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This Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

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The Secretariat's draft report was prepared for the Committee by Paul O'Brien and Stéphanie Jamet under the supervision of Peter Jarrett.

The previous Survey of France was issued in June 2005.

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BASIC STATISTICS OF FRANCE

THE LAND

Area (1 000 km ²), 2002	632.8	Major cities (thousand inhabitants), 2005	
Agricultural area, excl. overseas departments (1 000 km ²), 2002	302.8	Paris	2 154
		Marseille	821
		Lyon	466

THE PEOPLE (2005)

Population (thousands)	62 818	Total labour force, excl. overseas departments (thousands)	27 559
Number of inhabitants per km ²	99	Percentage of employment in:	
Average annual increase (thousands) 1990-2005	310	Agriculture	3.6
		Industry and construction	20.5
		Services	75.9

PRODUCTION (2005)

Gross domestic product at market prices (euros billion)	1 708	Gross value-added by activity, at basic prices (per cent):	
Gross domestic product per capita (euros)	28 050	Agriculture	2.5
Gross fixed investment as a per cent of GDP (current prices)	19.7	Industry	17.9
		Construction	5.0
		Services (excl. FISIM)	76.6

GENERAL GOVERNMENT (2006)

ESA95 concept, as per cent of GDP:	
Total expenditure	53.2
Total revenue	50.0
Gross fixed investment	3.3

FOREIGN TRADE (2005)

Exports of goods and services (% of GDP)	26.0	Imports of goods and services (% of GDP)	27.0
Main exports as a percentage of total exports (SITC):		Main imports as a percentage of total imports (SITC):	
Food, beverages and tobacco (0 + 1)	10.4	Food, beverages and tobacco (0 + 1)	7.4
Chemical products (5)	15.9	Chemical products (5)	13.3
Manufactured products (6 + 8 + 9)	25.8	Manufactured products (6 + 8 + 9)	27.5
Machinery and transport equipment (7)	41.6	Machinery and transport equipment (7)	35.7

THE CURRENCY

Monetary unit: euro		Currency unit per \$	
		Year 2006	0.796
		April 2007	0.740

Executive summary

While growth has proceeded in France since the 2001-03 slowdown much as in the euro area as a whole, it has been held back by weak competitiveness. Employment has been rising and the budget deficit coming down, but persistent high unemployment and low participation reflect underlying structural problems that need to be further addressed. Stronger employment growth would be beneficial for fighting poverty and social exclusion, as well as for boosting public finances. A key objective is to improve the efficiency of all resource use, in particular in the public sector, to tackle social problems more effectively and achieve greater longer-term sustainability of public finances. This Survey looks at a selection of key issues that the new government should place high on its reform agenda.

- The social safety net does a reasonable job of protecting most people from poverty but is less good at avoiding social exclusion by facilitating integration into the labour market. Better co-ordination of policies and agencies towards meeting this objective is needed.
- The education system produces high-quality graduates in many areas, but its labour-market focus is insufficient. Outcomes do not match ambitions with respect to equity at which the system aims.
- The challenge of ageing has been only partially dealt with. More attention both to seniors' labour-market participation and to the financing of pensions, health and dependency care is called for.
- Decentralisation has made important changes in the way a number of policies are formulated and implemented. Moving responsibility to sub-national levels has not always improved efficiency, however, and accountability has sometimes suffered.

Tackling poverty and social exclusion is especially important for French policy-makers

A certain degree of duality in the labour market, where very well protected workers (“insiders”) are together with the unemployed and workers in insecure jobs (the “outsiders”) tends to foster exclusion. Present targeted policies relieve poverty quite effectively but need to be more employment-oriented. Better results from scarce resources would result from smaller increases in minimum wages. Increases in, combined with better targeting of in-work benefits would help to reduce poverty further.

The education system tries to promote equity and growth, with mixed results

Pre-primary and primary education meet the equity objective and achieve good average outcomes, but thereafter the performance of the education system could be improved. Stronger incentives to achieve good performance are needed at all levels. Enhanced autonomy in schools and universities may be one way forward. Higher fees and selection on entry to university would allow greater efficiency to be achieved.

There is no time to relax in facing the challenge of demographic ageing

Past improvements in pension finance have not removed the need for further reform to avoid steady increases in contribution rates to finance the future commitments of public pension schemes. Health and dependency care also present long-term risks for public finance. Increasing participation rates at all ages would help, especially for older workers who currently tend to retire before the age of 60.

The efficiency gains from decentralisation of public services have yet to be fully achieved

Following substantial decentralisation it has been hard for the State to fully disengage. Reform is difficult, given the number of levels of government involved and the overlapping nature of many responsibilities. A period of consolidation is needed, focused on clarifying responsibilities and enhancing financial incentives for cost-efficiency.

Assessment and recommendations

Despite the fall in unemployment, a perception of economic insecurity is quite widespread

French people have rather high expectations of their economy. In many respects it meets these expectations, delivering a high overall standard of living for relatively short working hours. Recently, output has been growing, unemployment has been falling and public finances have improved. Nevertheless, it is taking a certain amount of time for this progress to be reflected in public opinion. Poverty is no more widespread in France than in most advanced European countries, yet the public tend to believe that it is. A feeling of pessimism and insecurity has been sustained by persistently high unemployment, often leading to social exclusion, a problem for which the educational system struggles to find solutions. Demographic ageing, long foreseen but whose consequences have not yet been fully addressed, will soon be having a real impact on labour-force developments and public finances. This *Survey* concentrates on these linked issues – most of which have been raised in *Going for Growth 2007* – of unemployment, ageing, poverty and social exclusion, with which the new government will have to deal. Short-term economic trends are given less attention, though they merit continuing monitoring. Meanwhile, a quiet revolution in the organisation of public finance has delegated a number of important functions – including many related to poverty and social exclusion – to sub-national levels of government. The *Survey* also looks at the consequences and challenges of this less well known phenomenon, especially as it interacts closely with the efficiency of government intervention in social and labour-market policies.

Low labour utilisation is at the heart of many problems

Employment is the main means of combating not just poverty, but also individuals' sense of exclusion; it integrates people into society beyond merely providing an income and also enables them to gain experience and accumulate skills. Getting more people into jobs, hence contributing to growth and paying social insurance and income taxes, would provide finance for pensions, health and dependency expenditure and contribute to long-term fiscal sustainability, which is far from assured. While the education system is doubtless partly to blame for poor labour utilisation, especially where young people are concerned, there is a two-way link: its ability to motivate young people would be boosted if the labour market functioned better.

Structural reforms need to be continued

France has implemented some significant reforms to public finance over the last few years, although vigilance cannot be relaxed and further measures are needed. The 2003 pension reform, which increased the contribution period and aligned the civil service scheme on its private-sector counterpart, and the 2004 sickness-insurance reform designed to make health-sector professionals and patients more responsible, have together improved the budgetary outlook. Efforts to modernise State finances, with the full implementation of the new budget framework law, have also been important. Efforts have also been made in respect of the labour market. Notably, working-time regulations were relaxed somewhat in 2003 and 2005, making recourse to overtime easier; a reform of the public employment service, whose results remain to be seen, is also under way. But progress has been much less significant in the case of employment protection legislation. The regulations governing work contracts have been relaxed for small companies with the introduction of a new type of contract (the *Contrat Nouvelle Embauche*), but this is not available to firms employing over 20 people. A similar option for any firm taking on young people was abandoned after popular protest, *but the need to reform rigid labour-market institutions and practices remains*. Dealing with economic adjustments by measures designed to insulate the French economy or protect certain jobs or industries is both costly and, in the end, usually ineffective; the restated OECD Jobs Strategy shows that what is needed is to protect people, rather than existing jobs, and to promote work opportunities. Nor can demand-based policies to stimulate the economy solve fundamental supply-side deficiencies; moreover, they undermine public finances. The 2005 OECD *Economic Survey* devoted a chapter to the labour-market, and the recommendations there remain relevant.

A too-high minimum wage works against efforts to combat poverty

Compared with the median wage, France's minimum wage (the SMIC) is the highest in the OECD. It is often thought of as a means to combat household poverty, although it is not a good instrument for this purpose. It has come to be seen as a wage *norm* rather than a starting wage, as elsewhere. Given strong increases in the past, the SMIC has risen faster than the productivity of the low skilled. To increase low-skilled employment, *the SMIC should grow at much slower rates in the future by at a minimum avoiding discretionary increases. Over a long period the SMIC should rise no faster than the productivity of the low skilled*. This would allow for a less compressed wage distribution above the SMIC level that revives the prospect of moving up the income scale. A more considered way of determining the SMIC would make greater use of expert opinion and consultation, as in some other countries (for example in the United Kingdom's Low Pay Commission). Reductions in social charges on wages close to the SMIC have been beneficial for low-skilled employment, allowing it to grow during the 1990s and be maintained by avoiding increases in the cost of such labour during the implementation of the 35 hours legislation. To fight poverty there is a better solution than raising the SMIC and further cuts in social charges. This would use the *prime pour l'emploi* (PPE), an earned income tax credit, focusing it more directly on poor families. In devising a better combination of these tools, care should be taken to try to keep marginal effective tax rates as moderate as possible over the range of income where benefits are phased out.

The insider-outsider divide on the labour market needs to be tackled

Governments have sought to protect those in work with rules that make it complex and costly to dismiss an employee with a standard indefinite labour contract (the CDI); costs arise notably from uncertainty surrounding *ex post* judicial decisions on dismissal procedures. Firms have responded in part by recourse to short-term contracts such as CDDs, to help them adjust to shocks and structural change. The resulting dualism sets workers with CDIs against the unemployed and certain wage-earners who remain for a long time in insecure employment. It makes it sometimes difficult to move into a CDI, potentially exacerbating poverty and certainly adding to perceived insecurity, since the risks of getting trapped in the “outsider” category are substantial. The feeling of insecurity does not spare insiders either, as they may fear loss of security even while they benefit from it. Limiting dualism and facilitating labour-market turnover can help people to remain in employment on a more lasting basis, even if some may have to change jobs relatively frequently. *Employment protection legislation therefore needs to be overhauled.* One possibility is for the government to introduce a single contract, such that protection gradually increases in line with experience with the firm, conserving a role for judicial monitoring to avoid unfair dismissals (such as in the case of discrimination) while leaving the judgment as to the economic relevance of a decision to dismiss one or several employees to the employer alone. But there is a risk that the “single contract” solution could ultimately lead to less overall flexibility than existing arrangements, if the uncertainty that surrounds the level of detail of judicial interpretation remains. If this risk precludes such a comprehensive reform, other ways to ease the legislation on CDIs, such as widening the definition of economic dismissal, simplifying layoff procedures and reducing firms’ redeployment obligations, must be considered. Any new arrangements will improve matters only if they provide employers with at least as much flexibility at the beginning of a contract as does the current situation.

The employment rates of older people should be increased

The low employment rate of people over 55 is also partly the result of public misunderstanding of labour market behaviour. Two decades of policies have encouraged workers to retire early in the unfounded belief that this might boost youth employment; employers also adopted this way of thinking. Such policies are being dismantled, yet many related provisions are still in place such as that people over 57 receiving unemployment benefit are under no obligation to search for work. Attitudes towards issues like these are difficult to change: during the 2007 social security budget preparations, talks aimed at scrapping tax exemption on compensation paid by employers when workers over 60 are forced to retire (which most often were in fact voluntary retirements deliberately disguised as compulsory) did not succeed, and the exemption was *de facto* extended temporarily to all lump-sum payments due at the moment of retirement. *Incentives to retire early should be repealed: the waiver of job-search requirements and tax exemptions on bonuses paid at the moment of retirement ought to be discontinued.* Apart from the problem of incentives, the difficulty of employing older workers may theoretically stem from a divergence between their productivity and their wages, although this has not been shown empirically. Furthermore, enterprises are probably tempted to buy social peace by laying off older workers in difficult

times. Lifelong learning is one way to improve employment prospects for older people, though insufficient on its own. Some measures taken, notably under the National Action Plan for Employment of Older People, such as the announced elimination of the additional tax on businesses that lay off workers over 50, the increase in the *surcote*, which gives higher pensions to those who contribute for more than the normal number of years, the implementation of individual training rights, and a wide-ranging information campaign to change people's mentalities, have gone in the right direction, though the effects of the new CDD senior are as yet uncertain. However, it should also be ensured that wages of older workers reflect their productivity.

Policies encouraging the excluded and the jobless to find jobs should be made more effective, to curb the persistence of poverty

Poverty is all the more detrimental when it persists over time. The unemployed are entitled either to unemployment insurance, if they have contributed long enough, or to some other form of income. There are nine "social minima", social transfers intended for the poorest groups of people, the main one being the minimum subsistence income (RMI). Entitlements and obligations vary greatly across the various schemes. It is important to *harmonise the rights and obligations of jobless and potentially active people, introduce a common system for bringing them back into employment, make looking for work compulsory and target the measures on those most in need instead of on the particular benefit they receive*. Harmonisation requires a system in which one single nationwide institution is in charge of all the schemes, which would be much easier if the body providing placement services for the unemployed (the ANPE) were better coordinated with and in the longer run merged with that responsible for unemployment insurance (UNEDIC).

Policies to address the geographic dimension of poverty should focus more on individual needs

The geographic concentration of poverty fosters its persistence, as people living in overwhelmingly poor areas lack access to social networks that might help them to integrate into the economy. The problems in question are made more complex by the fact that people of immigrant origin are over-represented in these areas. To deal with them "zoning" policies involve concentrating resources on such areas without targeting specific population groups. The most developed example relates to education. Targeting resources at education priority areas (ZEPs) has had a positive impact but also gives rise to the wrong sort of incentives. Areas classed as ZEPs are stigmatized; those who succeed leave them, and those who have the choice avoid living there. The schools in question are staffed with teachers who have less experience and are unable to choose where they are posted. *A larger proportion of resources should be allocated as a function of schools' needs rather than according to their location*. The schools selected in the "ambition réussite" programme can be thought of as a first step in this direction. *Furthermore, the system of salary and other incentives for teachers choosing to work in these establishments needs to be better thought out. This approach could be generalised to other interventions, shifting the focus of support more directly onto individuals*. Notwithstanding this general approach, there will clearly be occasions when radical, geographically-defined measures are appropriate.

Housing is also central to these problems, both as a reflection of poverty and as a factor potentially contributing to exclusion. Publicly provided low-cost rental housing aims at social diversity, precisely to mitigate the geographic concentration of poverty. But the resulting widespread eligibility for such housing leads to excess demand for it. Even if charging income-related rents meant that financial assistance were given only to people who need it, it is not certain that provision of public housing alone could eliminate homelessness, let alone substandard housing. For given resources, increasing benefits provided directly to individuals as housing assistance (which currently amount to about 0.8% of GDP) would be more efficient. However, if housing supply is partially inelastic in the short run, such assistance inevitably has the generally unpopular effect of benefiting landlords as well. To increase the elasticity of supply, legislation on security of tenure may also need to be revisited; for example, the effect of regulations making it difficult to terminate a lease in the event of non-payment is certainly to reduce overall supply for low-income tenants. *Regulations concerning the renting of accommodation must not be such that they depress the supply of private housing. Efforts to provide support for poor families must be continued and focus on cost-effective ways of increasing supply.*

The education system plays a vital and difficult role in reducing inequality and also in contributing to potential growth

The education system plays a key role in determining the rates of human capital formation and long-term potential growth and the average standard of living. It also aims to contribute to a reduction in inequality, although this is difficult, since parental influence comes into play at every stage of a child's development. Pre-school education for all children does reduce a large proportion of inequalities and is highly developed in France, where all children are enrolled in public pre-schools at age three, and the beneficial effects on equity seem apparent up until secondary school. Inequalities between students appear to become more marked at secondary level.

Better performance indicators must play a more direct role in the search for improvement by teachers, heads and schools

Educational expenditure per student at secondary level is high compared with other OECD countries. Recent OECD studies do not suggest that the system has any major shortcomings, but there are nevertheless a number of countries that achieve better results with comparable resource levels. To improve results, it is first necessary to be able to measure them properly. Measurements of "value added" already exist and are publicly available for upper secondary schools (*lycées*), but *these need to be improved and extended to lower secondary schools (collèges)*. Once these measures are available, it will be difficult for schools to avoid responding to any indications of poor performance.

A traditional feature of the French system has been the lack of autonomy given to school heads, at least in public schools. They have little say as to the recruitment of teachers or their pay, while the curriculum is drawn up in some detail at national level. *Improving secondary school results will require either that the education authorities be more responsive when a school's performance is inadequate, or that school heads be given more autonomy and made*

accountable for finding solutions, within the constraints of clear national standards for pupils' achievement. It is difficult to know which approach is preferable, but the OECD PISA study findings would seem to show that it is the systems with the most autonomy that give the best results. Certain reforms and experiments are already giving schools more autonomy, and these programmes should be continued while at the same time gauging their effectiveness.

The role of parental choice and the “carte scolaire” in improving school performance is controversial

The role played by competition between public schools is insignificant. As a rule, following egalitarian principles, pupils are assigned to schools on the basis of set geographic catchment areas (the “carte scolaire”). In practice, a small proportion of well-informed parents do succeed in getting round the constraints of their catchment area, and some upper secondary schools have managed to introduce more or less explicit selection for high-ability children. Furthermore, given the geographic concentration of poverty and exclusion already mentioned, some schools have a very high proportion of difficult-to-handle children, and the social mixing that the *carte scolaire* is meant to achieve is limited. Both of these phenomena tend to undermine equity and lead to calls for relaxation of the role of the catchment areas and (which need not mean the same thing) greater school choice. Free school choice could worsen the problem of segregation, given the advantage of better-off well-informed families, and lead to cream-skimming by schools. To avoid these problems, fundamental reforms would be needed to ensure that resources allocated to public schools reflect families' choices. *In the absence of such reforms, the “carte scolaire” should be retained.*

In any event, the responsiveness of the current system, with major decision-making concentrated in the bureaucracies of the regional education authorities needs to be enhanced and badly-performing schools must be given incentives to improve. However, it is unlikely that the ultimate sanction, used in certain countries, of closing schools whose performance remains persistently very poor despite significant efforts to improve the situation, would be acceptable in France.

Higher education suffers from the paradox that, while there is no selection at entry to university, this does little to enhance equity

Passing the *baccalauréat* – the end-of-secondary-school examination – entitles students to enrol in the university course of their choice (though entry is automatic only for universities within the student's *académie* of residence). The fact that there is no selection on admission (except in certain special cases) while education is essentially free is responsible for a series of dysfunctions. The best students seek to stand out by taking courses of study that involve selection, i.e. the *classes préparatoires* and then the *grandes écoles*. Others take shorter selective courses aimed directly at learning a profession, as in the higher institutes of technology (IUTs), often going on to take traditional university courses after avoiding the first two years. Graduates of these short courses are very well placed on the labour market, due to the ties established between IUTs and businesses. The IUTs were originally intended for students less well suited to longer and more theoretical university courses, but lack of places on the more expensive IUT courses means that many

such students find themselves at university anyway. For want of relevant information, a high proportion enrol in courses with poor career opportunities and are at risk of dropping out and then find themselves badly placed in the labour market. Universities are now developing systems for providing information on course-specific career prospects and are to advise students as to how compatible their choices are with the type of *baccalauréat* they passed and the grade achieved. This type of information is necessary and useful, but it will not be sufficient to achieve a significant improvement in the distribution of students among courses on the basis of their abilities. Given that the system is already implicitly selective in many ways, *selection should be made explicit and introduced for admission to university. High school graduates should not be allowed to enrol in free courses which the university considers them highly unlikely to complete successfully.*

Higher education also lacks resources, and they are poorly distributed

Expenditure per student in higher education is low compared with that in other OECD countries, and tuition fees contribute only a small part of the cost of the services provided. Students are slow to complete courses, and the dropout rate is high. This situation is inequitable: the students who benefit the most are those who engage in the most advanced studies, since they will be in the best position on the labour market; their parents, in many cases, have the highest incomes. In addition, increasing the input of public resources will be difficult, given the foreseeable pressures on the budget. But higher tuition fees could provide funds to improve the quality of higher education. *Such fees should be gradually but significantly increased and set at a level proportional to, though less than, the costs of courses. Equity in access to higher education could be ensured by a system of loans repayable on the basis of future incomes, if necessary augmented by a system of grants.* If universities were more accountable and had more autonomy – as recommended by the Cour des Comptes – competition to attract students would be stimulated, and they would be encouraged to make more effective use of these increased resources.

Pension reform must continue so as to cope with the pressure that will be exerted on government spending by population ageing

The additional government spending that France will have to finance between now and 2050 because of increased pensions, health and dependency care related to population ageing is estimated by the authorities at more than four percentage points of GDP, and that is under relatively optimistic assumptions. After the progress made in the 2003 pension overhaul, it is now essential to increase employment among older workers and to continue these cost-cutting efforts in 2008 *by preserving the rule that the contribution period should be indexed to life expectancy as foreseen in the 2003 law.* This solution, and/or a cut in the replacement rate, is preferable to increasing contributions; taxes and social contributions are already too high, damaging output and employment. Fairness and, to a lesser extent, public-finance concerns dictate *an immediate start to the process of gradually eliminating the privileges of the “special” regimes covering employees of current or former public enterprises, which have so far been spared reform.*

The cost and effectiveness of health care and dependency policies for the elderly need to be monitored

The health care and dependency-related costs of population ageing are more uncertain than those of retirement pensions because they depend on technological progress, price trends for services and treatment, and the share of expenses paid by families. Moreover, it can be difficult to distinguish between health care and dependency spending, while local government assessments of individuals' degree of dependence seem to be subject to inconsistencies. For these reasons, it is important to provide public information on the current level and projected trends in spending, and on the content of existing policies, their funding and how responsibilities are shared. Such information would provide the basis for deciding, jointly and explicitly, the magnitude of the costs to be borne by families, and thus for encouraging people to set aside the necessary savings.

Consistent principles promoting clear accountability should guide the organisation of State and lower levels of government

The different levels of local government have progressively been given responsibility for implementing, and in some cases formulating, a significant part of policy on poverty, education and population ageing, as well as in other areas. This "decentralisation" can take two contrasting forms: transfer of full responsibility for a given function; or transfer of the implementation of a public policy for which the State sets the specifications. In practice, there is a continuum of situations in which responsibilities are shared between the State and sub-national governments. Ideally, each case should reflect an appropriate trade-off between the need to make local authorities accountable to their electorates for framing and implementing effective local policies, and a desire for services that are of identical quality nationwide, and thus specified by the State. Decentralisation in France is partly the result of one-off decisions, taken without full consideration of this trade-off, and this has led to a number of inefficiencies. To achieve the hoped-for gains in the cost-effectiveness of government spending, *the division of responsibilities between the State and sub-national governments should be gradually stabilised and clarified with a view to enhancing accountability.* Unlike central government outlays, spending by lower-level authorities is not subject to rules to assign objectives nor to produce performance indicators. To stimulate competition through information and facilitate policy evaluation, *a system should be developed to give taxpayers readily accessible information on the expenditures of sub-national governments, how they are financed and the quality of services rendered, as recommended by a number of recent reports submitted to the government.*

The State also intervenes in local taxation by granting tax exemptions to certain kinds of households or businesses, and then compensates with offsetting financial transfers. As a result, own tax revenue has shrunk in relation to sub-national governments' total resources, loosening the ties between citizens and their elected officials and making those governments less accountable. *Functions lying essentially with sub-national governments should be financed by local taxes, and State-granted exemptions from local taxes should be gradually eliminated. Services over which sub-national governments have little decision-making power could be funded by transfers from the State, but with mechanisms that encourage those governments to*

pursue efficiency goals. The use of financial transfers from the State should be refocused on the objective of equalisation to offset inequalities between lower-level entities, which will be greater if responsibilities are financed to a greater extent by local taxes. Any other intervention by the State should be limited to situations where there are clear cross-jurisdictional externalities.

Responsibilities of the various levels of sub-national government should be defined more clearly and the system simplified

The system of sub-national governments is complex, comprising three main levels with no hierarchical relationships among them. Each level has wide powers within its borders, leading to a number of overlapping responsibilities. Added to this are multiple forms of co-operation between municipalities, most recently “intercommunality”, intended to improve efficiency but often not achieving it. On the contrary, this complexity lies at the root of a number of inefficiencies which should be corrected if decentralisation is to yield its full benefits. From the pure efficiency perspective, reducing the very large number of municipalities (36 500) would be a useful step. In its absence, *overlapping responsibilities should be limited by gearing the system towards greater specialisation by the various levels of sub-national government, thus limiting the “general powers” principle, and appointing “lead managers” to take responsibility in each domain.* Lead managers already exist in a number of areas; they must be given the responsibilities and the powers needed to implement effective policies. *The State intercommunality grant, intended to encourage co-operation but in practice also encouraging spending, should be time-bound, giving a stronger incentive to exploit available economies of scale.* In the longer term, the State could consider implementing a single consolidated grant to be distributed by the “intercommunality” groupings and the communes according to the tasks for which they are actually responsible. But this could weaken citizens’ control over decision-making, since those in charge of running these groupings are not directly elected at the moment, and decisions on allocating resources would be difficult.

To keep public finances sustainable, government employment must be rolled back

The State has not reduced the number of its civil servants in line with the reduction in its responsibilities. Lower levels of government have been recruiting massively. The resulting sharp rise in government employment leads to increased pension costs for the future as well. The State must take advantage of the forthcoming retirement of large numbers of its civil servants *to reduce overall government employment. So-called “deconcentrated” State services, which duplicate the efforts of corresponding agencies of sub-national governments, should be evaluated and abolished if they are not strictly necessary.*

Chapter 1

The key challenges facing the French economy

Output has been growing at near-potential rates since late 2005, accompanied by an acceleration in employment growth and falling unemployment. The general government budget deficit shrank quite significantly in 2006, even though economic growth was only moderate. The recovery remains rather hesitant, and the slight but persistent growth advantage that France has had over important trading partners such as Germany and Italy for more than a decade seems to have vanished or reversed. Relieving prevalent pessimism and improving the foundations for economic growth would be helped by dealing adequately with poverty and social exclusion, in large part through improved labour-market performance, and by operating an education system that is seen to promote equality of opportunity and prepare young people for the labour market; two chapters of this Survey deal with these issues. Despite the recent improvement in public finances, there remains the longer-term challenge of the demands that demographic ageing will bring, to which a further chapter is devoted. Another challenge for public finance is to organise the decentralisation of government functions to the appropriate level of local government, while maintaining incentives for cost-efficiency, an issue taken up in a chapter on fiscal federalism.

The French economy has been slowly improving since the severe slowdown in 2001-02, but the recovery has been neither strong nor steady. Prospects brightened in 2004, but performance in 2005 disappointed. Growth through 2006 and into 2007 looks to have been stronger, but quarterly variability makes it difficult to judge how sustainable the acceleration is. In 2007 growth is unlikely to be much higher than in 2006, and France may register another year of more sluggish growth than Germany (Table 1.1). This appears to mark a change in relative fortune: France outperformed Germany and Italy consistently in the 1990s and up to about 2005, though lagging growth outcomes in the United States, the United Kingdom and catch-up economies such as Spain (Figure 1.1).

Table 1.1. **Short-term outlook**

Percentage changes from previous period, at 2000 constant prices, unless indicated

	Current prices € billion in 2003	2004	2005	2006	2007	2008
Private consumption	900.4	2.5	2.1	2.6	2.2	2.6
Government consumption	378.5	2.2	1.1	1.9	1.7	1.0
Gross fixed investment	300.8	2.6	3.7	4.0	3.9	2.0
Private investment	131.4	2.7	3.7	4.2	3.7	2.0
Residential	80.2	3.3	4.1	2.5	0.7	0.5
Non-residential	169.4	2.4	3.5	4.9	5.0	2.6
Government investment		2.2	3.9	2.9	4.8	2.3
Final domestic demand	1 579.7	2.4	2.2	2.7	2.4	2.1
Stockbuilding ¹	1.1	0.3	0.0	-0.3	-0.4	0.1
Total domestic demand	1 580.8	2.8	2.1	2.4	2.0	2.2
Exports of goods and services	408.5	3.3	3.3	6.2	4.0	5.9
Imports of goods and services	393.1	5.9	6.5	7.1	3.5	5.8
Net exports ¹	15.4	-0.8	-0.9	-0.4	0.1	-0.1
GDP at market prices	1 596.2	2.0	1.2	2.1	2.2	2.2
Consumer price index, harmonised		2.3	1.9	1.9	1.3	1.7
Underlying price index, harmonised		1.8	1.5	1.5	1.6	1.7
Employment		0.1	0.5	0.9	0.9	0.9
Unemployment rate (average of INSEE monthly estimates)		10.0	9.8	9.0	8.4	8.0
Unemployment rate (average of Eurostat monthly estimates ³)		9.6	9.7	9.4		
Potential output		1.9	1.8	1.8	1.8	1.9
Output gap (level)		-1.4	-1.9	-1.6	-1.3	-1.0
Household saving rate (level)		12.7	11.9	11.9	12.5	12.0
General government financial balance ²		-3.6	-3.0	-2.6	-2.3	-1.7
Cyclically adjusted ²		-2.7	-2.0	-1.7	-1.7	-1.3
Gross public debt, Maastricht definition ²		64.5	66.7	65.6	63.9	62.1
Current account balance ²		0.1	-1.2	-1.2	-1.0	-1.0

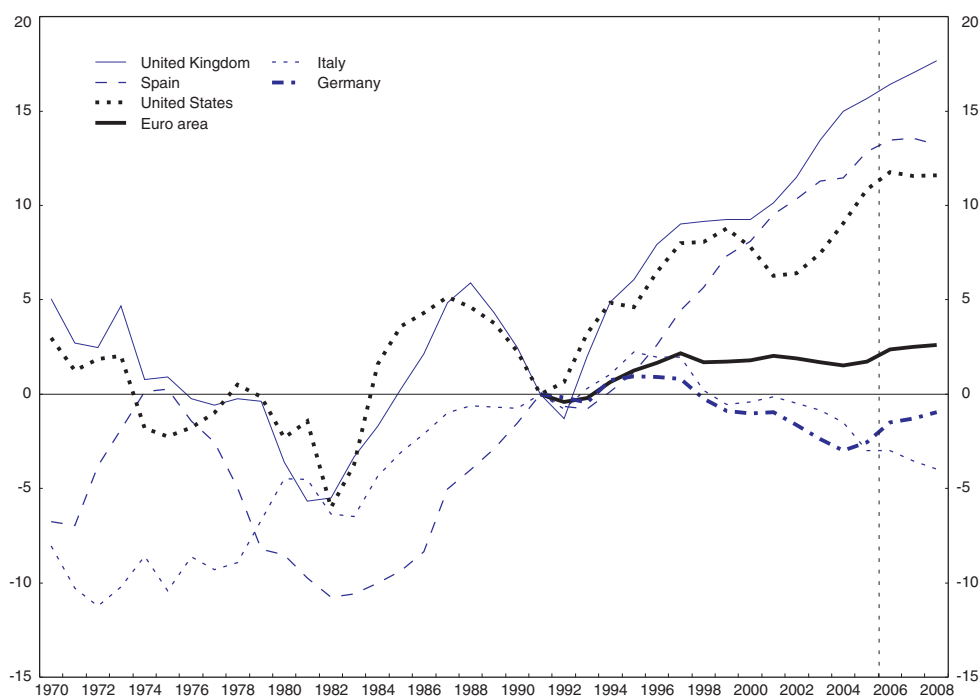
Note: Data in this table do not reflect revisions to historical series entailed by the shift to chain-linking constant price expenditure data; in particular new data show GDP rising 1.7% in 2005 and 2.2% in 2006.

- Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
- As a percentage of GDP.
- The monthly INSEE estimates may be substantially revised for 2005 and 2006 when the results of the 2006 labour force survey are taken into account; this revision was expected in March 2007 but has been delayed.

Source: OECD, OECD Economic Outlook, No. 81.


Figure 1.1. **Changes in relative GDP per capita, 1970-2008**

Per cent deviation from the 1991 level relative to France



Note: 2006 to 2008 data are estimates and projections (*Economic Outlook*, No. 80).

Source: OECD, *Economic Outlook* database.

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It is hard to argue that the major reason for the hesitancy of the recovery lies in aggregate demand. Consumption growth has been variable, but the saving rate has been declining since 2003, and export markets have been expanding vigorously, at rates fluctuating between 7 and 10% per year since 2004. It is true that investment growth has been only moderate, but this is perhaps not surprising since its level is relatively high, amounting to 20% of nominal GDP in 2006, its highest share since 1992. Although aggregate foreign and domestic demand has thus been rising quite rapidly, domestic output has not, on the whole, been able to keep pace. Of the total increase in final demand since 2000, less than three-fifths has been met from domestic supply, *i.e.* increases in GDP, the rest from higher imports; since 2003, as foreign demand has become a relatively stronger component of total demand, the split has been even less favourable, with not much more than half of the increase in demand satisfied by higher domestic output (Table 1.2).

Table 1.2. **Domestic and foreign supply in final demand**

Cumulative change, as a per cent of GDP ¹	2000-06	2000-03	2003-06
Total final demand, including exports	16.1	5.3	10.1
Domestic supply (GDP)	9.4	4.0	5.5
Foreign supply (imports)	6.7	1.4	4.6

1. For 2000-05, calculated as the cumulative sum of contributions to annual chain-weighted GDP growth. For 2005-06 calculated using the annual change in the sum of quarterly GDP components, 2000 prices.

Source: OECD *Economic Outlook* database.

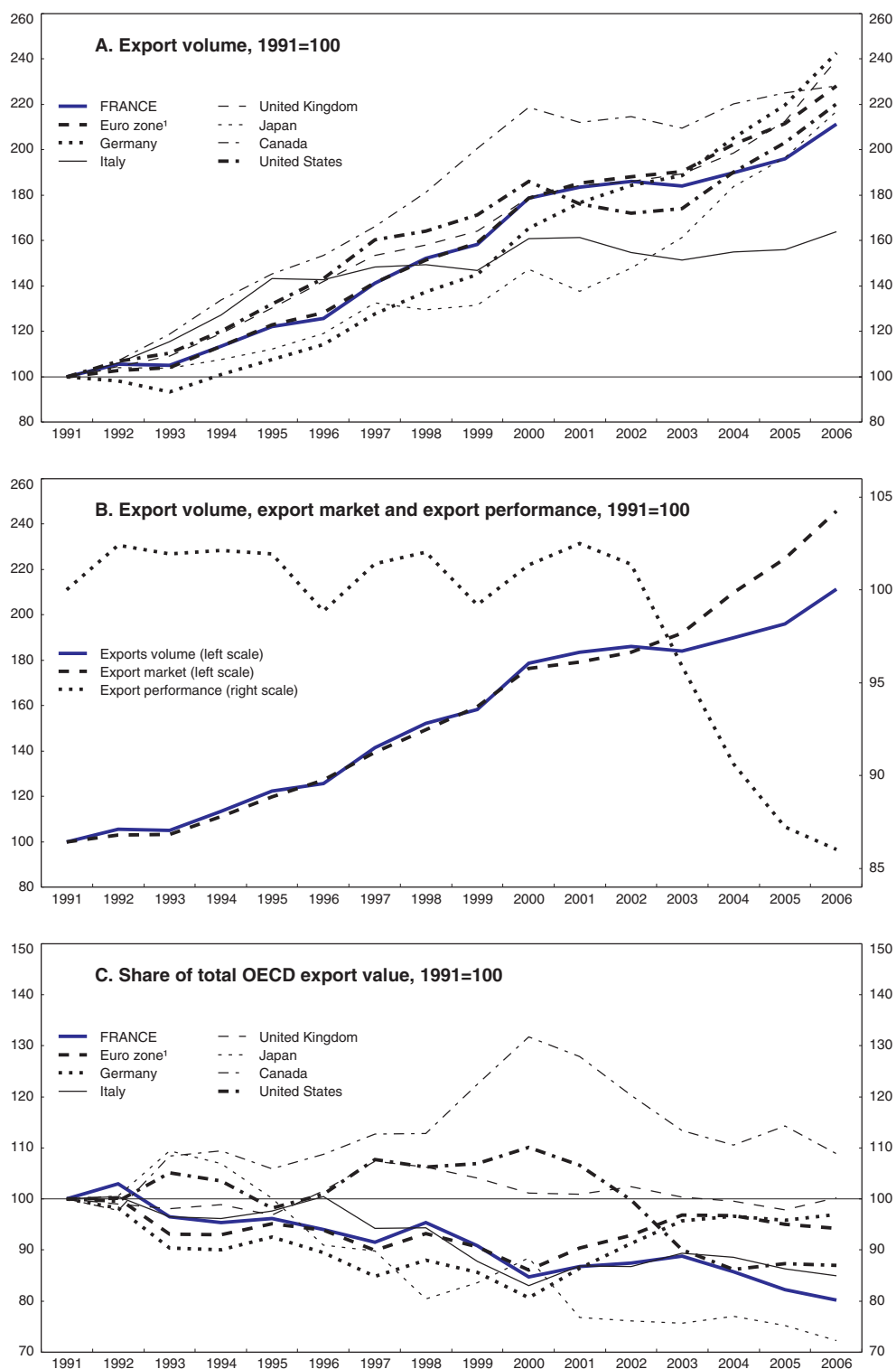
The French economy thus seems to have been unable to take full advantage of the upturn in domestic and foreign demand. At the same time, exports themselves have been growing somewhat less than might have been expected. In common with most of the high-income OECD economies, France has been slowly losing world market share over several decades, partly to some of the smaller but fast-growing OECD countries but mainly to the dynamic non-member countries. Part of the longer-term decline in France's share of OECD exports by value is attributable to a combination of small but persistent relative geographical specialisation and price effects. This can be seen by comparing the different measures in Figure 1.2, since for most of the 1990s export volumes grew in line with France's traditional markets; but over the period 1991-2006, French export market growth, as calculated by the OECD, averaged 6.1% compared with slightly higher rates for Germany and the United Kingdom and 6.8% for the United States. However, while France's performance in traditional markets was relatively stable during much of the 1990s, since about 2002 it has declined quite sharply (Figure 1.2, Panel B). Movements in cost competitiveness and other influences such as the geographical or commodity composition of trade do not fully explain the recent extent of market share losses. Previous *Economic Surveys* have suggested that improvements in competitive conditions and labour-market institutions could increase the supply responsiveness of the economy; some progress has been made in these areas, but more can be done.

This *Survey* focuses on the search for efficient ways to achieve policy objectives less directly related to growth, but which are nevertheless important for it, being closely related to labour market developments and the system of public finance. It covers poverty and social exclusion, as well as education, all closely linked to labour market performance. Many policies have been increasingly decentralised to sub-national levels of government; this follows a demand for more locally responsive policies but also seems to be associated with a degree of overlap and waste, at least in the short run. The *Survey* also looks at the longer-term impact of demographic ageing, whose impact on public finances is already building up.

The budgetary situation has improved, as the general government deficit fell in 2006, to an estimated 2.6% of GDP compared with 2.9% in 2005. Because the 2005 figure included a one-off contribution from a pension fund transaction with the public electricity company, this means that the underlying improvement was about 0.7 percentage point of GDP (Figure 1.3). Despite near-trend economic growth, tax revenues were quite buoyant, and there was some moderation in spending increases. Expenditure by the State has been particularly well controlled, with zero volume growth since 2004. This has been achieved partly by the transfer of potentially fast growing spending items to sub-national governments; in addition, some items that used to be classed as outlays – transfers to other levels of government or social security to compensate for reductions in taxes or social contributions – have been re-classified, perhaps more correctly, as negative revenues. Other opportunities for expenditure restraint have not yet been fully seized: notably, the accelerating pace of retirement of civil servants has not yet been used to bring about a significant fall in public employment. In 2007, the first year in which the State budget has been drawn up on a fully task-oriented basis, as required by the 2002 state finance framework law (the "LOLF"),¹ the target is for a real reduction in State outlays of 1%.

Both local government expenditure and social security and health spending have grown in real terms, and as a share of GDP, in the last few years. But there is some sign that control over health outlays is improving, as it came in within the planned nominal ceiling in 2005 for the first time in several years and did the same in 2006. Expenditure by sub-national governments has been growing steadily more rapidly than overall public

Figure 1.2. **Export trends and performance**
Goods and services



1. Includes intratrade.

Source: OECD, Economic Outlook 80 database.


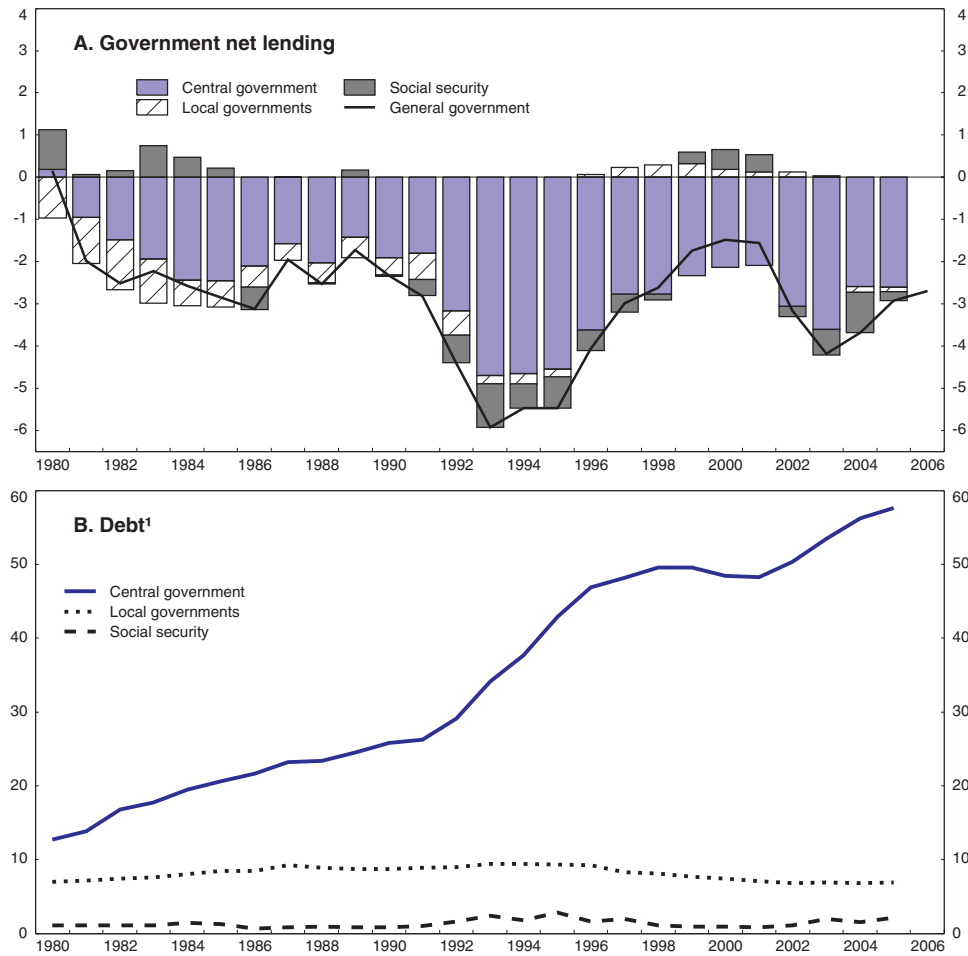
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Figure 1.3. **Government deficits and debt**

Per cent of GDP



1. Maastricht definition.

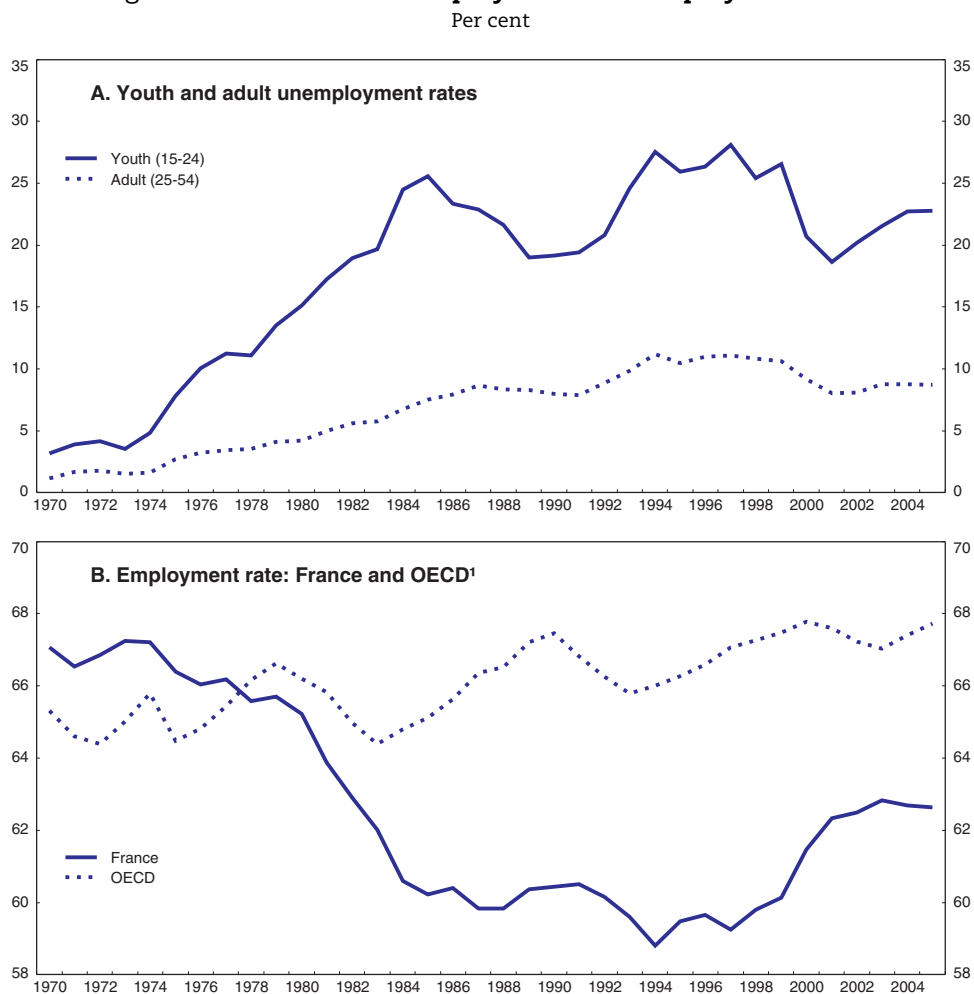
Source: INSEE, Comptes nationaux; OECD, National Accounts.

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expenditure for some years, however. In itself this does not lead to an increase in the overall deficit, because the borrowing rights of local government are fairly strictly circumscribed. But there are concerns about the efficiency of spending and local taxation, discussed later in this section and in Chapter 5.

With the rather hesitant upturn in output growth, employment, which had fallen during 2003 and early 2004, has also been increasing rather slowly. Hence, unemployment began to fall noticeably only in 2005 (Figure 1.4). According to the monthly count of registered jobseekers (estimates for which for 2006 have not yet been finalised by INSEE), by the beginning of 2007 it was at roughly the level to which it fell in 2001, at the peak of the last cycle. But labour force survey information (which has not yet been finalised by INSEE) suggests that it is considerably higher; it may be some months before the picture is clear.² Even so, it still represents a definite drop in unemployment after a period from 2003 to 2005 in which a moderate recovery in GDP growth appeared to be having little or no impact on labour-market conditions. Apart from the favourable effects of renewed

Figure 1.4. Trends in unemployment and employment rates



Note: Data for 2006 are estimates.

1. As a percentage of working-age (15-64) population.

Source: OECD, LFS database.

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economic growth, some part of the increase in employment is attributable to recent developments in employment policy, such as the *Plan de développement des Services à la Personne* (the Plan To Encourage Personal Services) and the *Plan d'Urgence pour l'Emploi* (the Priority Plan for Employment).

The level of unemployment is still high, however, and “insecurity” continues to be an important factor affecting sentiment. According to an opinion poll,³ despite these indications of improvement, in February 2007 73% of French adults felt that life in France was getting worse and only 5% that it was improving; some other large European countries displayed a similar degree of pessimism, but it seems more marked in France. “Insecurity” seems to concern a significant proportion of the employed as well as the unemployed, as there is a recognition of a certain degree of dualism in the labour market: the contrast between “insiders” with well-protected permanent jobs and “outsiders” in insecure, “precarious” employment has been steadily more clearly perceived. Much of this is related to different age groups, with most people having to wait at least until their thirties before

they accede to the insider group, and with perceived insecurity tending to increase for older age groups, even among the “insiders”.

The previous OECD *Economic Survey* described in some detail the main aspects of the labour market that create this situation. Employment law puts some groups of people at risk, ironically by requiring employers to protect their employees against a wide range of risks, including some which they are not well placed to cover. For example, firms above a certain size are required to make quite costly efforts to help redundant workers find new jobs; while this provision may not be too burdensome in the case of individual redundancies, when mass layoffs arise because of the economic situation of the firm, it may be hard for the employer to meet such obligations. Thus, employers are likely to be particularly wary of taking on new workers when they are uncertain of the outlook for their firm. They will tend to seek ways to increase output without increasing employment or by recruiting workers on temporary contracts; various types of such contract that are exempt from some parts of the standard labour code have been developed over the years.

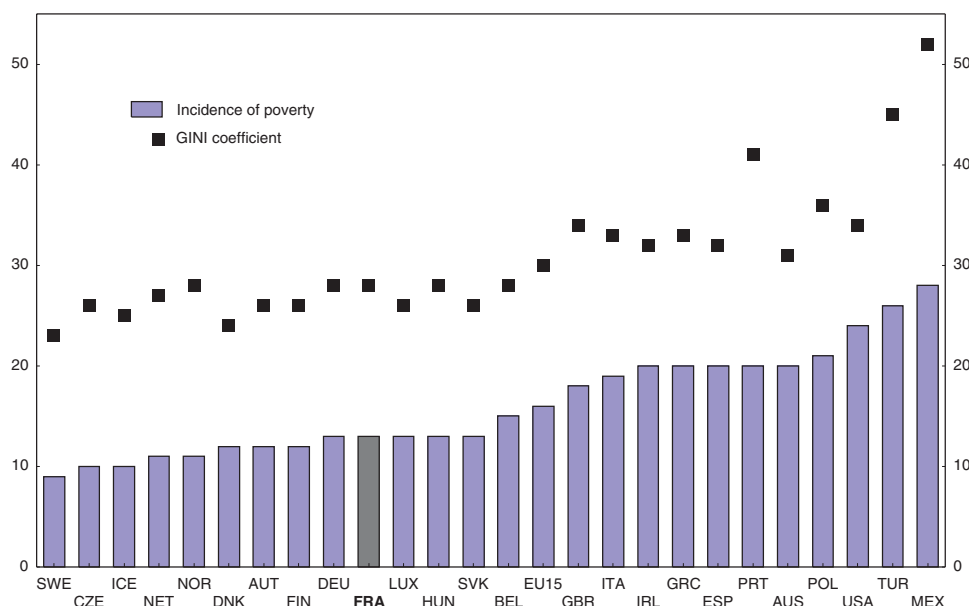
One way to reduce the insider/outsider problem would be for the authorities to try to unify the different employment contracts in such a way as to increase employment opportunities for everyone by creating flexibility at the beginning of the contract and reducing the risk of judicial intervention in layoffs.⁴ Wary of the political difficulties of undertaking a comprehensive overhaul of the labour code, the government has instead tried to widen the range of contracts, with only partial success. A successful step was the introduction in the autumn of 2005 of a contract which applies to small firms (i.e. with less than 20 full-time equivalent employees) which provides more flexibility at the beginning of a contract by establishing a two-year probation period. In early 2006 the government also announced a similar provision for people under 26, but this was soon withdrawn following widespread social protest, notably but not exclusively by students. The conclusion appears to be that French people are more worried about the possible behaviour of employers towards their current employees, if the employers were given more freedom, than they are about the possibility that current arrangements permanently restrict hiring and thereby raise unemployment.

Another aspect of labour market policy to which a number of previous *Surveys* have drawn attention is the minimum wage. The level of the minimum wage has risen substantially relative to the median wage as the compulsory reduction of weekly working time without loss of earnings was imposed over the years from 1999 to 2005. And the large tax wedge, a consequence of high levels of public spending, tends both to reduce work incentives and increase costs to employers. Reductions in social contributions for wages at or near the minimum have partially offset the perverse effects of the labour cost at the level of the minimum wage. A report from the Conseil d’Orientation de l’Emploi (Employment Policy Council) has underlined their effectiveness; although these reductions require higher contributions or taxation elsewhere, given the high level of the SMIC, their net effect on employment has been clearly positive.

Poverty and social exclusion are perceived as important problems


The incidence of (relative) monetary poverty in France is comparatively low among OECD countries, when conventionally measured as the share of the population living in households with per capita income below a certain percentage of the median (a 60% threshold is typically used in Europe) (Figure 1.5). Thus measured, it is lower than in most of the large European countries and than in the United States, and is only slightly higher

Figure 1.5. **Poverty incidence and inequality**¹
2005 or latest available year²



1. Percentage of people whose equivalent disposable income, including social transfers, is less than the poverty threshold, i.e. 60% of the median equivalent disposable income.
2. 2003: United Kingdom and Turkey; 2000: Australia, United States and Mexico.

Source: Eurostat database; Forster, M. and M. Mira d'Ercole (2005), *Income Distribution and Poverty in OECD Countries in the second half of the 1990s*, *OECD Social Employment and Migration Working Papers*, No. 22.

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than in the Nordic countries, which are the most successful in its minimisation. It is nevertheless a major public issue in France, perhaps because the “republican values” of liberty, equality and fraternity can be taken as laying particular emphasis on avoiding excessive income disparities, and economic debate frequently places a heavy weight on the potential impact of policy on poverty.

The low level of relative poverty suggests that this approach has been quite successful; there is no need for a major effort to deal with poverty among large numbers of people. Instead, several related issues stand out. One is the cost-effectiveness of the current set of policies: given that any individual case of poverty is important for the people concerned, whatever the overall level may be, an important question is whether existing strategies and institutions use resources in the best way. The other is the link between poverty and social exclusion. Social exclusion is hard to define precisely and even harder to measure statistically, but is more damaging than poverty *per se*, generally being associated with protracted periods of poverty. It concerns people whose links with society, and in particular with the mainstream economy, have become so weak that they are likely to be unable to take advantage of either market mechanisms or even many public policies that are aimed at the poor. A third issue, which is linked to these first two, is the degree of geographic concentration of poverty and social exclusion, and its connections with housing conditions and policy.

Despite the difficulty of defining some of the concepts clearly, most escape routes out of poverty or exclusion involve strengthened attachment to the labour market. Employment provides material resources but is also important for social links without which poverty can become exclusion. In-work poverty is no more widespread than in the

average OECD country and is mostly associated with households where there are dependants and only one earner. For some poor people the problem is that they do not have, or cannot find, full-time work throughout the year. But this is not always the case; for a significant number of families, having one person working full time, even at the relatively high minimum wage, is not always sufficient to avoid relative poverty.

Raising the minimum wage is thus often presented as a poverty-reducing measure. But, with 15% of workers earning the minimum wage, raising it is likely to increase unemployment. This may not have much direct effect on overall measured poverty insofar as the people who lose their jobs are already below the 60% threshold, while some who get the higher minimum wage may move above the threshold, thus possibly reducing measured poverty even if employment falls. But it is very likely to increase social exclusion by making it more difficult for the low-skilled unemployed to find jobs. As discussed in Chapter 2, there is room to improve the balance between raising the minimum wage on the one hand and cutting social security contributions to compensate employers, on the other, and the alternative use of the earned income tax credit, the *prime pour l'emploi*, so as to achieve both better employment outcomes and tighter targeting of resources to reduce poverty.

A large number of other monetary benefits exist, and they are mainly responsible for the low poverty rate (measured after taxes and transfers), despite the poor labour-market performance. But they are also a cost for public finances; among other things they help to maintain the high tax wedge on labour which, although partly compensated for by the reductions in social contributions, may discourage activity among employees whose net income is therefore reduced. Progress has been made in recent years in reducing the disincentives to work that can result from necessary targeting and means testing. The continuing challenge is to see what more can be done and to combine income support with the right mix of opportunities and incentives for people to seek work as the main means to reduce poverty.

Poverty and exclusion are particularly concentrated in certain areas and among particular ethnic or national groups; France is not different in this respect from most other countries. In dealing with the geographic concentration of these problems, which in France frequently means *cités* – suburbs on the margins of the major conurbations (but also urban centres in some of the medium-sized cities) – it is particularly difficult to see whether it should be treated as a locational phenomenon, requiring policies that are targeted on particular areas, over and above those targeted on individuals or families. A parallel issue arises regarding ethnic concentration: it is unclear whether policies should address only individuals or groups.

France's response has been different for the two different types of concentration. Certain urban areas are defined as "priority" or "sensitive" zones and thus attract extra funds for social, housing, education or economic policies. On the other hand, although a government agency, the HALDE (*Haute autorité de lutte contre les discriminations et pour l'égalité*), to fight racial and other discrimination was set up in 2004, the constitutional provision of equality before the law is generally taken to prevent positive as well as negative discrimination. The same provision can make it difficult to document discrimination, by making it difficult to collect data on people by racial origin, for example. Over the last few years, various discrimination testing studies have revealed that employers, for example, discriminate not only on grounds of race (using family name as a signal) but also on residence; a person with an address known to be in a "problem" neighbourhood has a lower chance of being asked for an interview. There is accordingly a challenge, faced by

many countries, in deciding how best to offset what might be called spatial or social hysteresis, or the transmission of disadvantage.

One part of this, a major issue in France recently, is housing policy. “Social” housing is quite widespread, but, unlike in many countries, is not specifically focused on the poor, though assisting them is certainly part of the objective. Instead, one of the main aims is to promote social mixing, to try to avoid the creation of “ghettos”. These have developed nevertheless, as might be expected, partly as a result of planning decisions in the past that located a number of large new, low-cost housing developments in places that are now not well enough linked to labour-market needs. A recent policy proposal has been to establish a legal “right” to housing, though it will be a problem to decide who is to be made answerable for such a right.

Education should use resources more efficiently, to help reduce inequalities and promote growth

Education is a key to reducing the extent to which disadvantage is transmitted between generations. In particular, giving people higher skills and more labour-market oriented education is all the more important for improving their employment prospects if wide-ranging labour-market reforms cannot be implemented. Reducing inequality is one of the principal objectives that French legislation gives to the education system. At the same time, it is of course vital to producing the human capital needed to support economic growth. These two objectives do not necessarily conflict, but when taken together with other objectives related to forming citizens, they certainly make for a rather complex set of goals (whose relative importance may also vary according to which stage of education is being considered), against which judging success is not easy.

In the past, education was organised on a highly centralised basis, with direct control over a wide range of issues residing in Paris. Over the last two decades the degree of direct control from the Ministry of Education has diminished considerably. Yet the system still exhibits many of the characteristics of centralised systems: the degree of autonomy of schools and universities, most notably in recruitment and placement of the main core of permanent teaching staff, is rather restricted compared with many other countries. This change in the degree of control exercised by the ministry may – arguably – have led to some dilution of responsibility for outcomes. A key challenge is therefore to find ways to focus sufficient attention by individual teaching establishments (and the system as a whole) on performance and cost-effectiveness.

Overall, spending on education, at some 6% of GDP, is close to the OECD average. France is one of only three countries with 100% enrolment in pre-school education at age 3 (along with Belgium and Italy) and spends a relatively high 0.7% of GDP on such education, a proportion exceeded only in Norway, Hungary and Denmark (in the last case, only because of higher private expenditure). This partly reflects a tradition of providing early childhood education and care as part of family policy in France. But it also follows the increasing recognition that early education can perhaps offset, at least partially, disadvantages related to social background that seem inevitably to influence educational achievement of children at primary school level and onwards.

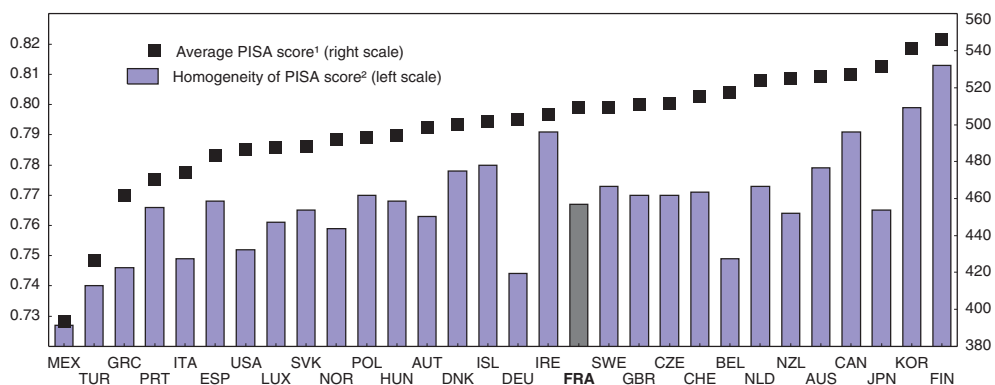
As with other aspects of social disadvantage discussed earlier, there is a significant geographic component to educational disadvantage, and the principal response, developed during the 1990s, has been to target additional resources on certain defined areas, known as educational priority zones (ZEPs). As many as one in five lower secondary school pupils

attend a school in a ZEP. Very recently this policy has undergone a number of refinements in the face of evidence that the increased resources were not being used very effectively and that there were a number of perverse effects that could arise when an area is designated as a ZEP. Other responses have included policies centred on detecting individual children with particular learning difficulties, picking out specific schools for additional resources and – more radically in the French context – an enhanced prerogative for the school principal to recruit additional teachers directly.

The use of a fairly rigidly-enforced catchment area system (the *carte scolaire*) for allocating children to schools may also exacerbate the transmission of social disadvantage. Better-off and better-informed parents already tend to avoid living in ZEPs and more generally try to find ways round the constraints of the *carte scolaire*. Although relatively few actually succeed, there are calls for a relaxation of the *carte scolaire* and the introduction of school choice for parents as ways to improve equity and efficiency. The existence of a small number of elite public upper secondary schools which clearly select their intake on the basis of ability, within a system which is supposed to avoid such selection, illustrates the strong pressures for choice and selection. It is important, but difficult, to separate the issue of what may be good for any particular individual and what may be good for overall education outcomes. A greater role for competition among schools to attract pupils could be one way to improve resource efficiency, but a number of other policies would also need to be in place to avoid exacerbating inequities with little or no gain in overall performance.


Just as France's expenditure on education is approximately average for OECD countries, so educational outcomes appear to be around average, perhaps just slightly above, according to the OECD Programme for International Student Assessment (PISA) (Figure 1.6). PISA results refer to the attainment of children at age 15, rather than to the performance of the educational system as a whole; but France actually spends relatively more on primary and secondary education than on tertiary education, so perhaps this represents a degree of underperformance once adjusted for this bias. This is not necessarily borne out by recent OECD work however. This shows that France would appear to be closer to the "efficiency frontier" than most, though not all, OECD countries.

Figure 1.6. Educational attainment and equity, 2003



1. Simple average of Maths, Reading, Science and Problem-solving.
2. Measured by the ratio of the average score of the 25th percentile to that of the 75th percentile (the higher the ratio, the greater the homogeneity in student performance).

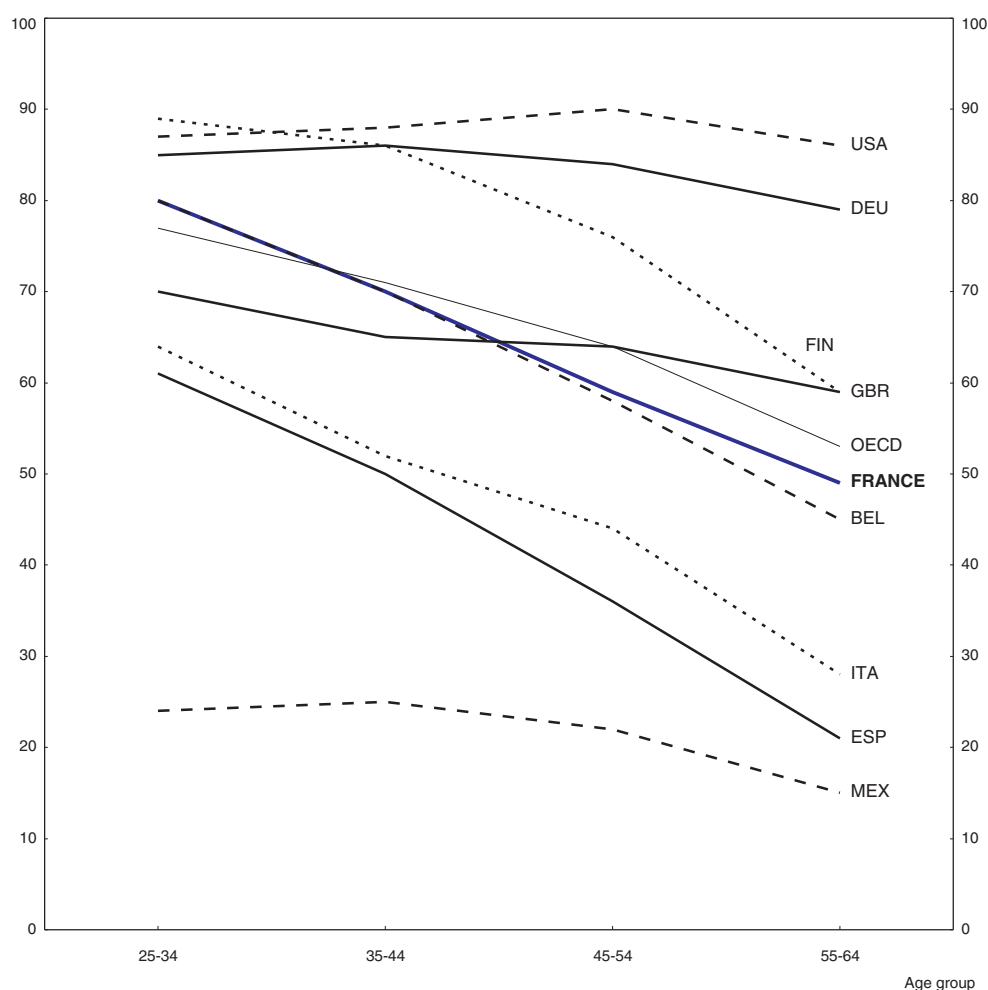
Source: OECD (2004), *Learning for Tomorrow's World, First results from PISA 2003*; *Education at a Glance*, OECD Indicators.

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These ambiguities in broad measures of value for money mean that no strong statements on the relative cost-effectiveness of French education can easily be made. As Chapter 3 outlines, however, there are many areas where there is room for producing better measures of school performance and making decision-makers more directly responsible for improving performance. The potentially crucial issue of school autonomy is unfortunately difficult to address. A comparison of PISA results across countries does tend to suggest that more autonomy gives better performance, but there is a great deal of uncertainty about this conclusion.

A major factor affecting both secondary and tertiary education was the very large increase in the 1970s and 1980s in the number of people completing upper secondary education. The proportion of the population aged 55-64 who reached this level of education in France is substantially lower than in comparable countries such as Germany and the United States (Figure 1.7). But France has caught up quite rapidly (along with a number of other countries), and for the cohorts aged up to around 40 in 2004 average

Figure 1.7. Educational attainment by age
Population that has attained at least upper secondary education
Percentage, by age group, 2004



Source: *Education at a Glance*, OECD Indicators 2006.

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attainment is at least as high as the OECD average, even if a moderate gap remains with the best performers. The large impact on tertiary education results from the fact that a large proportion of those now achieving an upper secondary diploma in France have an automatic right to a university place. Tuition fees for public universities are very low, and there is no selection at entry. At the same time, the amount of resources devoted to tertiary education has not kept pace with this growth, partly but not entirely because of the low fees, so that the average resources available per student are low; in fact, less is spent per year per head on the average university student than on the average secondary school pupil.

Yet while the basic public university system is non-selective, there is a variety of selective institutions, generally known collectively as the *grandes écoles*, which are much more attractive to the more able students and in which there is therefore a great deal of competition to enrol. At the same time, and in considerable contrast with the compulsory education system, the per capita resources available vary widely across the system, with the more elite institutions spending several times more than the public universities. Since universities are unable to turn away weak students, prospective students are apparently unaware that many of the courses to which they are attracted are both much harder than they imagine and unlikely to be very useful on the labour market, and the distribution of resources in what is intended as an egalitarian system is rather regressive. There is a clear need for a better way of guiding students in their choices and in allocating resources.

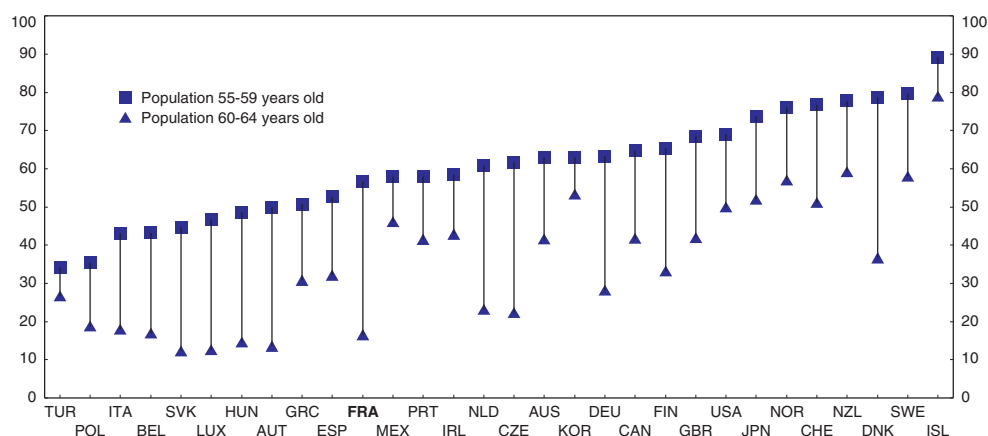
A number of helpful steps have indeed been taken recently. Universities are now encouraged to publicise information on the labour-market experience of their graduates (not many do so yet) and as from this year are to issue early guidance for prospective students. They remain unable to turn weaker applicants away, provided they have their baccalaureat (although zoning rules apply for certain courses and universities, most particularly in the Paris region), and any suggestion that this should change has always met fierce political opposition, as has any suggestion that higher fees should be charged. Many young people in France already face a difficult entry into the labour market, with high youth unemployment. It is very important both to reduce the waste of students' time and of public resources on unproductive courses and to improve the preparation for the labour market that the education system gives.

Another aspect of the structure of selection and resource allocation is that while the *grandes écoles* attract most of the most able students, in the past they have not typically been research oriented, depriving such students of valuable experience and conversely weakening the French research effort. Research has been located in the universities and in the public research organisations. This has been evolving recently, as some of the *grandes écoles* (which are also often relatively small in terms of student numbers) are associating themselves with universities in centres of excellence. A key challenge here is to find models of governance and finance that promote cost-efficiency in general, and not just in exceptional cases.

Progress has been made in dealing with demographic ageing, but problems remain

While young people suffer from especially difficult entry paths into employment, a striking characteristic of the French labour market is how quickly older people withdraw from it (Figure 1.8). For a while, this appeared superficially sustainable, as large numbers of working-age people were paying for the pensions or other transfer payments that the

Figure 1.8. **Employment rates for 55-59 and 60-64 year age groups**
Per cent of relevant population, 2005



Source: OECD, *Labour Force Statistics*.

StatLink  <http://dx.doi.org/10.1787/054762533172>

inactive receive. Even so, the labour taxes necessary to finance relatively generous pay-as-you-go pensions and other benefits were contributing to the high tax wedge on labour.

But by the early 1990s it was clear to policymakers that the situation was unsustainable in the longer run, with increasing longevity and lower fertility. The share of GDP needed to finance pension commitments was set to rise by six percentage points or more without reforms; other age-related spending, notably on health, would also rise. A pension reform in 1993, which reaches full maturity only in 2008, made a substantial contribution to reducing the extent of this increase, though by no means eliminated it. A lack of public appreciation of the size of the problem, and of its likely economic impact, made this reform less than complete, however – in particular, it did not touch public-sector employees. In 2003 this was largely rectified, though civil servants retain some advantages. Certain groups of workers (mostly in publicly-owned or formerly publicly-owned companies such as *Électricité de France* or the national and Paris area rail companies) remain untouched by either reform, in most cases because of their perceived ability to damage the economy if they were to take industrial action. It is now widely seen to be necessary to tackle this inequitable treatment in the next round of reform, due in 2008.

Despite the major impact these reforms have had on the sustainability of public finance, more needs to be done if a significant ageing-related rise in the share of public spending in GDP is to be avoided. Quite how large such an increase is likely to be is uncertain, especially in the case of health care where the tendency towards higher costs in recent years is due to a combination of factors that is difficult to disentangle: new treatments and technology, changing attitudes and financial arrangements, as well as ageing. In fact, the pure ageing effect has probably been relatively small so far, making it particularly difficult to project. The likely evolution of non-medical spending on care for older people is also unclear. Although at the moment it accounts for a rather minor part of public expenditure, this is because families are generally willing and able to look after it themselves; as the dependency ratio rises, the ability may decline. Taking pensions, health and long-term care together, official projections are currently that total spending will increase by as much as four percentage points of GDP by 2050. It could be argued that such a change over a 40-year period will be easily absorbed, given the rise in public spending

over the past 40 years (more than ten percentage points). But, with overall taxation, including social security contributions, already taking a heavy toll in terms of efficiency, quite apart from the risk that current estimates may be on the low side, it would not be wise to take this view.

The direct impact of the effective retirement age on employment of older people is less than it used to be because of the actuarial near-neutrality of the pension system. But it still matters, partly because of low-paid workers who may receive the minimum pension, which their own contributions would not be sufficient to finance, and partly because of the extra output – and public revenue – that increased employment generates. The reforms to the pension system and the reduction in the number of government measures that encourage early retirement should have improved incentives to work, but there has not yet been any visible impact on actual employment rates of older workers.

This lack of response is perhaps understandable, given the emphasis of policy over a number of years on encouraging withdrawal from the labour market: since 1980 there have been at least eight national publicly financed schemes to encourage early retirement. Most have been abolished or run down but probably still have an impact on attitudes, and unemployment benefit now serves as a partial replacement for early retirement for as many as 400 000 people over 55. A measure in the 2003 pension reform introduced the possibility of early retirement for those with a “long career”. This is available only for those who have made sufficient quarterly contributions before the age of 60. The government has begun public awareness campaigns to encourage both employees and employers to think differently and may need to address wage-setting behaviour and its link with the productivity of older workers, too. While some recent work does suggest that this is not a big problem, there does seem to be at least some age discrimination. Many firms, even large ones, seem to want to get rid of employees over a certain age, for reasons which may (the evidence is ambiguous) be linked with a gap between productivity and pay.

The process of government decentralisation raises accountability and efficiency issues

In all the policy areas discussed so far – poverty, education and ageing – quite significant elements of public policy are implemented and sometimes designed at a sub-national level. Indeed, as mentioned at the beginning of this chapter, spending by sub-national governments has grown faster than overall public spending for some years. This is partly because there has been considerable expenditure growth in the policy areas for which spending control has passed to lower levels of government since the 1980s, when the movement from the traditional highly centralised structure of French government began.

The main motivation behind this move has been to bring decision-making closer to those whom it affects in the expectation that this should improve the responsiveness of policy to local needs. Some competences have been fully delegated to local governments which are responsible both for designing and implementing expenditure programmes; in other cases local government is really acting as a manager for central government, which retains the power to define levels of expenditure or the rights of individuals. Responsibility for school buildings (though not for many other types of education expenditure) is an example of full delegation; the transfer of responsibility for the RMI, the non-contributory benefit for the unemployed, is a case of a programme where the State retains substantial powers of initiative – above all in setting the level of the benefit – but is not responsible for

financing it. The main questions in relation to these moves towards “proximity” concern their impact on the overall level of public expenditure, the efficiency with which it is employed and the links with the taxation needed to finance it. In sum, it is not at all clear that the goal of accountability is well served by the current structure.

One of the most often-cited statistics in this context is the number of *communes* (the basic element of local government) in France. There are just over 36 000 of them. While most countries in Europe share the same basic three-tier structure of sub-national government as France, these 36 000 municipalities outnumber the equivalent units in all other European Union countries combined. Furthermore, they are very heterogeneous in size: the average population is about 1 600, but a large number of rural *communes* have only a few hundred inhabitants. Yet their elected mayors have the same responsibilities and powers as those of towns ten or twenty times as large. The other two main tiers of government, the *département* and the *région*, do not display the same heterogeneity. All three levels of sub-national government are run by directly elected councils and are largely independent: no level is operationally subordinate to any other; and, within their budgetary and constitutional limits, each level is free to act in any domain it chooses. The situation is complicated by two further factors. One is the development of another layer of institutions in the form of groupings of communes for the purpose of improving economies of scale in providing local services (such groupings being encouraged by a central government subsidy); the other is the representation of the State in each *département*, in the form of a prefect, mainly responsible for issues related to law and order and the implementation of central-government policy but also with the ability to intervene in many policy areas (though with a very limited budget) either directly or in co-operation with local government.

These arrangements allow for considerable flexibility in response to local needs but complicate the task of ensuring cost-efficiency because of the potential for overlapping competences and co-ordination costs when there are multiple actors. As the share of sub-national government spending has been rising, both from internal growth and because of the decentralisation of a number of programmes formerly the responsibility of the State, their revenue needs have risen too. This has not been a trouble-free process. The traditional local taxes were based on residence and property for households, assets and employment for business. The local business tax has been the object of many *ad hoc* adjustments over the years, so that the actual tax base is no longer very close to the legal one; household taxes are a function of notional property values that were last brought fully up to date in 1970. Other sources of finance for local government are transfers from the State. These include those to cover lost business tax revenue that results from centrally mandated reductions, direct transfers to cover specific spending programmes and those intended to achieve some redistribution between the richer and poorer areas. More recently a small proportion of certain national taxes has been allocated to local government too.

This evolution in the allocation of resources has generally respected the basic constitutional rule that the State cannot impose spending responsibilities on local government without also providing sufficient resources to cover that expenditure. It is a significant policy challenge, however, to take stock of the current situation and perhaps to continue in the direction of further decentralisation where efficiency or democracy dictate, while at the same time promoting appropriate accountability and control over the overall size of the public sector in the economy.

Protecting the environment is a policy priority, but could be done more cost-effectively

Ensuring long-term environmental sustainability remains an important agenda item in France as in all other OECD member countries. Previous OECD *Economic Surveys* have consistently recommended that France move further in both expanding the use of economic instruments such as taxes and fees and in setting the level of these charges as a function of the estimated environmental damage caused. While some efforts have been made in this direction, and the setting of taxes as a function of externalities is part of the basic task of the general pollution tax (the TGAP), there are still plenty of missed opportunities and inconsistencies. Also, while France is in the forefront of working for the extension of international agreements on reducing some kinds of pollution, notably greenhouse gas emissions, there is still much to be done to improve the economic efficiency of these policies.

The principal tax related to polluting activity is the tax on petroleum products (the TIPP) which is not in practice designed as a pollution tax, but as a major revenue raiser, so it is perhaps unfair to criticise it for not meeting purist conditions for a well designed environmental tax. Nevertheless, no progress has been made recently on changing those of its features that provide inappropriate incentives from the environmental point of view. Some of these are: the lower volumetric rate of tax for diesel fuel than for petrol (gasoline), even though it is more polluting per litre; and the exemption of fuel used in agriculture, the building industry, commercial road transport, some ships and aircraft (though this last exemption is covered by international agreements). Household heating fuel is taxed over three times more than heavy fuel oil used in industry or power generation. It is also taxed six times less than the essentially similar fuel used in diesel engines, though here the comparison may not be fully appropriate, because the emissions from motor vehicles (other than those of carbon dioxide) are of a different form and often occur in more damaging places than those from household heating.

While fuel used for transport is mostly heavily taxed, and industrial uses of fuel are now subject to the European Union cap-and-trade system for carbon dioxide emissions, France has introduced additional tax breaks for bio fuels and has argued that ambitious targets for the production of renewable energy should be pursued by all EU countries. While renewable energy is clearly an important part of the response to the problems posed by growing greenhouse gas emissions, specific subsidies for their use, or targets for their production, impose unnecessary costs. The logic of the existing taxes and, especially, the European and Kyoto cap-and-trade systems, is that they will ensure that emission targets are met, and the economic incentives they create will encourage a combination of alternative energy sources and energy saving to emerge in the most economical way. Using too many overlapping instruments to pursue the same target can easily become rather costly. For example, bio fuels are exempt from the TIPP (though they should really only be exempt from that part of the TIPP which is thought of as a tax on carbon dioxide or other pollutants that use of bio fuels does not produce), but so are the other, polluting fuels that may be used by the agricultural industry to produce the bio fuels themselves; the application of nitrogenous fertiliser to increase crop yields is also a source of N₂O, a potent greenhouse gas which counts against the Kyoto targets but is not taxed or included in any domestic emissions cap. It is not altogether surprising that the farm sector is strongly in favour of the promotion of these fuels.

Other structural reform

While there have been no major reforms in structural policies since the last *Economic Survey*, the authorities have nevertheless taken a series of steps that have mostly gone in the right direction. In the area of regulatory and competition policy, a large number of changes since 2003, the date to which current OECD product market regulation indicators refer, would be expected to increase output per head significantly. See Annex 1.A1.

Notes

1. Some discussion of this can be found in the 2003 *OECD Economic Survey of France* (Chapter 3, on public expenditure management), and details of the law's objectives and implementation are available (in both English and French) on the Ministry of Finance website: www.minefi.gouv.fr/lolf/index1.html.
2. INSEE, the national statistical service, part of the Ministry of Finance, Economy and Industry, normally revises the monthly estimates derived from claimant count data in March, in the light of the annual labour force survey. This year's revision has been delayed by six months because INSEE believes that the labour force survey data may be unreliable. They imply an annual unemployment rate of 9.8% for 2006 compared with the average published monthly figure of 9.1%.
3. A Financial Times – Harris poll on migration in the European Union, published 19 February 2007.
4. Insider/outsider problems spill over from the labour market into other areas. It is difficult for people without an indefinite work contract to rent homes or to contract loans, to a greater degree than the objective risk might imply. This seems likely to be due in large part to inadequacies in the housing and loan markets, but many people tend to blame it on the labour contract *per se*.

ANNEX 1.A1

Progress in structural reform

This Annex reviews action taken on recommendations from previous *Surveys*. Recommendations that are new in this *Survey* are listed in the relevant chapter.

Recommendations	Action taken since 2005
Labour market policy	
Allow SMIC to decline relative to average wages.	Following increases in the relative level of the SMIC during the progressive implementation of the 35 hours law, its level has risen in line with average wages. A commission exists that must give its advice prior to any increase in the relative level of the SMIC. It would be preferable to hold the SMIC constant in real terms for some time, to allow some decline in its relative level.
Reduce risk of unemployment and poverty traps.	Reforms have made much progress in eliminating 100% marginal effective tax rates, though some zones of high marginal tax rates remain. The earned income tax credit (<i>prime pour l'emploi</i>) has been increased and incentives for welfare beneficiaries to make the transition from welfare into work have been improved. See Chapter 2.
Give priority to employability of youth and on-the-job training schemes.	Increased emphasis has been put on apprenticeship schemes. A training levy encourages on-the-job training, but its effectiveness is uncertain.
Fully phase out early-retirement programmes and eliminate recourse to the unemployment insurance system as a form of subsidised early labour-market withdrawal. Suppress or further reform <i>contribution Delalande</i> .	Except in the "special" pension schemes that cover about 520 000 workers, early-retirement schemes have been phased out. Unemployment benefit for the over 55s has become a partial substitute, however. The abolition of the Delalande contribution was announced for 2010. See Chapter 4.
Reduce the disparity of the conditions imposed on fixed and indefinite-term contracts, preferably moving to a single employment contract with lower protection, increasing with length of service. Reduce the obligations on employers to help redundant employees find new jobs.	No action, beyond the introduction of special contracts with reduced protection for the first two years for small (< 20 employees) firms only, and special short-term contracts for those over 57. Reform of employment protection legislation remains a priority. See Chapter 2.
Make working-time regulations more flexible.	The reduction in the mandatory size of overtime premium, from 25-50% to 10-25%, introduced in 2003 was extended to 2008 but still applicable from the 36th hour onward. Individual companies permitted to make deals with employers with less favourable conditions than branch agreements; this option is very rarely taken up by employers. Other measures introduce more flexibility, such as the increase in the annual limit for the overtime hours worked or the reduction in the mandatory overtime premium for the 36th hour in companies employing less than 20 workers.
Improve the efficiency of public employment services, especially through the creation of one-stop shops, increased coordination between the ANPE and the UNEDIC, and efficiency evaluations of specific programmes for the unemployed.	The creation of <i>maisons de l'emploi</i> continues (200 <i>maisons de l'emploi</i> already at work in 2006) but largely on the basis of local initiatives. A common service was set up by agreement between the State the ANPE and Unedic in May 2006 to increase coordination. Continuing efforts are needed to ensure that they become real one-stop shops, merging the ANPE and Unedic would help this. Support measures have been strengthened though the introduction of profiling, monthly interviews and the possibility of graduated sanctions. The first evaluations of these support measures are under way. See Chapter 2.

Recommendations	Action taken since 2005
Product market competition and regulatory reform	
Move to consumer interest as basic test in assessments of market structure and mergers.	France has transposed article 9 of the European directive on takeovers (concerning the approval by the shareholders' general assembly of defensive measures), on the basis of reciprocal treatment. Political discussion of the notion of "economic patriotism" may lead to confusion with national protection and should be clarified.
Increase independence of competition and merger authorities from government. Either transfer all functions to the <i>Conseil de la concurrence</i> , or make much clearer separation of functions within the Ministry of Finance.	Plans concerning possible mergers relating to a food group and an engineering group led to major political debates which could tend to support the belief that the government would oppose mergers with foreign enterprises. The March 2006 law transposing the European takeover directive set up measures against rumours similar to those used by the takeover panel in London. It also authorised "poison pill" defences provided these are approved by the shareholders' general assembly. According to the government, this is to improve the shareholders' negotiating position, not to permanently prevent a takeover. It will be important to verify that this is indeed the case.
Abolish unnecessary retail regulations – on pricing below cost, on television advertising. Ensure zoning restrictions facilitate new entry into retail distribution.	Pricing-below-cost regulations have been relaxed and should allow more competition, though they now use a more complex formula. Television-advertising restrictions on retailers have been relaxed. The change in pricing regulation appears to have allowed lower prices, and could be further relaxed to be based on a standard abuse of market dominance test, with a clear criterion restricted to damage to consumer interest.
Reduce restrictions on competition in professional services.	No action.
Increase competition in network industries, especially by removing unnecessary privileges of incumbent and/or publicly-owned operators and by increasing vertical separation and new entry where appropriate for consumer welfare. Public or universal-service obligations should be separated from public ownership and financed explicitly.	Increased entry in some areas (postal services, mobile phone operators) has improved competition. Vertical separation in the gas and electricity sector was enforced in December 2006 and already existed in the rail transport sector. But such separation needs to be made more effective, unlike in the rail sector, for example, where the rail infrastructure company is a subsidiary of the national rail operator, for example. No action on the treatment of public-service obligations.
Public finance	
Reduce public spending as a share of GDP.	The share is no longer increasing but is not on a clear downward trend; the share of State or central government spending in the total has declined. See Chapter 5.
Ensure that the state budget framework law (the LOLF) is implemented effectively.	The LOLF is now operating fully (as from 2007). A similar framework law has been introduced for social security funds.
Continue to reduce costs of tax collection: consider ultimately merging the main tax collection systems.	Collection of the television levy has been merged with that of local taxation. Income tax declarations can be made on-line. Tax collection for companies has been simplified (<i>interlocuteur fiscal unique</i>).
Simplify personal income tax, widen base, and introduce deduction at source.	The number of special tax deductions available has not declined. The introduction of deduction at source has been announced for 2009. Tax payers receive pre-filled income tax declarations. The income tax base has been broadened, its structure simplified and rates reduced. The 20% reduction previously applied to earnings and pensions of non-salaried workers has been abolished. The number of tax bands has been reduced from seven to five of which one is zero band; the rates are 5.5, 14, 30 and 40%. A <i>bouclier fiscal</i> has been introduced to cap personal taxes (income tax, wealth tax and local residence taxes) at 60% of total income.
Reduce tax wedge on labour through cuts in social security contributions; increase use of in-work benefits, with lower withdrawal rates.	The <i>prime pour l'emploi</i> , an earned income tax credit, has been increased. The range of reduced rates on social security contributions was slightly extended for small companies. The earned income tax credit (<i>prime pour l'emploi</i>) has been increased, especially for part time minimum wage earner.
Reduce corporate tax rate and the number of tax incentives for particular types of activity. Reduce bias against new equity finance relative to new debt.	The 3% surcharge was finally phased out in 2006. No action to reduce the number of tax incentives for particular types of activity. Long term equity capital gains are exempted from taxes and incentives to promote investment in equity by saving schemes have been extended. Addressing the underlying bias by a complex set of specific exemptions is inefficient compared with a more thorough reform. See also Chapter 4.
In health care, reduce excessive demand by higher co-payments and other ways of making patients more responsible.	The implementation of the 2004 health reform appears to have reduced expenditure growth, notably on pharmaceuticals and sick-leave payments.
Ensure greater equity between different pension schemes.	Implementation of the 2003 pension reform is equalising the treatment of private and government administration employees, but no action has been taken on the special schemes. See Chapter 2 for more details.

Recommendations	Action taken since 2005
Environmental policy	
Increase use of green taxes aligned on estimates of costs of externalities, and of other economic instruments.	Several tax incentives adopted in favour of bio-fuels, "green cars" and households' energy saving and carbon emission reducing investments. Diesel still under-taxed relative to petrol. Some progress on setting taxes on polluting activities. Agriculture remains a major beneficiary of a number of exemptions to the polluter pays principle, notably on fuel taxes and water charges, which cannot be justified on environmental grounds.
Promote international action on taxing air and sea transport emissions.	The French government has been urging this action on the European Union.

Chapter 2

Combating poverty and social exclusion

Reducing social exclusion and poverty is an important objective for all French governments. The current policy approach involves a large number of measures tailored to different circumstances, and conventionally measured poverty is in fact lower than in most other countries, though still higher than can be easily accepted. Some policies have unwanted side effects on labour market performance, and their cost-effectiveness could be improved to obtain better outcomes with the same resources. Concentrations of poverty and social exclusion in certain geographic areas and among certain groups of the population provide one of the most difficult challenges, for which contributions from education, labour market, housing, urban planning and anti-discrimination policies, as well as from the social services, are necessary.

Economic growth improves social welfare but may leave out a body of people who are faced with situations of poverty and, in some cases, social exclusion. In addition to having dire consequences for those concerned, poverty and exclusion generate negative externalities through increased criminality¹ and insecurity, which undermine the wellbeing of the population as a whole. But although the direct costs of the instruments for combating poverty and exclusion are mainly borne by public finances through income transfers, these costs are in turn borne by the economy as a whole. For both these reasons, it is essential to find solutions that remedy social exclusion at its roots, and not simply palliate its effects. To this end, it is necessary: i) to prevent poverty and social exclusion from developing by ensuring the proper functioning of the labour market, by ensuring that the education system efficiently prepares young people for jobs, that housing policy limits the creation of deprived “ghettos”, and by other reforms that promote a dynamic job-creating economy; and, ii) to put in place policies which will genuinely help people threatened by poverty or in danger of social exclusion to escape from such predicaments on a long-term basis.

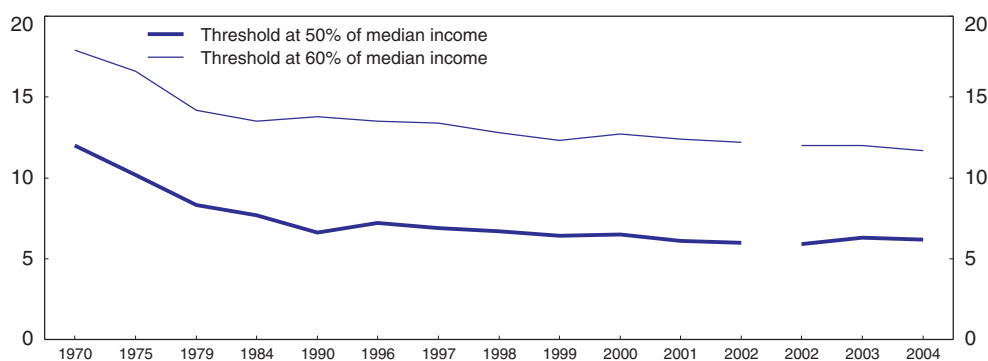
Scale of and trends in poverty and social exclusion

Income inequality (covering earned and unearned income) declined sharply in France during the 20th century (Piketty, 2003). The watershed occurred between the world wars and during World War II and was mainly attributable to the fall in the wealthiest families’ capital income, with wage inequality remaining for its part relatively stable. More recently, there was a decline in income inequality during the 1970s and 1980s, before it stabilised in the mid-1990s. The decline in inequality was accompanied by a fall in the risk-of-poverty rate, defined as the percentage of the population living in a household whose income falls short of the poverty threshold.² This is often put at 60% of the median income in international comparisons and amounted to € 788 per month in 2004 for a single person. Since 2002, the risk-of-poverty rate has fallen slightly when defined in this way, whereas if it is put at 50% of the median income, it has risen slightly (Figure 2.1). France’s position is somewhat better than the average of other OECD countries in terms of inequality (see Figure 1.5, and also Figure 2.5).

Poverty is all the more of a handicap to the extent that it persists over time and leads to worsening living conditions as savings are used up. Looking at the proportion of people who are at risk of poverty both in the current year and during two out of the preceding three years in European countries, France figures in the group of countries where monetary poverty is relatively low and tends to be temporary even though the persistence of poverty is a little higher in France than in the best performing countries (Figure 2.2).

Poverty and social exclusion are perceived to be widespread

The trends that derive from the statistics may seem in contradiction with the collective consciousness and the feeling of unease that currently exist in French society, as revealed for example by the violence in the suburbs of Paris in late 2005. That contradiction may be

Figure 2.1. Evolution of the monetary risk-of-poverty rate¹

1. From 1996 to 2002, the Taxable Income Surveys (*Enquêtes Revenus Fiscaux*, ERF) were based on data from the 1990 and 1999 censuses. A new series of income statistics using annual population censuses starts in 2002 (which uses reverse extrapolated data from the 2003 survey). The new series also take into account income subject to *prélèvements libératoires*.

Source: *Enquêtes Revenus Fiscaux*, 1970, 1975, 1979, 1984, 1990, 1999 and 1996 to 2003, INSEE-DGI.


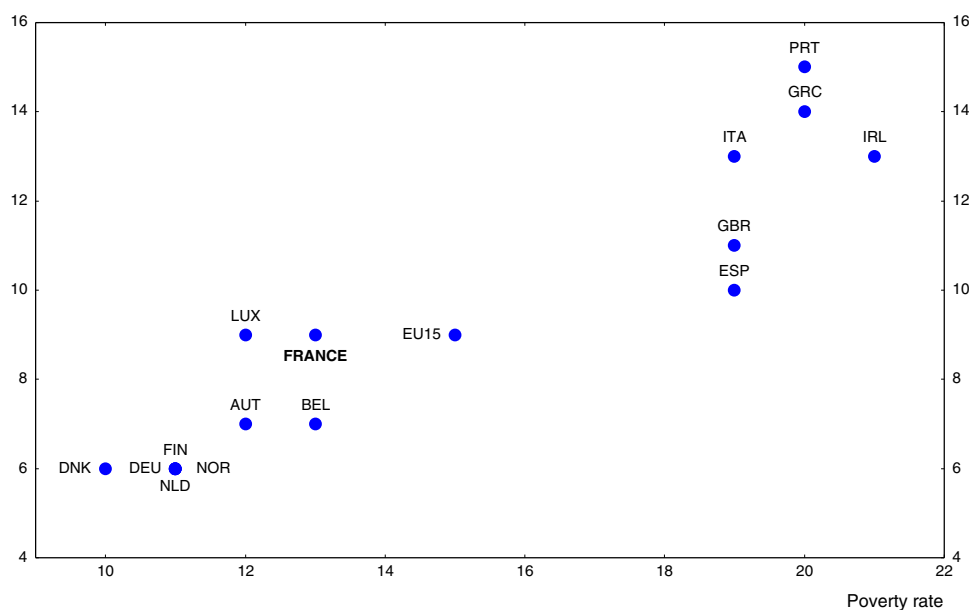
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Figure 2.2. Risk of monetary poverty and its persistence in OECD countries
2001 or latest year available¹

Risk of persistent poverty ²



1. 2000 for France and the United Kingdom.

2. Share of persons with an equivalent disposable income below the at-risk-of-poverty threshold in the current year and in at least two of the preceding three years. The threshold is set at 60% of national median equivalent disposable income (after social transfers).

Source: Eurostat database.

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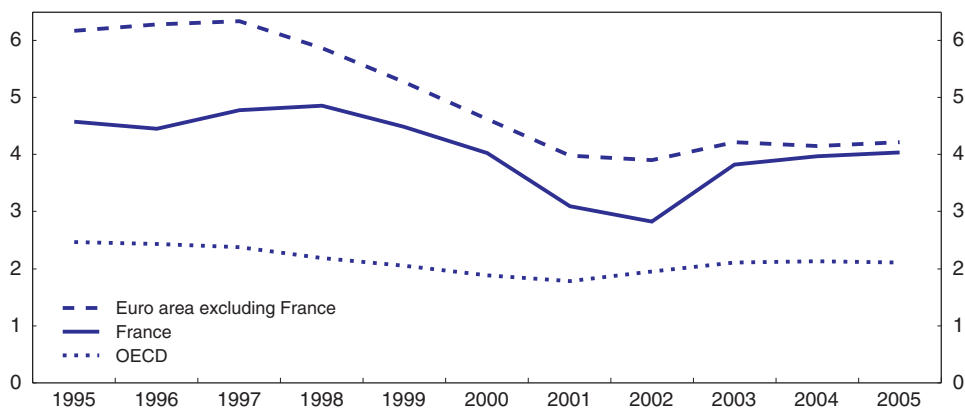
explained by the difficulty of measuring poverty because of its multidimensional nature: poverty encompasses all the material problems that people are faced with, which can result in restricted consumption, housing troubles, reduced access to health care and also, more broadly, a poor level of skills. So monetary poverty indicators give a simplistic picture of poverty; that said, they do have the advantage of being broadly comparable across countries.

Other measures of poverty exist, such as Eurobarometer, which tests public opinion on a variety of matters. According to this survey, the percentage of people feeling that there is a risk of falling into poverty in 2006 was higher in France than in the average European country and the view that anyone is at risk of poverty at some time in their lives was more widespread in France than anywhere else (European Commission, 2007). This discrepancy between the scale of measured and perceived poverty can be explained by the characteristics of poverty. It is the result of a sharp worsening of the labour market and has developed in a context in which social and especially family ties have weakened. The social protection system, which was designed to insure individuals against risks, is not up to looking after people facing lasting poverty. Compared to the sort of poverty affecting a fringe of the population whose profiles are well known (as in the countries of northern Europe), this type of poverty is both more difficult to “treat” using economic policy measures and more costly for the persons concerned, while it also has a larger negative impact on the well-being of the rest of the population (Paugam, 2005).

Poverty, which is accompanied by a loosening of social ties, can result in situations of social exclusion. Unlike poverty, there is no “official” definition of social exclusion and no consensus as to any indicators that might measure the scale of the phenomenon. Exclusion is more a process than a state. Often, it is the result of a sequence of unfavourable events. The first of these is sometimes the loss of a job, which can be accompanied by increased difficulty in finding somewhere to live and a breakdown of social ties (family and friends). The situation is made even worse when those involved are in ill health or run into problems related to alcoholism and drugs.

Inevitably, therefore, apart from the subjective indicators cited above, the scale of social exclusion is measured in a roundabout manner by looking at the characteristics of the individuals for whom the breakdown of certain social ties seems to result in exclusion-like phenomena. Being long-term unemployed makes people vulnerable to exclusion, and the rate of long-term unemployment (spells exceeding a year in duration) increased in 2003 before stabilising at a high level – around 4% of the labour force (Figure 2.3), despite a number of active labour market policies focused on such jobless people. Those of very limited means are entitled to a “replacement” income called a “social minimum” (see Annex 2.A1). There are

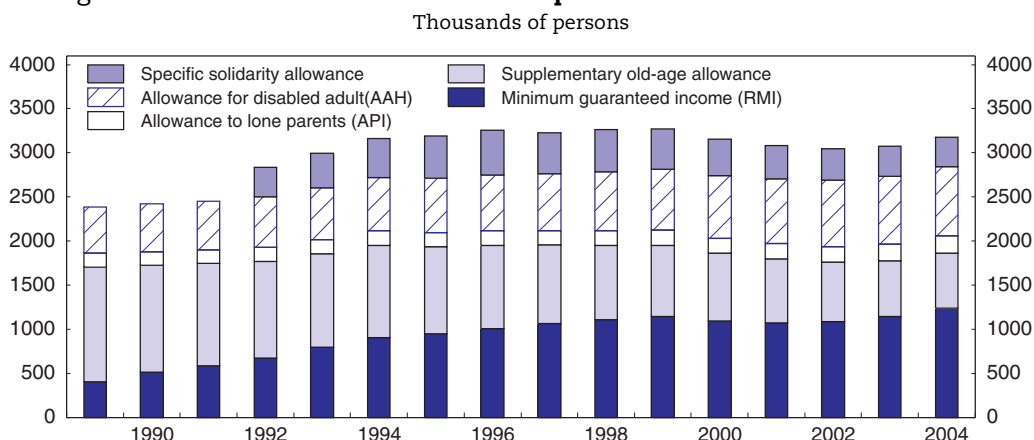
Figure 2.3. **Trend in long-term unemployment¹**
As per cent of the workforce




1. One year or longer.

Source: OECD, ELS database.

StatLink  <http://dx.doi.org/10.1787/054016674765>

Figure 2.4. **Trend in the number of recipients of the main social minima**

Source: Caisse nationale d'allocations familiales; Union nationale interprofessionnelle pour l'emploi dans l'industrie et le commerce and Direction de la Recherche, des Études, de l'Évaluation et des Statistiques of the Ministère de l'Emploi, de la Cohésion Sociale et du Logement.

StatLink  <http://dx.doi.org/10.1787/054036588104>

a number of these social minima, the most widespread of which is the *revenu minimum d'insertion* or RMI, which is below the poverty threshold. After these minima were introduced, the share of the population receiving them increased sharply up until 1999 and then fell slightly before picking up again briskly in 2004, with over 7% of those aged over 25 being concerned (Figure 2.4). In 2003, 45% of beneficiaries of the RMI had been receiving it for more than three years.

Statistically, it is much more difficult to keep track of people who are particularly excluded and living on the fringes of society. The homeless are not at all well covered by the statistical services. Nevertheless, a 2001 INSEE survey on the homeless put the number of people using the services providing shelter and hot meals at 63 500 adults accompanied by 16 000 children (Brousse and de la Rochère, 2002).

Inequalities are transmitted across generations

Inequalities affect individuals and the economy as a whole in ways that are all the more damaging when they pass from one generation to the next and thus result in unequal opportunities. Intergenerational income mobility is not easy to measure. The studies available do not point to any decline in mobility since the late 1970s (Dupays, 2006; Vallet, 2004; Lefranc and Trannoy, 2003). According to this last study, the degree of intergenerational mobility – measured by the elasticity of (permanent) income of children with respect to that of their fathers in France is intermediate – more marked than in the United States and Great Britain, but less so than in the countries of northern Europe.

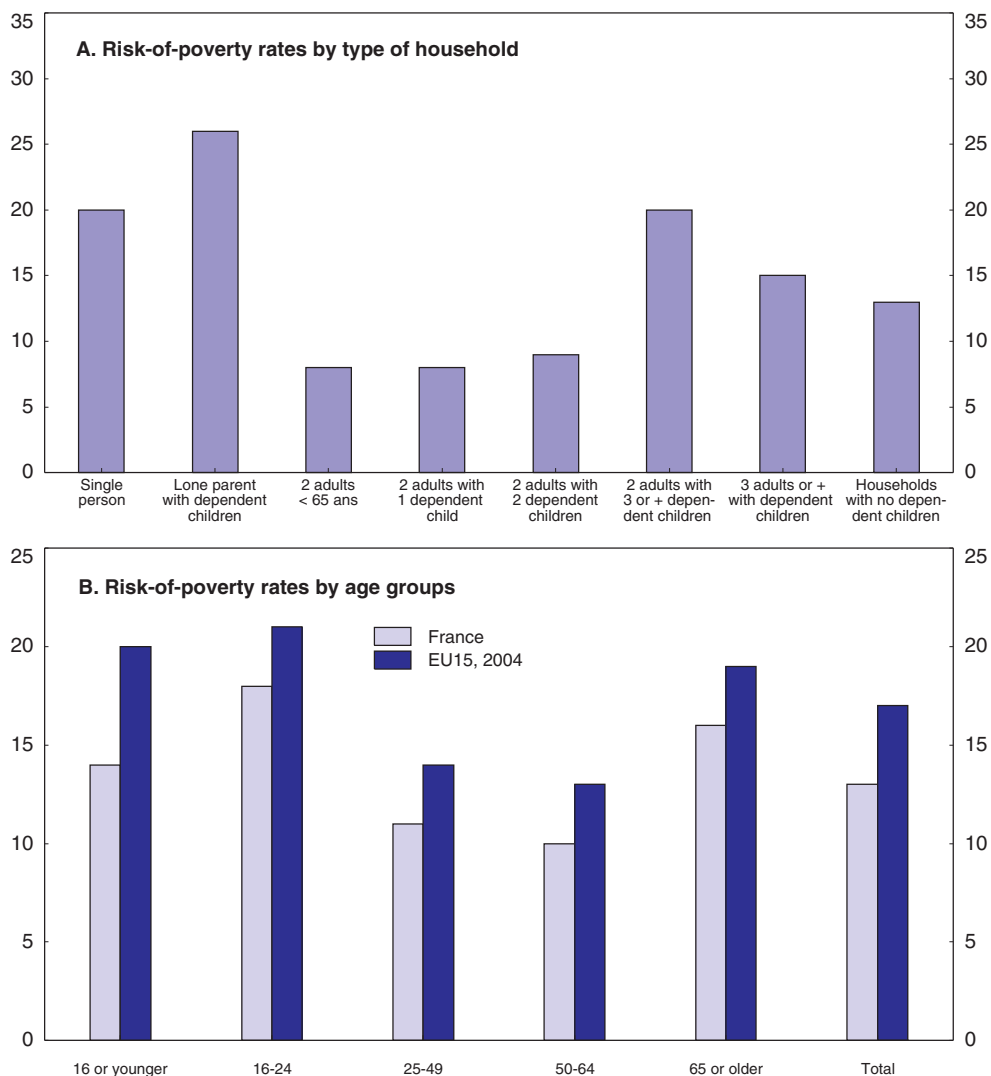
Nevertheless, academic failure affects the children of low-income families in particular. Disparities in academic success appear as soon as children start primary school (CERC, 2004). At age 17, 18% of children in the lowest decile of income distribution have stopped school, compared with 1% on average for the three most favoured deciles. The impact of social background on children's futures does not depend solely on such effects as the transmission of social capital or parents' aspirations. Poor children are more likely than others to find themselves in overcrowded accommodation or to develop health-related risks such as obesity. These concrete consequences of poverty have a very negative impact on academic success.

Inequalities of opportunity in the education system are not the only source of transmission of inequalities. For a given level of diploma, a strong impact of social background on jobs and future incomes restricts the returns of education for people coming from disadvantaged backgrounds. This phenomenon is magnified by students' expectations of the returns of education (Goux and Maurin, 2001). While inequality of social opportunity as regards education seems in fact to have diminished, the role of the diploma in affording access to social positions has also declined (Vallet, 2004).

Certain groups are especially hard hit by poverty and social exclusion

Together with family structure, a lack of employment accounts for a large proportion of all situations of poverty (see below), this being all the more true in that there is structural

Figure 2.5. **Risk of monetary poverty rate by selected criteria**¹
2005



1. Share of persons living in a household having an equivalent disposable income, after social transfers, below the poverty threshold, which is set at 60% of national median equivalent disposable income.

Source: Eurostat database.

StatLink  <http://dx.doi.org/10.1787/054130073326>

polarisation of employment among households (ONPES, 2006). Indeed, between 1975 and 2002, the proportion of households in which every person capable of working had a job rose from 57 to 68%, while the share in which nobody was working doubled, increasing from 6.3 to 12.2%. Single-parent families with a dependent child are the hardest hit (Figure 2.5). Also seriously affected are single people and couples with at least three children.

Young people are particularly hard hit by poverty, the likely reason for this being the low level of hours they work and the fact that there is no minimum replacement income for young people under the age of 25. With the introduction of a minimum benefit for pensioners and rising pension values, poverty has been sharply reduced among pensioners: using the 50% of median income threshold, the poverty rate for pensioners was over 20% in 1970 and under 5% in 2002 (ONPES, 2006).

Children are more affected by poverty than the population as a whole, even if their poverty rate in France is significantly lower than in most OECD countries. Even so, 7.4% of children under 16 were living in a family with income below the threshold of 60% of median income in 2001 (UNICEF, 2005). There are two reasons why child poverty is particularly troublesome. First, children cannot interact with the economic environment to escape from poverty, which strengthens the argument for public action to reduce child poverty. Second, since intergenerational mobility is less than perfect, people who are born poor are more likely to remain poor when they reach adulthood.

The poverty rate is high among immigrants, and especially immigrants from the Maghreb countries (Table 2.1). Their very characteristics make immigrants (and their descendants) particularly exposed to the risks of poverty and social exclusion (see below).

Table 2.1. **Risk of monetary poverty among immigrants**

The percentage of people in immigrant households who are poor, using the threshold of 50% of the median income¹

	Risk-of-poverty rate
Immigrant households	18.0
<i>Of which:</i> Europe	8.3
Maghreb	27.3
Other countries	18.0
Non-immigrant households	5.1
All households	6.2

Note: The table shows that 8.3% of people living in an immigrant household of European origin are poor.

1. An immigrant household is defined as one in which both the reference person and their partner, if any, are immigrants.

Source: INSEE-DGI, Taxable Income Surveys (Enquête revenus fiscaux) 2001.

Employment, the main source of social inclusion

Access to employment is the decisive factor for social inclusion. Income from work represents on average almost 70% of household income. But employment provides more than just an income; it integrates people in a social framework. As such, it has to be preferable to a situation of non-employment with the same level of resources but without integrating in society. What is more, having a job helps people to find accommodation and sometimes gives entitlement to other rights such as access to complementary health and pension schemes. However, poverty and unemployment do not overlap completely. Poverty being defined in terms of the household, a person can be jobless but not faced with poverty

as long as the household has sufficient income. Conversely, having a job does not necessarily rule out poverty, either because the person's earnings are insufficient to place him/her above the poverty threshold, or because the family situation and the employment status of the other members of the household do not provide the household with aggregate income above this threshold.

Employment and poverty

The weakness of employment is the main cause of poverty: among poor people, 67% did not have a job in 2004 (Table 2.2). Nevertheless, employment is not an absolute bulwark against poverty: 33% of people living in poor households (41% for people under 65) had a job, which amounted to 5% of the population. France is in an average position in terms of the prevalence of the working poor compared with other OECD countries and with the average of the EU15.

Among employed people living in poverty, two groups can be distinguished: full-time all-year-round workers, who represent the majority, and workers with a low duration of employment, either part-time workers, or people having worked full-time but for less than six months (Table 2.3). More than the hourly wage, it is a low number of hours worked annually that is a crucial source of poverty and inequality. Indeed, while the hourly wage of workers with annual incomes situated in the bottom decile of the distribution is 36% of

Table 2.2. **Poor people according to their labour-market status**
60% of median income threshold, 2004

	Thousands	Percentage of poor people 18 years old and over
Active	2 445	50
Employed	1 594	33
Unemployed	851	17
Inactive, 18 years old and over	2 421	50
Student, 18 years old and over	322	7
Inactive from age 18 to 64	1 123	23
Retired or inactive, 65 and over	977	20
Total, 18 and over	4 866	100
Children less than 18	2 001	..
Total	6 867	..

Source: Enquêtes revenus fiscaux, Insee-DGI.

Table 2.3. **Composition of poor active people according to their main employment status in the year**
2004, per cent

	Poor active people	Non-poor active people
Total	100	100
Mainly unemployed, receiving unemployment insurance	21	3
Mainly unemployed, not receiving unemployment insurance	19	5
Part-time employed, involuntary	5	3
Part-time employed, voluntary	11	10
Full-time employed between 6 and 12 months	9	7
Full-time employed throughout the year	35	72

Source: ONPES (2006).

that of those in the top decile, the annual earnings of workers of the bottom decile are only 8% of the top decile (CERC, 2006, p. 118). Poverty thus comes essentially from low employment, either in terms of the number of persons working in the household or in terms of low annual working time, or both.

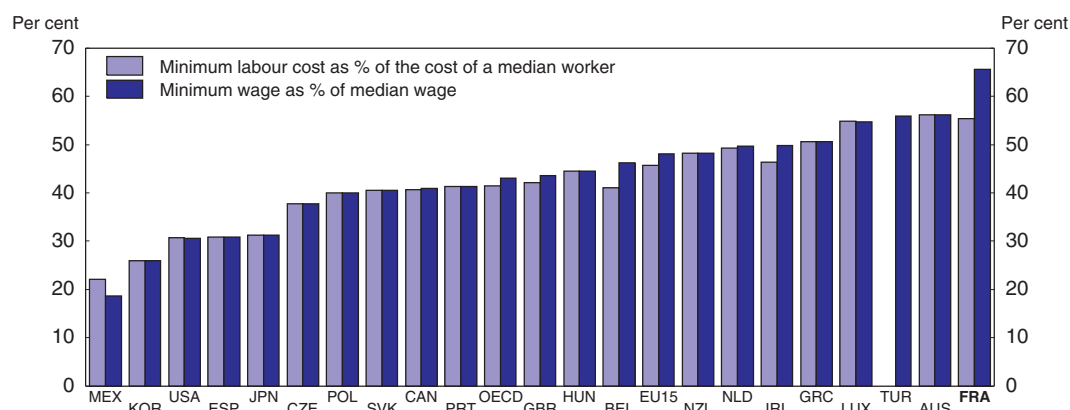
Job insecurity, involving alternating periods of employment and non-employment, exposes people to poverty. In such cases, they experience income fluctuations when they are no longer earning and, if they have not contributed long enough, they are not entitled to unemployment insurance. The fact is that more than a quarter of job seekers receive no compensation or social benefits. In the majority of cases, those involved are young people under the age of 25 who have not paid sufficient unemployment insurance contributions and are not entitled to the RMI. Delays in the receipt of social benefits accentuate these problems. This insecurity, proxied by the probability of shifting from employment to non-employment, is greater in France than in many other European countries (CERC, 2005). Job insecurity is not to be confused with job instability, which describes a break in the link between an employee and a firm, but which may be followed by very rapid re-employment in another job. While instability is no doubt harder to endure than a stable relationship with the same employer, it does not necessarily entail an increased risk of poverty. What is more, it enables the labour market to adjust to fluctuations in the economic environment.

In combating poverty, policies should seek to raise the employment rate and the number of annual hours worked, rather than attempt to strengthen the ties between an employee and a particular firm. Several reforms were proposed in the previous *Economic Survey of France* (OECD, 2005b), some of which are repeated and developed further in the following sections.

Co-ordinating policies regarding the minimum wage, reduced social charges and in-work benefits

It is usually acknowledged that a reasonable minimum wage can help to combat poverty by guaranteeing workers a minimum income and encouraging labour market participation (OECD, 2006a). The minimum legal wage, the SMIC, is equal to over 65% of the median wage (Figure 2.6), the highest among the OECD countries. Nevertheless a single-

Figure 2.6. **Minimum cost of labour in OECD countries¹**
2005



1. The labour cost is the wage plus the corresponding social security contributions paid by the employer.

Source: OECD (2007), *Economic Policy Reforms: Going for Growth*.

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worker household working full time at the minimum wage all year round, with one or two dependent children, had an income level in 2005 below the poverty line at the 60% threshold (though not at 50%), even with the various social transfers available. Such a household would require 1.3 times the SMIC, whatever the number of children, to reach the 60% threshold (CERC, 2007). The increase in the in-work benefit due in 2007 should, however, reduce this threshold.

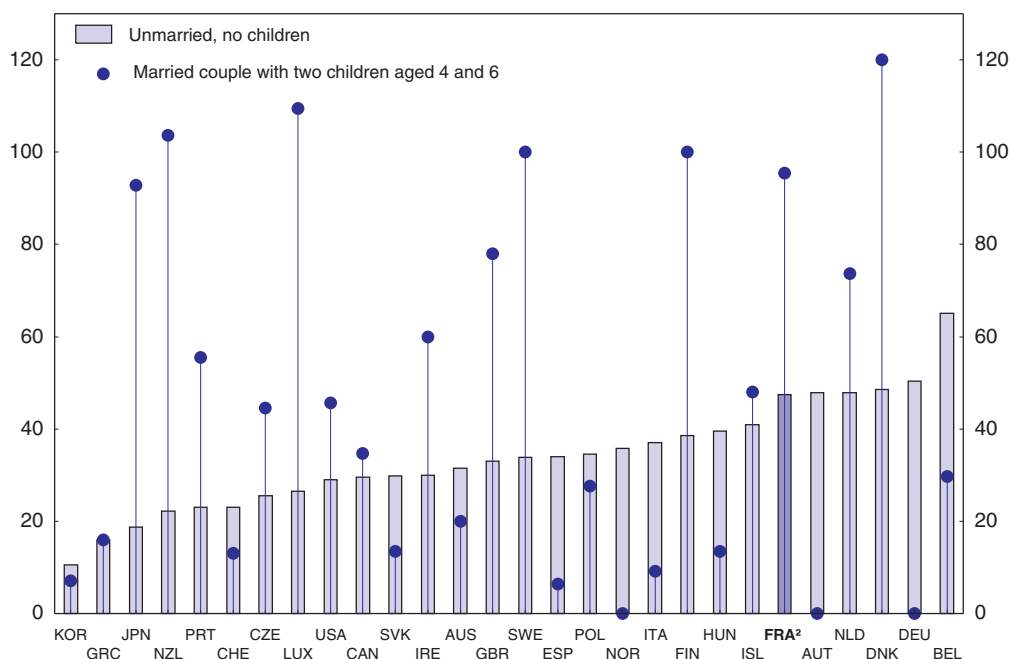
On the other hand, the high level of the minimum wage excludes some low-productivity workers from the labour market altogether. What is more, the minimum wage and its increases benefit workers who are low-paid but not necessarily concerned by poverty, since this depends on the household composition and the employment situation of other household members. For these reasons, the minimum wage is not the most effective tool to fight in-work poverty objective.

The impact of the SMIC on the cost of labour is in part attenuated by numerous reductions in social insurance contributions, but the cost of labour in relation to the level of the SMIC remains among the highest of all the OECD countries. This being the case, the negative impact of the SMIC on labour demand is liable to be greater than the positive impact on labour supply, and numerous studies have pointed to the negative impact of the cost of labour on the employment of unskilled workers in France.³ Indeed, the very marked positive impact on employment of policies implemented between 1993 and the late 90s to reduce social insurance contribution for workers at the level of the SMIC well illustrates that demand for lower-skilled workers is quite sensitive to their costs. The previous *Survey* recommended freezing the real SMIC over the next few years. In 2006, the return to the traditional method for revaluing the SMIC slowed its growth (it rose 3% in 2006 following annual average growth of 5% from 2003-05) but it rose more than prices (which rose by 1.9% over the reference period). If it is to facilitate low-productivity workers' access to the labour market and so help them to get out of poverty traps, the government has to keep future increases in the SMIC under control and allow the cost of labour at the level of the SMIC to fall by comparison with the cost at the level of the median wage.

Similarly, benefits linked to employment must be used not only to combat in-work poverty but also to encourage those without jobs to return to work. Successive governments have appreciably reduced inactivity traps, for example by introducing and then amending the earned income tax credit (*prime pour l'emploi*, PPE) for employees in low-paid jobs (Box 2.1), and by increasing the possibility of receiving – for a limited period of time – both income from work and a social benefit (Annex 2.A1). As a result, marginal rates of tax for people entering employment from a low income situation decreased. The possibility of receiving both income from work and an allowance means that rates of taxation are well below 100% during the period when both incomes are being received (Figure 2.7). Once this period is over, however, tax rates remain close to 100% in the case of a very part-time job paying the SMIC (Figure 2.8).


In 2006 the government introduced two additional credits supplementing in-work incentives for the long-term unemployed and the recipients of certain social minima (the RMI, API and ASS) who find employment at more than 52% of legally defined full-time work. These credits significantly increase the income of a person resuming work in the year the job is taken up. Given the probable threshold effects that these induce, it would be important to evaluate this reform.

Figure 2.7. **Marginal effective tax rates in OECD countries¹**
2004



1. For a person moving to work, not entitled to unemployment benefits before the transition, earning 67% of average production worker's wage. In the case of the couple, the working member earns 67% of average production worker's wage.
2. The possibility of cumulating earned income with income support for a limited period is taken into account.

Source: OECD, Benefits and Wages database.

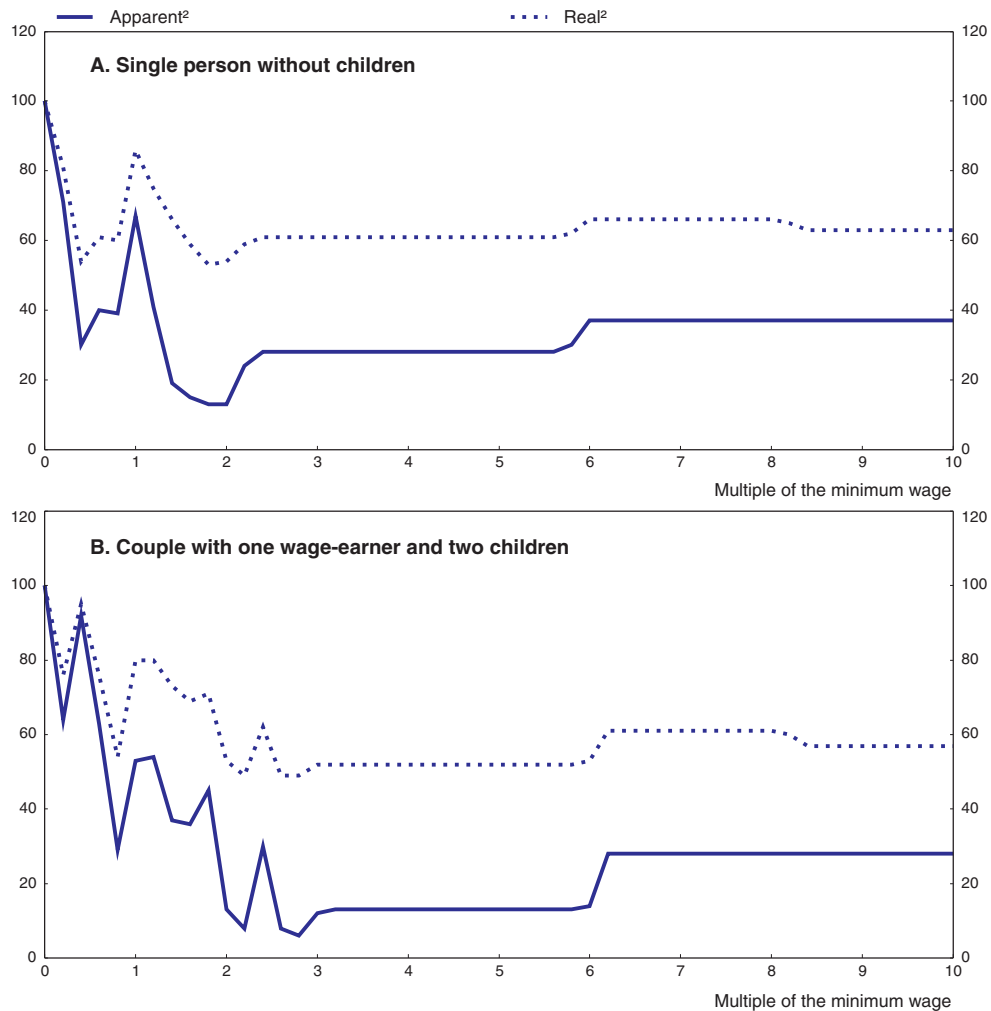
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A number of benefits (or related entitlements) for people with low income are linked to their status – i.e. whether they receive unemployment insurance benefit or one of the social minima (welfare). Changing status means that they forfeit access to the said benefits, which can also give rise to inactivity traps. This used to be the case for exemption from local property tax and housing grants, but the government has reformed these programmes so as to reduce the risk of an inactivity trap. Supplementary universal sickness cover (CMUC), which is extended automatically to recipients of the RMI, may still be responsible for inactivity traps (Hirsch, 2005). Assistance in acquiring supplementary health insurance has only partially offset this threshold effect. Moreover, the related entitlements that go with income from inactivity are substantial at local level (for example, reduction in or exemption from canteen and transport costs). It is very difficult to gauge with any accuracy the impact of these local entitlements on marginal rates of tax, but the study by Anne and L'Horty (2002) on selected local authorities does show that the impact is potentially considerable. The mechanisms for allocating entitlements on the basis of status should be restricted. The CMUC and assistance in acquiring complementary health insurance should be reviewed with the object of limiting the existing threshold effects. The government needs to persuade local authorities to reconsider their status-based allocation of related entitlements and move towards a means-based approach.

Another major obstacle to returning to work stems from the complexity of the system of welfare benefits and the frequent changes they undergo. As a result, it is very difficult for an individual to know what the financial advantages of returning to work are. If the different


Figure 2.8. **Effective marginal tax rate in France**¹

Per cent, 2007



1. The possibility of cumulating earned income with income support for a limited period is not taken into account.
2. The "apparent" EMTR is calculated from marginal tax and contributions paid by the employee and the loss of some social benefits. The "real" rate is equal to the apparent rate plus the marginal impact on the employer's contributions.

Source: Ministry of Finance.

StatLink  <http://dx.doi.org/10.1787/054235667237>

measures are to be made more effective, they need to be simplified and stabilised over time, so that there is less uncertainty as to the financial gains to be derived from a return to work.

In order to combat poverty more efficiently, the PPE, increases in the SMIC and cuts in social security contributions should be used in a more consistent manner. In particular, there is a better solution than increases in the SMIC combined with further reductions in social contributions. The SMIC should rise less fast than the median wage, which would lower the relative cost of low skilled labour and automatically reduce the share of reductions in social contributions, proportional to the SMIC, in GDP. Some of the available resources could be used to increase the in-work tax credit (the PPE) and this could be better targeted on those exposed to poverty. It is true that higher means-tested benefits tend to increase marginal effective tax rates (METRs) as perceived by employees since any

Box 2.1. Measures put in place by the government to increase the financial gains from employment

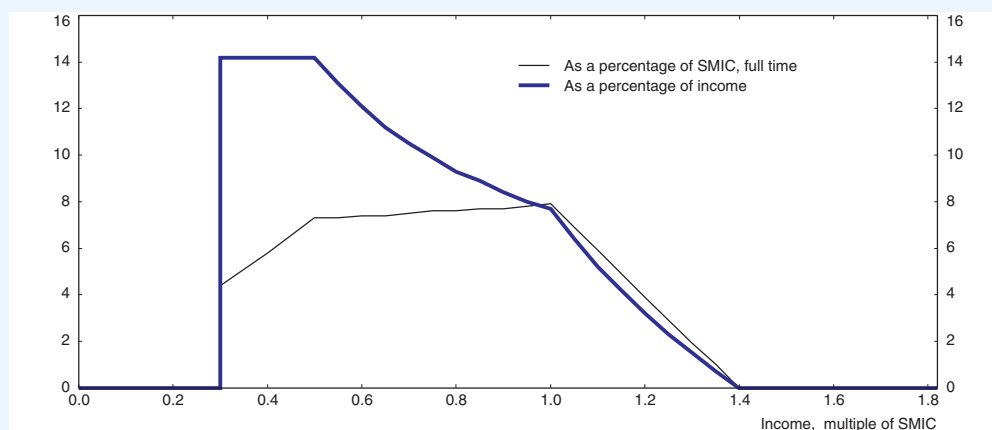
Financial incentives to be in work

The government has introduced a number of measures designed to make work pay:

- Since 2001 there has been an earned income tax credit (PPE), for employed persons whose work incomes fall within a certain range. The system has been updated on several occasions, especially in 2006. The PPE is paid to people with work incomes above 30% of the monthly SMIC and up to a threshold which depends on the family situation but can reach 2.1 times the SMIC for a single person or for a one-earner family with two dependent children. It is calculated on the basis of the previous year's income and, for persons who received it the previous year, it has been paid on a monthly basis since 2006. The credit is at its highest for jobs paying the SMIC (Figure 2.9).
- Since March 2006, incentives to take work for the recipients of certain welfare benefits (ASS, RMI, API, see Annex 2.A1) have been modified:
 - ❖ For those taking a job with fewer than 78 hours work per month, the previous system of cumulating the welfare benefit with earnings is maintained. Beneficiaries can fully cumulate both sources of income for the quarter in which the job starts and the subsequent three months, and half the welfare benefit is withdrawn for the following nine months.
 - ❖ For those work at least 78 hours per month the system is the same for the first three months. After this they can receive two further credits: a payment of € 1 000 in the fourth month (the back-to-work benefit) and another of € 150 per month for single people (€ 225 for others) for nine months.

All told, the single person in receipt of one of the welfare benefits who takes a job paying 60% of the SMIC will receive € 4 644¹ during the year following his return to work, i.e. 63% of the wage. A person in the same situation but who takes a job paying 50% of the SMIC will receive € 3 779, i.e. 62% of the wage.²

Figure 2.9. PPE and work income
Per year, in euros, for a single person with no children, 2007



Source: Ministry of Finance.

StatLink  <http://dx.doi.org/10.1787/054282245436>

1. The benefit levels payable in 2007 based on 2006 income comprise € 1 408 due to the temporary cumulation of benefit and earned income, € 886 in PPE, € 1 000 for the back-to-work benefit and a flat-rate benefit of 9 times € 150.
2. 2 907 from the cumulation and 872 from the earned income tax credit.

additional income will result in a decrease in the benefit received. This creates a disincentive to increase hours worked. For example, in the case of a two-earner couple not receiving the PPE, there is an incentive for one of the two to work less so as to qualify for it, particularly if the couple can thereby reduce its child-care costs. Hence, poverty can be reduced but, at the same time, inactivity traps may be enhanced. For this reason, it is not easy to find the most efficient combination of instruments. But the current regime of reduced social security contributions phased out as earnings increase is itself a cause of high METRs as perceived by employers. However, existing studies have not been able to show the existence of such a “low wage trap”. In the long run, it would no doubt be possible to reduce this part of the METR with a different combination of the instruments where the SMIC would be less of a burden on the cost of low-skilled labour. Indeed, the comparison of METRs among OECD countries shows that they are relatively high in France; it is possible to lower them overall, even if in families with certain characteristics they may remain high. With this different mix of instruments, the cost of combating poverty would be borne more by the State and less by increasing labour costs. This would allow employment to be increased, limiting social exclusion and losses of human capital. Nevertheless, in the short run, a significant cut in reductions in social contributions would result in a significant increase in the cost of labour at the level of the SMIC and would be damaging for employment.

Employment protection legislation is creating inequities among workers

Job insecurity is concentrated in the first instance among the least skilled employees, reflecting the marked dualism between jobs involving indefinite-term contracts (CDIs), which afford rigid job protection making it very costly for firms to break the employment link, and other jobs which allow adjustments to be made (OECD, 2005b). But this dualism also increases job insecurity for workers on permanent contract to the extent that those who lose their jobs are very likely to face strong difficulties to find a new one.

In 2005 the government introduced its “new recruitment contracts” (*contrats nouvelle embauche*, or CNE) which are confined to firms with 20 or more employees. These are contracts of indefinite duration, but during the first two years the contract can be terminated for no specific reason and the notice period is shorter than for a permanent contract (two weeks for the first six months and one month thereafter). Firms can therefore escape the constraints involved in being obliged to justify dismissals during the said period. In return for the flexibility gained by firms, they have to pay more compensation than in the case of permanent contracts.⁴ The employee is also entitled to unemployment benefit, or, if he or she has not worked long enough to qualify for such benefit, he or she is entitled to a standard allowance equal to one month’s indemnity for those who have worked at least four months. These measures do ease employment protection legislation (EPL) for firms able to take advantage of these contracts, but they also make the existing situation more complex by introducing a new type of contract. Moreover, because these contracts are confined to certain firms, they have created new inequalities among employees, with those working for small firms already in a different position from those in larger companies (CERC, 2005).

In order to reduce overall job insecurity, to facilitate the transition from non-employment to employment and to spread job-loss risks more evenly among wage earners, efforts to ease EPL should continue. Consideration should be given to EPL harmonization for different types of contract and the introduction of a single contract (Box 2.2). Different

Box 2.2. Adaptability of the “single contract” to the French case?

To end dualism in the labour market, several reports have suggested the creation of a single contract (Blanchard and Tirole, 2003; Camdessus, 2004; and Cahuc and Kramarz, 2005). The types of single contract proposed by these different reports vary somewhat, but they agree on the idea of a unique permanent employment contract where the rights to job protection and redundancy payments increase gradually according to the experience gained with the employer. At the same time, the ability of employees to contest the redundancy in court would be restricted and the procedural obligations of companies would be reduced, as would their obligations to find alternative work for redundant employees. The single contract has been taken up by the OECD in the revaluation of its jobs strategy, which outlines the Austrian model where the partially unpredictable cost of redundancy is replaced by a system of individual savings accounts. The employers contribute a certain percentage of salaries to the individual accounts of employees from the first day of employment. When the employee leaves the company, s/he may use this account as a redundancy payment or keep it. If s/he is engaged by another company, this one will in turn pay the contribution into the employee's account. This type of contract has the advantage of eliminating uncertainty about the cost of redundancy and dualism in the labour market. Being a form of compulsory saving, however, it provides no *insurance* against redundancy, which continues to be provided by the unemployment insurance system.

The implementation of this type of contract was discussed within the Conseil d'Orientation de l'Emploi and has begun to generate a set of articles on this topic (Barthélémy *et al.*, 2006). While this solution aroused a great deal of enthusiasm at the release of the first reports, the discussions within the COE with labour unions, the government and outside experts led to the feeling that implementing this single contract could give rise to substantial difficulties. There are two types of arguments:

1. A legal argument. An abolition of the role of judiciary in the relation between the employer and the employee is against the principles of the French law. These principles result not only from labour law but also from common law to which labour law is subjected to each time the employment law has no particular rules. Notions such as “good faith” and “abuse of process” are essential in labour law. So, it is not possible for the employee, even in the case of a breach of contract by mutual agreement, to give up the right to ask the courts to rule on a demand for compensation for redundancy or on a demand for it to be annulled. Nor is it possible to fix a ceiling to redundancy payments, which is what currently constitutes the essential source of uncertainty over the cost of redundancy, because it might not be possible to fully repair the damage in every case, which is against the principles of law. Finally, France is one of the eight OECD countries signatories to the agreement with the International labour organisation according to which an employee cannot be dismissed without valid motive and has the right to lodge an appeal.
2. A political economy argument. The other argument often advanced is that if agreement were found, the single contract which would result from it could be rather different from an economically efficient contract. Some feel that there would be a risk that the fixed-term contract would be suppressed and the permanent contract modified at the margin so that redundancy payments increase with experience, but that the important role of the judiciary and the restrictive obligations on companies would be retained. In that case, the flexibility currently allowed by the fixed-term contract would be lost while the “new” permanent contract would not provide enough flexibility to allow companies to adjust efficiently to shocks. This type of argument leads a number of people, including employers' organisations, to want to preserve the current fixed-term contract.

ways to ease EPL need to be considered, for instance, by relaxing the allowable reasons for “economic” dismissals that, at present, are strictly limited to cases where they are needed to maintain economic performance but can not be used to improve it, by simplifying the procedure, by providing employers with the possibility to escape obligations to help dismissed workers to find a job in exchange for a tax payable to the public employment service or by developing collective bargaining on these issues.

A social protection system which is developed but not fully efficient

A country’s capacity to reduce poverty via welfare spending depends both on the policies targeting the people hit by poverty and on their efficiency. Another decisive factor is the scale of the expenditure. Since welfare spending has to be financed, however, it is important to find the right balance between the scale of the spending and the cost to the economy of the corresponding taxes.

In France, as in the other OECD countries, the aims of the social protection system are manifold, including facilitating access to the health, housing and education systems, assisting families with children, providing the least well-off with a minimum income and helping people excluded from the labour market to find work. The importance attached to each objective determines the characteristics of the system. Two features in particular characterise the different systems: the degree to which they target the poorest people, and hence involve means testing, and the extent to which assistance involves obligations on the part of the recipients (Table 2.4). Compared with other OECD countries, the current French system remains moderately targeted on the poorest people, while transfers are not very conditional on recipients meeting any obligations. The main measures aimed at the disadvantaged are listed in Annex 2.A1. There are also tax benefits for people of limited means (OECD, 2005b).

Table 2.4. **Main instruments of the social protection system for combating poverty based on means testing and the obligation to be looking for or in employment**

		Conditionality on looking for or being in employment		
		None	Looking for work	In work
Means testing	No	<ul style="list-style-type: none"> – Family allowance – Health insurance 	<ul style="list-style-type: none"> – Unemployment benefit – Public jobs – Public Employment Service (training, job search assistance) 	<ul style="list-style-type: none"> – Minimum wage – Employment protection – Occupational training – Support for child minding
	Yes	<ul style="list-style-type: none"> – Other family benefits – Social minima (RMI, API) – Supplementary health allowance – Housing benefit – Education allowance – Transport – Food – Emergency aid 	<ul style="list-style-type: none"> – Social minima (ASS) 	<ul style="list-style-type: none"> – Earned income tax credit (PPE) – Supplementary support for child minding

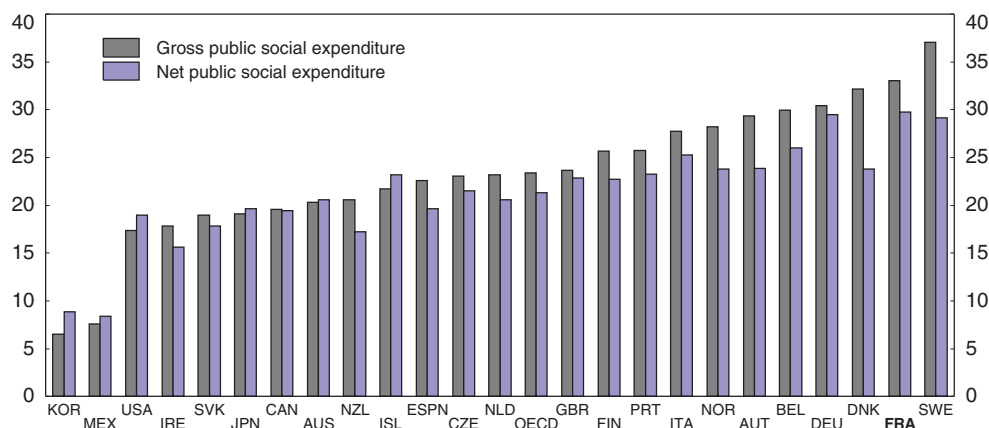
Social expenditure is high but not very targeted

The burden of public⁵ social spending in France is one the heaviest in the OECD countries, representing more than 30% of GDP. Since the mid-1990s, welfare spending

expressed as a percentage of GDP has remained stable. Its high level is attributable to the weight of pensions and health spending. The country's "welfare effort", or net social expenditure, is the difference between social expenditure and the taxes paid on this spending by recipients, including tax expenditures with welfare objectives (Ladaique and Adema, 2005). At 30% of GDP (at factor cost) in 2003, France's net social expenditure was the highest in the OECD (Figure 2.10).

Figure 2.10. **Gross and net social expenditure**

As percentage of GDP at factor cost, 2003¹



1. The net measure of social expenditure generates a consistent measure of the share of social expenditures while taking into account the diversity of taxation systems and is the best available indicator. Nevertheless, this indicator does not take account of tax reductions for pensions. For more details see OECD (2007), Social Expenditure database, www.oecd.org/els/social/expenditure.

Source: OECD (2007), Social Expenditure database 1980-2003.

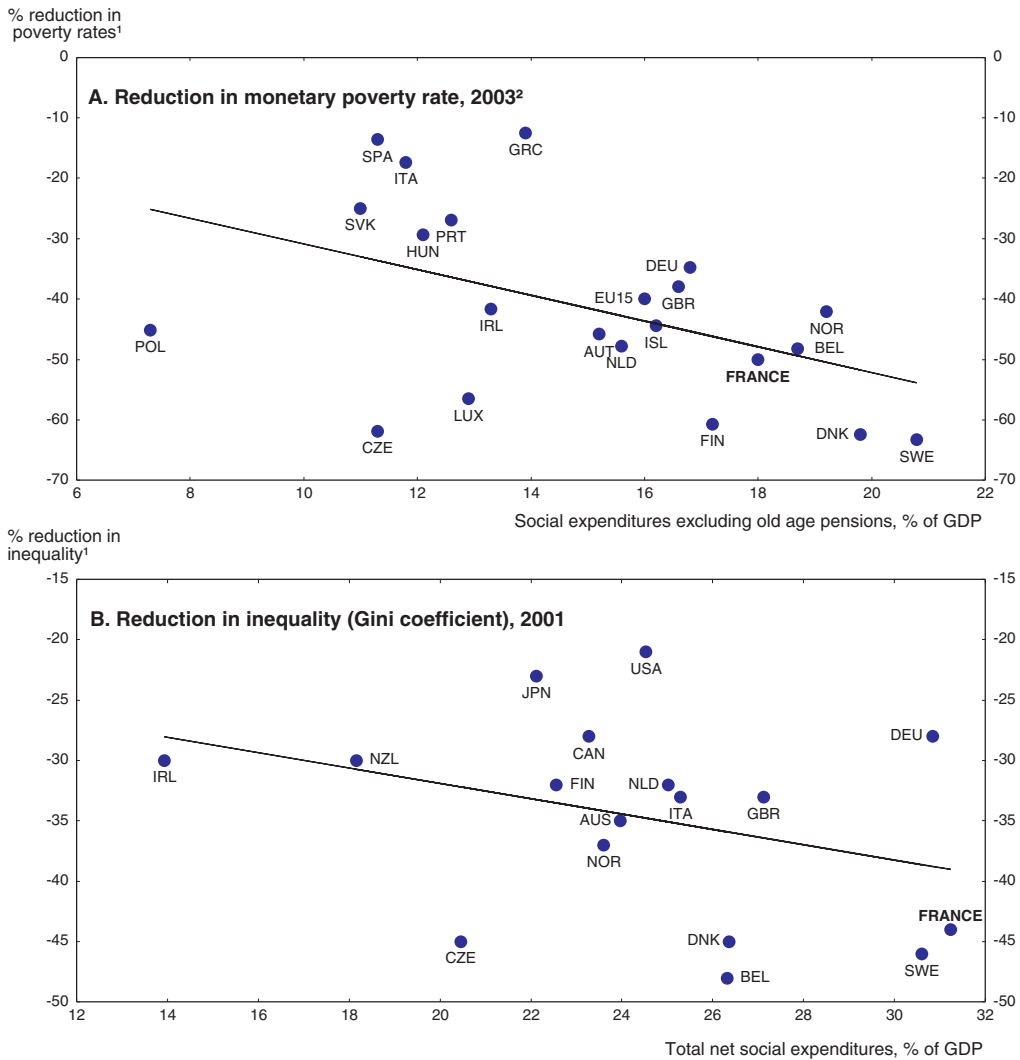
StatLink  <http://dx.doi.org/10.1787/053663877414>

Social expenditure reduces inequality and, in particular, the poverty rate (Figure 2.11). But some other countries, where welfare expenditure is more targeted on the poorest, manage to reduce the poverty rate more with much the same amount of spending. From this point of view, it follows that the efficiency of social expenditure could be improved. Nevertheless, poverty intensity, measured as the gap between the incomes of the poor and the poverty threshold, is low in France compared with in other European countries (Figure 2.12). Social expenditure thus makes a significant reduction in the gap between the incomes of the poor and the poverty threshold.

The amount of support received by the poorest 20% is relatively small compared to that received by the wealthiest 20% (Whiteford, 2006). Nevertheless, since social expenditure is substantial in France, transfers to the lowest quintile amounted to nearly 6% of all households' disposable income in 2000, a figure which is above the OECD average. In the countries of northern Europe, where the importance of social expenditure is similar but where expenditure is targeted more on the poorest people, transfers to the poorest 20% reach 8 to 9% of disposable income.


The fact that the French system of social protection is not very targeted stems from the weight of pension and health expenditure, which are not means tested (Figure 2.13). Family-related spending is also poorly targeted. Basic family allowances are paid as of the second child, without means testing, and the amount involved becomes substantial after

Figure 2.11. **Effect of social expenditure in reducing inequalities and the poverty rate**



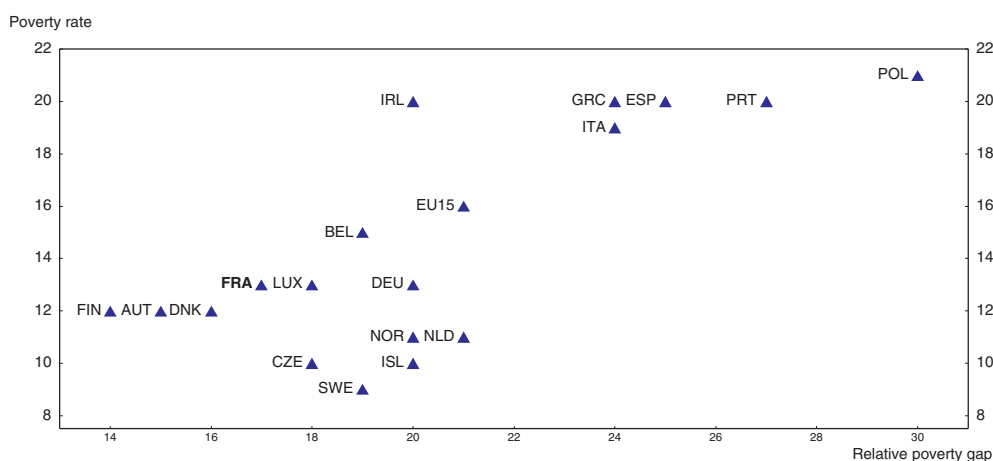
1. Percentage reduction in the two indicators (poverty rate and Gini coefficient) generated by the inclusion of social transfers.
2. 2004 for Iceland, Italy and Sweden.

Source: Eurostat database; and Forster, M and M. Mira d'Ercole (2005), "Income Distribution and Poverty in OECD Countries in the Second Half of the 1990s", *OECD Social Employment and Migration Working Papers*, No. 22.

StatLink  <http://dx.doi.org/10.1787/053671130801>

the third child. There are, however, supplements for families with limited resources and a means-tested allowance for children aged under three. The system results in moderate vertical redistribution: children in families whose income falls into the bottom quartile of the income distribution receive 38% of family allowances, above the European average (35%) but below the 50% share attained in Spain and Ireland (Lapinte, 2002). However, with other benefits being paid to families with children, the child poverty rate in France is low compared to other OECD countries, although, on a pre-transfer basis, it is the second highest among the OECD countries behind Mexico (OECD, 2006b).

Figure 2.12. **Poverty intensity**¹
2005



1. Poverty intensity is calculated as the difference between the median revenue of people below the 60% poverty threshold and the poverty threshold, expressed as a percentage of the threshold.

Source: Eurostat.

StatLink  <http://dx.doi.org/10.1787/053671850627>

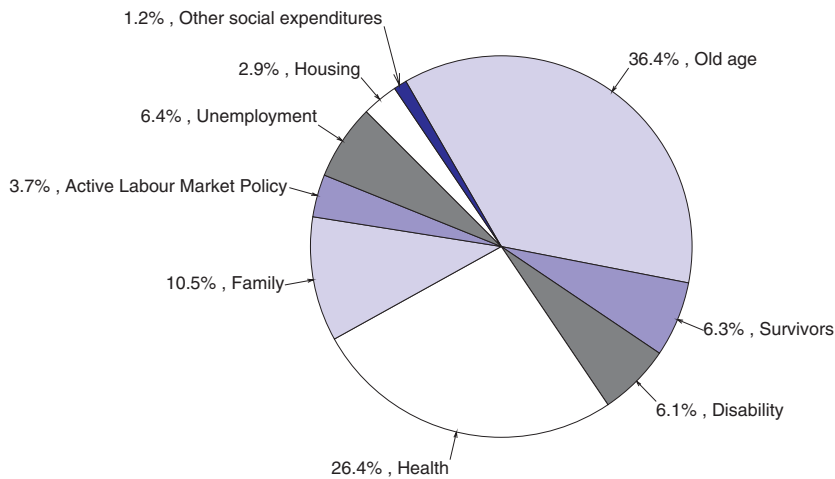
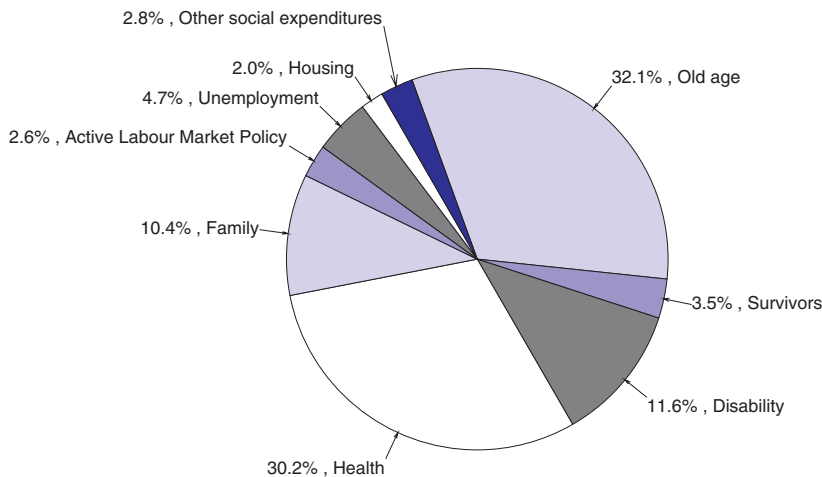
The social minima system is not an effective bastion against poverty and social exclusion

There is a range of means-tested welfare benefits (nine of them) which, with one exception, do not require the recipient to be looking for work (they are listed in Annex 2.A1). Three of them, the minimum subsistence income (RMI), the specific solidarity allowance (ASS) and the lone-parent allowance (API) are directed at a potentially working population. The supplementary old-age allowance and the supplementary disability allowance are designed to offset situations of permanent or sustained inactivity. The disabled adults allowance (AAH), the integration allowance (reserved for released prisoners, repatriates, refugees and asylum seekers) and the pension-equivalent allowance concern people some of whom may be economically active, but whose characteristics mean that they have particular problems to contend with. Lastly, the widowed person's allowance is paid to surviving spouses.


Depending on the system they belong to, the recipients of welfare benefits will not all have the same entitlements nor the same obligations, whereas these persons' characteristics would not warrant their receiving unequal treatment (Mercier and de Raincourt, 2005). Beneficiaries of the RMI have to sign an integration contract and comply with it or risk disciplinary measures. However, the contract does not include any obligation to seek employment and can, in practice, amount to no more than an inventory of the benefits to which the recipient is entitled, without having any real content. Recipients of the ASS have to look for a job, while API beneficiaries have no obligations and are not monitored in any particular way. The penalties for not complying with the requirements are stringent, hardly commensurate with the means available to those concerned and in fact very rarely applied. The systems are managed by different bodies. The ASS and API are State-financed, but recipients of the ASS are monitored by the ANPE, while recipients of the API are under no surveillance. Since the Act of 2003, management of the RMI, including the payment and integration measures, has been devolved to the *départements* (see Chapter 5).

Figure 2.13. **Types of public social expenditure**

As percentage of GDP at factor cost, 2003

A. France**B. OECD**

Source: OECD (2007), Social Expenditure database 1980-2003.

StatLink  <http://dx.doi.org/10.1787/053764500844>

While welfare benefits do give beneficiaries the essential minimum, they do not in the majority of cases give them incomes that reach the poverty threshold. What is more, receiving one of these benefits does not seem to make returning to work any easier. Many people continue to be on the RMI, which causes them to lose self-esteem, leaves them stigmatised and may be associated with poor health.⁶ Relatively few welfare beneficiaries go from welfare to work. Slightly over 25% of those in receipt of the RMI or ASS at the end of 2004 were in work in the first quarter of 2006. For the API the figure is slightly lower, about 20%. In most cases, the jobs in question were temporary, part-time or State-aided (Pla, 2006). It is thus apparent that these welfare programmes have served as limited bastions against poverty and have not been very effective in promoting integration.

Increasing the effectiveness of policies to promote integration and provide support for the jobless

In addition to the reforms aimed at improving the overall labour market framework, there is a need to introduce effective policies in support of integration and job search.

The system of support for the jobless is not fully effective

Some of the different components of an effective policy to deal with unemployment have been implemented for those receiving unemployment insurance benefits, although certain aspects of these schemes could be improved (Crépon *et al.*, 2005; OECD, 2005b; Debauche and Jugnot, 2006). Since 2001, all job-seekers who register with the UNEDIC (the body responsible for unemployment compensation) and who are entitled to unemployment benefit sign a plan to help them return to work (PARE), which lists the commitments entered into by the job-seeker and those undertaken by the ASSEDIC and the ANPE (the body providing placement services for job-seekers). The former must be actively looking for work, follow suggested training courses, take any acceptable job and agree to monitoring and controls. If the job-seeker fails to look for work or refuses an acceptable job, benefits are cut by 20% for two to six months if it is the first such incident, and by 50 to 100% for a second offence. Similarly, UNEDIC and the ANPE have to provide job-search support, and in this area co-ordination between the two agencies has improved. Some agencies have been created, called the “maisons de l’emploi”, that should gather all the actors involved in employment issues but no assessments of the efficiency of this system have yet been undertaken.

Job-seekers not receiving unemployment insurance benefit have to abide by the same rules or risk losing access to the services of the ANPE. But, in practice, the introduction of the PARE and the decentralisation of the RMI have led to a situation in which the jobless have widely differing rights and obligations depending on their “status” and on the institution, even though their characteristics are much the same. Rights and obligations of the jobless receiving unemployment insurance benefit have been increased, whereas those not in receipt of such benefit – recipients of the RMI, for example – are in practice not integrated in the return-to-work support scheme in the same way and have few obligations. (In theory, they have access to the same job-search facilities as the unemployed receiving benefit). In particular, job search controls are less frequent for these people. Welfare benefit recipients who are not job-seekers receive little assistance with integration and have few obligations.

To make the system more effective, the rights and obligations of people in similar situations should be harmonised. In addition, the balance between so-called insurance benefits, involving obligations, and solidarity allowances, which involve fewer binding obligations, should be redefined.

Introducing a common system and obligations for recipients of a replacement income

Receiving any allowance has to be conditional on signing a contract whose objective is to bring people closer to the labour market. The contract must include mutual obligations on job-seekers and the public employment service, and receiving an allowance has to be conditional on compliance with the obligations. The obligations should depend on the strength of the person’s links with the labour market. The PARE is a basis that could be used to integrate all potentially active but jobless persons. Some aspects of the PARE ought

at the same time to be improved so as to make it more effective. Thanks to experiments conducted at local level and in other countries, plus a number of reports on the integration of people in difficulty, it is possible to establish certain principles presented in Box 2.3 which, if followed, should lead to improvement in the present system.

Along with the harmonization of the rights and obligations of the non-employed, the various replacement income levels could also be updated. The welfare benefit amounts received by potentially active people need to be equalised. In order to combat poverty, especially among young people who are not entitled to the RMI (those under 25), resuming work, even of short-term duration, ought to afford entitlement to a supplement on top of the welfare level. At present, the right to unemployment benefits and the replacement rate depend on the “stream” to which an unemployed person belongs, this depending on his age and how long he has contributed to unemployment insurance. To have access to benefits, the minimum requirement is to have contributed for six consecutive months. This threshold could be lowered, but to avoid raising outlays, it would be best to reconsider the entire unemployment insurance system because its complexity and lack of transparency lead to various costs and inequities (Coquet and Sylvain, 2007).

When it comes to harmonising the rights and obligations of all non-employed but potentially active persons, as was proposed above, the problem is the multiplicity of actors involved and the fact that different levels of government have major responsibilities, resulting in a loss of efficiency (Marimbert, 2004). Communication and co-ordination between the different actors must continue and be encouraged with the object of narrowing the gap between the rights and obligations of the non-employed who are potentially active. Responsibilities have to be clearly defined. Responsibility for placing job-seekers as a whole, whether they receive unemployment insurance or welfare benefits, should lie with a single institution with the possibility to sub-contract the treatment of some jobless to private services. There should be the closest possible co-ordination between that institution and those which finance the allowances and insurance, and a merger of the ANPE and the UNEDIC should be considered (see Chapter 5). In any event, the schemes need to be assessed.

Enhancing the effectiveness of the specific programmes available to the unemployed and excluded

France has a large number of specific work contracts for the unemployed (OECD, 2003 and 2005b). These are contracts which are partly State-aided via reductions in social insurance contributions or specific forms of assistance for categories of people who have difficulty gaining access to the labour market. In some cases they are coupled with training. The 2004 Social Cohesion Plan has refocused these contracts on the persons furthest removed from the labour market and in the non-market sector. While these contracts no doubt enable some people to enter employment, a number of criticisms have been levelled at the system (OECD, 2005b; *Cour des comptes*, 2004) such as its complexity the perpetual changes to which it is subject. Furthermore, there has not been much evaluation of the impact of the different measures on the paths followed by beneficiaries. What is more, access to these systems depends on legal criteria⁷ which can exclude certain people for arbitrary reasons. Finally, the system of adult training as it is currently organized does not provide the unemployed who are the most distant from the labour market with the possibility of undertaking long and costly courses that they might need (Cahuc and Zylberberg, 2006). Focusing all these systems of support for returning to work on the

Box 2.3. Principles for defining the single integration contract

- *Setting up a one-stop shop.* Any potentially active non-employed person wishing to receive benefit must apply to a one-stop shop. Some efforts have been made in this direction with the creation and development of job centres, the *maisons de l'emploi*, which bring together all the actors involved in employment issues. They could become the place where the integration contract is written. This initial contact should allow people to be divided into two categories: those who are able to look for work immediately, with some degree of support, and those who need to solve specific problems before finding a job, the said problems including, for example, skills, health, childminding, geographic mobility, etc. The social structures (mother and child protection centres, services responsible for the allocation of low-cost housing, the health services, for example) have to collaborate closely with job centres, which is sometimes already the case. Some departmental councils (*conseils généraux*) have established special structures for integration, but since integration is closely linked to employment, it does not seem advisable to create additional structures.
- *Steering people towards specific integration programmes.* For those able to work immediately the initial interview is with the ANPE, as in the existing PARE, and it should result either simply in unrestricted access to the services of the ANPE for the majority of people, or in more specific measures. For people who are quite far from the labour market, the interview should be held with actors in the area in which the person concerned is encountering special difficulties but in association with the ANPE. The main factors impeding the person's integration (health, housing, skills, family situation, geographic mobility,) need to be identified and specific remedial measures drawn up in the areas in question together with the recipient and the social actors competent in those areas. The experience gained by other countries shows that profiling techniques can enhance the effectiveness of this orientation phase (OECD, 2006a). It would also seem preferable to focus resources on those most in need, rather than spending them over a large number of people. In any event, when the interview takes place, it is important to clearly establish people's obligations and to plan specific measures for those that need them.
- *For people capable of working, the obligation to look for a job.* Except in special cases where specific measures have to be taken before any job search is even possible, receiving benefit has to be made conditional on looking for work. Apart from these special circumstances, therefore, people should register with the ANPE. Job-search results could be assessed on the basis of how far the person is from finding employment. The category of those not liable to any job-search obligations needs to be as small as possible.
- *Monitoring compliance with the integration contract.* It would seem preferable for every person to report on changes in his situation to a single adjudicator. The latter may be an actor in the area in which the person has encountered the greatest difficulties. More random checks on compliance with contracts could be performed, using sample lists of beneficiaries. Checks need to be stepped up for all measures and should be accompanied by credible penalties in the event of non-compliance. Partial or total, temporary or definitive suspension of benefits ought therefore to be possible, which is the case for unemployment insurance but not for welfare benefits.
- *Systems evaluation.* The effectiveness of the services available to job seekers needs to be tested at regular intervals so that services which are ineffective can be altered or dropped. The people in charge of the services have to be trained and assessed. Communication between the different actors, territorial authorities, devolved government services and ASSEDIC needs to be strengthened so as to identify effective practices that can be adopted by all. Evaluations should be made public.

persons furthest removed from the labour market has to be continued in order to limit the deadweight losses. The system should be simplified and then stabilised; efforts to evaluate the effects of these measures, including the creation of the *maisons de l'emploi*, on employment must continue and even be stepped up.

The experience gained by other countries and existing evaluations of the French systems show that market-sector schemes are a more effective way of reintegrating people in the labour market than non-market systems. That said, the beneficiaries of the two types of measures are not the same, and it is probably not possible to integrate everybody in the market sector. "Social entrepreneurship" is an alternative to assisted contracts. This refers to firms operating in the competitive sector, with employees in difficulty (former long-term unemployed, welfare beneficiaries ...), subject to the normal labour code – especially in terms of wages – but receiving assistance from the State to offset poor labour productivity and the high level of supervision required. As a rule, the assistance received diminishes over time so as to encourage firms to become profitable. Reintegration companies do exist in France (Emmaus is one example). They have to take on employees far removed from the labour market, and labour contracts are for two years at the most. The advantage of these jobs compared to assisted contracts in the non-market sector is; first, that the beneficiary is plunged into a competitive world and thus better integrated in the normal labour market; and, second, the firm has direct incentives to make sure that the employee's productivity increases. Ultimately, this form of integration could replace a number of assisted contracts if it proves more effective.

Combating the spatial concentration of poverty and the hysteresis process

Poverty is mainly concentrated in the South of France (Provence-Alpe-Côte d'Azur, Languedoc-Roussillon and Corsica), the North (Picardy and Nord-Pas-de-Calais), the Ardennes and Ile-de-France. It is essentially urban (ONPES, 2006). In the major urban areas (Paris and Lyon), poverty is found more in the suburbs, whereas in those medium-sized urban areas that have been through major industrial restructuring, poverty tends to be more prevalent in town centres. The tendency for poverty to become more urban increased between 1996 and 2002, but the risk of poverty in rural areas remains high. Compared with poverty thresholds in metropolitan France, poverty rates are very high in the overseas departments, but, taking a threshold specific to each department, poverty appears less marked than in France itself.

Housing – the main source of spatial hysteresis

The appearance of pockets of poverty away from town centres, and hence away from employment areas, creates spatial hysteresis (Fitoussi *et al.*, 2004). People distance themselves that much more from the labour market and from links with society in general when they live far removed from economic activity or the majority of other people in the neighbourhood are also unemployed. The sort of social networks which are of assistance in looking for work are lacking in poor areas. Housing and planning policy itself are central to these kinds of hysteresis. Rising property prices have excluded the poorest households from certain geographic areas, while the expansion of public housing has brought them together elsewhere.

These spatial hysteresis effects, which are felt strongly by young people from disadvantaged areas, partly explain the "suburbs in crisis" episode. The autumn of 2005 saw rioting in the Paris suburbs and in other towns by certain youths who were mainly

from these areas and who set fire to and damaged cars and public buildings, including day nurseries and schools. These events illustrated the failure of integration policies and policies aimed at reducing inequality of opportunity.

Poor households are particularly hard hit by housing problems. Because of rent hikes, housing accounts for an increasing share of expenditure by poor households living in private accommodation. Their “rate of effort” in the private sector, *i.e.* the ratio of a household’s spending on housing to its income (including housing benefit), rose from 19% in 1998 to nearly 26% in 2002. The rate of effort in the social sector is much lower, reaching only 10% in 2002, but many households do not have access to this sector. The fact is that rent increases in the private sector, together with buoyant immigration, have resulted in a rise in unsatisfied demand for social housing, which was estimated at 1.3 million units in 2003.

Poor households are more likely to live in poor quality and overcrowded housing.⁸ Although overcrowding has diminished across all households since 1998, it has remained at the same level for poor households: one poor household in five lives in overcrowded conditions. Unsanitary conditions are more prevalent in private-sector housing, since the condition of social-sector units is more tightly controlled. The problems of unsanitary and overcrowded housing affect children above all, exposing them to considerable health risks and adversely affecting their chances of success at school (Goux and Maurin, 2006). They therefore help to perpetuate inequality.

Social housing, which could provide a way of dealing with the monetary aspect of the problem, generates other problems, like spatial segregation. A substantial proportion of the stock of social housing is isolated from employment zones, thus further attenuating the links between their inhabitants and the rest of society. Those who live in such developments, especially the children, mingle with others who are also on the margins of society, causing copy-cat behaviour that undermines their chances of success. These effects are amplified by the fact that “rich” households can choose where to live and hence the schools to which they send their children and therefore shun areas with this type of housing (Maurin, 2004). The fact that a substantial proportion of the population in such neighbourhoods is of immigrant origin further increases their isolation in relation to the rest of the population.

The problem of housing the poor is therefore a complex one. Successive governments have developed a set of policies to help poor households improve their housing (Box 2.4). The policies may be divided into three categories: the development of social or rent-controlled housing, housing benefit and assistance for home ownership. All of them have advantages and drawbacks.

Social housing was originally intended not for poor households as such but for production workers drawn to towns and cities by the industrial revolution. As time went by, the range of beneficiaries expanded to include all households encountering housing difficulties. The policy has always consisted of giving a broad slice of the population access to social housing in order to increase social mixing while linking rents to household income. However, the poverty level of social housing residents has risen with the creation of housing developments remote from centres of employment, though it remains low. In 2002, 35% of social housing units were occupied by households whose income was situated in the bottom quartile, compared with only 10% in 1973. The low proportion of poor households occupying social housing conceals different situations: very few poor

Box 2.4. The main forms of housing aid available to poor families

Public expenditure on housing represented 1.7% of GDP in 2002. Aid to consumers (tenants and owner-occupiers) has increased sharply over the last 20 years and now accounts for three-quarters of all aid, the remaining quarter being directed at developers, landlords and owners. Direct aid to individuals has levelled off in recent years, while tax exemptions have increased (Gilli, 2006). The main forms of housing aid are as follows.

Social housing and private low-rent housing

There are over 4 million social housing units in France, and social housing accounts for one principal residence in six. Unsatisfied demand for social housing is estimated at 1.3 million units. The number of social housing units built each year has fallen sharply over the last 15 years. To remedy this problem, under the Solidarity and Urban Renewal Act, which came into force in 2000, social housing must account for at least 20% of the housing stock in communes with over 3 500 inhabitants (1 500 in Ile de France) belonging to urban communities with over 50 000 inhabitants. In practice, a certain number of communes do not respect this threshold and pay a non-dissuasive tax (of € 150 per unit, but sometimes less).

Social housing is allocated according to family situation and financial resources. Rents are means-tested. Households in social housing whose resources exceed the ceiling are required to pay a rent supplement.

Social and rent-subsidised housing is financed either directly by the government, through the 1% housing levy (see below) or by developers with the help of tax incentives for investment (the so-called Quilès, Méhaignerie, Périssol, Robien, Besson and, more recently, Borloo laws). The methods also help to finance low-rent housing allocated according to less strict means testing. The Finance Ministry estimates the deadweight costs of these tax incentives at 25%. The most recent measures taken by the government (*Borloo populaire*) apply to lower-rent housing than the previous measures.

Housing benefit

Means-tested housing benefits are paid according to various criteria to households renting or buying an accommodation (see Annex 2.A1 for more details).

Promoting home ownership

There are several measures to promote home ownership. One of them is a means-tested, limited-amount zero-interest loan, available to first-time house buyers from credit institutions under contract with the government, which pays the interest. State-guaranteed loans are also available.

Financing housing policy

The government and the corporate sector finance housing policy through the 1% housing levy. Since 1953, firms have had to set aside a fraction of their payroll to finance employees' principal residences. The initial 1% rate was subsequently cut to 0.45%, the government funding the other 0.55% through the National Housing Aid Fund (FNAL). The levy used to apply to firms with more than 10 employees, but the threshold was raised to 20 employees in 2006. It helps to fund social or regulated rental housing and housing in areas where there is insufficient supply with the aim of promoting a better social mix, urban regeneration and home ownership.

households live in the units built most recently, whereas many more live in the oldest units and those most remote from economic activity. This phenomenon is due partly to the way in which the housing is financed, especially the fact that companies which provide finance can use such developments to house their own employees, and partly to a sometimes opaque allocation system. It is only since 1998 that social housing has had to be allocated as a priority to disadvantaged households.

To be effective, policies to promote social and rent-controlled housing must try to redress the imbalances in the property market, which requires a thorough knowledge of that market and the capacity to anticipate developments and react quickly. Paying aid directly to individuals helps to circumvent these problems. However, it raises other difficulties, especially the risk that, if landlords' supply of housing is partly inelastic in the long run, assistance might lead to higher rents and thereby be partly siphoned off by the owners. Rents for low-income households in France have risen sharply since the mid-1990s, and have caught up with the rent per unit of surface area of households in the top decile (Fack, 2005). It has been argued that this development is partly due to the expansion of housing benefit, more than half of which seems to have been absorbed by higher rents. The argument attributes this effect to the increase in demand, partly by students. As tax incentives designed to boost the supply of housing generate a significant windfall effect, it is very important to target them precisely.

The government increased its support for housing policy with the Social Cohesion Plan of 2004, focusing particularly on urban regeneration. This involves demolishing or refurbishing poor-quality social housing remote from employment zones in order to combat the "ghettos" that were forming in certain areas. Tax incentives targeting low-rent housing and aids to promote home ownership have also been expanded. They are steps in the right direction. Regeneration must continue and new housing built, close to employment zones wherever possible. As housing policy has consequences not only on the material conditions of people's lives and on access to employment but also on children's success at school and delinquency, it is important to assess the impact of such policies in all these dimensions. That in turn implies trying to define indicators of outcomes.

The housing problems encountered by poor people stem from insufficient appropriate supply. The reasons for that lack need to be identified and taken into account in housing policy. Letting a property to a poor household entails a higher risk of non-payment than letting to wealthier families. This risk generates a cost to the landlord, amplified by a whole set of regulations to protect tenants. For example, the legal procedure for terminating a lease for non-payment of rent is both complex and lengthy. Local authorities may refuse to enforce an eviction order if they consider that it may "disturb the public order". It is not possible for a landlord to recover a property for the use of his children if the tenant is over 70 and has little income. Although it is essential to prevent situations in which families are left without a roof over their heads because they have been evicted, passing the cost on to private landlords is not very effective since it discourages them from increasing the supply of housing. The aim of housing policy must be to stimulate this supply, for example by easing regulations and taking further steps to support homeless families. Legislation has tended to move in this direction, though some measures have increased the cost borne by landlords. In early 2007 a law was under discussion that would make housing a legally enforceable right. Its aim is to guarantee housing to disadvantaged people and, thus, to give them the possibility to bring their case before a court. At this stage, it is not decided yet how this law would be enforced, hence it is difficult to tell what its effects would be.

Nevertheless, supporters should not ask the level of government that will have the responsibility to enforce it to introduce new constraints on renting. If this were to occur, it would ultimately lower housing supply and lead to the opposite result from that which was originally desired.

Assessing the impact of locally targeted policies

The areas most affected by the problems of poverty and social exclusion are also those where tax revenues are low because households' taxable incomes are modest and there are relatively few firms. Various measures exist – mainly transfers from central to regional government – that go some way to correcting these inequalities (see Chapter 5). Transfers of resources to regional authorities and central government policies sometimes target specific, usually urban, zones. There are three types of zone, which do not completely overlap: priority zones under urban contracts; sensitive urban zones (ZUS), reflecting a range of urban policy concerns including housing and business implantation; and education priority zones (ZEP), which come under the aegis of education policy and are thus a matter for the Education Ministry (see Chapter 3). Having three types of zone with relatively similar objectives rather than a single, possibly graduated zoning system creates substantial administration costs, may cause inequalities among areas that face similar difficulties and hinders effective policy targeting.

In addition, the effectiveness of targeting social policy on geographic areas rather than people remains unproven. A report from the ZUS Observatory (ONZUS, 2005) paints a relatively unflattering picture of the effectiveness of the ZUS system. The upwardly mobile leave such zones. More fragile populations, such as immigrants, the least skilled and single mothers, tend to stay. More people leave than arrive, and the socio-economic characteristics of new entrants are very similar to those of existing residents, which does little to encourage social diversity (Maurin, 2004). The proportion of the most fragile populations living in ZUS has thus tended to rise. The fact that a neighbourhood is classified as a ZUS tends to create a stigma, increasing existing problems and further limiting upward mobility among residents.

The measures taken within ZUS do not appear sufficient to bridge the gap with the rest of the country in terms of health care, education and delinquency. Year six pupils in ZUS schools have more dental and obesity problems than those in non-ZUS schools, and these differences do not disappear thereafter. Crime levels are higher in ZUS than in other neighbourhoods. Likewise, the results of priority education zones (ZEP) are hardly supportive (see Chapter 3).

There may be two reasons for these disappointing results: either a failure of the measures in themselves, or insufficient targeting of zones where the difficulties are greatest. The government considers that the relative failure of zoning policies is due mainly to insufficient targeting of zones in difficulty. That is why ZEP zoning has been revised to improve targeting, though there are no plans at present to review the other zoning systems. Better targeting is doubtless necessary. However, the stigmatising effects of zoning should not be ignored. To limit those effects, measures that concern individuals directly (medical aid, for example) should be attached directly to the individual rather than mediated through a tier of local government. The impact of zoning measures should be assessed on a regular basis, and, where zoning is deemed ineffective, it should be dropped. Where it is effective, the system should be simplified. There should be a single zoning

system, defined according to the distribution of inequality across the country, which would provide a basis for all social policies that need local targeting.

The government has introduced several measures for children from disadvantaged areas, like the “educational success” programme, which is intended to take all of a child’s difficulties into account and try and remedy them, for example through one-on-one support. However, ambitious programmes like these should not mask the equal need to reduce the disparity in health outcomes between ZUS and non-ZUS children. Although in principle the government picks up the bill for providing health care to the most disadvantaged populations (see Annex 2.A1), it may be difficult for such people to access it, especially if they speak poor French. These difficulties have a knock-on effect on children and families. They may be remedied either by developing dispensaries that give those entitled to it free access to health care or by introducing intermediaries responsible for establishing a link between health care professionals and families and children encountering specific difficulties.

Specific policies for immigrants and ethnic minorities

The combination of unfavourable situations for immigrants in several dimensions (non-employment, overcrowded social housing, geographic isolation) leave them and their children highly exposed to the risks of poverty and social exclusion. Differentials in employment rates for immigrants and non-immigrants are not particularly great in France compared with other OECD countries (OECD, 2006c). Nonetheless, they exist. The unemployment rate for immigrants was 16.4% in 2002, twice that for non-immigrants. The activity rate for immigrant women is much lower than for non-immigrant women. The level of unemployment among immigrants makes them all the more likely to have low incomes and hence less favourable living conditions. Immigrants are more likely to live in overcrowded and social housing and are therefore also more exposed to spatial hysteresis. Immigrants, when in employment, are more likely to be in unskilled work than non-immigrants.

A new initiative to integrate new immigrants, the “welcome and integration contract”, was introduced in 2003. It contains a reciprocal commitment whereby new immigrants undertake to abide by the rules of the French Republic and attend a civic training course, and the government undertakes to help them with access to fundamental rights and learning French. Signatories are offered a number of services, including a medical check-up, a review of their situation with a social worker and French lessons. The scheme was tried out in a few *départements* and then extended to the whole of the country. It is a step in the right direction, since it introduces reciprocal obligations and offers new arrivals language classes which, in the light of experiments conducted in other OECD countries, are important elements of integration policy (OECD, 2006c). It should serve as an opportunity to direct unemployed immigrants as quickly as possible towards return-to-work contracts. Trying out the scheme before introducing it across the board is another constructive example.

Social characteristics are not the only reason why the risk of poverty is greater among immigrants. Discrimination also plays a part. Discrimination does not appear to be particularly prevalent in schools, at least until the secondary level. Taking social characteristics into consideration, the children of immigrant parents do as well as or better than the children of non-immigrant parents (Vallet and Caille, 2000). But serious discrimination exists in the labour market (Bébéar, 2004; Tavan, 2005).

Aware of these problems, the government is making equality of opportunity one of its priorities. Two institutions have been created to that end: the National Agency for Social Cohesion and Equal Opportunities (ANCSEC), which is supposed to set up initiatives for the residents of disadvantaged neighbourhoods, and the High Authority against Discrimination and for Equality (HALDE), tasked with combating discrimination prohibited by law. Given that the complexity of the institutional system in the fight against social exclusion has already been identified as a possible source of loss of effectiveness across the whole policy spectrum (Barberye *et al.*, 2003), it would be more appropriate to limit the number of existing institutions rather than add more. At this point, existing bodies appear to have roles close to the one assigned to ANCSEC. The creation of HALDE is more innovative. Though it is by no means self-evident that the possibility of reporting a discrimination offence is sufficient *per se* to reduce discrimination, HALDE's work in raising awareness of the extent of discrimination and promoting best practice is doubtless an appropriate way of curbing discrimination.

A number of positive discrimination measures have also been introduced. The *grandes écoles*, for example, set aside a certain number of places for students from education priority zones. Consideration was given to making jobseekers' CVs anonymous and some firms have indeed decided to introduce the anonymous CV. It is very difficult to know how effective these measures are, but in all events they do not offer in-depth solutions to the problems encountered by immigrants or ethnic minorities. Priority should be given to comprehensive measures in the labour market and the social sphere as a whole and to educational measures in order to facilitate the integration of all "high-risk" groups, including immigrants. Such measures should help to prevent situations of poverty and social exclusion and remedy them more effectively when they arise. They are summarised in Box 2.5. Policies targeting specific groups should be used only where broad measures are insufficient and should preferably focus on small, well-identified groups.

Box 2.5. **Summary of recommendations for combating poverty and social exclusion**

Increase job security for all throughout working life

- Co-ordinate policies to raise the minimum wage, to reduce social security contributions and to encourage employment through in-work benefits so as to combat poverty more efficiently. Ensure that the minimum wage grows more slowly than the median wage by, at the least, eliminating discretionary increases; this would reduce the relative cost of low-skilled labour and automatically reduce the cost of reductions in social contributions, which are proportional to the minimum wage, as a share of GDP. Use some of the available resources to enhance in-work benefits. Limit inactivity traps by ending the allocation of related benefits according to the type of benefit received.
- Review the benefit system to ensure that having a job, even if only for a short time, generates additional income in relation to benefits alone.
- Ease employment protection legislation to facilitate the move from unemployment into employment and reduce inequalities among workers. Move towards a single employment contract with employment protection that increases with length of service. Ensure that the contract provides adequate flexibility for firms to adapt to shocks and structural changes.

Box 2.5. Summary of recommendations for combating poverty and social exclusion (cont.)

Harmonise the rights and obligations of the jobless; increase the effectiveness of return-to-work schemes

- Introduce a common scheme to direct the non-employed who are potentially active towards programmes that encourage integration and entry into employment and job-seeking. Identify for each person the main obstacles to finding employment, propose specific measures to overcome them and define the person's obligations. Target these specific measures on those most remote from the labour market. Use profiling techniques to try and increase the effectiveness of targeting. Evaluate the efficiency of the scheme.
- Make payment of income support dependent on the fulfilment of obligations. Make it compulsory for any person receiving income support and capable of working to look for work. Develop enforcement procedures and introduce the possibility of graduated sanctions.
- Co-ordinate and forge closer links among players from across the social policy spectrum, i.e. social protection and employment policy. Use employment centres (“*maisons de l'emploi*”) in coordination with social policy. Ensure that intervention by different levels of government in social policy management does not hamper policy effectiveness. Allocate the responsibility for job placement to a national institution. Consider a merger of that institution and those which finance welfare benefits and unemployment insurance.

Resist the geographic concentration of poverty and spatial hysteresis

- Continue policies designed to develop social housing in areas with adequate employment opportunities. Increase targeting of this housing on the poor, but maintain the goal of social diversity. Assess housing policy, giving consideration to its many different impacts, not only on financial resources. Ensure that regulations governing private rental housing do not discourage its supply. Continue efforts to support evicted families without counterproductive constraints on landlords.
- Simplify existing zoning systems, focus them more tightly, regularly assess their effectiveness, and drop them when they are ineffective. Direct aid to the individuals concerned.
- Ensure that mechanisms for allocating resources between different geographic areas give sub-national authorities the means to fight poverty according to their needs and that they do so efficiently (see Chapter 5).
- Continue programmes to teach French to immigrants and children of immigrants who do not have a good command of the language. Increase efforts to achieve major improvements in health outcomes among the most disadvantaged children.

Notes

1. The youth unemployment rate has been shown to be positively correlated with the rate of criminality (Fougère et al., 2004).
2. Income from savings is excluded.
3. The results of these studies tend to be similar, although the sensitivity of employment to costs varies, and are summarised in Jamet, 2006.
4. This includes severance paid directly to the employee, which is equal to 8% of the total amount of gross remuneration due to the employee after termination of the contract, and also a payment made to the unemployment benefit funds to finance the enhanced return-to-work schemes

available to the employee, this being equal to 2% of the gross pay owed to the employee since the start of the contract.

5. Private social expenditure is very low in France.
6. According to a 2001 survey of recipients of welfare benefits, 20% of men and 19% of women receiving the RMI said that they were in bad or very bad health, whereas the figures for the population as a whole, in the same age group, were only 4 and 5% (Pla, 2006).
7. These criteria include the age, the level of education and the type of welfare benefit the person receives.
8. A housing unit is deemed overcrowded if it has fewer rooms than a standard established as follows: a living room for the household, one room for each reference person in a family, one room for two children of the same sex or aged under seven, otherwise one room per child. By that standard, one-room housing units are deemed overcrowded.

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ANNEX 2.A1

The French social protection system: Main measures for the disadvantaged

Health

Everyone living on French soil is entitled to health coverage. Those living legally in France who are no longer entitled to health insurance (unemployed persons not registered with ANPE, the national employment agency, after one year for the daily subsistence allowance and four years for reimbursement of treatment, if they are not related to a person with entitlement, for example) are entitled to basic universal medical coverage (CMU). Basic medical coverage gives the right to the same services as health insurance and under the same conditions except that patients covered by the CMU do not have to pay the € 1 co-payment on ambulatory services which was introduced in 2004.

For beneficiaries of complementary universal medical coverage (CMUC), the full cost of medical treatment is assumed and healthcare expenses do not have to be advanced. Those on income support (RMI) are automatically entitled to the complementary scheme without means testing. To limit the threshold effect resulting from the sudden loss of entitlement to complementary coverage when an individual's income exceeds the limit, a supplementary healthcare benefit has been created. It is available to those whose income exceeds the CMUC ceilings by up to 20%.

People who do not meet CMU residence criteria but who have lived in France without interruption for over three months, including those without a residence permit, are covered (subject to a means test) by state medical aid (AME). Beneficiaries of AME are not required to advance healthcare expenses.

Family

- Family allowance

Family allowance is paid without means testing to any person with two or more dependent children under 20 years of age. The benefit is € 117 per month for two children and € 150 for each additional child. There is a supplement of € 33 to € 58 per child for children aged between 11 and 16. There is a flat-rate allowance of € 74 for children during their twentieth year (depending on the child's financial resources).

There is a means-tested supplement of € 152 per month for families with three or more children (the thresholds are € 26 700 per year for a single-earner couple and € 32 700 for a dual-earner couple or a single-parent family).

- There is a means-tested schooling allowance of € 268 per child per year.
- Infant benefits

The following means-tested benefits are available to the parents of infants:

- ❖ a one-time birth allowance of € 841,
- ❖ a basic monthly allowance of € 168 per family until the child is three years old, that can be added to family allowances but not to the means-tested supplement,
- ❖ support for child-minding.

A supplement is also available for people who stop working or work part-time after the birth of a child. The supplement for a person who stops working is € 522 per month (but this can not be added to the basic allowance). The supplement for a person who works part-time varies between € 300 and € 400 per month depending on the number of hours worked. The benefit is payable until the child is three. There is a larger supplement (€ 746 at most) for a person with three dependent children who decides to stop working, though it is payable for only one year. Claimants must thus choose between a smaller supplement paid for three years and a larger supplement paid for one year.

Housing

Housing benefit is paid according to various criteria (resources, family situation, characteristics of the housing) to people renting or buying accommodation.

There is a means-tested individual housing benefit for persons renting regulated accommodation (i.e. social housing or housing for which the landlord has entered into a contract with the government) or buying a property with the help of a soft loan. The amount of benefit depends on financial resources, family situation and the characteristics of the housing unit.

A relocation allowance exists for persons eligible for housing benefit who move because their household has increased in size. It reimburses removal costs up to a certain amount.

Unemployment

Unemployment benefit is paid to jobseekers who have contributed to the unemployment insurance scheme. Calculating the amount of the benefit is complex: it depends on the salary before loss of employment and how long the person has contributed to the scheme. Benefit is paid for a maximum of 36 months and is taxable. In particular, the unemployed pay pension contributions. It is possible to cumulate unemployment benefit and paid work for the first 18 months after re-entering work if the earnings do not exceed a certain amount.

Social minima

There are nine social minima granted after means testing in various situations. 7% of the population aged over 20 receive a social minimum. The main benefits are as follows.

Minimum income support (RMI)

The RMI is paid to persons aged 25 and over who have few or no resources. Beneficiaries must sign an integration contract. It is a top-up benefit, meaning that the beneficiary receives the difference between his or her other resources and the maximum

benefit amount. The amount depends on the individual's situation. Amounts are reduced if the person receives housing benefit.

It is possible to cumulate the RMI with earned income for a limited period. If the recipient finds a job, the income is not taken into account when calculating income support for the quarter in which the person returns to work and for the following quarter. Subsequently, for those working less than 52% of the standard legal working time, half of the person's earnings is taken into account in the following nine months. For those taking a job with more 78 hours work per month, they can receive two further credits: a payment of € 1 000 in the fourth month (the back-to-work benefit) and another of € 150 per month for single people (€ 225 for others) for nine months. Recipients of the RMI are automatically entitled to universal and complementary universal medical coverage, which means that all their healthcare and hospitalisation costs are paid. They are also entitled to reduced telephone subscriptions and full exemption from local property tax.

Specific solidarity allowance (ASS)

Persons no longer entitled to unemployment benefit who have contributed to the unemployment insurance scheme are entitled to the specific solidarity allowance. It is subject to restrictive conditions. The maximum amount is € 406 per month. The same system of cumulating benefit and earnings as for the RMI has been in place since 2006.

Adult disability allowance (AAH)

The adult disability allowance is a means-tested, top-up benefit for persons with an 80% disability or persons with a lesser disability who are unable to work.

Single parent allowance (API)

The single parent allowance is a means-tested benefit for single people (unmarried, widowed, separated or divorced) expecting a child or with one or more dependent children that can be claimed until the youngest child is three years old. It is a top-up benefit, i.e. the person receives the difference between their other income and the maximum amount of the benefit. The amount depends on the person's family situation, and is reduced if already in receipt of housing aid. The system of cumulation is the same as for the RMI.

Minimum pension

There is a means-tested minimum pension for persons aged over 65, including those who have not contributed or who have made only small contributions to a social insurance scheme.

Other benefits for restricted categories of individuals

- **Supplementary disability allowance:** a top-up to the disability allowance for persons aged under 60 whose disability allowance is very small.
- **Integration allowance:** for ex-prisoners, repatriates, refugees and asylum seekers.
- **Pension equivalent:** for unemployed persons aged under 60 who have contributed to pension insurance for at least 160 quarters.
- **Survivor's allowance:** for surviving spouses.

Table 2.A1.1. **Amount of social minima and distribution of beneficiaries**

	Percentage of beneficiaries of a given social minimum (2004)	Allowance ¹ in per cent of the net SMIC (2006)
Minimum income support (RMI)	35	45
Specific solidarity allowance (ASS)	11	45
Adult disability allowance (AAH)	24	64
Single parent allowance (API)	6	58
Supplementary old-age allowance	18	64
Supplementary disability allowance	4	64
Integration allowance	1.5	95
Pension-equivalent allowance	1	98
Survivors allowance	0.4	51
Total	100	55²

1. For a single childless person.

2. Average weighted by the number of beneficiaries in 2004.

Source: OECD (2007), Social Expenditure database 1980-2003.

Specific measures for the most disadvantaged

The government has introduced various reception, accommodation and integration measures to assist the most disadvantaged. Other measures, not considered here, are taken by local authorities and NGOs.

Emergency aid

In urgent cases, especially for the homeless, government measures include:

- a telephone hotline (115), to help the homeless find accommodation. The capacity of emergency accommodation is updated on a daily basis;
- mobile teams (“SAMU social”) which can pick up the most disadvantaged and take them to emergency accommodation or hospital accident and emergency units if necessary;
- day centres, offering various services to the homeless (postal address, showers, laundry facilities, catering in some cases);
- supplementary winter accommodation: additional reception and accommodation facilities are opened during the winter.

Accommodation and integration

Several measures are intended to help persons in extreme difficulty back into society:

- accommodation and social reintegration centres (CHRS), which offer emergency or longer-term accommodation. Integration measures include counselling, information, monitoring by social workers, help finding independent accommodation, training and employment;
- transition centres, which are small units aiming to help persons in very great difficulty re-establish links with society;
- residential centres, which offer accommodation for a limited time to isolated persons or families before they can move into independent accommodation;
- integration measures: residents of accommodation centres are provided with support in various aspects of integration (healthcare, housing, employment, training, well-being, culture, etc.).

Reception and accommodation of asylum seekers

Specialist accommodation and social reintegration centres exist to help asylum seekers while their applications for asylum are being processed. Other emergency centres have been set up to cope with the influx of large numbers of asylum seekers in recent years.

Chapter 3

Enhancing incentives to improve performance in the education system

The French education system has a mixed record. A generally very successful pre-school and primary school level contrasts with underfunded public universities with high dropout rates alongside very successful higher education institutions for elites selected in various ways. Initial education, especially secondary education and the universities, along with labour market policies themselves, does not always succeed in improving labour market entry for a significant proportion of young people. Parts of the management of education have been decentralised, yet educational institutions themselves generally have a very restricted degree of autonomy. The system of performance measurement and incentives, at all levels, needs to be reviewed.

Education is frequently the subject of lively discussion in France. It is associated with many of the major issues in both economic and social affairs. Its role in the cycle of social exclusion was discussed in Chapter 2 and is discussed further below. The link between educational attainment and labour market outcomes is as direct in France as in most other countries, though it is less clear how education can or should respond, as it is hard to separate the impact of labour-market institutions from that of education. As an important contributor to the development of human capital, it has a major, if not entirely understood, part to play in the process of economic growth. While opinions are divided on which parts of the French education system are most in need of reform, two important problems concern, on the one hand, higher, or “tertiary”, education which suffers from excessive complexity and inequalities as well as inefficiencies in financing arrangements and, on the other hand, the fact that many secondary school leavers are not well placed to participate on the job market.

Having historically been renowned for its high degree of centralisation, with very little autonomy given to school principals, the French education system has evolved over the past two decades. From the point of view of the Ministry of Education, the system is no longer highly centralised, and many functions in primary and secondary education have now indeed been handed to lower levels of government. But a marked absence of autonomy at the school level, and in public universities, still characterises the system. The teacher in the classroom, however, has a considerable degree of freedom as regards teaching methods and material, both from the education authorities and the school principal, while nevertheless respecting national standards in terms of the curriculum to be taught and the competences that should be acquired by students.

This chapter discusses these issues, first outlining the organisation and finance of compulsory and higher education. It then focuses particularly on the questions of grade repetition and educational priority zones in secondary education, and on the problem of monitoring and improving performance. For higher education the emphasis is particularly on inequities and inefficiencies in the allocation of finance and the structure of institutions and courses offered. Box 3.2 at the end of the chapter summarises the main policy recommendations. These are oriented towards suggestions for changing the governance of education institutions to give better incentives for improving performance, rather than recommending pedagogical changes (with certain broad exceptions), which are mostly beyond the scope of this chapter. In higher education, it is suggested that both organisational changes and a new approach to selection of students and finance of higher educational institutions are required.

Education policy objectives and main issues

The aims of education policy

The law governing education (the *Code de l'éducation*) defines its aims as including both broad social goals and more student-centred objectives. The former include *mixité* (that is,

mixing children from different socio-economic backgrounds), equality between the sexes and the promotion of respect for human rights. Recent revisions to the law define the student-centred objectives as both ensuring that all students finish compulsory education with a recognised qualification and that they acquire a *socle commun de compétences et de connaissances*, a core set of knowledge and competences to equip them for the labour market and citizenship. In the past, more emphasis was placed on the acquisition of academic qualifications. A set of core competences introduced for pupils at the end of elementary school (generally aged 10-11) in 1998. In 2006 a common set of core competences and knowledge was established, providing for objectives to be reached by classes typically corresponding to ages 7-8, 10-11, and 14-15 (end of lower secondary), which is to operate as from the 2007/8 school year.

The role of higher¹ education is, according to the *Code*, to contribute both to broad economic aims such as increasing research and the level of human capital in France, but also to reducing social inequality (which is not an aim explicitly attributed to secondary or primary education). Higher education is also seen as having a specific role in regional and national economic development, taking into account the current and expected needs of the labour market.

Reducing inequality may not be an objective explicit in the law for all levels of education, but it has nevertheless been a policy aim for successive governments (the “republican values” of liberty, equality and fraternity are an important consideration in all policymaking in France). The system overall does not succeed in eliminating the influence of social background on educational and labour market outcomes, although France probably does as well as most countries in this regard. Nevertheless, a number of other countries appear to manage better than France, without any obvious cost in poorer average performance. Discussion about the best way to improve the system’s performance in this respect is an important element of the current policy debate in France.

Issues

Certain specific, though inter-related, questions arise in discussion of education in France:

- Secondary school quality and governance – if some aspects of school performance need improving, what mechanisms exist or could be introduced to ensure that the system responds to these needs?
- Higher education finance and structure – is higher education an excessively complicated system with poor and inequitable targeting of funding, or is it highly flexible, producing a large number of good graduates at low overall cost?
- Inequality, transmission of disadvantage – how well does the education system compensate for inherent inequalities arising from children’s social and educational backgrounds?

Before discussing these issues, which emerge under various headings, the next section describes the main features of the education system (with a particular focus on lower and upper secondary schools and higher education), which form the background for the subsequent analysis.

Education organisation and finance

Pre-school education is highly developed in France. Although it is not compulsory, participation was already 100% for children aged four and five in 1980 (90% for three-year-olds) and reached 100% for three year-olds by 2001. Apart from the increasingly well-documented beneficial effect that this universal coverage has on educational outcomes later in life, this is also one of the factors behind the rising labour market participation of women in France.

Compulsory education runs from age 6 through to age 16, including five years of elementary school and four or five years of lower secondary school (Figure 3.1). Lower secondary education finishes at age 15 (except for the significant proportion of pupils who repeat one or more years) when children take exams leading to the *Brevet*, which was once a significant milestone but has become of little relevance since the 1970s (and is strictly neither necessary nor sufficient for continuing into upper secondary school). By the time they reach the end of lower secondary school about one in three pupils has repeated one or more years. Although this proportion is much lower than it was 20 years ago, it is still the highest among OECD countries and the subject of considerable debate.

Figure 3.1. **Levels of school education in France**

Secondary education	Upper secondary (<i>Lycée</i>)			<i>Terminale professionnelle</i>	Aged 18 to 19	Optional	
		<i>Terminale générale</i>	<i>Terminale technologique</i>	<i>Première professionnelle</i>			Aged 17 to 18
		<i>Première générale</i>	<i>Première technologique</i>	CAP	<i>BEP</i>	Aged 16 to 17	Compulsory
		<i>Seconde générale et technologique</i>			<i>Seconde professionnelle</i>	Aged 15 to 16	
	Lower secondary (<i>Collège</i>)	3 ^e			Aged 14 to 15		
		4 ^e			Aged 13 to 14		
		5 ^e			Aged 12 to 13		
6 ^e			Aged 11 to 12				
Primary education	Elementary school	<i>Cours Moyen 2</i>			Aged 10 to 11		
		<i>Cours Moyen 1</i>			Aged 9 to 10		
		<i>Cours Élémentaire 2</i>			Aged 8 to 9		
		<i>Cours Élémentaire 1</i>			Aged 7 to 8		
		<i>Cours Préparatoire</i>			Aged 6 to 7		
	Pre-school	<i>Grande Section</i>			Aged 5 to 6		
		<i>Moyenne Section</i>			Aged 4 to 5		
		<i>Petite Section</i>			Aged 3 to 4		
					Optional		

Source: Ministry of Education.

Elementary schools, providing the first five years of compulsory education, are organised in districts covering a large number of schools. Individual schools are not managerially distinct but are under the responsibility of inspectors of primary education who report to the inspector of the *académie* (education district), the director of departmental education services. The inspectors manage staffing, participate in the operation of school zoning and implement national education policy and its evaluation. *Inspecteurs* may have between 30 and 70 schools, employing an average of 300 teachers, in their charge. They have no direct control over equipment, school buildings and many

support services, which are financed by municipalities with which it is necessary to develop coordination.

Secondary education

Lower secondary education is based on the *collège unique*, i.e. a comprehensive model in which no selection either on ability or orientation takes place before age 15, and in which the student body, both in the schools and in classes within the schools, is largely heterogeneous. Orientation starts at upper secondary schools, the *lycées*, which offer highly differentiated courses. The first of three years is used to decide which kind of course pupils should follow for the final two years. Probably the most significant problem is how to meet the needs of the labour market for those who will not go on to tertiary education: about one person in three, in recent cohorts. This latter group is concentrated in the Education Priority Zones (*Zones d'éducation prioritaire*, ZEPs, discussed in more detail below), and there is also a strong correlation between the level of diploma achieved and the social origin and labour market situation of the parents (Table 3.1).

Table 3.1. Level of secondary diploma obtained, by various criteria

	Pupils entering secondary school in 1995				Pupils entering secondary school in 1989			
	Percentage of pupils according to their diploma nine years later				Percentage of pupils according to their diploma 9 years later			
	No qualification	Lower vocational diploma or incomplete upper secondary ¹	Upper secondary diploma other than the Baccalauréat ²	Baccalauréat ²	No qualification	Lower vocational diploma or incomplete upper secondary ¹	Upper secondary diploma other than the Baccalauréat ²	Baccalauréat ²
<i>Household socio- economic category</i>								
Farmer ; artisan, sales person, entrepreneur	4	17	11	68	7	20	13	60
Manager, teacher	1	5	6	88	2	6	7	85
Intermediate profession	2	13	9	76	4	15	11	70
Other employees	9	27	12	53	10	28	13	50
Inactive	27	33	11	29	24	33	12	31
<i>Age of entry to secondary school</i>								
11 years or less	3	14	11	72	3	13	11	73
12 years and over	20	46	10	24	19	43	12	26
<i>Gender</i>								
Male	7	25	11	57	9	26	13	52
Female	5	15	10	70	6	18	10	66

1. Corresponds to level V in the French classification of educational levels.

2. The last two columns in each block, taken together, correspond to level IV in the French classification of educational levels.

Source: Ministry of Education.

Most students follow these three years of upper secondary school leading to the main secondary school diploma, the *Baccalauréat* (generally known as the *bac*). Over the past three decades the proportion of children completing upper secondary education has steadily increased. For some time an important target has been for 80% of children to obtain the *baccalauréat* or equivalent. In the 1970s, only about 30% of generations finishing secondary school (i.e. those born in the 1950s) did so with the *bac*. At that time, most of the rest obtained only a certificate of lower secondary education (the *brevet*) or a basic

vocational qualification, and the *bac* was an essentially academic qualification, with the expectation that holders would go on to further study.

As the number of children reaching this level has increased, the *bac* has become highly differentiated. The academically oriented *baccalauréat général* allows a certain degree of specialisation but still covers a wide range of subjects, much like the *baccalauréat* of earlier generations; students can, however, opt for a *baccalauréat technologique*, which is more narrowly science or technology based, and *baccalauréats professionnels* are designed as vocational qualifications, though retaining a minimum of academic content. The *lycées* themselves are also differentiated. Some (*lycées d'enseignement général et technologique*) offer only the “general” course or a choice between the general and the technology *baccalauréat*, while others (*lycées professionnels*) offer only the vocational route, including those that lead to vocational diplomas other than the *baccalauréat*, notably the *certificat d'aptitude professionnelle* (CAP) and the *brevet d'études professionnelles* (BEP). In the 1980s, the vocational schools were somewhat more numerous than the general and technology schools (excluding those in the private sector), but the latter have grown in number – now accounting for about 60% of all public *lycées* and a rather higher share of students. More recently, the number of people taking up apprenticeships has also begun to increase. The *bac* is particularly valued by students (and parents) because, once obtained, whether under the vocational, technical or general streams, and whatever the level of achievement within those studies (apart from the minimum pass mark), it entitles its holder to enter higher education at a public university with no further selection.

About 63% of children now obtain the *bac*, (about half of whom obtain the *bac général* and nearly one third the *bac technologique*), while a further 20% leave upper secondary school with vocational qualifications which do not lead directly to university education though they can lead to further vocational courses. National education statistics record that some 7% of children leave school with no formal qualification, but it is difficult to compare this figure directly with outcomes in other countries.² A slightly different measure is the number of people who do not finish upper secondary education (although they may have the *brevet*) which labour force survey statistics record as 14% of people aged 20-24 (16% of males and 13% of females) in France, compared with 7% in the United Kingdom, 10% in Sweden and Denmark, 12% in the United States, 17% in Australia (data for 2003).³

The private sector is relatively extensive. In 2005 21% of all lower and upper secondary school students attended private schools,⁴ and a similar share of secondary school teachers works in the private sector. This share has been fairly stable over time: it was the same in 2005 as in 1980, though it had previously been somewhat higher, 26% in 1960. Nearly all such schools are faith-based, overwhelmingly run by Catholic foundations. (Public education in France is strictly independent of religion, and this is felt to be one of the most important features of the system.) Private schools generally operate under contract to the education ministry and must teach the same programme as public schools; the state finances the cost of teaching staff and a contribution to running costs, while moderate school fees finance the rest. The amount provided per student by the state is generally less than the average per pupil expenditure in public schools. Teachers in private schools are subject to the same requirements on qualifications as those in the public sector, though they are not usually public-sector employees, and they do not seem to be paid any more on average. Recruitment is managed by the schools themselves.

Secondary school principals in public-sector schools have some responsibility for teaching methods and organisation in their schools, but limited responsibility for budgetary expenditure. With some exceptions they have no say in decisions to recruit teachers for their schools, and monitoring of teaching practices of individual teachers is left to the centralised education inspectorate, which is organised on a regional level within the Ministry of Education. Individual teachers see an inspector on average only once every five years, even though their career advancement can depend partly on the assessment of their teaching performance by the inspector (through observation of teaching, not results obtained); it also depends on their “administrative” performance, which is assessed by the head of establishment. Children are allocated to schools by geographical zones (the *carte scolaire*) and generally have little choice of school, except in rare cases.⁵ A small number of public lycées are nevertheless well known as schools for the élite which have succeeded in selecting their pupils, despite the theoretical rigidity of the *carte scolaire*.⁶ Because it is popularly thought that many well-connected parents are able to by-pass the *carte scolaire*, and because competition may improve results, there are occasional suggestions that it should be relaxed; giving all parents some choice over their children’s school, as in some other countries.

Higher education

Higher education in France is home to a number of paradoxes. Annual per capita spending on students is among the lowest in OECD countries. Less is spent per capita per year on the average student in higher education than on lycée students. There is a high drop-out rate for certain groups of students in the first and second year at public universities and poor job prospects for those following certain courses of study, but young people who are (statistically) unlikely to succeed still sign up in large numbers for these courses. Even though it is the avowed duty of higher education to help reduce social inequality, the system contains some of the most elitist institutions (albeit in the meritocratic sense) to be found in the OECD.

The majority of students enter public university programmes, for which the baccalauréat is a necessary and sufficient qualification; there is no further selection on the basis of results in the *bac* or likely aptitude for the subject chosen. One result of this is that many students repeat their first or second years and significant numbers move to other forms of further training or drop out of university altogether. In 2004, 20% of those who entered non-selective university courses leave the system with no higher education diploma (this figure is much higher for holders of the *bac professionnel*)⁷ and 15% shift to shorter courses. However, these non-selective university courses are not the only ones available. A large number of selective higher education institutions (HEIs) exist, choosing their students either on the basis of their *bac* result and school record or via specific entrance competitions by examination.

The structure of higher education has become rather complicated, with considerable differences in organisation and funding among the different kinds of institution (Table 3.2). Public universities themselves contain sections with some autonomy, authorised to select their students— notably the *Instituts universitaires de technologie* (IUTs). These are now more numerous than universities themselves, have a significantly higher success rate at the end of their two year courses (especially for holders of the *bac professionnel*) and their graduates have a much better employment record. The IUTs and some other HEIs select on the basis of results in the baccalauréat and a student’s school record. Many others require two years

Table 3.2. **Diplomas in higher education**¹

Years after upper secondary diploma	University		"Classes Préparatoires" (1st 2 years) and "Grandes Écoles"	"Section de technicien supérieur"	"Institut universitaire de technologie"
	Old system (until 2006)	New system			
1					
2	DEUG (diploma of general university studies)			BTS (Diploma of higher technical studies) ²	D.U.T. (Diplôme universitaire de technologie) ²
3	Licence (Bachelors degree)	Licence (Bachelors degree)		Licence professionnelle (vocational degree)	Licence professionnelle (vocational degree)
4	Maîtrise (1 year Masters)				
5	DEA or DESS (2 year Masters)	Masters	Masters		
6					
7	Ph.D	Ph.D			
8					

1. Excluding specialised courses such as medicine and law.

2. Holders of BTS and DUT can cross to certain university or *grandes écoles* courses.

of study after the *bac*, in *classes préparatoires* which are mostly located in certain *lycées*. While entry to university is guaranteed by successfully passing the *bac*, entry to a *classe préparatoire* is not; it depends on the type and level of *bac* results and recommendations from teachers. Teachers who teach at upper secondary level may also teach *classes préparatoires*. Most students find this period the most intensive that they ever undertake, but in itself it leads to no explicit diploma at all, rather conferring eligibility to take entrance examinations to some of the selective institutions collectively known as *grandes écoles*.⁸ Expenditure per student in *classes préparatoires* is, on average, twice what is spent on students in public universities (about 14 000 euros as compared with 6 900) (Table 3.3), reflecting the much more favourable staff-to-student ratio.

Table 3.3. **Students by type of institution, 2005/06**

Number of students	Share of total	Expenditure per student	
1 421 719	62.5	University	7 210
112 597	4.9	<i>of which, IUT</i>	10 890
230 403	10.1	<i>Sections de techniciens supérieurs</i>	13 360
81 565	3.6	Teacher training	
74 790	3.3	<i>Classes préparatoires</i>	13 560
25 944	1.1	<i>Grands établissements</i>	n.a.
108 057	4.7	Engineering schools	n.a.
87 666	3.9	Business and management schools	n.a.
3 191	0.1	<i>Ecoles normales supérieures</i>	n.a.
64 598	2.8	Artistic and cultural	n.a.
124 201	5.5	Paramedical and social	n.a.
52 910	2.3	Other	n.a.
2 275 044	100.0	Total	8 940

Note: In common usage, the term "*grandes écoles*" includes les "*grands établissements*" but also most engineering, business and management schools, the *écoles normales* and some other institutions.

Source: Ministry of Education (2006a) and direct communication. Figures for student numbers and costs vary slightly according to different definitions.

Finance and organisation

Education is mostly financed out of the central government budget. The salaries of teachers (who are mostly civil servants), the main expense, are paid directly by the state. As in most countries, however, some aspects of expenditure are decentralised, to different levels of government according to the level of the school and to the nature of the expenditure. Municipalities are responsible for pre-school care and for buildings and equipment of elementary schools. The equipment of secondary schools is the responsibility of departments and regions; local governments nevertheless receive transfers from central government intended to cover the bulk of their education expenditures. Higher education is more varied, with certain institutions depending directly on the Ministry of Education, some on other ministries. Although local government finances about 40% of total expenditure on primary education, much of this is in the pre-school sector (*maternelle*) (Table 3.4). The decentralisation of expenditure on primary and secondary public education does not cover teaching staff, relating rather to other operational expenses, equipment and building infrastructure.

Table 3.4. **Expenditure on education by level of education and level of government**

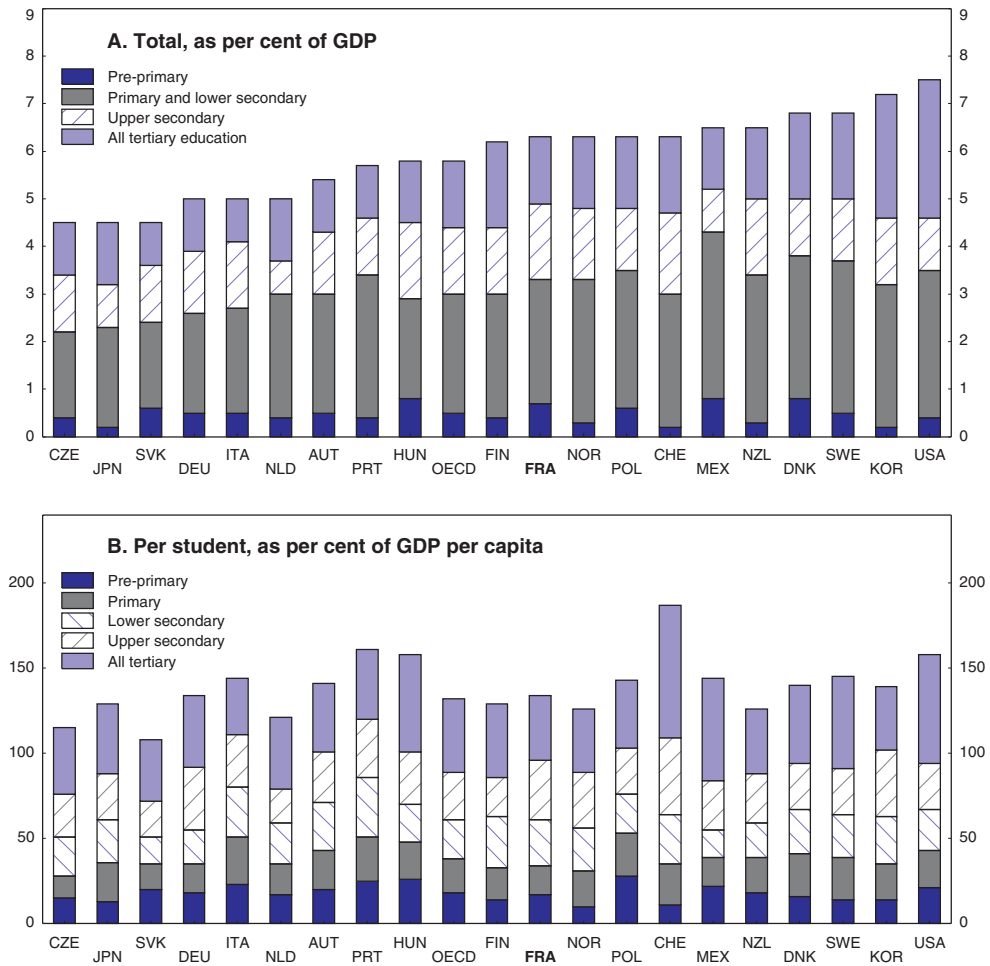
	Total	Primary (Maternelle and Elémentaire)	Secondary (Collège and Lycée)	Tertiary (Higher) (Education supérieure)	Adult education
Total expenditure (billion euros)	116.3	30.6	52.7	19.7	11.8
<i>Of which: (per cent)</i>					
Ministry of Education	55.9	52.9	65.4	64.8	12.2
Other state	7.5	0.1	5.4	9.8	29.2
Sub-national government	20.2	39.8	17	5.9	8.9
Other public	1.9	1.8	2.3	1.1	1.8
Companies	6.5	0	2.1	6.4	38.7
Households	8	5.4	7.8	12	9.2
Total	100	100	100	100	100
<i>Memo.:</i>					
Expenditure per student (euros)	6 810	4 600	8 530	8 630	..
Share of total public expenditure (per cent)	13.3	3.5	6.0	2.3	1.4
Share of GDP (per cent)	7.0	1.8	3.2	1.2	0.7
<i>Memorandum items (billion euros):</i>					
Total public expenditure	873.3	..	..	..	..
GDP	1 656.7	..	..	..	..

Source: Ministry of Education (2005).

In international comparisons, a number of things distinguish the use of resources in French education. One is the high level of enrolment of children from three to five years of age in pre-school, and its relatively high level among two year-olds. Another is the relatively high expenditure per student in secondary education (Figure 3.2). A third is the counterpart of this, the relatively low amount spent per student in higher education, where part of the reason for the low expenditure relative to the average is the low share of private finance, which varies much more across countries than does the share of public resources (Figure 3.3). In higher education, however, the variation in per capita spending in France is very high between different types of course and institution.

As far as the management of education is concerned, what stands out particularly is the lack of autonomy given to establishments in hiring, evaluating and dismissing teaching staff.

Figure 3.2. **Annual education expenditure**¹
2003



1. For Hungary, Italy, Poland, Portugal, and Switzerland, public institutions only.

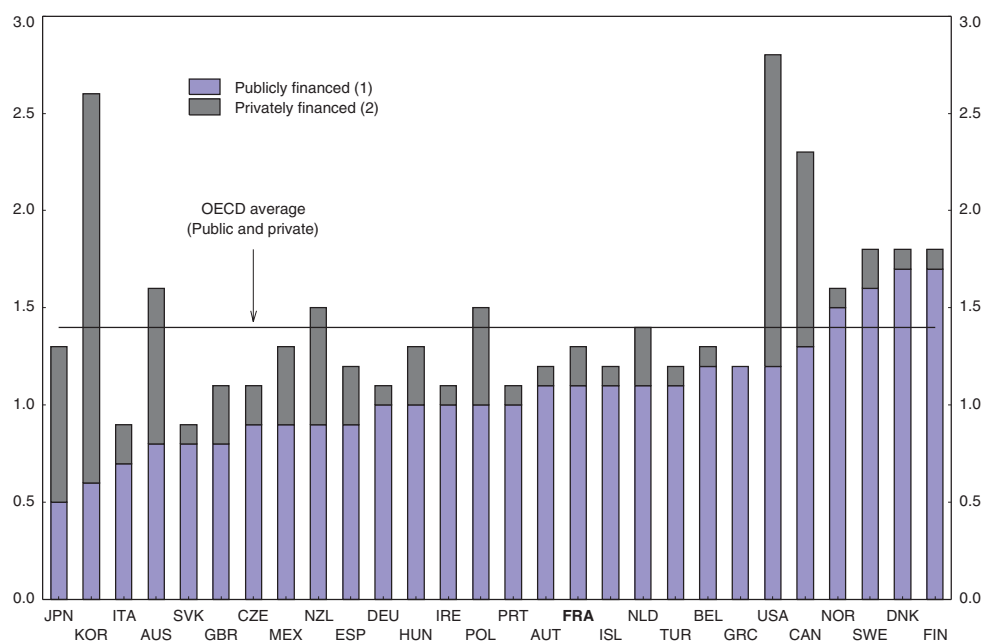
Source: Education at a Glance, OECD Indicators 2006.

StatLink <http://dx.doi.org/10.1787/054350350507>

This extends through part of the public education system, including certain public-sector research institutes. This is perhaps not technically the same as a “centralised” approach to these functions, since allocation of teaching staff is not determined centrally but usually through a locally-based process;⁹ it allocates teachers according to their expressed wishes, taking into account the number of career points that they have accumulated, so that more experienced teachers have more choice. These systems are managed by joint commissions comprised of representatives of teaching unions and of the administration. However, the fact that the heads of schools have little way of responding to local needs is one of the factors that makes the French education system appear relatively centralised in a recent OECD assessment of institutional indicators of education systems (see Sutherland *et al.*, 2007). Notwithstanding this general lack of autonomy, an increasing amount of experimentation is taking place. Principals may be able to recruit teaching assistants (not qualified to take classes on their own) themselves; the programme *ambition réussite* involves extra teaching resources being assigned to certain schools and the principal has the main role in deciding


Figure 3.3. **Expenditure on tertiary education**

Per cent of GDP, 2003



1. Including public subsidies to households tied to educational expenditure, as well as direct expenditure on educational institutions from international sources.
2. Net of public subsidies tied to private educational expenditure.

Source: *Education at a Glance*, OECD Indicators 2006.

StatLink  <http://dx.doi.org/10.1787/054376665115>

on what kind of teacher is to be sought and whom to recruit, though it seems that legal responsibility will remain with the *académie*. Generally, the authorities seem open to the idea of experimenting with increased autonomy, but are moving rather cautiously.

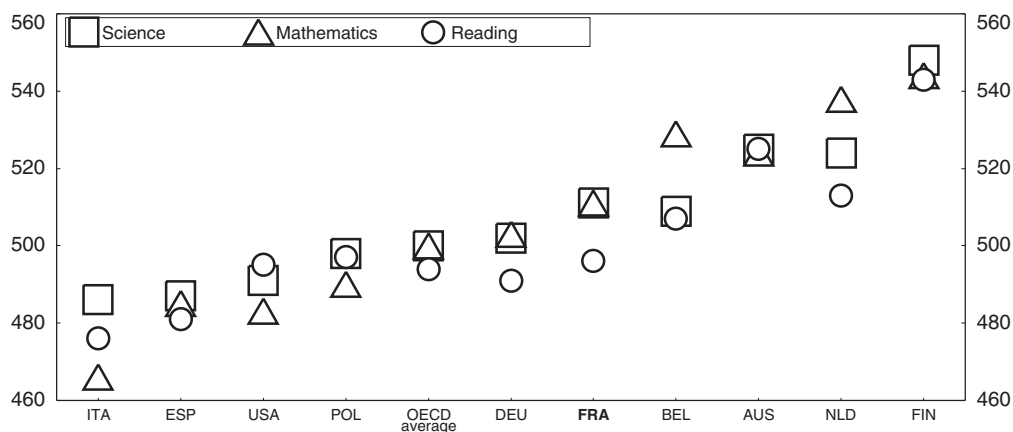

Educational achievement and its variance

According to the OECD's comparative data on the literacy, mathematics and science skills of 15-year-old children, educational achievement in France, for this age group, was around the average for OECD countries in 2003 (Figure 3.4); France was similarly placed in 2000. Variation within the population is somewhat greater than in most OECD countries, especially in performance on science.

It is rather harder to make any cross-country comparison of the performance of higher education. One assessment that receives a certain amount of comment in France concerns the annual world ranking of HEIs by the Institute of Higher Education of the Shanghai Jiao Tong University. The highest ranked French institution (University of Paris 6) is 45th. It is the 11th ranked non-US institution (after four from the United Kingdom, two from Japan and Canada, and one each from Switzerland and the Netherlands). This ranking is based on criteria related to research rather than teaching output, and the methodology is likely to favour English-language institutions, and also larger institutions over small ones. Other rankings which are less comprehensive but perhaps less subject to these last two biases nevertheless rank French institutions rather low.¹⁰

Figure 3.4. **Comparative educational performance at age 15**

Mean score in student performance, all students, 2003

Source: OECD (2004), *Learning for Tomorrow's World, First results from PISA 2003* (Annex B, Tables 2.5c, 6.2, 6.6).StatLink  <http://dx.doi.org/10.1787/054428517766>

Pre-school and primary education

Although not appearing in the education code, an important aim of elementary and pre-school education in France is to try to offset the impact of social background on educational achievement. Research in France and elsewhere has generally shown that the impact of early education on later achievement is significant (see, for example, OECD, 2004; Heckman, 2000; Jarousse *et al.*, 1992; Jeanthieau and Murat, 1998), and the expansion of pre-school provision in France has reflected the desire to improve overall outcomes and to reduce inequality. The general view is that elementary education in France is relatively successful, and that the universal free provision of pre-school from age 3 onwards plays an important part in this. Furthermore, it is thought that elementary schools succeed in isolating the effect of parental background, so that the remaining disadvantage does not get worse in elementary school, although social background re-asserts itself during lower secondary school.

A recent study (Caille and Rosenwald, 2005) may modify this view. The study investigates a panel of 8 300 children who started elementary school in 1997 and an earlier sample from 1978.¹¹ In explaining the variance of results in competence tests in the French language and in mathematics at the beginning of lower secondary school, it is found that while the single biggest explanatory factor is the level of achievement at entry in elementary school (where parental background is important), parental background is still a significant additional factor,¹² implying that even progress during elementary school is subject to the influence of social origin. However, the results also show that children of immigrant parents perform somewhat better than others, once account is taken of their level of achievement at the beginning of elementary school.

Another interesting result from that study concerns the impact of entry into pre-school at two years of age. The average performance of those who enter *maternelle* at age 2 is clearly better than that of those who enter a year later, both at age 6 and at age 11, confirming that investment in this age group produces results in performance nearly ten years later. But the results also suggest that the benefits of early childhood education may partially evaporate between these two ages, other things being equal. Though the impact

is small in itself,¹³ and not highly significant, further investigation of these results might be useful to confirm them and understand their origin; they may be related to teaching methods, for example.

Teacher training

OECD (2004) suggests that the programme of the *maternelles* has been too strongly oriented towards the acquisition of specific competences and knowledge required for entry into elementary school; the report recommends that "... pedagogical and evaluation approaches could be strengthened with more attention to children's holistic development ..." (p. 46). The same report also recommends that more attention be paid to the individual needs of young children, rather than delivering undifferentiated lessons to heterogeneous groups – public schools avoid grouping children by ability in elementary and lower secondary education. If this resulted in the more disadvantaged children being better prepared to follow lessons in elementary school, it could indeed act to reduce the tendency for differences associated with social background to re-emerge. Teaching targets have indeed moved in this direction, with elementary education being more focused on ensuring the acquisition of a minimum set of competences and knowledge. PISA results do suggest that class heterogeneity itself is not an obstacle to good average school performance, but teaching methods may need to adapt to suit the needs of classes with groups advancing at different speeds. In France it is tempting to see the recourse to grade repetition – see below – as a consequence of this heterogeneity, in the absence of sufficient adaptation of teaching methods.

A more individualised approach to education may call for changes in the training of teachers themselves. Teacher training for elementary school teachers has already evolved significantly over the past two decades, in the direction of increasing the length and level of studies required. Qualified teachers will now have the equivalent of a full undergraduate degree, plus two years of specific teacher training, of which the second is largely practical experience. This is the same standard as required for secondary school teachers. The resulting minimum requirement of five years of higher education before qualifying as an elementary school teacher is among the highest in OECD countries (in most, the minimum for teachers in elementary schools is four years). Despite the higher level of education required, however, a possible criticism is that not enough weight is placed on teaching teachers to teach, as opposed to selecting them because of their academic knowledge, which may be of little relevance to teaching in elementary schools. Furthermore, teacher training comes only after completion of a first degree. This "consecutive" approach contrasts with most other countries, in which at least part of a teacher's training programme has pedagogical instruction running concurrently with their training in some particular discipline; most countries nevertheless also allow the "consecutive" approach as an alternative entry path (OECD, 2005). The new programme in teacher training institutes (December 2006) is oriented towards this form of professional training.

Surveys of teachers indeed show that many of them feel that their training is over-weighted in the direction of ensuring depth of knowledge in their specialised subject, at the expense of practical training in how to deal with classroom situations and in mastering how best to communicate the main messages required at school level.¹⁴ This view of their training is also quite common in other countries (see OECD, 2005). It reflects genuine inadequacies in training but may also result from the fact that new teachers inevitably experience difficult classroom conditions when they start and which only experience can

help them to overcome. In France, trainee teachers are almost always allocated “easy” schools for their compulsory year of teaching experience, and they have a reduced teaching load even there. The feeling of being inadequately prepared may thus be partly inevitable, but steps need to be taken to reduce it.

Grade repetition

One area where educational practice is strikingly different in France is *redoublement*, or grade repetition, where students are required to repeat a year after not having reached the level of knowledge and understanding required for promotion to the next year. About 17% of children in France have repeated a year by the end of elementary school, and this proportion rises to 36% by the first year of upper secondary and continues through to the *bac*. By contrast, in many OECD countries, *redoublement* is almost unknown, except in exceptional cases due to illness, for example. Grade repetition has some potential advantages: it could potentially make allowance for the fact that children mature at different rates, avoid having too wide a range of ability in classes so that the slower pupils do not hold back the faster ones, and help to ensure that children do not pass from one year to the next without acquiring a minimum level that allows them to follow the next year’s programme. But in practice these potential advantages seem to be outweighed by other, more powerful, negative effects.

Testing the impact of this practice on educational outcomes can be done only using indirect methods, since it is not possible to randomly assign children to repeat a year and then compare them with those who do not repeat.¹⁵ Despite these methodological difficulties, many studies using different methods have concluded that widespread use of grade repetition is clearly counter-productive at least as far as weaker performers are concerned: children who repeat perform objectively less well in future years than similar children who do not repeat; not only do they perform objectively less well, they tend to underestimate their own ability and are also underestimated by teachers – the fact of having repeated a year tends to stigmatise. Evidence suggests that performance is poor for two main reasons: on the one hand they are discouraged by having been made to repeat a year, and on the other they have less psychological incentive to “keep up” with the class since their better performing contemporaries have moved on. Nor does grade repetition contribute to the objective of reducing the number of children who finish compulsory education with no qualification. Since the period of compulsory education is defined by age, children who may repeat twice or three times can reach the school leaving age before they have any diploma.

There is indeed a strong consensus among researchers in France that *redoublement* is ineffective, and this has in fact been the consensus for several decades. National education policy has also recognised the problem for some time, and grade repetition has been declining: in 1990 less than one in two pupils finished lower secondary school without repeating at least one year.¹⁶

Nevertheless, given the evidence, the question is why *redoublement* remains so widespread, even if declining. An important reason is that conclusions can only be based on statistical analysis. In most individual cases, the children concerned are likely to appear to teachers and parents to be doing better than before. But the incentives facing teachers and schools in France may also encourage the practice. Secondary school teachers’ principal objective is to ensure that they have delivered the full programme for the year to their class, and it is not the job of school principals to change this approach. This programme is

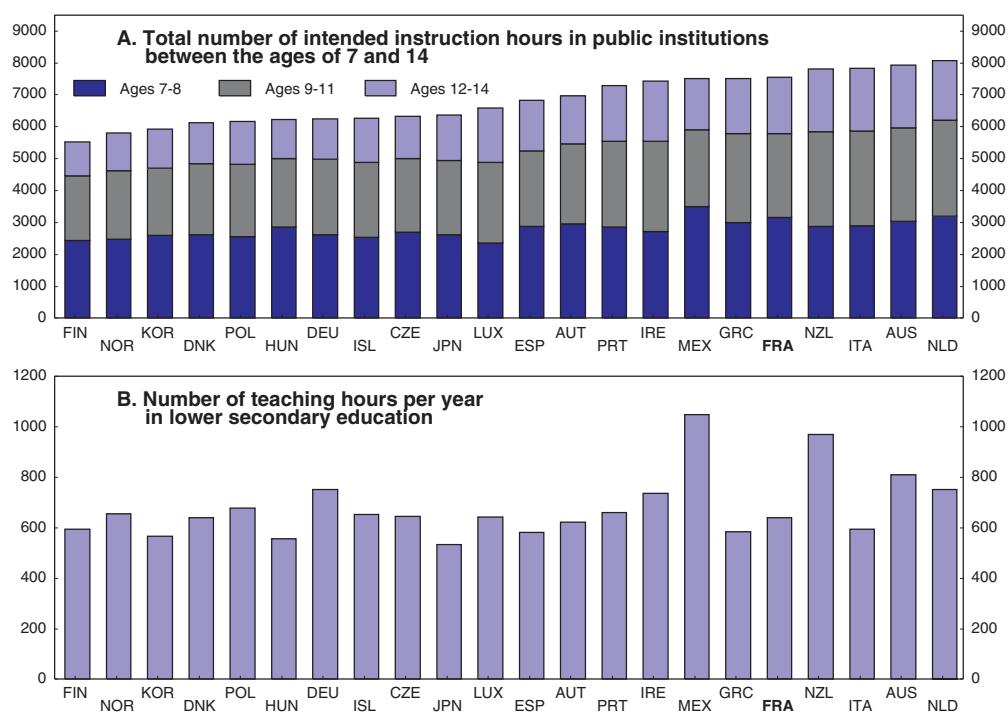
relatively demanding in France so that weaker students will struggle. Many parents respond by helping their children themselves or engage private tutors (who are either self-employed or employed by a number of for-profit businesses and who themselves may be school teachers). Access to either kind of help is correlated with family background and incomes, so that this may be one of the reasons why inequalities in educational performance tend to widen in lower secondary education.¹⁷ Two recent initiatives – *programmes personnalisés de réussite éducative* (personalised programmes for educational success) and *actions d'assistance scolaire* (schoolwork assistance) – are intended to resolve this problem.

The introduction of the common core (*socle commun*) of competences and knowledge at secondary school level, could contribute to the reduction in the use of grade repetition (and thus also release budgetary resources¹⁸), provided it represents a genuine shift towards ensuring that all pupils acquire the common core, even at the expense of reducing the breadth of the curriculum. This would probably require changes in teaching methods as already mentioned. The introduction of explicit disincentives for teachers and schools to use grade-repetition could also be considered. There may be a risk that teachers simply cease making children repeat but do not teach them any better; but even this would, according to most studies, improve overall outcomes, even more so if combined with appropriate changes in teaching methods. Properly assessed value added indicators, discussed below, could also be expected to penalise the use of grade-repetition, without it having to be explicitly discouraged.


Annual school hours for children are higher in France than in most other countries, whereas hours spent by teachers in the classroom are just below the average (Figure 3.5).

Figure 3.5. **Instruction and teaching hours**

2004



Source: *Education at a Glance*, OECD Indicators 2006.

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School terms are also relatively short, making the period of instruction particularly intense, which is unlikely to favour the slower pupils. More emphasis on ensuring that core competences are acquired by all pupils could involve fewer standard classroom hours for pupils, while teachers would spend relatively more hours in the classroom (as they do in many other countries), giving extra attention to and time for those with particular problems. A somewhat smaller number of standard hours for pupils, spread over a longer period, could also help this process without necessarily slowing the progress of the more able pupils. Even though evidence from the PISA studies suggests that this can be done and could improve both equity and overall average outcomes,¹⁹ this might conflict with pressure to continue producing a very highly educated élite at the same time.

Educational priority zones

Many social problems are strongly concentrated in certain areas (as discussed in Chapter 2). Poor educational results, at both primary and secondary levels, are both part of this and a consequence of it; furthermore, they are part of the cycle that reproduces it. In 1982 educational priority zones (*Zones d'éducation prioritaire* or ZEPs) were introduced. ZEPs are defined geographically on the basis of scholastic performance (including national test results, the frequency of grade repetition and the number of children who leave school with no diploma), as well as some more general indicators such as average family size, the rate of unemployment and the share of foreigners in the population. An updating of the policy in 1998-99 introduced education priority networks (*Réseaux d'éducation prioritaire*, REPs), which allowed the advantages of being in a ZEP to be extended to certain other schools with clear problems. By 2004 about one fifth of lower secondary school pupils were in ZEPs/REPs.

Schools in ZEPs and REPs are allocated more material resources than others. Particular objectives are to make free pre-school education available for all two-years-olds and to develop individually-oriented educational plans, also involving local actors other than schools, for pupils in difficulty, and to improve the social mix in schools. Teacher-pupil ratios are more favourable, and there are provisions for giving teachers higher pay and accelerated career development.

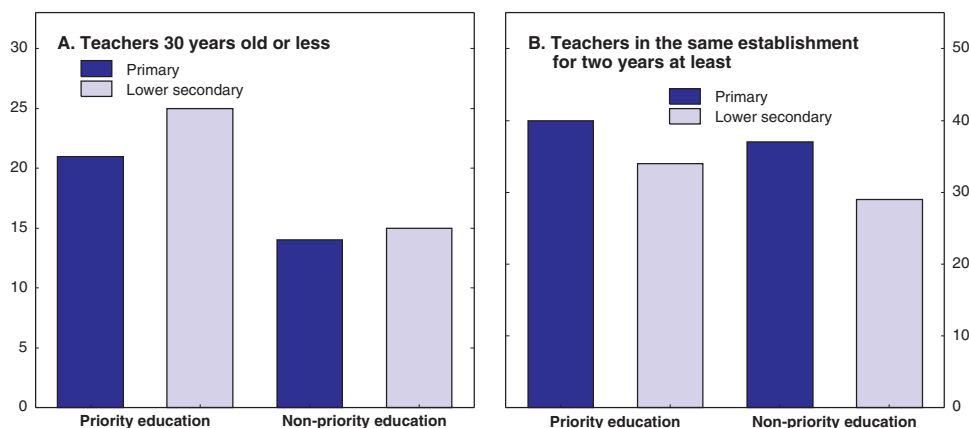
Existing statistical evidence suggests that, on average, and despite a definite though small reduction in average class size, the effectiveness of these policies has been only limited and there was no overall statistical impact of the ZEP programme on educational outcomes in its first decade (1982-92).²⁰ Two principal kinds of reasons for this have been advanced. First, it is estimated that schools in ZEPs have only approximately 10% more resources than they would otherwise.²¹ It is argued that resources spread so thinly in the face of such difficult problems cannot hope to have a significant impact. While it may be the case that resources could be better targeted,²² the “resources spread too thin” argument is not in itself convincing. In a careful analysis of the impact of class size, Piketty and Valdenaire (2006) show that reductions in class size do have an econometrically significant influence on children’s performance (though they confirm that the actual impact of incremental expenditure in ZEPs would be small), and there is no suggestion in this work that the effects of variations in class size are non-linear.²³

A more important reason for the difficulties faced by the ZEP programme is that it has generated a number of inappropriate incentives. One of these is that once a geographical area has been designated as a ZEP, it has tended to become stigmatised as a “problem”

area, so that, where they have a choice, parents tend to move away or avoid moving in. At the very least this simply increases the concentration of social problems in such areas, and possibly has a more than proportional impact on educational outcomes through peer-group effects, although Bénabou *et al.* (2006) concluded that this stigmatisation effect was rather small or even non-existent in the 1990s. But another important effect is through the incentives faced by teachers. Salary bonuses are available for teachers who work in ZEPs. But it appears that they are generally insufficient to attract the more experienced teachers and offset the disadvantages of teaching in ZEPs, not least problems of discipline and violence in the schools. Furthermore, giving incentives in the form of accelerated career progression, in the context of the formula-based method of allocating teachers to schools, has the result that teacher turnover is higher in ZEP schools than elsewhere (Figure 3.6).²⁴ It seems that many new or inexperienced teachers use the period in a ZEP precisely to acquire the “points” necessary to move more quickly to a position where they can get a job in the area of their choice.

Figure 3.6. **Teacher characteristics in priority education**

Percentages of staff



Source: Ministry of Education (2005).

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In addition to the possible stigmatisation effect and the clear impact on teacher experience and turnover, Bénabou *et al.* (2006) also suggest that the high variance of outcomes reveals another reason for the apparent lack of impact. They argue that there was little positive incentive to look for improved outcomes so that in many ZEPs no coherent programmes for dealing with children in difficulty were implemented; poor results in these areas masked better results in others. This highlights the importance of getting incentives right at all levels to get the best out of additional (or existing) resources.

In 2006, policy with respect to areas of priority education was substantially modified to differentiate between three levels of need (EP1, EP2 and EP3). Resources are being increased in priority 1 areas, including singling out particular schools for further funding, especially for recruiting more experienced teachers, in the programme *ambition réussite* (“objective: success”). It is also expected that there will be “mobility” between the different levels of priority, so that some areas should be able to graduate from one level to another or leave the programme altogether.

These changes are a clear response to some of the criticism of earlier policies. They provide for a high level of “contractualisation” intended to generate coordination between different schools and to establish both clear targets and agreement on methods to be used, allowing also for experimentation. Contractualisation appears to be intended to increase accountability for outcomes, though it does not include penalties for poor performance. The new system began to be put in place only during the 2006-07 school year, so it remains to be seen how it works out in practice. Vulnerable elements that remain may include the incentives for individual teachers – accelerated career development is retained as one of the incentives, for example. Nor does the new policy go as far as it could in changing the geographical focus of the programme: an alternative would be to allocate resources to each school as a function of the type of students it receives rather than the geographical area within which it is located. It is to be hoped that the co-operation encouraged by the contracts drawn up among the different bodies involved in education is enriched by coordination with the *réussite éducative* initiatives in the context of the *Plan de cohésion sociale* (see Chapter 2).

Maintaining and improving educational standards and efficiency in secondary education

There is no straightforward way to measure overall efficiency in education or even to assess the slightly simpler concept of educational standards, since education generally pursues more than one objective. Over the years 1990-2004, real costs per student in lower secondary school rose 34% and in upper secondary school they rose 50%. It is not clear that results have improved commensurately, so some reflection on cost efficiency is called for. This section considers some available aggregate indicators, the quite numerous recent efforts by the government to evaluate efficiency in particular areas, and some ways in which the organisation of secondary education may influence efficiency.

Recent OECD analysis has provided some cross-country comparisons of indicators of efficiency in education, using results from the 2003 PISA study (Sutherland *et al.*, 2007). This work investigates whether there appear to be countries that use fewer resources while achieving the same or better PISA results,²⁵ or alternatively whether there are countries which achieve better results using the same or fewer resources. On the first indicator, whether inputs could be used more efficiently and still achieve the same level of performance, France is quite highly ranked, with only five countries in which fewer inputs²⁶ could be saved than in France. On the other indicator, which assesses whether better performance could be achieved with the same resources, France is still ranked above average, but here about ten countries perform better.

Two developments that could potentially contribute a great deal to this are the revised presentation of the annual budget laws, following the model laid down by the 2001 framework law (LOLF, *Loi organique relative aux lois des finances*) and the related development of public expenditure audits. The presentation of budgets in terms of output-based programmes has forced spending ministries to identify indicators of performance so that the effectiveness of spending can be assessed. The 2006 budget was the first to be presented fully in this way, and it more experience is probably needed before the most appropriate set of performance indicators can be defined and tested. It can be expected that with time they will improve. The Ministry of Education collects a large amount of data and should be in a good position to develop appropriate indicators.²⁷

In parallel with the LOLF, education has been the subject of a number of government audits, at the instigation of the Ministry of Finance. So far these have focused on the teaching load in lower and upper secondary education and on the granting of time off from teaching for various reasons such as training or non-teaching duties. This latter report highlighted how the rules under which such *décharges horaires* were granted, many of which date from the 1950s, had become inappropriate and were in some cases entirely *ad hoc*; reform might imply reducing the total number of non-teaching hours allowed to teachers but targeting them on their most productive uses.

As described earlier, competition between schools, with parents free to choose which one they think would suit their child best, plays no part in maintaining or improving quality in the public sector. Introducing school choice in France is unlikely to be very successful, however, without other major reforms. As Hoxby (2006) notes, three conditions need to be met if school choice is to be implemented successfully: supply flexibility, money following students, and independent management of schools. Supply flexibility means that schools in demand have to be able to increase capacity and those rejected have to close; if not, at best the only result will be that some children may find schools better suited to their needs (if there is some variety in schools' approaches), at worst everyone suffers as choice results in "churning" without any overall increase in performance. Money must follow the students to give the schools a material incentive to expand and to avoid losing students (and the amount of money that follows has to be carefully calibrated). Independent management is required so that schools are motivated to follow these incentives. In France, while the second condition may be said to apply for the small number of children that currently go to schools other than those in their catchment area, the others do not. In any move towards more choice it would be necessary to implement these three pre-requisites, as well as to take into account parental access to relevant information and ability to make optimal choices.

Even if individual schools and their principals had more management autonomy, they cannot have any choice over the main input – the teaching staff – without radically changing current recruitment procedures. Giving school principals the possibility of hiring (and firing) the bulk of teaching staff would be strongly opposed by teachers. In the past, teaching unions have successfully resisted suggestions that school principals should be responsible for the teaching assessments currently carried out by the inspectorate. On the other hand, the inspectorate has found that school principals can make a difference in turning round schools that are performing badly. As noted earlier, part of the *ambition réussite* programme gives school principals the power to recruit various teaching assistant staff, although not the main teachers themselves, recognition that such local management flexibility can be important.

Although schools cannot compete for students, the Ministry of Education has for a number of years compiled statistics showing the relative performance of *lycées*. These are based on the rates of success different schools have in getting their students through the baccalauréat exam. Simply ranking schools on the basis of crude success rates would reflect as much the intake of the schools as their performance, so the measures are adjusted to generate so-called "value added" indicators. Unfortunately, although these measures are useful, they are not true value added measures, since no information is available on the performance of students at entry into the schools. Instead, the crude success rates are adjusted using available information on the social origins of the students to arrive at the published measures: the success rates that each school would have

achieved, according to a regression model, if their intake had matched the national average of indicators such as the parents' level of education.

Improving these performance measures so that they represent true "value added" should be done as soon as possible, and they could be extended to lower secondary, and indeed primary, schools. Nationally standardised tests to measure pupil achievement already exist at ages 8 and 11. Although all students already take the *brevet*, the exam taken at the end of lower secondary school, it ceased to be a nationally standardised exam some years ago; hence the difficulty in measuring value added. The decision to revert to a national basis as from 2008 means that by 2010 a better approximation to "value added" should be available. Until then, provisional measures could nevertheless be developed, with comparability between schools limited to those within the same educational district or to those whose pupils take the same *brevet* exam.

Carefully assessed measures of value added would be useful regardless of the model of school choice that might be adopted. They would encourage schools and teachers to compete not only for the "best" pupils but also for those who need more help, where just as much "value" may be added. However they were calculated, value added measures based on exam results could not be the only measure of teacher or school performance, however; other indicators, perhaps related to social development, for example, should be considered.

Higher education

The paradoxes of higher education in France were noted earlier. But this does not mean that higher education in France is especially inefficient overall: the returns to higher education are relatively high, for example (Box 3.1). This section looks at two particular aspects of the system where it does nevertheless appear that a reallocation of resources could be beneficial. It concentrates on the teaching aspects of higher education rather than addressing problems of research output and coordination.

Public universities, fees and selection

Because youth unemployment is particularly high in France, the calculated opportunity cost of years of study in the calculations above is relatively low. High take-up is also encouraged by very low university fees, which rarely exceed a few hundred euros per year except in some of the more selective areas such as business schools.²⁸ The absence of selection at entry, other than via possession of the *bac*, dates back to the time when the baccalauréat itself was obtained by relatively few people and its content broadly matched the kind of learning skills necessary to follow an academic course at university. With the expansion of access to the *bac*, and its broadening to include other skills, this is no longer true.

The result is that many students with a vocational baccalauréat, or with a general or technical baccalauréat but with low grades, have no other option than university if they wish to take higher education. Although universities are likely to be able to predict the chances of success of many of these weaker students, they are not able to turn any of them away (except for geographic zoning reasons, which in practice apply only in the Paris region), and so the selection process in practice occurs at the end of the first or second year, with some students repeating one or both of those years before eventually dropping out. From time to time ministers of education have suggested that some form of selection at

Box 3.1. The returns to higher education

Individuals' earnings increase in line with the level of education they have completed. In 2004, among 35-09 year olds, the salaries of those with at least an undergraduate degree (*bac + 3* years) were on average about 70% higher than of those who had no diploma beyond the baccalauréat, who in turn earned about 30% more than those with no diploma at all (Table 3.5). Those who had followed shorter post-baccalauréat courses earned a smaller premium over holders of the baccalauréat, earning about one-third more. Among older workers the premium for the baccalauréat over those with no qualification is somewhat greater, probably reflecting the greater relative scarcity of holders of the baccalauréat among older generations. The benefit to higher levels of education is also felt in relative exposure to the risk of unemployment. Although it persists throughout working life, this effect is felt particularly among younger people: in the 25-29 year age group, the rate of unemployment among those with the baccalauréat or other upper secondary diploma is about 9%, compared with 17% among those with no qualification and 6% among those with a diploma from higher education.

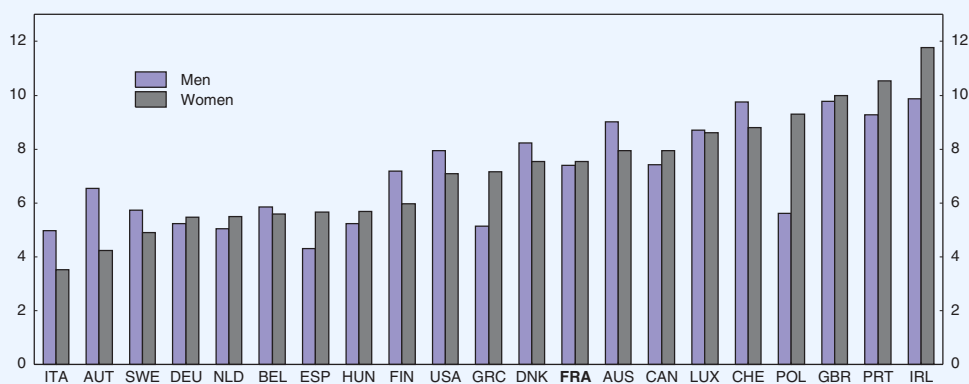
Table 3.5. Earnings premium relative to worker with no qualifications, 2004

Index, worker with no qualification = 100	Age group		
	30-34	35-39	50-54
Baccalauréat	119	130	162
Short higher education	142	163	186
Long higher education	177	222	231

Source: Ministry of Education (2005).

Recent OECD calculations have estimated the internal rate of return for higher education by taking into account the resulting differentials in lifetime incomes between holders of higher diplomas and those with only an upper secondary diploma, as well as the cost of the education (both the direct monetary cost and the opportunity cost in terms of foregone earnings) for a number of OECD countries. For France the internal rate of return is estimated at about 8%, roughly in the middle of the distribution of OECD countries, for both men and women (Figure 3.7).

Figure 3.7. Estimates of the internal rates of return to higher education¹
Per cent, 2001²



1. Labour productivity is assumed to grow at 1.75% in all countries.

2. Except Poland and Switzerland: 2000 and Hungary: 1997.

Source: Sutherland et al., (2007).

StatLink  <http://dx.doi.org/10.1787/054475846517>

entry is necessary, but it has never been possible to implement any such proposals, partly due to the intense opposition of student organisations.²⁹

One development that illustrates some of the dynamics involved is that of the IUTs (*Instituts universitaires de technologie*, University Institutes of Technology), introduced in the 1966 and greatly expanded over the last 20 years. The idea was to develop courses shorter than the standard three or four years to *licences* or *maîtrises*, oriented towards professional rather than academic studies. They are located within public universities, but given independent constitutions to allow them to select the students most suited for such courses – those who would be less able to follow the longer academic courses. Selection is largely on the basis of school reports and baccalauréat results. The IUTs are relatively well endowed, with more resources per student and smaller teaching groups than the mainstream universities, and as a result, demand for their courses is quite strong and they are able to select high-quality students. An important part of their courses is devoted to work-experience programmes, and employment rates among recent graduates of the IUTs are very high. Furthermore, about nearly two thirds of IUT graduates choose to stay on in higher education, moving to one of the selective institutions or rejoining the non-selective public universities but at a level where many of the weaker students (*i.e.* the group for which the IUTs were intended) have probably already dropped out.

The IUT programme is thus rather successful, but it is viewed by policymakers as in one sense a failure, because it did not help the target group it was originally designed for.³⁰ It illustrates a paradox: the introduction of general selection at entry is unpopular, but a large proportion (perhaps the majority) of students prefer, if they can, to attend a selective institution, and the results obtained in them are better.³¹ It seems unlikely that a system that refuses to introduce serious selection, either through entry requirements or charging significant fees which bear some relation to costs or expected returns, can avoid this problem.

Recently, the government has proposed to introduce, not selection, but an “orientation” policy whereby students will be encouraged to register earlier than they habitually do (most do not register until the summer, once they know the results of their *baccalauréat*). Universities would consider their record, and in some cases give “guidance” as to the appropriate kind of course for that student. They would not, however, be entitled to refuse a place to an eligible student. Universities are also expected to provide more information on their courses and information related to the employment record of past students on their websites; a number of universities have already begun to do this. This kind of initiative could be useful in avoiding some of the worst misallocation of students across courses and would certainly improve the efficiency of student choice in any system; it is unlikely to eliminate the underlying problem that if costs are low and access is unrestricted, excessive numbers of people are likely to enrol in public universities. The universities will be obliged to continue to use the initial one or two years as a *de facto* selection tool, with the weaker students eventually dropping out.³²

Although this group of weaker students is quite large, not all of those in it simply drop out of higher education with no qualification. According to Cour des Comptes (2003, p. 315), of 100 students who register for the first year at a public university, 23% of them will repeat that first year, 15% change course to an IUT or BTS course, and 20% will leave university without a higher qualification. But perhaps half of the last group eventually enrol elsewhere and obtain some kind of diploma later on, or drop out only because they have passed an equivalent competition for some specific employment.

Grandes écoles

The *grandes écoles* are a rather heterogeneous group of institutions. Many of them originated as places for training the élite for the military and then for public administration, as well as to train teachers and researchers for the universities themselves. They are mostly relatively small and specialised in the subjects they teach. In recent times, the distinction between their role and that of the universities has become more blurred, however. In many cases it seems only by accident rather than design that engineering schools, for example, are distinct from universities (some of them, indeed, are linked with universities). One of the characteristics of the *grandes écoles*, which is likely to lead to pressure for their reform, is that their diplomas do not fit easily into the increasingly standardised international nomenclature for academic study, on which the French system is now aligning itself, of a three-year bachelors degree followed by a one or two-year masters and then the doctorate. Instead, students effectively study for five years and are then awarded a masters degree, with no intermediate diploma.

Although they charge higher fees than the universities, public expenditure per student in the *grandes écoles* is high. Numbers in the most selective institutions are naturally relatively small, and even including the engineering schools and other institutions for which *classes préparatoires* are also required (and collectively all these institutions are generally referred to as the *grandes écoles*³³) they account only for about 10% of the over 2 million students in higher education. As Table 3.2 shows, it is not only these institutions that are better funded than the universities: the centres of higher vocational studies, the STS, also cost relatively more, again largely because of higher staff-to-student ratios, and partly because they need more technical equipment. But it is also likely that the private returns to education are the highest for students in the *grandes écoles*, since they provide most of the executive class in the private sector; senior civil servants and most politicians are also graduates of these institutions.

In most other countries, most of the functions of the *grandes écoles* are provided by broader-based universities forming part of the normal university system (although elite institutions always emerge). Because of the heterogeneity of the *grandes écoles* as a group and the specialised nature of most of them as individual institutions, as well as the special interest groups that have developed around them, it is hard to imagine moving rapidly to such an approach in France, though successful mergers would no doubt produce efficiency gains in the long run. However, steps could be taken that would generate some of the advantages of this approach. The main one would be to align all the *grandes écoles* and the system of *classes préparatoires* on the increasingly internationally accepted BAMA (Bachelors–Masters) standard (LMD in France). There would be no reason why universities could not offer courses leading to the *grandes écoles*, who could select a larger part of their entry on the basis of university diplomas, rather than relying exclusively on their own entry examinations. Already, in fact, students in *classes préparatoires* frequently enrol in universities in parallel, without attending classes, or take exams as external candidates, to obtain a university degree.

With a more standardised structure of diplomas,³⁴ which might require some national peer review system to ensure comparable standards across institutions, the universities and the *grandes écoles* could also compete in offering many of them. With more comparability of structure and content of teaching in different institutions, it would be easier to rationalise funding. The high level of per capita subsidy that goes to students in

some of the currently highly selective institutions would be easier to redistribute once other institutions were competing to offer similar qualifications. However, as noted when considering the possibility of introducing parental choice into secondary schools, a prerequisite of this kind of approach would be more flexibility and autonomy in the operation of universities. Recent OECD work on the determinants of investment in higher education shows that, despite the quite reasonable overall rate of return to higher education noted earlier, France's system rates extremely low on overall input flexibility (only Greece, Germany and the French-speaking part of Belgium have lower scores on flexibility). The relative lack of freedom to select either students or staff is important parts of this. A report from the Cour des Comptes has already called for giving universities increased autonomy and flexibility (Cour des Comptes, 2003).

Direct subsidies to students

Although fees are generally low, there are few direct subsidies in the form of grants or loans to students. A large number of students live with their parents, and public universities' students are largely recruited from their geographical catchment area. In recognition of this, income tax allowances for dependent children are extended to parents with children in full-time education; the effect is highly regressive, however, as the greatest benefit goes to high-income parents whose children will, on average, also be getting the greatest subsidy and the highest private returns from education anyway. Means-tested grants, and others based on academic criteria, do exist but are not widespread; there is also some housing aid available. In some cases loans are also available, with deferred repayment, but availability is patchy and take-up is low. If a reform of university finance were to include substantial increases in fees so as to improve the quality of public universities, it would be necessary to put both of these systems on a sounder footing if the reform were not to have a detrimental impact on participation of students from lower income families.³⁵

Conclusions and recommendations

French legislation allocates the education system a number of tasks for the economy: creating human capital, preparing young people for the labour market, reducing inequality. Assessing its success is not straightforward, since relevant outcomes, such as productivity and its rate of growth, unemployment and wages and their distribution, are also affected by many other policies.

The high rate of youth unemployment may be due to inadequate preparation for the labour market, but is also due to the too high minimum wage and employment protection legislation. It may in addition be related to an unwillingness to take low-status jobs for fear of getting locked in to a low-status career path. This in turn may be related to employers' excessive preoccupation with formal qualifications both in recruitment decisions and often in career advancement decisions, to the detriment of measures of on-the-job performance and achievement; signs of this can be seen, for example, in the career structures for teachers themselves. Although underlying productivity growth in France has been modest, the level of productivity per hour worked is relatively high, suggesting that plenty of human capital is being created, even if it may be unevenly distributed and perhaps could be produced and used more effectively.

As for reducing inequality, it is very hard to tell how successful the system is. Some aspects of education – the *carte scolaire* and central allocation of teachers, for example – are

Box 3.2. Recommendations on education

Secondary education

Introduce measures of secondary school performance based on genuine “value added”, for both lower and upper secondary schools. Such measures should be used to establish benchmarks for school performance, which should become an explicit focus for school principals and the education inspectorate.

School principals should be given direct responsibility for maintaining and improving performance against these benchmarks, with substantial autonomy in recruitment and reward of teaching staff and other resources. In the absence of such increased autonomy and responsibility for individual schools, the relevant local, regional or national education authorities must be given the incentives and the means to take prompt action in poorly performing schools.

Change the system of career progression, which rewards more experienced teachers by paying them the same salary regardless of where they choose to teach. Give experienced teachers greater incentives to remain in or move to areas where their experience is needed, but in the form of variations in salary or teaching load that are contingent on the particular job, not in the form of steps up the career ladder.

Extra resources for areas with particular needs should, as far as possible, be directed through use of a standard formula that takes into account relevant needs, largely on a school-by-school basis, rather than by separately specifying special geographical areas. The ZEP structure of educational priority zones could be retained for purposes of coordination and information exchange.

Make the rules which apply to the *carte scolaire* clear and enforce them everywhere. If parental choice is not to be the general rule because it generates inequities, then it should not be an option for the well-informed. If, on the other hand, parental choice is to be so used, the procedures should be clear and open to all; other far-reaching reforms to ensure supply flexibility, appropriate budgetary allocations and school autonomy would be necessary.

Higher education

Introduce stronger orientation for university entrance early in the last year of *lycée* and ensure that the supply of training allows young people to go where they have the best chance of succeeding. In the longer term, holders of the *baccalauréat* should not have the right to free university education in any subject they choose if the university considers them highly likely to fail the first year. Build on the successful models of the IUT and STS, including their emphasis on links with employers, provided they respect their original mission.

To introduce more funding into higher education and to improve the allocation of resources, charge higher tuition fees, related to the cost of provision. Introduce a nationwide system of student loans with provisions for income-contingent repayment through the income tax system. A system of means-tested grants could supplement the loan system. Any grants should be only for a fixed length of time, equal at most to the normal length of the course and subject to an overall ceiling, to discourage *redoublement*.

Consider on what grounds the separate system of rules for the *grandes écoles* is justified. They too should generally issue diplomas integrated into the Bologna scheme, which in many cases could also be offered by universities. The *grandes écoles* should then recruit from among holders of first degrees from universities as well as through the *classes préparatoires*.

Managements of higher education institutions should be given autonomy (as recommended by the Cour des Comptes), in both financial and personnel management and recruiting, in order to develop the range of courses they offer and to be held accountable for outcomes.

Box 3.2. Recommendations on education (cont.)

Teacher training

Training for teachers should give more emphasis to classroom skills, especially those related to dealing with heterogeneous classes. As well as selecting teachers on the basis of their deep knowledge of a single subject, some could also be selected and trained to teach more than one subject to improve flexibility in teacher allocation.

Research into education

Further develop the wide array of information and studies already provided by the Ministry of Education. Indicators and analysis should cover the whole range of educational institutions, not just those that come under the education ministry. Encourage independent researchers to use these databases. Continue and enhance French participation in international data collection exercises and analysis, for OECD and other international comparisons.

clearly designed to try to impose equality of treatment. Work reported here suggests that at least compared with a small number of other countries, France does not in fact do much better than others in limiting the transmission of inequality. Others – toleration of the élite lycées, the resources directed towards *classes préparatoires*, the importance attached to the final ranking of students in institutions that only a tiny proportion of students are capable of entering – suggest a system directed towards detecting and then privileging the successful minority.

These difficulties with assessment and a degree of potential conflict between objectives lead the policy recommendations below to favour changes that are intended to better align incentives with performance and desired results. Many of these recommendations are already contained in national reports, such as those from the *Cour des comptes*, and from the audits of parts of the education system.

Notes

1. In English usage, higher education and tertiary education are synonymous; French uses *éducation supérieure* but not *tertiaire*.
2. In fact it is quite difficult to fit together the official data on levels of qualification achieved by any given cohort of young people, although the otherwise user-friendly website of the Ministry of Education provides a number of statistical tables.
3. These figures cannot easily be compared with those for children leaving school without any qualification because the labour force survey data refer to upper secondary education – and some diplomas can be obtained before completing upper secondary; also, they may not use the same definition of completed studies. Labour force data also include those immigrants who completed their education before arriving in France.
4. The share of pupils in private schools is rather higher than this overall average in upper secondary education, and somewhat lower in elementary education.
5. In some cases certain optional subjects which most children would have difficulty with – often unusual foreign languages – are offered by schools as a sort of signalling device; parents claim that they want their child to learn such a subject, which is only available in a school to which they would not otherwise be able to go, with the result that such schools have a higher-than-average range of ability and of parents' social origin. In upper secondary school, there is also pressure to take the scientifically oriented “bac S” because of the higher level of maths it requires, even if intensive maths is not a requirement for a pupil's future studies, in the belief that the ability to study higher level of maths is itself a signal of more general ability.

6. Students in these schools may have been recommended to them by their teachers in lower secondary schools. Residential property prices also tend to be high in the vicinity of these schools, and according to anecdotes, some parents buy or rent very small apartments merely to establish residence in the relevant catchment area. Demand for private-school places also appears to have increased, though capacity has not responded, as parents look for ways to avoid certain public schools that are perceived as underperforming.
7. Unemployment rates for young people with a bac professionnel who drop out of university without any further diploma seem to be higher than for those who go straight onto the labour market after obtaining the bac.
8. Or “great schools”; more detail is provided later in the chapter. In this section, the term “*grandes écoles*” is used in a loose sense to include many *écoles d’ingénieurs* and *écoles de commerce*, for which a *classe préparatoire* is necessary, but which may not be technically *grandes écoles*. Another group of institutions, for which the description and analysis in this section are not so relevant, includes highly specialised schools, of medicine and law, for example.
9. For the 10% of teachers who have the qualification known as *agrégation*, the system is nationwide. The educational regions are known as *académies*, of which there are 30. They largely correspond to the political *régions*, though a few of these are divided into more than one *académie*.
10. The Shanghai Jiao Tong ranking uses quantitative indicators such as the number of citations and number of Nobel prize winners but does not properly adjust for the size of the institution. Other surveys include one from the UK Times Higher Education Supplement, a kind of “peer review” which ranks institutions according to subjective opinions of university researchers. The highest placed French institution, the *École Normale Supérieure*, is in 18th place. It and the *Ecole Polytechnique* (37th place) owe their ranking largely to their high staff/student ratios, a teaching-related indicator but unfortunately an input rather than an output measure.
11. Caille and Rosenwald (2005) use data from competence tests taken by all children in the first term of elementary school and (normally) five years later in the first term at lower secondary school, along with data on parental occupation, age and sex of child and family situation (living with one or two parents, immigrant or mixed origin). A number of expected results are the importance of parents’ (most particularly mother’s) educational background for success at all levels, and immigrant status. Regression analysis is also able to pick out a clear impact of date of birth within the year.
12. For example, the increase in performance in maths associated with having a mother with a tertiary diploma compared with a mother with no diploma is similar to the increase in performance associated with being almost two deciles higher in the distribution of achievement at entry into elementary school. See Caille and Rosenwald (2005, Table 5, pp. 122-23).
13. Thus, entry into *maternelle* at age two instead of age three, conditional on performance at entry into elementary school, is associated with a decline in performance at entry into lower secondary school equivalent to not much more than one tenth of the impact of moving down one decile in the distribution of achievement at entry into elementary school. This result does not imply that early entry to *maternelle* is counterproductive for children when they reach secondary school age, but that all of the impact is embodied in their performance at entry into elementary school, and may partially “evaporate” thereafter.
14. See, e.g. Ministry of Education (2006b), though this applies mainly to teachers at elementary school level.
15. For example, that 16-year-olds who have repeated perform worse than the average 15-year-old at least partly reflects the fact that the less able children are selected for redoublement, rather than in itself proving that redoublement is counter-productive. It is necessary to control for this selection bias. Studies that do so nevertheless show that it is indeed counter-productive; see Cosnefroy and Rocher (2004) for further discussion and references.
16. The practice is sufficiently common for statistics related to it to be commonly used in investigating factors influencing education outcomes, in the absence of standardised national measures of academic performance after the age of 11. A degree of grading is possible, since a significant minority of children repeat more than once, and a certain number also “jump” one year, so that any particular school year contains a significant number of children from one year younger to two years older than the “normal” age for that year.
17. One question which is not addressed in the literature on redoublement is whether the less able children benefit from the more able being held back, with the result that classes are significantly more homogeneous in ability level than in countries with little or no grade repetition (Cosnefroy

and Rocher, 2004, show this greater homogeneity in a comparison of France with England, for example). If they did so benefit, the policy problem would amount to a trade-off between average performance and its variance. Such evidence as is available suggests that this is not the case; countries where teachers put more emphasis on ensuring that all children reach the required level in each year seem to achieve both lower variation in PISA scores and as high or higher average scores than France. This does not rule out the possibility of such a trade-off for certain groups of students, however.

18. A crude indication of the potential cost might be as follows: one third of students are on average one year behind by the time they reach age 15, a lag that has built up over approximately nine years, so that the number of pupils in each year is nearly 4% (one-ninth of one-third) higher than it would be if grade repetition were minimal.
19. The Scandinavian countries tend to stand out as achieving this quite successfully.
20. See Bénabou *et al.* (2004 and 2006) and Moisan and Simon (1997). The latter assessed what distinguished the more successful ZEPs from the less successful, rather than giving an assessment of the overall programme.
21. This results in class sizes that are lower on average, but not by very much – in 2003-04 the mean effective class size in ZEP/REP schools (elementary and lower secondary schools together) was 21.3 students compared with 23.2 elsewhere. See Ministry of Education (2004).
22. Indeed, this was the main point of the changes introduced in 1998-99, largely following the suggestions of Moisan and Simon (1997).
23. If the effects of resources are linear, a concentration of a given quantity of resources in a smaller area would leave average outcomes unchanged.
24. Bressoux *et al.* (2005), in addition to showing that both class size and teacher training have significant impacts on educational performance, demonstrate that the more experienced teachers tend to get better schools – or at least those with classes of significantly higher levels of ability than those that beginners teach, and with fewer children who have repeated a grade.
25. The indicator used is a combination of the average level of PISA achievement in the country and its variation, to take account of the idea that societies value equity as well as level of average achievement. See Sutherland *et al.* (2007).
26. The input measure used is a combination of the number of teachers per student and the average socio-economic status of parents. This is of course a different concept from public expenditure on education. See Sutherland *et al.* (2007).
27. Much of this data is freely available on the Ministry's website www.education.gouv.fr. Data collection has its own costs, of course, and certain kinds of data from a large number of elementary schools have been unavailable for several years as heads of establishment have refused to collect them, in protest at the increasing burden that such data collection and other administrative tasks represent.
28. In these, and the selective engineering schools, fees may be up to € 6 000 per year.
29. It is frequently mentioned that any minister of education who has proposed this has eventually had to resign.
30. This view is relative, however. While only 15% of students with a bac professionnel who enrol in a public university obtain the diploma (DEUG) denoting successful completion of the first two years of studies (which takes up to five years to do for several thousand students each year, since repeated redoublement is possible), 51% of this group successfully complete the IUT courses and four-fifths of these complete on time in two years. (Data for 2003. Source: Ministry of Education, 2005a.) On the other hand, less than one third of all IUT students have the *bac professionnel*; two-thirds have the general version.
31. A more unusual example of this pressure is the university Paris Dauphine (Paris IX). One of the more highly reputed institutions in the field of economics, Paris Dauphine operated a system of selective entry that was, strictly speaking, illegitimate but tolerated. In 2004, it obtained a change in its statutes to make it one of the *grands écoles* and is therefore no longer a public university. A small number of other universities also have some more or less tolerated *de facto* selection procedures.
32. It could be argued that this is a cost-effective approach, because it has the merit of allowing late maturing students who might not otherwise have qualified to get a university education. On balance, this seems unlikely.

33. The list of *grandes écoles* and *grands établissements* issued by the Ministry of Education covers about 40 institutions (compared with about 80 universities) and includes, for example, the Paris Observatory and the national natural history museum; but it does not include the *École polytechnique* or the *École nationale d'administration*, generally considered the elite of the elite schools. The term is used in this chapter to cover educational institutions for which entry is (mostly) through *classes préparatoires* or other selection methods involving several years of study beyond the baccalauréat.
34. In fact, there is a huge variety of existing diplomas in higher education, much more than the sketch in Table 3.2 might suggest. Job descriptions, for example, frequently refer to qualification requirements in terms of “bac plus x” years of study, rather than referring to a particular diploma.
35. It can be argued that, from a market-oriented point of view, since the student is the main beneficiary from higher education, education institutions should charge full cost fees and the only public intervention necessary might be in the form of loan guarantees if students or financial markets are excessively risk averse. Linking repayment of the loans to the subsequent level of earnings would also be an element of risk sharing. Means-tested grants might be unnecessary even in the presence of inequalities. There is some debate about how social externalities from higher education are generated: does society have an interest in a more highly educated population than individuals would choose, even when protected against some of the risks? If so, means-tested grants would be a useful policy tool. In the French context, even without such externalities (but most French policymakers probably believe, implicitly, that they exist), it is hard to see how the system could move from its current structure directly to a market-based system with student loans; an extensive system of means-tested grants would be necessary, at least for a (fairly long) transition period.

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Chapter 4

Coping with demographic ageing

Past pension reforms have reduced the future costs of ageing for public finance. These costs are still set to rise, however, and health care finance may also pose a problem of similar magnitude – but subject to greater uncertainty. If the reforms are successful, they will stop and reverse the trend towards ever earlier retirement, but low employment among people over 55 is still an important problem, with its origins largely in mistaken policies of the past. The Conseil d'orientation de retraites, COR, has been instrumental in creating a degree of consensus on the nature of the problems; the new government will need to continue the reforms, building on the recent COR report.

As in many countries, the policy response in France to the problems raised by the changing age structure of the population has been rather slow and piecemeal. It was clear by the late 1980s that the foreseeable rise in the dependency ratio would lead to a substantial increase in the share of public expenditure that would have to be devoted to pensions (Hagemann and Nicoletti, 1989). Low participation rates among people in their 50s and 60s were already a noticeable potential problem in many countries, especially France (see Hagemann and Nicoletti, 1989, Table 9).

A first response was the pension reform of 1993, which made major changes to the standard pension scheme, but between 1993 and 2003 neither the structure nor the parameters of the other schemes were changed. The 1993 reform did not affect the pensions of public-sector workers and a number of special schemes for particular sectors or companies. Furthermore, a widely shared but misplaced belief that jobs for young people could be created by encouraging older people to retire early led to a multiplication of schemes that encouraged early retirement, often subsidised directly or indirectly by the state. As from the late 1980s, public policies to encourage early retirement were moderated, but not eliminated until the reform of 2003. All explicit direct subsidies to early retirement have now been withdrawn, but the legacy of the period is that certain policies and attitudes still effectively discourage participation by older workers. The creation of the *Conseil d'orientation des retraites* (COR, Pensions Advisory Council) contributed to this change in approach and prepared the ground for the 2003 reform.

In 2003 a law was passed that progressively extends the provisions of the 1993 reform to public-sector workers; but it still left untouched the special schemes, where workers benefit from exceptionally favourable treatment. This law also further developed the role of the *Conseil d'orientation des retraites* (COR), the Pensions Advisory Council, a consultative body created in 2000. It brings together the social partners, members of parliament, and civil servant and academic experts, and seems to have succeeded in achieving a large measure of consensus on the nature and magnitude of the problems facing the system, though this has not guaranteed agreement on which solutions to adopt. The 2003 law gave the COR the task of monitoring the implementation of certain aspects of the 2003 reform. The law also foresees a periodic review of the parameters of the system, and requires the COR to recommend to the government the areas in which action is needed. The first such report was published in January 2007, and the new government will need to respond to this with proposals for further action in the first periodic review due in 2008.

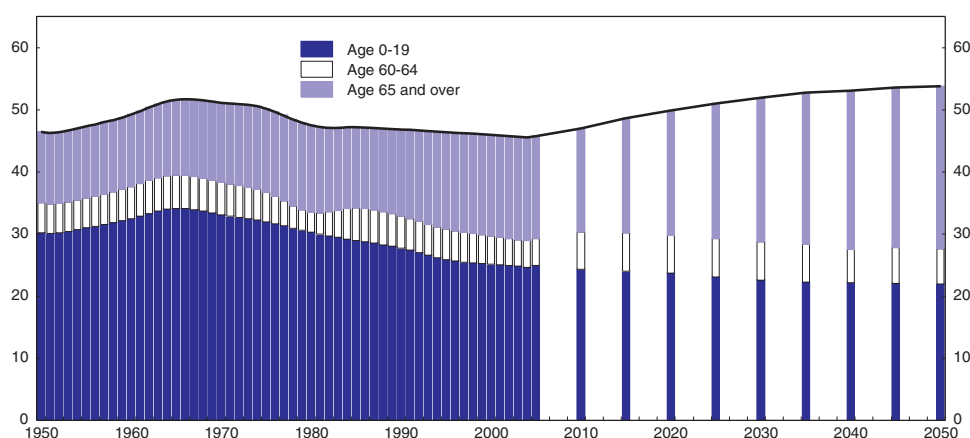
This chapter briefly presents the demographic background to the process of population ageing in France; it then discusses the labour-market and public-finance aspects of the problem, before presenting recommendations summarised in Box 4.3. The general move towards aligning compulsory pension provision on actuarial neutrality should be pursued and special treatment of particular groups of workers

should be phased out. Policies that directly or indirectly discourage the employment of older workers should be definitively abolished. Policymakers must encourage employers to reconsider their apparent undervaluation of older people, and worker representatives need to negotiate wage and employment conditions that are more flexible to accommodate the needs and abilities of people approaching retirement. A clear and coherent policy towards financing the provision of appropriate care for dependent older people should also be developed.

Population ageing, but recently rising fertility

The old-age dependency ratio is set to rise fairly steadily up to the middle of the century (Figure 4.1). This is a resumption of the trend that held during the first half of the last century but which was interrupted by the post-war baby boom. France is not alone in this; almost all countries can expect a significant rise in the ratio of older people to those of working age over the next 50 years (Figure 4.2), although the expected raise in the overall dependency rate is less pronounced than for the Euro area as a whole. Figures 4.1 and 4.2 exaggerate the “dependency” aspect of future developments by focusing on the over-60s as if the average over-60 person in 2050 is as “dependent” as the over 60s in the mid-20th century. This is certainly not the case: the increasing life expectancy of the over 60s has gone hand in hand with improvements in their general health and fitness (OECD, 2006a); but such improvements are far from sufficient to prevent a large increase in the dependent population. The decline in dependency ratios between the late 1960s and 1990 is partly responsible for the difficult situation pension systems faced in most countries in the 1990s. It permitted increases in the generosity of pensions and reductions in the retirement age to be implemented in pay-as-you-go (PAYG) schemes without any immediate negative impact on public finances.

Figure 4.1. **Dependent population share, 1950-2050**
Per cent of total population



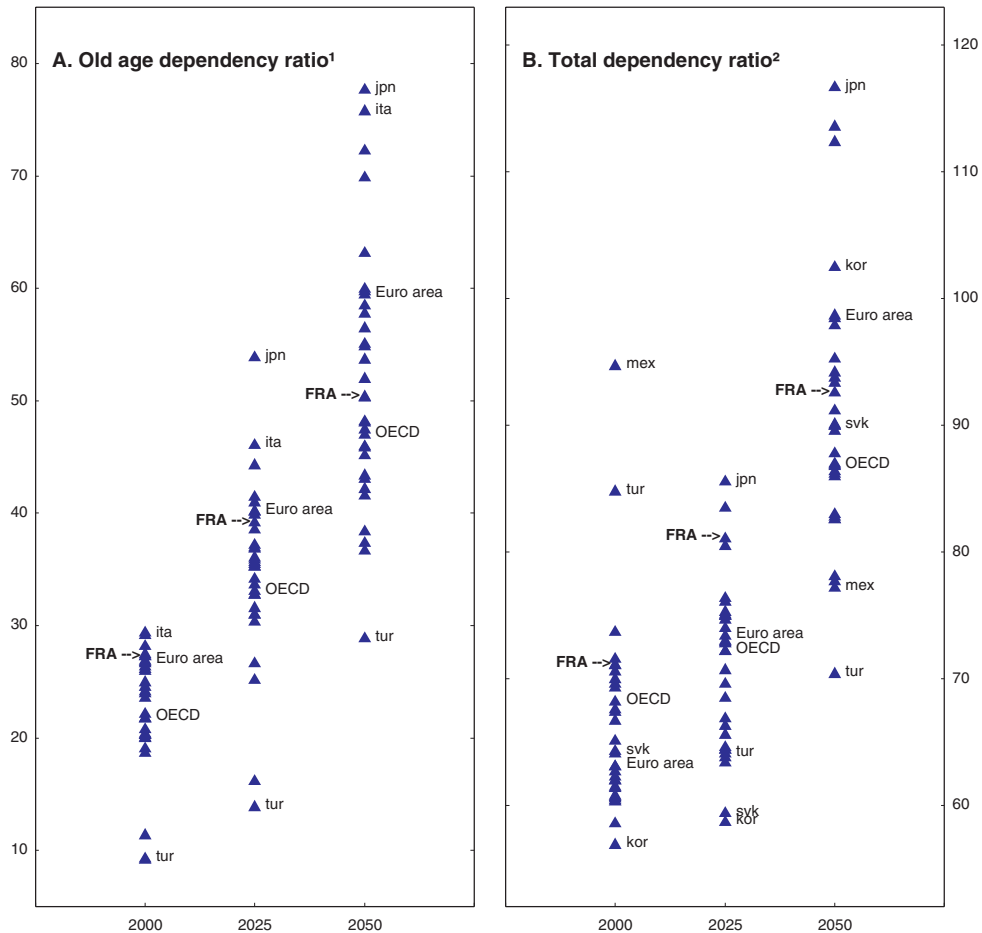
Source: United Nations; INSEE for the projections (*Insee Première*, No. 1089 – July 2006).

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The demographic forces behind population ageing in France, as in most other OECD countries, are a combination of the one-off impact of the baby boom generation passing through, the secular increase in life expectancy, and what looked until recently like a slowly declining fertility rate. In France, the latter (defined as the average number

Figure 4.2. **Demographic dependency ratios, 2000-50**


Percentages



1. Ratio of population aged 65 and over to population 20-64.

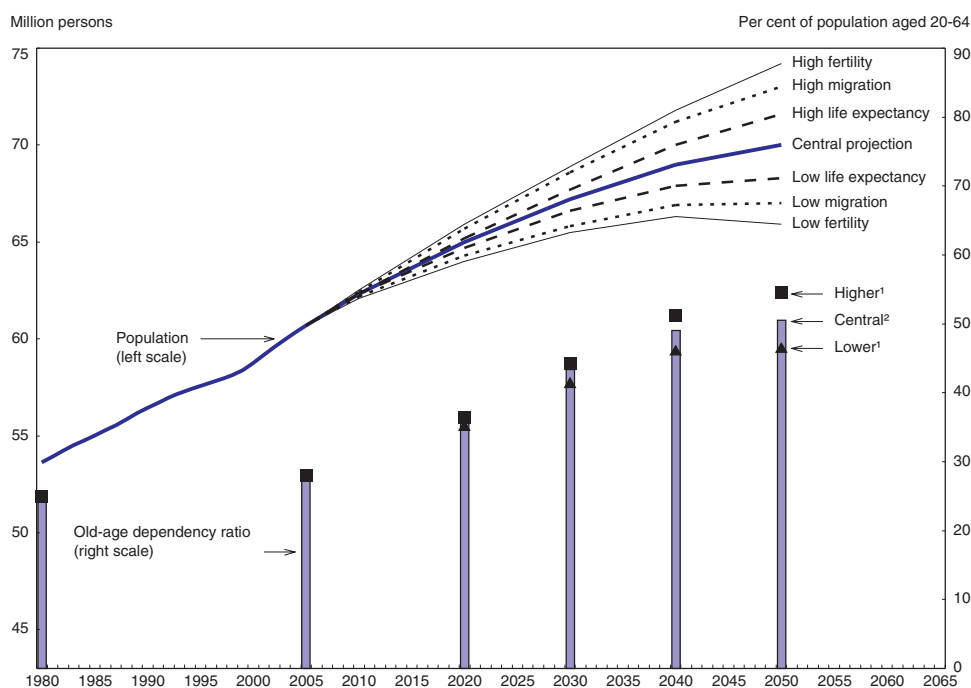
2. Ratio of the sum of the population aged less than 20 and the population aged more than 65 to the population aged 20 to 64.

Source: United Nations; for France, *Insee Première*, No. 1089 – July 2006.

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of live births per female) had fallen to around 1.7 in the mid-1990s; at such a level the population would decline in the long run, unless there were a steady and substantial inflow of migrants. Population projections until recently assumed that the fertility rate would rise only slightly in the longer run; in the last five years, however, the fertility rate has risen, to reach 2.0 in 2006, and population projections have been revised substantially upwards. Furthermore, since 2002 net immigration flows have averaged around twice the previous assumption for the long-term average. These changes make a noticeable difference to the forecast dependency ratios, but do not nevertheless prevent it increasing substantially (Figure 4.3).

Figure 4.3. Uncertainty in population and dependency projections



1. Higher and lower old-age dependency ratios correspond to high and low life expectancy projections.
2. The central old-age dependency ratio corresponds to the central population projection.

Source: INSEE; INSEE Première, No. 1089 – July 2006.

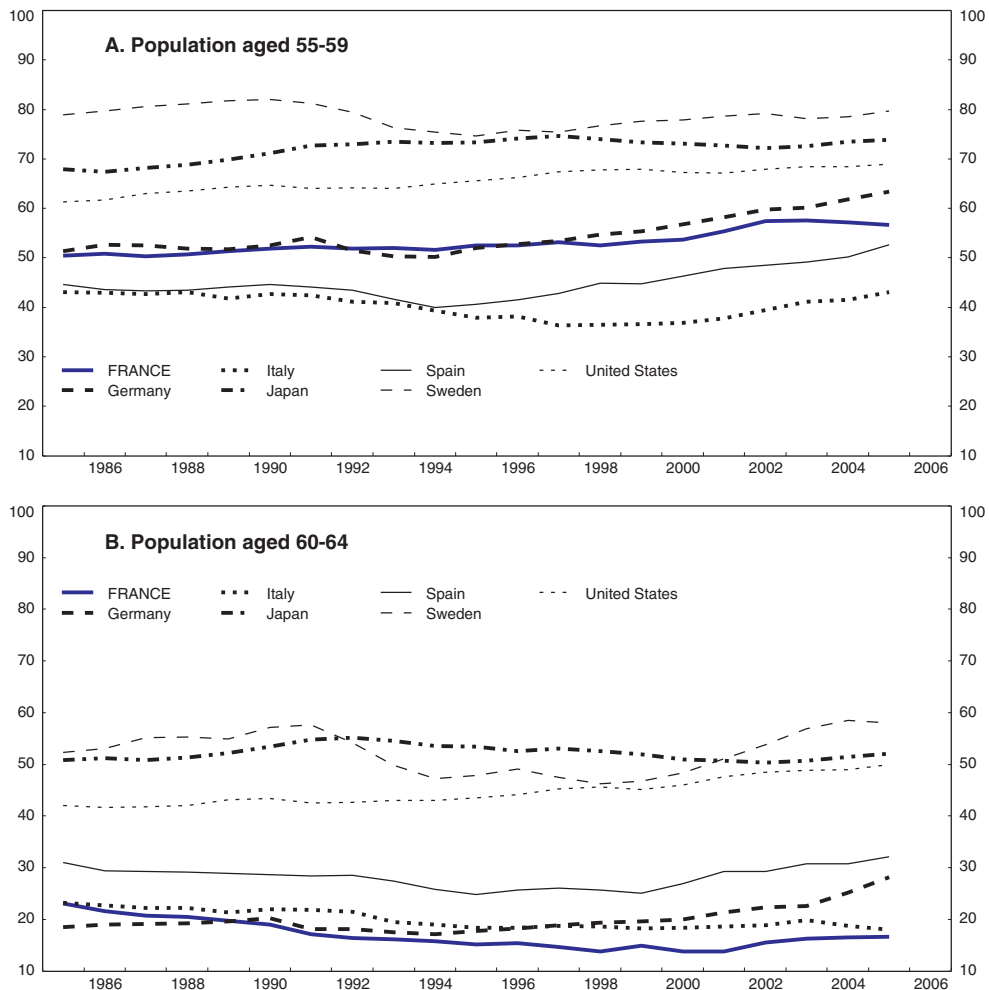
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Employment

With the demographic dependency ratio set to rise steadily, it is all the more important to ensure that people of working age are actually working so as to ensure that resources are available to sustain the increasing population of dependants. So far there is not much reason for optimism in France. Employment rates among people aged 55-59 and 60-64 are much lower than in most other countries and the withdrawal over the last few years of most explicit incentives to early retirement has had no obvious impact (Figure 4.4). The rise that can be seen in Figure 4.4 in 2002-04 is due partly to a composition effect, as baby boomers approaching retirement increased the share of the population in those age groups at the lower – and more active – end of the range. Much of the rest of the increase is among women, associated with the general increase in female participation over the last two decades, rather than due to changes in incentives (COR, 2007).

Two policy factors that may account for apparently unchanging behaviour are the rules for unemployment benefit and a side effect of the 2003 pension reform. Unemployed people over the age of 57 years and 6 months (plus, since 1999, those over 55 years if they have already made 40 years' worth of pension contributions) are exempted from the normal requirement to seek work in order to qualify for continued payment of unemployment insurance benefit or the welfare payments that they may receive after such benefits have run out. They continue to receive unemployment insurance or assistance benefit until they become entitled to a full pension. While this is to some extent a recognition of the reality that it is hard to find a job for people of this age, it also makes it somewhat easier to accept being made redundant and does little to change attitudes about the need to increase employment

Figure 4.4. **Employment rate trends**
Per cent of working-age population



Source: OECD, Labour Force Statistics.

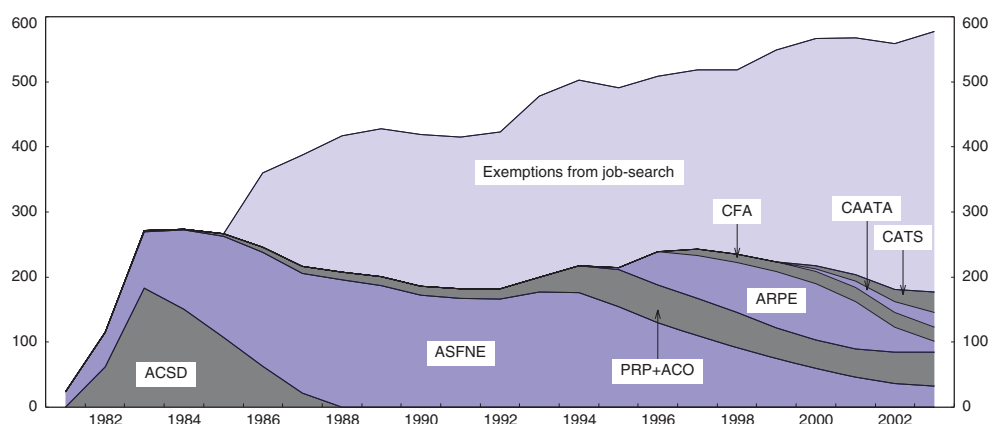
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of such people. The number of people benefiting from this exemption (who are not counted in the unemployment statistics) has now risen to over 400 000 from 325 000 in 1999, just as the decline in numbers of people in the many and varied subsidised pre-retirement schemes began (Figure 4.5). Growth in the number of exempted unemployed has nevertheless declined recently, and their share in the population aged 55-64 has fallen from 6.5% in 2003 to 5.8% in 2006. The concurrent increase in the number of people taking pensions before 60 after 42 years of contributions may explain part of this fall.

This option for people who have paid contributions for 42 years to take immediate retirement on a full pension even if they are not yet 60 is a part of the 2003 pension reform. Prior to 2003 such people had to wait until they were 60 before they were entitled to a full pension. It was expected that this would lead to the retirement of about 330 000 people in the three years to 2006 (half of them in 2004). Slow take up of this option led to fewer early retirements than expected in 2004 but more thereafter, with the cumulated total to date similar to predictions. About 100 000 retirements per year are expected under this heading

Figure 4.5. **Forms of early retirement, 1981-2005**

Public pre-retired end-of-year stocks and exemptions from job-search Thousand persons



Note: ACSD: Allocation conventionnelle de solidarité démission; ASFNE: Allocation spéciale du fonds national de l'emploi; PRP: Préretraite progressive; ACO: Allocation complémentaire; ARPE: Allocation de remplacement pour l'emploi; CAATA: Cessation anticipée d'activité des travailleurs de l'amiante; CFA: Congés de fin d'activité; CATS: Cessation anticipée d'activité de certains ravaillleurs.

Source: Conseil d'analyse économique (2006), "Les seniors et l'emploi en France".

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up to 2008, after which it will decline and concern only people retiring at 59, due to the effect of the increase in the compulsory school leaving age to 16 in 1953. Aside from these special influences, the only other incentives to early retirement are those in certain "special" pension regimes (such as the railways, and the public gas and electricity companies), which have normal retirement ages of under 60 (see below).

A low-activity "habit" has reinforced policies

Even if all the people involved in these exceptional measures were employed, activity rates would still be low by international standards. Part of the explanation seems to lie in the attitudes and expectations of employers and employees. People had become used to the idea of falling retirement ages, paying less attention to the increasing length of survival in retirement and the consequent budgetary pressure. The large number of different measures taken in the 1980s and 1990s has been seen in Figure 4.5. One way or another all of these schemes were based on (and gave credence to) the assumption that labour supply made little or no difference to the level of employment or unemployment,¹ so that the fiscal cost of the resulting early retirement was creating employment for younger workers. Similar reasoning made early retirement schemes seem an attractive solution to "down-sizing" problems in companies, perhaps helping overcome resistance to layoffs, especially if the burden could be off-loaded onto future taxpayers; such an approach became so widespread that considering such a scheme has become a reflex, even if there are now many fewer incentives.

The close link that develops between behaviour and fiscal incentives is illustrated by a policy modification in respect of compulsory retirement during 2006. Provided that a relevant industry agreement provides for it, employers can oblige employees over 60 to retire. This possibility is subject to a number of conditions, among which is the payment of suitable indemnities by the employer. It is intended to change the treatment of such industry, but, for the moment, the indemnities are exempted from income tax and social security charges; whereas, if a person of the same age retires voluntarily, any indemnities or

leaving allowances received are taxed. In the social security budget for 2007 it was proposed to eliminate the tax exemptions for these indemnities, but after protests and lobbying in parliament by many large companies, this suggestion was dropped. The companies' argument was that in fact nearly all such "compulsory" retirement was voluntary, negotiated by agreement between the employee and the company precisely so as to benefit from the tax exemptions. The outcome was that the tax exemptions were retained up to 1st January 2014, except for the CSG and CRDS (about 11% for the two together) which will be imposed as from 2010. The tax exemptions were even extended to voluntary departures. Though all concerned no doubt argue that they value the experience of older workers, the effect is to discourage their continued employment, at some cost to the taxpayer.²

A mismatch between labour costs and productivity?

There are a number of possible explanations for reduced employment rates among seniors. It might be that older workers are affected by productivity that declines with age more than wages do, so that employers make less, or no, profit from employing them. This is perhaps plausible, particularly in the case of manual work. However, while measuring productivity of individual workers or of groups of them is very difficult, recent research has argued that although this is perhaps a problem in some cases, it may not be a major problem (Box 4.1).

If this conclusion were accepted, and if the results could be extended to the whole labour force, the implications would be relatively simple: low employment rates are mainly the legacy of early-retirement schemes (as well as the reduction in the retirement age from 65 to 60 in 1982) and their aftermath in terms of attitudes to employment, and this behaviour

Box 4.1. Recent evidence on wages and productivity of older workers

Aubert and Crépon (2003) estimate relative productivity of different age groups by using a large set of enterprise data (employing at least five workers, in sectors defined as "private and semi-public") covering output levels, capital stock and labour force by age over the period 1994 to 2000. By comparing variations in output across companies and/or through time with variations in the age structure of the labour force, age-specific productivity rates are inferred for different types of labour. Estimation by instrumental variables is used to reduce simultaneity bias. Aubert (2005) provides evidence on differences between unskilled, skilled and highly-skilled workers by looking at partial correlations between the relative wages of older age groups and their share in the workforce.

The authors' main conclusions are that productivity increases up to the age of 40 and then stabilises; the same is true for wages, except for highly-skilled workers and, perhaps less so, for skilled workers. Any gap appears to emerge only after the 45-49 age group, but it is argued that it is not statistically significant except perhaps for the 55-59 group in the industrial sector.

Although these studies take care to avoid some sources of estimation bias, others cannot be eliminated, notably the fact that only the productivity of those still in employment can be estimated this way, so that if those who stop working have a higher or lower productivity than average this could bias the results. Since employment rates among older workers are higher for more highly-skilled groups, estimated productivity is likely to be biased upwards. Furthermore, although the gap between estimated age-specific productivity and wages may not be statistically significant, it nevertheless points in the direction of a disincentive to employ older people.

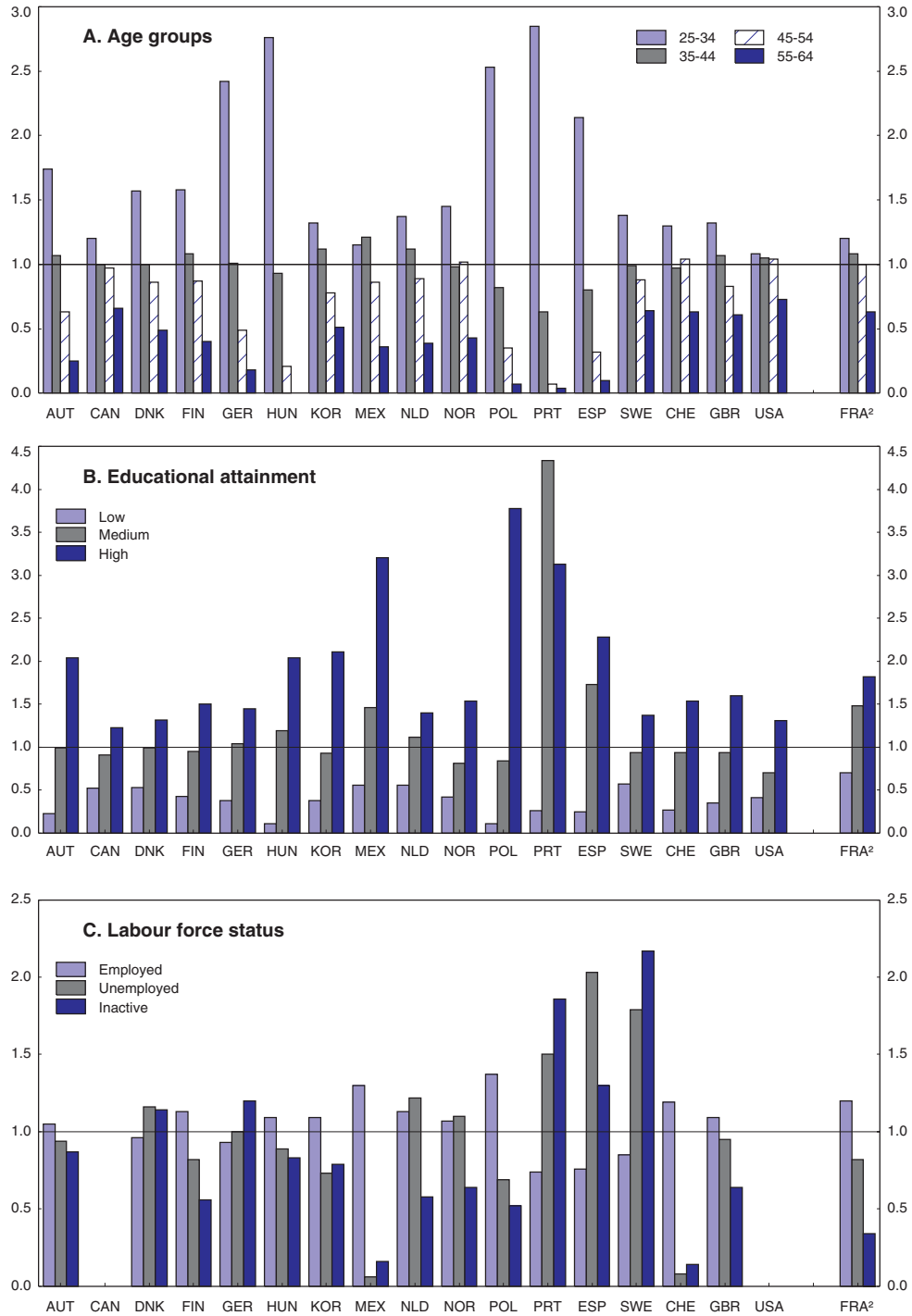
runs counter to the interests of employers and (potential) employees. In this case, policy could restrict itself largely to pointing out to employers that they are undermining their own interests by not employing older workers. Certainly, programmes of persuasion of this sort are needed, and the *Plan Senior* launched in mid-2006 provides for this sort of publicity campaign. Such campaigns drew inspiration from those in the Netherlands and Finland, but at best they will work only slowly. At worst, if they do not address the underlying problem, they will have little effect save to divert attention from more fundamental measures that might be needed.

Notwithstanding the empirical evidence, the disparity between activity rates for the over-55s in France and those in other countries, not to mention those in France a generation ago, is too great to be explained just by employers making mistakes. The explanation must also include a real mismatch, as well as a perceived one, between what employers require from employees and what they think employees can provide after 55. One possibility is that employers expect the variance of age-specific productivity to increase with age, making the return to employing labour increasingly uncertain. This would occur if employers cannot easily observe productivity directly or if it is difficult to vary wages in line with productivity (either to reduce wages to match declining productivity, or to pay less-productive workers less than some of their contemporaries). The relatively high minimum wage and strong employment protection legislation (EPL) in France are likely to be part of the story: the high minimum wage increases the possibility of wages exceeding productivity, and EPL increase the cost of a recruitment error for the employer. The “Delalande contribution” raises this cost even further by imposing a tax on employers who dismiss workers over the age of 50; the government has recognised that it has had perverse effects, and it is currently planned to phase it out as from 2008, eliminating it by 2010.

The pattern of (in)activity among people over 55 matches (though cannot be said to *prove*) this hypothesis: employment rates are lower among the low-skilled. Productivity may be low among older unskilled workers either because it inevitably declines with age or because the skills people initially possess depreciate as technology and production methods change, and those with initially lower skills are less able to adapt and maintain the required level of type of skills than more highly-skilled or highly-educated workers. In either case, training could offset some of the impact of ageing, and the importance of lifelong learning has frequently been emphasised (*e.g.* OECD, 1998). However, while most OECD countries are making efforts to increase the amount of time adults spend in ongoing training, it is clearly difficult to ensure that older workers or unemployed people do enough. In all countries, time spent in training is heavily concentrated among the young and the highly educated (Figure 4.6). France is no exception, but the disparity appears somewhat smaller than in many other countries in Figure 4.6 (although this is not certain, because the data may not be fully comparable).

Over the age of 60, it is the incentives to take “normal” retirement rather than “early” retirement that matter, since once aged 60 anyone is entitled to take their pension. This is low compared with most countries, but it should be noted that it is the contribution period that is more relevant, since only 8% of people take their pension before completing the minimum period necessary for a full pension. The 2003 reform in fact made it likely that this proportion will increase. Previously the penalty for taking the pension early was as high as 10% per year, which was unfair (in the actuarial sense) to the employee; the reform reduced it to 5%, which is approximately actuarially neutral for the average worker. So far,

Figure 4.6. Adult learning participation rate by socio-economic characteristics
 Ratios of participation rates for each subgroup to the national average participation rate 25 to 64 year-olds, 2002¹



1. A ratio above 1 implies that the proportion of those in adult learning in a specific category is above the average participation rate for that country; a ratio between 0 and 1 implies that it is below the average rate
2. Data for France are not strictly comparable and refer to 2003 in Panel A, to 1999 in Panels B, C.

Source: Eurostat, Labour force survey 2003, special survey on lifelong learning; CEREQ, Les taux d'accès à la formation (2000); OECD (2005), Promoting Adult Learning.

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however, there does not seem to have been an increase in the number of people paying the smaller penalty to retire early with less than the full pension. It is thought that, even if there is an impact on the proportion of people taking their pensions early, the impact on both public finances and employment will be small. As far as public finance is concerned, this is because the system is quite close to actuarial neutrality at the margin; the employment effect would be small because a large proportion of those who do take their pension early are in fact already inactive, frequently women whose spouses are already drawing their pension, whether still working or retired.

Nor has there been much change in the (small) number of people continuing to work after they are already entitled to a full pension, following the introduction of a premium in the form of an increased pension; initially set at 3% per year, this was much less than actuarially neutral, and still penalised the worker. It was kept low partly to minimise the revenue cost of the measure in terms of the pensions of those who would have continued to work anyway. Under the *Plan Senior*, it is now 3% for the first year, then 4%, and 5% for years over the age of 65. It would need to start at perhaps 7% and rise quite considerably with age, if it were to be fully³ neutral, but it is difficult to apply the concept of actuarial neutrality when the person chooses the date of retirement because there may be a selection bias. Although the reaction to the 2003 reforms seems slow to appear, one study suggests that it may develop quite strongly over the next few years. Blanchet and Crenner (2006) use a microsimulation model to assess the joint impacts of the 1993 and 2003 reforms on retirement age and activity rates. Although the average retirement age appears to increase rather modestly (except in the public sector), the impact on overall participation rates is quite substantial, even by 2010 (Tables 4.1 and 4.2).

Table 4.1. Impact of the 1993 and 2003 reforms on average age at retirement

Simulated change in average retirement age, years	1993 reform			2003 reform	
	Total	Men	Women	Private sector	Public sector
Cohort					
1935-40	0.3	0.4	0.2	..	..
1940-44	0.2	0.2	0.3	..	..
1945-54	0.4	0.4	0.4	0.0	1.6
1955-64	0.5	0.4	0.5	0.4	2.2
1965-74	0.6	0.7	0.5	0.2	2.2

Source: Blanchet and Crenner (2006) Tables 2 and 3, DESTINIE model.

Table 4.2. Impact of the 1993 and 2003 reforms on participation rates at age 60-64

Simulated Increase in participation rate, percentage points	2010		2040	
	Males	Females	Males	Females
1993 reform	2	2	7	5
2003 reform, excluding the premium for delaying retirement	6	6	15	14
Premium for delaying retirement	4	4	1	3
Total reforms 1993-2003	12	12	23	23

Source: Blanchet and Crenner (2006), Figure 2, DESTINIE model.

It can be seen in Table 4.1 that the increase in the effective retirement age in the private sector is much less than in the public sector, despite the fact that in both cases the reform increased the number of contribution years from 37.5 to 40. The minimum retirement age remained 60 years in both cases. The reason for this is that even before the reform, many people in the private sector completed 40 years of contributions before reaching the age of 60 (without this giving them any higher pension) so that it is this minimum retirement age rather than the number of contribution years that constrains their decision. In other cases, the reform can increase the “retirement age” but have little effect on labour market participation; this is the case of people who are already inactive, through unemployment or withdrawal from the labour market (common among women with incomplete careers), but who have pension contribution years credited for each year of unemployment. The financing impact of the 1993 reform was almost entirely due to the cut in the real value of pensions due to the change in indexing method, and rather little due to the increase in the contribution period.

The joint action plan for older workers’ employment

In the summer of 2006, the government announced the *Plan d’action concerté pour l’emploi senior* which aims to increase the employment rate of 55-64 year-olds to 50% from the current 37%, by 2010. A number of the plan’s measures are essentially focused on persuasion – encouraging companies to retain older workers, to use mentors and to improve working conditions. It is also planned to eliminate the industry agreements that allow compulsory retirement before age 65 by 2010, though the difficulties putting this into effect were mentioned earlier. Others work more directly on the demand for labour notably the introduction of a type of short-term employment contract intended for those over 57 and out of work for at least three months, the *CDD senior*, and the planned abolition of the *contribution Delalande* (though not until 2010 for its final abolition). The *CDD senior* is not very much more flexible than a standard short-term contract, and was the subject of difficult negotiations between the social partners – the employers would have preferred to negotiate some reductions in age-related wage increases, for example. Other measures include expanding the possibilities for retired people to take a job while continuing to receive a pension and increasing the premium from working longer than the standard 40 years from the 3% mentioned in the previous paragraph to 4% in the second year and then 5% when over the age of 65. While all these measures should be helpful, it is doubtful whether they alone are likely to increase the employment rate by the two percentage points a year necessary to meet the 2010 target.

New employment needs?

As the number of retired people increases, patterns of consumption can be expected to shift. In a market economy this is of little interest for policy, since in the time period concerned this kind of change in consumption patterns will no doubt be dwarfed by others due to changing tastes and technology. It is perhaps a slightly more interesting question when it comes to services, especially personal services. The current generation of retired people has been showing a tendency to retire in parts of France where temperatures, and often unemployment too, are higher than average. According to a report by the *Conseil d’analyse économique* (CAE, 2006b), there are already some parts of France where 30% of disposable incomes are those of retired people (and half of the rest are civil servants’). This

tendency is likely to continue and will imply some geographical as well as sectoral shifts in the demand for labour.

Notwithstanding the fact that people are living both longer and on average in better health, demand for long-term care is likely to rise. Most older people seem to prefer to stay independent and living in their own homes as long as possible. Some of them will need little or no care, some will require frequent visits, and some may need full-time attendance. This increase in demand may be quite substantial but will be spread over many years and does not call for any specific policy measures. But those who will need care, especially those of limited means, will not be very well placed to search for the right kind of help. Where public assistance is to be available, it is important that it is organised so as to give the best match between what people want and need and what the labour market can supply.

Current arrangements seem relatively efficient from this point of view, at least on an *a priori* basis. Some support for people who need care is provided through the *Allocation personnalisée d'autonomie* (APA), introduced in 2001 (replacing the earlier *prestation spécifique dépendance*). This involves a two-stage process, in the first of which the person is assessed for their degree of incapacity. In the second stage, the local social services put together a package of care tailored to the person's particular needs, within a cost ceiling determined by the assessed degree of incapacity. In some ways this lacks the cost-saving incentives of arrangements such as the Austrian system, in which the initial assessment results in a specific amount of money being allocated to the person who then spends that money as desired, and it can be spent on care at home or on institutional care. On the other hand, the requirement that different actors coordinate to put together a care package is also potentially a source of cost savings; and the system is the same for residential as for home-based care. Frequently the packages do not reach the ceilings specified, though this could be as much a reflection on the appropriateness of the ceilings as on the efficiency of coordination. This is an area where policy experimentation and evaluation would be desirable, especially as the likely growth in potential spending on care is substantial (see below), making an emphasis on appropriate targeting and efficiency essential.

The need for care varies considerably from person to person, depending also on family circumstances, and to increase as the person ages. In some cases, a combination of relatively undemanding help and quasi-medical services may be required. In addition to the financial considerations, it may require some thought to get the level of regulation of such employment right. Too-tight regulation, motivated by the desire to ensure that medical care is of suitable quality, might lead to under-supply of the less specialised non-medical care, especially at home. Too little regulation may lead to insufficient quality of care for a vulnerable group of people. For the moment, there is no sign that the balance is wrong, or that people are forced into residential care for lack of availability of home help, for example (though much of this is provided by families). On the contrary, there may be a shortage of public residential-care institutions in some departments – this kind of provision is the responsibility of local government rather than the health system.

Ageing and public finance

Despite two important reforms in the last 15 years, the public pension system remains complicated and is still financially unsustainable without further changes in contribution rates, retirement age or pension levels. Broadly speaking, there are three sets of publicly

financed pension schemes: the general regime, the complementary regimes and the “special” regimes. All of these are pay-as-you-go schemes. In the general regime, to which almost all private-sector workers are affiliated (and on which the contribution period in the basic scheme for civil servants will be aligned as from 2008), pensions are determined as a function of the number of years’ contributions and the average salary of the best 25 years of a person’s career; there is some redistribution within this system, as the replacement rate (i.e. the level of the pension as a proportion of the reference salary) is biased downwards because the calculation of the pension increases with earnings only up to a certain threshold. But this redistributive effect is strongly offset by the positive correlation between life expectancy in retirement and earnings. The compulsory complementary schemes mimic a defined contribution system but operate through “points” rather than accumulating a genuine fund through saving. Contributors accumulate points for each year of work and their complementary pension is determined by the number of points they have accumulated by the time they retire. The price at which points are acquired, and their value in terms of the pension annuity, are varied to keep contributions and payments in balance.

The main elements of the 1993 reform, which affected only the general regime for private sector workers (though the principal complementary regimes were revised in 1996 in the light of the 1993 general reform) were: an increase in the number of contribution years from 37.5 to 40, calculating the reference salary over the best 25 rather than 10 years, and an indexing rule based on price inflation rather than average wage inflation. This indexing rule applies to the annual updating of pensions once they are awarded, but also to the calculation of the reference salary – past salaries in the best 25 years are updated using the consumer price index rather than average wages. In 2003, elements of the 1993 reform were applied to the civil servants’ schemes (which cover about 4.2 million state and local-government workers), to be phased in up to 2008; however, the reference salary for calculation of pensions remains the final six months’ salary, retaining the unfortunate incentive for end of career promotions as an incentive device. In addition, an innovative reform planned the indexing of the contribution period to life expectancy. This will mean an increase in the contribution period to 41 years by 2012; it will rise to an estimated 42 years by 2020 if the indexation method is retained after the review which is due in 2008.

The special pension regimes cover just under half a million workers in current or formerly state-owned companies.⁴ The special pension schemes are relics of company and sector-based schemes that existed before the second world war, when there was no general pension coverage. Over time, a number of other schemes (for example, for agricultural workers) have been effectively absorbed into the general scheme, essentially because falling employment in certain industries meant they experienced an “ageing” process before the economy as a whole.⁵ The remaining special regimes have managed to avoid this, even though they generally receive some transfers from the state budget to balance their books, transfers that are likely to increase over time.⁶

The most important special regimes are those for public-transport workers and that for employees of EDF and GDF, the publicly-owned electricity and gas companies; the half million workers covered represent about 3% of total employment, but about 6.4% of all pensions paid in 2003. They have so far been spared reform,⁷ even though they are more generous and in most cases in greater long-term financial difficulty than the reformed schemes. For example, in the pension scheme for the SNCF (the publicly-owned national railway company), drivers can retire at 50 after 25 years of total service of which at least 15 years driving (on average they retire at 50.3 years) and the average retirement age for

other SNCF employees is 55.1 years (the minimum being 55).⁸ The scheme for the RATP (which runs the metro and most bus and local rail transport in the Paris region) scheme is slightly less generous, but the average age at departure is about 56 and 86% of workers retire before 60.⁹ In nearly all of the regimes the reference salary is the final year's salary.

Although these unreformed schemes represent a relatively small part of the overall pension burden, bringing them into line with the general regime would increase equity and also probably make it politically easier to take further measures to reduce the future cost of the general regime. Although the scheme for civil servants has been aligned on the private sector as far as contribution years is concerned, the reference salary remains the final year's salary and is therefore more generous than one which averages over a number of years, given the prevalence of age-related salary scales in the public service. Such salary scales have become much less common in the private sector.

Further reform is needed because projections of pension finance out to the year 2050 show that the financing burden will increase, despite past reforms. The *Conseil d'orientation des finances publiques* adopts the estimate of the European Commission that the overall rise, taking account of the offsetting impact of reductions in education and unemployment expenditures, will amount to 3.2% of GDP (Table 4.3). Broadly speaking, therefore, reforms since the early 1990s have dealt with about half the long-term increase in claims on public finances that ageing would have been expected to generate.

Considerable uncertainty is attached to estimates of likely increases in expenditure. The OECD estimated that public health care expenditure would rise from its 2005 value of 7.1% of GDP by between 0.2% and 2.7% of GDP between 2005 and 2050, with a central estimate of 1.2% (OECD, 2006). Although there is a peak in spending on health care in old age, this peak is nearly always concentrated at the end of a person's life and thus recedes as life expectancy increases, so these increase are perhaps less than might be expected. With advances in technology, some of the major lifetime expenses now come at relatively young ages.¹⁰ Within these estimates, however, trend growth in the real cost of health care per age-adjusted member of the population is assumed to diminish to zero.

Table 4.3. Estimates of the impact of ageing on public expenditure

Estimated increase in public expenditure between 2004 and 2050 due to:	Per cent of GDP
Pensions	2.0
Health	1.8
Dependence	0.2
Unemployment	-0.3
Education	-0.5
Total	3.2
<i>Memorandum items:</i>	
Impact of previous reforms:	
1993	-2.0 ¹
2003	-1.2
Total for other countries:	
EU25	3.4
Germany	2.7
United Kingdom	4.0

1. OECD estimates.

Source: Conseil d'orientation des finances publiques (2007) (from European Commission EPC report); COR (2007).

Spending on long-term care may also be quite difficult to predict, although according to the estimates reported in Table 4.3 it does not represent a major long term threat. OECD (2006) projects a larger increase in total expenditure, public and private, on long-term care of 2.6% of GDP (from 8.2% in 2005), within a possible range of 1.2 to 6.0%. According to the Gisserot report (2007), demand for long-term care may grow at an average 1% a year up to 2050, but somewhat faster than this in the decade after 2020. The main explicit public expenditure item is the APA, described earlier. The APA for a person in the highest category of dependence¹¹ is approximately the same as the minimum wage, but it is means tested. A person whose income is more than 2½ times the minimum wage has to finance 90% of the care plan established under the APA. Despite this quite strong conditionality, the number of beneficiaries of the APA has recently been growing much more rapidly than the long term rate of 1% per year assumed in the Gisserot report. In 2006 it rose by 8%, and total expenditure on the APA and closely related benefits was some 0.3% of GDP in 2004. The APA is entirely on the budget of departments, whose services also provide the assessment of the degree of dependence, although the maximum benefits are determined by national legislation. These assessments can vary from department to department but can also be quite inconsistent within any one department – there do not seem to be clear or consistently applied rules.

The finance and organisation of the APA seems relatively clear, although the recent rapid growth in the number of beneficiaries may suggest that estimates of the future growth in associated costs may be somewhat optimistic, although it may be due to the administration of the relatively recent APA (introduced only in mid-2001) still getting up to speed. The amount spent on the APA in 2004 already exceeded a projection made in the same year by INSEE for expenditure in the year 2020 (see *Cour des comptes*, 2005, pp. 181-82). These INSEE projections, which are similar to those included in the EU Commission projections in Table 4.3 rely strongly on the assumption that an increasing proportion of actual dependency-related expenditure will be met by individuals themselves and their families. The range of estimates in OECD (2006) gives an idea of how important it will be to monitor needs and actual public expenditure to ensure that the latter evolves as a function of a clear policy choice.

The report by the *Cour des comptes* notes that financing for non-medical old-age care is rather fragmented and unclear. Individuals and their families do already provide or finance most dependency-related care. When an old person is in a public residential home, medical care is theoretically financed by the (national) health system, dependency care is financed by the department, and living costs are financed by the individuals themselves or by the department if the person is too poor. For the living expenses, French law requires that relatives also participate if they are able, and expenses incurred by the department can be reclaimed after death from the estate of the deceased person; in principle there are no exemptions, even for a principal residence. This provision, rather unusual among OECD countries, establishes strong incentives for family involvement in care for the old; not all departments use this possibility consistently, however.

The theoretical clarity of the allocation of responsibility for expenditure is not necessarily matched by what happens in practice. The health system itself has a provision for “medical-social” expenditure, which is expressly provided to cater for dependency-related expenditure for older people and the handicapped. And in practice, it is can be difficult on the margin to distinguish expenditure on medical services from that on care; according to *Cour des comptes* (2005), medical-social expenditure is actually partly

provided for out of the hospital and general health-care budgets. As far as the burden on departments is concerned, there is a significant amount of redistribution between them, according to the burden of financing the APA, and the Caisse nationale de solidarité pour l'autonomie (national solidarity fund for independence, CNSA) was created in 2005 to help departments fund their obligations. The CNSA itself is financed by the notional incremental public sector revenue that arises from the abolition of the national holiday for Pentecost in that year.

Private provision for pensions and dependence, and the taxation of saving

Before 2003 there were very few private pension schemes in France, if by this is meant schemes conferring some tax advantages on enterprise-based or voluntary personal saving that is held until retirement. Without any tax advantages, such saving would thus be made out of post-tax income and any interest or dividend income would be subject to personal income tax and to the 11% social contribution¹² allocated to social security (though not to the other social charges levied only on income from employment). However, there are varying fiscal incentives for a large number of different forms of saving. In most countries that have significant private pension provision, the form of tax advantage is usually, using the conventional shorthand¹³, EET. In France there is considerable variation: most of the schemes are approximately EET, but the single most important one – life insurance contracts – is approximately TET. The PERP (*Plan d'épargne retraite populaire*, “People’s Retirement Saving Plan”), the PERE (*Plan d'épargne retraite d'entreprise*, “Enterprise Retirement Saving Plan”) and the PERCO (*Plan d'épargne retraite collectif*, “Collective Retirement Saving Plan”), introduced in the 2003 reform, correspond to EET. However, conditions for exemption, and the degree of exemption, can vary from one scheme to another. The introduction of these schemes was made feasible by diminishing unwillingness to accept the idea of pension funds.

This unwillingness was hard to understand, given the widespread popularity of life insurance schemes as a form of tax-favoured saving. Life assurance schemes are home to a stock of savings equivalent to about two-thirds of GDP, compared with only around 1% of GDP for tax-favoured schemes specifically designed as pension saving, although total funds managed by private pension funds amounted to nearly 6% GDP in 2005. There are also more than a dozen other forms of tax-favoured saving. The recent introduction of tax advantages for individual and company-based pension schemes, PERP and PERCO, may change the picture, but only slowly: inflows are quite significant but, averaging under 0.3% of GDP per year, they will take some time to alter the balance of the stock of saving. The tax treatment of life assurance has changed through time (the main changes occurred in 1983 and 1997); it can vary according to the proportion of shares in the underlying investment, as a response to another policy objective, increasing risk capital available for small and medium-sized firms.

In all cases, tax treatment also varies according to the holding period of the investment, with some minimum holding period required in order to benefit from any reduction, usually about four years, and five to eight years before maximum deductions are granted. Since unsheltered saving can be taxed relatively heavily, it is not surprising that sheltered schemes are popular, even when they are tied to an insurance contract that savers might not otherwise want. The multiplicity of tax arrangements seems unlikely to promote efficient saving behaviour since, as Aubier *et al.* (2005) point out, both households and financial institutions focus first on tax issues and only second on matters such as

return, risk and management fees. Frequent changes in the legislation further muddy the waters. The complicated provisions of the law sometimes tempt governments to use them to manipulate aggregate demand, as in late 2005 when the government temporarily relaxed the minimum holding period for certain types of company-based saving to try to induce households to consume more so as to boost the economy, to no obvious long-term effect.

There seems little justification for this degree of complexity. A key aspect of the existing arrangements is to favour longer-term saving. The variation in the other aspects of the schemes is a response to other objectives such as equity financing for enterprises, a desire to lower the taxes and charges on the savings of the less well-off, or to encourage investment in property. The resulting complexity is difficult to justify and is likely to reduce transparency and increase compliance and administration costs.

Future reforms

Although previous pension reforms have improved the situation markedly, Table 4.2 emphasises that ageing still presents a problem for long-term government finances. As far as pensions themselves are concerned, it seems clear that the extra generosity of the special regimes should be phased out (unless current participants are willing to pay extra contributions to finance current and future excess generosity) and these schemes brought into line with that for the private sector. Maintaining the final-salary basis of the civil servants' regimes may not be a financial problem in itself, but it leads to some poor incentives for costly end-of-career promotions while making it difficult to plan for a smoother transition to retirement through, for example, part-time work or work of lower intensity. Current plans to increase the *surcote*, the premium to pensions earned by contributing than the normal number of years (currently 40, due to increase) should be followed, increasing it at least to the level of the *décote*. It is true that the impact on pension finance of any resulting increase in employment would then be quite small, but the benefit to overall public finances would still be significant.

Indexing the minimum contribution period required for a maximum pension was a good idea and should be followed through. But this should not prevent further reflection on the appropriate balance between the length of working life and retirement that is built into the indexing rule. Some further adjustment of the balance between length of retirement, level of pensions and level of contributions is still necessary for long-term balance in pension finance, and the already-decided indexation rule should not force further adjustment to be restricted to pension and contribution levels alone. It is probably the case that further increases in the relative length of working life would be a sensible part of future adjustments, given the enormous increase in the relative length of retirement enjoyed on average by current retirees compared with their parents.

The overall level of taxation in France is already comparatively high, so further cuts in average pension levels would be preferable to increases in contributions. However, should increases in contributions be favoured nonetheless, it would be better to increase them immediately, rather than to rely on being able to increase them in the future. They could be used to build up the *Fonds de réserve pour les retraites* (the retirement reserve fund) to a more substantial degree to share the burden between current and future working generations more equally. However, previous attempts to provide room for future manoeuvre by

creating special funds do not make for much optimism; they seem to have been used more to give the impression that action had been taken than to make a real difference (Box 4.2).

Whether or not some kind of advance funding is used, overall public finances need to be presented in a form that allows taxpayers and voters to see what the gap is between the current level of taxation and that needed to ensure long-term balance. There is more than one way to do this, whether it be presented in the form of implicit debt as in the Pébereau (2005) report on public debt, or in terms of a “tax gap”. Such a calculation, including a range of estimates as a function of variations in important parameters such as rates of growth and return, should form part of annual budget presentations (covering combined State, local government and social security budgets).

Box 4.2. The perversities of accounting transparency (?)

One of the consequences of the lack of a durable consensus on the state of public finances is the multiplicity of taxes and special funding arrangements. On the one hand, the recognition that the level of taxation is already high leads to a reluctance to increasing existing taxes. On the other, the idea that money can always be raised, if only a “new” untapped source of resources can be found, is pervasive. This taken together with a desire, in itself laudable, to separate accounting for certain social expenditure policies from others can have perverse results. It creates layers of funding that do little except obscure the underlying situation and probably amplify the distortions that a given level of average taxation creates. As examples, consider the *fonds de solidarité vieillesse* (FSV) and the *fonds de réserve pour les retraites* (FRR).

The FSV was created in 1993 to finance the pension rights that people can acquire without making corresponding contributions – the minimum pension, for example. It would have been feasible to finance this by increased pension contributions, all the more so since the PAYG nature of all pensions means that the link between contributions and rights is purely notional. Instead, the FSV was instituted, receiving its funds from a share in the revenues of the CSG and a tax on drinks (and, subsequently, a tax on company contributions to certain complementary insurance (*taxe prévoyance*) and a special tax on companies, the *contribution sociale de solidarité des sociétés*). These taxes are totally unrelated to the expenditure needs of the FSV so, perhaps inevitably, it has run a deficit ever since its creation, as have the pension regimes it is supposed to finance.

The FRR was created in 1999 within the FSV and separated from it in 2001. The idea is for it to play the role of the Social Security fund in the United States. It is to build up a reserve fund up to 2020, to be run down subsequently as the “operational” deficit of the pension regimes increases. To operate as a sensible form of current saving to meet future needs, it would have made sense to reduce current public consumption. Instead, a certain amount of wishful thinking led to the fund being allocated resources that have turned out to be completely inadequate – they included for example, privatisation revenues and surpluses from the current operations of the main pension schemes; the Conseil d’orientation des retraites estimates that the resources of the FRR will be only between 15 and 30% of what was planned.

Thus, while the creation of the FSV and FSR followed a certain logic, it also muddied the waters by making it look as though action had been taken when in fact the hard decisions on reducing current expenditure to meet future needs had yet to be made.

The complexity of the tax treatment of different forms of saving is unnecessary. The tax treatment of pension funds should be at least as favourable as that given to life insurance contracts, which are currently the main vehicle for saving for old age, other than through house purchase. There is no reason why tax advantages for saving should be linked to the purchase of life insurance. It would be helpful to go further and harmonise the tax treatment of all forms of saving. There are arguments for *all* saving to be deducted from taxable income, but this would probably be too radical in France. At the very least, reforms could base exemptions on a simple holding-period criterion, cutting any dependence on the nature of the assets held or the institutional organisation of the saving, which should concern only prudential regulation.

Other tax expenditures, notably that related to indemnities for compulsory retirement (recently extended to voluntary retirement as described earlier) should be abolished immediately. It is true that this may be inconvenient for certain employer-union agreements that seek to take advantage of tax loopholes, but it is better to put pressure on such agreements – thereby helping to break the current implicit consensus that older workers can costlessly withdraw from the labour market to “make room for” younger people – than to actively encourage them. Ending the dispensation for the unemployed over 57 (in some cases over 55) from actively seeking work would go in the same direction. The immediate impact may be small, but it can only undermine publicity campaigns that seek to encourage greater participation if the public employment agencies implicitly accept that once unemployed at that age there is no point in searching for work; and it would cause no real hardship to those involved.

In the case of health and dependency-care finance, the long-term implications of ageing for public finances currently appear to be modest. In the case of health care proper, they seem to be dominated by the already existing problems of coping with cost inflation

Box 4.3. **Main recommendations with respect to population ageing**

- Extend the principles of the reforms of 1993 and 2003 to all the special pension regimes, and complete alignment of the civil servant schemes on the general system.
- Maintain the indexation of the length of the contribution period on life expectancy. In addition, consider extending further the relative length of the contribution period.
- Pursue policies to align pension provision on actuarial neutrality, especially at the retirement age margin.
- Publish an estimate of the annual financing gap (in the form of the estimated increment to unfunded future liabilities, or a tax gap, with confidence limits) as a memorandum item in annual public finance reports.
- Abolish the fiscal exemptions for indemnities related to either compulsory or voluntary early retirement.
- End the dispensation of the older unemployed from the requirement to actively seek work.
- Harmonise tax treatment of savings on (at most) a simple holding-period criterion.
- Provide more information on the likely future balance of public and private provision for health and especially dependency care. Reconsider the balance between central and decentralised responsibilities.

and the implications of technical progress; this does not make the search for ways to control the burden of health care on public finances any less important, but this need is relatively independent of population ageing. As for dependency finance, current estimates may be deceptive. The Cour des comptes concludes that current projections of only a modest increase in the burden of care on public finance are conditional on an increasingly large share being paid for privately, and OECD projections corroborate this. It is not clear that the right balance has been struck between different sources of public finance, notably in defining the provisions of the scheme centrally while delegating provision and finance to the departments, with *ad hoc* arrangement for compensatory finance. The current reliance on self and family finance for most of these needs is sensible, but the fact that the burden for families in the future is likely to increase should be more widely publicised, to encourage long-term planning by families and individuals. As care needs evolve, there may be pressure to add another layer to the compulsory social security system, which could be very expensive if it sought to cover more than the minimum needs. Greater accounting transparency will be needed to plan for an appropriate balance of burden sharing.

Notes

1. This reasoning is based on the so-called “lump of labour fallacy”.
2. Conseil des Impôts (2003) puts the cost rather low, however, at some € 13 million in 2001 (Table 19, p. 131).
3. This path would be neutral when averaged over both males and females. Because of their different life expectancies, the neutral premium at any given age would be higher for males than for females, if separate calculations were permitted.
4. Some categories such as miners and merchant sailors also have their own separate schemes.
5. Some exceptional measures for agriculture persist, however. The penalty for taking a pension early (the “*décote*”) is to be reduced to 4% per year for the poorest agricultural workers, as from 2008. The normal *décote* is 6%.
6. Where the companies concerned have become quoted companies, they are now faced with accounting legislation that requires them to treat implicit pension obligations as liabilities in their accounts. This has led them to make agreements with the general pension regime to transfer a large part of their liabilities to the State, leaving them to provision only the “excess” generosity of their schemes. The transfer of this liability is accompanied by a transfer of funds (known as *soult*) that can have a significant distortionary effect on general government finance, such as the *soult* associated with the absorption of part of the EDF pension scheme by the general regime. This improved the apparent budget balance by 0.5% of GDP in 2005, although it represented no underlying improvement in the budgetary situation.
7. The Bank of France regime is an exception.
8. According to CFDT Région de Tours, the excess liabilities (*i.e.* those due to the extra generosity of the scheme compared with the general regime, the amount for which the company will have to make provisions in its 2007 accounts) of the SNCF scheme amount to about 9 billion euros in present value, or about 0.6% of GDP, compared with a present value of all gross pension payments of perhaps 100 billion euros. (Source : les Echos 9/3/07, and CFDT Région de Tours, *Dossier retraites* 22/1/07.)
9. See COR (2007). Both the SNCF and RATP have suffered aggressive strike action in defence of pension rights.
10. For example, on average, dealing with a heart attack is much more expensive for a person of working age than it is for an old person. This is because, in the nature of things, an older person is more likely to die from the heart attack itself, or during convalescence, than a younger person. And medical advances mean that younger people are increasingly likely to survive the initial attack and therefore need convalescent care.

11. There are six levels of dependency, of which only the highest four give rise to eligibility for the APA, which is also restricted to people over the age of 60.
12. I.e. the CSG (*contribution sociale généralisée*), the CRDS (*contribution pour la réduction de la dette sociale*), the 2% Social Levy (*prélèvement social*) and the 0.3% Additional Contribution (*contribution additionnelle*).
13. In which three stages of the saving cycle are distinguished – the act of saving or contributing to a scheme, the accumulation phase and the withdrawal phase. For example, EET thus means that contributions are made out of pre-tax income, that accumulation is not taxed, and that withdrawals are subject to the normal personal income tax rules. Alternatively, TEE means that contributions are made from post-tax income, but accumulation and withdrawals are not taxed. Under certain conditions, the two are equivalent and efficient since they do not discriminate between present and future consumption.

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Chapter 5

Meeting the challenges of decentralisation

Despite France's previously well-deserved reputation as a highly centralised state, a significant number of responsibilities have been devolved to regional and local government over the past two decades. The process has not been easy. The extremely large number of very small municipalities makes economies of scale in the implementation of policies hard to realise, and measures to overcome this have been at best only partially successful. Competence is often shared between levels of government, obscuring accountability, and the central government has often retained an arguably unnecessary degree of prerogatives. Reorganising the system to avoid overlapping responsibilities and improving transparency and accountability in local government finance provide some difficult challenges.

Over the past twenty-five years, France has moved forward in a decentralisation process intended to shift new powers and responsibilities to local officials and sub-national levels of government. Ultimately, this new division of powers, by bringing policymakers and citizens closer together, should make it possible to offer high-quality policies tailored to the diversity of local circumstances. But while decentralisation promises to deliver positive outcomes in policy effectiveness, there can be no guarantees, and the transition towards a State with less centralised powers is a difficult exercise. A number of problems have emerged in France that are linked to the system's complexity, the sharing of responsibilities and insufficient empowerment of sub-national governments. Since decentralisation remains in a transitional phase, it is important that solutions to these problems be found rapidly so the system can evolve towards a more effective organisation of power-sharing.

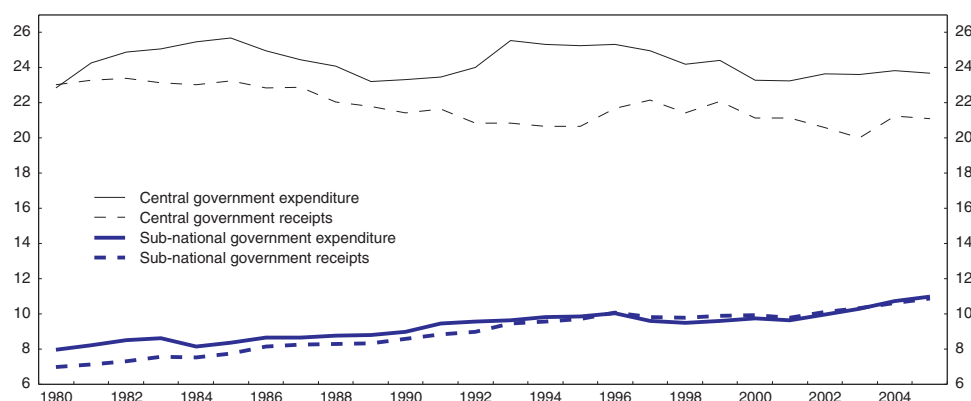
While the French budget situation has improved somewhat in recent years, since 1980 the debt burden has tripled as a proportion of GDP, whereas France, like other OECD countries, has been forced to contend with new budgetary pressures. Decentralisation is not unrelated to these trends, even if it is not the primary cause. As a result, the future sustainability of public finances hinges to some extent on the success of decentralisation, and more specifically on the balance to be struck in all of the relationships between the State and sub-national levels of government.

The growing importance of local public finances

While France remains a centralised country, the importance of local public finances has expanded continuously over the past 25 years, and today's spending by sub-national governments has reached 11% of GDP, or 20% of aggregate public expenditure (Figure 5.1). The growing importance of local government spending has not been accompanied by a deterioration of the finances of those governments (Figure 1.3). Their budgets have been practically balanced since the early 1990s, and their debt burden is low in relation to GDP and has declined over that period.


The soundness of local public finances is the result of a budget rule that compels sub-national governments to fund all of their operating expenses out of their own revenues (taxes, transfers and operating income). Only to finance capital investment may they incur debt, and this limits the widening of their deficits. Many other OECD countries also impose fiscal obligations to limit the indebtedness of sub-national governments, thus prompting them to balance their budgets. A comparison with the fiscal rules of the other OECD countries shows that the rules in France are effective in ensuring the sustainability of sub-national government indebtedness, but that they impose no constraints on the growth of the public sector as a whole (Sutherland *et al.*, 2005). This finding is consistent with comparative spending and revenue trends for the central and sub-national governments. The rise in spending by sub-national governments was only partially offset by the drop in State expenditure, and, in all, since 1980 the total of this expenditure has risen by four

Figure 5.1. **Central and sub-national governments spending and revenue trends**¹
Per cent of GDP



1. Social security expenditure and receipts are not included.

Source: OECD, National Accounts.

StatLink  <http://dx.doi.org/10.1787/054650103118>

percentage points of GDP. Aggregate taxes and social charges imposed by all levels of government rose by two points of GDP over the same period.

France, like other OECD countries, will have to cope with strains resulting from spending triggered by population ageing (see Chapter 4), and sub-national governments will not be spared by those pressures. As yet unfunded retirement benefits for employees of those governments are very substantial (Pébereau, 2005). Local and regional authorities will have to address the population's growing needs for long-term care, especially insofar as they bear responsibility for administering the "personalised autonomy" benefit (*aide personnalisée d'autonomie* – APA) for people over 60 who lose the ability to care for themselves. Demographic trends can be expected to allow unemployment to recede, which would consequently limit expenditure on the minimum subsistence income (RMI), which is financed by the *départements*. Yet, the magnitude of this effect is uncertain, insofar as it hinges on enactment of structural policies in the labour market and is probably insufficient to offset the other strains on public finances.

To deal with these pressures, the central government has adopted a cost-control strategy¹ and reforms regarding social security were undertaken, such as the pension (see Chapter 4) and the health insurance (OECD, 2005a) reforms, although substantial efforts are still needed. At the same time, the central government aims to reduce the rates of aggregate taxation and social security contributions, which are among the highest of any OECD country, and which hamper the French economy's resilience. The challenge now is to continue these reforms and encourage sub-national governments to adopt the same objectives. However, the organisation of the system of sub-national governments and the way decentralisation has been carried out so far pose a number of problems, both for the control and effectiveness of government spending and for the burden of tax and social contributions.

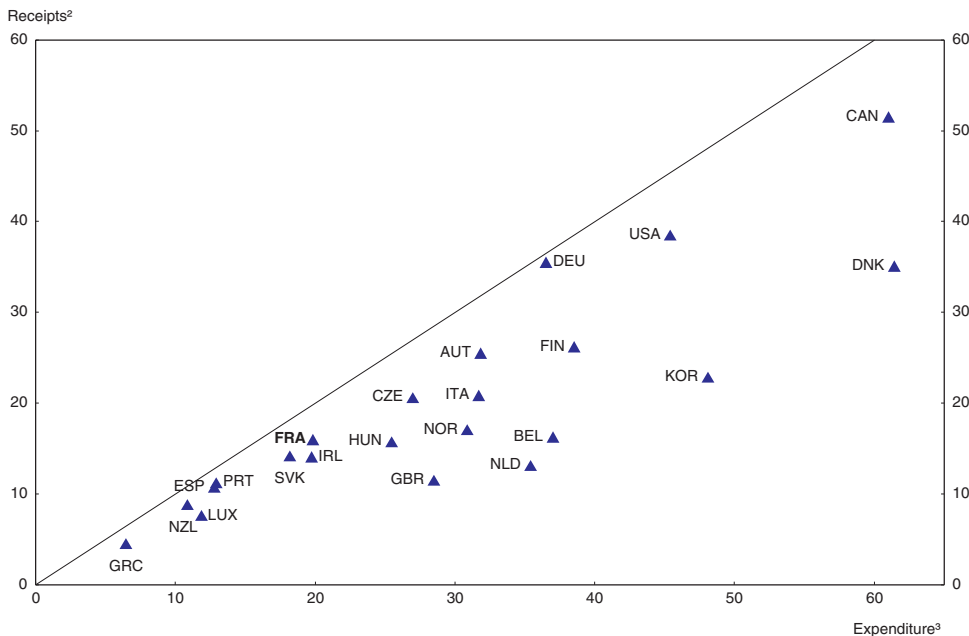
The main characteristics of the system of sub-national government

Decentralisation was carried out in two main stages. The first took place in the early 1980s and actually implemented decentralisation, including a transfer to local elected officials of the executive powers previously wielded by the prefects – the central

government's representatives at the local level. Regions became an official level of government, and the first clusters of powers, such as partial administration of secondary schools, were devolved. The second stage, begun in 2003 and still in progress, aims to deepen decentralisation. One of its objectives is to clarify the division of powers by creating the possibility of designating a given sub-national government as lead manager (*chef de file*) for a particular area of responsibility. Regions are supposed to have the lead in fields concerning economic measures for enterprises and employment, whereas departments are generally to have the lead in health and social areas. Sub-national governments were also given the right to experiment with policies in certain domains. Power transfers have continued, including the shifting of administration of the RMI and – for the first time – transfers of personnel, such as elementary-school technical staff.

Despite these two waves of decentralisation, France remains a relatively centralised country (Figure 5.2). The State has retained full responsibility in relatively few areas, such as defence, foreign policy and pensions, but in many other areas it shares powers with the lower levels, often holding on to a major role for itself. Responsibility is still almost totally central with regard to labour market and health policies, even if certain employment policy contracts, occupational training and selected health care mechanisms have been decentralised. Responsibilities for education are heavily shared, with management of elementary and secondary schools, as well as the technical staff of those schools, lying with sub-national governments but teaching staff and curriculum controlled centrally (see Chapter 3). The same holds true for the RMI and APA, with the amounts of the allowances set centrally but their administration assigned to the *départements*. However,

Figure 5.2. **Decentralisation ratios in the OECD countries**
Percentage of decentralised expenditures and receipts, 2005¹




1. 2003 for Canada and New Zealand; 2004 for Korea.

2. Including tax sharing agreements and excluding transfers received from other government levels.

3. Excluding transfers received from other government levels.

Source: Statistics Canada; US Bureau of Economic Analysis; Statistics Norway; OECD, *National Accounts*.

StatLink  <http://dx.doi.org/10.1787/054685207350>

some experimentation is taking place as regards the RMI (see below), in order to see whether measures giving more power to local authorities would be more efficient than general rules fixed by the State for the whole country.

One of the particularities of the French system is that the State is represented at each level of elected sub-national government (regions, *départements* and municipalities²). Departmental and regional prefects³ have been maintained, but their roles have evolved. They are still the representatives of the State and are responsible for implementing central government policies at the local level. They head the prefectural services, which are organised to mirror the various areas of central government policy. The State is generally present locally through the Ministries' "deconcentrated" services; for each Ministry, regional or departmental directorates implement and monitor ministerial policies. What may therefore be called "dual representation", with both deconcentrated services and services of the lower levels of government, is peculiar to France, even though there are equivalents of French prefectures in other unitary countries with histories of centralisation (OECD, 2006).

A "multi-layered" system with shared responsibilities

The French system of sub-national governments is complex and often described as multi-layered (Box 5.1). As in many OECD countries, there are three main levels written into the Constitution: regions, *départements* and municipalities, which are administered by

Box 5.1. Co-operation between municipalities

There are various types of groups of municipalities:

- Associations (*syndicats*) of municipalities, which in most cases predated communities.
- Communities of municipalities, associating municipalities in rural areas.
- Metropolitan communities (*communautés d'agglomération*), uniting municipalities to form a metropolitan area with a population of over 50 000.
- Urban communities, uniting municipalities to form an ensemble of over 500 000 people.

Associations of municipalities were set up to administer certain public services (water, sanitation, transport, electricity, etc.) At the same time, "intercommunality" groupings of municipalities began spouting up in the 1970s and started becoming more numerous in the late 1990s as a result of legislation passed in 1992 and 1999. Municipalities join forces in public intercommunal co-operation establishments (*établissements publics de coopération intercommunale* – EPCIs) to deliver certain services – either technical services, as in the case of associations of municipalities, or broader undertakings such as economic development or town planning. Intercommunality has been encouraged by higher State subsidies for municipalities that join forces, transfer powers to communities and accept the principle of a single business tax (*taxe professionnelle*) (see below).

EPCIs differ from territorial entities in a number of respects. The persons administering them are not elected directly but are delegated by municipal councils. Their powers are limited. Lastly, to create an EPCI requires central-government approval (*via* prefects).

EPCIs have their own tax revenue. This can be either additional, consisting of an extra share of local taxes, or unique, when business tax (the chief local tax) is earmarked for the community. The 1999 legislation gave municipalities belonging to the same community ten years to harmonise their business tax rates.

councils elected by direct universal suffrage.⁴ Adding to this structure are other levels, whose roles vary depending on the area involved, but which stem essentially from the desire of various governments to remedy the division or fragmentation of the municipalities (of which there are 36 500, including 15 000 with populations of under 300). Instead of the municipality-merging policies enacted in other countries, such as Denmark and Japan, France has chosen the path of co-operation. This has developed on a number of occasions and taken a variety of different forms, but in each instance specific powers have been handed over to groups of municipalities, with each holding on to other broad responsibilities. The main form of co-operation is known as *intercommunality*, which the central government began to encourage greatly in the 1990s, and which has subsequently spread massively. This involves municipalities that join forces via public intercommunal co-operation establishments (*établissements publics de coopération intercommunale* – EPCIs) to deliver certain services. In 2006, 86.5% of the population was covered by a *community*. Adding to these communities are other forms of co-operation which in some cases predated them, and which may overlap, but which have not been dismantled. There exist, for instance, many associations of municipalities (*syndicats de communes*) empowered to handle specified technical issues, but also “countries” (*pays*) in the sub-national sense, which are groups of municipalities clustered around a given economic, social or cultural activity. In all, France’s very clear territorial division into three levels of government – regions, *départements* and municipalities – is supplemented by a multitude of overlapping groupings of municipalities.

The Constitution gives sub-national governments financial autonomy with regard to revenue and expenditure. They are free to use their revenue as they please, and there is no hierarchy of authority between these territorial entities. Adding to this principle is the general authority clause for sub-national governments, which are theoretically free to govern any areas of “relevant local concern”. Accordingly, they must not infringe the powers of the central government, nor those of other entities. In practice, insofar as there are no precise definitions of each entity’s domain of authority, the distribution of powers is complex, and in many cases different levels of government get involved in the same areas (Table 5.1). To cope with the multiplicity of players and shared responsibilities, the State has developed a policy of contractual relations with the other levels of government (OECD, 2006). The policies of the various territorial entities within any given region are often co-ordinated under a “regional scheme” and lead managers have been designated in certain fields, though not systematically. Responsibilities are very often still shared.

The books of sub-national governments and EPCIs are audited by regional accounting boards and the prefects. Audits look at the legality of budgets and compliance with the budget rules governing local-government debt, but not at expenditure before the fact. The financial interests of sub-national governments are upheld and aligned with those of the State within the *Local Finance Committee*, made up of representatives of Parliament, local authorities, and the central government. This committee has decision-making power over the apportionment of the State’s main transfers to the lower levels (see below), and it must be consulted on local-government financial issues.

Local government resources

The resources of sub-national governments consist primarily of tax revenue (50% of total resources) and *grants* from the State (35%⁵). Under a constitutional principle, when a power is devolved, the central government must also transfer the resources previously

Table 5.1. **Sub-national government – Who does what?**

Levels of government	Regions	Départements	Communities	Municipalities	State interventions
Economic Development					
“Coordination”	x				
Support to business		x	x	x	x
Infrastructure					
Road maintenance		x	x	x	
Highway management and cleanliness		x			
Fishing ports	x	x	x	x	
Airports		x	x	x	
Infrastructure and transport planning	x				
Education					
Teaching					x
Child care			x	x	
Primary school buildings and equipment			x	x	
Lower secondary school buildings and equipment and technical staff		x			
Upper school buildings and equipment and technical staff	x				
Universities					x
Employment and integration					
Adult training	x				
Administration of the RMI and the RMA benefits		x			
Housing					
Construction of social housing		x	x	x	
Departmental plans to house disadvantaged people		x			
Old people’s homes			x	x	
Solidarity fund for housing		x			
Support for people in difficulty					
Coordination of support for people in extreme difficulty		x			
Fund for assisting youths in difficulty		x			
Personalised autonomy benefit		x			
Health					
Financing medical equipment	x		x	x	
Training of social and para-medical workers	x				
Other medical-social measures	x	x	x	x	
Environment					
Sewage treatment		x	x	x	
Waste			x	x	
Combating noise			x	x	
Combating air pollution			x	x	
Water			x	x	
Departmental planning		x			
Culture and tourism					
Tourist offices		x	x	x	
Historic monuments	x	x	x	x	x

Source: OECD based on the following websites: www.assemblee-nationale.fr/index.asp, www.interieur.gouv.fr, www.senat.fr/themes/td1recents.html.

spent exercising that power, either by increasing the tax revenue of the governments in question (this has generally been done by transferring a portion of State tax revenues) or through grants.

There are a great many local taxes. The primary direct local taxes, known as the “four oldies”, are: business tax, paid by companies on the value of their fixed assets, equipment and value added (see Box 5.4 below); residency tax, paid by households (and by businesses

in respect of premises for private use) on the estimated rental value of their dwelling; and separate property taxes on developed and undeveloped land, which are paid by owners on their property's rental value.

The powers of sub-national authorities over the four main local taxes encompass rates and bases. Sub-national governments and EPCIs vote to set the rates of the four direct local taxes (with each level voting to set its own rate for each tax). To avoid excessive disparities between tax rates, and so that the tax burden is shared between households and businesses, there are rules governing tax rates⁶. With respect to tax bases, sub-national governments may decide to exempt certain categories of taxpayers from property tax or business tax. They may also alter certain allowances in respect of residency tax. In all, and by international standards, sub-national government power over these taxes is high, and it is used extensively (Blöchliger and King, 2006).

Sub-national authorities also collect a number of indirect taxes. The two main ones that are partially transferred to sub-national governments are real estate transaction taxes (*droits de mutation à titre onéreux*), and the excise tax on petroleum products (*taxe intérieure sur les produits pétroliers* – TIPP). Unlike the four direct local taxes, sub-national governments have little or no power over these taxes. As a result, there is no reason for the corresponding revenue trends to mirror the expenditure that they finance. Within aggregate tax resources, the relative importance of these indirect taxes has grown because of their dynamic performance. The transaction taxes in particular, which chiefly benefit *départements*, have risen sharply with the buoyant real estate market. These accounted for 40% of aggregate revenue from the four main departmental taxes in 2005, versus only 30% in 2001.

Sub-national governments also receive packages of transfers from the State, which have evolved far more dynamically than prices. Such transfers are paid for three main reasons: to finance public services; to offset revenue losses resulting from State-ordered exemptions from local taxes; and to reduce wealth and expenditure disparities between localities (Box 5.2).

Inequalities between municipalities are substantial

Inequalities between regions, as measured by per capita GDP, are lower than the average of OECD countries (OECD, 2005b). But the percentage of the population living in the poorest regions is close to the average in OECD countries, with 49% of the population living in regions where GDP per capita is below the national average (Figure 5.3).

Wealth inequalities tend to increase as the level of territorial subdivision narrows, and they are especially great between municipalities. Inequalities between regions or between *départements* account for only a minor proportion of total resource inequalities: 78% of resource inequalities between municipalities stem from unequal resources within regions, and 60% within *départements* (Table 5.2). The main source of resource inequality is business tax (see below), and unequal expenditure is attributable in part to the geographical concentration of poverty (see Chapter 2). In all, the ratio of expenditure to revenue, which is called purchasing power, varies sharply among sub-national governments.

The State strives to narrow wealth gaps between sub-national governments by means of equalisation mechanisms. As in many other OECD countries, the equalisation policy that France has put in place seeks to diminish inequalities of both resources and expenditure, but unlike the situation in some other countries, the French system does not

Box 5.2. Financial transfers from the State to sub-national governments

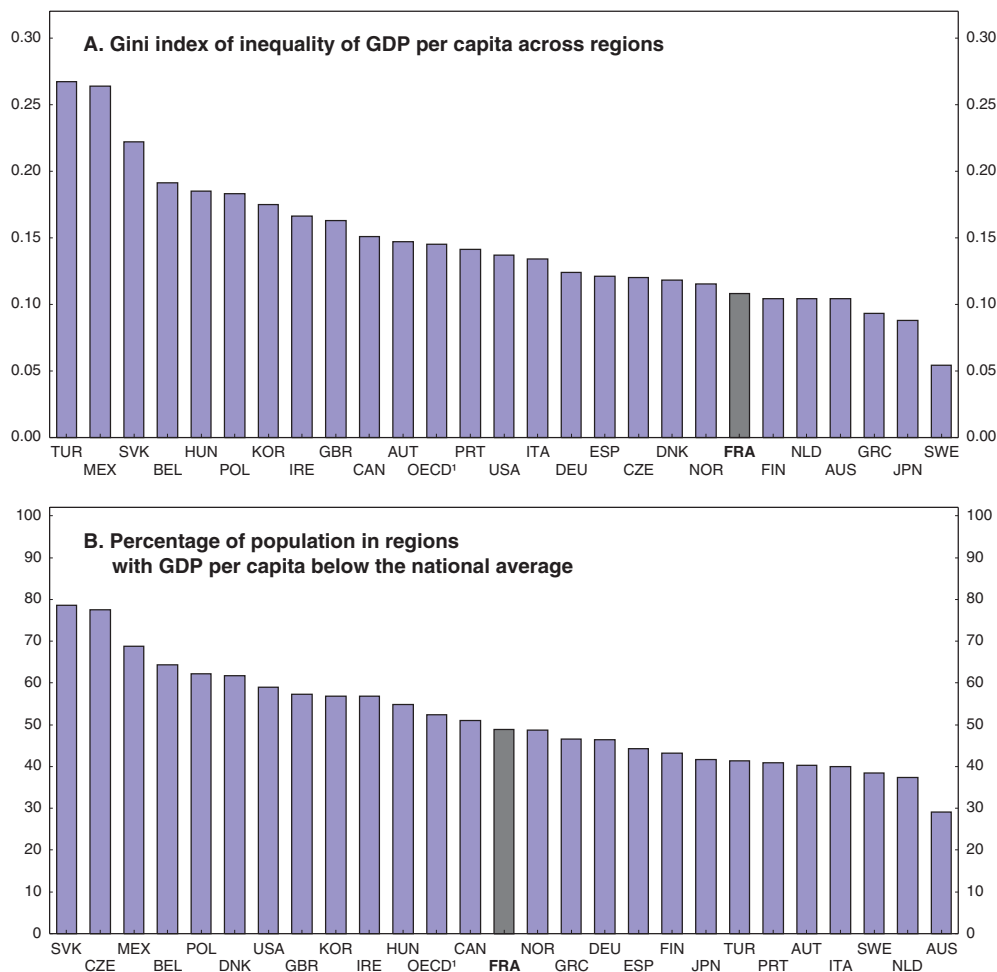
Financial transfers from the State to sub-national governments are paid for different purposes, and the grants take a variety of forms. The system is made complex by the fact that the various grants do not correspond to the different purposes. The three leading purposes are:

- To finance functions assigned to the sub-national governments. Whenever the State delegates a function, it provides the sub-national governments with the resources previously earmarked for that purpose, either through tax revenue or through grants. Thereafter, grants are adjusted according to a formula that has turned out to be more favourable than inflation.
- Tax compensation to offset exemptions. When the State decides to exempt certain taxpayers from a given local tax (or to lessen the amount of the tax), it compensates the sub-national governments for the lost revenue. There have been many such exemptions with regard to residency tax and business tax.
- Equalisation. The State uses transfers to reduce some of the difference in purchasing power (ratios of expenditures to revenue) between sub-national governments. Each year, the State decides the amount of an equalisation “envelope” to be apportioned among sub-national governments on the basis of indicators of their respective resources and expenditures.

Under the initial system, the various grants corresponded to the various purposes, but over time, as it became increasingly difficult to offset transfers of responsibilities or longstanding exemptions exactly, individual grants were consolidated into larger ones. The current system that has resulted from these changes is intermediate. It consists essentially of an overall operating grant (*dotation globale de fonctionnement* – DGF), but other grants still exist. The DGF accounts for over 60% of State funding and includes transfers in respect of all three purposes. Sub-national governments may use it as they choose. One part of the grant consists of a set amount proportional to amounts paid the previous year, which depends on population and also includes an offset for the elimination in 1999 of the wage-related portion of the business tax. The other part seeks to promote equalisation; it depends on the shortfall of the tax potential and tax revenue from households. It includes the “urban solidarity grant”, the “rural solidarity grant” and the “national equalisation grant”. The DGF is paid to municipalities, EPCIs, *départements* and regions. Since 1996, the DGF has been indexed to the sum of inflation and 50% of volume GDP growth. Apart from this grant, there are other grants that finance particular expenditures. The decentralisation grant, for example, finances transfers of responsibility not included in the DGF.

seek to eliminate inequalities altogether. The equalisation system is complex; there are a number of different transfers having equalisation as their specific objective (such as the DGF’s equalisation component). Other transfers not initially intended to promote equalisation may in fact have equalising effects. In all, 40% of the purchasing power inequalities of the municipalities were corrected in 2001, the corresponding proportions being 51% for *départements* and 54% for regions (Gilbert and Guengant, 2004). These rates for correcting inequalities vary sharply among municipalities. The resources earmarked for equalisation have increased over time. Nevertheless, they amounted to a scant 0.3% of GDP in 2006, which seems low in comparison with other countries’ outlays, even if such figures are difficult to compare (Blöchliger *et al.*, 2007). The extent of the correction of

Figure 5.3. **Per capita GDP disparities between regions**
2003



1. Average of 26 countries.

Source: OECD Regional database.

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Table 5.2. **Breakdown of the variance of municipal resources by region and département**

		Variance between	Variance within	Total Variance
Tax capacity per resident ¹	• Regions	83%	17%	100%
	• Départements	69%	31%	100%
Resources per resident ²	• Regions	78%	22%	100%
	• Départements	60%	40%	100%

Note: Total variance of municipal resources disaggregated into a variance *between* regions and *départements*, and a variance *within* regions and *départements*.

1. As determined by the four principal municipal taxes.

2. Tax capacity plus transfers from the State.

Source: OECD calculations based on detailed data on the State operating transfer provided by the French Urban Communities Association.

inequalities, while it has increased over time, would also appear relatively slight as compared with the results of other European countries, whose equalisation systems manage to reverse an average of two-thirds of inequalities.

The special case of the RMI

This organisation of sub-national governments poses a number of problems, which may be illustrated by what happened when the RMI was decentralised. When it was created in 1988, the RMI mechanism was shared between the central government, which administered the allowance, and the *départements*, which were supposed to handle back-to-work aspects, and yet no extra resources were allocated for that purpose. In actual fact, however, very little was done in the way of back-to-work measures, insofar as the *départements* lacked the incentives (and the special resources) to develop them in order to reduce the number of people on benefit, since the State paid the bulk of benefits. To remedy this problem, administration of the RMI allowance (and of the RMA – the special contract to help RMI recipients get back to work) was decentralised to the *départements* in 2003, although the central government retained the power to set the amount of the allowance.

As it does whenever it delegates responsibilities, the State pledged to hand over funding “euro for euro”, and to transfer to the *départements* the amount it had allocated for this purpose in 2003. This was done by granting the *départements* a fraction of the domestic duty on petroleum products (TIPP), which is a State-imposed levy, the rate of which *départements* have no means of adjusting. The plan was for future variances between RMI-related outlays and TIPP revenue, which were expected to remain slight, to be borne by the *départements*. But by 2004, financing problems began to emerge. The TIPP base expanded only slightly, whereas RMI outlays rose sharply because of poor labour-market conditions and a reform of unemployment benefits that shifted many jobless on to the RMI. In addition, along with decentralisation of the RMI came spending growth above and beyond the cost of the allowance itself, probably because of insufficient staff provided by the central government and the high cost of National Agency for Employment (ANPE) services invoiced to the *départements* (Mercier, 2007). In all, compensation from the State covered only 92% of RMI expenditure in 2004 and 85% in 2005. The central government decided to close that gap with an exceptional grant in 2004. For 2005 through 2007, a “departmental mobilisation fund for labour-market integration” (*fonds de mobilisation départementale pour l’insertion* – FMDI) has been set up and will be able to meet some of the shortfall between revenue and expenditure, but it will be tailored to the special needs of disadvantaged *départements* and their efforts to promote labour-market integration.

While all of the decisions that followed the initial choice to decentralise labour-market integration aspects of the RMI were taken for consistent reasons, such as to bolster *départements’* incentives to get involved in labour-market integration and enable them to finance such responsibilities, they have also led to a situation that poses a number of problems and threatens to impair policy effectiveness:

- The autonomy of *départements*: they must finance the RMI for which the amount and the beneficiaries are defined by the State. This lack of autonomy may have prompted some of them to cut spending on labour-market integration in order to finance the allowance, which they are obliged to pay, thus causing a loss of spending efficiency. Insofar as the RMI is partially financed by a State-imposed levy, taxpayers do not see their contribution to its funding and are therefore not motivated to demand results from the policy.

- Shared responsibilities: the *départements* finance the allowance and must establish the integration contract that is incumbent on all recipients of the allowance; the State sets the amount of the allowance. Moreover, the Family Allowance Fund (*Caisse d'allocations familiales* – CAF) keeps the rolls of RMI recipients up to date and disburses the allowance; the *départements* contract out integration measures to the ANPE, which is a State-run agency; and the regions handle adult training. Under this system, there is no clear head of integration policy, no specifically proclaimed objective and no evaluation of the system as a whole. It is difficult to implement a purely local labour market integration scheme. Each player may therefore pass the buck to another, which creates scant incentive for a truly effective mechanism. While the State tries to limit its participation so as to spur sub-national governments to enact more effective policies to scale back the number of recipients, as long as the central government sets the amount of the allowance and therefore influences expenditures, it is difficult for it to stop playing its current role as financier of last resort.
- Overall coherency: decentralisation of the RMI raises problems of social-policy asymmetry insofar as other social minima remain wholly State-financed (see Chapter 2). Moreover, employment policy still remains essentially a central-government prerogative, and employment plays an important role in individual integration. It would seem more effective for employment and integration policies to be administered at the same level of government.

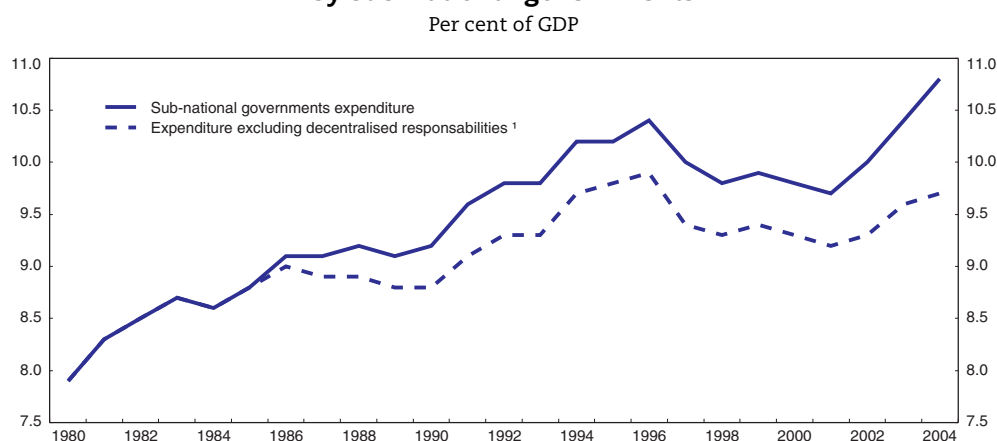
The potential solutions to these problems provide a fairly good illustration of the directions that a reform of the system as a whole would take, and of the problems that would arise. Several solutions are possible. One would be to give the *départements* more power and autonomy by having them administer all social benefits, along with major responsibilities in the realm of employment policy, as well as tax revenues to fund the expenditure, and over which they would have real decision-making powers. Partial trials of this option are being conducted in certain *départements* (under the 2007 Budget Act) that have been empowered to make use of the earned income tax credit (*prime pour l'emploi* – PPE) as they see fit, as well as integration policies to institute new incentives to help people get back to work. Yet the RMI remains, as in many other OECD countries, fixed at a national level in order to guarantee a certain amount of income for all. Responsibilities would thus still be shared. Another solution would be to restore the State's authority over the RMI and to make employment and integration policies a package under central-government control.

Limiting pressures on government spending

The experience of other OECD countries shows that it is not uncommon for decentralisation to be accompanied by an initial increase in aggregate government spending, either because of rigidities that prevent State expenditure from decreasing by as much as sub-national government expenditure increases, or on account of issues involving how the system is organised. Ultimately, however, decentralisation ought to be able to lead to greater efficiency in government spending.


Spending by sub-national governments grows mechanically with transfers of responsibilities from the State. And yet a Ministry of Finance study shows that such transfers of responsibilities account for only half of the growth in their spending, as a percentage of GDP, since 1985 (Figure 5.4). A number of factors may explain these upward pressures, which have been amply documented in recent research (Bonrepaux and Mariton, 2005; Richard, 2006).

Figure 5.4. **Impact of transfers of responsibilities on expenditure by sub-national governments**



1. Excluding expenditure linked to the transfers of responsibilities.

Source: Ministry of Finance, Direction générale du Trésor et de la Politique économique.

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Improving inter-governmental co-operation

Decentralisation can take two opposite forms: a transfer of all responsibilities connected with a given function, or delegation of the management of a service for which the State continues to make specifications and thus retains most responsibilities. Between these two extremes lies a continuum of configurations in which responsibilities are shared, but each of these should be the result of an optimal trade-off between the need to make sub-national governments accountable and a desire to deliver services of identical quality nationwide. In practice, apart from transfers of major functions, decentralisation has taken the form of numerous one-off transfers – in many cases of public services, the management of which is delegated with no real consideration for trade-offs. Nevertheless, delegation of a service for which the State continues to set specifications may well entail higher costs, because neither sub-national governments nor the State has an incentive to take the best decisions in terms of cost-benefit analysis, insofar as responsibilities are shared. More generally, for all sub-national government expenditures, the State retains an important power via the definition of public service standards in which the lower levels of government have little say (Richard, 2006). So that decentralisation may ultimately deliver a benefit in terms of efficient government spending, responsibilities between the State and the lower levels of government should be defined more clearly, and the division should be stabilised. Co-ordination between the State and the lower-level authorities should also be improved, especially by allowing those authorities a role in setting standards of relevance to them.

Successful decentralisation in the realm of expenditure depends to a great extent on proper re-allocation of resources, and human resources in particular, from the State to sub-national governments. Yet from this standpoint, decentralisation has been a failure. There has been practically no such re-allocation in 25 years of decentralisation (Box 5.3). The ranks of central-government employees have continued to increase, while sub-national government payrolls have expanded massively (Pébereau, 2005; Richard, 2006). This rise in State employees at a time when State prerogatives were declining was absorbed by a bolstering of the State's *deconcentrated services* (see above), which has made the system of

Box 5.3. Decentralisation and government employment

There are three types of “civil service” in France: State, territorial and hospital, which are heavily compartmentalised. Given the impossibility of lay-offs, adjustments in the employment volume of the first two civil services are possible through: i) decentralisation of staff, i.e. transfers from the State civil service to the territorial civil service; ii) *secondment*, whereby civil servants are sent to work for another civil service while officially remaining part of their initial unit; iii) adjustment of the number of job openings to be filled through competitive examinations; and iv) non-replacement of State civil servants who retire. Prior to 2003, there was no decentralisation of staff, so short-term adjustments were possible only through secondments. Secondments were arranged for low or moderately-skilled civil servants (Categories B and C), but they were rare for the most highly skilled (Category A), because insofar as State service is deemed the most prestigious, there is no incentive for managers to transfer, even temporarily, to the territorial civil service. Non-replacements of retiring State civil servants were very rare. In all, public employment rose sharply in the sub-national governments (by 43% in 20 years), whereas it did not begin to slow significantly at the State level until 2005.

sub-national governments more cumbersome. Nevertheless, since 2004 some transfers of State employees to sub-national government have occurred to accompany transfer of competences, and the government is trying to re-orient the State administration towards the implementation of national policies. In the future, it is essential that the State take greater advantage of the large number of retiring civil servants to trim the central-government payroll and expand staff transfers from one civil service to another, as was the case with National Education technical staff.

In addition to these rigidities concerning the volume of employment, salaries in the three branches of civil service are indexed to the same civil service “point” value that is negotiated with the trade unions by the Ministry for the Civil Service. These pay trends are not always suited to the resources of sub-national governments nor to regional prices and may therefore on occasion have put pressure on their spending. These governments should thus play a greater role in pay negotiations.

Ensuring that the system’s organisation does not hamper its effectiveness

The system as it has emerged, with multiple layers of administration, is especially conducive to generating a number of additional costs. These costs are of two types. Because of the system’s complexity, expenses can exceed the lowest cost at which a given service of given quality could be delivered. This “technical” production cost overrun stems in particular from the duplication of administrative services. Apart from the extra technical cost, the system in which the same service can be offered at more than one level, thus offering households and businesses multiple channels through which to benefit from the service, can therefore trigger a mechanism of one-upmanship between levels of government that leads to an overproduction of services. The most striking example of this is aid to businesses, where it is commonplace for a company that sets up in a commune to receive assistance from each level of government (OECD, 2006). This overproduction of local public goods and services can potentially reduce production of private goods and services and thus induce a change in consumption patterns, which would constitute an opportunity cost. Such costs, and more generally the cost-benefit analysis of

decentralisation, are difficult to measure. Some evaluation methods exist, but they have never been implemented in France (Gilbert *et al.*, 1998) while other countries, such as Spain and Italy, have tried to assess the cost of inefficiencies of the decentralisation system.

The overlapping of functions between multiple levels of government also leads to a situation in which responsibilities are not defined clearly, expenditure is not determined by the results obtained, and policy evaluation becomes more difficult as a result. The contracts that the State uses to co-ordinate the players are necessary and central to successfully implement decentralisation but, as they are currently working, they are themselves a source of administrative red tape and systemic inertia and therefore do not fully solve the problem of the lack of ultimate authority (André, 2005; OECD, 2006). To avoid such problems, the system should be geared towards greater specialisation and a more coherent allocation of responsibilities and, therefore, towards the phasing out of the general authority clause. An intermediate solution would be to define lead managers for each function that would be given responsibility for co-ordinating actions, checking that resources are allotted properly and reporting to citizens on the policies carried out. The proposal made in several reports to attribute neighbourhood services to municipalities, social welfare to *départements* and land-use planning and economic development to regions is one possible division of responsibilities. Whatever formula is chosen, it should be dictated by policy coherence, especially with regard to the battle against unemployment; thus, for example, occupational training should not be administered separately from the RMI.

Intercommunality seems to have been another source of additional costs. When it was first introduced, intercommunality led to an increase in aggregate local expenditures, which is not surprising insofar as the municipalities that joined forces received additional *intercommunal grants*. Subsequently, municipal spending should have slowed, but this has not been a sustained trend. Since 2000, the consolidated expenditure of municipalities and communities has been outpacing the long-term spending trend of municipalities alone, largely due to an expansion of the services they provide (Richard, 2006).

Municipalities have been encouraged to group together to receive the intercommunality grant, but to keep intercommunality from remaining an empty shell, and in order that there be a genuine transfer of resources and expenditures from municipalities to communities, a number of mechanisms were instituted. The intercommunality grant depends on a fiscal integration coefficient, which measures the share of fiscal resources that are directly used by communities and not redistributed to municipalities (otherwise, this would mean that expenditure has not been really transferred to communities) It is the prefect's responsibility to monitor the amounts redistributed to municipalities. In addition, transfers of functions from municipalities to communities have to comply with certain rules designed to ensure that related expenditure does not remain with the commune, which would result in additional costs (OECD, 2006).

Now that municipalities have been encouraged to group together and transfer functions to the community level, they should be encouraged to achieve economies of scale. One possibility would be to put a time limit on the intercommunality grant. If this solution does not seem feasible, the government might wish to make the intercommunality grant conditional on achieving economies of scale and to bolster controls on doing so⁷. But implementation of this might entail a certain amount of red tape and would pose problems that would be difficult to overcome, insofar as economies of scale are hard to identify and to measure. In the longer term, the State might consider

implementation a single grant, consolidated between communes and the intercommunal groupings so that the latter would share out the funds according to functions actually carried out. But this solution could weaken citizens' control over decision-making because those running the groupings are not currently directly elected, and it would run up against difficulties in deciding how to share out the funds among the communes.

The advisability of having technical functions administered by associations of municipalities rather than by communities should be explored, and if that would result in inefficiencies, then the associations should be incorporated into the communities. Other forms of co-operation should be gradually eliminated unless they are fully justified.

Developing an information system to stimulate competition and allow sub-national government spending to be evaluated

The current system's efficiency problems stem in part from the shortage of available information about sub-national governments' choices regarding expenditures, revenue and the quality of services rendered. This lack of information has several consequences. Citizens are unable to make proper judgements about either the effectiveness of the policies carried out or the choices that are made, and as a result they exert no real pressure on policy decisions. This lack of pressure does not encourage elected officials or local managers to be accountable, and so information is not developed. Neither office-holders nor citizens can compare the effectiveness of their government's expenditure as compared to others.

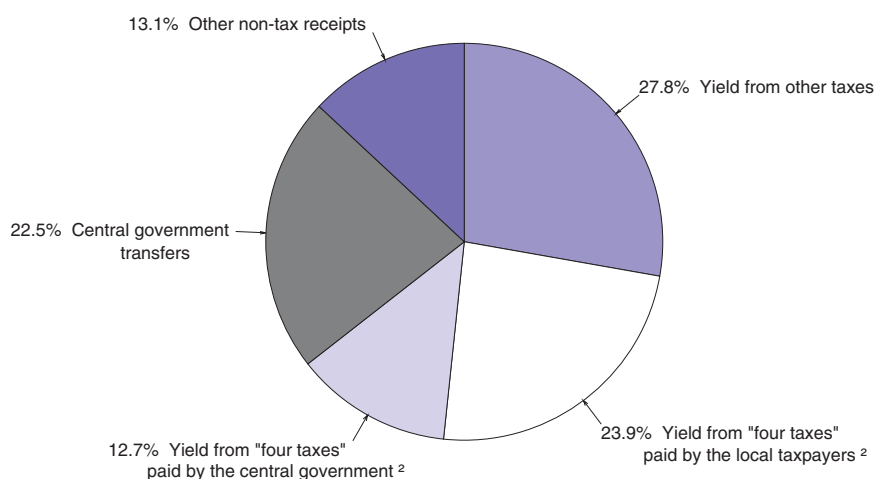
It is therefore important to develop an information system on all sub-national government expenditure and how it is financed, which citizens could access easily. The figures should be comparable between governments, and they should be consolidated, especially between municipalities and communities. The central administration is working to create an information system to collect and organise available data – no longer in response to statistical needs as is the case today, but to further the objective of facilitating comparisons between local administrations so as to give them incentives to provide the quality of services that people want in a transparent manner and at minimum cost. Here, France could learn from what has been done in other countries, such as Norway, which has developed such a very comprehensive information system.

Another objective of the information system could be to encourage sub-national governments to set spending priorities, to develop measures of the efficiency of services rendered, (thus to formulate budgets using rules similar to the framework law for national budgets), and to move towards an agreement between the State and sub-national governments on a standard for their spending trends, if this seems desirable. Some governments, especially those of significant size, have already adopted this type of model for their budgets. Such experiences ought to be developed, within the Local Finance Committee, for example, disseminating the experiences of pilot governments and helping others to implement the methods.

Making sub-national governments accountable for resources while at the same time limiting pressures on taxes

Changes in the structure of the revenue of sub-national governments have reduced their fiscal autonomy. Tax revenue as a percentage of total resources has declined continuously, whereas transfers from the State have risen, reaching nearly 35% in 2003 (Figure 5.5). Since sub-national governments are not answerable to citizens for how they

Figure 5.5. **Resources of sub-national governments**¹
Regions, *départements* and municipalities, 2003



1. Operational receipts only.

2. Professional tax, housing tax, built and non-built real estate taxes.

Source: Ministère de l'Intérieur et de l'Aménagement du Territoire; DGCL, "Les collectivités locales en chiffres, 2006".

use State transfers, the increase in the share of these transfers in their gives those governments no strong incentive to spend money most efficiently. The cost of that inefficiency is borne partially by the State (as a major contributor to local finances), and ultimately by citizens of France.

A system with little transparency that does not give sub-national governments financial autonomy

This trend stems in particular from the State's increasing control over local taxes. As explained above, the State may decide to grant reductions or full exemption from local taxes, in which case it provides compensation for the lost revenue. This option has been used extensively, especially for business tax (Box 5.4) and also for the property tax. In all, the proportion of aggregate revenue from the four main local direct taxes that is financed by the State has increased steadily, to nearly 35% in 2003⁸.

Because the State has come to bear the cost of an increasing share of sub-national government tax revenue, a distinction has been created among three notions that ought to coincide – "voted revenue", "paid revenue" and "received revenue" (Valletoux, 2006). The distinction between "voted" and "paid revenue" introduces a lack of transparency for the taxpayer and incentives for the authorities to raise rates, insofar as the increases are not borne directly by voters. The distinction between "paid" and "received revenue" has enabled sub-national governments to take in resources in excess of what taxpayers pay in local tax. Yet these resources do place an indirect burden on national taxpayers since State transfers must ultimately be financed, and thus State taxes have paid part of the bill. In the

Box 5.4. **Business tax**

This tax is payable annually by unsalaried individuals or legal entities engaged in a business. The tax is assessed in the commune in which the firm has premises or land. It is collected by municipalities and EPCIs, *départements* and regions. Business tax has three bases which are combined in a complex manner: the rental value of assets subject to property tax (fixed assets); the rental value of equipment and moveable assets; and a fraction of turnover. Historically, a fraction of salaries was also part of the base, but this was abolished so as not to discourage businesses' demand for labour (OECD, 2005a).

Business tax is made complex because of its component mechanisms:

- An equalisation contribution to reduce rate differences between sub-national governments, which is paid by establishments located in municipalities in which the tax rate is below average.
- A minimum contribution payable by all taxpayers, including those whose tax base is zero or very low, which is based on the property tax.
- A minimum contribution based on value added. Above a certain threshold of turnover (€ 7.6 billion, excluding tax), businesses must pay at least 1.5% of their value added in business tax.
- Numerous deductions from the base and many exemptions, which in many cases are decided by the State to assist certain businesses. One quarter of businesses are exempt.
- A ceiling in relation to value added, which has been changed several times. From 2007, the amount paid by a business may not exceed 3.5% of its value added (1.5% for agricultural firms). Prior to 2007, the ceiling had been between 3.5% and 4%, depending on the firm's turnover.

This capping of the amount of business tax on the basis of value added has led to a situation in which 52% of business tax revenue was based on value added in 2003. The proportion of business tax financed by the State increased from 25% in 1998 to 39% in 2003. Business tax has thus drifted very far away from the tax as it was conceived originally. At the same time, it poses a number of problems, which were explained at length by the Fouquet Commission in 2004 as part of its mission to review the tax and propose reforms. Since salaries were removed from its base, the business tax has hit hardest at capital, and thus at highly capital-intensive firms, creating inequalities between sectors. In addition, business tax has proven to be a handicap for companies exposed to international competition.

To address these problems, the Fouquet Commission was asked to propose measures to make business tax more neutral economically, but not to reduce it. The Commission proposed replacing it by two separate taxes: one based on value added, with a rate set locally between a nationwide floor and ceiling (from 1.2% to 3.2%); the other based on the rental value of the firm's property, also with a rate set locally. Such a system would have imposed less of a surtax on capital-intensive industry. Sub-national governments would have been empowered to set the tax rates within a given range. Lastly, exemptions would have been re-examined in the light of a constitutional principle of equal taxation for all.

The Government did not take up these proposals, essentially because they would have resulted in substantial shifting of the tax burden between sectors of the economy, part of which the State wanted to offset, which would have been very costly. In the end, the tax was changed as follows:

- Implementation of a true ceiling since this is now fixed as a function of each year's tax rather than as a function of the rate in 1995.
- The value added ceiling was reduced to 3.5%.
- The tax credit for new investment was made permanent.
- Sub-national governments were asked to share in financing the value added-based ceiling. The State still bears the cost of the differential between theoretical revenue using the 2005 rate* and the 3.5% value added ceiling, but local government now bears the whole burden of foregone revenue due to rate increases in excess of the 2005 rate applied to companies at the ceiling.

* Or, if either is lower, the 2004 rate or the rate of the tax year.

end, taxpayers may be under the illusion that the levy tax is not increasing, whereas the pressures are in fact shifted to central government taxes. The lack of transparency prevents them from knowing the real cost of the policies implemented within their borders and thus from judging their effectiveness. For their part, sub-national governments have only scant incentives to provide the best policies, given the taxes imposed on their residents.

In addition, the multiple exemptions awarded by the State lead to a situation in which taxpayers are not all taxed on the same basis. Because business tax is capped in relation to value added, half of all firms pay this tax on the basis of their value added alone. Likewise, because of income-related reductions, half of all households pay property tax solely as a function of their income. Households and businesses that benefit from such reductions are unaffected by small rate changes. Moreover, households with identical income and businesses with identical value added are subject to taxes having different bases, depending on their geographic location.

Alongside the State's increasing control over local taxes, the bases for residency and property taxes have become archaic insofar as registered rental values are still those of 1970. These bases were re-valued in 1990, but the new bases have never been used. A national coefficient has been applied to the 1970 base each year, with the result that in many cases bases have become both undervalued and disconnected from their current market values.

In all, revenue from the "four taxes" as a proportion of aggregate sub-national government tax revenue has decreased, from 70% in the mid-1990s to only 57% in 2003. Yet these taxes, over which local authorities wield considerable power, are the ones that provide financial autonomy. Another explanation for this trend is the fact that the latest functions to be transferred and financed by tax revenue were funded via the transfer of a portion of a State tax, such as the TIPP or the property transfer tax, rather than by prompting the sub-national governments to finance them with local taxes. While some of these taxes, such as the transfer tax, may constitute substantial resources for sub-national governments, those governments have only very limited say over the revenue they yield (essentially with respect to the base and little regarding the rates). As a result, they do not deliver the same financial autonomy as local taxes.

Lastly, some of the functions transferred have been financed by transfers from the State rather than tax resources. Equalisation grants have become more widespread, even if they remain limited (see above). For these reasons, the share of State transfers in the aggregate resources of sub-national governments has also increased.

The financial autonomy of the sub-national governments can be measured through the ratio of own resources to total resources. Own resources include the revenue from taxes for which sub-national governments are empowered by law to set the base or the rate, and other non-tax local resources over which they wield control. The financial autonomy ratio has dropped in recent years, to 61% in 2003 for municipalities and EPCIs, 63% for *départements* and 41% for regions. This ratio does not incorporate the loss of local autonomy triggered by the increase in State tax revenue for sub-national governments, to the detriment of local taxes.

Towards ensuring effectiveness through accountability

Sub-national governments need the financial resources to perform the functions that are devolved to them and to meet the obligations arising from decisions taken by the State. They ought to be able to fund the services and policies for which they bear major

responsibility through local taxes, since this is the type of funding that enhances accountability and encourages them to report to their citizens (Blöchliger and King, 2006). But this principle runs counter to the State's increasing control over local taxation and the dysfunctions of local taxes. The aim of this chapter is not to propose comprehensive reform of local taxation, because that would require consideration of all of the levies imposed on businesses and households (see OECD, 2005a for proposals on this issue). Nevertheless, certain principles towards which local taxation should strive will be stated.

As long as problems related to intercommunality remain unsolved, the broad outline of the areas in which sub-national governments exercise responsibility has not been stabilised, and expenditure by those governments is not subject to binding budget rules, the danger is that creation of a new tax would lead to greater pressures on spending and the overall tax burden. Efforts should therefore focus on reforming sub-national government resources as they exist today.

Because of the resultant impairment of the accountability of sub-national governments for their use of resources, the State should reduce its role in funding local taxes. Broadly speaking, there are a great many tax exemptions in France, but they are not always justified (Conseil des impôts, 2003; OECD, 2005a). In the particular case of exemptions from local taxes, the State should give more consideration to how its decisions affect the resultant incentive structure for sub-national governments, rather than looking at the problem solely from the standpoint of compensating lost revenue. Exemptions decided by the State should relate exclusively to taxes levied by the State.

The bases for local taxes should be clarified, both to avoid problems of inequalities among taxpayers and to enable sub-national governments fully to assess the impact on taxpayers of any rate changes they decide to make. A solution should be found for situations in which a second tax base has in fact come into existence, in particular for property tax and business tax. Two solutions are possible: to abolish existing reductions and revise the initial local bases (i.e. rental value for property tax and fixed asset value for business tax), or to shift these taxes towards their new *de facto* bases – income for property tax and value added for business tax. While these bases are more mobile than the initial ones and thus theoretically less relevant for local taxes, their values are simpler to ascertain. In connection with comprehensive reform of taxation, other options could be considered.

As with all State expenditures, clear objectives should be set for financial transfers from the State to sub-national governments, and their results should be evaluated. The two main objectives ought to be financing of public services and equalisation. Public services over which the State retains primary responsibility could be funded by grants, but with mechanisms to encourage sub-national authorities to administer the services efficiently. Regarding equalisation, the current system is particularly complex and thus difficult to evaluate, whereas a tax such as business tax gives rise to substantial inequalities in resources from one locality to another. In particular, State transfers to offset the multiple exemptions benefit the areas where the taxpayers concerned reside, especially if these are high-tax jurisdictions. This would likely have an impact on wealth inequality, though no evaluations have been made.

In connection with objectives to keep public spending in check, State grants to sub-national governments should be made subject to a more stringent standard of evaluation. Commitments to this effect need to be pursued.

Conclusion and summary of recommendations

France has undertaken a process of decentralisation that has brought policies closer to citizens, but that has not fully achieved the expected gains in efficiency because of the system's complexity and inertia, as well as the low level of accountability of sub-national governments. Recommendations to meet the challenges of decentralisation and ensure that it is consistent with control over public spending and overall taxation are summarised in Box 5.5. Nevertheless, implementation of these reforms is made difficult *inter alia* by multiple office-holdings – a particularity of France in which politicians tend to combine local offices with seats in Parliament. A number of reports have shown this practice to be an obstacle to proper implementation of decentralisation, especially insofar as it leads to conflicts of interest, *e.g.* with regard to equalisation issues (Roman, 1998). Multiple office-holding has already declined somewhat, and solutions for institutional renewal, which transcend the scope of this chapter, have been proposed. Nevertheless, this element of the problem ought to be considered if decentralisation is to be completely successful.

Box 5.5. Summary of recommendations to meet the challenges of decentralisation

Keep pressures on public spending under control

Clarify, and gradually stabilise, the sharing of responsibilities between the State and sub-national governments. Avoid transferring administration of a function without transferring all of the related responsibilities. Give sub-national governments a greater say in decisions that concern them, and especially decisions that specify standards of public service. Ensure that the system for setting national civil-service pay does not trigger inappropriate trends for the employees of sub-national governments.

Impose strong limits on upward pressures on public employment by not replacing a portion of retiring State employees, and by continuing the process of staff decentralisation. Assess the role of deconcentrated State services and scale them back when justified, especially if there are duplications of effort with the services of sub-national governments.

Limit overlapping functions between sub-national governments by gearing the system towards greater specialisation and a more coherent allocation of responsibilities. Enact the proposal to rescind the general authority clause for regions and *départements*. If this proposal is not implemented, try out the notion of “lead manager” when more than one sub-national government intervenes in a given area.

Ensure that intercommunality leads to economies of scale and efficiency gains by doing away with the associated grant. Evaluate the relevance of associations of municipalities and other co-operation structures redundant with intercommunality, and gradually eliminate them when they are a source of inefficiencies.

Make sub-national governments accountable while limiting upward pressures on overall taxation

Establish a correspondence between types of responsibilities of sub-national governments and types of financing such that all parties involved are more motivated to achieve efficiencies. Ensure that sub-national governments can use local tax revenues to finance functions over which they have full responsibility. Use grants to finance services over which the State retains substantial decision-making powers, while at the same time instituting mechanisms to promote management efficiency. Transfers of State tax would be one way to finance such expenditure.

Box 5.5. Summary of recommendations to meet the challenges of decentralisation (cont.)

Limit and gradually eliminate local tax reductions accorded by the State. When tax relief is contemplated, consider its impact from the standpoint of incentives to sub-national governments and not just compensation for lost revenue.

Set clear objectives for State transfers to sub-national governments and evaluate the results thereof. Implement plans to limit the progression of such transfers. Make equalisation a more central objective of the transfers. Fully evaluate the results of equalisation and review the system if they are not satisfactory. Consider simplifying the system.

Review local taxes to rectify the drift away from their original bases, preferably as part of a general review of principles and practices for all of the levies imposed on households and businesses.

Develop an information system so as to spur competition and ease evaluation of local government expenditure efficiency

Develop an easily accessible information network on spending by sub-national governments, focusing on how that spending is financed and the quality of services rendered. Introduce a system of comparable data on the accounts of sub-national governments and the consolidated accounts of municipalities and communities.

Encourage sub-national governments to emulate the principles of the framework law for national budgets to approach their spending in terms of missions with attached objectives and performance indicators. Develop *ex ante* control over expenditure. Try to reach agreement between the State and sub-national governments on a standard for spending trends.

Notes

1. Implementation of the framework law for national budgets (*loi organique relative aux lois de finances – LOLF*), whose purpose is to assign a mission and a performance indicator to each expenditure, the launch of a great many audits and procurement policy reforms.
2. In a *commune*, the mayor is both the representative of the State and the (elected) head of the municipality.
3. The regional prefect is the prefect of the *département* in which the regional capital is located.
4. There are 36 500 municipalities, 100 *départements* and 26 regions. Municipalities are the oldest and smallest administrative subdivision. The *départements* were created at the time of the French Revolution and the regions have been instituted in the wake of the first wave of decentralisation, in 1986.
5. When tax compensation from the State to offset exemptions are included.
6. First, the rates of the four taxes can not be higher than the previous year's average rates. Second, a rule requires co-ordination between changes in the rates of the four taxes, although many exceptions to this rule have been introduced.
7. As suggested by the Richard report (2006).
8. It is impossible to know the percentage for subsequent years, insofar as this compensation has been incorporated into the DGF.

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Glossary

AAH	Allocation aux adultes handicapés	Adult disability allowance
ACO	Allocation complémentaire	A supplementary social benefit
ACSD	Allocation conventionnelle de solidarité démission	A redundancy benefit
AME	Aide médicale de l'État	State Medical Aid
ANGSEC	Agence nationale pour la cohésion sociale et l'égalité des chances	National Agency for Social Cohesion, Equal Opportunity and Voluntary Service
ANPE	Agence nationale pour l'emploi	National Employment Agency
APA	Allocation personnalisée d'autonomie	Personal Autonomy Allowance
API	Allocation de parenté isolée	Single parent allowance
ARPE	Allocation de remplacement pour l'emploi	A supplementary social benefit
ASS	Allocation de solidarité spécifique	Specific solidarity allowance
ASFNE	Allocation spéciale du fonds national de l'emploi	A special benefit from the national employment fund
ASSEDIC	Association pour l'emploi dans l'industrie et le commerce	Association for Employment in Industry and Commerce: Organization managing unemployment contributions and payments
BEP	Brevet d'études professionnelles	Certificate of technical education
BTS	Brevet de technicien supérieur	Vocational Training Certificate
CAE	Conseil d'analyse économique	Council for Economic Analysis
CAF	Caisse d'allocations familiales	Social Security Office
CAP	Certificat d'aptitude professionnelle	Vocational training qualification
CAATA	Cessation anticipée d'activité des travailleurs de l'amiante	Early retirement scheme for asbestos workers
CATS	Cessation anticipée d'activité de certains travailleurs salariés	Early retirement scheme for certain workers
CDD	Contrat à durée déterminée	Fixed-term employment contract
CDI	Contrat à durée indéterminée	Permanent employment contract
CERC	Conseil de l'emploi, des revenus et de la cohésion sociale	Council for Employment, Income and Social Cohesion
CEREQ	Centre d'études et de recherches sur les qualifications	Centre for Study and Research on Occupational Skills

CFA	Congés de fin d'activité	End of employment leave
CFDT	Confédération française démocratique du travail	French Democratic Confederation of Labour –French trade union
CHRS	Centres d'hébergement et de réinsertion sociale	Social Reinsertion Accommodation Centres
CMU	Couverture maladie universelle	Universal Health Coverage
CMUC	Couverture maladie universelle complémentaire	Complementary sickness cover – free complementary health insurance for low-income groups
CNE	Contrat nouvelle embauche	New Employment Contract
CNSA	Caisse nationale de solidarité pour l'autonomie	National Solidarity Fund for Independence
COE	Conseil d'orientation pour l'emploi	Employment Policy Council
COR	Conseil d'orientation des retraites	Pensions Advisory Council
CRDS	Contribution pour la réduction de la dette sociale	Social Debt Repayment Contribution
CSG	Contribution sociale généralisée	General Social Contribution
DARES	Direction de l'animation et de la recherche des études et des statistiques	Research Surveys and Statistics Directorate
DEA	Diplôme d'études approfondies	Post-master Advanced Studies Postgraduate certificate (prior to doctoral thesis)
DESS	Diplôme d'études supérieures spécialisées	Post-master in Advanced Specialised Studies Postgraduate degree taken after Master's
DEUG	Diplôme d'études universitaires générales	General University Diploma University diploma taken after two years' study
DGF	Dotation globale de fonctionnement	Global operating grant
DUT	Diplôme universitaire de technologie	University Diploma in Technology Two-year diploma from a university institute of technology
EDF	Électricité de France	French Electricity Company
EPCI	Établissements publics de coopération intercommunale	Public Institutions for Inter-communal Co-operation
EPL	Legislation pour la protection de l'emploi	Employment protection legislation
FMDI	Fonds de mobilisation départementale pour l'insertion	Departmental fund for employment
FNAL	Fonds national d'aide au logement	National Housing Aid Fund
FRR	Fonds de réserve pour les retraites	Pension Reserve Fund
FSV	Fonds de solidarité vieillesse	Old Age Solidarity Funds
GDF	Gaz de France	French Gas Company

HALDE	Haute autorité de lutte contre les discriminations et pour l'égalité	Equity and Anti-Discrimination Authority
HEI	Établissement d'études supérieures	Higher Education Institution
INSEE	Institut national de la statistique et des études économiques	National Institute for Statistics and Economic Studies
IUT	Institut universitaire de technologie	University Institute of Technology
LMD	Licence, master, doctorat	Bachelor, master, doctorate
LOLF	Loi organique relative aux lois de finances	Constitutional Bylaw on Budget Acts
ONPES	Observatoire national de la pauvreté et de l'exclusion sociale	National Observatory of Poverty and Social Exclusion
ONZUS	Observatoire national des zones urbaines	National Observatory of Sensitive Urban Zones
PARE	Plan d'aide au retour à l'emploi	Return to Employment Aid Plan
PERCO	Plan d'épargne pour la retraite collectif	Collective Pension Savings Plan
PERP	Plan d'épargne retraite populaire	Popular Retirement Savings Plan
PISA	Programme international pour le suivi des acquis des élèves	Programme for International Student Assessment
PPE	Prime pour l'emploi	Employment Allowance – earned-income tax credit
PRP	Préretraite progressive	Progressive early retirement
RATP	Régie autonome des transports parisiens	Paris public transport system / Paris public transportation authority
REP	Réseau d'éducation prioritaire	Priority Education Network
RMA	Revenu minimum d'activité	Minimum employment income
RMI	Revenu minimum d'insertion	Social/occupational integration minimum income – minimum benefit paid to those with no other source of income
SAMU	Service d'aide médicale urgente	Mobile accident unit Emergency medical service
SMIC	Salaire minimum interprofessionnel de croissance	Guaranteed minimum wage
SNCF	Société nationale des chemins de fer	French national railway company
STS	Section de technicien supérieur	Advanced vocational course
TGAP	Taxe générale sur les activités polluantes	General Tax on Polluting Activities
TIPP	Taxe intérieure sur les produits pétroliers	Tax on Petroleum Products
ZEP	Zone d'éducation prioritaire	Education Priority Zone
ZUS	Zone urbaine sensible	Sensitive Urban Area

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