surrounding the budget law that is submitted in October. It provides the economic context as well as aggregate targets (revenue, expenditure, and balance) for each component of general government. The minister for finance and the economy, moreover, presents the budget situation to the finance committees of parliament every two months. The RESF filed with the budget law provides a detailed and updated macroeconomic framework for the budget debate. The budget is presented in detail in seven broad *titres*, each divided into *sections*, and each section further subdivided into *chapters*. Existing policy expenditures ("appropriations for current services") are clearly distinguished from "items of expenditure reflecting new policies." This distinction is required

⁵ Negotiable debt data are available in *Situation mensuelle des opérations du Trésor* in *Notes bleues de Bercy* (available by subscription) and in *Situation résumée des opérations du Trésor* in the *Journal Officiel de la République française*.

⁶ Mainly treasury correspondent bank deposits, representing just under 9 percent of total public debt and steadily decreasing.

Box 1. Improving Transparency of the State Accounts

The CGAF report for 1999 approved by the Minister of Finance and the State Secretary for Budget on April 13, 2000 aims for more comprehensive statements of accounts than in previous years (see http://www.finances.gouv.fr/pole_ecofin/finances_Etat/). This document has been produced as part of a program to modernize public accounting practices and to develop more comprehensive fiscal reporting.

The reform was initiated in November 1997 by a task force denominated "*Comptabilité Patrimoniale de l'Etat*." Its main objectives are: (i) to provide financial information based on accrual accounting practices in addition to traditional cash-based information; (ii) to foster performance-related evaluation of public management through a better knowledge of overall costs; and (iii) to increase transparency and monitoring over long-term liabilities such as pensions, guarantees, and privileged savings plans.

The CGAF report for 1999 is one of the first steps of the reform which will continue to be carried out in the coming years. The report provides detailed information regarding the fiscal position of the central government, 1999 budget execution, reconciliation table with the 1999 financing, analysis of the evolution of the balance sheet of the state, and additional information on off-balance sheet liabilities. Assurance of the quality of the information has been increased through changes in accounting standards, which are clearly stated in the report. An accrual basis for recognition of transactions has been introduced for interest on public debt (as well as for discounts or premia on debt) and for tax revenue. In the latter case, a provision for the estimated value of tax arrears is also incorporated in the CGAF. Other standards relate to nonfinancial assets (new valuation of real estate assets), equity holdings (use of a new classification according to the state's level of holdings, and consolidation of all group subsidiaries), and off-balance sheet liabilities (pension plans, subsidized housing savings plans, guarantees granted to specific companies or entities, or for insurance against a risk of default on export credit).

The reform provides additional information on public financial management and the fiscal position of the state. More in-depth assessment of spending units financing needs, and performance-related management practices are expected to develop on this basis. Questions regarding possible changes to the format of the budget presentation and parliamentary approval processes will be considered at a later stage.

In addition, a number of measures aimed at improving fiscal transparency were announced in the report for the preparation of the 2001 budget (*Débat d'orientation budgétaire*, Annexe VII). In particular, a methodological annex to the budget will include information on methods used to forecast revenues, changes in the presentation on expenditures from one year to the other, and financial relations between various components of government.

by the organic budget law and, under that law, current services appropriations are subject to only one vote in parliament while new policy items are subject to detailed voting processes.

14. Clear fiscal targets are set, but mechanisms for control could be made more explicit. Fiscal targets consistent with the requirements of the Stability and Growth Pact (SGP) are set for the budget and the stability program that is reviewed each year by the ECOFIN (the EU council of economic and financial ministers). The general government balance is the main indicator for budget monitoring. The primary balance is also presented and discussed in the budget documentation. The stability program for 2001–2003 includes an

assessment of structural balance trends for the period. Emphasis is given to a reduction in the ratio of expenditure to GDP in attaining Stability program targets. However, mechanisms for reining in expenditure in following years in the event of slippage are not adequately defined. In this regard, particular problems are experienced in the area of local government and health care.

15. **Analysis of budget risks and policy sustainability is published.** Major risks to the budget through possible changes in the economic environment are examined in detail in the RESF. The stability program submitted to the EU includes sensitivity analysis of the effects of interest rate increases and reduced export demand. Implications of different growth assumptions are explored by the provision of two growth scenarios. Other risks, such as contingent liabilities, are reported in the accounts, but are not specifically examined in the budget documents. Medium-term sustainability issues are examined in the context of the stability program, and there have been reviews of the long-term sustainability of the French pension system which indicate growing pressures from population aging beginning in 2005. Long-term analysis of sustainability issues is not, however, systematically integrated into budget processes.

16. **Aggregate fiscal targets are carefully monitored.** Targets set in the budget and the stability program are monitored and reviewed in a timely way. Thorough accounting procedures apply to all stages of the payments process to provide assurance of reliable data as the basis for monitoring and avoidance of overcommitment against parliamentary authorization. The budget review law (which must be presented to parliament within a year after year-end) reports at the same level of detail as the budget law authorizing expenditures and is accompanied by reports from the Court of Audit. Accounting is presently on a modified cash basis⁷, but efforts are being made to move toward an accrual basis. As noted in Box 1 above, first steps toward an accrual system were made in the 1999 CGAF report, which included reports on financial assets and debt, including disclosure of potential and future liabilities. Fiscal reports for the national accounts and the stability programs are prepared according to ESA 95 (accrual basis) standards.

17. **Work on measuring results of fiscal activity is ongoing.** Increasing use is also being made of indicators of social and economic outputs arising from fiscal activity. From the 2000 budget, fiscal activities are categorized according to whether they provide direct services, social assistance, or a support function. In each area, specific quantifiable objectives are to be identified and performance against these measured. Reports on performance in terms of objectives are to be appended to the draft budget review law.

18. **Internal management controls are open and effective.** Clear regulations and open competitive procedures are in place for both recruitment of civil service personnel and procurement of goods and services. Internal audit is open and effective, relying first on financial controllers from the Ministry of Economy, Finance, and Industry (MEFI) Budget

⁷ That is, accounts are reported on the basis of payment orders issued by the accountants, but a complementary period after the end of the fiscal year allows payments for expenditures authorized during the preceding year. Cash payments are thus related to the year in which commitments are made.

Directorate, who ensure compliance with budget appropriations prior to commitments being made by spending units. The Inspectorate General of Finance, under MEFI, carries out inspections of the operations of authorizing officers and public accountants for all ministries and agencies that have budgetary support. Its reports are published if the minister so directs.

D. Independent Assurances of Integrity

19. **An independent judicial agency is responsible for reviewing fiscal management.** The Court of Audit is made up of independent judges, selected through a professional career stream. The court is required under the constitution (Article 47) to assist the parliament and the government in overseeing budget law execution, and under the 1996 constitutional reforms is also specifically required to assist in oversight of laws governing social security financing. The court provides a report on the government accounts (and, since 1995, on the accounts of social security agencies) to parliament each year. The reports are aimed at verifying the regularity and accuracy of the accounts and verifying the quality of management and the proper use of public funds, up to and including an assessment of public policy. The court also prepares reports on special topics and submits these to both assemblies of parliament and to the president. It may conduct investigations on behalf of parliamentary commissions.

20. **The basis of macroeconomic forecasts is subject to external scrutiny.** Macroeconomic forecasts are reviewed by the National Economic Commission, chaired by the Minister of Economy and Finance, and including 22 members chosen for their economic and financial expertise. The Planning Commissioner and the Governor of the Bank of France are ex officio members. A technical group prepares and reviews macroeconomic forecasts prepared by key independent institutes and banks for the current year and the forthcoming year immediately prior to the Spring and Autumn plenary sessions of the National Economic Commission. The RESF presented with the budget law specifies the assumptions adopted by the government for the budget. The assumptions are also the basis for stability program submissions and are subject to review through ECOFIN.

21. **The national statistical office has technical independence.** INSEE has full authority and technical independence to publish fiscal data in quarterly national accounts periodicals and annual accounts of general government applying ESA 95 standards. The data and accounts are prepared from accounts provided by the Directorate General of Public Accounting of MEFI. The National Council for Statistical Information (CNIS) coordinates statistical operations of the government and the law governing the CNIS (Decree 84-628 of July 17, 1984) provides assurance of the quality of statistical data.

III. IMF STAFF COMMENTARY

22. **France has achieved a high level of fiscal transparency.** Very high standards are set in most aspects covered by the fiscal transparency code. A sound basis in law and close observation of these requirements have for long been features of fiscal administration in France. The coverage and presentation of fiscal information have been very much improved

in recent years, notably by publishing more complete information on government financial assets and contingent liabilities, and by presenting multi-annual budget plans. Another area that is the subject of present reforms is the reduction of quasi-fiscal activity by the public financial and enterprise sectors.

Possible areas where further improvements in transparency could be made are as follows.

- Continuing quasi-fiscal activities should be clearly identified and reported in the budget presentation. Areas that could be further investigated from this viewpoint include interest rate regulation, investment and pricing by public utilities, and the impact of social security protection on insurance companies.
- Presentation of data on fiscal activity that occurs outside the appropriation process (in particular, issuance of contingent liabilities, quasi-fiscal activity, and tax expenditures) could be covered in a consolidated annex to the budget to give a full picture of the range of fiscal activity at the time the budget is being considered.
- Although progress has been made at the central government level, a more detailed presentation of expenditure plans and strategies for adjustment of all components of general government and a more comprehensive process of reconciling previous plans and current proposals would help make expenditure policy more transparent and accountable.
- Strengthening the mechanism to track government compliance with the Court of Audit findings should be considered.

