



The difference in public spending in France and Germany

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Public spending in 2015 represented 57% of GDP in France compared with 44% in Germany. The difference was only around five percentage points of GDP from 1996 to 2002. Since then, the slowdown in per capita GDP growth in France has not been accompanied by a weaker progression in per capita public spending. Germany has been more successful in keeping its public spending in check, by implementing important reforms, while reporting faster growth in per capita GDP. Divergence in per capita GDP growth accounts for half of the divergence in public spending ratios. Breaking down spending by government function shows that certain differences have remained relatively stable (education, health, defence), and are due primarily to demographic factors or public/private organisation. Others, particularly pension spending, have widened and therefore deserve special attention.

Divergent trajectories in public finances

Public spending in the annual national accounts (Eurostat figures) represented 57.0% of GDP in France in 2015 compared with 44.0% of GDP in Germany. Public spending in France is higher than in any other European Union country, while Germany spends less than the European Union average.

From 1996 to 2002, the difference in public spending between France and Germany was significantly smaller (on average five percentage points of GDP) and relatively stable. Since 2002, the difference has widened by eight percentage points of GDP with public spending increasing by five percentage points in France and decreasing by three percentage points in Germany during the same period.

Consequently, the weight of public spending in France has led to increased government levies. Taxes and social security contributions in France amounted to 47.9% of GDP in 2015, up four percentage points on 2002,¹ compared with 40.0% in Germany (an increase of one percentage point compared with 2002). In addition, while Germany balanced its public accounts and generated a surplus of 0.7% of GDP in 2015, France's public deficit amounted to 3.5% of GDP in the same year.

This has had a major consequence: the public debt trajectories of France and Germany have diverged significantly. Prior to the crisis of 2008, the national public debt of both countries was at a similar level but in 2015 it amounted to 96.2% of GDP in France compared with 71.2% in Germany. The debt service cost in 2015 therefore weighed more heavily on French public finances (by 0.4 percentage point of GDP).

How can such a difference in public spending be explained?

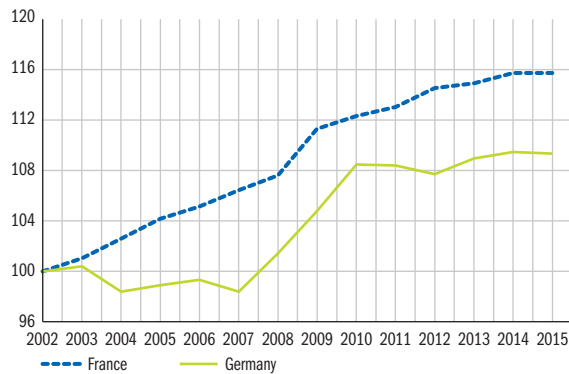
Divergent trajectories in GDP and public spending per inhabitant

Levels of public expenditure, almost 60% of which is spent on health and social protection (particularly pensions and unemployment benefits) are linked to the number of inhabitants. Therefore, a comparison between the trajectories of public spending per inhabitant and GDP per inhabitant of the two countries (see Charts 1 and 2) provides a useful insight.

¹ Source: Eurostat, including imputed contributions and excluding uncollectible taxes, but before deduction of tax credits (treated as an expense).

C1 Change in real public spending^{a)} per inhabitant in France and Germany

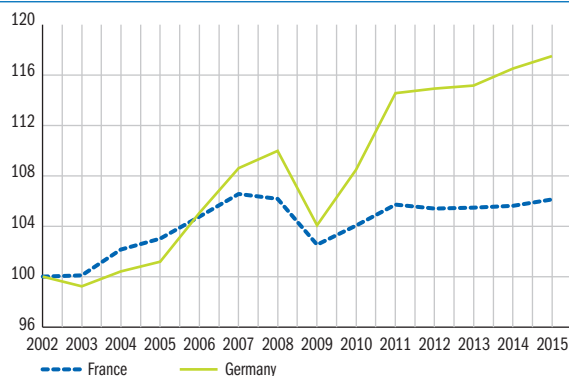
(2002 = 100)



a) adjusted for the GDP deflator
Sources: Eurostat, authors' calculations.

C2 Change in real GDP per inhabitant in France and Germany

(2002 = 100)



Sources: Eurostat, authors' calculations.

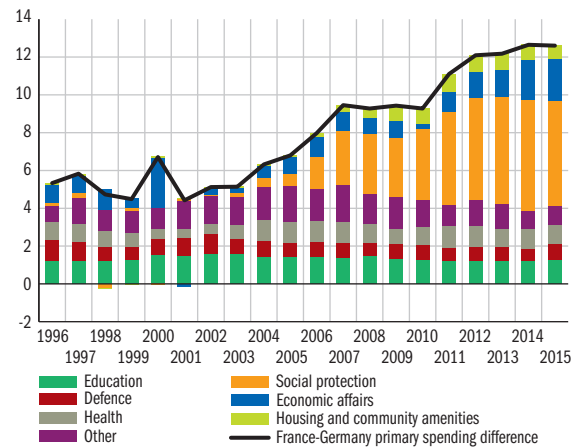
The slower growth in GDP per inhabitant in France during the 2002-2015 period accounts for half of the divergence in public spending as a share of GDP between the two countries. Contrary to the situation in Germany, public spending per inhabitant in France was not kept in check while the adverse economic context curbed revenue growth.

Evolutions in the difference vary depending on the government spending function

A breakdown of primary spending² by government function (based on the COFOG³ nomenclature) highlights the areas where France's higher public expenditure is particularly spent compared with Germany (in % of GDP, see Chart 3). It shows that the differences in spending on health, education and defence have remained constant over time, but also

C3 Breakdown by government function of primary public spending as a share of GDP in France and Germany

(in % of GDP)



Sources: Eurostat, authors' calculations.

illustrates the government functions where spending has diverged since 2002: the difference between the two countries has widened mainly because of social protection expenditure and, to a lesser extent, spending on housing and economic affairs.

The analysis that follows aims to dissect and explain the majority of the difference in percentage point of GDP observed in 2015 between the primary public spending of the two countries (i.e. excluding interest expenses) as a share of GDP (11.5 of the 12.6 percentage point difference identified).

Approximately half of the difference between France and Germany is due to accounting choices, public/private organisation and demographic differences

1.5 percentage points of GDP arise from the expansion of tax credits and their accounting method

Payable tax credits are accounted for as public spending (mainly under the economic affairs function) despite, economically, being a tax reduction. These mechanisms have been widely developed in France during the past 10 years but have no equivalent in Germany.

² Our analysis in the remainder of this study focuses on public spending excluding interest expenses.

³ The COFOG (cClassification of the fFunctions of gGovernment) is an internationally accepted nomenclature that breaks down general government expenses into 10 categories according to their purpose.

2 percentage points of GDP can be explained by different choices of costs borne by the public or private sector in relation to health and pension spending

It is compulsory to have health insurance in Germany but the German system allows certain households (salaried employees with income over a given threshold and public servants) to opt for private health cover. This expense, which is borne by basic private insurance coverage and has no equivalent in France, represents around one percentage point of GDP and 8% of current German health expenditure. Ultimately, the current health expenditure (i.e. all payments related to health care, irrespective of the finance provider) of both countries is identical in percentage points of GDP (11% in 2015 according to OECD statistics) and is actually higher per inhabitant in Germany than in France.

With regard to pension spending, certain independent professionals in Germany are not required to be affiliated to the basic government pension insurance scheme. In addition, while supplementary pension schemes are compulsory in France and fall within the public domain, they are optional in Germany and are covered by industry level (private) agreements. Therefore, private pensions represent around one percentage point of GDP in Germany.

2 percentage points of GDP are linked to the specific demographic or historical characteristics of each country

France spends the equivalent of 1.3 percentage points of GDP more than Germany on education. This difference, which has remained unchanged over time, is the result of a younger population (0 to 24 year-olds represent 31% of the population in France, compared with 24% in Germany) and a differently organised pre primary education (three to six year olds).⁴ Therefore, based on comparable data from primary school to higher education, the difference is only 0.6 percentage point of GDP and Germany spends more in euros per pupil than France.

With regard to defence, the budget is 0.7 percentage point of GDP higher in France than in Germany. This difference is stable over time and can be explained by the contrasting histories and international policies of the two countries.

⁴ In Germany, the equivalent of the French pre-school system (*école maternelle*) is the *Kindergarten*, which on the whole is private and not free. Public financing for kindergartens (subsidies) represented around 0.5 percentage point of GDP in 2014 (OECD, *Education at a glance 2016*), classified under the COFOG category of social protection.

The other half of the difference between France and Germany is due to pensions, unemployment benefits and housing expenditure choices over the past 15 years

Approximately 4 percentage points of GDP on retirement benefits and 1 percentage point on unemployment benefits result from German reforms implemented in the 2000s, which are reflected particularly by a higher employment rate among older people

The reforms implemented in Germany during the 2000s resulted in a reduction of one percentage point of GDP in pension-related public spending between 2002 and 2014. During the same period, spending in France increased by three percentage points of GDP.

Thus, current retirement expenditure in Germany, despite its more aged population (27% of the population is over 60 years old compared with 24% in France), is far lower than in France, even when private pensions are taken into account. Old-age and survivors' pensions, including private cover, represented 10.9% of GDP in Germany in 2014 compared with 14.5% in France (social protection data, Eurostat ESSPROS⁵ database) due to a stricter system with a higher effective retirement age and less generous pension levels (lower replacement rate). The employment rate of 60-64 year olds is therefore significantly higher in Germany (53.3% in 2015 compared with 27.6% in France, according to Eurostat data), which in addition to reducing spending, has a positive impact on economic growth. However, it is important to note that since 2005, the living standards of the over-sixties in Germany have dropped compared with the rest of the population.⁶

The structural reforms implemented in Germany during the 2000s, particularly the Hartz plan, also impacted unemployment spending as they introduced stricter conditions for unemployment benefits. They also had a profound effect on the functioning of the German labour market and reduced structural unemployment by encouraging people to get back into the job market. In 2014, with a far lower unemployment rate (5.0% of the labour force compared with 10.3% in France, according to Eurostat data) the unemployment benefits paid in Germany were almost half that of France, at 1.1% and 2.0% of GDP respectively (although the amount paid per jobseeker was similar).

⁵ European system of integrated social protection statistics.

⁶ For example, the proportion of people over 60 years old whose revenue, after transfers, is less than 60% of average income increased in Germany from 14.3% in 2005 to 17.9% in 2014. During the same period, this same proportion of the population declined from 17.1% to 10.1% in France, according to Eurostat.

Pension costs, a key factor in controlling public spending

Pension reforms in Germany during the 2000s helped to keep public spending in check. The Riestert reform (2001) in particular transformed the single-pillar pension insurance system into a multiple-pillar scheme, reducing government pensions in favour of state-subsidised private retirement savings policies.¹ Subsequently, a viability criterion was added to the indexation of government pensions in 2004, in response to the change in the number of pensioners relative to the number of contributors. These reforms have weighed heavily on the evolution of pensions: in constant euros, adjusted for the GDP deflator, the average pension (including private pension schemes) hardly grew between 2006² and 2014. During the same period in France, the average pension increased by 11%.

Using the following equation, we can break down the change in the ratios of pension spending to GDP for both countries, based on the contribution of various factors:

$$\frac{\text{Pensions}}{\text{GDP}} = \frac{\text{Pop. 60+}}{\text{Total pop}} \times \frac{\text{Pensioners}}{\text{Pop. 60+}} \times \frac{\text{Pensions}}{\text{Pensioners}} \times \frac{\text{Total pop}}{\text{GDP}}$$

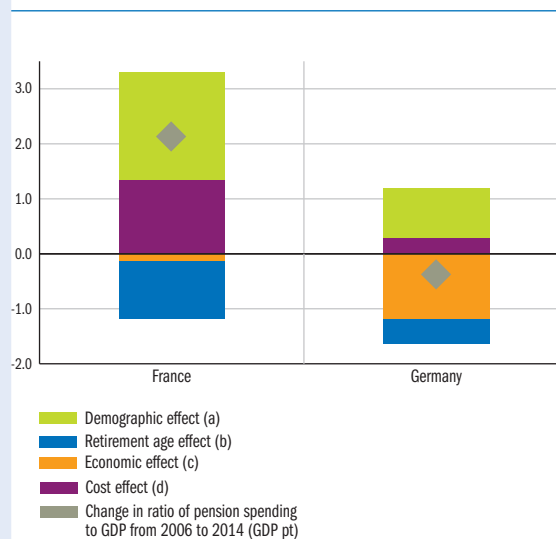
There are three main factors behind the divergence between 2006 and 2014 (see Chart below):

- the change in the average pension, which contributed 1.4 percentage point of GDP to the increase in the pension spending ratio in France, compared with 0.3 percentage point in Germany;
- demographics (change in the proportion of over-sixties), which contributed two percentage points of GDP in France compared with 0.9 percentage point in Germany (in France, the first of the baby-boom generation started to retire, whereas in Germany the impact of this aspect of population change was far more limited);
- the relative growth in GDP per inhabitant, which led to a reduction in the pension spending ratio of only 0.1 percentage point in France, compared with a 1.2 percentage point decrease in Germany.

Lastly, the retirement age has gone up in both countries, contributing more to a decrease in the spending ratio in France, where the retirement age was previously lower, than in Germany (a 1.0 percentage point reduction compared with a 0.5 percentage point reduction, respectively).

In France, the pension reforms that have already been implemented should limit the growth in spending in the coming years. In Germany, government pensions will be subject to significant reassessment in 2017.³ According to the European Commission's Ageing Report projections, the difference in government pension spending between the two countries is expected to decline by 2030, with a reduction of 0.2 percentage point of GDP in France compared with a 1.6 percentage point increase in Germany over the same period.⁴ Nevertheless, this will only halve the difference.

Contributing factors to the change in the ratio of pension spending to GDP from 2006 to 2014
(in % of GDP)



Notes:

- (a) change in ratio of over-60s/total population,
 (b) change in number of pensioners/over-60s,
 (c) change in real GDP per inhabitant,
 (d) change in average pension (real).

Source: authors' calculations based on Eurostat ESSPROS data (all old-age and survivors' pension schemes, including private pension plans).

¹ The cost of the measure in premium payments is estimated at 0.1 percentage point of GDP in 2011 (see Batard et al., 2012), equivalent to retirement savings tax incentives in France (EUR 2 billion according to the French State Auditor, the Cour des comptes).

² Data are not available to perform this calculation for periods prior to 2006.

³ IMF Country Report, No. 17/193, Selected Issue, July 2017.

⁴ This change is expected to result from less favourable demographic changes in Germany and a gradual catch-up in France in terms of the employment rate among older people, the replacement rate, etc.

1 percentage point of GDP corresponds to housing expenditure

The two countries have had opposing public spending trajectories in terms of housing expenditure (excluding welfare benefits). Investment subsidies and building grants (particularly for the construction of social housing) have expanded since the mid-2000s in France and represented 0.4 percentage point of GDP in 2014. In Germany, the private housing grants that represented approximately 0.6 percentage point of GDP at the beginning of the 2000s have been gradually phased out since 2006.

Furthermore, public spending on housing includes individual benefits paid by the social security authorities (classified in the social protection function) that are higher in France than in Germany, at 1.0% of GDP and 0.5% of GDP, respectively.

The French system also offers other benefits not accounted for in public spending (tax relief, reduced VAT, beneficial tax rates, etc.). Total government housing assistance in France amounted to 1.9% of GDP in 2014 (according to the French housing accounts, the Comptes du logement) with often questionable results and effects (see Sode, 2016).

Conclusion

On the face of it, the scale of the difference in public spending as a percentage of GDP between France and Germany and the way it has increased so rapidly are striking. Contrary to the situation in Germany, the growth in real public spending per inhabitant in France has not tailed off since 2002 while per capita economic growth has been significantly weaker.

Part of the difference, for example in health or education spending, can be explained by different choices of costs borne by the public or private sector and demographics. For these types of expenditure in particular, it is important to develop the analysis beyond a simple comparison of spending levels and also consider the effectiveness, quality and organisation of public services.

The comparison with Germany also highlights a critical area of intervention for controlling public spending: the proportion of spending on pensions, which it seems, can be reduced in France. The employment rate among the over sixties in particular is far higher in Germany. This not only has a positive impact on public spending control but also on economic growth. However, in these respects the social consequences cannot be ignored: the effectiveness of the German reforms

in terms of curbing spending on pensions has been achieved at the cost of a drop in the living standards of the over-sixties compared with the rest of the population.

In addition, there is a notable difference in public-sector employment, which is higher in France than in Germany. This difference should be qualified due to differences in accounting classifications,⁷ but remains nonetheless significant. This point has not been addressed in this study, and will be explored in other analyses.

Bringing French public spending closer to German levels to improve public debt sustainability would therefore require reforms whose economic effectiveness and social consequences need to be closely considered, which goes beyond the remit of this Rue de la Banque.

⁷ In Germany, public hospitals are categorised as non-financial corporations, thereby reducing the total government payroll but on the other hand impacting benefits in kind.

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