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BETTER POLICIES FOR BETTER LIVES

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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.

The economic situation and policies of France were reviewed by the Committee on 31 January 2013. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 4 March 2013.

The Secretariat's draft report was prepared for the Committee by Hervé Boulhol and Balázs Égert under the supervision of Peter Jarrett. Research assistance was provided by Patrizio Sicari.

The previous Survey of France was issued in March 2011.

BASIC STATISTICS OF FRANCE, 2011

(The numbers in parentheses refer to the simple OECD average)

LAND, PEOPLE AND ELECTORAL CYCLE

Population (millions):	63.1		Population density per km^2	114.9	(34.3)
Under 15 (%)	18.4	(18.4)	Life expectancy (years, 2010):	81.4	(79.7)
Over 65 (%)	17.3	(14.9)	Males	78.0	(76.9)
Foreign-born (%, 2010)	11.4		Females	84.7	(82.5)
Latest 5-year average growth (%)	0.5	(0.5)	Last general election	June	2012

ECONOMY

GDP, current prices (billion USD)	2 776.5		Value added shares (%):		
GDP, current prices (billion, local currency)	1 995.4		Primary	1.8	(1.6)
Latest 5-year average real growth (%)	0.4	(0.8)	Industry including construction	18.7	(27.8)
GDP per capita, PPP (thousand USD)	36.3	(35.4)	Services	79.5	(69.5)

GENERAL GOVERNMENT

Expenditure (% of GDP)	56.1	(45.0)	Gross financial debt (% of GDP)	100.0	(90.2)
Revenue (% of GDP)	50.9	(38.1)	Net financial debt (% of GDP)	63.0	(51.4)

EXTERNAL ACCOUNTS

Exchange rate (EUR per USD)	0.719		Main exports (% of total merchandise exports):	
PPP exchange rate (USA = 1)	0.872		Machinery and transport equipment	37.6
Exports of goods and services (% of GDP)	26.9	(52.7)	Chemicals and related products, n.e.s.	17.1
Imports of goods and services (% of GDP)	29.7	(49.7)	Manufactured goods	12.0
Current account balance (% of GDP)	-2.0	(-0.7)	Main imports (% of total merchandise imports):	
Net international investment position	-10.6		Machinery and transport equipment	32.8
(% of GDP. 2010)			Mineral fuels, lubricants and related materials	16.4
			Chemicals and related products, n.e.s.	13.8

LABOUR MARKET, SKILLS AND INNOVATION

Employment rate (%) for 15-64 year olds:	63.9	(64.9)	Unemployment rate (%):	9.2	(7.9)
Males	68.2	(73.0)	Youth (%)	22.1	(16.2)
Females	59.7	(56.8)	Long-term unemployment (%)	3.8	(2.6)
Average worked hours per year	1 476.0	(1 776.0)	Tertiary educational attainment 25-64 year olds		
Gross domestic expenditure on R&D (% of GDP)	2.3	(2.4)	(%, 2010)	29.0	(30.7)

ENVIRONMENT

Total primary energy supply per capita (toe):	4.0	(4.9)	CO_2 emissions from fuel contribution	5.7	(10.2)
Share of renewables (%)	7.3	(8.2)	per capita (tonnes, 2010)		
Fine particulate matter concentration			Water abstractions per capita (1000 m^3, 2009)	0.5	
(urban, PM10.ug/m^3, 2008)	12.9	(22.0)	Municipal waste per capita (tonnes, 2010)	0.5	

SOCIETY

Income inequality (Gini coefficient, late 2000s)	0.293	(0.314)	Education outcomes (PISA score, 2009)		
Relative poverty rate (%)	13.5	(17.7)	Reading	496	(493)
Public and private spending (% of GDP):			Mathematics	497	(496)
Health care (2010)	11.6	(9.7)	Science	498	(501)
Pensions (2009)	13.9	(8.2)	Share of women in parliament (%, July 2010)	25.1	(25.3)
Education (excluding tertiary, 2009)	4.0	(4.0)	Net official development assistance (% of GNI)	0.5	(0.4)

Better Life Index: *www.oecdbetterlifeindex.org*

Note: As latest available data are used to calculate the OECD average, the year is chosen when data are available for at least 75% of the member countries.

Source: OECDSTAT (*http://stats.oecd.org*), *OECD Economic Outlook Database*.

Executive summary

Main findings

The French economy has been hit hard by the global recession and, more recently, by turmoil in the euro area. The crisis has been well managed, but unemployment has been rising sharply. As confidence recovers, activity should pick up gradually in the coming two years and the unemployment rate stabilise in late 2013. Yet, France faces serious long-term challenges. While the degree of inequality remains moderate, growth of per capita GDP has been among the lowest in the OECD in the last 20+ years, and firms' poor competitiveness has risen to the top of the policy agenda.

The political timetable offers a unique opportunity to implement an ambitious strategy of reforms to make government less costly and more effective and to raise seniors' employment and improve the prospects of the young, who have been deeply affected by the economic malaise. Recent adoption of the Employment Competitiveness Tax Credit and the labour market agreement between social partners send encouraging signals. The functioning of the labour market needs to be further improved. The goal is to continue to reduce the duality of contracts and offer companies more flexibility to distribute the costs of adjustment to shocks more equitably. More effective employment services and training must also be provided. Greater competition in services and rationalisation of housing policies are crucial reforms to boost purchasing power, create jobs and enhance competitiveness.

Fiscal consolidation remains a priority. Recent governments have shown laudable determination to restore public finances to good health following decades of rising public indebtedness. Deficit reduction efforts must continue as planned while letting automatic stabilisers operate fully. Public spending is very high as a percentage of GDP and needs to be reduced over time to ease the tax burden in the medium term. The planned spending review should be used to identify measures with little benefit. The complex system of sub-central government should be simplified and its financing restructured. The promised 2013 public debate on pensions is an opportunity to promote further reforms. Health-care costs can be lowered without harming quality. Eliminating inefficient tax expenditures and increasing environmental, property and inheritance taxes would allow taxes on labour and businesses to be reduced further.

Tax and transfer changes can raise efficiency without sacrificing equity. France is one of the few OECD countries in which income inequality has not increased over the past quarter century. But the size, complexity and instability of the tax and transfer system weigh on the economy, calling for thorough going simplification. Savings are taxed very differently depending on asset classes, and, more generally, tax bases, including for VAT, are narrow. Reforms to unemployment benefits would save costs and promote employment.

Improving the situation of young people calls for wide-ranging reforms. Replacing the many income-support programmes with an extension of the minimum income scheme to young adults would allow the intensity of poverty to be reduced, but this change must be coupled with an effective requirement to train, search for and accept work. The high minimum wage tends to exclude the least educated youths from jobs, while both public employment services and guidance-related functions need to be better coordinated. The transition from school to work is indicative not only of weaknesses in the labour market, but also of an unsatisfactory education system and a poor distribution of resources that generates dropouts, and a still too fragmented and tightly controlled tertiary system.

Key recommendations

Bolster the economy's potential growth rate and restore firms' competitiveness

- Reduce public spending to rein in the budget deficit and then ease taxes on labour and business income.
- Broaden the definition of economic dismissal; simplify lay-off procedures and streamline legal procedures; ease employer redeployment obligations; ensure that employers' social security contributions are higher on temporary contracts than on permanent contracts; lengthen the probationary periods on permanent contracts; and enhance the effectiveness of occupational training and job-search assistance programmes.
- Boost product market competition, e.g. by easing the regulations limiting access to numerous professions.

Consolidate the public finances by reducing spending

- Systematically review the efficiency of existing and proposed spending items, including government subsidies to businesses, and gradually phase out or reject those found to be ineffective, badly targeted or distortionary.
- Merge smaller municipalities and abolish the *départements*. Transform earmarked tax revenues into budgetary transfers.
- Rapidly adjust the parameters of the pension system to limit spending in the short and medium terms. Phase out special pension regimes. Modify the survivors' pension system by offering the possibility of opting for survivors' pensions, where the cost would be incorporated into the pension amount or contributions.
- Rationalise hospital care, in particular by relying more extensively on outpatient care. Decrease drug costs by reimbursing only the price of generics, and continue focusing more on products whose therapeutic benefits are well established.

Improve the efficiency and the equity of the tax and transfer system

- Reduce the complexity and enhance the stability of the tax and transfer system. Broaden tax bases.
- Enhance the neutrality of capital taxation across and within asset classes, in particular by ending preferential tax treatment of certain investment income. Streamline the taxation of dividends.
- Implement a universal points-based or notional accounts pension system.
- Simplify substantially all social benefits. Merge the *RSA-activité* and the earned-income tax credit (PPE).
- Eliminate the specific provisions contained in the unemployment regimes applicable to older workers. Phase out gradually long-term unemployment benefits (ASS, AER) and replace them with the RSA. Introduce a staggered reduction in unemployment benefits during a spell of unemployment. Strengthen the link between benefits, job-seeking and participation in more effective activation measures.

Improve the economic situation of young people

- Extend entitlement to the RSA to young adults who have completed their studies according to an age-dependent progressive scale, strictly conditional on implementing an effective activation strategy based on training or active job-search. Index the minimum wage to age according to the same progressive rate as for this extended RSA.

- Streamline the schemes for helping young people to find jobs, centralise responsibility for "local missions" at the regional level, and consolidate guidance-related functions at the regional level.
- Shift some secondary education funding to primary schools and to admitting children in disadvantaged areas from age two. Expand the autonomy of primary schools and their principals.
- Devote the additional government expenditure recently allocated for education to making "priority education" (favouring the disadvantaged) a genuine priority. Improve the quality of teaching staff and of management teams in schools in disadvantaged neighbourhoods.
- Shift public resources from the elite tertiary institutions (*grandes écoles*) to universities. Give universities more autonomy in management, student selection and setting tuition fees. Provide student loans with income-contingent repayment and adjust means-tested grants to ensure equitable access.

Assessment and recommendations

The French and euro area economies are highly interconnected. Even though France weathered the crisis relatively well, it is not immune to the profound difficulties afflicting the euro area. Under pressure from financial markets, the authorities have gained credibility in their handling of the budget deficit, and fiscal discipline is being rewarded by the low cost of debt financing. While embarking on fiscal consolidation was inevitable given the level and uptrend of debt, its short-term impact has been to undermine economic growth and exacerbate social problems.

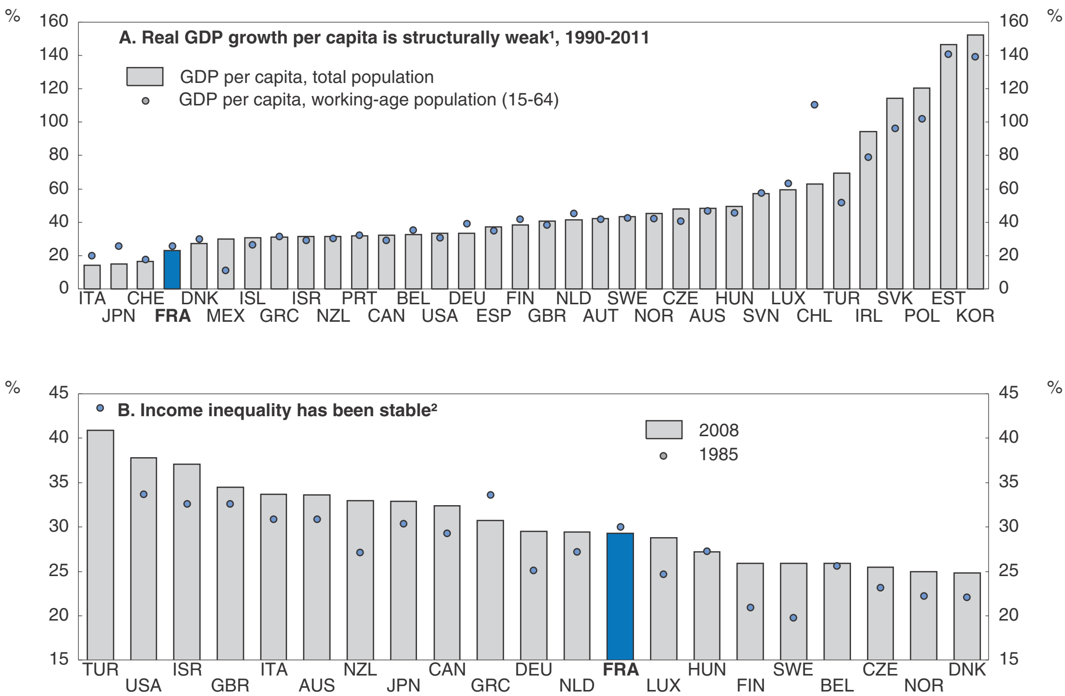
Despite many assets (private debt levels relatively low compared to other OECD Members, rather prudent lending practices, high household saving rates, a dynamic demography), the economy remains characterised by significant imbalances in public finances and external trade, along with high unemployment. Its structural weaknesses are pervasive, extending well beyond problems encountered in industry: France is among OECD countries that have recorded the weakest growth in real GDP per capita over the past 20+ years, even though it is also one of the few where income inequalities have not increased (Figure 1). The improvement of the economic outlook will depend closely on the reduction in inefficient public spending and the implementation of crucial reforms aimed at reducing structural unemployment and restoring firms' competitiveness. The government's recent adoption of the "National Pact for Growth, Competitiveness and Employment" and the labour market agreement between social partners send encouraging signals. The authorities notably plan to reform the pension system, unemployment benefits, vocational training and education. The political calendar now offers a unique opportunity to follow a bold strategy of reforms.

In the short term growth is set to remain weak and unemployment to rise further

Weakened by persistent difficulties in the euro area and fiscal tightening, economic activity has been stagnating since the end of 2011. Real GDP at the end of 2012 was just below its 2007 level (implying a 3% per capita decline), placing France near the OECD average (Figure 2). Unemployment is again rising steadily, and, while youths were particularly affected in 2008-09, it now affects all age groups similarly (Figure 3, Panel B).

According to the government's multi-year programme, based on optimistic growth assumptions of 0.8% in 2013 and 2% in 2014, the government deficit would decline to 3% of GDP in 2013 and 2.2% in 2014. The structural deficit, as estimated by the OECD, would be close to zero at the end of 2014. The implied cumulative reduction in the structural deficit of 2.6 percentage points of GDP, built into the projections below (Table 1), is ambitious given current headwinds.

Figure 1. **Weak trend per capita GDP growth but stable income inequality in France**



1. At 2005 PPPs.
2. Gini index, after taxes and transfers.

Source: OECD, *Economic Outlook 92 Database* and *OECD Database on Household Income Distribution and Poverty*.

How to read this figure: Panel A – In France, for example, the ratio of real GDP to the total population rose by 23.1% between 1990 and 2011 and by 25.8% for the working-age population (15-64 years). Panel B – The Gini index is calculated here on the basis of household income after tax and transfers per consumption unit. This is an inequality indicator varying from 0% when everyone has the same income to 100% when a single household captures all income.

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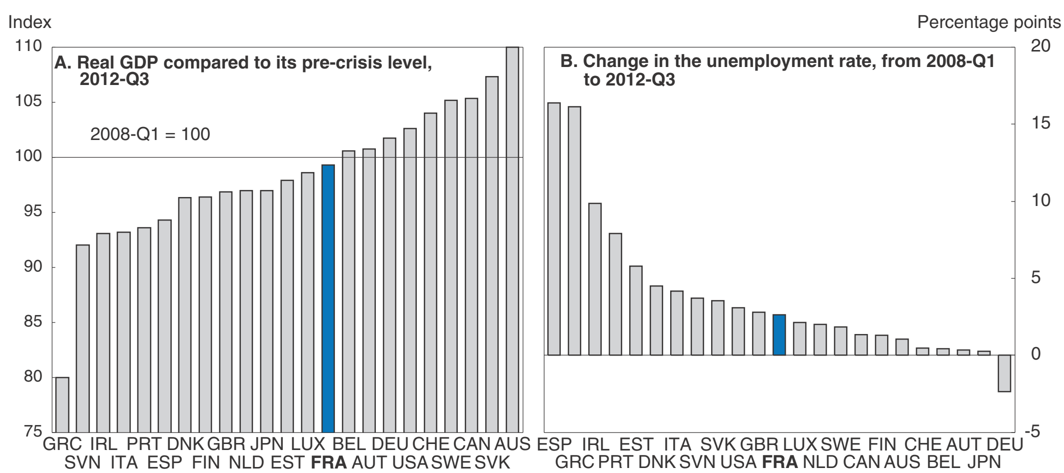
Figure 2. **France is in an intermediate situation in terms of the impact of the crisis**



Source: OECD, *Economic Outlook 92 Database*.

How to read this figure: Panel A – The difference between the index value and the reference value (100) measures the percentage change in real GDP between 2008-Q1 and 2012-Q3.

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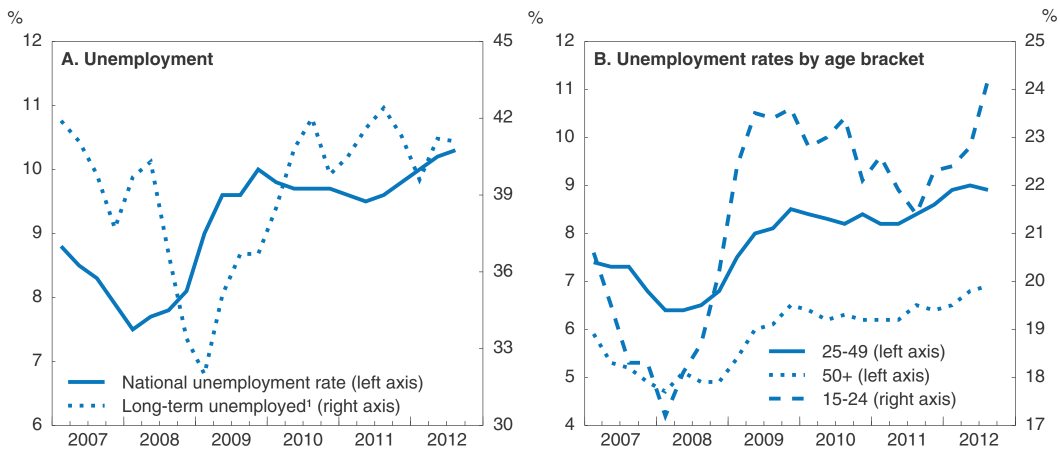
Figure 3. **Unemployment is rising**



1. Long-term unemployment (at least 12 months) as a percentage of total unemployment.
Source: OECD, *Economic Outlook 92 Database*; INSEE.

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Table 1. **Recent macroeconomic developments and projections**

	2009	2010	2011	2012	2013	2014
	Current prices in billions of euros	Percentage change in volume				
GDP	1 886.1	1.6	1.7	-0.0	0.1	1.3
Private consumption	1 095.7	1.5	0.3	0.0	0.5	0.7
Government consumption	467.3	1.7	0.2	1.4	1.2	0.8
Gross fixed capital formation	367.6	1.0	3.5	0.0	--1.1	2.9
Public sector	64.4	-8.2	-1.8	0.2	-1.0	0.3
Private sector, residential	104.1	-0.2	3.1	0.7	-1.6	0.9
Private sector, non-residential	199.2	4.6	5.3	-0.4	-0.9	4.5
Variation in inventory[1]	-10.7	0.0	0.8	-1.1	-0.4	0.0
Total domestic demand	1 920.4	1.5	1.7	-0.7	-0.1	1.2
Exports of goods and services	441.0	9.2	5.5	2.3	2.0	6.0
Imports of goods and services	475.3	8.4	5.2	-0.3	1.5	5.4
Net exports[1]	-342	0.0	-0.0	0.7	0.1	0.1
Memorandum items:						
National unemployment rate		9.7	9.6	10.3	11.0	11.2
Total remuneration of employees		2.3	3.4	2.1	1.6	1.6
Harmonised consumer price index		1.7	2.3	2.2	1.3	1.2
Underlying HCPI		1.0	1.1	1.5	1.0	1.0
Household gross savings rate[2]		12.6	12.9	12.9	12.4	12.4
Public debt, Maastricht definition[3]		82.4	86.0	91.3	94.5	96.1
Financial balance of general government[3]		-7.1	-5.2	-4.5	-3.5	-3.0
Financial balance corrected for cyclical variations[3]		-5.9	-4.2	-3.0	-1.2	-0.4
Balance on current account[3]		-1.6	-2.0	-2.4	-1.7	-1.7
Net trade balance[3]		-2.2	-2.8	-2.2	-1.9	-1.9

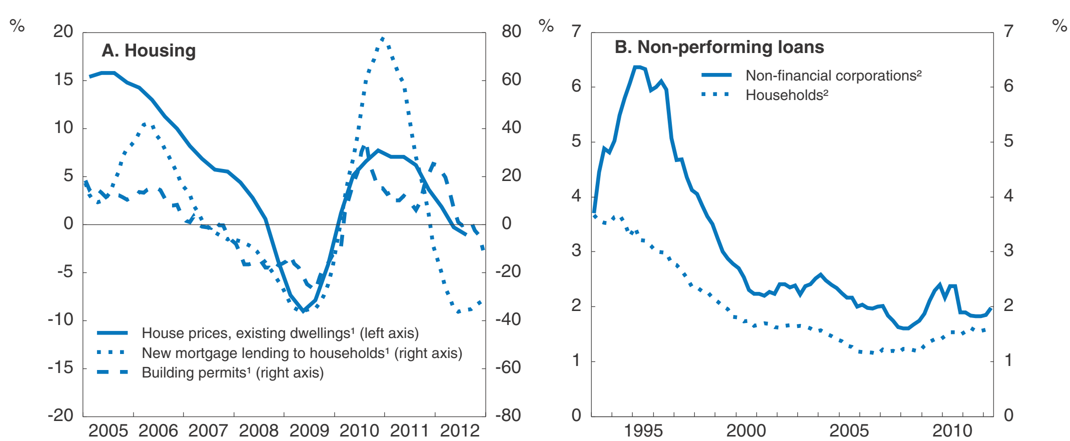
Note: The national accounts are based on chained price indices.
1. Contributions to changes in GDP by volume (as a percentage of GDP by volume for the preceding year).
2. As a percentage of disposable income.
3. As a percentage of GDP.
Source: *OECD Economic Outlook 92 Database* plus updates.

In this context, while confidence has been improving at the international level for several months, real GDP would grow rather slowly: by 0.1% in 2013 and by 1.3% in 2014 in the OECD projections. Residential investment would decline in 2013, while a recovery in business investment would be held back by the weakness of firms' profit margins and their heavy indebtedness. The unemployment rate would continue to rise, eventually stabilising at 11¼ per cent at the end of 2013. Significant slack should bring inflation down to less than 1.5%. With growth below government forecasts and favourable debt financing conditions, automatic stabilisers should be allowed to play fully. This would imply higher-than-planned government deficits of 3.5% of GDP in 2013 and 3.0% in 2014. However, it is important to remain alert for the repercussions a derailing of the cyclical deficit might have on the credibility of fiscal policy. Parallel reform actions designed to increase medium-term productive capacity would minimise the risks.

The euro area is still weighed down by a number of uncertainties. Given the high level of household savings, the theory of Ricardian equivalence predicts that France is well positioned to benefit from an improvement in confidence, which would cushion the impact of fiscal restraint on economic activity. By contrast, targeting the total government deficit (rather than its structural component) could have adverse affects on economic activity in the short run by exacerbating the impact of the downturn, in particular if inadequate structural reforms were to cast doubt on France's ability to reduce its imbalances.

The construction sector has been particularly hard hit (Figure 4, Panel A). Weak credit demand has resulted in a sharp decline in new mortgages since the end of 2011. Real estate prices have fallen slightly from their mid-2011 peak and are likely to drop further; the increased risk of negative equity during the past decade (COREFRIS, 2011) could contribute to market deadlock in the event of a downturn. However, the quality of mortgage loans is relatively good (Panel B), owing to lending practices by the banks that are prudent and based on sound assessment of borrowers' creditworthiness. It could deteriorate significantly with a prolonged rise in unemployment hitting new segments of the population, particularly as the ratio of debt service to income was growing until 2011.

Figure 4. **The real estate sector is weaker, but few loans are non-performing**



1. Year-on-year growth rate, moving six-month average for building permits.
2. As a percentage of total outstanding debt by sector.
Source: OECD, *Economic Outlook 92 Database*; INSEE; Banque de France.

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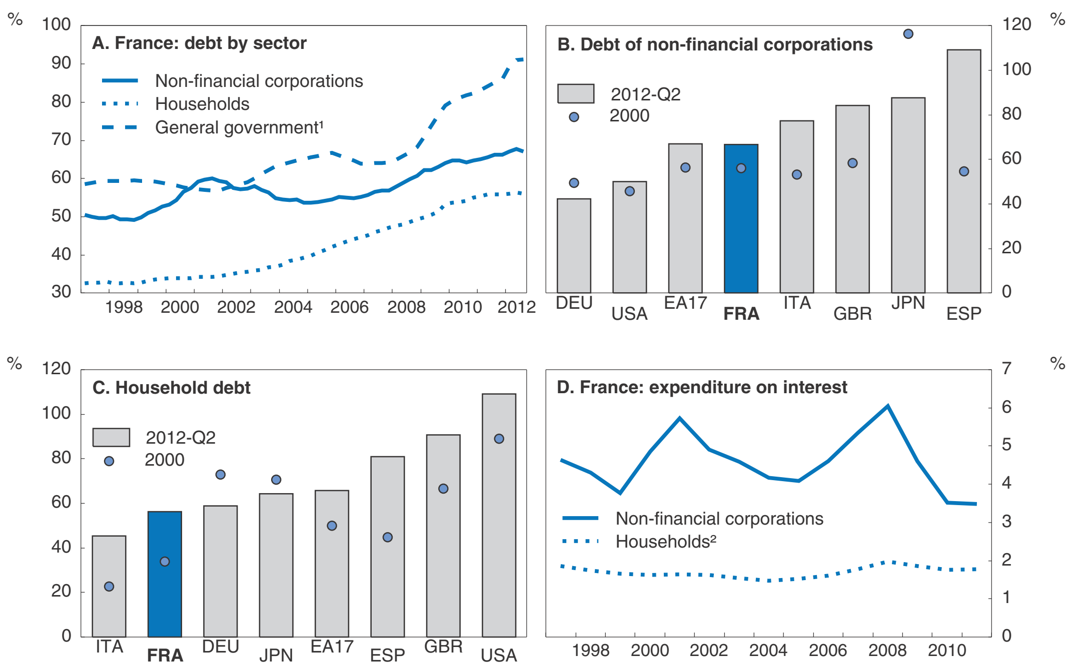
Indebtedness in various parts of the economy has grown sharply over the last decade (Figure 5, Panel A). Yet, private debt positions remain relatively sound by international comparison (Panels B and C). Lower interest rates have favoured this trend while ensuring relative stability in interest charges (Panel D). An upturn in financing rates would certainly depress private investment but would have little effect on households' capacity to repay their loans, since their borrowing is largely at fixed rates. It would deter new credit applications and thus potentially lead to deleveraging. However, an upswing in rates could adversely affect banks' balance sheets due to maturity mismatches related to their intermediation activities.

Figure 5. **Private debt has grown sharply from a low level**

As a percentage of GDP



1. Maastricht definition.
2. Interest paid by households, excluding individual entrepreneurs and excluding correction for Financial Intermediation Services Indirectly Measured (FISIM).

Source: INSEE; ECB and national central banks.

StatLink http://dx.doi.org/10.1787/888932789747

French banks have been resilient, but they suffer from some vulnerabilities

French banks were particularly affected by 2011's sharp decline in cross-border lending. Although it had fallen significantly prior to 2012, their exposure to southern European countries, and to Italy in particular, is still high (Table 2). Managing Dexia's resolution plans and the near-collapse of Crédit immobilier de France (CIF) have been the main difficulties faced by the banking system, which, for the most part, has weathered the crisis relatively well. In all, the French government has extended guarantees to private financial agents worth about 4 percentage points of GDP. Since the end of 2007, the five biggest French banks, which have around 80% of all bank assets, have boosted their capital substantially (Figure 6, Panel A). As of mid-2012, they were in full observance of the 9% target (the Basel 2.5 standard) for the "Core Tier 1" capital ratio (relative to risk-weighted

Table 2. **Bank claims on selected countries of the EU periphery**

A. Exposure to EU periphery countries by nationality of banks[1] (end 2012-Q3, as percentages of GDP)

Exposure:	Type of exposure	Nationality of banks						
		FRA	DEU	ESP	ITA	GBR	JPN	USA
Total	**Total claims**	19.4	10.9	8.3	1.8	10.9	1.4	0.9
	Public sector	2.8	2.3	1.3	0.3	0.5	0.6	0.1
	Banks	2.5	2.5	0.6	0.4	1.2	0.1	0.3
	Non-banking private sector	14.1	6.1	6.4	1.1	9.2	0.7	0.5
Greece	Total claims	1.2	0.2	0.1	0.0	0.2	0.0	0.0
Ireland	Total claims	1.1	2.5	0.5	0.5	4.9	0.4	0.3
Portugal	Total claims	0.7	0.7	5.5	0.1	0.7	0.0	0.0
Spain	Total claims	4.1	3.7	-	1.1	3.2	0.4	0.3
Italy	Total claims	12.4	3.8	2.3	-	1.9	0.6	0.3

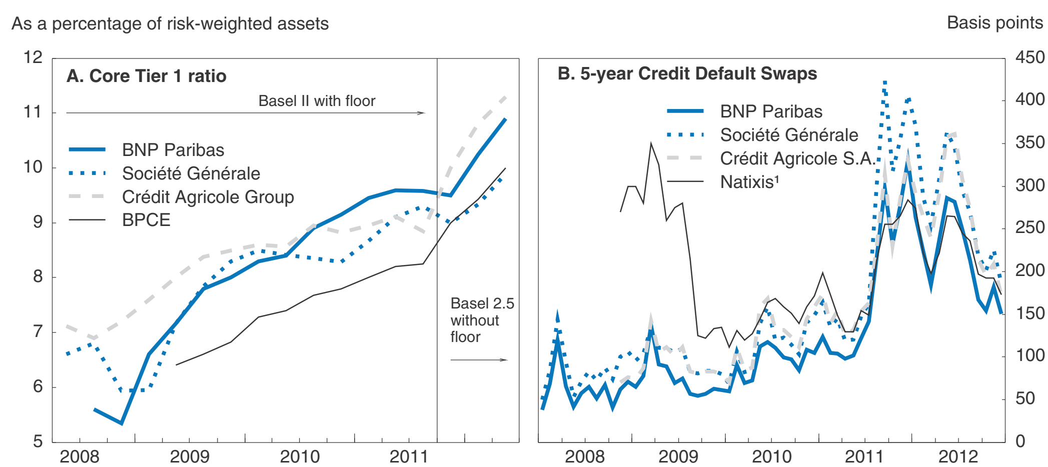
B. Total claims of French banks on EU periphery countries (as percentages of GDP)

	End 2007	End 2009	End 2011	2012-Q3
Greece	2.3	2.8	1.6	1.2
Ireland	3.4	1.9	1.0	1.1
Portugal	1.2	1.6	0.8	0.7
Spain	6.8	7.5	4.2	4.1
Italy	17.3	18.1	12.3	12.4
Total	31.0	32.0	20.0	19.4

1. The exposures of banks headquartered in their respective countries are not included.
Source: Bank for International Settlements (BIS).

How to read this table: In 2012-Q3, for example, Italian banks held Spanish, Greek, Irish and Portuguese debt amounting to 1.8% of Italian GDP (1.1% in Spanish debt alone).

Figure 6. **The capitalisation of French banks has risen, and pressures have diminished**



1. Investment bank of the BPCE Group.
Source: Datastream and communications with financial authorities.

How to read this figure: Panel A – The ratio is between equity as numerator and risk-weighted assets as denominator. The equity considered here is Core Tier 1 capital (basically the capital provided by shareholders), in accordance with Basel Committee rules. The principle of weighting assets is designed to give more weight to risky assets. Panel B – The CDS is an insurance contract. A spread of 100 basis points for a given issuer means that it costs EUR 10 000 a year to insure EUR 1 million of its debt against default.

StatLink http://dx.doi.org/10.1787/888932789766

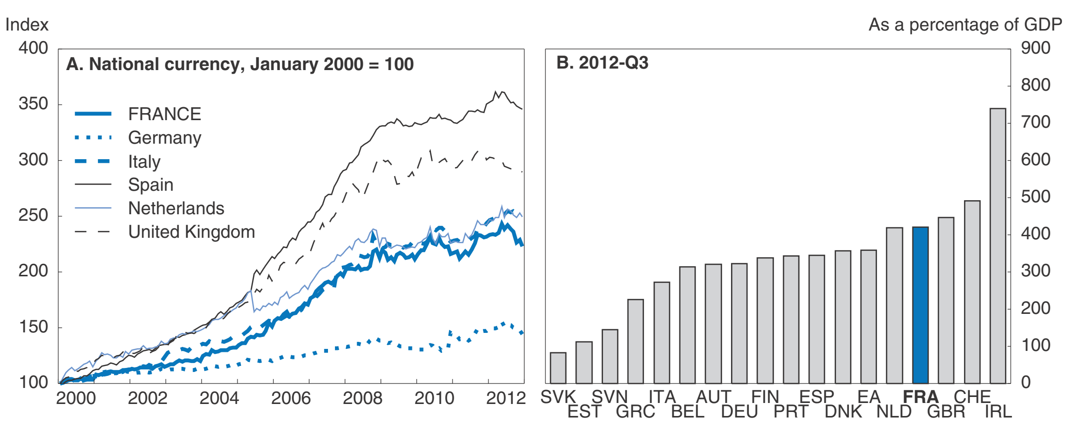
assets) established by the European Banking Authority (EBA), and they have benefited from the calming of tensions in the euro area (Panel B). They expect to reach strict "full Basel 3" capitalisation objectives of between 9 and 10% by the end of 2013. However, an obvious weakness of this approach, which is defined at the international level, is that it gives zero weight to sovereign debt, notably to that issued by highly stressed euro area countries.

French banks have a strong international presence and tend to have larger balance sheets than their European counterparts, even though expansion since 2000 has been a general trend (Figure 7). The average leverage ratio, which measures unweighted assets as a proportion of Core Tier 1 capital, is above other European countries' levels with the exception of Greece (OECD, 2012a). This indicator seems to be a better predictor of default risk than the risk-weighted capital ratio (Blundell-Wignall et al., 2010; Haldane and Madouros, 2012). However, there is an inescapable limit on this type of analysis ("Goodhart's law"): the different ratios are a function of the regulation in place (endogeneity bias), and the observed statistical properties can be weakened by a regulatory change.

In addition, more than elsewhere, banks in France remain heavily dependent on wholesale funding, and refinancing the large amount of their debt that is maturing in 2013-14 (EUR 131 billion) might be difficult (IMF, 2012). Overall, pockets of vulnerabilities persist, in particular with regard to liquidity risk (IMF, 2012). This reflects the importance of off-balance-sheet mutual funds and tax-sheltered savings instruments, which compete with bank deposits (Artus, 2012). If on-balance sheet savings are included, more than two-thirds of household financial assets (representing approximately 150% of GDP, in total) benefit from some form of tax relief. This is probably profitable for financial groups but introduces serious distortions into the allocation of capital, as well as costs for government finances. Specifically, they encourage risk-averse household investment behaviour with repercussions for entrepreneurial financing. However, the key concern probably still relates to the intricate nexus of banking and sovereign risks and the possibility of a prolonged deterioration in the euro-area macroeconomic environment.

Figure 7. **Monetary and financial institutions in France have large balance sheets**

Total assets



Source: ECB and national central banks.

How to read this figure: For Panel A an index value equal to 300 means that the total assets of the banks of a given country as a % of the GDP of that country tripled since January 2000.

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According to the IMF's recent in-depth assessment of the French financial system (IMF, 2012), supervision is of a high quality. However, the IMF points out that the presence of a non-voting representative of the Treasury at the Colleges of Supervisors could constitute a conflict of interest and undermine the *de jure* independence of the supervisory authority, even if it does encourage useful exchanges of information. In addition, France lags behind many other countries in terms of publishing detailed and comparable figures on its financial institutions.

The government has proposed a banking reform law to enter into effect in 2015, separating activities that are not associated with servicing its clientele from those that "usefully" finance the economy. This element of the reform would be limited in scope in order to preserve the essentials of universal banking, which the authorities and the IMF see as having proved its mettle. Therefore the cost of the reform to French banks will also be limited. On the one hand, it is designed to prohibit the most speculative activities, such as high-frequency trading and speculation in agricultural commodities and to separate the proprietary trading activities that have no relation to services provided to customers. On the other hand, in a step back from the Liikanen report, the reform would not force banks to hive off market-making activities that are closely linked to proprietary trading but are also an integral part of customer services and public-debt management. An important issue is how strict this ring-fencing would be.

The draft law also includes a welcome provision concerning the resolution of banking crises. Management of bank failures has been identified as the weak point in French prudential regulation (Ahrend et al., 2009), and the lack of a framework for resolution complicated the handling of the CIF case. As this is seen as a key element for restoring confidence in the euro area, the government is giving strong support in European discussions to the idea of a banking union in its three components of integrated supervision, mutualised resolution and deposit guarantees. France's draft law calls for strengthening the powers of the prudential oversight body (ACP) (dismissing directors, appointing a provisional administrator, transferring assets to other banks in case of serious problems and the option of imputing losses to stockholders and junior creditors) and instituting financial solidarity among banks by mobilising the deposit guarantee fund which is becoming the French resolution fund (Michel, 2012). Finally, the draft law also seeks to bolster macro-prudential oversight by conferring legally binding powers (notably the establishment of counter-cyclical reserve ratios) on the ACP.

Box 1. **Recommendations to improve the financial system**

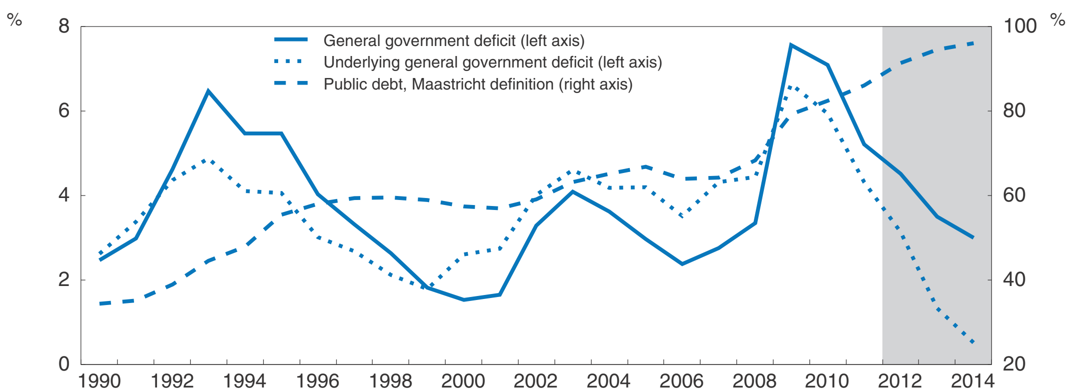
- Continue to encourage banks to increase their capital.
- Gradually eliminate the many inefficient tax expenditures on savings (see also Box 4).
- Improve transparency by publishing data that are easily accessible and comparable across financial institutions.

Reducing the weight of public spending must be vigorously pursued

Since the late 1970s, the general government budget has always been in deficit, resulting in a trend increase in the public debt-to-GDP ratio (Figure 8). The main cause has been the sharp rise in public spending, primarily on pensions and healthcare (Figure 9). In 2011 France had the second highest public spending ratio among OECD countries. The share of public employment in total employment was 23%, the highest ratio in the OECD except in Nordic countries. The resulting high level of taxes creates distortions that weigh heavily on the economy. Therefore, fiscal consolidation should involve a decrease in the spending ratio allowing taxes to be cut in the medium term without undermining equity. This is essential for improving the competitiveness of firms.

Figure 8. **Public deficit and debt, 1990-2014**

As a percentage of GDP



Source: OECD, *OECD Economic Outlook 92 Database*.

How to read this figure: The underlying general government balance is the general government balance excluding the impact of economic cycles on public finances, notably due to automatic stabilisers. The underlying balance shows in principle the impact of discretionary fiscal policies. For instance, a rise of one percentage point of GDP in the underlying deficit corresponds to a discretionary fiscal loosening of one percentage point.

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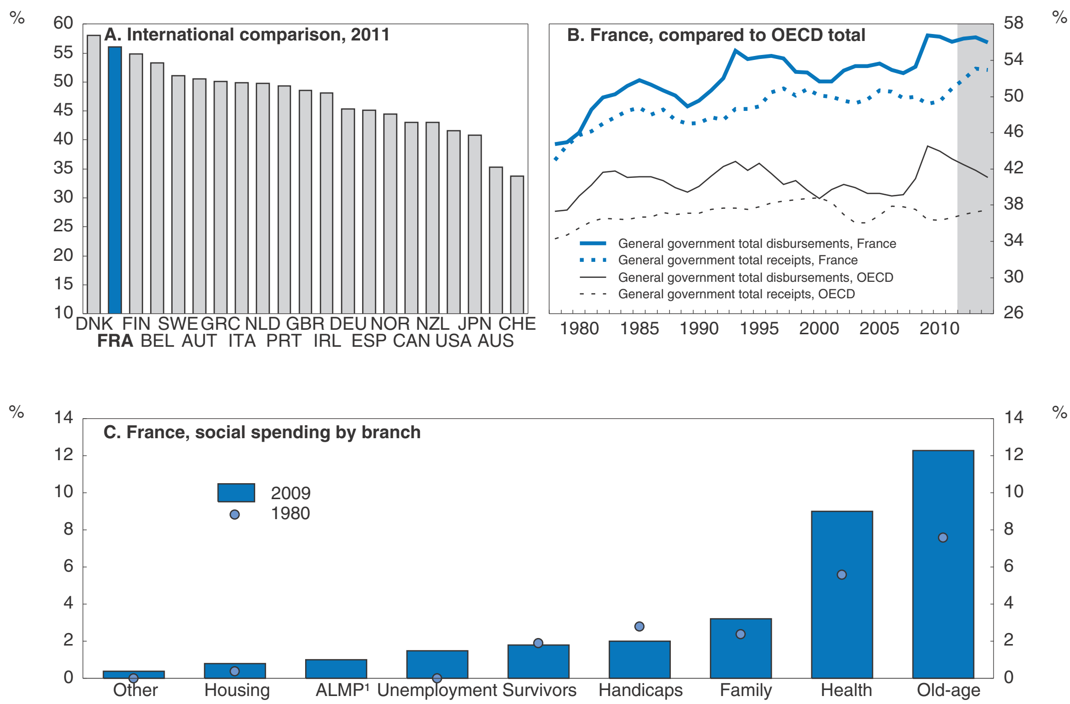
Hitting announced budget targets over the last three years has enhanced France's fiscal credibility, as reflected in the low interest rates on its public debt. According to the multi-year budget programme 2012-17, the deficit should decline to 3% of GDP in 2013 and 2.2% in 2014, before reaching 0.3% in 2017. The public debt-to-GDP ratio (Maastricht definition) is projected by the OECD to have risen from 57% in 2001 to 91% in 2012 before it reaches nearly 96% of GDP in 2014 (Figure 8). Cutting public indebtedness substantially is crucial for ensuring macroeconomic stability and underpinning long-term growth (Égert, 2012).

The government's strategy consists of combining tax hikes concentrated in 2012-13, targeted primarily at large businesses and affluent households so as to minimise their impact on economic activity, and an important spending-reduction effort in the medium term. According to the 2012-17 multi-year budget framework adjusted for the National Pact for Growth, Competitiveness and Employment (see below), the tax revenue-to-GDP ratio would rise from 44.9% in 2012 to 46.3% in 2013 and start declining in 2015. The public

Figure 9. **General government expenditure as a percentage of GDP in France and other OECD countries**



1. Active labour market policy.

Source: OECD, Social Expenditure Statistics (SOCX) and *OECD Economic Outlook No. 92.*

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spending ratio would stabilise in 2013 at the same level as in 2011 and 2012, i.e. 56.3%. It should then gradually decline to 53.1% by 2017. However, specific measures for reducing spending have not yet been decided.

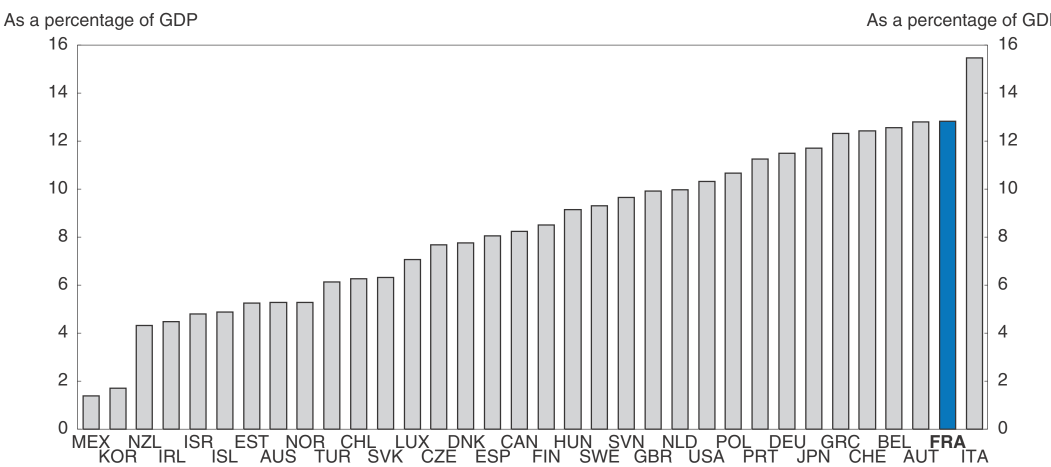
This approach can be justified by the size of the tax and spending multipliers. According to econometric estimations, spending multipliers are, on average, greater than tax multipliers in the short term (Table 3). Tax hikes may also be more attractive than spending cuts in the short run because they trigger less social resistance that might unnerve financial markets. But in the medium run, spending cuts are thought to hurt economic growth less than tax hikes, perhaps because they reflect a stronger and more lasting commitment (Alesina et al., 2012; Molnár, 2012). In light of already high taxes in France, placing too much reliance on tax hikes for fiscal consolidation could thus prove risky in the medium term.

Table 3. **Estimated short-term fiscal multipliers for France**

Biau and Girard (2005)	Tax multiplier is -0.1. Spending multiplier is 1.4.
OECD (2010a)	Short-term multipliers for government investment, consumption and transfers to households are 1.0, 0.8 and 0.6, respectively. Short-term multipliers for indirect taxes and personal income tax are -0.3 and -0.6.
Créel et al. (2011)	Multipliers are near 1.0 for both spending cuts and tax hikes but slightly higher in downturns.
Barrell et al. (2012)	Multipliers for government consumption and transfers to households are 0.7 and 0.3. Multipliers for indirect and direct taxes are -0.3 and -0.1.
Batini et al. (2012)	Tax multipliers are near zero or even positive at a one-year horizon. The spending multiplier is approximately 2 during recessions.

There is substantial scope for cutting public spending. First, spending on pensions is among the highest in the OECD (Figure 10). The projected trajectory of the pension system deficit requires that hard decisions be taken soon to limit spending in the short and medium terms. Furthermore, the reduced generalised social security contribution (*contribution sociale généralisée*, CSG) and the exemption from health insurance contributions that pensioners benefit from should be eliminated, as well as their preferential treatment in local taxes and capital gains taxes on property, even if this requires increasing the minimum pension. Savings may be also achieved in pension regimes of employees of state-owned companies, whose pension benefits are higher than those of private-sector workers. As for the pension scheme of civil servants, the rules to calculate pension benefits are so different from those in the private sector that it is difficult to have an overall idea about which scheme provides higher pensions. While the level of pensions can be seen as an integral part of global compensation, special pension regimes (including that of civil servants) not only render the entire system opaque and probably inequitable, but they also reduce mobility between sectors with different plans and complicate the opening of state-owned companies to competition.

Figure 10. **Public and private pension spending**



Source: OECD (2011), Pensions at a Glance 2011.

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In addition, the survivors' pension regime is generous, particularly because the pension amount does not take account of the cost of this type of life insurance at the individual level, which favours married couples, in particular those with generous pensions. Employees should be given the possibility, as in Sweden, of opting for a pension for the surviving spouse in return for an additional contribution (or a reduced pension). It is also possible to achieve further savings by eliminating implicit early retirement schemes and by reforming unemployment benefits (cf. below).

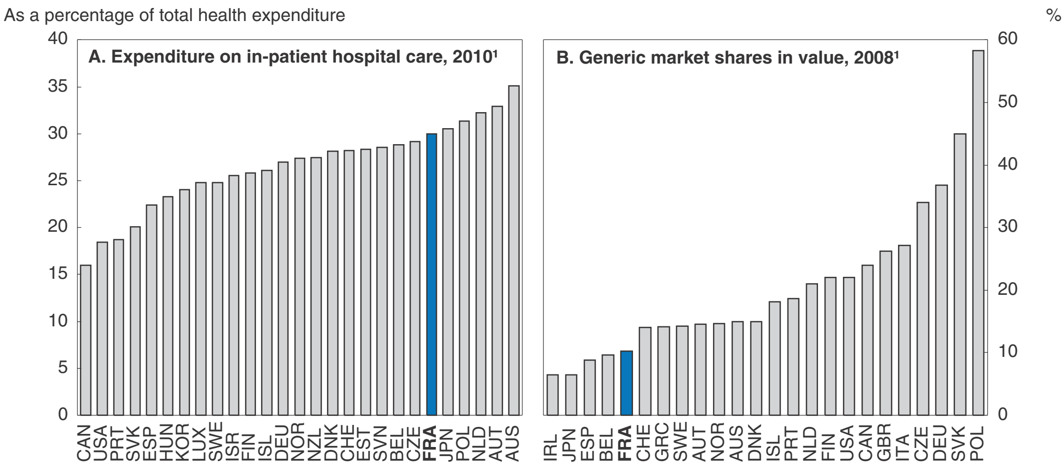
Existing and proposed public spending at all levels of government should be subject to thorough efficiency analysis in order to phase out or eliminate items found to be ineffective, badly targeted or unjustifiably distortionary. For instance, the cost of tax collection as a share of net revenue collected is three times higher than the OECD average (OECD, 2011a). Improving the efficiency of tax collection and simplifying the complex and ever changing tax code could potentially save 0.3% of GDP. Subsidies to specific sectors, SMEs and associations, among others, should be most closely re-examined. Also, the adult training system, which absorbs 1.5% of GDP, benefits little those who need it most (unskilled workers and those on temporary contracts) and often provides low-quality training (CESE, 2011). Its costs could be reduced significantly and its effectiveness substantially improved in the framework of the reform planned for mid-2013. At the end of 2012 a "Modernising government action" plan was launched to identify, at all levels of government, the reforms required to meet the budgetary goals for 2012-17.

Streamlining the structure of sub-national governments, notably by merging the smallest of France's 36 700 municipalities and abolishing the *départements*, could yield substantial scale economies. The average French locality has approximately 1 800 inhabitants, compared to 5 500 in the European Union and 55 000 in Denmark. Inter-municipal co-operation, which should have helped rationalise spending, has in fact added yet another territorial layer to an already complex structure. The current downward pressure on central government transfers to municipalities is likely to encourage the pooling of services and thereby generate savings.The widespread practice of politicians holding both national and local offices, which is a uniquely French arrangement (Bach, 2012) and which the government intends to do away with despite strong resistance, is a major obstacle to serious reforms, including any overhaul of territorial organisation, and to the proper functioning of institutions (Cahuc and Zylberberg, 2009; Jospin Commission, 2012). Further cost savings could be achieved by increasing incentives for local authorities to better control their spending. First, earmarked central government tax receipts (excise duties, notably the domestic consumption tax on petroleum products) should be transformed into transfers that are fixed in advance, given that any unexpected tax revenues tend to be spent. Second, central government grants, which represent roughly half of local government revenues, could be reduced when achievable productivity gains, determined on the basis of benchmarking, are significant (OECD, 2011b).

Given France's well developed transport and network infrastructure, some incremental investments are likely to yield relatively low returns. Some planned high-speed train lines will probably never break even, and prestige projects including the new headquarters of the Ministry of Defence (Furuto, 2012), regional airports and stadiums may prove a burden for future generations. Likewise, some local investment spending will have no more than a negligible impact on future growth. Therefore, returns to public investment projects should be assessed carefully. Thus, the new mandate of the General Investment Commission (*Commissariat général à l'investissement*) to evaluate all public investment projects exceeding a certain threshold is a welcome development.

Public spending on healthcare might be reduced by some 1.3% of GDP without impairing quality, according to the OECD's cross-country analysis (OECD, 2012b). Greater reliance on outpatient care would reduce hospitalisation costs. Furthermore, had the alignment of hospital fees with those of clinics been carried through, savings of approximately 0.4% of GDP would have ensued (Cour des comptes, 2011), while payment by act should take account of the heterogeneity of the cases treated. The cost and overconsumption of drugs in France could be lowered by: *i)* systematically reducing reimbursement when therapeutic value is limited; *ii)* reimbursing only the price of generics, which are insufficiently used (Figure 11); and *iii)* raising patients' co-payments on the basis of means-testing.

Figure 11. **The efficiency of healthcare expenditure can be improved in France**



1. Or closest year.

Source: OECD, OECD Health Data 2012 and *Value for Money in Health Spending* 2010.

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The strengthening of the budgetary framework is welcome

Existing fiscal rules, described in the previous *Survey* (OECD, 2011b), were maintained and even strengthened in the 2013 budget. At central level, the zero value (excluding interest payments on public debt and civil servants' pension) and zero volume spending norms have been retained for 2013, 2014 and 2015. The management of the rule for health insurance spending (ONDAM) has also improved over the last two years via the creation of a committee to monitor spending overruns and the strengthening of the alert procedure in case of slippages. The freeze on central transfers to local governments has been renewed in 2013, and small nominal cuts are planned starting in 2014. Lastly, tax expenditures will be voted only for a limited duration. The multi-year budget act for 2012-17 also requires the government to systematically evaluate the effectiveness of 20% of all tax expenditures every year and to transmit the results to Parliament. It is important that an independent institution carry out these evaluations.

The general fiscal framework has been amended in line with the European budgetary pact. Annual and multi-year budgets will be based on a target trajectory of general government structural balances**.** Although computing the cyclical adjustment will be challenging, this should considerably reduce fiscal policy pro-cyclicality. The trajectory of public finances at all levels of government will be voted by Parliament prior to the central government and social security budgets, thereby improving consistency by making pointless transfers of deficits from one sector to another.

A fiscal council (*Haut conseil des finances publiques*) was set up in January 2013. Members of the *Cour des comptes* will play a leading role in this council, ensuring its independence. The council will assess the macroeconomic projections underpinning the budget and the stability programmes. Successive governments have often made excessively optimistic growth projections (OECD, 2011b). The council will also assess the annual budget's consistency with the multi-year trajectory of the structural deficit voted by Parliament. This assessment will be used by the Constitutional Court to assess the "sincerity" of the budget and, in case of major conflict, it could even invalidate the budget bill. The success of this new institutional framework will depend on how much weight will be given to the council's evaluations. But, thus far, things are moving in line with the recommendations made in the previous *Survey* (OECD, 2011b).

Box 2. **Recommendations for the management of public finances**

- Allow automatic stabilisers to operate in 2013-14.
- Systematically review the efficiency of existing and proposed spending items, including government subsidies to businesses, and gradually phase out or reject those found to be ineffective, badly targeted or distortionary.
- Rapidly adjust the parameters of the pension system to limit spending in the short and medium terms. Phase out special pension regimes. Modify the survivors' pension system by offering the possibility of opting for survivors' pensions, where the cost would be incorporated into the pension amount or contributions.
- Merge smaller municipalities and abolish the *départements*. Transform earmarked tax revenues into budgetary transfers.
- Rationalise hospital care, in particular by relying more extensively on outpatient care. Decrease drug costs by reimbursing only the price of generics, and continue focusing more on products whose therapeutic benefits are well established.
- Follow the recommendations of the new fiscal council. Task an independent institution with the systematic evaluation of the cost efficiency of tax expenditures in order to eliminate inefficient ones.

Improving the equity and efficiency of the tax and transfer system

Income inequality has been relatively low and broadly stable over time due to significant redistribution

France is one of very few OECD countries where income inequality after taxes and transfers remained broadly unchanged between 1985 and 2008 (Figure 1, Panel B). While inequality across households' pre-tax and transfer market incomes has been among the highest in the OECD, due mostly to the low employment rate, taxes and cash transfers reduce income inequality more in France than elsewhere in the OECD (Figure 1, Panel B). After redistribution, inequality is quite low by international standards. Benefits account for two-thirds of income redistribution, with the tax system accounting for the remaining third (Duval et al., 2012).

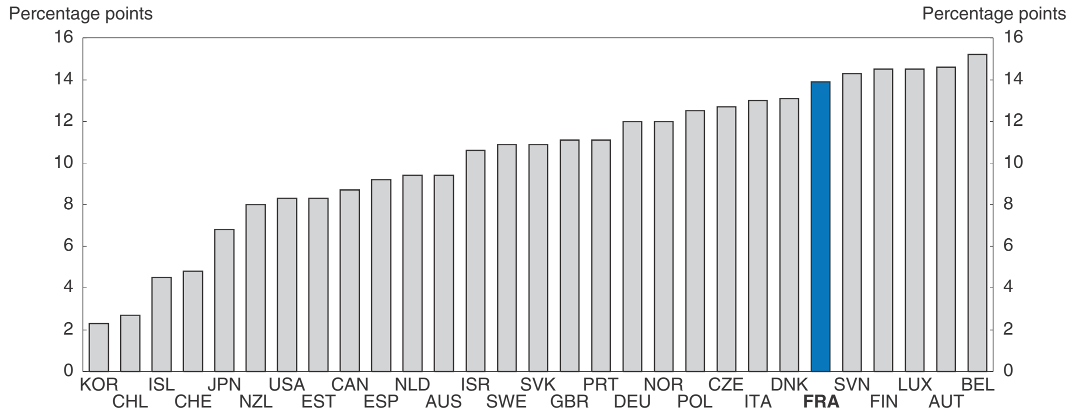
A certain degree of tax progressivity is desirable for overcoming income inequality. However, if the tax system is not to undermine incentives to work, save and invest, it needs to be as stable, simple and neutral as possible (Mirrlees Review, 2011). Yet the French tax system is a source of considerable distortions that affect the decisions of economic agents. Making it more neutral would also help to diminish its complexity and thereby reduce opportunities for tax avoidance and evasion. Stability would lower the costs of tax compliance. Nevertheless, non-neutrality is desirable in the presence of externalities, such as those generated by environmental pollution or innovation.

Simplifying the tax system and ensuring more transparency would improve economic performance

France's tax system is very complex and includes a great number of deductions, credits and exemptions. New tax expenditures are often created, and existing ones are frequently modified. This complexity makes tax compliance burdensome for economic agents and encourages rent-seeking activities, generating significant distortions. The high cost of tax collection (Figure 13) reflects this complexity.

Figure 12. **The degree of redistribution is high in France**[1]

Late 2000s



1. Gini coefficient before taxes and transfers minus Gini coefficient after taxes and transfers.

Source: OECD, *OECD Database on Household Income Distribution and Poverty*.

How to read this figure: The figure shows the absolute difference between the Gini coefficient before taxes and cash transfers and the Gini after taxes and cash transfers. The higher the difference, the higher the redistribution through the tax and transfer system. For instance, the 14 percentage points shown for France indicate that taxes and transfers reduce the Gini coefficient from 43% to 29%.

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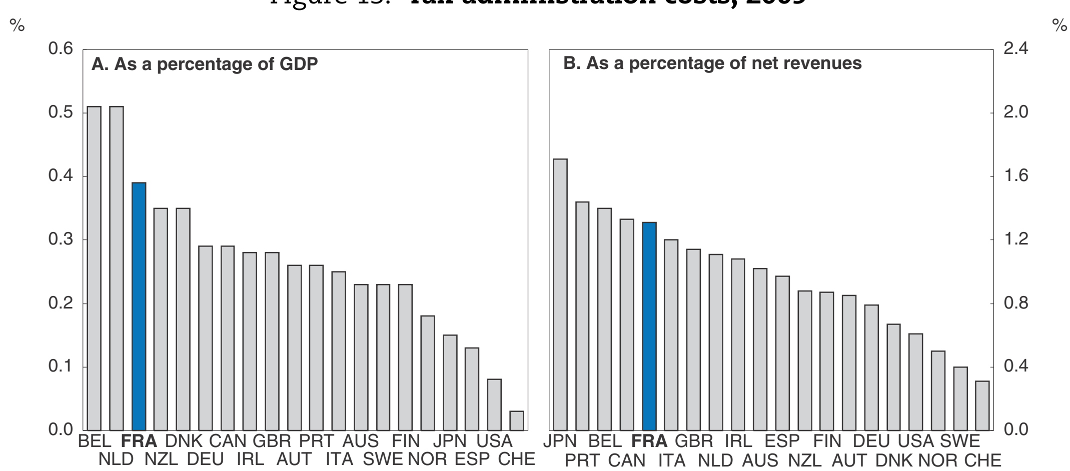
Figure 13. **Tax administration costs, 2009**



Source: OECD (2011), Government at a Glance 2011.

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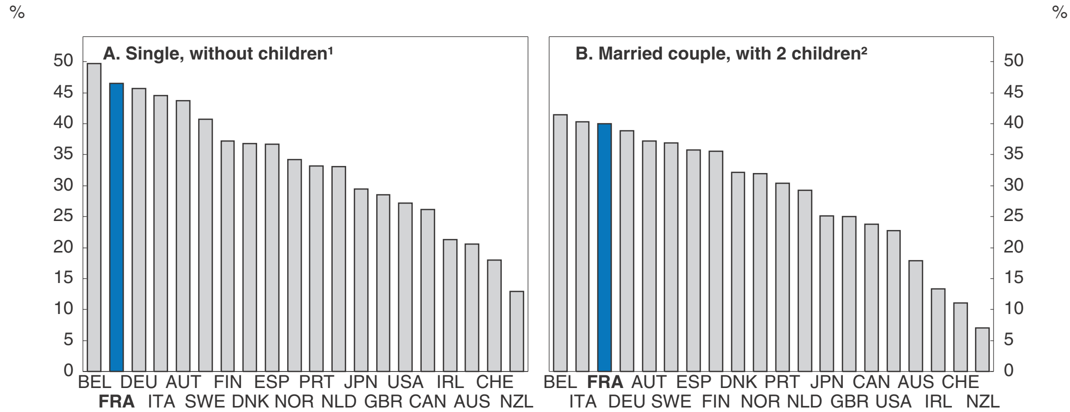
Marginal tax rates on labour are high

Actions taken by successive governments have allowed the tax wedge on low income earners to be reduced. At over 40% of labour costs at the median wage, it nonetheless remains one of the highest in the OECD, reducing both the demand for and the supply of labour for the affected workers (Figure 14). The Tax Credit for Employment and Competitiveness (which is a key feature of the Competitiveness Pact) is an important step forward and will amount on average to a reduction of more than four percent of labour costs of workers receiving up to 2.5 times the minimum wage. Effective marginal tax rates are high because of the effect of social security contributions and the reduction or elimination of means-tested unemployment allowances and other benefits as labour income increases.

Figure 14. **The labour tax wedge is high in France, 2011**

As a percentage of labour costs



1. Evaluated at 67% of average worker earnings.
2. For a couple whose first and second breadwinners respectively earn 100% and 33% of the mean wage.

Source: OECD, Taxing wages 2011.

How to read this figure: The tax wedge is the difference between the gross salary including employee and employer social security contributions and the net after-tax salary the employee takes home. For instance, a single French earner without children takes home 45% less than what (s)he gets before taxes and social security contributions.

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The two main instruments used for offsetting the impact of the reduction in benefits for low-income households are the earned-income tax credit (PPE) and the activity part of the minimum income scheme (*revenu de solidarité active*, *RSA-activité*, the supplement paid to workers with modest incomes). These two instruments are different in terms of payment frequency, the basis for means-testing and the inclusion of revenue of other members of the household, which reduces their transparency and the incentive they provide. Consequently, they should be merged. In the framework of the Multi-year Poverty Reduction Plan (Box 3) the government announced its intention to improve the link between the RSA and the PPE.

The personal income tax base is narrow because of many loopholes, which need to be reduced. Moreover, the government introduced in the 2013 draft budget bill a temporary tax bracket of 75% on annual incomes over EUR 1 million per individual. Aside from its detrimental impact on France's ability to attract innovative and high value-added activities, it would have generated little revenue (0.02% of GDP), or even none if highly mobile taxpayers were to start leaving the country. This provision was annulled by the Constitutional Court in late 2012 because it was not imposed on a household basis.

Incentives to work are weak, especially for older workers and women

Explicit early retirement schemes have been gradually eliminated, allowing a marked increase in the participation rate of seniors (OECD, 2011b). The transfer system continues to feature provisions that may reduce the labour supply of older workers. First, workers over 50 who have acquired enough entitlements are able to collect unemployment benefits for three years instead of the standard two years. Second, unemployed persons who are no longer entitled to unemployment benefits are eligible, under certain conditions related to past labour market participation and resources, for the "specific solidarity allowance" (*allocation de solidarité spécifique*, ASS), which is more generous in certain cases than the RSA

Box 3. **The government's poverty reduction package**

In January 2013, the government announced its poverty reduction plan (Bureau du Premier Ministre, 2013). The following measures concern public transfers and young people:

- A cumulated real increase of 10% in the basic social benefit (*RSA socle*) over the period 2013-17.
- A reform of the activity RSA linked to that of the existing in-work tax credit (PPE).
- Facilitating access of families with modest income to public nurseries.
- A means-tested increase in family benefits for single parents and for families with three or more children.
- Extending the basic RSA to those not in employment, education or training (NEET) aged 18-25 years in very precarious situation, conditional on participation in activation programmes.

In other areas the main proposed changes are:

- Extending the minimum healthcare insurance scheme to an additional 750 000 individuals.
- Increasing investment in and improving access to housing. A first measure aims to increase the supply of emergency accommodation by at least 9 000 units.
- Extending the average length of subsidised work contracts to 12 months.
- Creating a positive debtor list to reduce households' over-indebtedness. Creating a new body (Observatoire de l'inclusion bancaire) evaluating publicly how individual banks treat clients in difficult financial situation.

Source: Bureau du Premier Ministre (2013), *Plan pluriannuel contre la pauvreté et pour l'inclusion sociale*, January.

and which counts as a contribution period for pension benefits. Finally, unemployed persons over 61 who have exhausted their unemployment benefits can extend their eligibility until they are able to receive a full pension.

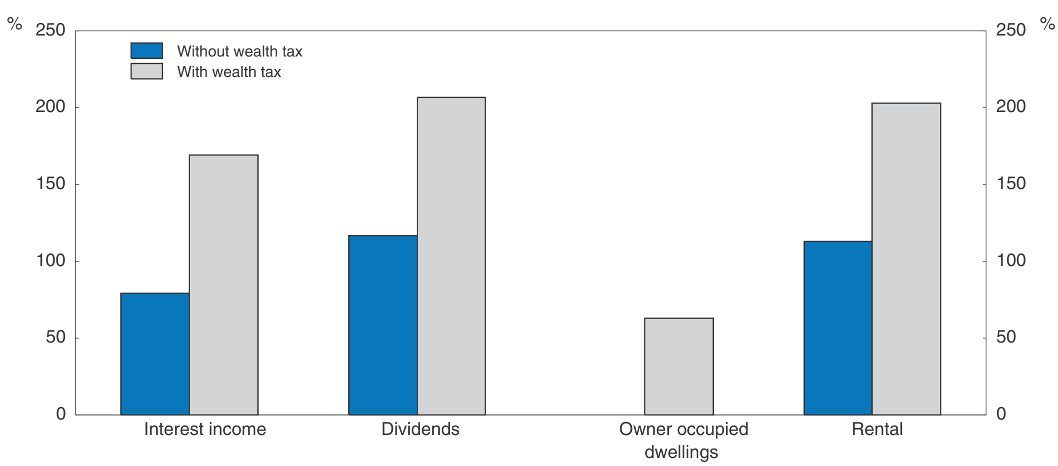
To increase the employment rate of older workers, it would be useful to bring the maximum duration of their unemployment benefits into line with the general unemployment insurance plan on the one hand, and to co-ordinate the benefits paid for long-term unemployment (ASS and *allocation équivalent retraite, AER*), which are mostly claimed by older workers, with the general income supplement system (RSA), on the other hand. Public spending on unemployment benefits is both high and combined with ineffective activation policies (Chapter 1). It could be reduced by systematically enforcing penalties for non-compliance with obligations and/or, when the economy recovers, by reducing benefits over the course of the unemployment spell, as in Belgium and Sweden (see below). These measures would allow employment rates and total income to be increased while improving government finances, but they could also increase the poverty rate and have an ambiguous impact on inequality.

Women also face disincentives to work, especially when they are young and unskilled. The parental leave allowance (*congé de libre choix d'activité*), as currently designed, can push unskilled mothers into an "inactivity trap". This lump sum provides a relatively high replacement rate for low-income workers and can last for six consecutive years for those who have three children during that period, after which it may be very difficult to return to work. Therefore, the length of this benefit should be shortened. Moreover, the mutualisation of the cost of survivors' benefits can also discourage second-income earners from working longer. Pensions of this kind do not exist in Denmark or the Netherlands, while in Sweden a person can choose either to receive a lower pension but one that is transferable upon death or a higher pension without survivors' rights (Whitehouse, 2013). Lastly, joint family taxation implies high marginal tax rates for second earners if the income gap between the spouses is significant. Hence, the government should adopt an individual tax system, as many other OECD countries have done, to encourage labour force participation of females with low educational attainment.

The taxation of capital should be made more neutral

Effective marginal capital income tax rates vary substantially across different asset classes (financial savings, real estate, etc.), distorting investment and financing decisions (Figure 15). Thus, dividends are subject to multiple taxation: corporate income tax, the recently instituted 3% dividends tax, income tax (though with a 40% exclusion to limit the double taxation of dividends) and social security contributions. By contrast, until recently, only income tax was payable on interest earned. Similar tax treatment should also be applied to all savings products. There are a number of measures providing preferential tax treatment of capital income, reducing effective tax rates. Rather than bringing capital income within the income tax schedule, which causes a sharp increase in marginal rates for high-income households, it would be better to eliminate such measures. Many countries have opted for capital tax rates that are lower than those on labour income.

Figure 15. **Top effective marginal tax rates on real returns on different asset classes, 2011**[1]



1. Effective tax rates are calculated assuming a nominal return of 4% and an inflation rate of 2%.
Source: OECD calculations, Chapter 1.

How to read this figure: The figure plots real effective tax rates based on top marginal tax rates. For personal income tax, 41% in 2011 is used. The figure shows that about 70% of real interest income is taxed away if wealth taxes are not considered and that more than 100% of real interest income is taxed away if wealth taxes are taken into account. A tax rate higher than 100% is possible because taxes apply to nominal interest income rather than its real counterpart. Any tax imposed on nominal income higher than 50% will result in an effective tax rate on the real return exceeding 100% if a nominal interest rate of 4% and an inflation rate of 2% are assumed. In such a case, the real return of 2% will be fully wiped out and part of the tax above 50% will tax the inflation component, thereby reducing the real value of the asset.

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In the housing sector, income from owner-occupied dwellings enjoys preferential tax treatment compared not only to non-housing investment but also relative to investment in rental housing. Furthermore, the tax-free capital gains on primary residences should be aligned at least with capital gains tax due on other assets. Given that imposing capital gains taxes on principal residences may discourage mobility, they should be paid only upon succession (OECD, 2011b). Transaction taxes on real estate should be reduced. At the same time, the taxation of gifts and bequests should focus on amounts received over one's lifetime, irrespective of the source.

Reduced VAT rates are an expensive form of redistribution

There are a multitude of goods and services benefiting from reduced VAT rates, which is difficult to justify on distributional grounds. Distributional objectives could be achieved more cost-efficiently by a uniform VAT rate coupled with means-tested offsets, such as in Canada where low-income households get a refund through the income tax system for part of their VAT payments. The impact of an increase in reduced VAT rates would be limited for those on low incomes, given that many social minimum income schemes are inflation indexed.

Progress has been made in internalising local pollution, but implicit carbon prices vary a lot across energy sources

France has been making good progress in internalising the externalities created by local pollution by increasing the general pollution tax (TGAP) levied on dumping and burning waste, though the external costs of pesticide and fertiliser use are only partially accounted for. The carbon prices implied by existing taxes on various energy sources, including motor fuels, heating oil, natural gas and coal differ widely. Furthermore, many exemptions and reductions apply to various energy sources. The government should therefore seek to equalise implicit and explicit carbon prices, as discussed in the 2011 *Survey* (OECD, 2011b).

The transfer system should be radically simplified

The cash transfer system has about 60 spending programmes (on top of the 90-odd old-age and survivors' pension schemes). Such complexity increases administrative costs, and the resulting lack of transparency reduces benefit take-up. Some transfers overlap with others, and programmes are not always designed jointly, sometimes because of co-ordination problems among different levels of government. A strong case can be made for a sweeping simplification of all social benefits in a budget-neutral way. This simplification should focus on harmonising eligibility criteria and implementing a one-stop shop while retaining the ability to account for unique situations. Likewise, the collection of payroll-based social contributions is fragmented and should be unified.

Incentives to find a job could be strengthened for beneficiaries of social transfers. For unemployment benefits, the maximum duration of two years goes hand in hand with an unchanged replacement rate over the entire period. The lack of data makes it impossible to lay to rest doubts as to the actual withdrawal of benefits for refusing to accept a job offer. Similarly, the application of the incentive element remains very limited for recipients of the basic RSA (*RSA-socle*), even though the return to work has shown a very slight improvement over the previous measure (Comité national d'évaluation du RSA, 2011). The conditionality of benefits could be strengthened without amplifying income inequalities *ex post* by enhancing the role of activation policies and making the threat of benefit withdrawal more credible by enforcing penalties. With regard to unemployment benefits, a reduction in the replacement rate according to the length of time benefits have been paid could help overcome some shortcomings of activation policies. Based on observations in other countries, strengthening work and activation requirements for social assistance and reducing possibilities for early exit from the labour market could encourage recourse to disability pensions, which are higher than social assistance and have less stringent requirements. Care must therefore be taken to ensure that adequate activation policies are also implemented for those receiving such pensions.

The French old-age pension system has a highly complicated structure with around 40 compulsory schemes with different eligibility criteria and benefits. A more transparent single system with points or notional accounts is a way to simplify this complex web. Such a systemic reform would provide the greater flexibility needed to achieve long-term financial balance despite adverse demographic trends. It would also be fairer within a given generation: special pension schemes cover almost 4 million pensioners (essentially former civil servants, employees of state-owned companies and certain professions (actors, miners, notaries and seamen). Reducing complexity is also essential to facilitate transparency and neutrality for employees who switch sectors and regimes during their careers.

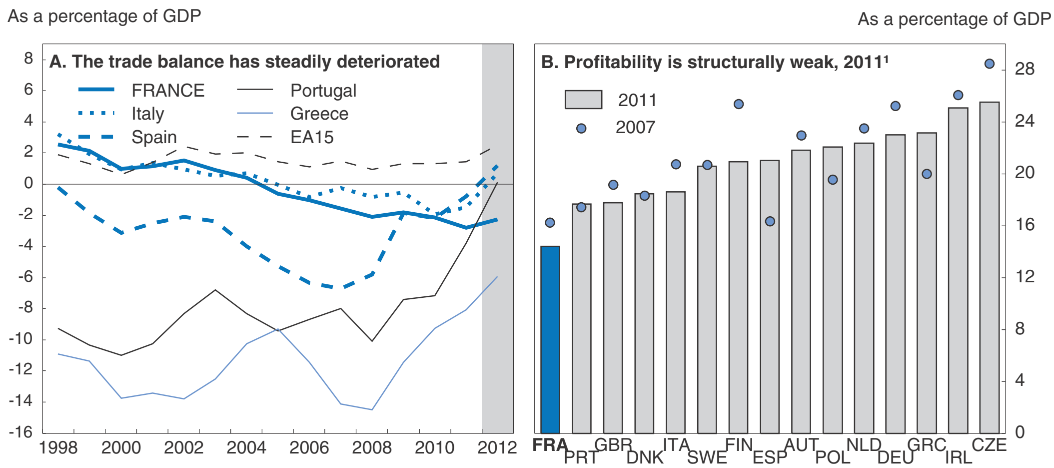
Box 4. **Recommendations to improve the efficiency and equity of tax and transfer policies**

- Reduce the complexity and enhance the stability of the tax and transfer system. Broaden tax bases.
- Enhance the neutrality of capital taxation across and within asset classes, in particular by ending preferential tax treatment of certain investment income. Streamline the taxation of dividends.
- Move to individual-based personal income taxation and shorten the duration of the parental leave allowance.
- Implement a universal points-based or notional accounts pension system.
- Equalise implicit and explicit carbon prices across emission sources.
- Eliminate the specific provisions contained in the unemployment regimes applicable to older workers. Phase out gradually long-term unemployment benefits (ASS, AER) and replace them with the RSA. Introduce a staggered reduction in unemployment benefits during a spell of unemployment. Strengthen the link between benefits, job-seeking and participation in more effective activation measures.
- Simplify substantially all social benefits. Merge the *RSA-activité* and the earned-income tax credit (PPE).

France's poor export performance reflects generalised weakness on the supply side

For the last 15 years, France's trade balance has been deteriorating steadily (Figure 16). While the shrinkage in export market shares has been similar to that experienced by other major OECD countries, except Germany, it is one of the most pronounced in the euro area. This weak performance is not satisfactorily attributable to developments in the price-competitiveness in industry, which has held up better than its cost-competitiveness as business profits have been squeezed (cf. Boulhol and Sicari, 2013a, for further details).

Figure 16. **Trade balance and business profits**



1. Profits of non-financial corporations before taxes, interest and dividends.
Source: OECD, *Economic Outlook 92 and National Accounts 2012 Databases.*

StatLink http://dx.doi.org/10.1787/888932789956

The difficulties encountered by industrial firms are a reflection of more generalised structural weaknesses on the supply side, including in services (the structure of taxation, labour markets, legal and regulatory complexity, competition in non-industrial sectors, innovation, education, etc.).

Boosting competition in product markets

Reforms that would remove barriers to competition are essential in France, as they have the capacity to raise national income substantially. For example, according to Bouis et al. (2011), an ambitious reform easing regulations in services would increase GDP by about 5% over a 10-year period. Numerous and excessive regulations increase production costs and depress households' purchasing power. Lightening the regulatory burden would also open the way to new sources of employment. Because competition is inadequate, prices are high in sectors as varied as drugs (Benkimoun, 2012), opticians (Babeau, 2012), automotive parts and repairs (Autorité de la concurrence, 2012), and, more generally, in services. In mobile telephony, the entry of a fourth operator in early 2012 once again revealed that more competition can generate significant savings.

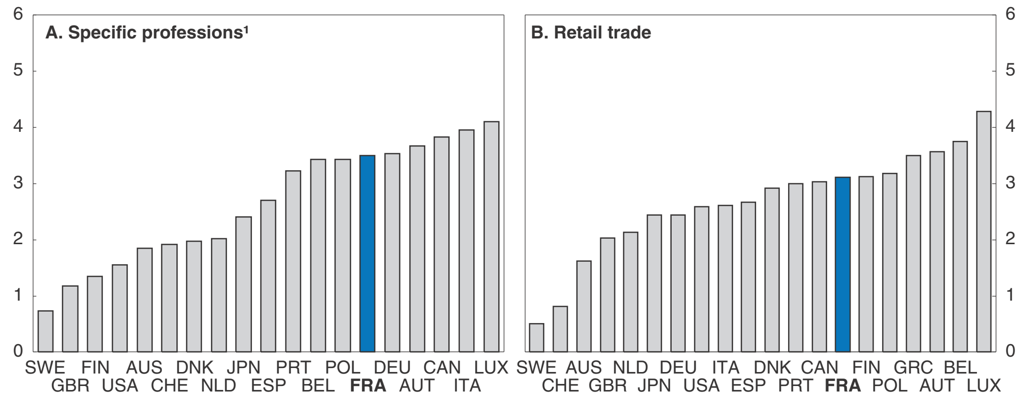
Regulated professions, retail trade, transportation

Regulatory barriers to entry in certain professions (legal occupations, accountants, architects, pharmacists, physiotherapists, veterinarians, hairdressers, taxi drivers, etc.) impose drastic restrictions on competition and go well beyond what is desirable (Figure 17, Panel A).

Competition is also inadequate in the retail trade sector, despite advances made with the 2008 Law on Modernisation of the Economy (Panel B). The structure of the market is heavily influenced by urban zoning rules and by restrictions on negotiations between retailers and suppliers. A special authorisation is required to open a store of more than 1 000 m², while the rules for awarding building permits already take into account the objectives of land-use planning, urban development and the environment, as noted in the 2009 *Survey* (OECD, 2009a). Applications to open large stores should be examined and granted on the basis of criteria established in general urban planning instruments, without

Figure 17. **Regulation is still heavy**

Index scale of 0 to 6, from least to most restrictive, 2008



1. Arithmetic mean of indicators for legal, certified accounting and architectural services.
Source: OECD, *PMR Database*.

StatLink http://dx.doi.org/10.1787/888932789975

discrimination as to size. Similarly, retailers are not allowed to sell at a loss, even though predatory pricing is already forbidden under competition law. Lastly, and despite some recent relaxation, store opening hours are still highly regulated, particularly when it comes to Sunday openings, thereby restricting competition, consumer choice and employment.

In addition to regulatory barriers, the creation of new stores is hobbled by behavioural barriers. The Autorité de la concurrence (2010) has complained about the length and rigidity (non-compete clauses, priority rights, etc.) of contracts that restrict the ability of independent shops to shift between rival brands, resulting in high concentration in some local markets. The draft "Lefebvre" law of June 2011 aimed at strengthening consumers' rights, protection and information, and called for reducing these obstacles to competition among brands. Although it was adopted by the Senate in December 2011, it has not yet been given second reading in the National Assembly.

Rail transport is another sector in which France lags behind most European countries in terms of liberalisation and competition, a situation that generates extra costs for users and for the public purse (CAS, 2011). The incumbent operator (SNCF) was sanctioned in 2012 for practices that hindered new entry on the freight market (Les Echos, 2013). The government's recent decision to merge the rail network manager (RFF) and the SNCF is a step backwards, even if the 1997 separation was handled in a way that did not sufficiently strengthen competition – its purpose was essentially to remove a portion of the sector's debt from the Maastricht definition. Looking ahead, the operational and legal separation of train stations from the SNCF is advisable. The German example has shown that as well the special status of railway workers must be abandoned for the incumbent operator's new recruits if there is to be real competition in the sector.

Finally, competition in transport is also inter-modal, and the entire sector – including air and road transport, which are poorly regulated today – should be placed under a single independent regulator (Autorité de la concurrence, 2011a). For example, insufficient interconnections between ports and the railway network as well as the poor quality of industrial relations and the low level of competition in port activities are often cited to explain the substantial decade-long loss of market share that French ports have suffered (Merk et al., 2011).

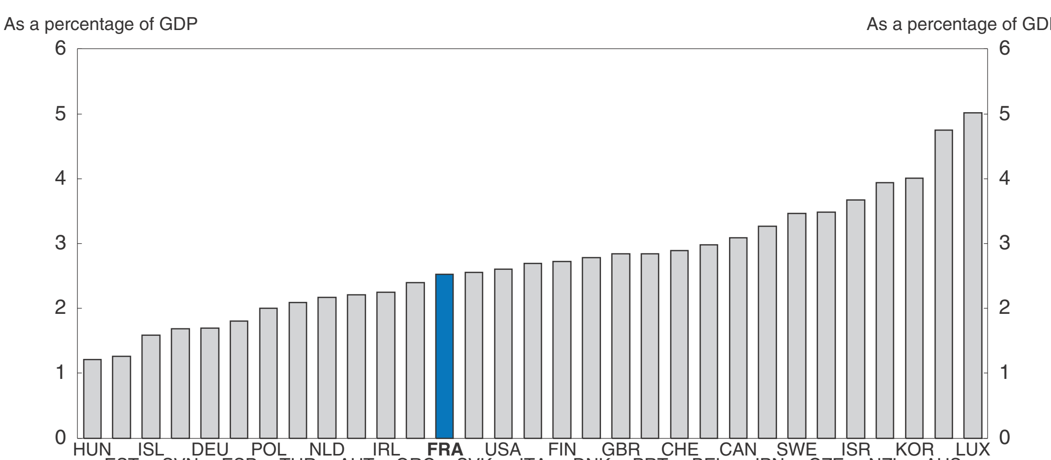
The competition framework and business growth

With respect to the competition framework, the notion of class actions should be introduced into French law so that consumers can seek collective redress for common damage. The government has launched consultations on this matter, which should pave the way for a new draft law in the spring of 2013. The new mechanism must allow for private sanctioning by consumers of anticompetitive practices and improper business behaviour (OECD, 2009a), while explicitly imposing liability for violations of competition law. So-called "follow-on" actions, in the wake of a finding of violation by the competition authority, offer advantages in terms of simplifying legal proceedings, ensuring legal security and preventing frivolous appeals.

The scarce presence of French SMEs on export markets has been well documented. While there is no convincing evidence of structural problems in access to credit, regulatory obstacles are certainly hindering firms' growth. Beyond certain – numerous – staffing level thresholds, French enterprises face a heavy administrative and financial burden, which limits their capacity to grow and to reap economies of scale (OECD, 2009a). For example, if a firm has more than 50 employees it becomes subject to more than 30 additional laws and regulations, the cost of which represents about 4% of payroll (CLCF, 2008). According to Ceci-Renaud and Chevalier (2010), these threshold effects explain only a small share of the size differentials between France and Germany. However, their impact on total employment and productivity might not be trivial. Garicano et al. (2012) estimate that the most important threshold (50 employees) costs the economy at least 0.5% of GDP.

The attractiveness of doing business in France would be strengthened by making the effective corporate tax rate more transparent. Despite the very high corporate tax rate (Chapter 1), revenues as a percentage of GDP are relatively low (Figure 18) because of the multiplicity of tax expenditures, particularities of the corporate income tax, the existence

Figure 18. **Corporate tax revenues, 2011**[1]



1. 2010 for Australia, Greece, the Netherlands, Poland and Portugal. Norway, where corporate tax revenues exceeded 11% of GDP in 2011, is excluded from the graph to make it more readable.

Source: OECD, *Revenue Statistics 2012 Database.*

StatLink http://dx.doi.org/10.1787/888932789994

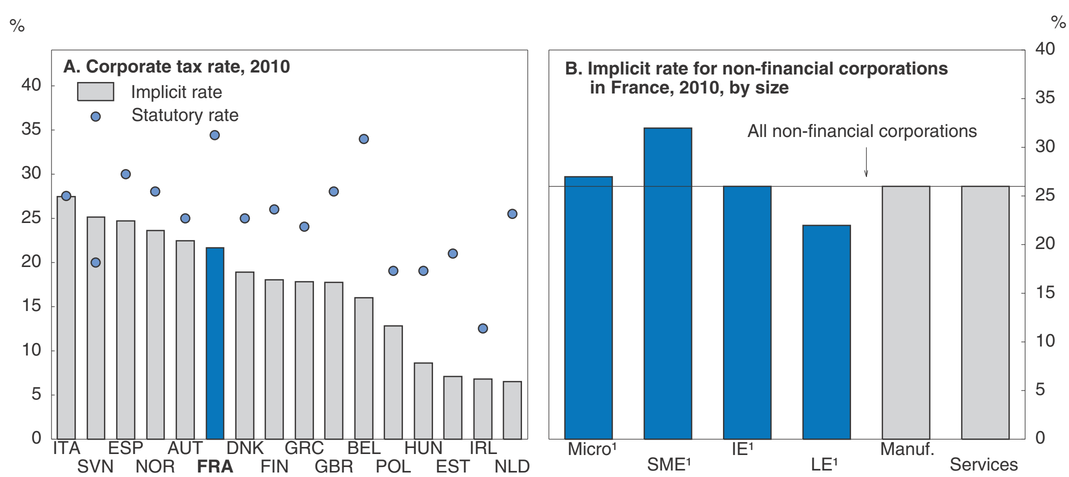
of a reduced rate for SMEs (15%) (Figure 19, Panel A) and poor profitability. These exceptions are thus a source of complexity and create distortions between firms: effective tax rates are much lower on big business (Panel B) (Partouche and Olivier, 2011). The 2013 budget reduces the scope of these provisions, but the broadening of the corporate income tax base should be pursued and the statutory rate reduced. Finally, regulatory inflation of the labour code – which has virtually tripled in volume over the last 40 years – generates both complexity and instability, which tend to penalise small businesses disproportionately.

Another area in which French competitiveness could be improved is research and innovation. R&D performed by business, especially by SMEs, has fallen well behind its competitors over the last decade, and there are inadequate links between public and private research efforts. The result is that few micro firms and SMEs graduate to the ranks of larger employers. Specifically, France must make better use of its universities to provide the wherewithal to lay the scientific foundations for its enterprise sector (see below). While there have been efforts to overcome this problem in the recent past, these need to be assessed to ensure that only the best provisions are retained.

Improving the workings of the housing market

Beyond its impact on purchasing power and inequality, rising real estate prices may undermine business competitiveness. According to Égert and Kierzenkowski (2010) and *Ministère de l'économie* (2012), the uptrend in real estate prices contributed to the poor performance of French exports. The previous *Survey* (OECD, 2011b) put forth recommendations to improve the consistency of housing policies, to make supply more responsive, to foster a better allocation of resources and to make the housing market work more smoothly. Those recommendations are for the most part still relevant (Annex).

Figure 19. **Corporate tax loopholes are very significant**



1. Micro-enterprises have fewer than 10 employees, and sales and assets below EUR 2 million. SMEs have fewer than 250 employees, sales below EUR 50 million and assets below EUR 43 million. Intermediate sized enterprises (IE) have fewer than 5 000 employees, sales of EUR 0.5 billion and assets of less than EUR 2 billion. Finally, large corporations (LE) are those that exceed the IE thresholds.

Source: OECD, *Tax Database*; Eurostat (2012), Taxation trends in the European Union; 2010 tax returns (DGFiP), calculations by DG Trésor.

How to read this figure: The implicit rate is the ratio between corporate tax revenues and its economic base.

StatLink http://dx.doi.org/10.1787/888932790013

Reforming the labour market

The social partners reached an agreement to reform the labour market in January 2013. The government intends to translate it into law in March, but there is still uncertainty about the final outcome of the legislative process. Based on this compromise, employees will get new rights and employers greater flexibility. The most welcome advance comes from the "agreements on safeguarding jobs", which open the possibility to negotiate legally secured firm-level agreements that would allow, in times of serious economic difficulties, wages and working time to be adjusted for up to two years in order to safeguard employment. Once such an agreement is signed, a worker who refuses to participate will be subject to a fair dismissal for economic reasons.

In addition, partial unemployment schemes will be simplified, and both internal mobility and dismissal regulations (especially for collective dismissals) will be eased in order to lower the uncertainty and length of legal procedures, a clear break from the past as the collective dismissal process has been tightened and made more complex since the 1970s. The agreement aims also at facilitating conciliation in case of separation by setting a reference scale for lump-sum compensation as a function of tenure, which might act as a focal point in reducing compensation for unfair dismissals and shorten legal procedures.

On the social protection side, compulsory complementary health insurance would be extended to all workers, with the commendable objective of reducing inequality among workers in terms of health-insurance coverage. However, such an extension will be financed by an increase in employers' and employees' social contributions, equally split, thereby reducing the benefits of the Competitiveness Pact. This also points to the inherent problems of the responsibility of the social partners for deciding on the financing of social protection, as social contributions are the only instrument they can directly influence.

The agreement also would increase the generosity of the unemployment benefit scheme by allowing workers to cumulate their rights to unemployment benefits in terms of duration across spells up to the standard two-year maximum. While this measure was put forward as a way to improve incentives to go back to work, its overall impact on labour supply and on unemployment insurance finances is unclear and might well prove perverse. It is therefore important that it is combined with adjustments in the benefit system in order not to put further strain on the budget. The agreement also includes a limited increase in employers' unemployment contributions for some temporary contracts (from 4% to 5.5% for contracts shorter than 3 months and to 7% for those lasting less than 1 month). This measure can help to internalise the social costs of overusing temporary contracts and reduce labour-market dualism. Further easing employment protection for individual dismissals would also serve the latter purpose.

Overall, this reform would be an important first step in removing labour-market rigidities. Short-time work schemes contributed importantly to the resilience of labour markets during the crisis, especially in Germany and Japan, even though their negative effect on necessary long-term restructuring is still being debated (Hijzen and Venn, 2011). Much of the impact of the reform will depend on how the social partners seize the opportunity to improve both internal flexibility and social dialogue at the firm level, and on the effective legal simplifications in case of dismissals. On the other hand, this reform is likely to have a limited effect on OECD indicators of Employment Protection Legislation, which do not include regulations related to firm-level bargaining.

A large number of OECD countries have recently eased regulations on permanent contracts (the Czech Republic, Estonia, Greece, Hungary, Italy, New Zealand, Portugal, Spain, the Slovak Republic and the United Kingdom; see Table 4 for those countries for which the OECD has already assessed the changes). In France, boosting employment will still require implementing a broad array of reforms in areas such as not only unemployment benefit and activation measures, professional training and wage formation, but also public spending, taxation, regulations, education and product-market competition.

Table 4. **Scope of recent reforms easing regulation on labour market contracts in selected countries**

	FRA[1]	ESP	GBR	GRC	ITA	PRT
Reduce severance pay for permanent contracts				X		X
Reduce red tape for individual dismissals	**X**				X	X
Extend probation periods for new hires		X	X	X		
Expand the definition of fair dismissal	**X**	X				X
Improve functioning of courts in dismissal cases	**X**	X			X	
Reduce compensation for unfair dismissal		X				X
Reduce regulation on collective dismissals	**X**	X		X		X
Reduce regulation on non-permanent contracts				X	X	X
Increase regulation on non-permanent contracts		X			X	

1. The assessment for France is based on the assumption that the social partners' agreement is translated into law.
Source: OECD Employment Outlook (2013), forthcoming.

The labour tax wedge will shrink

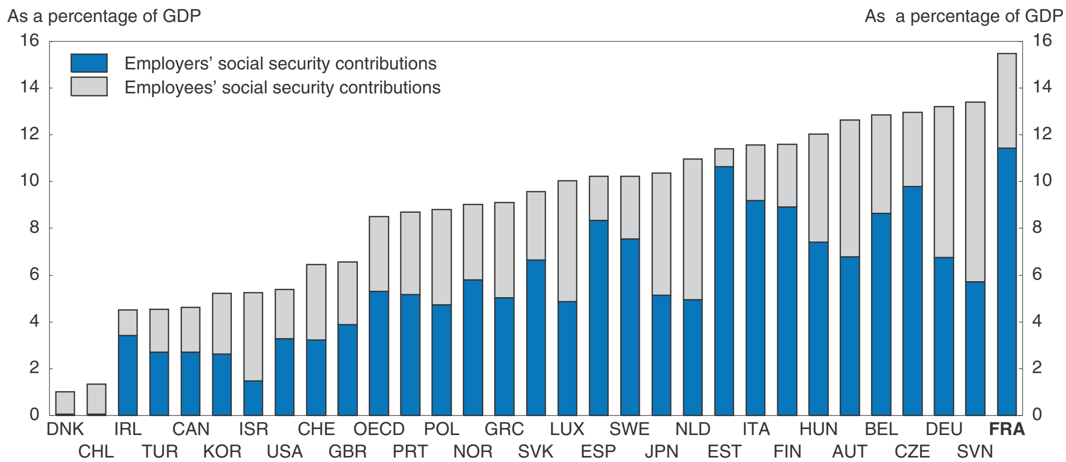
The labour tax wedge at the median wage level is high in France (Figure 14). With the National Pact for Growth, Competitiveness and Employment of November 2012, the government reduced the cost of labour for employees earning less than 2.5 times the minimum wage by means of a corporate tax credit. This reduces the levies on labour by one percentage point of GDP, half financed by reducing government expenditure and half by raising VAT (including by increasing the intermediate rate from 7% to 10%) and still undefined environmental taxes.

This reform is broadly in line with past OECD recommendations (OECD, 2012a) and would fill about half the gap between the French labour tax wedge and the OECD average at the median wage. It should be implemented with a phase-out range around the salary ceiling to avoid a "trap" at that level (2.5 times the minimum wage). Over the medium term, it would be advisable to cut labour taxes further (Figure 20). As indicated earlier, the best solution would be to reduce government spending by an equivalent amount. If new revenues are needed to ensure financing, these should be found by eliminating inefficient tax expenditures and increasing environmental, property and inheritance taxes.

Pursuing wage moderation at the minimum wage level and improving the quality of industrial relations

The negative impact of the labour tax wedge on employment is exacerbated by wage rigidities. The minimum wage (SMIC) as a proportion of the median wage is higher in France than in any other OECD country (Figure 21). In absolute terms, though Australia and the Netherlands have comparable minimum wage levels, they allow broad exemptions for

Figure 20. **Taxes on labour are high**[1]



1. 2010 for Greece, Japan, the Netherlands, Poland, Portugal and the OECD.
Source: OECD, *Revenue Statistics 2012 Database.*

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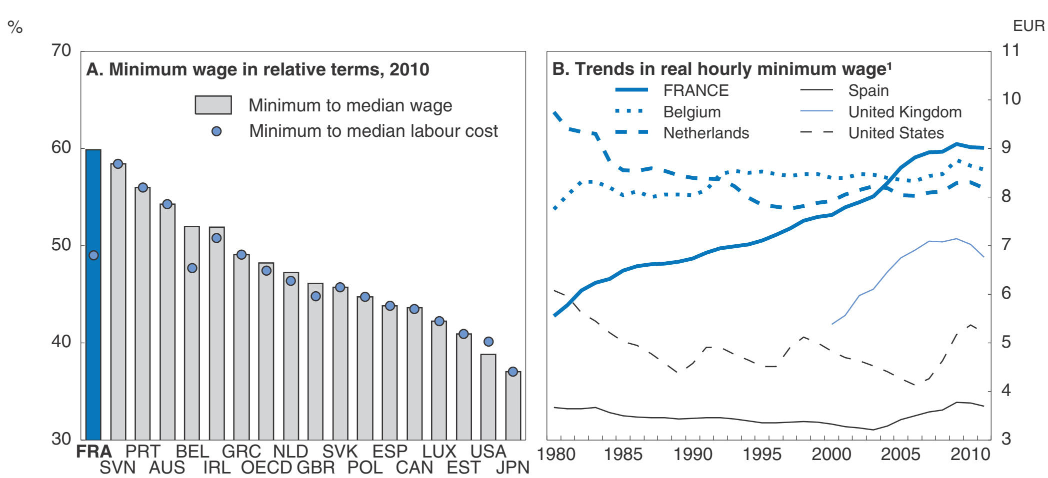
young workers (Chapter 2), which is not the case in France (except for apprentices and those under 18 years of age). Despite the rebate on social security contributions on low income earners, the cost of labour at the minimum wage level relative to the cost of labour at the median wage level is relatively high, near the mean of OECD countries having a legal minimum wage. While the SMIC may limit wage inequalities for full-time workers, it is not an efficient instrument for narrowing income inequalities, nor for combating poverty, because it has negative implications in terms of involuntary part-time employment and unemployment for the young and low-skilled. Mechanisms to support labour incomes (the earned-income tax credit and the *RSA-activité*) are, in principle, superior instruments.

Figure 21. **The relative minimum wage is high**



1. At constant 2011 prices and exchange rates.
Source: OECD, Going for Growth 2012 and *OECD minimum wage Databases.*

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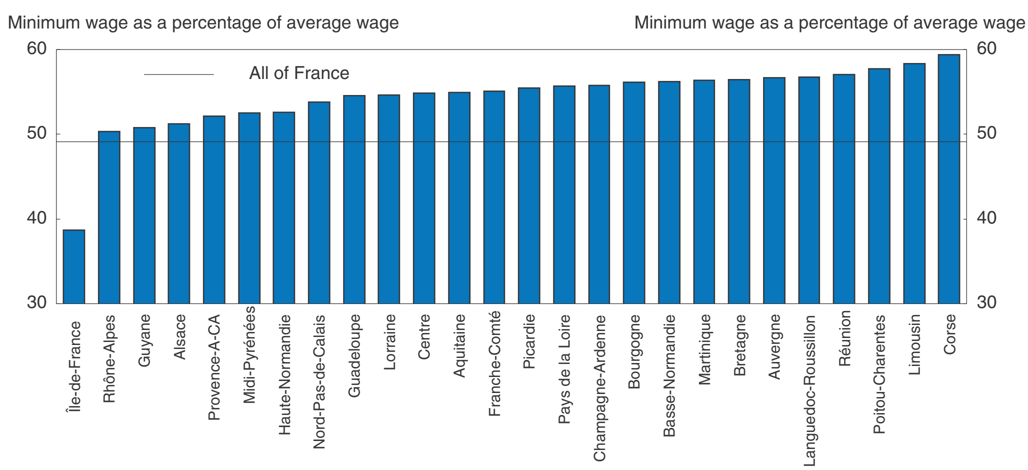
Outside the Ile de France region (Paris and its surroundings), the ratio of the minimum wage to the mean wage is very high, and the minimum wage can be extremely binding in some regions (Figure 22, which is simplistic in the sense of ignoring structural differences in employment between the regions). It would be of interest to conduct an analysis that accounts for heterogeneity across local employment pools to determine the extent to which the minimum wage limits the demand for labour at the regional level. In fact, a uniform minimum wage is at odds with the fact that the productivity of a given individual may vary geographically because of agglomeration effects, which have been amply documented in the economic geography literature. The cost of living also varies greatly across the country, implying large regional differences in the purchasing power of minimum-wage workers.

Figure 22. **Relative minimum wage by region, 2009**



Source: INSEE, DADS 2009.

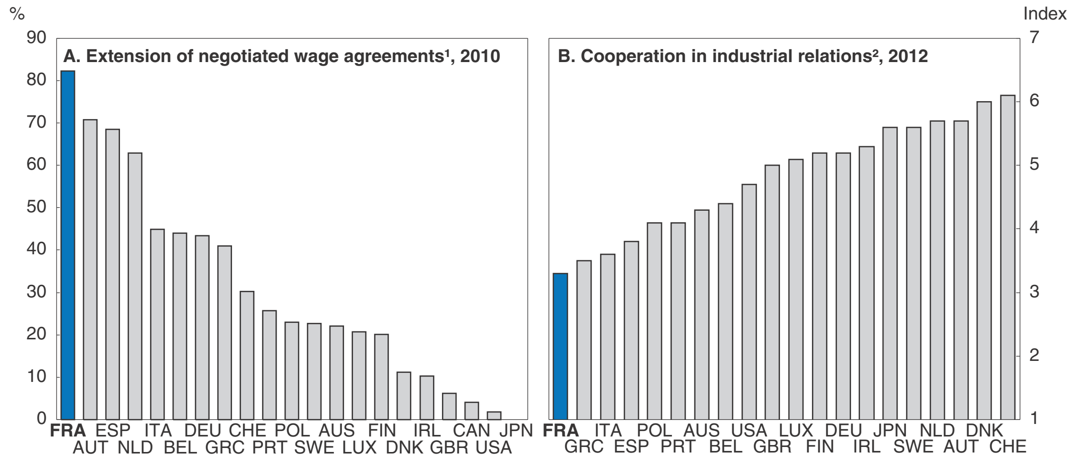
How to read this figure: In France, the minimum wage applies uniformly across all regions but differs from one region to another as a percentage of average wage.

StatLink http://dx.doi.org/10.1787/888932790070

A high minimum wage also tends to lessen the interest in collective bargaining, thereby damaging the quality of "social dialogue" (Aghion et al., 2008) and contributing to weak unionisation (Cahuc et al., 2008). Besides, the insufficient level of representativeness (Figure 23), measured as the differential between the percentage of workers covered by collective agreements and belonging to a union, seems to be an important contributor to unemployment (Murtin et al., 2013). The law of August 2008 will make unions more representative by rooting their legitimacy in the results of professional elections. However, it is still difficult to foretell the extent of that improvement.

Social dialogue might be stimulated by the possibility of legally secured firm-level derogation agreements that temporarily suspend contracts or collective agreements. The recent National Interprofessional Agreement of 11 January 2013 paves the way for that (see above). Moreover, as Cahuc and Zylberberg (2009) and the Perruchot Report (2011) point out, the financing of workers' and employers' organisations lacks transparency and is not sufficiently based on members' contributions, features that explain much of the sharp drop in unionisation rates and the poor quality of industrial relations (Andolfatto, 2007). This poor quality has often impeded achievement of better labour market outcomes in France. The success of negotiations between social partners launched in the wake of the "Grand Social Conference" of July 2012 (jobs of the future, generational contracts, job security) suggests that industrial relations are improving in France.

Figure 23. **Labour-management relations do not seem to be of good quality**



1. Arithmetic difference between the coverage rates of collective bargaining agreements and trade union density rates.
2. Index ranging from 1 to 7, based on a question posed to 14 000 business leaders (of which 129 in France), with 7 indicating the greatest possible level of co-operation.

Source: OECD, Going for Growth 2012; World Economic Forum, Global Competitiveness Report 2012-13.

StatLink http://dx.doi.org/10.1787/888932790089

Reducing the duality of employment contracts by decisively moving towards flexicurity

The labour market still features a firmly entrenched duality of employment contracts and insufficiently developed active labour market policies. Currently, 90% of recruiting is done on temporary contracts, and the road to stable employment is long and in many cases bumpy (Chapter 2). Contract segmentation might limit the economy's capacity to adapt to shocks (and thus aggregate productivity). In particular, it distributes the necessary adjustments unequally between those who are protected and those who are exposed, and fails to allay workers' feelings of insecurity, even for those on permanent contracts. Furthermore, segmentation generates substantial inequalities in access to both on-the-job training and housing**.** The *rupture conventionnelle* – a negotiated termination of individual labour contracts instituted in 2008 – allows layoffs to be more harmonious but reduces duality only marginally.

To reduce segmentation, the definition of so-called "economic dismissals" should be expanded, redeployment obligations imposed on businesses scaled back and lay-off procedures simplified. With regard to economic dismissals, an important objective must be to limit the discretion of the judge in determining the motive. In Australia, for example, such dismissals are deemed fair if they are accompanied by an elimination of the position and do not conceal a personal motivation. These flexibility provisions could be combined with higher employers' social security contributions for temporary contracts than their permanent counterparts, effective administrative restrictions on using them excessively (as in Finland and Norway) and a lengthening of the trial period for permanent contracts.

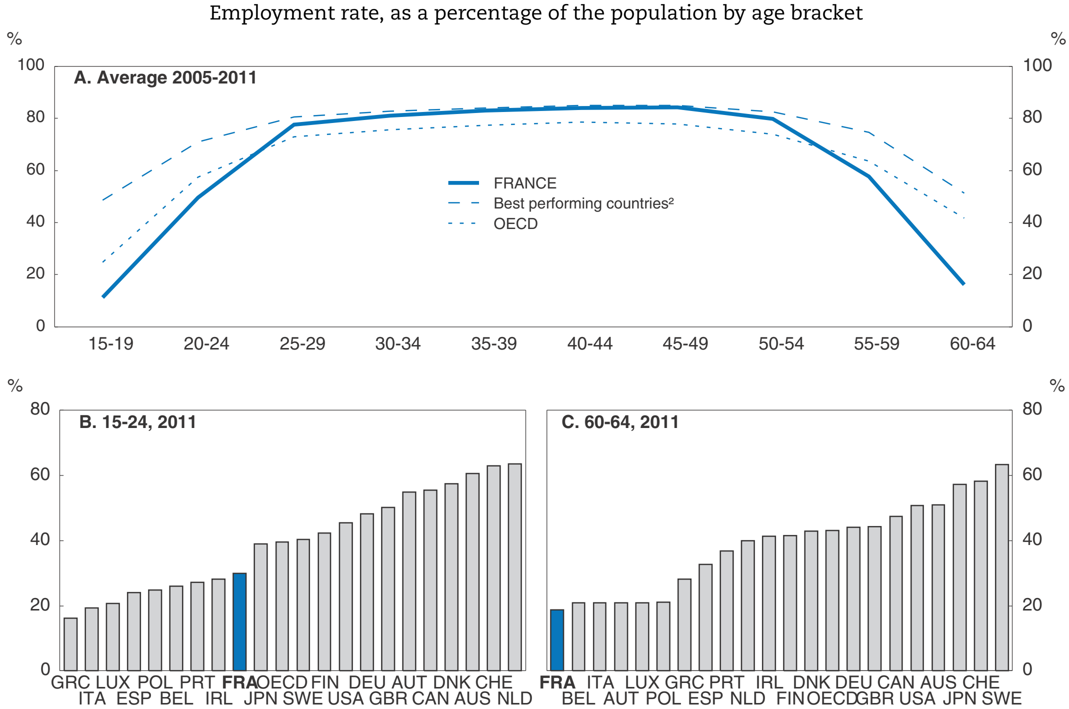
France must build on recent progress and decisively move toward "flexicurity". This is a system that organises the labour market so as to combine the flexibility of permanent contracts, a high level of income security for workers between jobs and an active employment policy, which by harnessing intensive tracking, guidance and retraining services makes it easier for laid-off workers to be reemployed. Flexicurity aims to protect people's income and employability, rather than to preserve low-productivity jobs, thus facilitating adjustment to economic transformations. For the system to work properly, the guarantee of resources for the unemployed and support to job-search efforts (though costly) must be accompanied by an effective obligation that beneficiaries accept reasonable job offers, even when that entails conditions less attractive than those previously enjoyed. The objective here would thus be to formulate a strategy for helping people get back to work that would reinforce the link between benefits, job search and participation in active measures, bolstered by effective support services for all job-seekers, including beneficiaries of the RSA, in keeping with the provisions of the law of December 2008.

Expanding seniors' employment is still a priority

Employment for young people and seniors, despite advances in the case of the latter, remains France's Achilles' heel (Figure 24). Although the employment rate of older workers (especially women) has been trending up, even during the crisis, for those aged 60 to 64 it is still the lowest in the OECD, so that the average duration of retirement is one of the longest (OECD, 2011c) (Figure 25). This increase in seniors' employment rates can be explained at least in part by an array of policy changes implemented during the past decade (OECD, 2011b). With regard to labour supply, the 2010 pension reform will help modify behaviour by employers and employees alike *vis-à-vis* employment at older ages, as well as regards investment in lifelong training. On the other hand, although most government measures to subsidise early retirement schemes have been removed, other options still let seniors leave the labour market early, in particular via the *rupture conventionnelle* or layoffs combined with more generous unemployment benefits (see above).

Figure 24. **French employment rates vary widely by age bracket**[1]

Employment rate, as a percentage of the population by age bracket



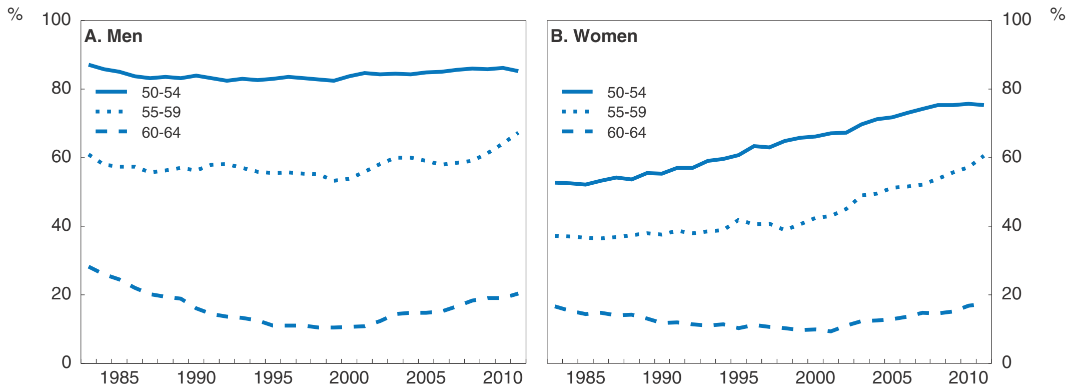
1. A ranking was used to identify groups of OECD countries according to employment rates by age bracket (see Chapter 2).
2. Australia, Canada, Denmark, Iceland, New Zealand, Norway, the Netherlands, Switzerland and the United Kingdom.

Source: Boulhol and Sicari (2013b); OECD *Labour Force Statistics 2012 Database*.

StatLink http://dx.doi.org/10.1787/888932790108

Figure 25. **Employment rates of older workers in France**

As a percentage of the population by age bracket



Source: OECD, *Labour Force Statistics 2012 Database.*

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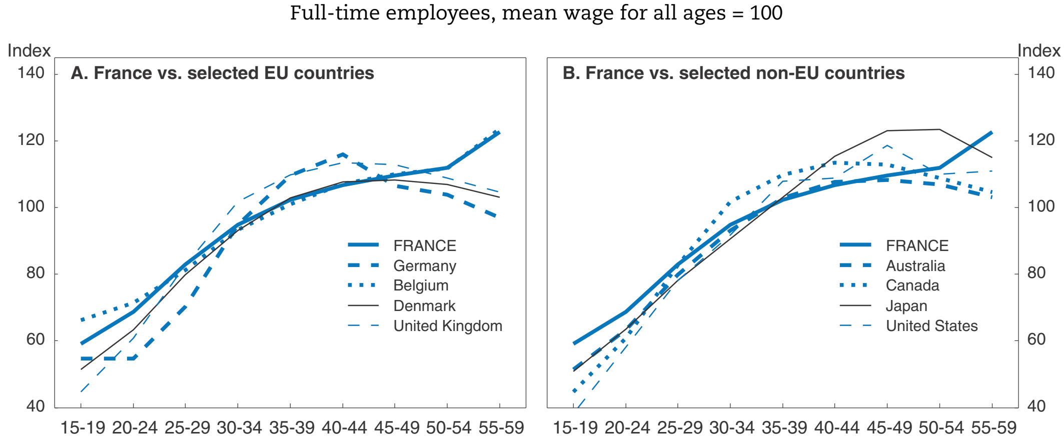
With regard to labour demand, the mechanism of length-of-service-related salary increases (automatic uprating resulting from negotiated salary scales under industry-wide agreements, end of working life bonuses) can be detrimental to seniors' employment if it does not reflect productivity levels. Now, compared to other countries, relative salaries in France seem particularly high for young people and seniors (Figure 26). The authorities could encourage labour and management to put the issue of age-related salary progression at the heart of wage negotiations, including in the public sector.

In 2013 the government will implement "generational contracts". This new scheme grants subsidies to firms with fewer than 300 employees that hire a young person on a permanent contract while at the same time preserving the job of a worker over the age of 57. This measure reduces the labour cost of youths and seniors, though that is not the primary intention given by the government for this provision. It would be preferable to tackle directly the wage-setting process for these age groups (minimum wage, age-related pay), which would avoid putting a drain on government finances (Chapter 2).

Figure 26. **Distribution of mean wages by age bracket, 2009**

Full-time employees, mean wage for all ages = 100



Note: These graphs must be interpreted with caution because they may reflect compositional effects, for example if the least qualified are the first to exit the French labour market.

Source: OECD, *Wages and Earnings Database.*

StatLink http://dx.doi.org/10.1787/888932790146

Box 5. Recommendations to bolster the economy's potential and restore firms' competitiveness

- Reduce public spending to rein in the budget deficit and then ease taxes on labour and business income.

Markets for goods and services

- Boost product market competition, e.g. by easing the regulations limiting access to numerous professions.
- Eliminate tax breaks that unduly benefit large firms. Eliminate or lessen the obligations imposed on businesses arising from employment-based thresholds that are superfluous or secondary, and spread out more those that are necessary in order to smooth their effects.
- Remove the need for special authorisation for commercial zoning and the ban on selling at a loss, and ease restrictions on store opening hours. Expand the powers of intercommunal authorities, in particular with regard to building permits and local urban planning. Adopt the 2011 bill on the "Rights, Protection and Information of Consumers".
- Create a single independent authority to regulate the whole transport sector. Maintain and clarify the separation between the rail network manager (RFF) and the incumbent operator (SNCF) so as to ensure conditions conducive to effective competition.
- Introduce class action lawsuits into French law, in particular encompassing anti-trust law.

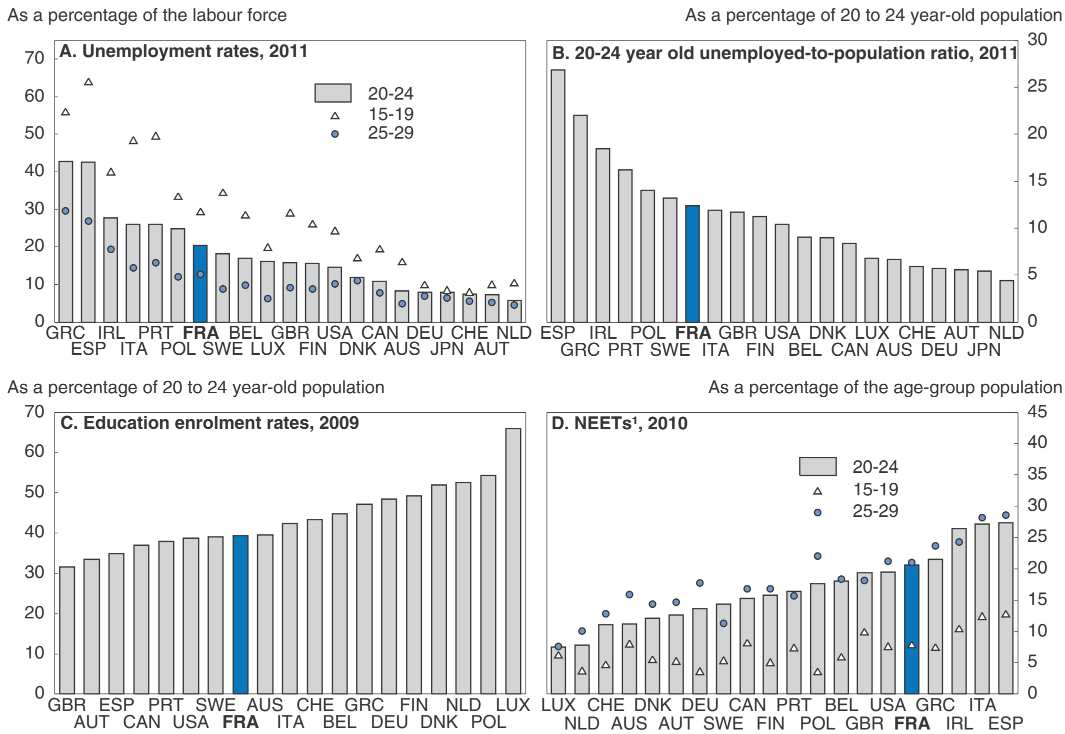
Labour market

- Broaden the definition of economic dismissal; simplify lay-off procedures and streamline legal procedures; ease employer redeployment obligations; ensure that employers' social security contributions are higher on temporary contracts than on permanent contracts; lengthen the probationary periods on permanent contracts; and enhance the effectiveness of occupational training and job-search assistance programmes.
- Pursue wage moderation at the minimum wage level, and consider adjusting the minimum wage at the regional level if further detailed analysis shows labour costs weigh heavily on regional employment outcomes. Encourage labour and management to put the issue of age-related salary adjustments at the heart of wage negotiations, including in the public sector.
- Reform the unemployment insurance system and improve activation policies (Box 4).
- Increase opportunities for companies to opt out of sectoral and individual agreements. Reform the financing of labour and employers organisations so as to enhance representativeness and continue to improve social dialogue.

Improving the economic situation of young people

Young people have been hit hard by the deterioration of the economic situation since 2008. But the main difficulties they face are structural. Educational inequalities have been widening for over a decade – a situation made worse by the fact that they stem from a sharp decline in the results of the weakest students. French youths suffer from a number of labour market problems (Figure 27, Panels A, B and C), last assessed in depth in OECD (2009b); in particular, the unemployment rate for those aged 20-24 has not dropped below 16% for nearly 30 years. They are also highly pessimistic about the future (see Figure 2.6) and express great distrust of institutions (government, the media, big business, etc.). The geographic concentration of situations of extreme insecurity contributes to a climate of tension.

Figure 27. **The difficulties of young people in the labour market**



1. Neither in employment, nor in education or training.
Source: OECD, Labour Force Statistics 2012 and *Education 2012 Databases*.

StatLink http://dx.doi.org/10.1787/888932790165

Young people must cope with an inadequate supply of student housing and of small dwellings in social housing. Apart from housing aid that is available to them on an individual basis, support measures for young adults are based on about 100 different age thresholds and delivered for the most part through family allowances (Commission sur la politique de la jeunesse, 2009). Childless young adults under 25 are virtually excluded from the main social assistance mechanism (the RSA), an exception in Europe shared with Spain and Luxembourg. This hybrid system sits uneasily between autonomy and family solidarity and is unfair because young people who are unemployed and have no solid financial backing from their families find themselves in precarious situations.

Extending the RSA to young adults would reduce the intensity of poverty and, if well designed, facilitate the transition to work. It should be age-dependent and reserved for NEETs (those not in education, employment or training). The key to the scheme's success, and a *sine qua non* condition, in particular to avoid discouraging them from pursuing their studies, would be to tie it firmly to compliance with reciprocal obligations that enhance school-to-work transition, a challenge in France that transcends young people alone (cf. above). This RSA extension could be fully financed by eliminating the regressive tax breaks that accrue when young adults are included in their parents' tax units, along with any family benefits to which they confer entitlement. In the framework of the plan to fight poverty (Box 3), the government intends to implement a "youth guarantee" conditional on participation in activation programs, for an amount similar to the RSA and reserved for NEETs "in very precarious situations". The provision's target is to ultimately cover 100 000 youths aged 18 to 24 years, or only approximately 10% of NEETs in this age group.

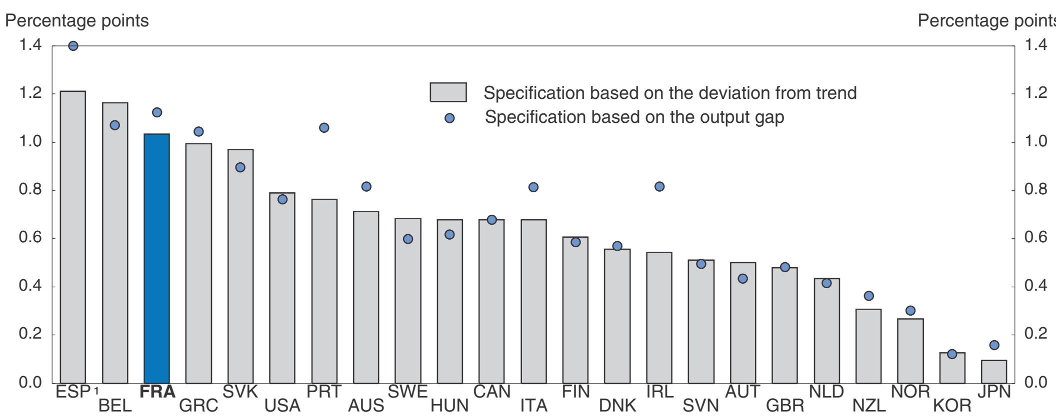
The level of the minimum wage and the duality of work contracts are detrimental to young people

The rate of indexation of the minimum wage to age could follow (in relative terms) that of this revamped youth RSA. Indeed, the level of the minimum wage tends to keep low-skilled youth out of work. In contrast to many countries that have adopted an age-related minimum wage, young adults in France find themselves in competition with experienced workers but without any cost advantage. This leads firms to develop circumvention strategies (notably internships).

France, along with Spain and Belgium, are the OECD countries whose youth unemployment would seem to be most sensitive to economic cycles (Figure 28). Strong employment protection puts new entrants at a greater disadvantage in the event of declining demand, and it distributes the burden of the economy's necessary structural adjustments in a highly unequal manner, to the detriment of young people and especially those with low skills. Among jobs held by people aged 15 to 29, 34% are temporary, versus 13% for employees of all ages (DARES, 2012). France, like the countries of southern Europe, combines a poorly developed system of ties between young people and business with labour market rigidities. As a result, the time needed to break into the workforce is longer.

Figure 28. **Sensitivity of the youth unemployment rate to economic fluctuations, 15-24 years**

Estimated unemployment rate variation one year after a one-point negative GDP shock



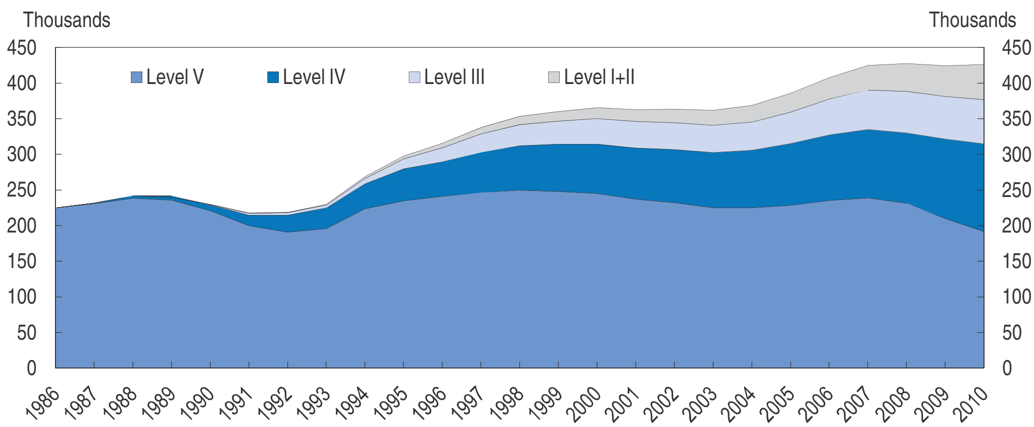
1. For the specification based on the output gap, the change in the youth unemployment rate has been capped at 1.4 to improve the readability of the graph, the true value being 2.4.

Source: Boulhol and Sicari (2013b).

StatLink http://dx.doi.org/10.1787/888932790184

Successive governments have implemented various types of subsidised contracts, including apprenticeships, to attempt to overcome the difficulties youths face on the labour market. They represent approximately one quarter of the jobs occupied by those aged less than 26 years, and one half of those occupied by youths with a *baccalauréat*. Research is convergent as regards the absence of a lasting positive impact of the subsidies in the non-market sector and the benefits of apprenticeship. In response to the persistent crisis, the government has launched a new programme of over 150 000 non-work-study wage-subsidised contracts in 2013 and 2014 (*emplois d'avenir*). These contracts differ from traditional subsidised contracts in the market sector: having long durations and stringent conditions on employers for the provision of tutoring, training and support alongside the public employment service – all of which might somehow make a difference in the school-to-work transition. It is important, however, to limit such measures to emergency counter-cyclical initiatives, given their limited effectiveness as a tool for integration into stable employment. Apprenticeship has experienced welcome sharp growth, but its development has left behind those who are least skilled (Figure 29). In this case the windfall effects might be substantial, as employers can use the apprenticeship scheme to hire qualified youth as apprentices in order to take advantage of the subsidies (Martin and Grubb, 2001). Vocational training programmes should be better co-ordinated, apprenticeship programmes simplified and subsidies refocused on the low-skilled.

Figure 29. **Number of apprentices at year-end, by level of diploma**[1]



1. Certificat d'aptitude professionnelle (CAP), brevet d'études professionnelles (BEP) and mention complémentaire (MC) for level V; brevet professionnel (BP), baccalauréat professionnel (Bac pro) and mention complémentaire (MC) for level IV; brevet de technicien supérieur (BTS), diplôme universitaire de technologie (DUT) for level III; licence, maîtrise for level II; diplôme d'ingénieur, diplôme d'études supérieures spécialisées (DESS), master for level I.

Source: Ministry of National Education, DEPP.

StatLink http://dx.doi.org/10.1787/888932790203

Better co-ordination of support and better guidance for young people

The primary function of "local missions" is the occupational and social integration of young people. Although they form part of the public employment service, numerous co-ordination defects appear to be undermining the system's coherency, underscoring the absence of an integrated policy for getting young people into work. Centralising responsibility for local missions at the regional level (while at the same time preserving involvement in local employment markets) would generate efficiency gains.

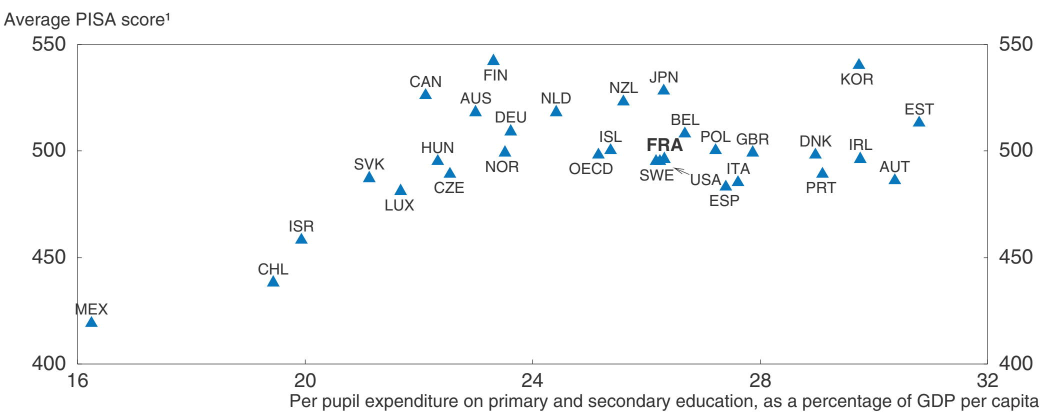
The system of educational and occupational guidance is one of the weak links of the school-to-work transition. Students following technological or vocational tracks must decide amongst a myriad of specialisation options already at the end of lower secondary school, which is too early (Galland, 2011), calling for another year of more general studies. This problem is exacerbated because guidance counsellor/psychologists often lack detailed knowledge of the world of work and employment opportunities (HCE, 2008). Their guidance responsibilities, which should be expanded through specialised training, should be clearly separated from their psycho-social functions. Teachers are also too removed from business. The various parties providing guidance should also be better co-ordinated, in particular by bringing closer together at the regional level, if not by merging, the current functions of the information and guidance centres, the General Integration Mission of the Ministry of National Education and local missions.

As the education system is failing to reduce inequality, priority should be given to early interventions

PISA results suggest that there is substantial scope, in a budget-neutral way, for improving the performance of the French compulsory education system, which are near the OECD average (Figure 30). Inequalities in terms of educational attainment have reached a worrisome level (Figure 31), and the influence of social origin on academic performance is one of the largest in the OECD. Severe economic and social difficulties loom in the long term if nothing is done to remedy the situation. It seems paradoxical that wide educational inequalities persist in France upstream and that generous, but very costly, social protection is harnessed downstream in order to offset the ensuing socio-economic inequalities.

Figure 30. **Outcomes are not related to education spending for the more affluent OECD countries**

2009

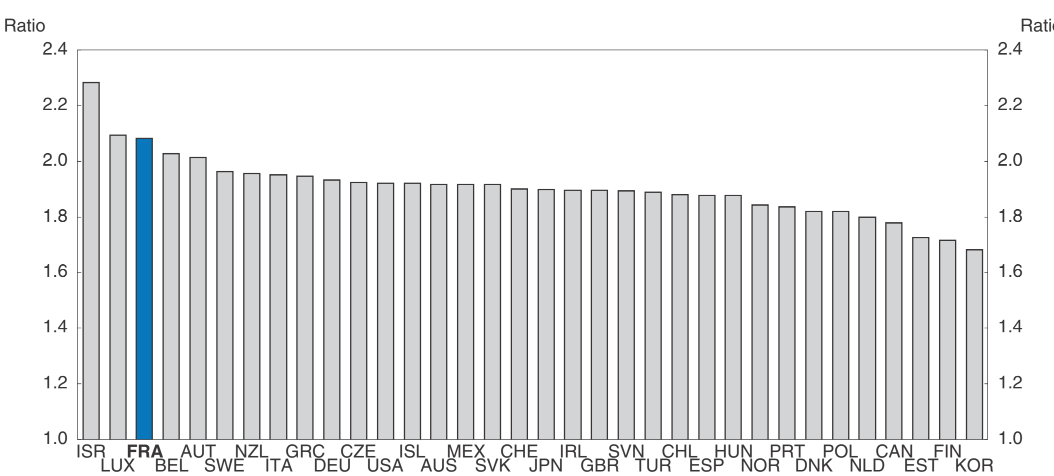


1. Average of PISA scores on the reading, mathematics and science scales.

Source: OECD, Education at a Glance 2012 and of *PISA 2009 Results Databases*.

StatLink http://dx.doi.org/10.1787/888932790222

Figure 31. **Ratio of PISA scores of the best and worst students[1], 2009**



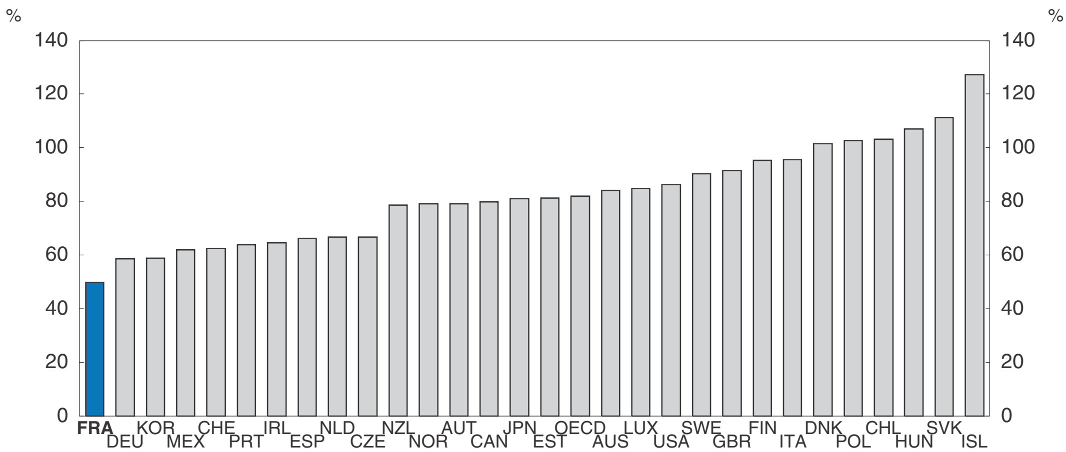
1. Ratio of the average score of the top 5% of students and the average score of the bottom 5%. Scores are averages of PISA scores on the reading, mathematics and science scales.

Source: OECD, *PISA 2009 Results Database*.

StatLink http://dx.doi.org/10.1787/888932790241

Fighting effectively against academic failure implies concentrating resources at an early age, especially for disadvantaged children (Heckman and Carneiro, 2003). And yet expenditure per pupil in primary school averages only half as much as for upper-secondary students, as opposed to an average of four-fifths in the OECD (Figure 32). Furthermore, the percentage of two year-olds at school has been declining rapidly since the early 2000s.

Figure 32. **Ratio of annual spending per primary school pupil to that for upper-secondary education, 2009**



Source: OECD, *Education at a Glance 2012 Database.*

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Increase resources for priority education considerably, and use them effectively

Approximately one student in five is enrolled in priority education – a territorial policy of positive discrimination instituted in the early 1980s. This erratic policy has yielded disappointing results. The resources allocated are very limited and poorly identified. On the basis of successful initiatives abroad, an additional 0.13% of GDP per year (according to estimates from Chapter 2) should be deployed to mount a serious attack on scholastic failure in disadvantaged areas. This order of magnitude corresponds to the amount committed by the government to create 60 000 teaching jobs during the five-year presidential term.

How the resources are used is just as important as the amounts involved, and the emphasis should be put on three courses of action in schools in disadvantaged neighbourhoods: strengthening teaching quality (financial incentives, specialised training, multidisciplinary teams), improving managerial effectiveness (training, selection, autonomy and support for principals) and encouraging the involvement of parents. A more radical approach would be to question the very idea of zoning, which generates strong stigmatisation effects. Additional budget allocations would then be made to schools depending on the individual characteristics of the students enrolled there, as is done in the Netherlands, for example.

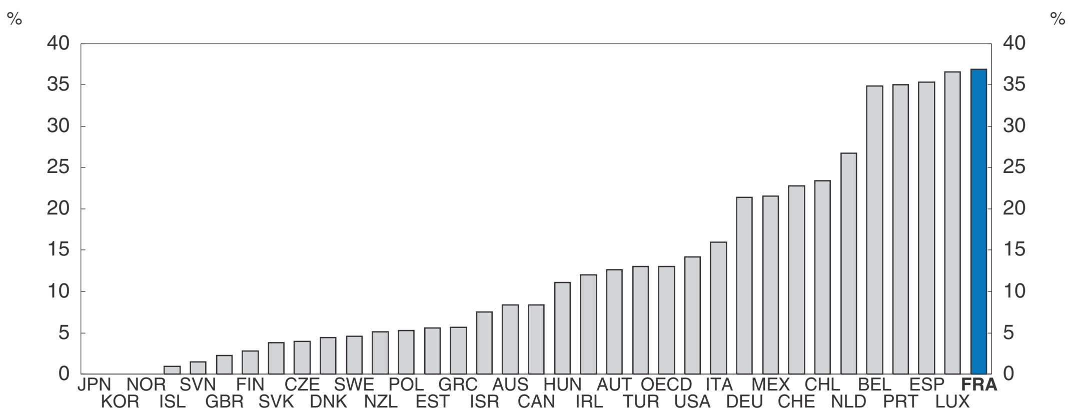
Give primary school principals autonomy, improve teacher training and increase individual tutoring

Apart from the issue of priority education, initial teacher training is still too academic and insufficiently geared toward learning pedagogical methods. Moreover, the best way to deal with the wide variety of local situations would be to expand primary schools' autonomy. Primary school principals' duties are unclear, and they have neither the authority required to assume genuine pedagogical responsibility, nor sufficient resources to fulfil their administrative functions (Obin, 2007). Resources are also insufficiently rationalised because of a large number of small schools, which in turn stems from the multitude of small municipalities.

The high, albeit declining for the past 20 years, frequency with which students are made to repeat grades (Figure 33) is both ineffective and costly. Limiting the practice will necessitate greater individualisation of teaching through effective tutoring of those with learning difficulties. In addition, school days are among the longest in the OECD, the primary school week is only four days (rather than five almost universally), and holidays are relatively long. This is ill suited to children' biorhythms (OECD, 2012f). The government intends to improve weekly schedules for primary schools as of 2013-14.

Figure 33. **Grade repetition is very high in France**

Percentage of young people aged 15 who have repeated at least one school year, 2009



Source: OECD (2012), Equity and Quality in Education.

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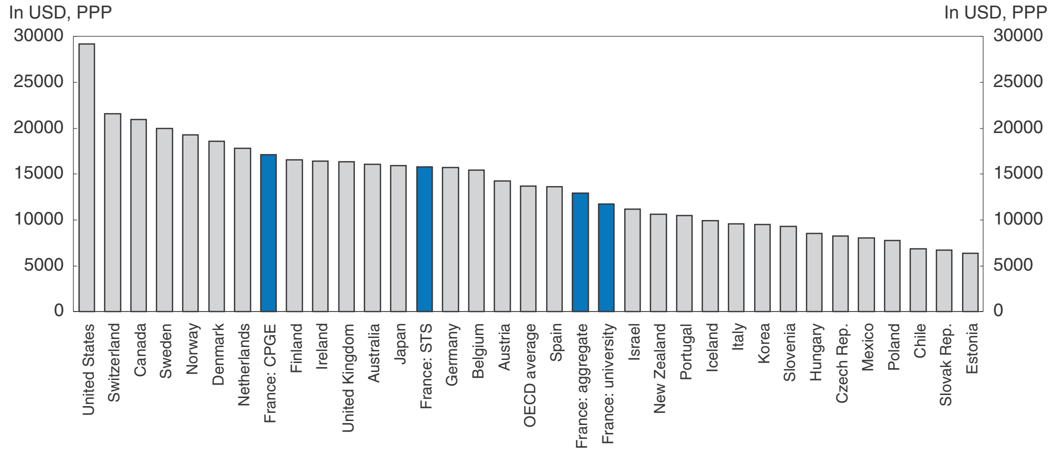
Shift public funding for higher education to universities and expand their autonomy

With over 400 institutions supervised by 11 different ministerial authorities (Cour des comptes, 2011), French higher education is fragmented despite efforts that have been made to improve its transparency with the creation of research clusters (PRES, cf. the Annex). Despite recent efforts, universities' financial resources remain inadequate both by international standards and relative to those of other tertiary institutions (Figure 34). Beyond differences in public spending, the success of the *grandes écoles* has been built on a very selective environment and relatively significant autonomy. Because the university system lacks these attributes for the most part, the overall system is dualistic, with the universities being deprived of a vast proportion of top inputs and to a fairly large extent cut off from the elites.

Even though this issue is not on the policy agenda in France, raising tuition fees will be difficult to avoid if the quality of the university system is to be improved, adequate autonomy and accountability are to be granted and if students become more demanding as regards the quality of higher education services. Even if higher education is, as elsewhere, dominated by children from middle-class families, any increase should be accompanied by better access to student loans with repayment contingent on future income and by an upgrading of the grants system. To optimise use of the necessary additional resources,

Figure 34. **Spending per student for the various higher education sectors, 2009**[1]

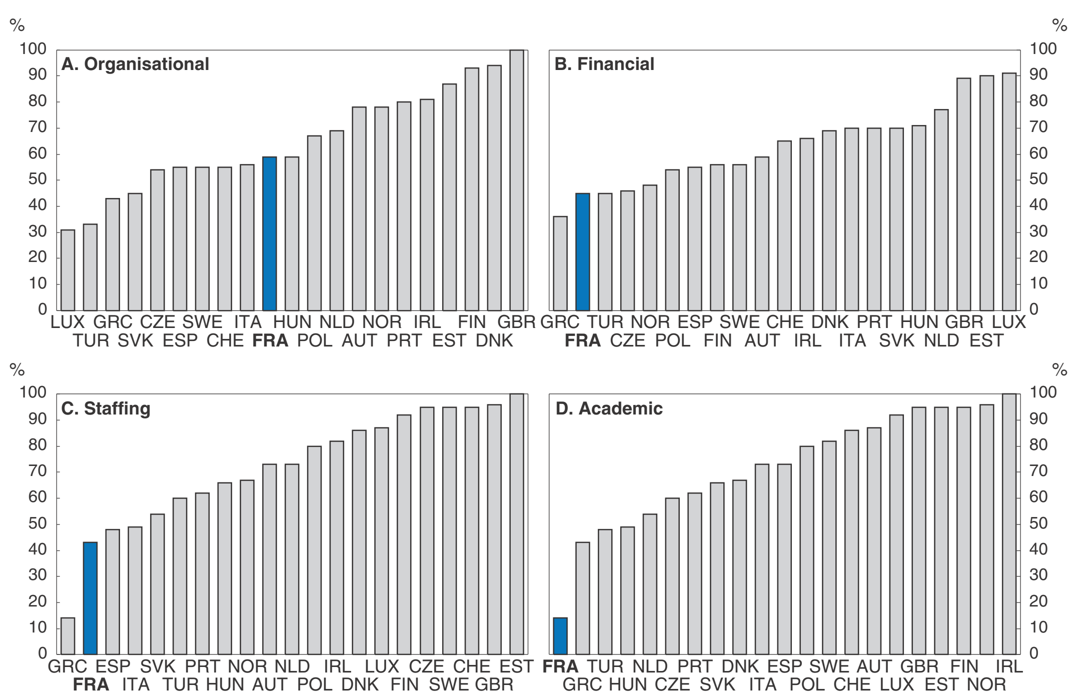


1. For France: Preparatory classes for admission to Grandes Écoles (CPGE) and Higher Technicians' Sections (STS).
Source: OECD, Education at a Glance 2012; Ministry of National Education-DEPP, *L'état de l'école* 2010, 2012.

StatLink http://dx.doi.org/10.1787/888932790298

universities must also enjoy greater autonomy. Despite recent improvements, the university system remains one of the most constrained in Europe (Figure 35). Expanded autonomy could offer universities greater freedom to set their tuition fees, select their students and manage their human resources.

Figure 35. **Degree of university autonomy in Europe, 2010**[1]
In percentages



1. 100% is the highest degree of autonomy given to universities in the four areas reported in the figure.
Source: European University Association, 2011.

StatLink http://dx.doi.org/10.1787/888932790317

Box 6. **Policy recommendations for improving the economic situation of young people**

Reduce poverty and increase employment for youth

- Extend entitlement to the RSA to young adults who have completed their studies according to an age-dependent progressive scale, strictly conditional on implementing an effective activation strategy based on training or active job-search. Index the minimum wage to age according to the same progressive rate as for this extended RSA.
- Reduce the duality of the labour market (see Box 5).
- Streamline the schemes for helping young people to find jobs, centralise responsibility for "local missions" at the regional level, and consolidate guidance-related functions at the regional level.
- Maintain the work-study orientation of subsidised contracts, which should be refocused on the least educated and made more attractive for businesses. Better coordinate vocational programmes.

Concentrate funding for education on primary schools and disadvantaged areas

- Shift some secondary education funding to primary schools and to admitting children in disadvantaged areas from age two. Expand the autonomy of primary schools and their principals.
- Devote the additional government expenditure recently allocated for education to making "priority education" (favouring the disadvantaged) a genuine priority. Improve the quality of teaching staff and of management teams in schools in disadvantaged neighbourhoods.
- Make pedagogical practices a more central part of teacher training. Cut back rapidly on grade repetition, and enhance teaching tailored to individual needs. Adapt school calendars and schedules to children's biorhythms.
- Separate clearly the guidance functions from the psychological objectives of guidance counsellor/psychologists. Introduce a first year with a common curriculum within each of the upper secondary technological and occupational tracks.

Improve the equity and effectiveness of higher education

- Shift public resources from the elite tertiary institutions (*grandes écoles*) to universities. Give universities more autonomy in management, student selection and setting tuition fees. Provide student loans with income-contingent repayment and adjust means-tested grants to ensure equitable access.

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ANNEX

Progress in structural reform

This Annex reviews the measures taken in response to the recommendations from previous *Surveys*. The recommendations that are new to the present *Survey* are contained in the corresponding chapters.

Recommendations	Measures taken since beginning of 2011
Labour market policy	
Ensure that the minimum wage grows more slowly than the median wage, by at least avoiding discretionary increases.	The minimum-to-median wage ratio has been roughly stable at a high level. The government opted for a discretionary "nudge" (i.e. beyond what is mandated by law) in July 2012, but it only represented an advance on future automatic rises.
Promote flexicurity, and reduce labour market dualism.	No measure implemented prior to the National Interprofessional Agreement of 11 January 2013 (see body of text)
Extend the return-to-work strategy to reinforce the link between benefits, job search and participation in active measures relying on efficient public employment services.	The long-lasting economic crisis has not been favourable to strengthening those links. The public employment agency's new three-year plan (Objectif, 2015), decided in July 2012, includes progress in terms of performance measurement and better targeting of those in difficult y (see Chapter 1).
Give priority to making young people employable and to on-the-job training opportunities. Target subsidies in the work-study schemes more on the less skilled, and evaluate their efficiency regularly.	The government has created new subsidised contracts (*emplois d'avenir*) targeted at the low-skilled with an objective of 100 000 contracts by 2014 (see Chapter 2). A new scheme is being put in place (*contrats de génération*) granting lump-sum rebates on payroll taxes to businesses with fewer than 300 employees that sign a permanent employment contract with a youth aged below 26 while retaining a senior aged over 57 (see Chapter 2).
Make better use of the earned-income tax credit and the RSA to support low-income working households.	No action taken. The government intends to better articulate the RSA and the PPE (see Box 3).
Reduce the labour tax wedge.	The 2012 Budget (Amendments) Act of 29 December 2012 introduced the Employment Competitiveness Tax Credit which cuts the cost of labour by means of a business tax credit (or income tax credit, depending on the employer's tax regime) for employees earning less than 2.5 times the minimum wage. This reduces the levies on labour by one percentage point of GDP. Half of this is financed by reducing government spending and the rest by VAT (in particular by raising the intermediate and standard rates) and still undefined environmental taxes. This reform is broadly in line with past OECD advice and will remove about half the gap between the French labour tax wedge and the OECD average.
Ensure that the unemployment insurance system does not implicitly subsidise early labour-market exit.	No action taken.
Make pensions actuarially neutral, especially in the retirement age bracket. Align the civil service schemes fully with the general system.	Although various reforms over the past decade have decreased the implicit tax on continuing to work, the pension system remains very fragmented. The promised 2013 public debate should aim to adopt a single points-based system.
Encourage the social partners to put the question of age-related pay raises at the centre of wage negotiations.	No action taken.

Recommendations	Measures taken since beginning of 2011
Education policy	
Higher education institutions should be given autonomy in both financial and personnel management.	No progress since the implementation of the 2007 "University freedom and responsibility" law. Universities' autonomy is one of the most limited in Europe (see Chapter 2).
Candidates for university entry should be explicitly selected, and students should be offered more effective guidance at the beginning of the last year of upper-secondary school.	No action taken with regard to selection. The 2012 degree reform (*Plan pour la réussite en licence*) strengthened the upper-secondary school guidance scheme ("Admission Post-Bac") by putting universities in charge of both providing better information in terms of available places, graduation rates and labour-market integration and tasked them with building with candidate students a suitable training programme related to a professional career path.
Raise university tuition fees to reflect courses' differing cost. Introduce a system of student loans with income-contingent repayment through the income tax system.	No action taken.
Research and innovation policy	
To make the "competitiveness clusters" policy more effective, maintenance of state aid should be contingent on results; establish a sunset date for subsidies while gradually replacing them with private financing.	The 2012 National Pact for Growth, Competitiveness and Employment includes a commitment to distinguish the internationally oriented strategic clusters from those dedicated to regional development. Projects will be evaluated based on their economic outcomes and innovation diffusion.
Harmonise the diploma-granting and recruitment rules of the *grandes écoles* and the universities.	In May 2012 there were 23 higher education and research clusters (Pôles de recherche et d'enseignement supérieur, PRES) covering 60 universities (out of a total of 83) and 13 other establishments (engineering schools, business schools, etc.). Yet, the precise role of the PRES is unclear, even if they are supposed to become the leading actors in the rebuilding of the university landscape (see Chapter 2). The pending Higher Education and Research Act (*Loi sur l'enseignement supérieur et la recherche*) also makes provision for better coordination between universities and preparatory courses for the *grandes écoles.*
Assess the effectiveness of the research tax credit regularly so as to optimise its configuration and scope of application.	The research tax credit is one of the most generous R&D support mechanisms in the world. In September 2010, the report by the Inspectorate-General of Finance had found that it exerted a leveraged effect on private expenditure and recommended stability for the scheme, at least until 2013. Its cost of about EUR 5.3 billion in 2012 largely exceeds projections (less than EUR 3 billion)
Facilitate class-action lawsuits and ensure that they are applicable to damages from anti-competitive practices	The government has launched consultations on this matter, which should pave the way for a new law in 2013
Competition on goods markets, competitiveness and regulatory reform	
Repeal the Royer and Raffarin laws on commercial zoning for large stores to do away with the requirement for approval formalities other than a building permit.	No action taken.
Assess the impact of measures under the Law of Modernisation of the Economy regarding the conditions of negotiation between retailers and suppliers and ascertain whether they should be eased further.	The ban on resale below cost is still in force.
Eliminate gradually the quotas (*numerus clausus*) in certain legal professions (attorneys before the Council of State and the Court of Cassation) as well as in health-related professions (pharmacists, physiotherapists and veterinarians).	No action taken.
Simplify entry conditions in certain professions, either by reducing the field of activities over which they hold exclusive rights (architects, notaries, bailiffs) or by reconsidering the required years of study (architects, veterinarians, hairdressers).	No action taken.
Strengthen competition in mobile telephony by proceeding with the decision to attract a 4^{th} network operator during the next bandwidth allocation and facilitate access for VMNOs and to these networks.	The entrance of a fourth 3G operator (Iliad, parent of Free) has led to a sharp reduction in prices. Licenses for 4G were awarded to three operators at the end of 2011 for a total of 3.6 billion euros.
In the case of electricity, allow the transitional regulated prices (Tartam) to expire. More generally, reconsider the scope of application of various regulated prices in the retail market, at least as they apply to non-residential customers.	The Tartam was to have expired by June 2010, but it has been extended. The Regulated Access to Incumbent Nuclear Power (*Accès Régulé à l'électricité Nucléaire Historique*, ARENH) provision of the Law on the new organisations of the electricity market (NOME law) was implemented in July 2011 to promote competition in the electricity market, except for small consumers, and gradually eliminate regulated rates. In January 2012, the sale price to EDF's competitors was fixed at a relatively high price (EUR 42 per MWH). Regulated prices will be fully eliminated by 2016 for companies consuming more than 36KVA, while they will remain for small consumers.
Lower the corporate tax rate in exchange for a reduction in tax expenditures. Reduce the distortions that encourage recourse to debt over equity financing.	Tax expenditures related to the deductibility of interest have been reduced, and the corporate income tax payments have increased by 5% for big companies with an annual turnover in excess of 250 million euros for 2012 and 2013.
Lighten the regulatory and fiscal burdens associated with the statutory social thresholds for firms with 50 employees and more.	No action taken.

Recommendations	Measures taken since beginning of 2011
Housing policy	
Update the registry of cadastral values, and implement a mechanism for periodic revaluation.	No measure has been taken for residential housing. For commercial housing, the registry will be revised in 2013 and will be updated annually from 2016.
Broaden the responsibilities of intercommunalités, in particular with regard to building permits and local land-use plans, raise coverage coefficients, and consider broadening the scope of application of the taxes on vacant housing.	The 20 March 2012 law attempted to increase coverage coefficients by 30% but was abrogated in August 2012 due to implementation difficulties and opposition from local representatives. From January 2013, the tax rate on vacant properties, initially set at 10%, rose to 12.5% for the first year and 25% for the second.
Merge social housing companies at a supra-municipal level in order to achieve economies of scale; remove social housing from local pressures, including in matters of allocation; and reduce mismatches between needs and new construction.	Programmes for social rental units were significantly refocused onto distressed areas (37% of dwellings subsidised in highly distressed areas in 2011, versus 27% in 2009).
Evaluate the way social housing is financed through a cost-benefit analysis taking into account the probably significant distortions that it may generate in the allocation of savings and investment and the structure of rents. Open up the social housing market to private providers subject to appropriate regulation.	No action taken.
Index rent over the life of contracts on the basis of a published index reflecting trends for new rental contracts, preferably at a sufficiently localised level. Bring rents in the social housing sector closer to market values, rather than linking them to costs at the time of construction.	Rent control was temporarily strengthened in July 2012 in 38 distressed agglomerations. A new law is planned for 2013 aiming at controlling rents in certain areas, thereby potentially further limiting supply.
Continue to target the allocation of social housing toward the most disadvantaged households, and increase the exit from social housing of those with above-median income, in particular by strengthening and enforcing the rules on extra rent charges. Relax the provisions governing mobility within the social housing sector.	No action taken.
Environmental policies	
Introduce a carbon tax that passes the scrutiny of the Constitutional Council. Undertake a systematic evaluation of the abatement costs of the individual elements of France's comprehensive climate-change mitigation policies and put more emphasis on low-cost abatement options.	No action taken.
Review fuel tax reliefs for agricultural vehicles and fishing boats with a view to reducing them, and abolish tax relief for heavy goods vehicles and taxis. Eliminate the favourable tax treatment given to diesel compared with petrol.	No action taken.
Reduce the subsidies to renewables, in particular to solar. Focus on the least-cost abatement solutions without favouring specific technologies.	Subsidies to renewables have been reduced, but large technology-specific differences remain.
Fully implement the polluter-pays principle for farmers' water use and environmental pollution. Raise water prices for industry and farming to cover both operating and capital costs. Apply the standard VAT rate to water use.	No action taken.

Chapter 1

The efficiency and equity of the tax and transfer system

Taxes and cash transfers reduce income inequality more in France than elsewhere in the OECD, because of the large size of the flows involved. But the system is complex overall. Its effectiveness could be enhanced in many ways, for example so as to achieve the same amount of redistribution at lower cost. The French tax code should be simplified and changed less frequently. High statutory rates are coupled with a wide range of effective tax rates resulting from a multitude of tax expenditures. There is a need for base broadening combined with lower rates throughout the system, including VAT. The tax wedge on labour is high, except at the bottom of the wage distribution, which can reduce worker participation and job offers. Greater neutrality both across different capital asset classes but also within specific taxes, and shifting taxes from labour and capital inputs to environmental and property taxes would improve economic outcomes. Likewise, the system of social and family benefits should be simplified to enhance transparency and consistency. Eliminating schemes that let people leave the labour market early, abolishing the pension privileges of specific occupational groups and internalising the costs of survivors' pension benefits would increase fairness while at the same time generating savings. Better labour-market performance would result from increasing job-search incentives and shortening the parental leave allowance.

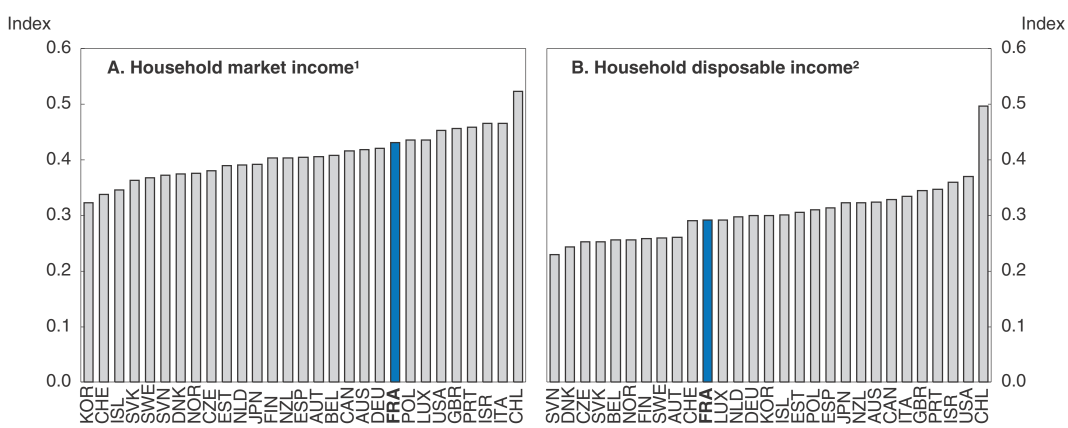
Income inequality is relatively low, thanks to redistribution, and has been stable over time

Inequality across French households' pre-tax-and-transfer market income has been among the highest in the OECD, measured for instance by the Gini coefficient (Figure 1.1). This can be mostly explained by France's low employment rate. The combination of low participation rates and high structural unemployment implies that an important fraction of the working-age population does not have any labour income. The dispersion in capital income (excluding imputed rents) plays a minor role in overall household market income dispersion: the contribution of capital income to income inequality in France is only about a quarter that of the average OECD country and is lower only in Central and Eastern European countries, Portugal and Korea (Hoeller et al., 2012; Koske et al., 2012).

Figure 1.1. **Income inequality, late 2000s**

Gini coefficients of household market and disposable income for working-age population

Per consumer unit



1. Before taxes and transfers.
2. After taxes and transfers.

Source: OECD, *Income Distribution and Poverty Database.*

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Given the large size of the overall system, taxes and cash transfers reduce income inequality more in France than in most OECD countries (see Box 1.1). The Gini coefficient drops by around 14 percentage points after taxes and cash transfers are taken into account, whereas this decline is only 10 points in an average OECD country (see Figure 13 in the Assessment & Recommendations). The sizable income redistribution reduces households' observed market income inequality from well above the OECD average to below it. The French statistical office, INSEE, estimates that, considering income that already

Box 1.1. **From individual wage dispersion to income inequality at the household level**

The starting point for determining disposable income at the household level is *labour income at the individual level*: this may differ because of different wage rates, differences in hours worked or because of the lack of labour earnings due to unemployment or inactivity. The next step is *labour income at the household level*, which depends on family size and composition. Household income is expressed in terms of consumption per standardised unit, which helps compare living standards per person. Households also receive capital income, which in combination with labour income gives *household market income*. What income remains at a household's disposal (*household disposable income*) hinges upon the amounts received in cash transfers and paid in taxes. Households' *adjusted disposable income* is their income after taxes and transfers adjusted for their consumption of public services (OECD, 2011a; Hoeller et al., 2012).

Measuring the degree of redistribution

The degree of income redistribution at any point in time can be measured by comparing the Gini coefficient, a measure of income inequality, for household market income (income before taxes and transfers) and for household disposable income (income after taxes and transfers). A standard way is to compute Gini coefficients based on households ranked according to their market income (Gini before taxes and transfers) and disposable income (Gini after taxes and transfers). Gini coefficients calculated for total population include old-age pensioners. Based on this measure, public pension benefits will show up as pure redistribution between younger and older people, given that pensioners' market income will be zero, while their disposable income will equal pension benefits. If public pensions, including both contributions and benefits, are thought of as over-the-lifecycle redistribution for individuals, including pensioners in the calculation may overstate overall income redistribution. One very rough way of attempting to correct for this problem is to calculate the Gini coefficient for market income using households re-ranked in accordance with disposable income. Nevertheless, public pension systems may contain strong instantaneous income redistribution in the presence of minimum pensions, unrelated to lifetime pension contributions, and generous special occupational pension schemes, or if the parameters of the system change over time. Another way of filtering out the effect of pension benefits is to calculate the Gini coefficient for the working-age population (15-64) alone. However, such Gini coefficients may not be fully comparable across countries if the average retirement age differs and thus the share of old-age pensioners in the population aged 15-64 years varies.

How much income redistribution does the French tax and transfer system undertake?

According to the dataset used in Joumard et al. (2012), in the mid-2000s income redistribution resulting from the tax and cash transfer system reduced the Gini coefficient (for working-age population) less than the OECD median. But the Gini coefficient was calculated by ranking households in accordance with their disposable income, including for the Gini coefficient on household market income. Yet the calculation for a new vintage of the data for the end-2000s shows a redistribution of 9 percentage points for France, against an OECD median of 7 percentage points. Income redistribution, obtained using household market income for households ranked by household market income, as used in this chapter, was around 14 percentage points (the median Gini decline was around 11 percentage points), both in the mid- and late 2000s. Overall, income redistribution is higher in France than in many other OECD countries.

Source: Joumard, I., M. Pisu and D. Bloch (2012), "Less Income Inequality and More Growth – Are They Compatible? Part 3. Income Redistribution via Taxes and Transfers Across OECD Countries", *OECD Economics Department Working Papers*, No. 926, OECD Publishing.

incorporates pensions and unemployment benefits, which are largely insurance-based benefits, cash transfers account for two thirds of redistribution and taxes for the remaining third (Duval et al., 2012). Transfers related to family and housing and those aimed at maintaining a minimum income level represent 90% of redistribution effected by cash transfers. Sixty per cent of the redistribution generated by taxes comes from the personal income tax. Recent government measures, including a new top tax bracket and the integration of capital income into the personal income tax schedule, will increase the overall progressivity of the tax system.

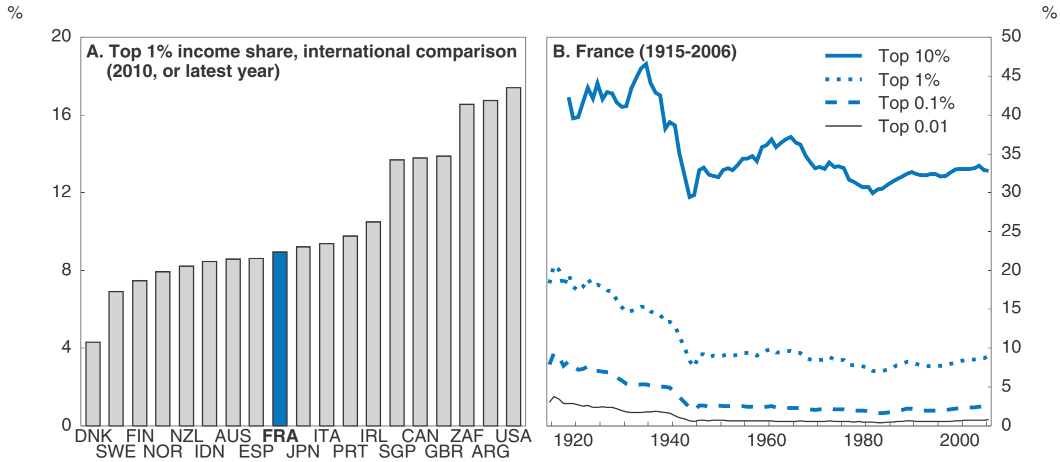
France is one of the very few OECD countries where income inequality after taxes and transfers across households remained stable between 1985 and 2010. But behind this development lies a U-shaped evolution: after a drop until the mid-1990s, income inequality started to rise slowly during the 2000s. According to Cazenave et al. (2011), cuts in the personal income tax and the indexation of cash transfers to inflation (rather than to wage growth, for example) slightly reduced the progressivity of the tax and transfer system and were only partially offset by the introduction of the CSG (generalised social contribution) and the increase in the progressivity of the local residence tax (*taxe d'habitation*). As a result of booming asset prices, the income share of households in the top decile of the income distribution almost doubled from the mid-1990s to the late 2000s.

Wealth inequality was twice as high as inequality of household disposable income in 2009 and increased between 2004 and 2010 (Chaput et al., 2011). The interaction between wealth concentration and capital incomes is likely to accentuate income inequality in the longer run. A large and increasing share of extremely high income earners, partly due to business income being taxed increasingly as personal income to avoid double taxation of corporate income, is the main reason for rising income inequality in the United States and other OECD countries (Figure 1.2). In France, however, the income share of the top 1% and 0.1% of all earners is, respectively, only half and a third of that in the United States for instance, and these shares have risen only moderately since the mid-1990s.

In-kind benefits provided through government services reduce France's Gini coefficient, which measures income inequality, by about six percentage points, slightly less than the OECD average (OECD, 2011a) (Figure 1.3, Panel A). Health care and education services are the most effective in-kind benefits for lowering income inequality among French households (Figure 1.3, Panel B). The effectiveness of social housing, early childhood education and care (ECEC) and long-term care in decreasing income inequalities is, in contrast, rather limited.

Much of the redistribution is achieved by the considerable volume of public spending, financed by a high level of taxes, which can weigh on economic performance. By tackling the sources and causes of household market income inequality, the government could more efficiently achieve the same level of inequality. It would be preferable to make changes to certain measures so as to reduce market income dispersion and thus the need for explicit redistribution and by better targeting. Then public spending and taxes could be diminished.

Figure 1.2. **The level and evolution of the share of top income earners in total income**



Source: The World Top Incomes Database, *http://g-mond.parisschoolofeconomics.eu/topincomes*.

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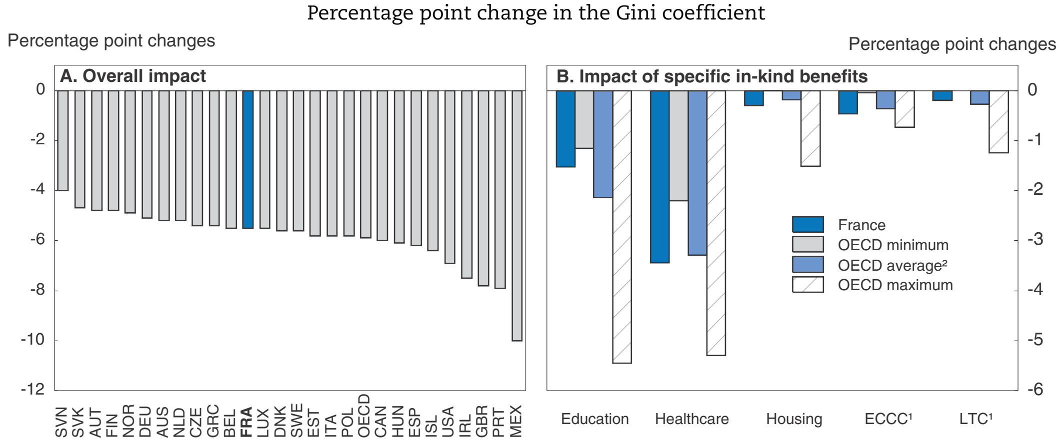
Figure 1.3. **The impact of in-kind benefits on income inequality, late 2000s**

Percentage point change in the Gini coefficient



1. ECCC and LTC stand for early childhood care centre and long-term care, respectively.
2. Averages by category are computed across available data.

Source: OECD, Divided We Stand, 2011.

StatLink *http://dx.doi.org/10.1787/888932790374*

A recent OECD study identifies a number of policies that would help reduce income inequality in general (Koske et al., 2012). The ones that might be relevant for France are as follows: *i)* making access to education effectively equal and lessening the link from socio-economic background to educational outcomes; *ii)* elimination of labour-market dualism; *iii)* increased spending on active labour market policies; *iv)* better integration of immigrants (OECD, 2012a); and *v)* reduction of gender discrimination by increasing female labour market integration and lowering the gender wage gap. Also, continuing wage restraint at the minimum wage level would be beneficial because high minimum wages tend to increase rather than reduce income inequality and poverty by pricing low-skilled workers out of the labour market (Cahuc et al., 2008). The minimum wage in France (the SMIC) is very binding: it applies equally to all sectors and regions, and, even if only 10.6% of all employees are paid the SMIC, the wages of about 35% of workers depend directly or indirectly on its evolution.

The French tax system is complex, changes frequently and induces serious distortions

The French tax system is very complicated: there exist a large number of taxes and levies accompanied by a multitude of tax credits and exemptions. Tax provisions change frequently. This is burdensome, since, in order for a tax system not to penalise economic activity excessively, three guiding principles must be borne in mind: stability, neutrality and simplicity (Mirrlees Review, 2011). A neutral tax system does not interfere with household consumption decisions, nor influence the form of income received, the types of savings chosen, investment decisions nor whether current income is consumed now or in the future. The French tax system contains a large number of non-neutralities, which have important implications for employment, investment, saving and consumption decisions. Non-neutralities within asset classes arise mainly from numerous tax expenditures, which imply higher statutory rates and a very wide range of effective tax rates. Moving toward neutrality would also reduce complexity. Greater neutrality and simplicity would in turn reduce opportunities for tax evasion and avoidance and reduce administrative and compliance costs.

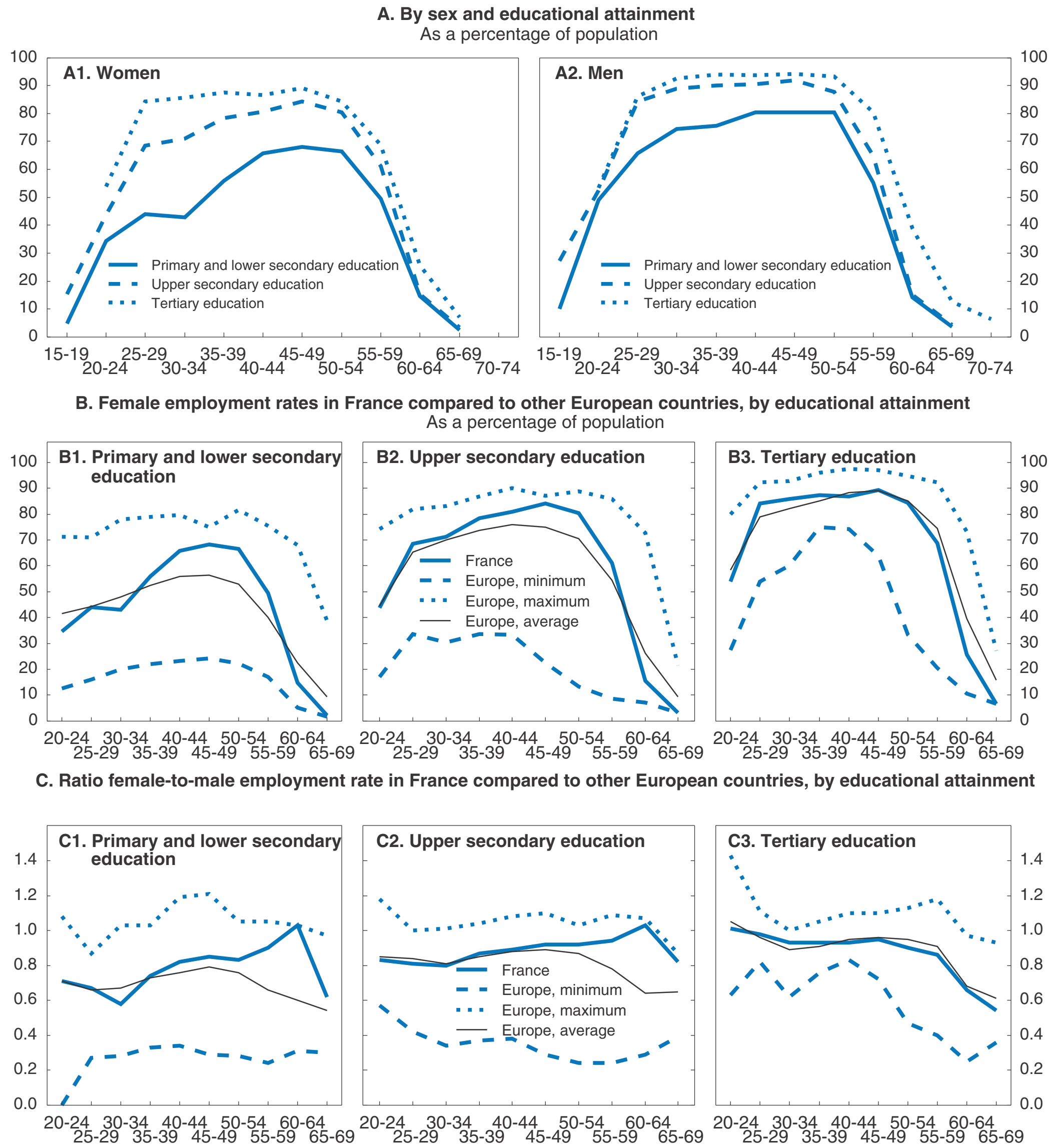
Stability is also desirable to minimise administrative and compliance costs and to reduce the negative effect of policy uncertainty on investment and saving decisions. Tax changes are reflected in asset prices and may create volatility and hence uncertainty regarding valuations. If changes are needed, they should be decided in a transparent framework and in line with a long-term strategy. However, non-neutrality is desirable in the presence of externalities, such as environmental pollution or positive spill-over effects from innovation. In addition to efficiency, redistribution is also central to any tax system. Nevertheless, there may be trade-offs between efficiency and redistribution: a more efficient system may do less to reduce income inequalities, and greater redistribution may harm incentives to work, save and invest.

The taxation of labour is heavy despite substantial targeted measures

Different parts of the working-age population are likely to respond differently to tax changes. Labour-supply responses for (unskilled) low-income workers, single parents, second earners (usually women) with dependent children and seniors are highly sensitive to the level of taxation. Studies show that low-skilled workers react at the extensive margin rather than at the intensive margin, i.e. they react more in terms of either taking a job or not than in terms of the number of hours worked (OECD, 2011b). Taxation can also alter geographic location choices for mobile workers, often highly skilled. French tax policies strengthen work incentives to low-income workers. Yet, while close to the European average, the employment rate of women with low educational attainment is fairly low in the absolute and in comparison with the best-performing countries (Figure 1.4).

A high tax wedge on earnings of low-income workers, in particular if coupled with a high minimum wage such as observed in France, curbs labour demand. Consecutive French governments have lowered employer social security contributions (SSCs) for very low-income earners since 1993. Since 2007, a relief of 26 percentage points (28.1 for firms with less than 20 employees) has been applied to those on minimum wages, with the relief linearly decreasing to zero for those earning 1.6 times the SMIC. Recent empirical evidence suggests that reduced SSCs may have created or maintained between 600 000 and 1 100 000 jobs between 1998 and 2009, without causing low-income traps (Ourliac and Nouveau, 2012).

Figure 1.4. **Employment rates, 2010**



Source: Eurostat.

StatLink http://dx.doi.org/10.1787/888932790393

Nevertheless, as reduced social security contributions are phased out, the marginal (but also the average) tax wedge becomes very high, especially for the unmarried and single parents (Table 1.1), which may reduce the supply of labour of those at those wage levels. The government's competitiveness pact, which reduces the tax wedge by six percentage points up to 2.5 times the SMIC, is a welcome measure, even though the abrupt removal of the reduction would result in a wage trap around that threshold.

The overall tax burden comes not only from taxes and SSCs but also from the withdrawal of benefits upon entering the labour market (losing unemployment or social benefits) or working more hours (losing means-tested benefits). Benefit withdrawal can create sharp increases in marginal effective tax rates (METRs). However, there is a trade-off:

Table 1.1. **Tax wedge in % of labour costs for different wage levels and household types, 2011**

Single						Married couple					
No children			Two children			No children			Two children		
67% of average wage						100%+33% of average wage					
	MARG	AVE		MARG	AVE		MARG	AVE		MARG	AVE
Belgium	66.3	49.7	United Kingdom	76.3	7.1	Belgium	66.3	48	Belgium	66.3	41.4
France	**63.2**	**46.5**	Ireland	67.9	-24.6	Hungary	63.5	46.7	Hungary	63.5	34.3
Austria	56.9	43.7	Belgium	66.3	35.5	Austria	60.6	44.7	Austria	60.6	37.2
Germany	56.0	45.6	Canada	60.5	-6.3	Finland	57.2	39.3	Israel	60.3	12.2
Italy	54.0	44.5	Australia	58.0	-6.0	Germany	56.0	45.6	Finland	57.2	35.5
Finland	53.1	37.2	**France**	**57.7**	**38.4**	Italy	54.1	44.5	Germany	55.7	38.9
Hungary	51.6	45.2	Austria	56.9	26.8	**France**	**51.3**	**45.6**	Italy	55.1	40.3
Portugal	50.7	33.1	Czech Republic	55.7	16.4	Norway	51.2	35.0	Czech Republic	54.0	30.7
Netherlands	48.7	33.1	Italy	54.5	29	Slovenia	51.0	40.2	Norway	51.2	31.9
Czech Rep.	48.6	39.5	Germany	54.2	31.2	Portugal	50.7	34.0	Portugal	50.7	30.4
Sweden	45.6	40.7	Finland	53.1	26.4	Czech Republic	48.6	40.3	New Zealand	50.0	7.0
Spain	45.2	36.6	Spain	52.4	29.5	Spain	48.1	36.9	Spain	48.1	35.8
Slovak Republic	44.4	36.1	Netherlands	51.7	11.5	Sweden	47.9	41.0	Sweden	47.9	36.9
Slovenia	43.6	38.6	United States	51.4	8.2	Netherlands	47.0	33.8	Iceland	47.9	27.6
Iceland	43.5	29.2	Portugal	50.7	23.7	Slovak Republic	44.4	35.8	Netherlands	47.0	29.2
Norway	43.2	34.2	Iceland	50.6	18.5	Iceland	43.5	29.5	**France**	**46.9**	**40.0**
Estonia	42.9	38.8	Sweden	45.6	32.5	OECD	42.9	32.2	Canada	44.5	23.8
Luxembourg	42.5	29.2	Slovak Republic	44.4	23.6	Estonia	42.9	38.8	Slovak Republic	44.4	29.5
Turkey	42.2	35.4	OECD	43.8	15.6	Denmark	42.3	37.0	OECD	44.1	27.2
Denmark	40.9	36.8	Norway	43.2	21.4	Turkey	42.2	37.9	Slovenia	43.6	30.6
OECD	40.9	31.6	Estonia	42.9	24.3	Luxembourg	40.9	27.7	Estonia	42.9	34.2
United Kingdom	40.2	28.5	Luxembourg	42.5	2.4	Canada	40.8	27.7	Denmark	42.3	32.1
Australia	39.1	20.6	Turkey	42.2	34.2	United Kingdom	40.2	28.5	Turkey	42.2	37.3
Ireland	37.7	21.3	Denmark	40.9	11.4	Israel	38.6	16.6	Luxembourg	40.9	17.7
Poland	36.1	33.4	Hungary	35.8	20	Ireland	37.7	20.3	United Kingdom	40.2	25.0
Canada	33.5	26.1	Slovenia	32.9	12.7	Poland	36.1	33.4	Ireland	37.7	13.3
United States	32.5	27.2	Japan	31.6	19.7	Japan	35.8	30.0	Poland	36.1	29.6
Japan	31.6	29.5	Poland	28.4	28.4	Australia	35.4	22.9	Japan	35.8	25.1
Israel	30.0	13.0	Switzerland	18.7	2.8	United States	32.5	27.8	Australia	35.4	17.9
Switzerland	23.0	18.0	Korea	18.6	17.0	New Zealand	30.0	14.8	United States	32.5	22.7
Korea	19.8	17.7	New Zealand	17.5	-18.7	Korea	28.8	19.4	Korea	25.1	17.9
New Zealand	17.5	12.9	Mexico	17.5	13.2	Switzerland	26.0	18.6	Switzerland	23.6	11.1
Mexico	17.5	13.2	Israel	16.8	0.1	Mexico	18.7	14.4	Mexico	18.7	14.4
Chile	7.0	7.0	Chile	7.0	6.0	Chile	7.0	7.0	Chile	7.0	4.9

Note: MARG and AVE denote the marginal and average tax wedge, respectively.
Source: OECD, Taxing Wages, *www.oecd.org/tax/taxpolicyanalysis/taxingwages.htm*.

a more gradual cut-off of benefits could reduce such threshold effects, but doing so is more costly. That cost could be financed either by higher taxes, which may reduce the labour supply of other workers, or via lower benefits, which would hurt the poor (OECD, 2011b).

The OECD's Tax-Benefit models show that French METRs never exceed 100% (Table 1.2). However, groups that are more sensitive to marginal rates (low-wage workers and single parents) do not face lower METRs than others. For the transition from unemployment benefits to full-time work, the METR is about 80%, independent of family composition. Such a high rate is problematic, given the combination of long unemployment benefit duration (two to three years) without degressivity and poor activation policies. Unemployment benefit withdrawal accounts for two thirds and income

Table 1.2. **Marginal effective tax rates (%), 2010**

Family situation		Extensive margin: From unemployment benefit to full-time job	Extensive margin: From social assistance to full-time job	Intensive margin: From part-time to full-time
		33% of average wage level		50% => 100%
No children	Single person	87	67	36
	One-earner married couple	86	62	44
	Two-earner married couple	88	15	35
Two children	Lone parent	86	55	47
	One-earner married couple	85	56	55
	Two-earner married couple	87	31	34
		67% of average wage level		33% => 100%
No children	Single person	77	55	50
	One-earner married couple	72	57	60
	Two-earner married couple	76	27	38
Two children	Lone parent	72	61	75
	One-earner married couple	72	61	75
	Two-earner married couple	75	33	30
		100% of average wage level		67% => 100%
No children	Single person	76	48	32
	One-earner married couple	75	50	39
	Two-earner married couple	76	28	32
Two children	Lone parent	73	55	37
	One-earner married couple	73	57	50
	Two-earner married couple	75	32	31

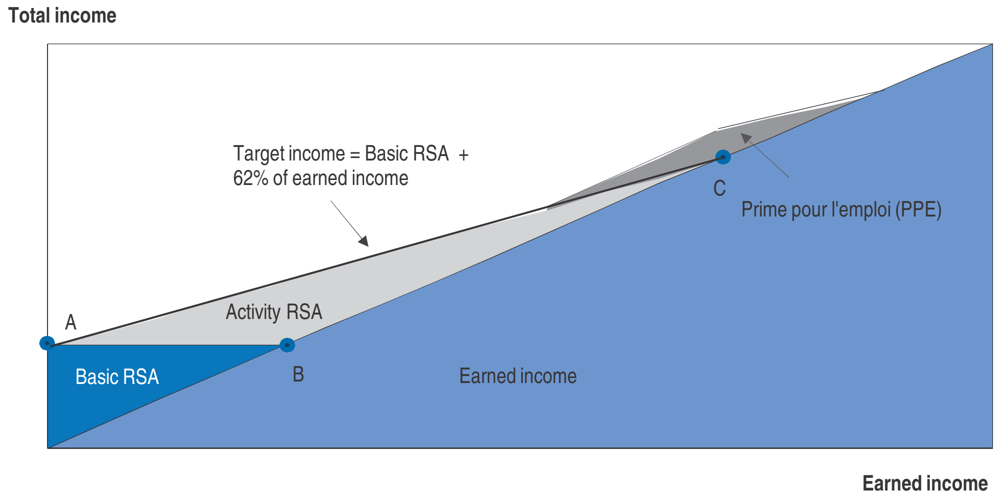
Source: OECD Tax-Benefit models, *www.oecd.org/els/benefitsandwagesstatistics.htm.*

taxes and employees' SSCs for one third of the high marginal rate. In-work tax credits play only a minor role in offsetting these factors. METRs are somewhat lower for moving from social assistance to a job. At the intensive margin, the METR is particularly high for moving from one-third time to full-time work for single-earner families with two children.

Two important instruments are in place to reduce the impact of benefit withdrawals on the implicit marginal tax rate of low-income households. The first is a refundable, in-work tax credit (*prime pour l'emploi*, PPE), a tax credit for low-income workers created in 2001. The second is embedded in a more general programme targeted at poverty reduction, the active solidarity income (*revenu de solidarité active*, RSA). RSA has a component, the activity RSA, which provides a bonus to those who have modest revenue from labour earnings. The PPE and activity RSA are complementary: activity RSA tops up basic social transfers and earnings to enhance incentives to work, to which PPE is added at higher but still modest levels of income (Figure 1.5).

But activity RSA and PPE are not fully consistent with each other. RSA is paid on a monthly basis based on the previous quarter's earnings, while PPE is deducted from taxes paid a year after labour income is earned. Whether someone is eligible for activity RSA depends on household revenue. By contrast, the basis for means-testing PPE is individual income (Bonnefoy et al., 2009), with a ceiling on total household income. A recent evaluation of activity RSA shows that almost 70% of individuals who would be eligible for activity RSA do not claim it. A major reason for this is lack of information regarding RSA

Figure 1.5. **Simplified depiction of the RSA**



Source: Bourgeois and Tavan (2009).

eligibility (Bourguignon, 2011). Against this backdrop, the government should streamline and simplify the current system by merging activity RSA and PPE and by paying the income support on a monthly basis using immediately previous earnings to maximise the incentive effects on labour supply. The government announced in its multi-year plan against poverty (see Box 3 of the Assessment and Recommendations section) a better harmonisation between the RSA and the PPE.

Joint family income taxation may discourage female labour force participation

Joint family taxation is compulsory in France: the tax burden depends on income declared in the joint tax declaration, divided by the *part*, which is two for a childless couple. The main argument for family taxation is that of horizontal equity: equal tax rates for equal pre-tax standards of living ("*à niveau de vie égal, taux d'imposition égal*"). The presence of a second adult does not double living costs, however, because of scale effects, and therefore a weight of two favours couples. Furthermore, family taxation favours couples with very different earnings relative to individual taxation. French income taxation also accounts for the number of children, as discussed below.

A major drawback of the joint taxation of spouses or partners is that it can create work disincentives for second earners, usually women, especially if the first earner falls in a higher tax bracket and that the number of *part* is too high: a second earner entering the labour force is taxed at a higher marginal rate than a single individual would be. For this reason, many OECD countries have opted for individual taxation (OECD, 2011d). In France, the average tax wedge, computed based on the gross wage minus employee SSCs and personal income tax (including CSG), is about 5 percentage points higher for a second earner without children than for a single earner. The gap widens to 10 percentage points in the presence of two children (OECD, 2011d). The effective marginal and average tax rates on second earners are likely to be considerably higher if cash transfers and in-kind benefits received on a family basis are also taken into accounted. Carbonnier (2007)'s findings would suggest that even if the overall impact on the female participation rate is limited, for certain categories of women – including those who are childless, have children older than three years or whose spouses earn between 2.5 and 4 times the SMIC – it reacts more strongly to incentives. On a sample of OECD countries, Jaumotte (2003) shows that joint taxation reduces the participation rate of women significantly. The government should encourage female labour force participation by moving to individual-based personal income taxation.

Incentives for older workers to keep working can be further improved

There is an asymmetry in the treatment of earnings and pensions with regard to SSCs, which may provide disincentives to work longer. Pension income enjoys reduced rates for the CSG (6.6% instead of 7.5% for employees) or even zero rates below a certain threshold, costing the budget about 0.35% of GDP (Cour des Comptes, 2012). In addition, pensioners are not subject to SSCs relating to health care. Eliminating this asymmetric treatment would help reduce, in a budget-neutral way, the tax wedge on labour income. At the same time, workers above the statutory retirement age, in particular if they receive pensions simultaneously, should pay only SSCs applying to current pensioners, such as for health care.

Pensioners also receive favourable tax treatment (compared to the active population) on local taxes: below a certain income threshold they are entitled to full or partial exoneration from recurrent property taxes (*taxe d'habitation* and *taxe foncière*) and capital gains tax on property sales. Such tax breaks overlap with (though the income brackets are slightly different) and complement the main instrument to counter old-age poverty: the minimum pension (*allocation de solidarité aux personnes âgées*). While the 10% reduction of the personal income tax base (which is capped) to which every wage earner is entitled is viewed as a lump-sum proxy for work-related costs, the similar reduction from pension income, even with a much lower upper ceiling for the absolute deduction, is more difficult to justify. In addition, pensioners can take advantage of a flat amount tax reduction below a certain income threshold (about 23 000 euros in 2012), and pensioners who had three children do not have to pay tax on the 10% pension premium for children. These tax reductions and exemptions are strongly regressive and amount to about 0.3% of GDP (Cour des Comptes, 2012). The government should simplify the current system of minimum pensions, eliminate pensioners' tax breaks, discontinue the 10% tax reduction for pension income and, if needed, increase the minimum pension (which, however, was almost twice the amount of social assistance (basic RSA) for a single person in 2012).

The so-called *surcote* (bonus) ensures an increase of 5% in annual pension benefits, a figure close to actuarial neutrality, by working an extra year beyond the period required for a full pension. But a number of useful measures encourage older people to work longer. People at pension age are allowed to work while receiving pensions (*cumul emploi-retraite*), and it is also possible to retire only partially while continuing to work part-time (*retraite progressive*). Finally, employers cannot lay off individuals wishing to work until the age of 69. But unemployed people over 50 can receive unemployment benefits for up to three years rather than the standard two years (which may be extended substantially by long-term unemployment benefits (*allocation de solidarité spécifique*, ASS and *allocation équivalent retraite,* AER)). This constitutes an implicit early retirement scheme and as such should be abolished as discussed below in more detail. In June 2012, the government decided to lower the minimum retirement age to 60 for persons who by that age had contributed the length of time required for a full pension. The absence of a bonus for quarterly contributions beyond the contribution period required for a full pension and prior to the legal minimum age (62) discourages those eligible for early retirement on long-career grounds from continuing to work. It would therefore be advisable to change the rules for the bonus so that quarterly contributions beyond the legal duration required for a full-rate pension would increase the amount of the pension.

The mobility of high-income earners will limit the revenue yield of raising the top marginal tax rate

In theory, top incomes may react to higher marginal rates through three channels: *i)* reduced labour supply, *ii)* tax avoidance through income shifting due to tax loopholes that narrow the tax base, and *iii)* the power of top executives to influence firms' compensation committees. Prerequisites to increase top rates with no loss in tax revenues are in fact a broad tax base with few loopholes and little opportunity for tax arbitrage. The government capped tax expenditures on personal income tax at 10 000 euros per taxpayer, though some tax expenditures are not concerned by this limit, which is an attempt to close the tax-arbitrage channel. The only unavoidable factor that limits the size of the revenue-maximising top marginal rate is the labour-supply elasticity. Piketty et al. (2011) show for a panel of 18 OECD countries that the labour supply of high income earners has a low elasticity. In the case of the United States, Saez et al. (2012) show that once the possibilities for tax arbitrage have been eliminated, the labour supply of high income earners is affected little by tax increases. According to these studies, top marginal tax rates higher than those observed in many countries may be optimal. However, they do not factor in the possibility of migration to countries with lower top marginal tax rates. In fact, while there is little direct empirical evidence on the migration of top income earners as a function of changes in taxation, empirical evidence on the international migration of football superstars in Europe shows that migration decisions depend to a large extent on changes in top income tax rates (Kleven et al., 2010).

The government has added a new bracket of 45% (in addition to the existing 41% bracket) for earnings exceeding 150 000 euros per individual share of household income (*part fiscale*). The Mirrlees Review (2011) suggested that the revenue-maximising top marginal rate, including SSCs, should be around 50 to 60%. Employers' and employees' SSCs combined with the proposed top rate of 45% imply a marginal rate of about 62 to 65%. For individual income in excess of 1 million euros, a temporary bracket of 75% (including the CSG of 8%) was legislated for 2012 and 2013, generating predicted tax revenues of 0.02% of GDP. Such hikes are meant to increase tax progressivity, and the marginal rate of 75% was presented as a political symbol of fiscal justice. But the Constitutional Court invalidated the 75% bracket because it applied to individuals' revenues and not to family income, violating the principle of equal sharing of the tax burden because households with the same revenue may be taxed differently depending on the composition of individual labour and capital income. Increasing tax rates to 75% would be counterproductive if it results in lower revenues. The top marginal rate of 75% would result in an effective top marginal rate of 79%. On the one hand, the work of Piketty et al. (2011) and Saez et al. (2012) suggests that the optimal top marginal rates could be higher than the current rates. On the other hand, according to Simula and Trannoy (2009), in a model calibrated to French data, the previous 40% top rate might already have been too high to prevent emigration and tax-base erosion. These authors even argue that revenue-maximising top marginal rates could be below the rates applied at lower income levels, for which the propensity to emigrate is low. Generally speaking, a tax base narrowed by numerous tax expenditures, coupled with high marginal tax rates is not best practice: rather a broad tax base and lower marginal tax rates are preferred.

The taxation of capital

Effective marginal tax rates on capital income vary substantially

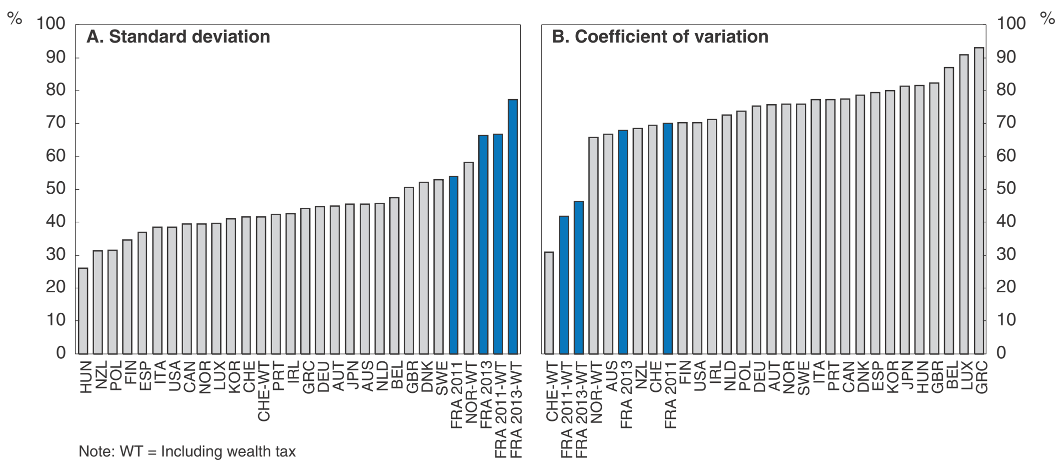
Taxes applied to capital income of individuals and corporations are one type of capital taxation. While certain economic modelling setups would predict that capital income should not be taxed at all (Atkinson and Stiglitz, 1976), taxing capital at non-zero rates can be desirable for a number of reasons. First, the most highly productive individuals have a higher capacity to pay taxes: they tend to save more and to obtain higher yields on their savings. Second, capital income taxes can be viewed as a tax on bequests spread over someone's lifetime. Third, taxing capital income can encourage individuals to invest in human rather than financial capital. Lastly, constituting precautionary savings in order to protect oneself against permanent negative shocks can create disincentives to work if these shocks do not materialise (Denk, 2012). An important practical concern is to avoid tax arbitrage from labour to capital income for small businesses and the self-employed. At the same time, high taxes on capital income often imply double taxation of labour income, given that the primary source of savings is labour earnings. High taxes could also encourage taxpayers to move capital out of the country in a context of high capital mobility (Denk, 2012).

The government's recent decision to phase out the dual income tax system through integrating capital income into the personal income tax schedule may increase considerably the tax burden for those falling into the upper tax brackets (top marginal rate of 45% and social levies of 15.5%) compared to the previous, already high flat tax rate of close to 40% (21% for dividends and 24% for interest income plus social levies of 15.5%). Capital gains (excluding one's primary residence) are also henceforth integrated into the PIT schedule. Dividends are subject to multiple taxation: corporate tax, the 3% dividends tax (at the corporate level) adopted in July 2012, income tax (though with a 40% exclusion, which limits double taxation) and social levies. This implies a much higher effective tax rate on dividends than before and compared to that on interest-bearing assets. Double taxation of dividends is avoided or to a large extent attenuated in Canada, Chile, Mexico and New Zealand (Ernst &Young, 2011) by accounting for corporate income taxes in calculating personal taxes due on dividends. The French government should reduce the extent of multiple taxation of dividends.

At the same time, a number of savings vehicles benefit from preferential tax conditions, even though some of these tax expenditures were scaled back in 2012. Gains stemming from share savings plans (*plan d'épargne en actions*, PEA) are exempt from income tax (but not from CSG) if assets are withdrawn after five years. Workers' voluntary savings plans at the company level (*plan d'épargne salariale)* also enjoy tax breaks and are subject to reduced SSCs. Income from savings in the form of life insurance is taxed only when capital is withdrawn and at lower rates after eight years of possession. Finally, a number of savings deposits (*livret A, livret d'épargne-populaire, livret d'épargne-logement, plan d'épargne-logement, livret jeune, livret d'épargne-entreprise, livret de développement durable*) are exempt from tax and in some cases not subject to social levies. The recent increase in the ceilings of *livret A* and *livret de développement durable* accentuates the existing distortions. There is therefore a general need for reforming the taxation of savings by applying similar tax treatment to all products.

The absence of neutrality for investment in housing is also an important issue: taxing income from renting real estate but not imputed rents encourages home ownership, as the previous *Survey* argued (OECD, 2011e). The standard deviation of effective tax rates (and thus the divergence from neutrality across asset classes -- interest, dividends, rental and owner-occupied housing) was already large prior to the integration of capital revenues and gains into the PIT schedule in 2013 (Figure 1.6, Panel A). A related issue is the treatment of capital gains, which should be subject to the same tax across different assets, and all gains should be deemed to have been realised at death.

Figure 1.6. **The dispersion of top marginal effective tax rates across different asset classes, 2011**[1]



1. Underlying the calculations are the top marginal effective tax rates of the four asset classes presented in Table 1.3 based on a nominal return of 4% and an inflation rate of 2%.

Source: OECD calculations based on Table 1.3, displayed below.

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Inflation affects the effective tax rate on capital income, if the tax base is nominal income. A high statutory tax rate on the nominal return may imply a very high effective tax rate on the real return, especially if inflation is high and/or the real return is low. In an extreme case, taxing the nominal rate could even lower the real value of the capital stock. These effects would be eliminated by basing taxation of capital income and gains on real, not nominal returns, notwithstanding the technical problems this might pose. To date, most countries, including France, tax the nominal rather than real return on capital. However, in Israel and Luxembourg, capital gains taxes are levied on the increase in the inflation-adjusted value of secondary residences, while a special construction-sector price index is applied in Portugal to calculate real capital gains. Capital gains, a form of capital income, should be taxed similarly to other capital income.

As a result of taxing nominal rather than real returns, METRs, calculated assuming a nominal return of 4% and an inflation rate of 2%, can be very high, even above 100%, implying a depreciation of the real stock of capital. Table 1.3 shows that, for assets not benefiting from the numerous tax breaks discussed earlier, France is among the countries with the highest METRS: about 80% for income from interest-bearing assets and above 100% for dividends and rental income. METRs are generally zero on owner-occupied housing.

Table 1.3. **Effective top marginal tax rates on real returns of different asset classes, 2011**

Per cent

	Nominal return = 4%, inflation = 2%				Nominal return = 8%, inflation = 2%			
	Interest income	Dividends	Owner occupied	Rental	Interest income	Dividends	Owner occupied	Rental
Australia	90	93	0	90	60	62	0	60
Austria	50	88	0	100	33	58	0	67
Belgium	30	88	0	100	20	59	0	67
Canada	50	96	0	58	33	64	0	39
Chile	70	80	0	80	47	53	0	53
Czech Republic	30	62	0	30	20	42	0	20
Denmark	50	113	0	103	33	75	0	69
Estonia	42	42	0	42	28	28	0	28
Finland	56	81	0	60	37	54	0	40
France 2011	**79**	**115**	**0**	**113**	**53**	**77**	**0**	**75**
with wealth tax	**169**	**205**	**63**	**203**	**83**	**107**	**21**	**105**
France 2013	**121**	**148**	**0**	**121**	**81**	**99**	**0**	**81**
with wealth tax	**196**	**223**	**53**	**196**	**106**	**124**	**17**	**106**
Germany	50	97	0	90	33	65	0	60
Greece	20	80	0	90	13	53	0	60
Hungary	32	64	0	32	21	43	0	21
Iceland	20	72	0	64	13	48	0	42
with wealth tax	95	147	75	139	38	73	25	67
Ireland	60	97	0	82	40	64	0	55
Israel	50	78	0	90	33	52	0	60
Italy	40	73	0	86	27	49	0	57
Japan	40	103	0	80	27	69	0	53
Korea	40	96	0	70	27	64	0	47
Luxembourg	20	79	0	76	13	52	0	51
Mexico	40	60	0	35	27	40	0	23
Netherlands	60	88	0	104	40	58	0	69
New Zealand	56	56	0	71	37	37	0	47
Norway	56	96	0	56	37	64	0	37
with wealth tax	111	151	14	78	56	83	5	45
Poland	38	69	0	64	25	46	0	43
Portugal	43	85	0	92	29	56	0	61
Slovak Republic	38	38	0	38	25	25	0	25
Slovenia	40	72	0	82	27	48	0	55
Spain	42	89	0	54	28	60	0	36
Sweden	60	97	0	122	40	65	0	81
Switzerland	70	74	0	96	47	49	0	64
with wealth tax	145	149	75	171	72	74	25	89
Turkey	30	64	0	40	20	43	0	27
United Kingdom	40	105	0	100	27	70	0	67
United States	60	90	0	70	40	60	0	47

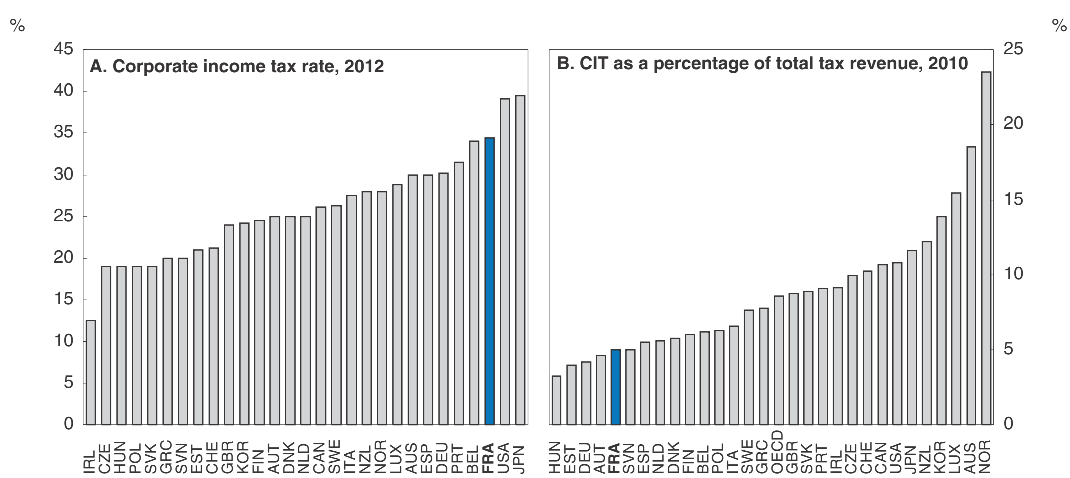
Note: Returns are assumed to be realised through capital income and not through capital gains and that the top marginal rate of the income tax schedule is applied unless there is a withholding tax or if no taxes apply at the personal level. Tax breaks on various asset types are not taken into account. The effective tax rate on dividends includes corporate and personal income taxes and social security contributions. For owner-occupied housing, local property taxes are not included. France's effective tax rate on owner-occupied housing accounts for the fact that only 70% of the value of the property enters the tax base. The PIT marginal rates of 41% (2011) and 45% (2013) are used for France.

Source: OECD calculations.

The prevailing statutory rate of the corporate income tax of 34.4% (base rate of 33.33%, multiplied by 1.0333 to account for social contributions) is among the highest in the OECD, even though it was cut by around five percentage points over the last two decades. Only Japan and the United States have higher statutory corporate income tax rates (Figure 1.7). The rate rises to 36.1% if one adds the exceptional 5% tax for big companies with an annual turnover in excess of 250 million euros for 2012 and 2013. For an open economy with free capital movements, the level of corporate income taxes is an important factor determining a country's attractiveness for foreign investors and its international competitiveness.

To avoid this problem, the nominal corporate income tax rate should be reduced in a revenue-neutral way by continuing to broaden the tax base. France's high statutory tax rate is coupled with low revenues, measured either as a share of GDP or total tax revenues (Figure 1.7) because of the large number of loopholes and tax breaks. As the Conseil des Prélèvements Obligatoires (2009) points out, the result is an effective tax rate paid on realised profits of only 8% for companies included in the CAC40 and 22% for SMEs. More generally, the report finds that the effective tax rate diminishes as company size increases. The three major tax expenditures include: *i)* the tax consolidation regime, whereby the profits and losses of individual companies belonging to the same group may be consolidated (CPO, 2010), *ii)* the deductibility of interest payments on debt financing, and *iii)* the tax credit on investment in research and development. The way global corporations consolidate their profits depends on tax rates in other countries, so having a high nominal tax rate naturally encourages businesses to pay taxes elsewhere. If interest income is taxed at the household level, interest deductibility can be justified to avoid double taxation. The government's decision to cap the deductibility of interest payments on borrowing goes in the direction of double taxation but at the same time will reduce the differential cost of debt and equity financing.

Figure 1.7. **Corporate income tax (CIT) rates and revenue from those taxes as a % of total tax revenue**



Source: OECD, Revenue Statistics 2013; Ernst & Young (2011).

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While the tax burden falls with company size, there is a special corporate tax rate of 15% applying to profits not exceeding 38 000 euros for small businesses owned by physical persons and with annual turnover not exceeding 8 million euros. The experience of many OECD countries shows that a tax rate on small businesses much below that for self-employed individuals and wage earners will encourage income shifting from labour to capital income. This is not a danger in France because the average tax rate on net wages of 38 000 euros is exactly 15%.

Taxation of the net capital stock

Only a few OECD countries, including France, have net wealth taxes (Table 1.4). In principle, such taxes can be viewed as taxes on capital income. For instance, a 1% tax on the asset stock would correspond to a tax rate of 25% on the nominal return and 50% on the real return, under the assumption of a nominal return of 4% and an inflation rate of 2%. In France, wealth tax is levied on top of the direct taxation of capital income and yields receipts of 0.3% of GDP), and, as a result, substantially increases the tax rate on capital. Table 1.3 above shows that net wealth taxes almost double the maximum effective tax rate on capital income in all four OECD countries having such a tax. For those taxed at the marginal rate of 45% (41% in 2011), the top marginal wealth tax rate in France generates effective tax rates of close to 200% for interest income, dividends and income from rented dwellings. This implies that the real value of the capital stock of the wealthiest French citizens decreases significantly. Too high METRs could prompt tax avoidance and evasion and discourage saving and investment (Denk, 2012).

Table 1.4. **Net wealth taxes in OECD countries, 2011**

Country	Highest marginal rate	Assets concerned	Country-specific details
France (2011)	1.80%	Individuals' assets	7 brackets, top bracket starts at EUR 17 million
France (2012)	0.50%	Individuals' assets	3 brackets, top bracket starts at EUR 3 million
			Exceptional tax decided in August 2012 puts back tax to 2011 rates and brackets
France (2013)	1.50%	Individuals' assets	6 brackets, top bracket starts at EUR 10 million
Norway	1.10%	Individuals' assets	Above NOK 770 000
Switzerland	1.50%	Individuals' assets	Rates vary across cantons
Iceland	1.50%	Individuals' assets	Above ISK 70/100 million, temporary until 2013
Luxembourg	1%	Net company assets	

Source: Ernst & Young (2011); Denk (2012).

The harmful effect on saving of very high METRs stemming from a combination of capital income and wealth taxes can be better understood if they are thought of as taxes on deferred consumption. In France, if taxpayers subject to the highest marginal rate of the net wealth tax decide not to consume today but to save and consume their labour income 30 years later, the real value of their savings and thus their purchasing power will be more than one third lower at that point. By contrast, with the earlier assumptions, the real value of their savings would increase by more than 10% in the absence of the wealth tax and by 80% if there were no capital income or wealth taxes. France's capital income tax on deferred consumption and the combination of capital income tax and wealth tax are the steepest in the OECD for high-income earners (Table 1.5). In practice, there exists a wide range of METRs because of the many loopholes, especially those for savings products.

Table 1.5. **The real value of savings (deferred consumption) after 30 years, 2011**

First year = 1

	Nominal return = 4%, inflation = 2%, taxes on fixed-income assets				
	No tax on capital income	Tax on capital income		No tax on capital income	Tax on capital income
Australia	1.79	1.06	Italy	1.79	1.42
Austria	1.79	1.34	Japan	1.79	1.42
Belgium	1.79	1.51	Korea	1.79	1.42
Canada	1.79	1.34	Luxembourg	1.79	1.60
Chile	1.79	1.19	Mexico	1.79	1.42
Czech Republic	1.79	1.51	Netherlands	1.79	1.26
Denmark	1.79	1.34	New Zealand	1.79	1.29
Estonia	1.79	1.40	Norway	1.79	1.29
Finland	1.79	1.29	with wealth tax	1.79	0.94
France 2011	**1.79**	**1.13**	Poland	1.79	1.44
with wealth tax	**1.79**	**0.66**	Portugal	1.79	1.40
France 2013	**1.79**	**0.88**	Slovak Republic	1.79	1.44
with wealth tax	**1.79**	**0.57**	Slovenia	1.79	1.42
Germany	1.79	1.34	Spain	1.79	1.40
Greece	1.79	1.60	Sweden	1.79	1.26
Hungary	1.79	1.49	Switzerland	1.79	1.19
Iceland	1.79	1.60	with wealth tax	1.79	0.77
with wealth tax	1.79	1.03	Turkey	1.79	1.51
Ireland	1.79	1.26	United Kingdom	1.79	1.42
Israel	1.79	1.34	United States	1.79	1.26

Note: The calculations follow the methodology used by Denk (2012). The index on the real stock of savings shows the evolution after 30 years compared to the first year where the index = 1. Top marginal tax rates (where applicable) are used for the calculations.
Source: OECD calculations.

Residential housing enjoys considerable tax advantages

Real estate enjoys preferential tax treatment compared to non-housing investment. The same holds true for home ownership relative to investment in rentals. The sources of non-neutrality are: *i)* imputed rent, the service that the owner receives from living in his property, is not taxed; *ii)* capital gains on primary residences are not taxed; *iii)* government provides subsidies for investment in private rental housing; and *iv)* only 70% of the net value of the primary residence enters the tax base of the wealth tax, while other financial and real assets are assessed at full value. On the other hand, the standard VAT is levied on the sale of new homes, which largely removes another potential source of non-neutrality related to the fact that the consumption of housing services is not subject to VAT.

The first-best option to re-establish tax neutrality for housing would be to tax imputed rents at market value, which could be measured relatively easily, especially in cities, as the private rental market accounts for about 20% of the dwelling stock. Levying a tax on the market value of primary and secondary homes would do a similar job, even though this approach assumes that the price-to-rent ratio is homogeneously distributed geographically. In principle, the local property tax (*taxe foncière*) is based on properties' rental values and thus implicitly taxes imputed rents. But the current *taxe foncière* is based on values obtained from cadastral registries, which were last updated only in the mid-1970s. The previous *Survey* recommended regular updates of these values to ensure a more realistic base for property taxes. Updating the system on a regular basis could turn this property tax into a direct tax on imputed rents. In such a case, actual rents from rental housing should not be taxed. A second complication is that the *taxe foncière* is determined at the local level. In order to make it work as a nation-wide tax on imputed rents, it should have a minimum uniform rate country-wide and be aligned with taxes on capital income from other sources.

Furthermore, the tax-free capital gains on primary residences should be aligned with capital gains due on other assets. Capital gains on secondary residences or rental real estate are fully exonerated from taxes if the property is owned for 30 years (compared to 15 years prior to 2012). The current system correctly allows the deduction of transaction and investment costs (including quality upgrades and additions but excluding maintenance, renovation and repair) from the tax base. Taxing capital gains on principal residences may discourage mobility, thereby creating lock-in effects. To circumvent this problem, the payment of capital gains taxes should be deferred if the receipts from the sale are used to buy another principal residence, in which case capital gains taxes should be payable on succession.

Improving the taxation of the transfer of capital

A final part of capital taxation concerns capital transfers. Taxes levied on transactions can be split into two broad groups: *i)* the purchase and sale of capital goods; and *ii)* the transfer of capital goods without any monetary compensation in the form of a bequest or gift. Taxes on the commercial transfer of financial assets are low, even though the new tax of 0.2% on transactions levied since August 2012 can potentially create large distortions in resource allocation. But transaction taxes and notary fees are very substantial for real estate (see the previous *Survey*). It is widely recognised that transaction costs are detrimental for economic growth because they discourage the optimal re-allocation of resources in the face of a changing economic environment. Lock-in effects caused by high real estate transactions costs could lead to reduced residential mobility and thus to sluggish labour-market adjustments. It would therefore be desirable to reduce transfer taxes on the sale of property by shifting to other less harmful types of taxes.

As far as taxes levied on bequests and gifts are concerned, two major issues deserve discussion. First, a major justification for inheritance taxes is to reduce the inequality of opportunities and *ex post* income inequality. French inheritance taxes are strongly progressive and concern mostly very wealthy individuals. Inheritance taxes can also ensure that receiving a large bequest does not alter economic incentives by reducing the recipient's labour supply. Therefore, unplanned bequests could, in principle, be taxed at a rate of 100% without having any influence on the receiver's economic behaviour. But if bequests are planned in advance, a very high tax rate may discourage people from leaving bequests.

Second, from a more practical viewpoint, inheritance taxes should be coordinated with gift taxes because taxes on bequests could be potentially avoided by planning bequests through *inter vivos* transfers. In France, exactly the same brackets and marginal rates apply for bequests and gifts to children. For more distant relatives taxes on bequests are not only at least as high as for children, but gifts are more heavily taxed than bequests

(Table 1.6). Currently, children can receive from their parents a tax-free bequest or gift below a threshold of 100 000 euros (just lowered from 156 000 euros) every 15 years. After that, another period of 15 years starts with the same amount of tax-free bequest or gift. But the objective of reducing both income and wealth inequality would imply that gifts and bequests received over somebody's lifetime should be considered, whatever the source (whether parents or more distant relatives or friends). It is important that unrealised capital gains, on both financial and real assets, should be taxed at the moment of succession.

Table 1.6. **Top marginal rates on gifts and bequests in OECD countries, 2011**

	Inheritance	Gift	Inheritance	Gift	Inheritance	Gift	Inheritance	Gift
	Spouse		Children		Brothers & sisters		Nephews & nieces	
Australia	0	0	0	0	0	0	0	0
Austria	0	0	0	0	0	0	0	0
Canada	0	0	0	0	0	0	0	0
Chile	25	25	25	25	30	24	24	24
Czech Republic	2.5	5	2.5	5	6	12	6	12
Denmark	0	15	15	15	15	36.25	40	36.25
Estonia	21	21	21	21	21	21	21	21
Finland	16	16	16	16	32	32	32	32
France	**0**	**0**	**45**	**45**	**45**	**55**	**55**	**60**
Germany	30	30	30	43	43	43	43	43
Greece	10	10	10	10	20	20	40	40
Hungary	21	21	0	0	30	30	40	40
Iceland	5	5	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Ireland	0	0	30	30	30	30	30	30
Italy	4	4	4	4	6	6	6	6
Japan	50	50	50	50	50	50	50	50
Korea	50	n.a.	50	n.a.	n.a.	n.a.	n.a.	n.a.
Luxembourg	16	4.8	15	1.8	28.8	6	48	8.4
Mexico	0	0	0	0	0	0	0	0
Netherlands	20	20	20	20	n.a.	n.a.	n.a.	20
New Zealand	0	0	0	0	0	0	0	0
Norway	0	0	10	10	15	15	15	15
Poland	7	7	7	7	7	7	12	12
Portugal	0	0	0	0	0	0	0	0
Slovak Republic	0	0	0	0	0	0	0	0
Slovenia	0	0	0	0	14	14	14	14
Spain	n.a.	34	n.a.	34	n.a.	34	n.a.	34
Sweden	0	0	0	0	0	0	0	0
Turkey	n.a.	15	n.a.	15	n.a.	30	n.a.	30
United Kingdom	n.a.	0	n.a.	0	n.a.	0	n.a.	0
United States	n.a.	0	n.a.	35	n.a.	n.a.	n.a.	n.a.

Source: Ernst & Young, International Estate and Inheritance Guide 2012, *www.ey.com/GL/en/Services/Tax/International-Estate-and-Inheritance-Tax-Guide---Country-list*, retrieved in June 2012.

Reduced VAT rates are an inefficient way to redistribute income

Taxes on goods and services are an important part of the French tax system, accounting for about one fourth of total tax revenues. Given that the value of a good or service depends on the flow of benefits it provides, consumption taxes should be concerned with taxing these benefits (and not the transaction itself) either upfront when the good or service is first sold or annually, in line with the flow of benefits. The value added tax (VAT) is generally considered to be a good tax, and the use of excise duties can also be justified if they aim to internalise negative externalities triggered by the consumption of specific goods and services. The OECD, including in the previous *Survey*, has long advocated a VAT system based on a uniform rate and a broad tax base rather than one with multiple rates and a narrow base.

The most common justification of reduced rates for essential goods and services is based on equity grounds: those products primarily purchased by the poor should be taxed less. Another argument is that the average propensity to consume is higher for the poor and thus they pay more of their income in a single-rated flat VAT scheme. Empirical observations show that in France, rich households benefit from those rates to a much larger extent than poor households (Bozio et al., 2012). In addition, some reduced rates may be regressive, as for example in the case of restaurant meals and renting yachts. Micro simulations carried out by Ruiz and Trannoy (2008) for France show that reduced rates generate only a small amount of redistribution. Distributional objectives could be achieved more cost efficiently by considering the tax system as a whole rather than VAT in isolation. Therefore, reduced VAT rates should be eliminated. The very poor would be protected by the fact that social transfers (including the RSA) and minimum wages are indexed to inflation. If needed, further compensation could be provided by increasing means-tested lump-sum payments to reduce inequality at a lower cost (Mirrlees Review, 2011; OECD, 2011e). Such a system operates in Canada, where low- and modest-income households get a partial refund of estimated sales and value added taxes on their income taxes.

As of January 2014, the intermediate VAT rate of 7% will increase to 10%, while the reduced rate of 5.5% will drop to 5% and the standard rate will go up to 20% from 19.6%. The effective VAT rate is lower than the standard rate not only because of the numerous reduced rates but also because financial intermediation, unpaid domestic services and non-market educational, healthcare and social welfare services are not subject to VAT. It is difficult to levy VAT on domestic and non-market services. VAT on imputed and actual rents is imposed via VAT paid on new housing.

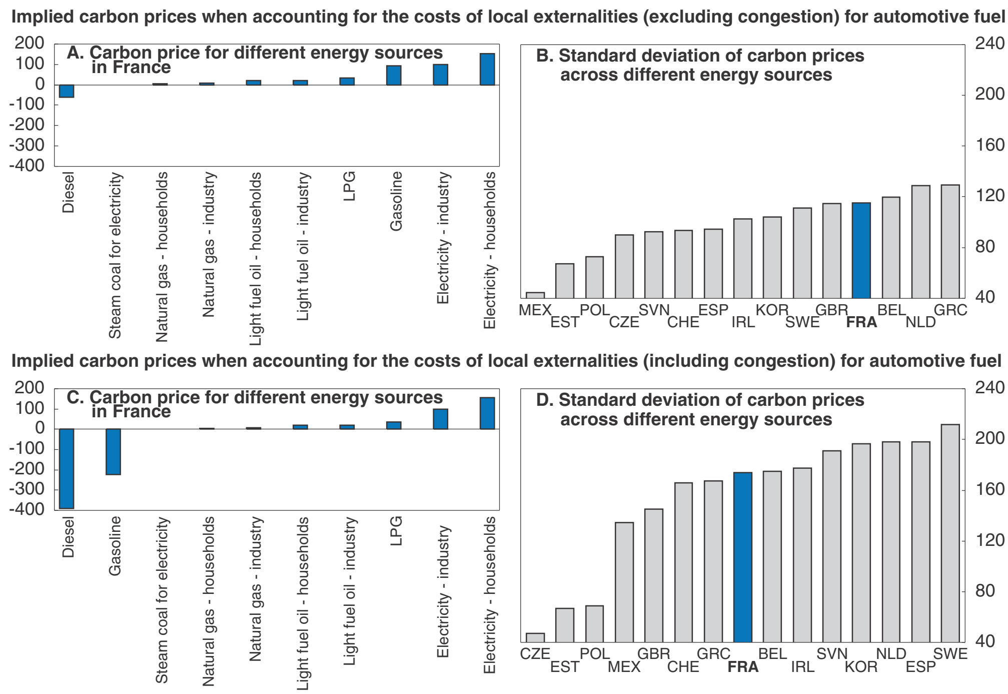
A large dispersion of implicit carbon prices but good progress in internalising local pollution

To the extent that damage done to the environment is not irreversible, the costs of negative externalities stemming from greenhouse gas (GHG) emissions and localised environmental pollution should be fully internalised in the final price of polluting products by setting taxes equal to the social costs of pollution. The two waves of the Grenelle programme launched under the Sarkozy presidency included a great number of price and non-price instruments aimed at mitigating GHG emissions and reducing local air and water pollution. Nevertheless, the current set-up is not cost efficient. Estimated carbon prices implied by existing taxes on various energy sources, including automotive fuel, heating oil, natural gas and coal, vary widely.

Ideally, a single carbon price should be imposed across sectors (and countries) to reduce GHG emissions where it is the cheapest to do so (OECD, 2011e). This condition is generally not met, and in some cases the implicit price of CO_2 is even quite negative (Figure 1.8). The tax system not only differentiates between different energy sources, but a large number of tax exemptions and reductions apply for a given energy source. A case in point is the excise tax exemption granted to fuel used for fishing vessels and maritime navigation and reductions for trucks, large agricultural vehicles, buses and taxis. However,

Figure 1.8. **Carbon price dispersion across OECD countries and within France, 2010-Q4**[1]

EUR/tonne of CO_2



1. The implicit carbon tax level is obtained as follows: the starting point are excise taxes, from which two types of costs are deducted: *i)* the external costs of air pollution, noise and accidents; and *ii)* the external cost of the forms of pollution listed in *i)* plus that of congestion, standardised in EUR/tonne of CO_2. See Figure 4.4 of the *Economic Survey of France, 2011*.

Source: OECD calculations based on the OECD *Economic Surveys of France 2011* and of *Poland 2012*.

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the kilometric levy on heavy goods vehicles, which should take effect throughout France in July 2013, will cover more of the external costs associated with road freight traffic. In all, the dispersion of French carbon prices is relatively high but remains close to the average of the OECD countries for which this indicator can be calculated (Figure 1.8). Therefore, the government should seek to equalise implicit and explicit carbon prices across emission sources so as to minimise the cost of abatement.

An additional weak point of current climate-change mitigation policies is the often substantial overlap between different instruments, which can increase the costs of achieving policy objectives. The two main examples are the upfront fees charged for passenger car purchases, in particular the bonus-penalty system introduced in 2008 and extended to hybrid and electric cars in mid-2012, and the compulsory feed-in tariffs for renewable energy sources. These tariffs represent a tax on final electricity consumers and overlap with both the implicit carbon prices contained in taxes on fossil energies and the price signal from the European emissions trading scheme (EU-ETS). The upfront financial penalty imposed by the bonus-penalty system may be justified if the price elasticity of fuel consumption is low and if myopic behaviour and asymmetric information would prevent consumers from fully perceiving the reduced lifecycle consumption of more carbon-efficient cars. But there is little economic justification for maintaining the bonus part, which financially rewards a negative global and local externality since even very low-emission cars cause a negative externality

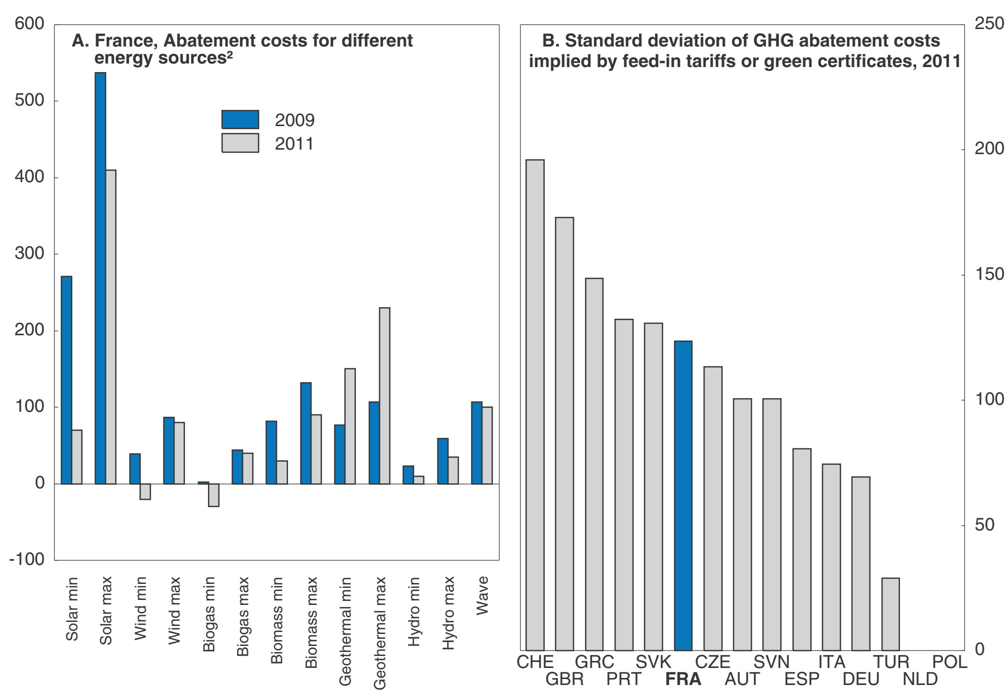
(OECD, 2011e). Even if the bonus-penalty system has led to a reduction in unit emissions and fuel consumption in new vehicles, a recent study (Givord and d'Haultfoeuille, 2012) shows that the bonus part increases global GHG emissions through an expansion of the car fleet and the so-called rebound effect (increased mileage).

Feed-in tariffs targeted at renewables overlap with price signals provided by the EU-ETS and are therefore costly. But actively supporting renewables may be necessary if France wants to comply with renewables targets determined at the EU level or because of learning-by-doing and infant-industry arguments. Yet supporting renewable energy should be done in a cost-efficient and technology-neutral way by providing each technology the same amount of support per tonne of CO_2 avoided. Abatement costs implied by feed-in tariffs fell significantly between 2009 and 2011, in particular for solar energy, and the dispersion of technology-specific abatement costs shrank sharply. Yet, these costs remain high for solar energy and still vary substantially. This holds true even in international comparison, in which France is at the higher end of the scale (Figure 1.9). The government should further adjust and render abatement costs more homogeneous to achieve its renewables targets cost efficiently.

With regard to the internalisation of local pollution, France has been making good progress in increasing the general tax on polluting activities (TGAP) for dumping and burning waste. The tax on landfill was raised to 20 euros per tonne in 2010, broadly in line with estimated external costs, and is expected to be boosted to 40 euros by 2015. The TGAP aligns taxes on incineration with social costs. In contrast, the external costs of pesticide and fertiliser use is currently only partially internalised or not at all, as emphasised in the

Figure 1.9. **Dispersion of carbon abatement costs implied by indirect support schemes (feed-in tariffs, green certificates)**[1]

EUR/tonne of CO_2



1. Abatement costs are calculated against a benchmark of coal-fired power plants.
2. Min and max denote abatement costs based on the lowest and highest feed-in tariffs for specific energy groups.

Source: OECD calculations based on the OECD *Economic Survey of Poland 2012*.

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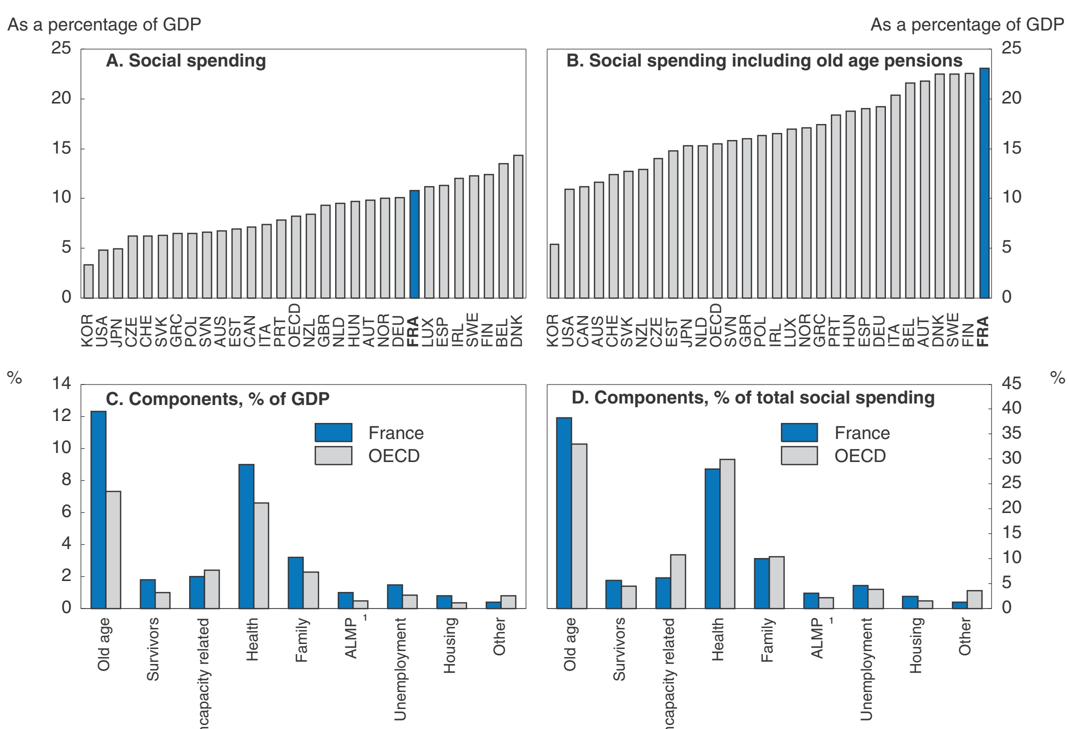
previous *Survey* (OECD, 2011e). So the government should think about the introduction of a tax on fertilisers and raising the tax on pesticides to match estimated external costs. With regard to air pollution, the 2013 budget raised TGAP rates on sulphur oxide and other compounds, lowered the application threshold and extended the TGAP to five new pollutants that can be found in the air (benzene, arsenic, selenium, mercury and polycyclic aromatic hydrocarbons). The government has announced that it intends to raise additional environmental tax revenues of EUR 3 billion by 2016, but the details have not yet been made public.

The transfer system should be simplified

The French cash transfer system is the cornerstone of the system of income redistribution, as it channels roughly 70% of redistributed income. Social spending, including public expenditure on family, housing, unemployment, survivor and disability benefits and active labour market policies (ALMPs), accounts for 10% of GDP, the seventh highest in the OECD (Figure 1.10, Panel A). But if old-age pensions and health-care spending are also taken into account, France becomes the top OECD spender, with the share of this wider but less comparable definition of social spending reaching 30% of GDP. With the exception of incapacity and miscellaneous social spending, in 2009 every subcategory of social spending represented a higher share of GDP in France than in the OECD average (Figure 1.10, Panel C). Looking at the respective shares of various social spending in total social spending reveals that France spends considerably more on old-age pensions and somewhat more on survivors' pensions, labour-market-related policies and housing than the average OECD country (Figure 1.10, Panel D).

Figure 1.10. **Social spending in France and the OECD, 2009**



1. Active labour market policy.
Source: OECD, *Social Expenditure (SOCX) Database.*

StatLink http://dx.doi.org/10.1787/888932790488

The system is complex, with more than 60 spending programmes (in addition to the 90-odd old-age and survivors' pension schemes). Complexity increases administrative costs, and the resulting lack of transparency poses a barrier for potential beneficiaries and reduces benefit take-up. There is also a general problem regarding the system's overall consistency because some transfers overlap with others and they are not always designed jointly, sometimes because of coordination problems among different levels of government. Decisions are not always based on detailed cost evaluations. For instance, the cutback in places in the public pre-school education system for 2-3 year-old children (*école maternelle*) for cost-saving reasons was largely offset by more places in alternative forms of public pre-school education (such as *halte-garderie* and *crèche*), which are actually more costly to public finances. Objectives of spending programmes can be contradictory. For instance, family policies seek to improve conditions for pre-school childcare to allow parents (mostly women) to return quickly to the labour market, whereas the parental leave allowance (*complement de libre choix d'activité*, CLCA, paid subject to certain work-related conditions) to those deciding to stay at home with young children give strong incentives, especially for (low-skilled) low-income individuals to stay at home for many years, which considerably reduces their chances to ever return to work. Moreover, the revenue base and thresholds of means-tested transfers are not always harmonised, and the period for which income is considered can differ. For instance, past-quarter income is the basis of the incentive part of the RSA, income lagged one year serves as a basis for PPE (*prime pour l'emploi*), and income lagged two years is used to determine eligibility for housing subsidies.

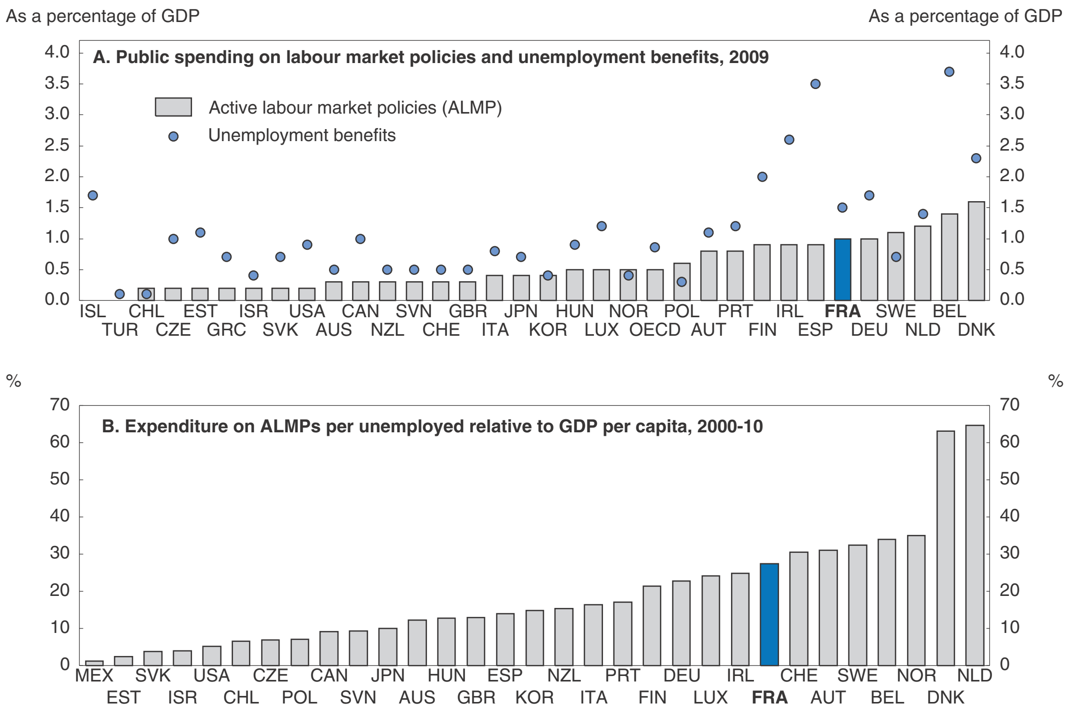
Against this backdrop, a strong case can be made for a simplified cash transfer to households. One avenue to explore (currently in an experimental stage in the United Kingdom) would be to combine all means-tested and non-means-tested benefits into a single benefit in a budget-neutral way, improving the system's transparency and eliminating its inconsistencies. This single benefit should also include housing benefits, provided the landlord-tenant relationship is rebalanced as recommended in the previous *Survey*.

Conditionality of unemployment benefits should be strengthened

Public spending on unemployment benefits and active labour market measures (ALMPs) as a share of GDP are relatively high in France, but it ranks lower if spending on ALMPs is measured per unemployed relative to per capita GDP (Figure 1.11). Reasonably high net replacement rates offered by unemployment benefits, such as France's 70%, coupled with a fairly generous maximum duration are viewed as justified to ensure that job seekers can find a position that fits their skills. Active measures, especially retraining programmes, may be necessary to help unemployed individuals update their human capital or acquire new skills, which would improve their job-market prospects. But benefits should be combined with incentives to shorten unemployment spells and avoid long-term unemployment, which is costly to the individuals concerned, public finances and society.

When the economy recovers, the incentives embedded in the French system to return to work could be strengthened, without magnifying income inequalities, via degressivity and/or conditioning benefits on participation in active measures and the obligation of accepting "reasonable" job offers. First, the maximum duration of benefits is two years (three years for those aged 50 and above), and the replacement rate stays flat over this period. Long-term unemployment benefits (*allocation de solidarité spécifique*, ASS, and *allocation équivalent retraite,* AER) prolong that period considerably. The ASS is a long-term unemployment benefit that is very near to the level of the basic RSA, but it enables an accumulation of pension

Figure 1.11. **Active labour market policies and unemployment benefits**[1]



1. Active labour market policies include public employment services and administration, training, employment incentives, integration of the disabled, direct job creation, and start-up incentives.

Source: OECD, *Social Expenditure (SOCX), Employment Policies/ALMP and Labour Force Statistics Databases.*

StatLink http://dx.doi.org/10.1787/888932790507

entitlements (see below). The AER, which is significantly higher than the ASS and basic RSA, is intended for those unemployed who have contributed long enough for a full pension but have not reached the minimum retirement age. Abolished in 2011, the AER is likely to be restored in 2013, under strict eligibility conditions, for persons born in 1952 or 1953. Care should be taken not to prolong this scheme, which encourages early departures from the labour market and is a drain on public finances, and to provide a bonus (*surcote*) instead.

Empirical evidence for several countries suggests that jobseekers tend to intensify search efforts as they come close to the end of benefit eligibility. But as jobs are less plentiful during downturns, duration and the amount of benefits should depend on the local unemployment rate. Second, the METR implied by the withdrawal of the unemployment benefits varies from 75% to 90% for a wide range of income and family situations (Table 1.2). Therefore, it is important to effectively condition benefits on active job search and participation in retraining programmes. According to a 2008 law, non-acceptance of a second "appropriate" job offer is sanctioned, in principle, by the withdrawal of the benefits for two months. The lack of available data makes it impossible to dispel suspicions that benefits are in fact rarely withdrawn when job offers are refused. Introducing degressivity, i.e. a decline in the unemployment benefit during the spell, would strengthen incentives to find a new job, in particular because the reservation wage declines with the chances of finding work again and when the end of the benefit period approaches, just as does conditioning unemployment benefits on active job search. But gradual degressivity can be complex to administer if there is overlap between unemployment benefits and other social transfers.

However, a steeper drop, with two steps, for example, over the duration of eligibility for payments, could avoid this problem. In fact, this form of degressivity has been implemented in many OECD countries (Table 1.7). Whereas according to Dormont et al. (2001) the degressivity with which France experimented in the 1990s did not appear to have any positive impact on getting people back to work, Prieto (2000) suggests that a more abrupt drop in benefits increases returns to work more than a gradual decrease.

Furthermore, the public employment service (PES), Pôle emploi, is well placed to administer the unemployed and deal with benefit payments, but it struggles to carefully monitor jobseekers and provide them with tailored training and job solutions. For instance, a counsellor monitors an average of 160 jobseekers (Pôle emploi, 2012), which is two to three times higher than in the United Kingdom. Relative to the number of jobseekers, the personnel of the French PES is half of that in Germany and the United Kingdom (Inspection Générale des Finances, 2011). Since 2009 Pôle emploi has faced competition from private job-placement agencies. A recent report commissioned by the Senate argues that a more intense monitoring would necessitate more resources (Alduy, 2011). The recent report Dares-Pôle emploi (2013) shows that people who are closely assisted by a private organisation get more intensive and personalised assistance, but that back-to-work and back-to-long-term-work rates are higher for the unemployed who are assisted by Pôle emploi than for those assisted by private agencies. However, no concise information is available on the costs of placing a jobseeker permanently in a new job. Overall, better data should be collected with regard to cost effectiveness. Australia could be a useful benchmark of how performance-related contracts with private providers, which would increase competition and sort out low-quality firms, can help place benefit recipients into permanent jobs in a cost-efficient way (Behaghel et al., 2012; OECD, 2012b). The experiments in outsourcing job-placement services carried out in the Netherlands also show the importance of the type of contracts concluded and the incentives given to outside operators.

Pôle Emploi's new three-year strategic plan (Objectif 2015), decided in July 2012, includes progress in terms of performance measurement and better targeting at those in difficult situations. It calls for staff redeployments and additional resources so that the advisers in charge of helping the job-seekers least equipped for the labour market carry a

Table 1.7. **Degressivity of unemployment benefits in Europe, 2010**

For a 40-year old (where benefits are conditional on work history, the table assumes a long and uninterrupted employment record)

	Payment rate (% of earnings base)	
	Initial	At end of legal entitlement period
Belgium	60	53.8 (after 1 year)
Czech Republic	65	50-45 (after 2 and 4 months)
Estonia	50	40 (after 101 days)
Italy	60	50 after 6 months
Netherlands	75	70 (after 2 months)
Poland	Fixed amount 30% of average wage	Fixed amount 23% of AW (after 3 months)
Slovenia	70	60 (after 3 months)
Spain	70	60 (after 6 months)
Sweden	80	70 (after 9 months). 65 (after 14 months).
Latvia	65	32.5 after 7 months
Lithuania	40 + fixed amount of LTL 350 per month	20 after 3 months

Source: www.oecd.org/els/social/workincentives.

case load of no more than 70 persons. Yet, there are also three burning coordination and efficiency-related issues that should be addressed. First, the unemployment benefit system, UNEDIC, is run by the social partners for historical reasons: UNEDIC was founded by the social partners in 1958. The main parameters of the system are decided by the trade unions and employer organisations. The government's only power is to refuse to sign the convention: this has happened only once over the last 40 years. UNEDIC is independent from the State, and the social security administration and can issue its own bonds to finance it deficits. But the State explicitly guaranteed UNEDIC's bond issuance in 2011 and 2012 (Standard & Poor's, 2012) and, more generally, the debt of UNEDIC enjoys a virtually explicit State guarantee. Second, training programmes offered to the unemployed are provided by local governments (regions), Pôle emploi and the State. A failure of co-ordination among these actors may easily lead to badly targeted programmes (CNFPT, 2010). Pôle Emploi's 2015 strategic plan includes a number of measures to enhance the effectiveness of training services. Finally, the integration of ANPE and ASSEDIC into Pôle emploi has not yet reaped its full benefits, because of difficulties in fully automating back-office paperwork (Alduy, 2011). Overall, the government should seek to improve the cost effectiveness of the system and better enforce and strengthen activation policies.

Social transfers should be focused on getting beneficiaries into jobs

The active solidarity income (RSA) is the cornerstone of France's broad-based social assistance. Its introduction in 2009 helped streamline the complex web of social benefits, an encouraging step forward. The basic scheme (*RSA socle*) provides basic financial support for jobless individuals according to their household income and composition. Household income is assessed on a very broad basis, including all other regular benefits (housing, family, etc). One of the aims of the 2009 reform was to combine social assistance with a back-to-work support strategy by strengthening conditionality: benefit recipients were meant to be obliged to actively look for a job and enrol in retraining and other ALMPs (OECD-ILO, 2011). Non-compliance with regularly meeting with social and job counsellors or participating in active programmes results in the suspension of benefit payments. But implementation of the incentive element remains limited: some RSA recipients are not advised at all, and monitoring is insufficient. Instead of a single counsellor in Pôle emploi, basic RSA recipients are advised by other bodies as well, including the social security administration and local governments (OECD-ILO, 2011; Bourguignon, 2011). At the beginning of 2012, sanctions for non-compliance with job-search obligations by basic RSA recipients were toughened. This measure is welcome, but whether it is applied systematically remains to be checked.

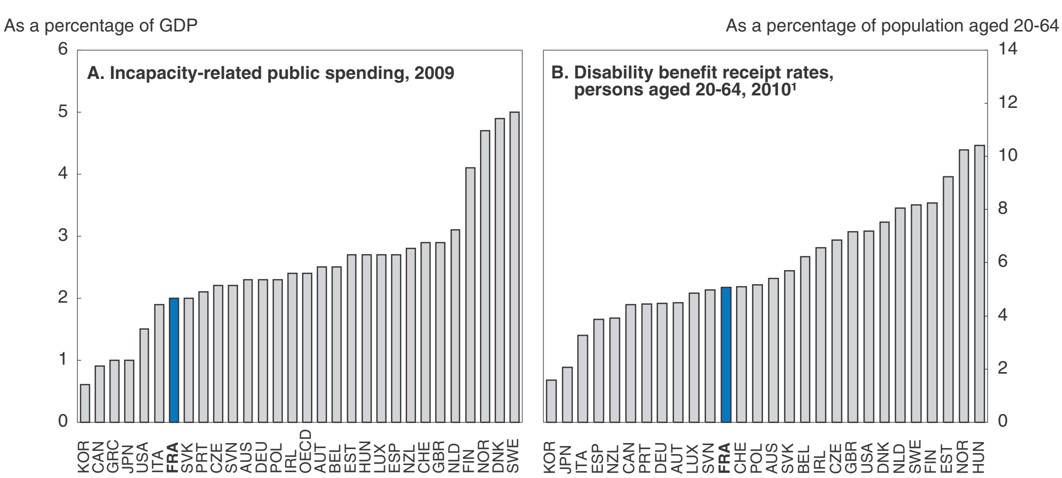
The financial work incentive (*RSA activité*) is a bonus of about 60% for every euro earned below a ceiling and decreasing linearly above that. It eliminates the previous poverty trap, which was the result of having any extra income lead to a proportionate reduction in social benefits. Yet, the overall result of the reform on employment is uncertain, and enrolment rates remain low for activity RSA. Nevertheless, Bourguignon (2011) shows that the RSA alleviates poverty substantially.

The specific solidarity allowance (*allocation de solidarité spécifique,* ASS), a long-term unemployment benefit conferring entitlement to a retirement pension, is targeted in general at unemployed people after the expiry of their unemployment benefits and at specific occupational groups (artists, seamen and dockworkers) in case of unemployment in the absence of unemployment insurance eligibility. ASS is conditional on five years of work during the 10 years preceding the end of the employment contract and is household means-tested. It requires job search and, like the RSA, offers a safety net while at the same time allowing the accumulation of benefits and income so as to encourage a return to work. But a major drawback of ASS is that it can reduce the labour supply of certain older workers, especially low-skill/low-income workers. If somebody becomes unemployed at the age of 52 and has worked long enough, after having received unemployment benefits for three years, (s)he may receive social benefits until retirement. The ASS is replaced by plain unemployment benefits for those aged 61 and over: those of this age coming to the end of their three years of unemployment benefits are entitled to continued unemployment benefits until they reach the minimum retirement age. Indeed, almost half of those receiving ASS in 2010 were aged 50 or over (DARES, 2012). While access to ASS is stricter than for RSA, it is also more generous, in particular because it confers pension entitlements.

Disability benefits are a potential channel of benefit substitution

Strengthening work and activation requirements for social assistance and shutting down implicit channels of early retirement through unemployment benefits could give rise to benefit substitution towards incapacity benefits, for instance. Optimal policy design should therefore firmly maintain access conditions to disability pensions (Røed and Westlie, 2012). Disability pensions are naturally higher than income support from social assistance. Also, even though disability benefits are less generous than unemployment benefits, the lack of work and activation requirements could make them appealing. Public spending on incapacity benefits (disability pensions and sickness allowances) are relatively low in France (2% of GDP), and the share of disability benefit recipients in the working-age population is also comparatively low, yet rising since the mid-1990s (Figure 1.12). Incapacity-related public spending consists primarily of passive measures (cash benefits). Flanking measures include anti-discrimination laws and a penalty for private and public companies in case of non-compliance with employment quotas for disabled people. That employers hire mostly only moderately disabled people is not surprising, given the absence of differentiation for the quota among different levels of disability (OECD, 2010; IZA, 2010).

Figure 1.12. **Incapacity-related public spending and disability benefit receipt rates in OECD countries**



1. Or latest year available; 2007 for France.

Source: OECD, *Social Expenditure (SOCX) Database* and OECD (2013), Mental Health and Work: Belgium.

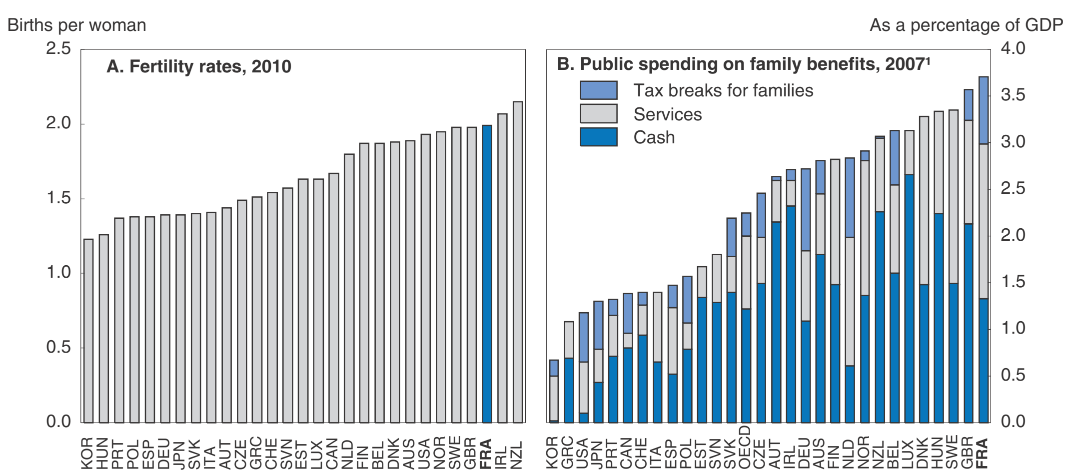
StatLink http://dx.doi.org/10.1787/888932790526

Inflows to disability pensions could be reduced in two ways. First, the length of sick leaves should be monitored carefully because an extended duration increases the probability of entering disability, and, in 2004 at least, the average duration of sick leave in France was among the highest in the OECD (OECD, 2005). Second, as in many other OECD countries, disability rates are higher for low-skill and older workers. Furthermore, the employment rate of disabled people is well below that of people without any disabilities, and disabled people, if they work at all, tend to hold part-time jobs. Hence, in contrast with current practise, ALMPs (including job counselling, training and education) should have a place in the disability policy mix, which would complement income security with work incentives.

Family benefits are tilted towards those having at least three children

Family policies embodied in family benefits seek to encourage people to have more children and aim to maintain living standards of families with children in accordance with horizontal equity. In this spirit, families with children should pay lower taxes because their living standards are lower compared to those of childless households with the same earnings. It is often argued that such a policy is regressive from a vertical equity point of view because it subsidises children more in wealthy families. However, horizontal equity can be achieved without increasing overall income inequality by taxing households without children at higher marginal rates than those with children. The empirical literature suggests that these monetary incentives, which combined with other family policies diminish the cost of raising children, have a tangible effect on fertility rates (D'Addio and Mira D'Ercole, 2005; Luci and Thévenon, 2012). Both the fertility rate and spending on family policies as a share of GDP are in fact high in France (Figure 1.13). Spending on family policies involves direct cash payments, numerous tax breaks and in-kind benefits. The two main fiscal measures used to achieve horizontal equity and thus reduce extra costs of having children are basing family taxation on the number of children and paying non-means-tested family allowances. In 2010 tax reductions for children and spouses cost more than 1% of GDP and family allowances 0.6% of GDP.

Figure 1.13. **Fertility rates and family benefits**



1. Public support included here concerns only that which is exclusively for families (e.g. child payments and allowances, parental leave benefits and childcare support). Spending recorded in other social policy areas such as health and housing support also assists families, but not exclusively, and is not included here.

Source: *OECD Family Database.*

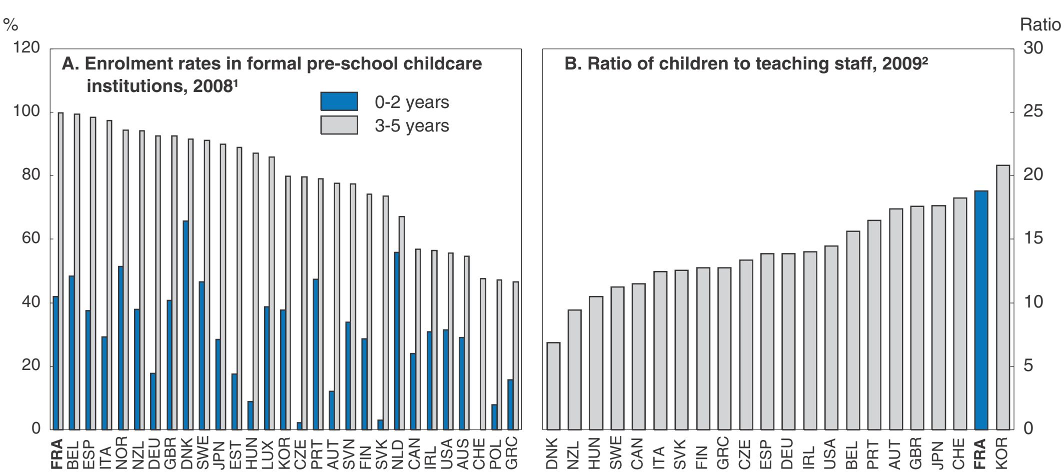
StatLink http://dx.doi.org/10.1787/888932790545

Family support is tilted towards those having at least three children. For personal income tax, the first two children are allocated 0.5 *part*, while others are worth a full *part* in the calculation. The monthly family allowance is zero for one child, about 130 euros for two children, and more than 160 euros for each additional child. Means-tested benefit (*complément familial*) is available for families with three or more children older than three. It is noteworthy that other entitlements are also sensitive to numbers of children. For instance, both parents are entitled to a (non-taxable) 10% increase in pension benefits if they have raised three or more children. Families who have to move because of the arrival of a third child are also entitled to a moving allowance.

The design of the parental leave allowance may push low-skill mothers into an inactivity trap

Another important aspect of family policies is the granting of a parental leave allowance (CLCA) before and after birth and the access to pre-school childcare, which jointly determine whether and when women return to work. Maternity leave is 16 weeks (26 weeks from the third child). After maternity leave, parents have three options: *i)* staying at home with the newborn and receiving an allowance; *ii)* employing a qualified nanny or putting the child in a private nursery and receiving direct cash payments and a tax credit on 50% of the nanny's employer SSCs; or *iii)* placing the child in a public nursery (*crèche* or *halte-garderie*), where children whose parents both work have preferential treatment. The two latter measures, backed by a lump-sum income-dependent benefit for young children (on top of the family allowance), clearly favour female labour market participation. Whereas enrolment rates of around 40% in formal pre-school childcare institutions for 0 to 2 year-old children are relatively high, there is scope to increase them further. Quality, reflected in the children-to-teaching-staff ratio for 0 to 3 year-olds, seems to be a problem (Figure 1.14). There is also anecdotal evidence that public nurseries for 0 to 3 year-olds are not evenly distributed geographically and not sufficiently targeted at low-income, single-parent households, who cannot benefit from tax advantages.

Figure 1.14. **Enrolment rates in formal pre-school childcare institutions and the ratio of children to teaching staff in formal daycare services**



1. Enrolment rates are given in full-time equivalents.
2. Average for 0-3 year-olds.
Source: OECD Family Database.

StatLink http://dx.doi.org/10.1787/888932790564

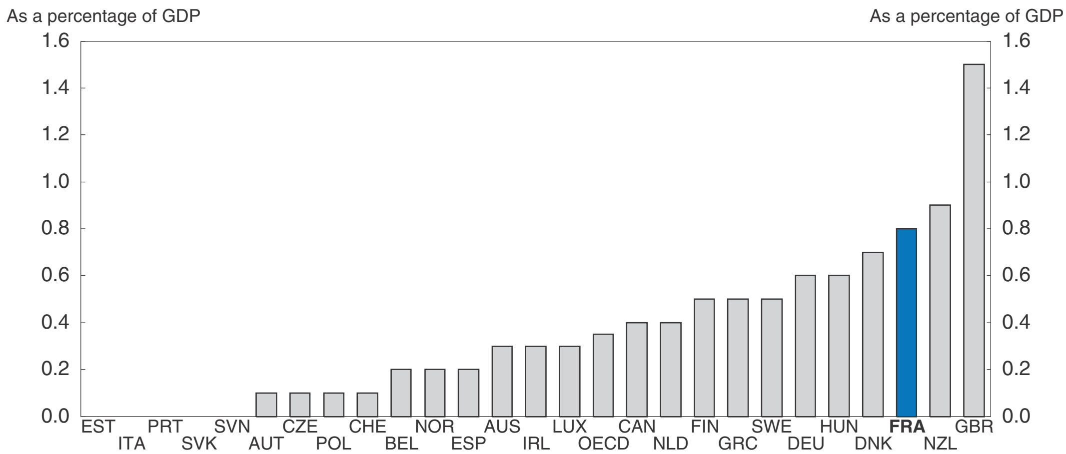
The design of the parental leave allowance (CLCA) may create an inactivity trap for low-skill (low-income) mothers by, in certain cases, offering them the benefit for six consecutive years: this flat amount can be received for six months for the first child and three years after the birth of the second and third children, provided they are born within, respectively, four and five years after the mother's last job. This can give the following birth pattern: first child in year t, second in t+1 and third in t+3. After six years spent at home, low-skill women may find it very difficult to return to the labour market (even though their job is kept in the company in which they worked before the birth of their first child). Indeed, the employment rate of low-skill women of childbearing age is low (Figure 1.4). The CLCA leads to an acceptable replacement rate for low-income individuals/families, but high-income earners' low replacement rate encourages an early return to one's former job. Admittedly, the current system has a mild incentive element for women to return to work more quickly after the second or third child: instead of staying at home three years with the third child, the mother can decide to stay only one additional year at home (reducing the six years to four), and receive a 30% higher allowance in return. Overall, the duration of the CLCA should be shortened. A precondition of a shorter parental leave is an increase in places in nurseries available for children aged less than three.

The system as it stands now has a potentially strong redistributive element. Means-tested support for private pre-school child care and income-based fees in nurseries certainly favour the less affluent. In addition, there is some overlap between the CLCA, the means-tested benefits relating to the start of the school year (*allocation de rentrée scolaire*) and a young-child allowance for dual-career families (*allocation de base de la prestation d'accueil du jeune enfant*, PAJE). Furthermore, annual income caps vary to a large extent across different measures: about EUR 49 000 for a single-earner couple with three children for the birth allowance and PAJE, EUR 35 000 for the complementary benefit related to the third child, EUR 34 000 for the school starting allowance and EUR 27 000 for the direct subsidies of private pre-school childcare.

Housing subsidies should be better integrated with the rest of the transfer system

Amongst OECD countries, France spends a relatively large amount of its GDP on direct housing subsidies (Figure 1.15).The relevant transfers are the personalised housing support (*aide personnalisée au logement*, APL), the social housing benefit (*allocation de logement social*, ALS) and the family housing benefit (*allocation de logement familial*, ALF), together worth around EUR 16 billion a year and covering roughly 6 million households. They can lower either the rent or the monthly reimbursement of first-home buyers. APL supports low-income families and is paid directly to the landlord or to the bank (in the case of mortgage repayments). The landlord has to sign an agreement with the State. He or she gets special tax treatment but has to respect a rent ceiling. ALF can be used by families with children or young couples who do not qualify for APL. ALS is designed for low-income individuals who cannot benefit from APL and ALF. The benefits are means-tested: eligibility depends on household income and the working situation of its members but also the composition of the household and the location of the dwelling. Not only is the system very complicated, which makes it difficult for potential recipients to gain an overview and increases the administrative burden (all three benefits are administered by the *Caisses d'allocations familiales,* CAF), but it also has some serious drawbacks. First, means-testing is based on income reported two years before the application. This is too long a delay:

Figure 1.15. **Public spending on housing benefits in OECD countries, 2009**



Source: OECD, *Social Expenditure (SOCX) Database.*

StatLink http://dx.doi.org/10.1787/888932790583

potential beneficiaries might have higher income or become unemployed in the meantime. Second, the amount of support is a function of the rent below a certain fixed amount, which is akin to making the subsidy vary with the size of the flat. It would be better to have a fixed amount and leave the decision to the tenants whether they want to have a smaller flat and keep some of the money or take a bigger dwelling and have a higher out-of-pocket payment. Finally, according to HCF (2012), the income thresholds for means-testing have not been fully adjusted for higher market prices, which has reduced the redistributive impact of the system.

The complexity of the financing side does not enhance transparency either. ALS and APL are financed by FNAL (Fonds national d'aides au logement), whereas the financing of ALF is provided by FNPF (Fonds national des prestations familiales). These funds are fed by central government transfers and employer SSCs. Indeed, businesses with more than 20 employees are required to pay 0.95% of their wage bill as a contribution (which sums to EUR 4 billion, given various exemptions). Roughly half of that goes to FNAL; the rest finances subsidies for first-time homebuyers and improvements to the private housing stock, expanding the rental housing supply, subsidies for relocating workers and funding for national policies, in the realm of urban renewal in particular.

Public support to housing goes well beyond direct subsidies. Various tax breaks violate tax neutrality and bias investment decisions and should therefore be phased out. Social housing, which in principle can be an important element of income redistribution, enjoys generous tax breaks, direct government subsidies and soft loans. While targeting has improved over time, the last *Survey* pointed to a number of weaknesses: *i)* the funding through special subsidised savings vehicles potentially distorts saving and investment decisions at the macroeconomic level; *ii)* social housing operators are too fragmented to exploit economies of scale and do a poor job of targeting needy neighbourhoods; *iii)* rents depend on past funding costs and, to a variable extent depending on the area, are unrelated to market rents; *iv)* tenant turnover is very low; and *v)* a part of social housing benefits well-to-do households, which reduces redistributive effects. Improvement on these points would substantially raise the system's cost effectiveness.

Old-age pension complexity should be reduced to facilitate necessary systemic reforms

The French old-age pension system has a highly complicated structure with around 40 compulsory schemes with different eligibility criteria and pension benefits. Simplifying this complex structure is essential to facilitate transparency for employees who switch sectors and pension regimes over their careers, and most importantly, to increase fairness by reducing pension privileges of those enrolled in special pension schemes. Such heightened transparency could also facilitate achievement of financial equilibrium in the system. A system based on points or notional accounts is probably the solution that would offer the most operational flexibility.

Special pension regimes (including for the civil service) cover almost 4 million pensioners, essentially former civil servants, employees of state-owned companies and those in some specific sectors (miners, notaries and seamen), and pay annual benefits amounting to 3.5% of GDP. These regimes tend to offer more generous retirement conditions than the general scheme. Specific groups of civil servants in "active" service, including military personnel, policemen, firemen and prison guards, and in dirty jobs such as sewermen, can retire before the legal retirement rate and receive a pension after a shorter minimum contribution period (Table 1.8). Employees of the electricity and gas sectors, railway workers and employees of the Paris public transport company enjoy similarly favourable retirement conditions. The rules to calculate pension benefits for civil servants are so different from those in the private sector that it is difficult to have an overall idea about which scheme provides higher pensions. Overall, no reliable information

Table 1.8. **Major special pension regimes in 2009**

	Number of retirees (thousand)	Pension benefits paid (EUR billion per annum)	Minimum retirement age
Civil servants			
Central government	1 590	41.6	5 years less than in the general system for policemen, prison guards
Army	499		After 15 or 25 years of contribution
Local governments (CNRACL)	927	12.0	5 years less than in the general system for firemen, policemen and 10 years less for specific categories (e.g. sewermen)
Gas and electricity industry (CNIEG)	152	3.8	
Railways (CRPSNCF)	284	5.1	10 years less for "rolling" employees and 5 years less for the rest
Paris transport company (CRPRATP)	41	0.9	
Industrial workers of public companies (FSPOIE)	62	1.5	5 years less for specific groups (*service actif*)
Bailiffs and notaries (CRPCEN)	65	0.7	
Seamen (ENIM)	73	1.1	10 years less in the case of 25 years of contribution
Miners (CANSSM)	183	1.7	50 years for pit workers
Churches (CAVIMAC)	57	0.2	
Banque de France	12	0.4	
Opera de Paris	2	0.02	
Comédie française	2	0.005	
Tobacco industry (SEITA)	2	0.2	
Port autonome de Strasbourg	2		
Total	**3 953**	**69.2**	

Source: Bureau des régimes spéciaux, Direction de la sécurité sociale.

is available about the costs of the special regimes. But one pre-condition of EDF/GDF being listed on the stock exchange in 2005 was the incorporation of its pension regime in the general scheme. Because the eligibility criteria were left unchanged, the State had to pay a compensation of about 0.5% of GDP to the national pension insurance fund (CNAV), an amount corresponding to the net present value of future pension payments due to its special conditions.

While France's public spending on old-age pensions is among the highest in the OECD relative to GDP, it is projected to increase only at a slow pace, by a further 0.5 percentage point of GDP by 2060 (European Commission, 2012). The 2010 pension reform aimed to ease pension spending obligations by progressively extending the minimum legal retirement age from 60 to 62 years and the retirement age to receive a full pension from 65 to 67 years by 2018 (which was subsequently brought forward to 2017 as part of fiscal consolidation). Under the 2003 Fillon reform, the government may change, by decree, the minimum contribution period, using expert opinions regarding changes in life expectancy at age 60. Accordingly, the minimum contribution period needed for a full pension, which was 40 years at the time of the reform, was increased to 41.5 years for people born in 1955 or later. This is an important step towards long-term sustainability. However, the link between gains in life expectancy and the contribution period conferring entitlement to full pension benefits should be rendered fully automatic, such as in Latvia, Poland, Sweden and Norway (European Commission, 2012), thereby removing the possibility of any government interference. Scheme participants who have not contributed long enough to have a full pension are penalised by 1.25% per missing quarter on the pension payment. However, whatever the number of years worked, everybody receives a full pension when retiring at 67, without any penalty but still proportional to the contribution period. The government's decision in June 2012 to reduce the minimum retirement age to 60 years for those who have reached the contribution period giving the right to a full pension increases fairness as they were unduly penalised by the rise in the minimum retirement age to 62 years. At the same time, as this change could impose an annual financial burden of EUR 1.1 billion in the short run and almost EUR 3 billion in 2017 on the pension system and hence public finances, the government decided to increase pension contributions. Overall, maintaining 62 as the minimum legal retirement age and providing long-career workers a bonus for extra years worked would have been preferable. According to a recent report by the Pension Advisory Board (Conseil d'Orientation des Retraites, 2013), under the best of circumstances, the pension system's balance can be restored only in the long term (by the early 2040s in a best-case scenario). However, under a number of long-term macroeconomic scenarios, the pension system's deficit would persist until 2060. Between 2012 and 2040, the accumulated debt of the pension system would amount to between 15 and 50% of GDP. Consequently, additional adjustments to the pension system's parameters will be needed quickly to reach financial balance.

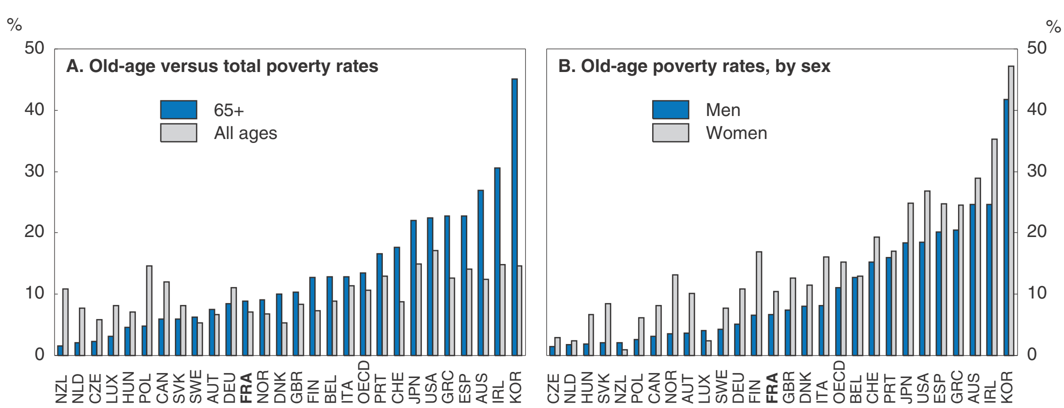
Achieving actuarial fairness and neutrality would help maintain the pension system's long-term sustainability. An actuarially fair system would ensure, in a broader sense, that expected pension benefits would be directly linked to pension contributions paid over the working lifetime. According to a narrow definition of actuarial fairness at the individual level, the net present value of lifetime contributions and the net present value of lifetime benefits should be equal (Queisser and Whitehouse, 2006). But there is a trade-off between actuarial fairness and a potential desire to reduce income inequality in the pension system through redistribution, which would reduce fairness at the individual level. In France, pension benefits in the general system are determined on the basis of the best 25 years' income over one's career. The full career should be taken into account to approach actuarial fairness. Actuarial neutrality means that working longer is not penalised and that marginal incentives to continue working are the same at all ages (which in theory would imply that bonuses and penalties should vary according to age). The bonus and penalty applied in the French system seem to broadly achieve this.

The 2010 reform also scheduled discussions to take place in 2013 about achieving long-term balance in the pension system. A universal pension system based on points or with individual notional accounts would not only make it easier to enforce actuarial neutrality and fairness, it would also provide the flexibility to achieve financial balance as population ageing proceeds. In addition, it would make the system more transparent for the insured. Points can be converted into pension payments using an aggregate conversion coefficient, which accounts for life expectancy at the time of retirement, demographic projections and projected receipts and outlays of the pension system. The conversion coefficient can be set in a way to balance outlays with receipts. Such a system is well equipped to deal with forthcoming population ageing insofar as the conversion factor can be revised during pensioners' lifetimes. But this flexibility would come at the expense of reducing intergenerational equity. A points-based system could also have redistributive elements, which would come at a cost of distorting actuarial fairness at the individual level.

Old-age poverty rates in France are below the OECD average. Pension systems in some countries, including the Czech Republic, New Zealand and the Netherlands, generate extremely low old-age poverty rates, well below those observed in the general population, and almost no pension inequality between men and women. In France, the poverty rate for pensioners is comparable to that of workers and lower than for the whole population; however, older women tend to fall much more often below the poverty line than their male counterparts (Figure 1.16). Indeed, the French system reduces pension inequality to a large degree: gross and net pension replacement rates are considerably lower for high-income earners than for low-income individuals (OECD, 2011c). Retirement income is redistributed

Figure 1.16. **Old-age poverty rates in OECD countries, mid 2000s**

Percentage with incomes less than 50% of median household disposable income



Source: OECD (2011), Pensions at a Glance.

StatLink http://dx.doi.org/10.1787/888932790602

via several channels. Some measures aim to top up low pension benefits. They include a minimum pension paid by the general regime (*minimum contributif*) and a means-tested minimum income benefit (*minimum vieillesse*), which is paid mostly to people with low-incomes (OECD, 2011c). Other measures seek to compensate for shorter careers to achieve the minimum contribution period needed for a full pension: periods of unemployment during which unemployment benefits are received and time spent in sickness and invalidity are taken into account for benefit determination. On the other hand, Aubert and Bachelet (2012) show empirically that taking the best 25 years as a basis for the calculation of pension benefits amplifies pension income inequality because low-income individuals tend to have shorter careers than those with high earnings.

Survivors' pensions lower female participation and discriminate against private-sector pensioners and unmarried people

Survivors' pension benefits account for almost 2% of France's GDP, which is higher than the OECD average (Figure 1.10, Panel C above). This system should internalise the costs of death within the family (James, 2009). Moreover, they imply redistribution from women who work to those who stay at home and from singles and two-earner families to single-earner families, penalising second-earners' labour market participation. Survivors' pensions are indeed generous in France because they do not account for the cost of such additional (life) insurance. Employees should be able to opt for survivors' pensions, as in Sweden, in which case they would either pay higher contribution rates or receive lower pension benefits (Whitehouse, 2013).

There is also some disparity between eligibility criteria for survivors' pensions for private- and public-sector employees. The spouse of a private-sector pensioner can claim survivors' benefits if he or she is older than 55. The survivor benefit cannot exceed 60% of the pension of the deceased, is means tested and has an upper limit. By contrast, a spouse of a public-sector retiree can receive survivor benefits without any restrictions regarding the survivor's age and income (but the survivor benefit rate may not exceed 50%). The survivor benefit is increased by half of the 10% bonus received after three or more children. Overall, the asymmetric treatment of private- and public-sector pensioners should be phased out.

In-kind benefits: health-care and education services

In-kind benefits provided through public (health and education) services reduce income inequality in France. Their redistributive impact depends on the volume of those services and the targeting of the benefits. Health-care services make a substantial contribution to income redistribution because of their sheer mass: public health-care expenditures account for 9% of French GDP and cover 80% of total health-care spending. The same amount of public services, allocated as a first approximation in equal portions to all households increases household disposable incomes more the lower the household is in the income distribution. INSEE estimates suggest that a few years ago public in-kind benefits from health-care services accounted for over 35% of the reduction in income inequality (Marical, 2007; Amar et al., 2008).

Redistribution occurs along the following dimensions: gender, age and income. Women of childbearing age tend to consume more health services than men of the same age. Children and elderly people make more use of public health-care services than other demographic groups, leading to horizontal redistribution between families of different size and between different generations. Intergenerational redistribution is amplified by the fact that old people tend to be situated in the lower part of the income distribution. When age and gender are controlled for, low-income individuals consume more hospital services and primary care, the reimbursement rates for which are high, in contrast to dental and specialist care, of which wealthier people avail themselves more often. The fact that public health insurance covers the bulk of hospital and primary care, combined with socialised funding, results in redistribution to those least well-off through the health-care system.

Similarly to public health-care services, public spending on education has a massive impact on income redistribution, when calculated on the basis of average costs per person enrolled in public educational institutions. In the middle of the 2000s, the contribution of public educational services to redistribution was 30% (Amar et al., 2008), because they absorb about 5% of French GDP and also because the monetary value of these in-kind transfers diminishes as household income rises. But redistribution is uneven depending on the type of educational service. Transfers related to pre-school (excluding nurseries) and primary education benefit most the least affluent households, which tend to be single-earner families with more children. But the value of in-kind benefits relating to secondary education increases for more wealthy households, given that children from these households opt more often for general secondary schools, at which attendance is longer and more costly than at vocational schools utilised by poorer families (Allègre et al., 2010). Finally, there is a U-shaped pattern for tertiary education because poor student households receive important financial aid and because the children of the most affluent households have a higher propensity to attend.

Nevertheless, using current spending on education as a measure of income redistribution may be flawed if present differences in income are due to past expenditures on education. In any case, spending does not necessarily reflect the quality of education, which may vary a great deal across locations. Also, whether a given amount of public spending on education reduces or increases income inequality depends to a large extent on the returns to education: in fact, socio-economic background and social capital have a much larger impact than actual public spending (Allègre et al., 2010). Rather than incorporating the monetary value of public educational services into the definition of income, a more useful benchmark would be to see the extent to which public education reduces the impact of parental socio-economic status on educational outcomes and future income and improves inter-generational social mobility. A related area is the training of employees, which costs up to 1.5% of GDP, financed partly by a tax levied on employers' wage bill. It is not only a very complex system and of low quality but also magnifies inequality by favouring those who need it least (Cahuc et al., 2011).

Box 1.2. **Recommendations for improving the efficiency and equity of tax and transfer policies**

Improve neutrality of taxation of across asset classes and within specific taxes

- Reduce the complexity and enhance the stability of the tax system.
- Broaden tax bases by phasing out costly tax expenditures, rather than increasing statutory rates. Reform the taxation of saving products by imposing similar tax treatment for all products. Explore the possibility of shifting taxes from nominal to real returns. Streamline the taxation of dividends.
- Turn the *taxe foncière* into the equivalent of a tax on imputed rents by regularly updating the cadastral/rental values and phase out taxes on actual rents. Align the taxation of capital gains on housing with that applied to other assets, though the payment of capital gains taxes on housing should be deferred until the owner's death. Cut transaction taxes on the purchase of property.
- Tax bequests and gifts based on the amount received over one's lifetime, no matter the source.
- Gradually phase out reduced VAT rates, and compensate the poor if necessary via means-tested annual payments to achieve distributional objectives in a more cost-efficient way.
- Equalise implicit and explicit carbon prices across emissions sources, make abatement costs due to feed-in tariffs more homogenous for renewables, and alter the bonus-penalty system applied to new car purchases so as to eliminate bonuses and enhance cost effectiveness.

Tax system

- Increase CSG on pension income, introduce pensioner contributions for health care and simplify the current system of minimum pensions by eliminating tax breaks for pensioners and, if needed, raising the minimum pension.
- Adopt individual-based personal income taxation.

Transfers

- Simplify all social benefits substantially. Merge activity RSA and the in-work tax credit (*prime pour l'emploi*, PPE).
- Abolish all of the special provisions of unemployment benefit schemes applicable to seniors. Introduce degressivity into allowances paid during periods of unemployment. Strengthen the linkages between compensation, job search and participation in back-to-work measures that are more effective.
- Impose stricter job-search requirements on social benefit recipients, and introduce activation policies for disability pensions. Avoid potential benefit substitution by firmly enforcing access conditions for disability pensions.
- Delay retirement by reducing the maximum duration of unemployment benefits of older workers and by phasing out the special solidarity allowance (ASS). Internalise at the individual level the costs of survivors' pensions in old-age pension benefits. Render the link between gains in life expectancy and the pension eligibility age fully automatic. Eliminate special occupational pension schemes, and introduce a universal pension system based on points or notional accounts.
- Increase incentives for low-skilled women to return to the labour market after the birth of their children by shortening the duration of the parental leave allowance and by increasing the supply of places in public nurseries.

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Chapter 2

Improving the economic situation of young people

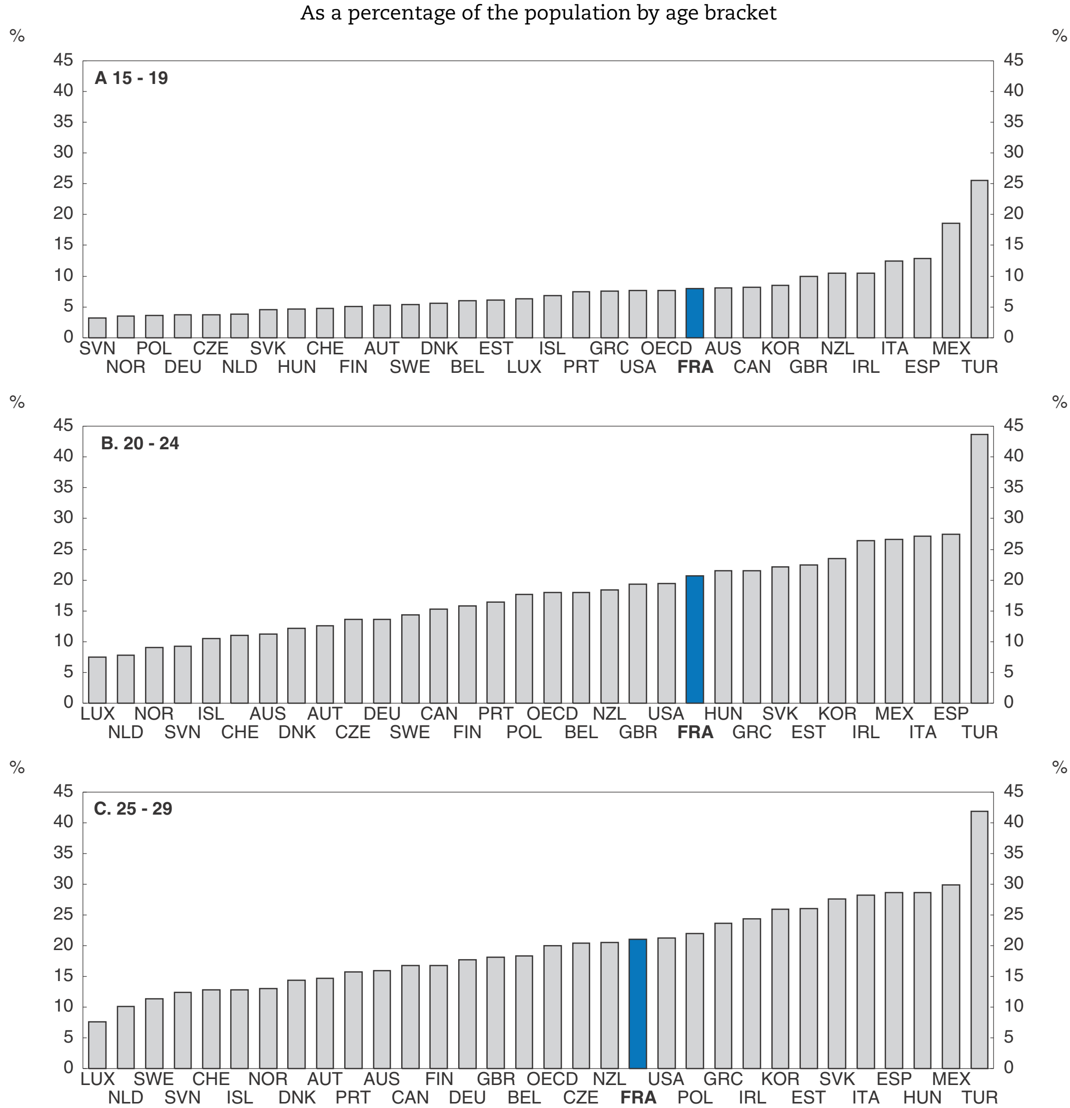
The economic situation of young people is unsatisfactory. Educational inequalities have been widening for over a decade, due to a sharp decline in the results of the most highly disadvantaged students. The unemployment rate for the 20-24 age bracket has not dropped below 16% for nearly 30 years. French youth are highly pessimistic about the future and express great distrust of institutions. The social safety net sits uneasily between autonomy and family solidarity and is unfair because young people who are unemployed and have no solid financial backing from their families find themselves in precarious situations. Positive discrimination in education policies should be given a real priority and education spending rationalised to draw more resources to primary schooling. The autonomy of universities should be increased, as should the financial independence of young people. The workings of the labour market, some features of which penalise new entrants, need to be reformed and youth employment services enhanced.

The priority for the President's term of office

Youth is the priority of the French President. Educational inequalities have been widening for over a decade, with an absolute decline in outcomes for the most disadvantaged students. The unemployment rate for the 20 to 24 age bracket has not dipped below 16% for nearly 30 years. At year-end 2010, roughly 1.9 million young people aged between 15 and 29, i.e. one in six, were neither in employment nor in education or training (NEET): 300 000 aged 15 to 19 (7% of that age bracket), 800 000 aged 20 to 24 (21%) and 800 000 aged 25 to 29 (21%) (Figure 2.1).

Figure 2.1. **NEETs in OECD countries, 2010**[1]

As a percentage of the population by age bracket



1. NEETs are those who are not in employment, nor in education or training.

Source: OECD, *2012 Education Database*.

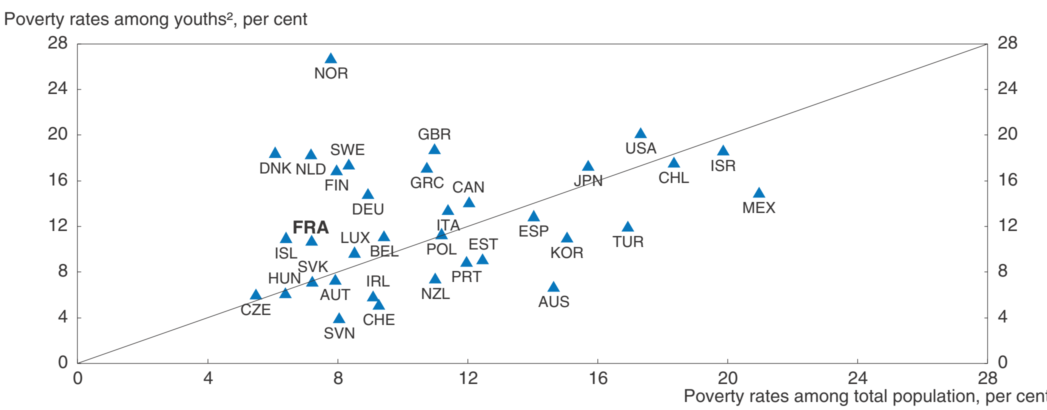
StatLink http://dx.doi.org/10.1787/888932790621

Their paths to achieving stable employment are long and difficult. These characteristics place France in the lower half of OECD countries in terms of performance in this area.

Between 2000 and 2010, the relative poverty rate of those aged 18 to 29 increased from 16 to 18% using a threshold of 60% of median income. At the same time, the corresponding proportion for the population as a whole was virtually stable between 13½ and 14%, but it has increased since the beginning of the crisis in 2008. As compared to other OECD countries, France has nonetheless performed well in combating poverty for the population as a whole and for young people as well, albeit to a lesser extent (Pisu, 2012 and Figure 2.2).

Figure 2.2. **Poverty rate, youth versus the population as a whole**

End of the 2000s[1]



1. The poverty rate is measured by the proportion of individuals whose equivalised household disposable income is lower than 50% of the median income for the population as a whole.
2. Aged 18 to 25.

Source: OECD Database on income distribution and poverty.

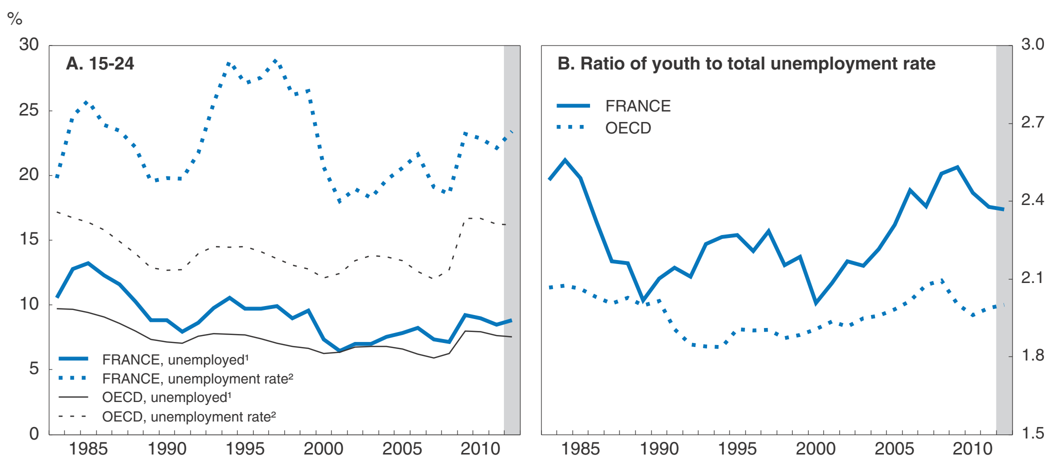
StatLink http://dx.doi.org/10.1787/888932790640

The geographic concentration of situations of extreme poverty in which young people are overrepresented creates a climate of tensions. The 2005 violence in certain suburban housing projects left a lasting impression and was widely publicised. According to Mauger (2007), by burning schools and libraries, young people were saying symbolically that public schools have not only treated them as they should have, but that the schools have even amplified the inequalities and injustices afflicting them. The failure rate is so high that the institution would no longer be perceived as a help, but as an instrument of humiliation and exclusion (Mauger, 2007). And yet young people constitute a diverse population that cannot be reduced merely to the problem of so-called “sensitive urban zones” (ZUS) (in fact only one in seven young NEETs lives in a ZUS). More generally, youth unemployment and insecurity are powerful determinants of delinquency (Fougère et al., 2011). Youth issues involve the education system as a whole, labour-market integration and, beyond that, the prerequisites for attaining autonomy, and youth policies should strive to facilitate the transition from childhood to adulthood.

Starting from an already unfavourable position, young people have been hit by the crisis

As in most OECD countries, young people have been hit especially hard by the worsening employment situation since 2008. Declining aggregate demand weighs more heavily on jobseekers and those whose employment contracts provide less protection. While 9% of young people aged 15 to 24 are unemployed, their unemployment rate (relative those in the labour force) reached 24% at the end of 2012 (Figure 2.3). And among these young people, in France as elsewhere, it is those with the least education that are paying the highest price for the protracted crisis (OECD, 2011a). The situation is all the more worrisome insofar as young people who have the misfortune of entering the labour market at a time of economic crisis may bear the resulting scars for a long time (Scarpetta et al., 2010a). However, according to the estimates of Gaini et al. (2012) using French data between 1982 and 2009, the employment and wage differentials between "lucky" and "unlucky" cohorts tend to vanish within four years.

Figure 2.3. **Youth unemployment and total unemployment, 15-24**



1. As a percentage of the population aged 15 to 24 years.
2. As a percentage of the active population aged 15 to 24 years.

Source: OECD, *2012 Labour Force Statistics Database*.

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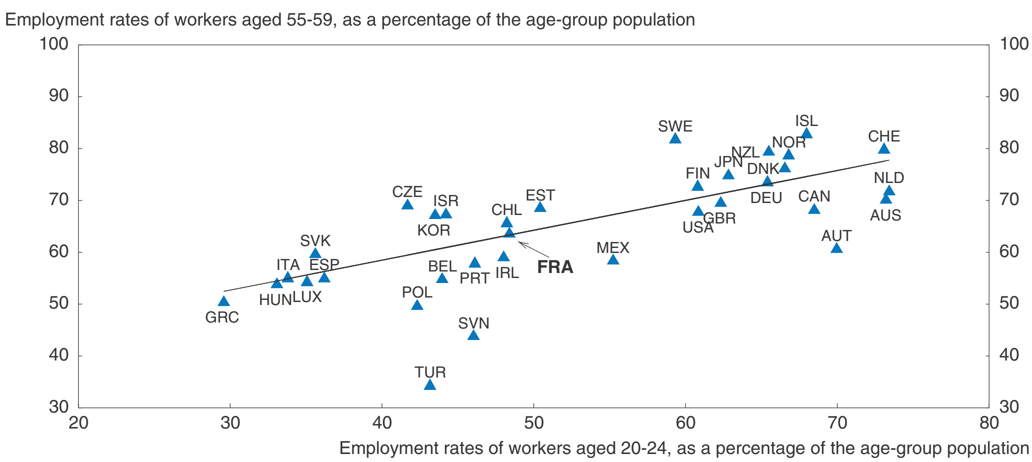
OECD (2011a) has highlighted the urgency of providing suitable support to those young people running the greatest risk of losing contact with the job market. This is especially true in France, where the young can slip through the cracks of a social protection system that otherwise provides an effective safety net. Insofar as youth unemployment is for the most part structural,[1] this state of emergency is a permanent fixture. To improve preparations for the end of the crisis, efforts to train NEETs should be stepped up (OECD, 2011a). For young unskilled people the emphasis should be on apprenticeship contracts that combine job-related training and initial occupational experience, since international initiatives have shown that for this age group the use of training programmes alone yields limited results.

In France, the poor state of public finances has precluded an optimal countercyclical response. Nevertheless, to limit the economic slowdown's impact on young people's situation, between April 2009 and December 2010 the government instituted an emergency youth employment plan, including work-study, incentives to convert internships to permanent contracts and a relaunching of subsidised contracts. These measures contributed to the drop in youth unemployment between late 2009 and mid-2011. At least the errors of the past were avoided: early-retirement schemes were not used to "make room for the young" (OECD, 2011a), as experience has indeed shown clearly that there is no substitution between the employment of young people and seniors (Gruber et al., 2009) (Figure 2.4). Faced with the persistent stagnation of economic activity since year-end 2011, in September 2012 the new government launched new subsidised contracts – "jobs for the future" and began in early 2013 to introduce "generational contracts", the goal of which is both to encourage the hiring of young people on permanent contracts and to keep seniors at work (see below).

Figure 2.4. **Countries which have higher employment rates for youth tend also to be those with higher employment rates for seniors, 2011**



Source: OECD, 2012 *Labour Force Statistics Database*.

StatLink http://dx.doi.org/10.1787/888932790678

Enhancing the autonomy of young people

The social networks work well for health care and housing benefits

Having lower income,[2] young people may encounter difficulties accessing such essential goods and services as health care and housing. Nevertheless, social security cover for basic health care is universal in France, and complementary insurance schemes (including complementary universal coverage, which is provided on a means-tested basis) cover 94% of the population. Young people and those over 80 are admittedly the least well covered, yet still at a rate of 90%, which is the average that had prevailed for the population as a whole at the beginning of the 2000s. Young people can also get relatively generous personal housing subsidies. These benefits amount to approximately EUR 5 billion (0.25% of GDP) for those 16 to 25, EUR 1.5 billion of which for students, and are split evenly between aid to families (for "dependent children") and benefits paid to young people directly (Clergeau, 2009).

Despite these aid schemes, young people are bearing the full brunt of higher housing costs. The shortage of student housing has recently attracted the attention of policymakers. In April 2011 the authorities committed themselves to the extremely bold objective of doubling the number of student dwellings to 680 000 by 2020 (for his part, however, President Hollande foresees the construction of 40 000 student dwellings over five years (Floc'h, 2012)). Nearly half of those between 18 and 30 live with their parents, and the proportion of social housing dwellers under 30 dipped from 12.5% to 10% between 2003 and 2009 as a result of population ageing (OPH, 2011). The low share of young adults living in social housing can also be explained in part by the relative shortage of small dwellings, problems related to poor targeting in social housing assignment and low residential mobility in this sector – inefficiencies that were analysed in the previous *Survey* (OECD, 2011b).

A hybrid system that puts substantial emphasis on family benefits…

In addition to public expenditure on education, labour market integration (see below) and individual housing aid, government spending on youth essentially comprises: family benefits paid to parents in respect of their adult dependent children (EUR 2.3 billion per year); personal income tax relief, thanks to the "family quotient" (see Chapter 1), deductibility of higher-education expenses and of child support payments (EUR 2.5 billion); means-tested higher-education scholarships paid directly to students (EUR 1.8 billion); and coverage of the deficit of the students' health insurance scheme and subsidies to regional student welfare offices (EUR 1 billion) (Commission sur la politique de la jeunesse, 2009; HCF, 2010). In the aggregate, these expenditures amount to approximately 0.4% of GDP.

Thus, most of the measures benefiting youth involve housing aid or family benefits, the system for which is designed around the notion of "dependent children", conferring entitlement to financial compensation and tax breaks). Roughly 30% of young people aged 16 to 25 are classified as dependent children for tax purposes. Age limits for inclusion in the family tax unit vary from one benefit to another; for example, the maximum is 18 for the yearly back-to-school allowance, 20 for family allowances (which are not means-tested), 21 for the family income supplement (for families with at least three dependent children under the age of 21, which is means-tested) and 25 for the inclusion of students. There are, in fact, over 100 age limits covering young people in employment, social benefits and tax schemes (Commission sur la politique de la jeunesse, 2009, Annex 5). There are intermediate situations whereby young adults can be included in their parents' households for tax purposes, while still receiving personal allowances (housing aid, certain social minimum income allowances, etc.) in their own right. As a result, the actions of the family branch of Social Security with regard to young adults lack clarity in its objectives and in the effectiveness of its various schemes (Clergeau, 2009). Between autonomy and family solidarity, youth policy wavers haphazardly.

… that is rather unfair and limits young people's autonomy

Childless young adults are virtually excluded from the main social welfare scheme – the "active solidarity income allowance" (*revenu de solidarité active*, RSA), for which they are eligible only from age 25. This unfavourable treatment is rather unique in the OECD area, since welfare benefits are open to the young as from age 18 in all countries except Spain, France and Luxembourg (OECD, 2009). Compounding the disadvantage, despite entitlement after four months of contributions (during the last 28 months), is an inherently shorter duration of unemployment benefits for people with little average work experience. In some ten OECD countries, 20 year-old jobseekers who have never worked are entitled to benefits, provided, however, that they meet certain conditions, including compliance with reciprocal commitments (OECD, 2009, Box 6.3). The strategy for getting young dropouts into work should be centred on the acquisition of a skill, as in Denmark – a pioneer in this area. Since 1996, the unemployment benefit for Danish 18 to 24 year-olds without an upper-secondary school diploma has been cut in half after six months of unemployment, to a level equivalent to that of a student benefit, and recipients are required to return to initial training, in most cases under an apprenticeship programme. In France, their overall situation puts young people who are unemployed and without solid family financial support in a shaky situation.

For a genuine extension of the RSA under strict conditions

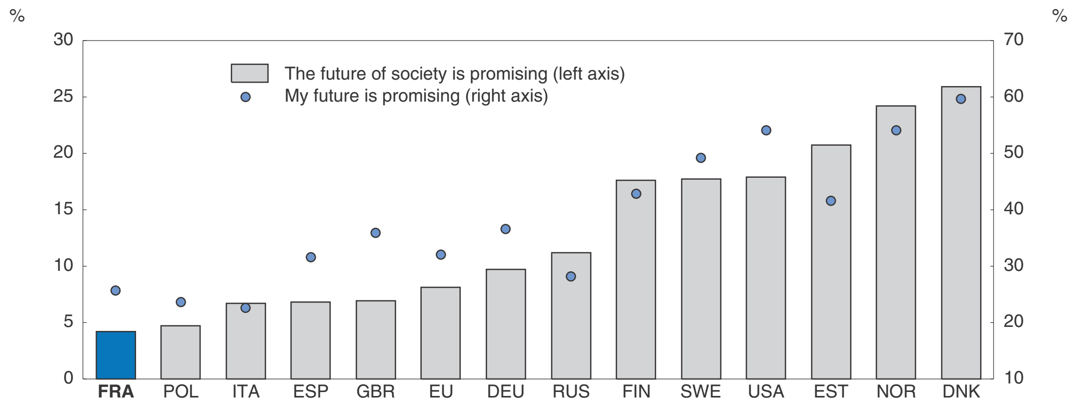
A genuine extension of the means-tested RSA to young adults would reduce the intensity of poverty and, if well designed, would facilitate labour-market integration, which takes longer than it did in the past and is longer than in many neighbouring countries. To limit the cost and optimise effectiveness, it should be increasing with age and reserved for NEETs alone, while students would continue to be supported by the scholarship system (subject to parents' means-testing) and by loans with repayments conditional on future income, which ought to be developed (see below). The key to the scheme's success and a *sine qua non* condition would be to root it firmly in compliance with reciprocal obligations facilitating integration into work. These mutual obligations would drastically reduce both the negative impact of the allowance on the supply of labour and the opportunity cost of continuing one's studies. The allowance could even enhance the effectiveness of job placement support, since current schemes generally lack effective incentives. Supporting the allowance by effective activation measures therefore constitutes a prerequisite for its successful implementation. This is an area in which France must do better (Chapter 1), insofar as its performance falls far short of the good practices developed in such countries as Australia, Denmark, the Netherlands and the United Kingdom (OECD, 2009). As part of the fight against poverty (see Box 3 of the Assessment and Recommendations section), the government intends to institute a "youth guarantee" conditional on participation in programmes for getting them into work, the amount of which would be similar to the RSA and reserved for highly vulnerable NEETs. The scheme would ultimately target 100 000 young persons aged 18 to 24, or only about 10% of the NEETs in that age cohort.

If, for example, the allowance were to rise gradually from 50% of the full RSA (which is EUR 475 per month for a childless single person) at age 18, to 100% at age 25 (or 23), the annual cost of the measure would be close to EUR 4 billion (or EUR 4.3 billion) and could be financed entirely by eliminating the advantages that result from the inclusion of young adult children in the family tax unit (EUR 4.8 billion, see above). Ideally, such a reform would be accompanied by complementary measures, the rationale for which is set out in this chapter. For example, the RSA phase-in rate, as a function of age, could also be used to index the minimum wage to age (see below).

Young people are pessimistic about the future and distrustful of institutions

French youth are pessimistic about their futures and that of society (Figure 2.5). According to Galland (2009), this pessimism could stem in part from difficulties finding work, which in turn result from the protection of workers on permanent contracts and a limited social safety net for young people, but also a deep mistrust of institutions and elites and the frequency with which students are rated during their schooling. On average, French youth consume significantly more alcohol, tobacco, cannabis and other drugs than do youth elsewhere (Figure 2.6). By international standards, they also have an especially low degree of trust in politicians (and in the media and multinational enterprises as well) (Figure 2.7).

Figure 2.5. **Young people's views of the future**[1]



1. Percentage agreeing with each statement.

Source: Les jeunesses face à leur avenir: une enquête internationale; Fondation pour l'Innovation Politique, 2008.

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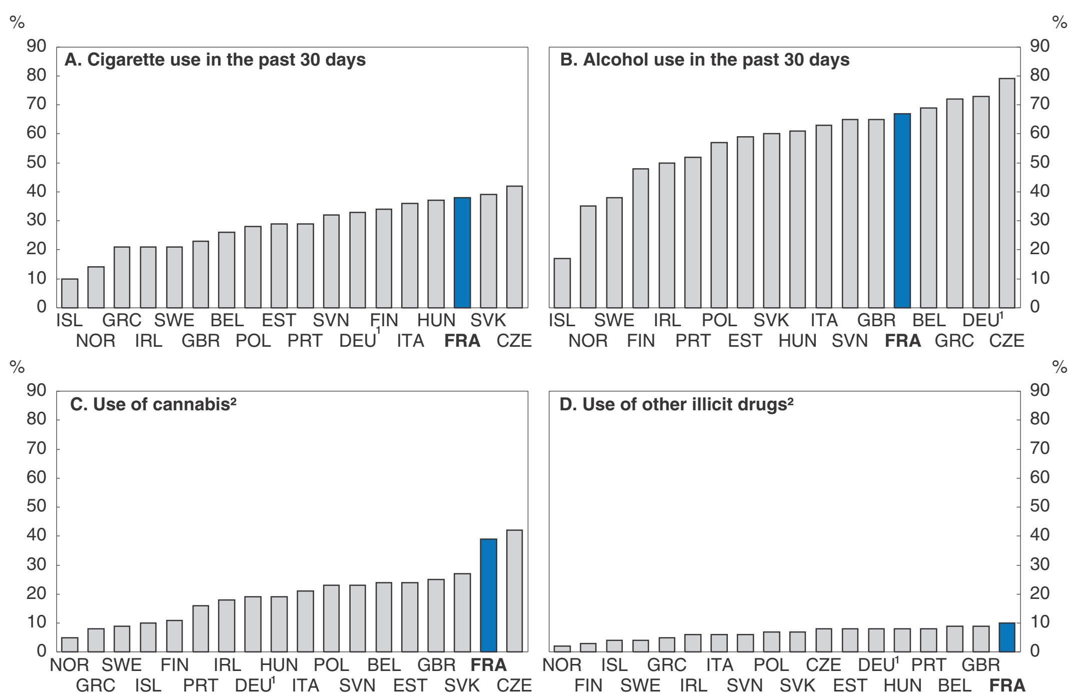
Figure 2.6. **Consumption of psychoactive substances by students aged 15 to 16, 2010**

As a percentage of students aged 15 to 16



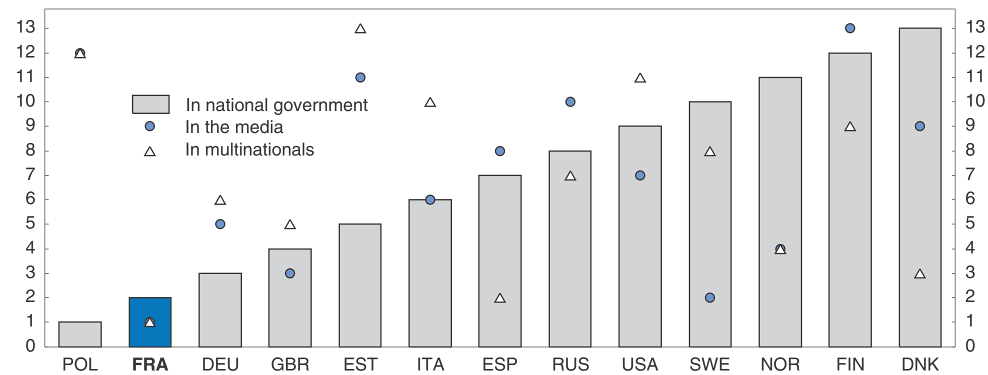
1. Seven Länder only.
2. At least once in their lives.

Source: The European Monitoring Centre for Drugs and Drug Addiction (EMCDDA), 2011 ESPAD survey.

StatLink http://dx.doi.org/10.1787/888932790716

Figure 2.7. **Level of youth confidence in institutions, media and multinational corporations**[1]

Young people aged 16 to 29



1. Countries are ranked by percentage of those having confidence in the institution in question; thus young Poles are the least likely to express confidence in their country's government, whereas young Danes rank first.

Source: Fondation pour l'Innovation Politique (2008), *Les jeunesses face à leur avenir, une enquête internationale.*

StatLink http://dx.doi.org/10.1787/888932790735

In terms of political economy, young people might suffer from an insider-outsider power struggle unfavourable to them: a high minimum wage, which tends to exclude them from employment; strong protection for permanent contracts, which complicates their finding work; and exclusion from the RSA, which impoverishes them Cahuc et al., 2011).

Combating failure at school

The quality of education is a key determinant of a country's economic performance and of integration into society and the autonomy of all young people. When it works, the education system can be a powerful force for lessening inequalities. There is scope for improvement in France at all levels, but efforts should focus mainly on primary schools and universities.

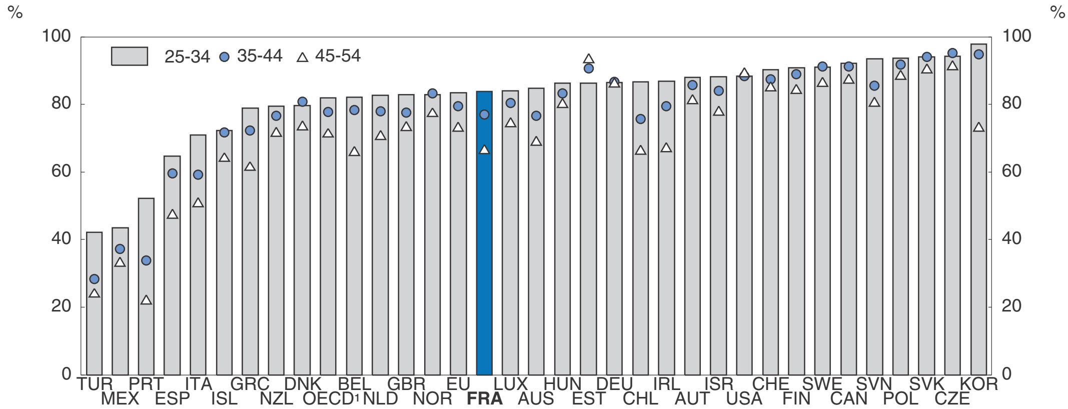
The education system is failing to reduce inequality

The general level of education improved spectacularly until the mid-1990s, allowing France to bridge most of its gap with the most economically advanced countries (Figure 2.8). After growing very rapidly between 1985 and 1995, and then more moderately, the share of the 25-34 year-old age cohort who receive an upper-secondary school qualification is 84%, slightly above the OECD average. The share of those getting a *baccalauréat* increased significantly, from 20% in 1970 to 66% of the age cohort in 2012, thanks in part to the creation of a vocational version in 1987.

Nevertheless, the deterioration of certain indicators is worrisome and, if nothing is done to remedy the situation, would seem to portend severe economic and social difficulties in the longer term. First, surveys conducted at the conclusion of primary school at a roughly ten-year interval show that pupils' average proficiency has dropped (Table 2.1). Second, the proportion of 15 year-old students whose performance is strictly below Level 2 proficiency (on a scale of 0 to 6) rose significantly, from 15% in 2000 to 20% in 2009

Figure 2.8. **Population with at least an upper-secondary school education by age group, 2010**

As a percentage of the population



1. Excluding Japan.

Source: OECD, *Education at a Glance 2012 Database*.

StatLink http://dx.doi.org/10.1787/888932790754

Table 2.1. **Proficiency trends of pupils in the final year of public primary schools**[1]

Excluding French overseas departments and territories

	1987	1997	2007
		Reading	
Average	**0**	**-0.03**	**-0.37**
Standard deviation	**1**	**1.02**	**1.22**
≤ 1st decile 1987	10 %	11 %	21 %
≤ Median 1987	50 %	51 %	61 %
≥ 9th decile 1987	10 %	10 %	8 %
		Mathematics	
Average	**0**	**-0.65**	**-0.84**
Standard deviation	**1**	**1.19**	**1.15**
≤ 1st decile 1987	10 %	28 %	32 %
≤ Median 1987	50 %	75 %	80 %
≥ 9th decile 1987	10 %	8 %	4 %
		Writing[2]	
Number of errors	**10.7**	**-**	**14.7**
≤ 2 errors	13 %	-	6%
≥ 25 errors	6 %	-	12%
Lexical (spelling) errors	2.1	-	2.6
Grammatical errors	7.1	-	10.8
Punctuation errors	1.1	-	0.9

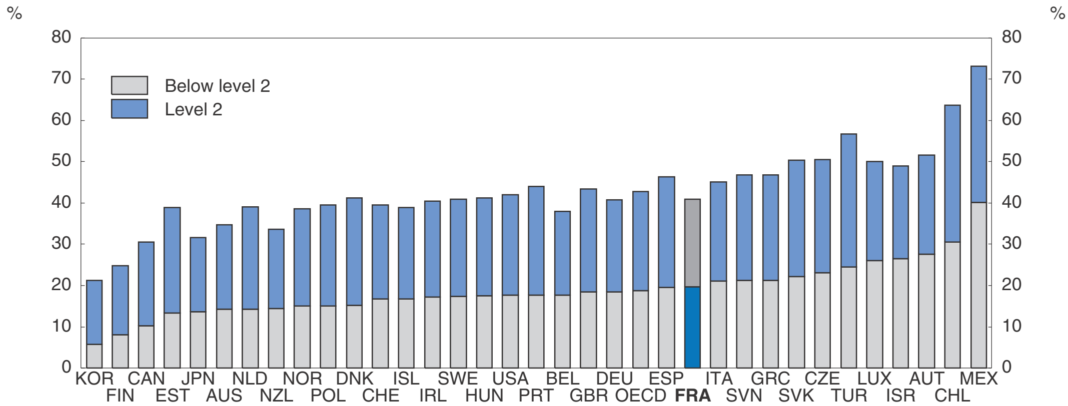
1. The reference here for comparisons is 1987: scores averaged 0, and the standard deviation was 1 in 1987. A negative average value indicates a value lower than the average score in 1987.
2. Based on the same dictation exercise over all surveys.

Source: Ministry of National Education (2009), *L'État de l'école*.

(Figure 2.9), whereas that share remained stable on average across the OECD area, placing France in the low-to-average range. Third, after a low point of 15% in 1998, 20% of students (or about 150 000 young people each year) drop out of school without an upper-secondary school diploma, placing them at a handicap in finding work. Fourth, the enrolment rate at age 18, which had risen sharply to 85% in 1995, has slipped back to 80% since 2005. Trends in the latter two indicators put France near the OECD average.

Figure 2.9. **A substantial number of pupils do not master basic reading skills**

Percentage of 15 year-old students with proficiency at or below Level 2 on the PISA reading proficiency scale



Source: OECD (2010), *PISA 2009 Results: Overcoming Social Background; Equity in Learning Opportunities and Outcomes.*

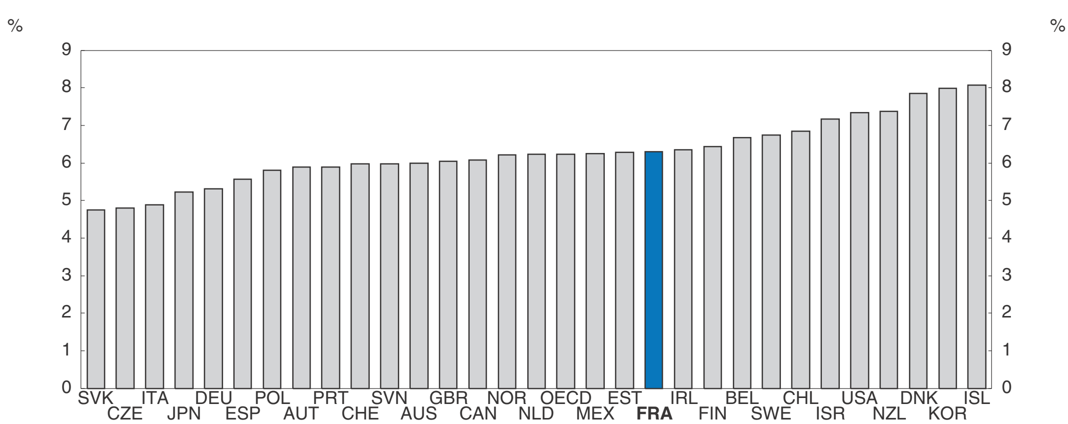
StatLink http://dx.doi.org/10.1787/888932790773

Since the late 1990s, France has each year allocated approximately 6% of GDP to education, expenditure per student representing roughly a quarter of per capita GDP and the number of students a quarter of the total population. These figures put France near the OECD average (Figure 2.10). The OECD's PISA tests have revealed that the better performance achieved by countries such as Finland, Canada, Japan, the Netherlands and Australia in particular could not be explained by greater expenditure (Figure 2.11). This would suggest that there is substantial scope to increase the effectiveness of the French education system, even without increasing its budget.

Above all, according to PISA results, the dispersion in terms of the level of education of 15 year-old students is reaching a disturbing level. The ratio of scores obtained by the top 5% of students to those of the worst 5% performers exceeds 2, with Luxembourg alone showing higher levels of inequality (Figure 2.12 , Panel A). Since 2000, France (along with Japan, which started from a moderate level of inequality) has seen inequality increase

Figure 2.10. **Aggregate spending on education in OECD countries, 2009**

As a percentage of GDP

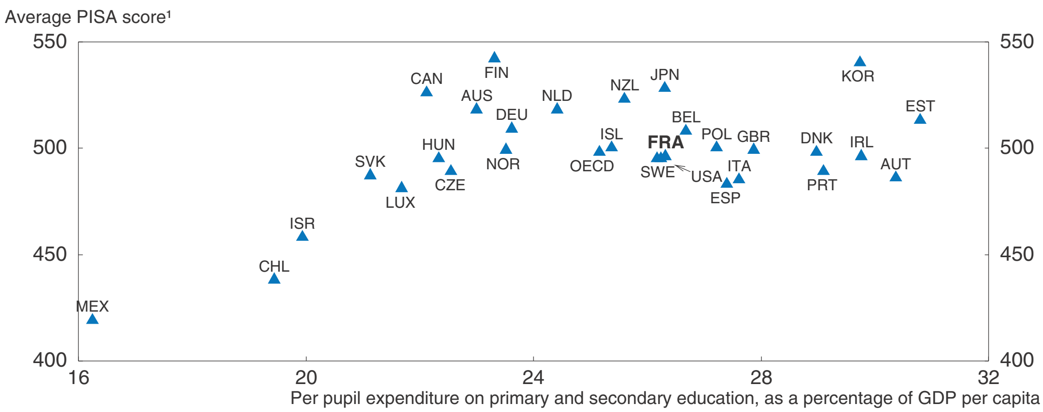


Source: OECD, *Education at a Glance 2012.*

StatLink http://dx.doi.org/10.1787/888932790792

Figure 2.11. **Outcomes are not related to education spending for the more affluent OECD countries**

2009

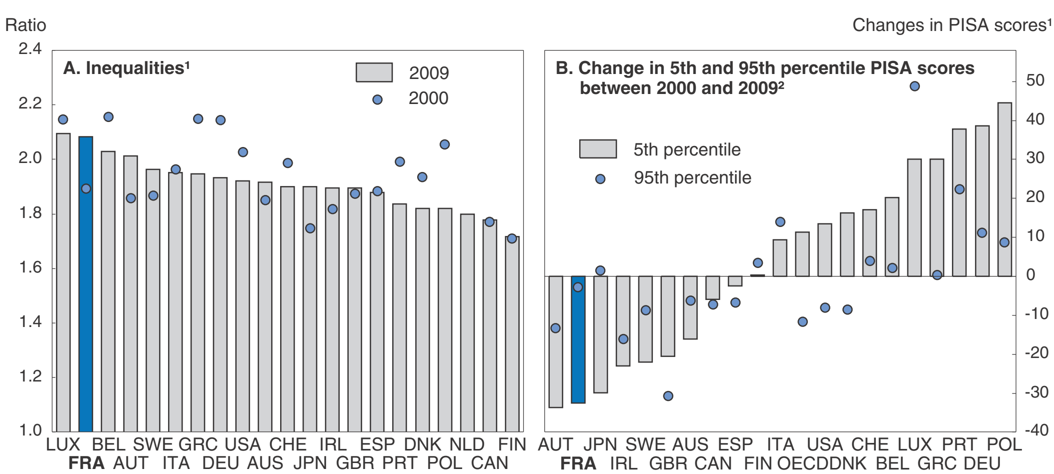


1. Average of PISA scores on the reading, mathematics and science scales.

Source: OECD, *Education at a Glance 2012* and *2009 PISA Results Databases*.

Note: To download the data corresponding to this graph, refer to figure 30.

Figure 2.12. **Inequality of PISA results between students**



1. Panel A shows the ratio of the average score of the top 5% of students to the average score of the bottom 5%. For panels A and B alike, scores represent the average of proficiency in reading, mathematics and science.
2. Unweighted average for the OECD.

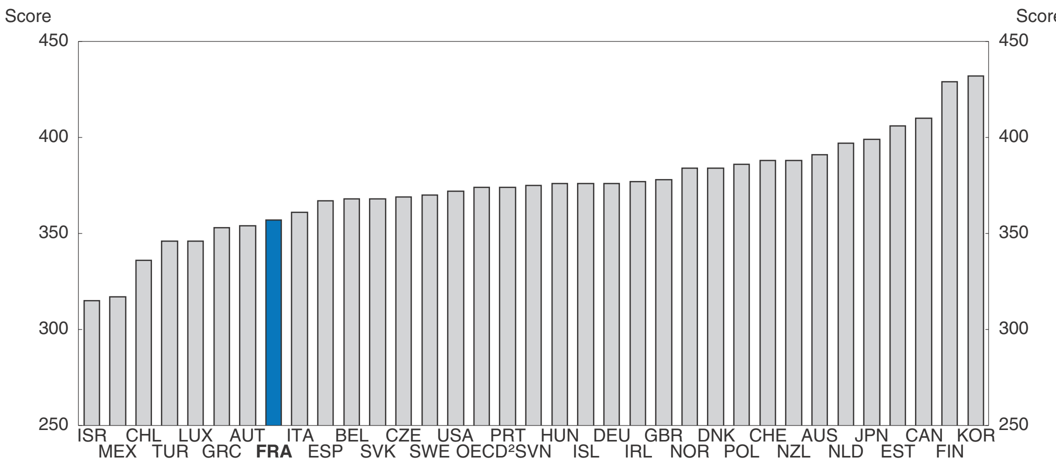
Source: OECD, *PISA 2009 Results Database*.

StatLink http://dx.doi.org/10.1787/888932790811

most sharply; this situation is made even worse because it stems from a pronounced decline in the results of the worst performing students (Figure 2.12, Panel B). As a result, their level is among the lowest in any OECD country (Figure 2.13). When the heterogeneity of the population is taken into account, France's cumulative gap with the best performing countries shrinks by about half. Nevertheless, the bulk of the poor results of the weakest students remain (Boulhol and Sicari, 2013a). From this standpoint, the policy of "priority" education (see below) carried out since the early 1980s to improve the level of education in disadvantaged areas has been a failure.

In France, inequalities of opportunity seem to be greater than elsewhere. The influence of social background on children's reading performance has increased and is one

Figure 2.13. **PISA scores of the poorest-performing students (10th percentile)[1], 2009**



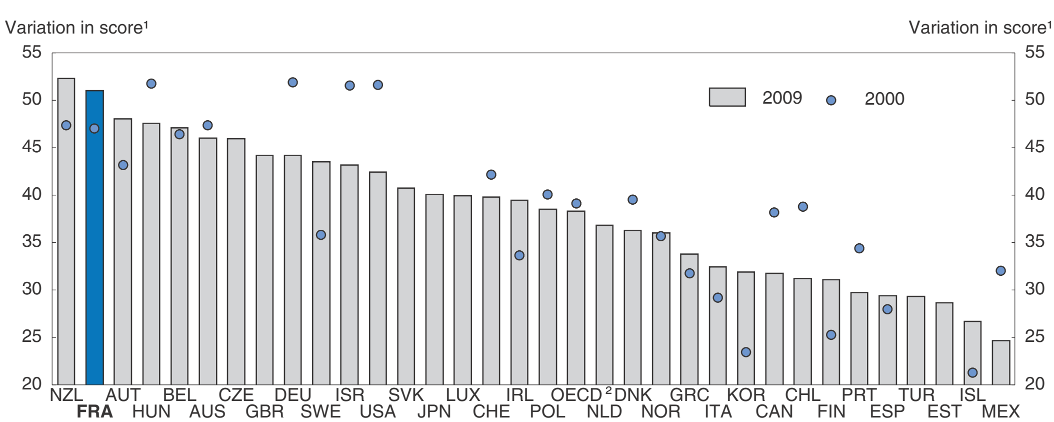
1. Average of scores obtained for proficiency in reading, mathematics and science.
2. Unweighted average.
Source: OECD, *PISA 2009 Results Database.*

StatLink http://dx.doi.org/10.1787/888932790830

of the largest in the OECD (Figure 2.14). Improving the education system's performance therefore becomes an eminently social issue, entailing a battle against school failure in order to reduce inequality. International experience shows that it is possible to limit educational inequality drastically without penalising the performance of the best students. The paradox of France, relative to the other OECD member countries, is that it carries out policies that perpetuate or fail to bring down sharp scholastic inequalities at an early stage but significantly correct induced market income inequalities later through a costly system of social protection.

Figure 2.14. **Relationship between student reading performance and socio-economic background**

Estimated slope of the relationship between student performance on the reading literacy scale and the PISA index of economic, social and cultural status (ESCS)



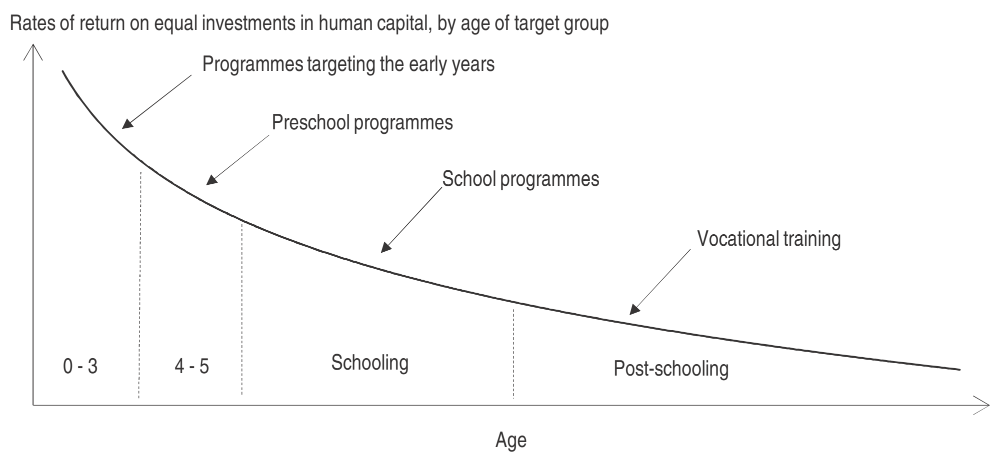
1. Variation in score associated with a one-point increase in the PISA index of economic, social and cultural status.
2. Unweighted average of 26 OECD countries.
Source: OECD, PISA 2000 Results and *PISA 2009 Results Databases.*

StatLink http://dx.doi.org/10.1787/888932790849

Priority should be given to intervening early in the educational process

Fighting effectively against school failure entails concentrating the resources of national education, and of "priority" education in particular, at an early stage in the process – in nursery and elementary school, if not in very early childhood (Figure 2.15). This is the conclusion reached by all of the research into the effectiveness of policies to counter school failure (Heckman and Carneiro, 2003; Maurin, 2007). In contrast, corrective measures at later stages probably have only scant benefits. Actions taken during early childhood have long-lasting effects that can enhance learning abilities and reduce delinquency. Their effectiveness is attributable essentially to the increased returns on subsequent investment that such measures generate: learning is a cumulative process; in short, human capital is synergistic (Heckman and Carneiro, 2003). Moreover, returns on investment at an early stage are highest in respect of children from disadvantaged backgrounds, where the development of interpersonal skills and discipline gets little encouragement (Heckman, 2008). Thus, measures targeting very young children from disadvantaged backgrounds raise no equity-efficiency tradeoff: such investments are highly beneficial economically and lessen inequality.

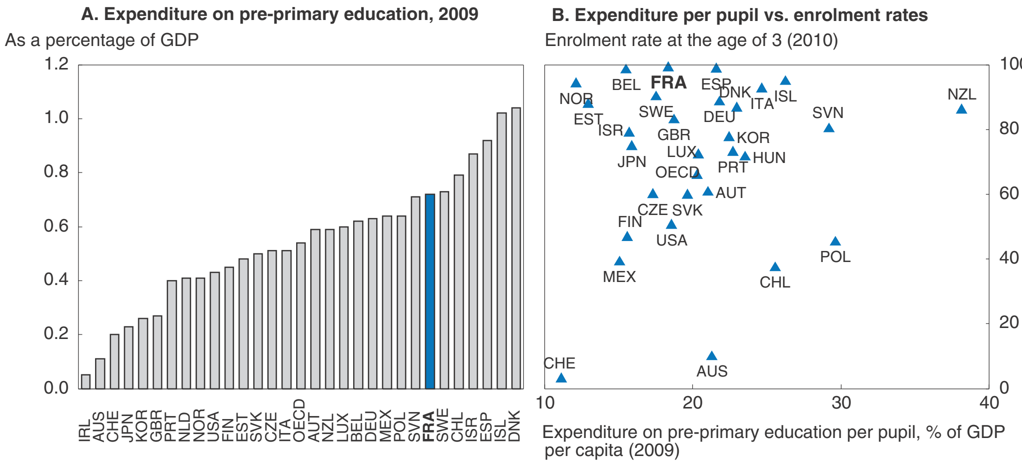
Figure 2.15. **Rates of return on equal investments in human capital, by age of target group**



Note: The figure traces the returns on investments in human capital at various stages in the life-cycle for a person having given capabilities. All else equal, a one euro investment in a very young child's education yields very high returns, generally far in excess of the opportunity cost of government funds, and much greater than a similar investment for an adolescent, which in turn yields greater returns than a euro invested in an adult.
Source: J. Heckman (2008), "Schools, Skills and Synapses", *NBER Working Papers*, No. 14064.

France is well placed with regard to resources allocated to pre-primary programmes, thanks to its high enrolment rate as from age three, and despite below-OECD average expenditure per pupil (Figure 2.16). In contrast, expenditure per child in primary school accounts for approximately half of what is spent on upper-secondary education, as compared to an OECD average of four-fifths (Figure 2.17). Insofar as the socially optimal strategy would be to equalise the (decreasing) rates of return on investment in human capital for the various programmes, the current allocation of resources is inefficient and should be re-geared in favour of primary school – a shift that would be consistent with the government's stated priorities. For example, the average number of hours taught per teacher is 17% higher in primary school than in the average OECD country but 8% lower in

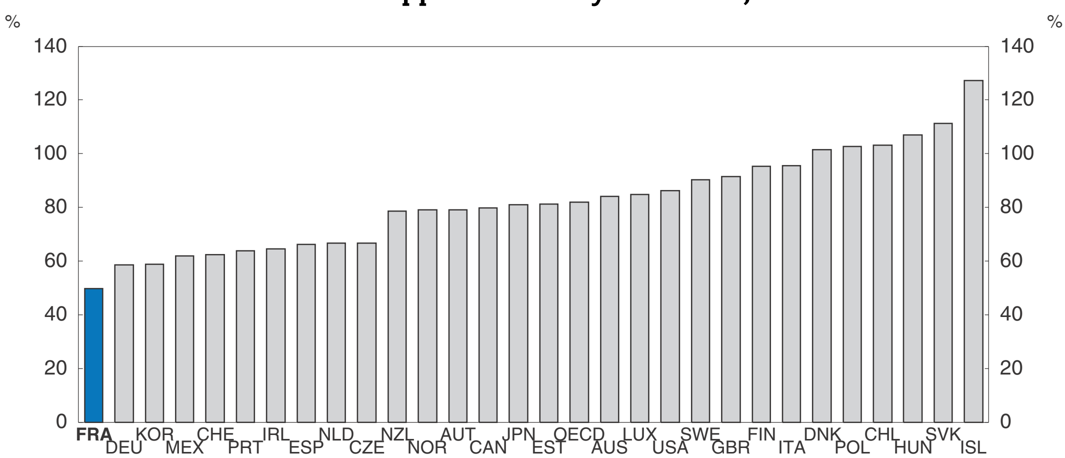
Figure 2.16. **Pre-primary education expenditure, 2009**



Source: OECD, *Education at a Glance 2012 Database*.

StatLink http://dx.doi.org/10.1787/888932790868

Figure 2.17. **Ratio of annual spending per primary school pupil to that for upper-secondary education, 2009**



Source: OECD, *Education at a Glance 2012 Database*.

Note: To download the data corresponding to this graph, refer to figure 32.

lower secondary (OECD, 2012d). It also seems that such a re-allocation could be facilitated by the elimination of numerous curriculum options in secondary school, which are costly and tend to increase inequalities as a means of disguised early selection.

The issue of the positive repercussions of schooling at age two is a debate that has not been settled (Maurin, 2007). Research using French data would seem to indicate that the positive effect on scholastic performance of enrolment at age two applies above all to children from disadvantaged backgrounds, and especially when they are foreign or of immigrant origin, insofar as it enables more effective assimilation of the French language and culture (Caille, 2001). Yet, the enrolment rate for two year-olds has been declining at a disturbing rate for a dozen years, from 35% in 2000 to 12% in 2011. Above all, the *départements* with the most acute social problems are not those with the highest enrolment rates of two year-olds, contrary to the objective of the Act of 23 April 2005 (Cour des Comptes, 2010). The annual cost of applying this principle to the priority-education sector is roughly EUR 500 million.[3]

Funding for priority education should be increased considerably

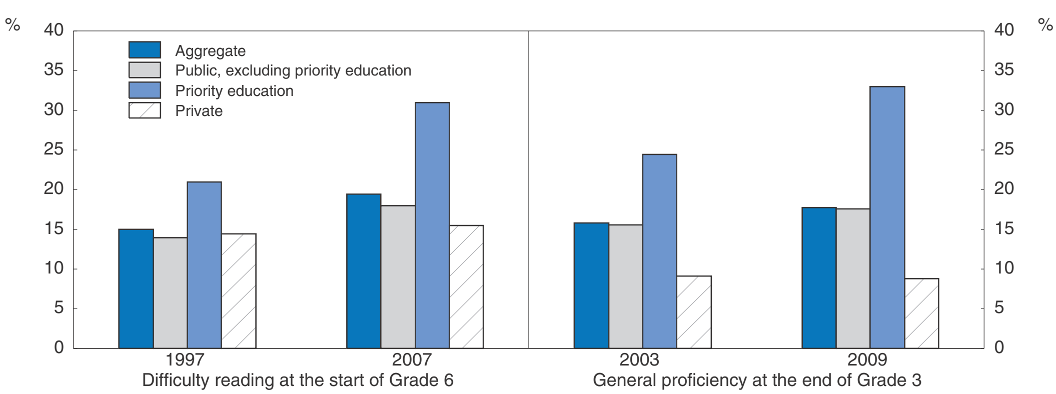
Since the early 1980s, France has carried out a policy of positive discrimination aiming to combat social background-related inequalities at school. This policy of "priority" education zones (ZEPs) arose with an awareness of the urban segregation of suburbs and of the effect of that segregation on success at school. Since 1998, and especially as from 2006, priority education has been remodelled around the notion of networks (lower-secondary schools and lower-level schools in the same zone). The shift consisted of: first, improving teamwork and encouraging pedagogical continuity between primary and lower-secondary school in connection with the "common base of knowledge and skills" (Moisan, 2011); and, second, focusing resources more closely on networks in which the greatest difficulties are concentrated ("primary, elementary, lower-secondary and upper-secondary schools for ambition, innovation and success" – the so-called ECLAIRs) since 2011. There are also "scholastic success networks" (RRSs). At the beginning of the 2012/13 school year, roughly one in five students was enrolled in priority education.

There has been no independent evaluation of these programmes using recent data. The Conseil Économique et Social (2011) has pointed out the repeated fits and starts of priority education policy, leading to a piling-up of measures that render the system opaque. Bénabou et al. (2009) have shown that the conditions for attributing ZEP status were unclear and erratic and that the ZEP policy was inefficient, but that study covered old data (1982-92). The fact is that it is in lower-secondary schools in ZEPs that the percentage of students with difficulties in writing has risen most sharply since the late 1990s: nearly a third of these students experience such difficulties, versus a quarter 10 years ago (Figure 2.18), which cannot be explained by the shifting social profiles of these schools (Daussin et al., 2011). Assessment of the priority education "networks" in terms of eliminating the education gap offers scant encouragement (MEN, 2010), in contrast to the rather positive official view.

The disappointing outcomes of the priority education policy should not be surprising, given the low level of resources deployed. First, even today the quantification of these resources is very imprecise, whereas priority education has been targeting between 15 and 20% of students for the past 30 years. Revealing inadequate management, the cost of

Figure 2.18. **Evolving difficulties, by sector and education zones**[1]

As a percentage



1. Interpretation: the percentage of students in priority education schools with reading difficulties at the start of Grade 6 increased from 20.9% to 31.3% between 1997 and 2007.

Source: Daussin et al. (2011).

StatLink http://dx.doi.org/10.1787/888932790887

education policies – and of priority education first and foremost because of the challenges involved – has not been calculated, contrary to the spirit of the Framework Law on Budget Acts (LOLF), which prescribes that appropriations be allocated to targeted objectives (Cour des comptes, 2010; Bénabou et al., 2009). The Ministry of National Education's annual financial contribution to priority education is believed to be roughly EUR 1.1 to 1.2 billion (0.06% of GDP) (Cour des comptes, 2010; Moisan, 2011). The Institut Montaigne (2004) considers this estimation deceptive, because it does not account for the fact that priority education primarily "attracts" teachers who are just starting their careers and who are therefore less costly, and it even evokes the possibility that discrimination is effectively negative (i.e. penalising ZEP pupils). Even sticking with the "official" figure of EUR 1.1 to 1.2 billion, this would represent an excess cost per student of only about 10%.

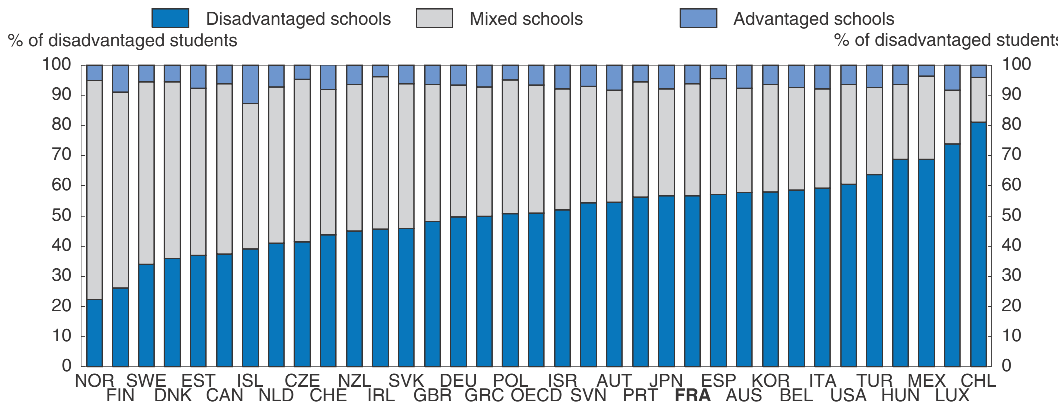
Such an effort falls short of the challenges involved. The target of 15 to 20% of students is appropriate, since that is the proportion experiencing major difficulty at school. Increasing resources for those who are in even less favourable situations (enrolled in ECLAIR networks) is also judicious. But to convey an idea of the magnitudes involved, some successful initiatives abroad have deployed far greater funding of at least EUR 12 000 (in 2012 prices) per child (OECD, 2007a), or roughly double France's current expenditures. By concentrating the funding on the most severely disadvantaged 15% of students between 4/5 and 7/8 years of age, the aggregate additional cost would come to EUR 2.6 billion a year, or 0.14% of GDP.[4]

This ambitious policy would imply raising priority education to another level. But the President's headline platform measure that the government intends to implement over his five-year term of office is the net creation of 60 000 jobs in National Education for an estimated annual cost of EUR 2.5 billion,[5] which is roughly the same order of magnitude. The opportunity afforded by the democratic mandate should be seized in order to concentrate the resources made available on the highest priority, which also holds out the most promising potential benefits: disadvantaged children at the end of nursery school and the initial years of elementary school. It can be argued that such a targeting would have decreasing returns, and that to generalise the initiatives carried out in other countries – admittedly successful but involving a far more limited scope – might not be as beneficial (Maurin, 2007). This policy, subject to a favourable assessment, could be implemented gradually, extending an initial experimentation phase to all of the ECLAIR networks.

A more radical approach would be to call into question the very idea of zones, which generate powerful stigmatisation effects (Merle, 2011), possibly stemming from the inadequacy of the resources deployed. Despite the "school maps" that assign students to schools according to where they live, and which were made more flexible in 2007 for secondary schools, school segregation is more pronounced in France than it is on average among OECD countries (Figure 2.19). First, 13% of elementary school pupils and 21% of lower-secondary school students attend private schools; and, second, school districting induces residential location strategies (Maurin, 2004), which accentuate urban segregation and in so doing can have profound and harmful consequences. One solution preserving school maps that would avoid the excessive dichotomisation of zoning would be to abolish priority-education labels (ZEPs, RARs, ECLAIRs, RRSs, etc.) and grant schools supplementary budget allocations on the basis of the individual profiles of the students attending them. In the Netherlands, elementary school funding is weighted by the number of disadvantaged students enrolled, which has improved the allocation of resources amongst schools (OECD, 2012b). This system of weighted financing has recently been developed in Chile and the United States as well.

Figure 2.19. **School segregation is high in France**

Distribution of disadvantaged students in disadvantaged, mixed and advantaged schools, 2009



Source: OECD (2012), *Equity and Quality in Education: Supporting Disadvantaged Students and Schools.*

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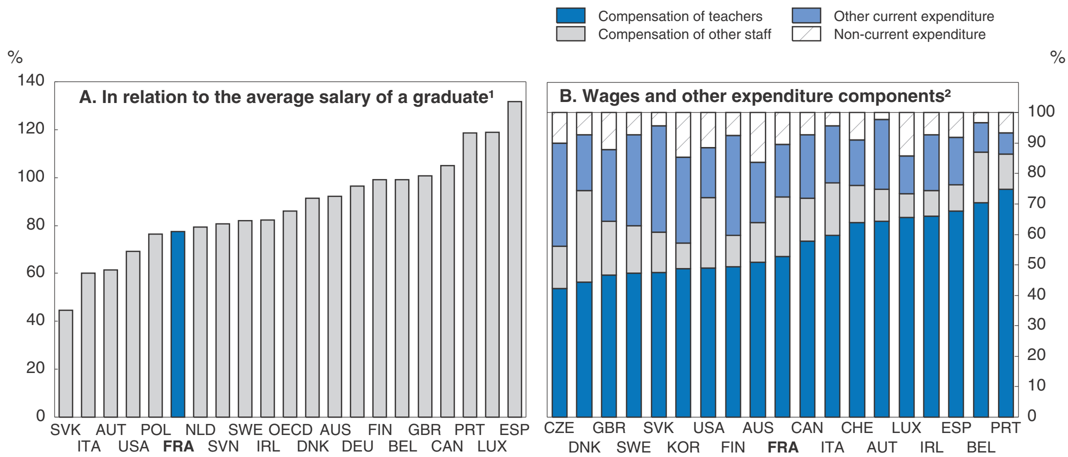
Make effective use of priority education resources

How resources are used is as important as the amounts involved. To provide students from disadvantaged backgrounds with effective support, the emphasis should be put on three courses of action. Comparatively, the non-targeted measures to reduce class sizes that are often put forward yield poor returns (see Heckman and Carneiro, 2003 and OECD, 2012b for other references).

First, the aim should be to enhance the quality of teaching staff in disadvantaged schools, which would have a major impact on student performance. All studies concur on this point: more than any of the other levers of public action, teacher quality is the factor that most influences student performance (OECD, 2005). Priority education establishments are those that are the least well served in this respect: due to the unattractiveness of the incentives offered, a quarter of all teachers in the "success ambition networks" (*réseaux ambitions réussites*, RARs), the predecessors of the ECLAIRs between 2006 and 2010, were aged under 30 (compared to 10% outside priority education) in 2008, and over a third of them had worked in the same establishment for less than two years (MEN, 2010). Achieving improvement calls for (OECD, 2012b): strong financial incentives that can attract competent teachers; working conditions that are capable of enhancing their effectiveness and that will help retain them; independence of schools with regard to recruitment; specialised training focusing on the skills and knowledge required to work with children with learning difficulties; support from a management team providing continuing education and coaching; and a multi-pronged approach combining more intensive instruction supervised by a teacher and complementary action by a specialist teacher and a multi-disciplinary team, as in Finland (see OECD, 2007b, Box 4.2). Beyond priority education, a teacher's salary is equal to 77% of the salary of an average graduate, compared to 86% in OECD countries (Figure 2.20, Panel A). The authorities must remain vigilant in this respect, because difficulties in teacher recruitment have emerged in recent years despite high levels of unemployment, perhaps reflecting teaching's loss of attractiveness. It should be possible to increase salaries at constant overall costs by rationalising other current expenditure items, in particular administrative costs, which are high (Figure 2.20, Panel B).

Figure 2.20. **Primary and secondary school teacher salaries, 2010**



1. Basic annual salary of teachers in public establishments compared to the income of a graduate aged 25 to 64 working full-time all year.
2. As a percentage of public and private expenditure on the operation of teaching establishments.

Source: OECD, *Education at a Glance 2012 Database*.

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An effective management team is the second most important aspect after teacher quality (Augustine et al., 2009). Besides the need to give primary school principals greater authority (see below), the emphasis needs to be placed on their selection and training as well as on the support given to them (OECD, 2012b). Their training needs to focus on general skills in improving learning, teaching and teamwork as well as on the specific knowledge needed to manage the problems inherent in disadvantaged schools. It is therefore essential to offer them sufficient incentives (salaries, career prospects, working conditions). It is also important to put in place objective monitoring of schools' performance and to take remedial action with regard to those reporting persistently poor performance. Ontario (Canada) and Ireland have adopted good practices in this respect (OECD, 2012b).

Third, the involvement of parents is an essential factor in success at school. Priority education schools must step up their efforts to forge links with the least involved parents. Some strategies have proved their worth, notably in the Netherlands, where a programme has been developed to encourage immigrant parents to get involved (OECD, 2012b). It includes home visits by teachers, lessons (language lessons in particular) and information for parents. In France the *mallette des parents* initiative in secondary schools is well worth mentioning and has undergone assessed trialling, which highlights the success of this measure (Avvisati et al., 2010). It allows support to be given to parents by helping to explain to them the meaning and challenges of schooling, how schools operate and their expectations of parents. This low-cost scheme (costing around 1 000 to 2 000 euros per school) has achieved encouraging results in terms of reducing absenteeism and violence in schools. A similar programme should be developed for primary schools, but strengthened and targeted on priority zones.

Improve teacher training

Initial teacher training in France remains too academic, is not sufficiently oriented towards instruction in teaching methods and does little to develop the non-cognitive capacities of children that are so essential for their success (OECD, 2012c). Teaching methods place too much importance too soon on grading, a practice that places stress on students, particularly those with learning difficulties who may start to fear and then reject school. The French method of training teachers is quite unique in Europe, with professional training given after the teacher qualification examination according to the so-called "consecutive" model, whereas formal and professional training in other countries is often provided at the same time by combining coursework with practical work experience (EAO, 2009). It is that model that has been adopted in the government's proposed reform, which will be in effect as from the 2013-14 academic year. In Finland, teachers' capacity to transmit knowledge and adapt their lessons to students' levels is an integral part of the programme and is one of the key elements explaining the success of the system. Many OECD countries are strengthening these aspects of teacher training.[6]

Continuing professional training is also inadequate and poorly targets the real needs of teachers (CESE, 2011). In France, as in other countries, such training is compulsory, although in practice participation is optional. In Spain, Luxembourg, Poland, Portugal, Slovenia and the Slovak Republic, continuing training, although optional, is clearly taken into account in career advancement and salary increases (EAO, 2009). According to the Institut Montaigne (2010), only a third of teachers avail themselves of continuing training each year in France, whereas best international practices suggest that 10% of the working time of teachers should be given over to such training, in particular to allow exchanges based on colleagues' experience and to gain access to specialised "coaches".[7]

Give school principals greater independence

Taking greater account of the heterogeneity of local circumstances requires schools to be given greater independence. Such independence is necessary to ensure that their managers, as in other countries, can adjust programmes, teaching methods and support measures to the specific needs of students, and more generally improve the functioning of their schools. In France, however, primary school management is subject to one of those particularities inherited from the past which leaves their principals little room for manoeuvre. Unlike lower-secondary schools, which since 1985 have been local public teaching establishments (EPLEs) with some financial and administrative responsibilities (which should also be extended) and with genuine teaching and educational independence, public primary schools are not legal and moral persons nor are they financially independent; from a legal standpoint they are municipal services (Obin, 2007). In this respect they still suffer from inadequate rationalisation of resources due in part to the continued existence of a great number of small municipalities: the Ministry of National Education has been conducting a relatively successful drive to persuade small schools to merge at the inter-communal level (and not only in rural areas).

Furthermore, while secondary schools are managed by a head supported by a team of colleagues, primary school principals are on their own and simply tasked (without any line responsibility and in most cases working on this part time) with administrative and teaching duties while retaining their status as teachers. Hence, their responsibilities are unclear: they often suffer from a lack of legitimacy and have neither the authority they need to assume such teaching responsibilities nor sufficient resources to fulfil their administrative duties (Obin, 2007). Primary school principals report to an inspector who assesses them (according to the same criteria as teachers, but in any event without any specific protocol) and also to the mayor. Giving them more authority and the accountability that would go with it would go hand in hand with changing the status of schools from municipal services to EPLEs (Institut Montaigne, 2010). The Law of 13 August 2004 makes this possible but is not applied (the enabling decree has never been published).

Review the school day and school year

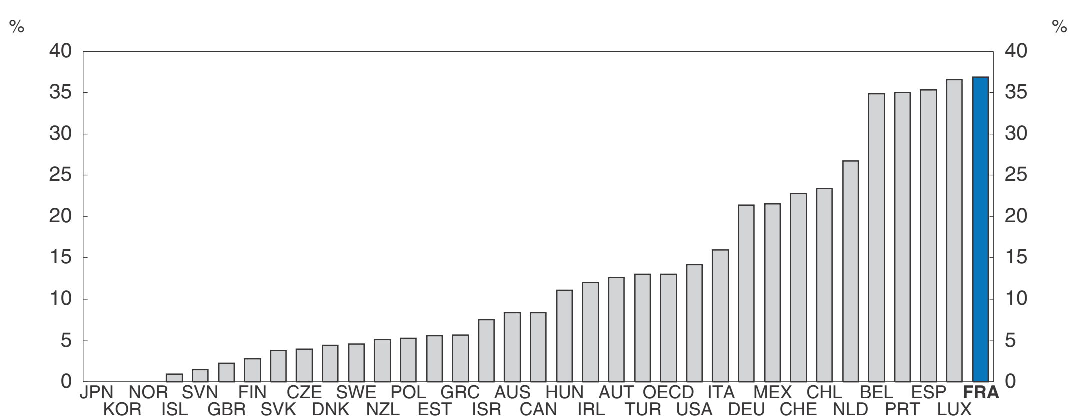
These difficulties are exacerbated by a school day and school year that are totally mismatched to children's biorhythms. The system is characterised by one of the longest school days in the OECD area due to the concentration of a high number of hours of instruction into a small number of days of lessons (OECD, 2012d). In the Netherlands, for example, the school year is spread over 40 weeks, whereas in France it amounts to only 35 weeks (and the OECD average is 38 weeks). Furthermore, the four-day week is too short and tiring for students, and does not allow enough time for those who for a time fail to keep up with their studies to eventually catch up. It would therefore be advisable to lengthen the school week, to reduce the number of hours of classes a day and to shorten school holidays. The government intends to extend it to four and a half days; five days is standard in almost all other OECD countries. These changes are a step in the right direction. They would inject greater flexibility into the organisation of the school day and would enable more numerous individual support sessions and at better times than those currently offered, for example, during the lunch hour.

The use of year repetition should be drastically reduced and support for schoolwork improved

Another feature of French education is intensive recourse to grade repetition. It is both ineffective and costly. In France, some 37% of students had repeated a year at least once by the time they were 15 in 2009, compared with an average of 13% in OECD countries (Figure 2.21). Repeating a year is ineffective in remedying long-term learning difficulties. Firstly, a student who fails to keep up loses several months of the school year and often repeats the same mistakes the following year. Second, repetition tends to stigmatise students in difficulty, thereby adding to drop-out rates (OECD, 2012d). It is extremely costly due to the longer period of studying it entails, amounting to some 2 billion euros in 2009 (Cour des comptes, 2010). It illustrates a certain inefficiency of the current allocation of resources.

Figure 2.21. **Grade repetition is very high in France**

Percentage of young people aged 15 who have repeated at least one school year, 2009



Source: OECD (2012), Equity and Quality in Education.

Note: To download the data corresponding to this graph, refer to figure 33.

The Ministry recognises that grade repetition is an inappropriate instrument with which to fight failure at school. In fact, repetition rates are trending downward: the proportion of students who have fallen behind by the end of primary school, for example, dropped from 52% in 1960 to 37% in 1980 and 13% in 2010. However, the authorities are finding it hard to accelerate the trend, as shown by the difference between the objectives announced and the actual outcomes (Table 2.2). Efforts should therefore be stepped up to raise the awareness of stakeholders – teachers, school councils, parents, etc. – of the negative implications of this practice.

Table 2.2. **Rate of year repetition**

Per cent

	2008 Actual	2010 Forecast APP 2010	2010 Actual	2011 Forecast APP 2011	2011 Actual	2012 Forecast APP 2012	2012 Updated forecast	2015 Target
CP (age 6)	3.7	1.5	3.5	1.0	3.4	1.5	2.9	2.0
CE1 (age 7)	4.1	2.0	4.2	1.0	4.0	2.0	3.5	2.0
CE2 (age 8)	1.8	1.3	1.8	1.0	1.6	1.0	1.3	0.5
CM1 (age 9)	1.2	1.0	1.3	1.0	1.1	0.8	0.8	0.5
CM2 (age 10)	1.6	1.2	1.6	1.0	1.5	1.2	1.2	1.0
Sixième (age 11)	5.0	3.5	3.4	2.5	2.8	2.0	2.0	1.0
Cinquième (age 12)	2.3	1.5	1.9	1.0	1.5	1.3	1.3	0.5
Quatrième (age 13)	3.6	2.5	2.7	2.0	2.1	1.5	1.5	1.0
Troisième (age 14)	4.7	3.8	4.2	3.5	3.7	2.5	3.0	2.0

Source: Annex to the draft Finance Act for 2010, 2011 and 2013, section on teaching in schools; Interministerial mission on annual performance plans (APP).

Reducing year repetition also requires teaching to be tailored more closely to individual needs. The aim is to remedy shortcomings as they are identified during the year by providing support for students experiencing difficulties and by adapting teaching methods and programmes to work in small groups of students. However, even if the systems designed to take account of students' learning difficulties at a more individual level are constantly growing in number, they are poorly co-ordinated and therefore a source of confusion (Cour des comptes, 2010; Claus and Roze, 2009).

Better guidance

The educational and career guidance system is one of the weak links of the school-to-work transition in France. In the light of youth unemployment that is both pervasive and deeply entrenched and the dominant role played by the educational path in accessing employment, guidance provided at the end of lower secondary school evokes great apprehension because it signals, even determines, students' aptitudes. Often experienced as a failure, approximately four students in ten consider that they endured rather than profited from their guidance (HCE, 2008). In fact, this guidance is essentially failure driven, in the sense of reflecting a desire to choose the best and brightest rather than to offer everyone the chance to succeed (HCE, 2008; Cour des comptes, 2010; Cahuc et al., 2011).

Many secondary-school students, especially in underprivileged areas, have only a vague sense of the trajectories offered by a given type of training. While students who choose the general programme in upper-secondary education settle on a stream after a first year of general courses, those who opt for technological or vocational programmes must select from a myriad of courses as of the end of lower-secondary school before the abrupt transition into upper-secondary education. It would be better if these students also benefited from an initial transition year at the beginning of upper secondary (Galland, 2009).

This problem is exacerbated by the fact that the Guidance Counsellor/Psychologists (*conseillers d'orientation-psychologues*, CO-P) often lack the skills and familiarity with employment opportunities required to impart the relevant information and effectively advise students (HCE, 2008). For equivalent educational attainment, guidance is highly influenced by the socio-professional class of the parents, in particular because children from disadvantaged backgrounds lack the requisite information, confidence, or ambition, or self-censor their aspirations, and CO-Ps are not able to counterbalance this influence – or they, themselves, unconsciously participate in this cycle of social replication (HCE, 2008). Many experts believe that teachers in France are too far removed from the world of business. While switching disciplines during higher education is very rare in other OECD member countries (3% at most in Denmark and New Zealand), 15% of students in France abandon their initial choice of field of study in university and switch to more technical training of the IUT or STS type (see below) (OECD, 2009).

However, recent measures reflect movement in the right direction, though their implementation is still embryonic. The 24 November 2009 law proposed a redesign of the guidance system and life-long professional training. In particular, it was intended to deliver a better public guidance system and improvements to the status and recruitment of CO-P. The goal is to prod CO-P missions to be more in tune with economic and social realities. The terms and organisation of the recruitment process were modified in March 2012 to place more emphasis on the required knowledge of the economy and national, sectoral and territorial characteristics of the job market.

These efforts should be pursued in three directions. First, reform of the CO-P must go much further, with a clear separation between the functions specific to guidance, to be developed by specialised training, and psycho-social functions that require other skills. The activity of these future guidance counsellors must also be better controlled than is the case with the CO-P (HCE, 2008). Their recruitment should be expanded to professionals with experience with business (Institut Montaigne, 2012) or with labour-market integration. Second, teachers must receive appropriate training to be more involved in the guidance given to students, as is notably the case in Germany, Denmark and the Netherlands (Institut Montaigne, 2012). Teachers today tend to avoid getting involved in guidance and are poorly equipped for it, even though they receive a lump-sum stipend for monitoring and guidance (HCE, 2008). In general, it is a matter of creating more room within education for an initiation into the world of work. Third, guidance missions must be better co-ordinated. This would involve, for example, a meshing or even merging at the regional level of the management bodies that jointly perform the current functions of information and guidance centres, of the Ministry of Education's General Integration Mission (MGI) and the PES (local missions, see below).

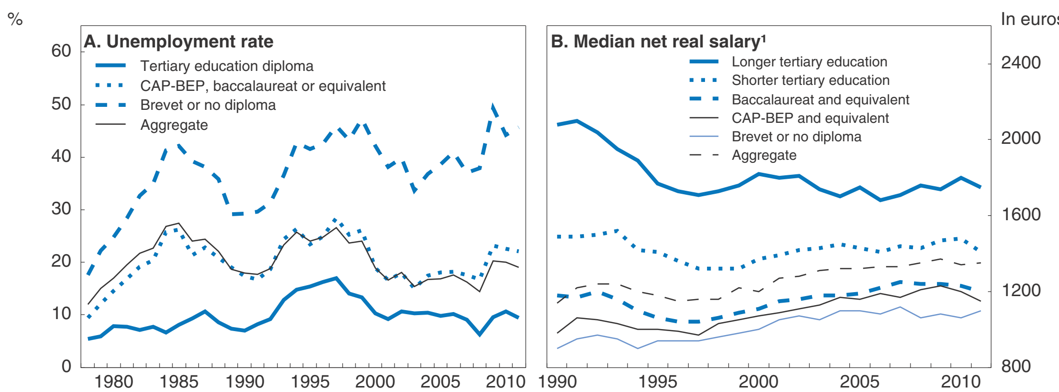
Young people in the higher education system

Thirty years ago France lagged behind many countries with merely 17% of age cohorts obtaining a tertiary qualification, compared to an OECD average of 20%. Today, with 43% of 25-34 year olds holding such a qualification, compared to an average of 38% in OECD countries, France is outranked by only 11 countries compared to 17 previously

(OECD, 2012d). This "mass" entry into higher education has not reduced the value of diplomas in helping to secure access to employment (Figure 2.22, Panel A; Le Rhun and Minni, 2012). In contrast, against a background of very high unemployment over the past 30 years, returns in the form of higher real salaries for higher levels of educational attainment have tended to fall (Panel B).

Figure 2.22. **Unemployment rate and real salaries from one to four years after initial training**

All working hours, in constant 2011 euros



1. Series break in 2003.

Source: INSEE, Employment surveys.

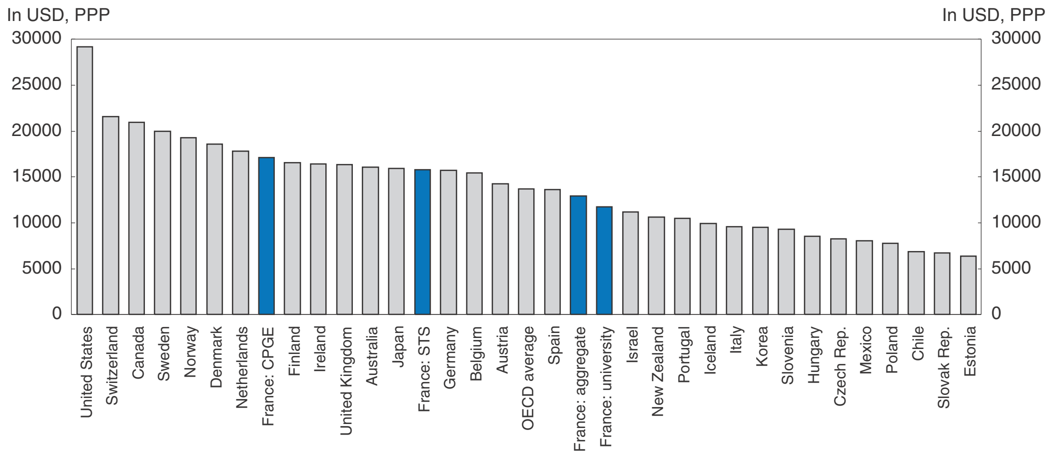
StatLink http://dx.doi.org/10.1787/888932790944

Rebalance public funding in favour of universities and raise enrolment fees

This progress, however, should not obscure the fact that serious problems remain. French higher education must face up to challenges regarding financing, equal opportunities, efficiency and quality (OECD, 2012d). The sector is highly segmented and its complexity clear to see in the fact that it comprises over 400 establishments reporting to 11 ministerial supervisory agencies and spread over some 650 sites (Cour des comptes, 2011). The reason for this dispersion lies in the large number of different alumni groups that dominate the sector, which leads to widespread inaction and inertia. The higher education sector is made up of highly competitive elite establishments (the *grandes écoles* and their preparatory classes, CPGE), short vocationally oriented training courses (university technology institutes (IUT), higher technician sections (STS) in schools) and universities (research and training units (UFR) in the strict sense of the term). While there are tight admission criteria, high levels of student and teacher commitment to the educational process and sufficient resources in the first two sectors, universities admit all secondary school graduates with no selection and get less funding per student, even if financial efforts for the universities are being made. The proposed educational steering act would bring the CPGE closer to the universities by asking CPGE students to enrol in a university (and for non-scholarship students to pay registration fees).

Despite recent efforts, the financial resources of French universities remain insufficient compared to foreign universities and also in relation to other French teaching establishments: in per student terms, their expenditure is 36% lower than that of STS and 50% lower than that of the CPGE (Figure 2.23). In the case of the *grandes écoles*, the data the

Figure 2.23. **Spending per student for the various higher education sectors, 2009**[1]



1. For France: preparatory classes for the grandes écoles (CPGE) and higher technician sections (STS).

Source: OECD, Education at a Glance 2012; Ministry of national education – DEPP, L'État de l'école 2010, 2012.

Note: To download the data corresponding to this graph, refer to figure 34.

Ministry has at its disposal are not sufficiently detailed to be able to determine aggregate expenditure. Differences in the allocation of funding to establishments can be justified only on the grounds of efficiency. The current disparities are highly inequitable. The advantage in terms of per capita *public* funding for the CPGE and STS alone, for example, amounts to EUR1.25 billion a year, comparable to the upper limit of the budget allowance for "priority" education. Furthermore, this advantage is regressive, given the over-representation of children from privileged backgrounds in these streams. Beyond differences in public spending, the success of the *grandes écoles* has been built on a very selective environment and relatively significant autonomy. Because the university system lacks these attributes for the most part, the overall system is dualistic, with the universities being to a fairly large extent cut off from the elites, especially as regards the first cycle of higher education.

Raising tuition fees is more or less unavoidable if the quality of the university system is to be improved. The share of private financing is very low, primarily due to the very low level of such fees, which the Ministry set at 181 euros a year for a bachelor's degree for example, in 2012-13, and represent overall a twentieth of higher education expenditures. However, the benefits of higher education are primarily private, given that students are the first to benefit from their degrees. To the extent that disadvantaged social groups are less well represented in the tertiary student population, this primarily public financing tends to be regressive. An increase in tuition fees would need to be accompanied by improved access to student loans repayable out of future earnings and/or reinforcement of the grants system. These contingent loans offer the advantage of not passing on the cost of studying immediately to the student but rather to the future employee who will have profited from studying. Several OECD countries propose means-tested grants and loans repayable out of future earnings, including Australia, Canada, Chile, the Netherlands, New Zealand, the United Kingdom and the United States.

Increase the independence of universities

To optimise the use of the additional resources needed, universities must be given greater independence and offered proper incentives (Aghion, 2011). Recent reforms have aimed at improving their efficiency. To remedy the fragmentation of the higher education system the higher education and research clusters (PRES) created in 2006 allow establishments to combine their resources with a view to generating economies of scale and enhancing their international profiles. In May 2012 there were 23 PRES covering 60 universities (out of a total of 83) and 13 other establishments (engineering schools, business schools, etc.). A law passed in 2007 (*Loi relative aux libertés et responsabilités des universities,* LRU) laid the initial foundation for the independence of French universities, notably with regard to management of their overall budgets, which nonetheless remains for a large part constrained and centralised. The *Plan Campus*, launched at the end of 2008 with funding of EUR 5 billion, covers the renovation of campus buildings. Lastly about two-thirds of the 2010 "investing in the future" programme (*investissements d'avenir*), with total funding of 35 billion over 10 years, will benefit the higher education and research sector. Within this envelope, EUR 15.35 billion is being allocated to "clusters of excellence" mostly, although not all, selected from among the PRES. However, the precise role of the PRES, which were to become the leading actors in the rebuilding of the university landscape, is unclear (Cour des comptes, 2011). It is therefore important to develop incentives that will help strengthen the clusters. The necessary increase in independence and allocation of resources should be made conditional upon achieving precise objectives in this area. The government would like to do away with the PRES and replace them by 30 "university communities".

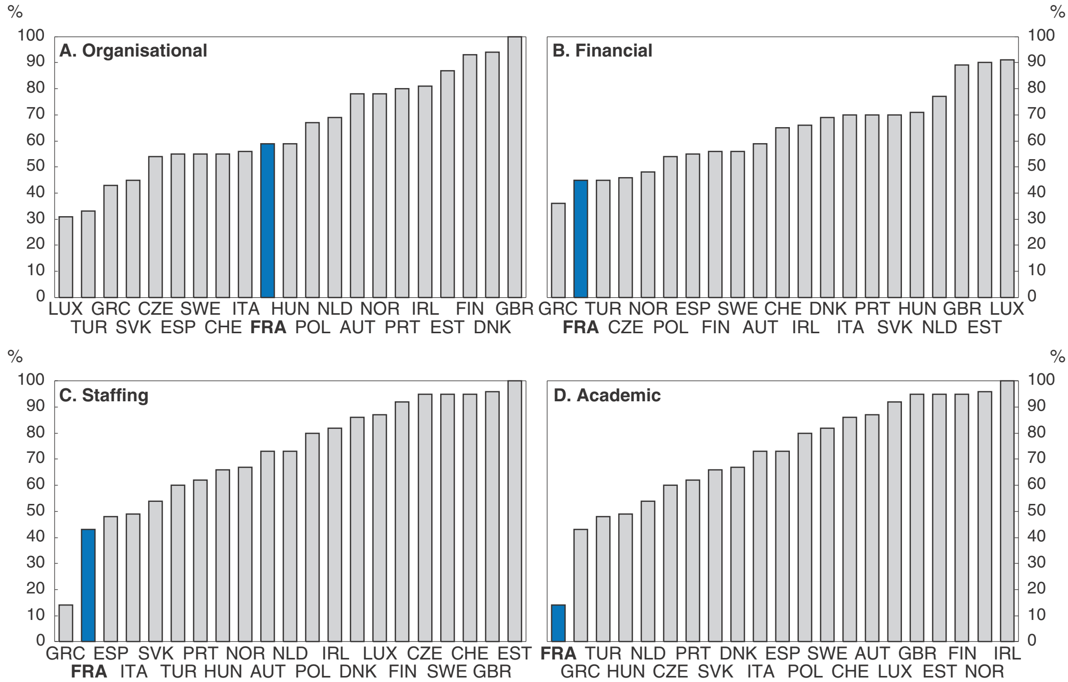
Despite the LRU, the university system remains one of the most constrained in Europe, according to a comparative study conducted by the European University Association (Estermann et al., 2011) covering 26 countries and based on 30 criteria covering four specific areas. The United Kingdom has the most independent university system. France is ranked in 16th position in terms of organisational independence, last but one for human resources and last for teaching (fields of study, number of students, selection, structure and content of diplomas, etc.) (Figure 2.24). Universities would benefit from greater latitude in setting tuition fees, selecting students and managing their human resources (recruitment and salaries). This would require enhanced management skills, including the introduction of more professional financial management, and could also facilitate the mobilisation of other sources of private financing.

Fighting failure at degree level

The overall strategy should be aimed not only at creating excellent universities, but also at increasing the effectiveness and relevance of the teaching offered in all universities (OECD, 2012c). Only 52% of students admitted to university progress to the second year: 23% repeat the first year, 19% change course and 6% drop out. The success rate for students from the professional and technological streams in the *baccalauréat* is very low, around 20%. Students should be given more rigorous course advice before entering university to avoid costly repeating of years and leaving without gaining a qualification (OECD, 2012c). A yawning gap now exists between the secondary and higher education sectors, and many students have difficulty in obtaining the information they need to choose the type of course they wish to follow. Greater independence could encourage universities to improve the information they provide on job opportunities as well as the quality of their course

Figure 2.24. **Degree of university autonomy in Europe, 2010**[1]

In percentages



1. 100% is the highest degree of autonomy given to universities in the four areas reported in the figure.

Source: European University Association, 2011.

Note: To download the data corresponding to this graph, refer to figure 35.

advice. Strides have been made with regard to this particular information and advice, such as the creation of the Occupational Placement Assistance Office (*Bureau d'aide à l'insertion professionnelle*, BAIP), and these efforts should be pursued.

The "plan for success at degree level" was launched in 2008 for a period of five years with funding worth EUR 730 million, i.e. an average of around 200 euros per degree student per year. This plan is designed to provide tailored support for individual students. According to the Cour des comptes (2012a), however, the plan falls short because of the insufficient guidance provided by the Ministry and the lack of proper financial monitoring by the universities. The government intends to allocate 5 000 out of the 60 000 teaching posts created to the higher education sector by targeting the bachelor's level. It is important that as much weight be given to teaching as to research in the recruitment process, notably by fostering greater awareness of teaching criteria during the recruitment of teacher-researchers.

Beyond rebalancing public funding in favour of universities and increasing their independence, the response to failure at degree level calls for the introduction of training courses that lead to a qualification such as vocational degrees, which account for around a quarter of degrees awarded. Aghion (2011) cites a couple of examples of universities in the United Kingdom, which, although much less reputed than the more prestigious universities in that country, achieve remarkably high rates of success for their graduates in finding employment as a result of their offering courses that are strongly focused on vocational rather than general and basic skills. In France, the success of the IUT and STS has been founded on developing short courses that lead to qualifications which are valued in the labour market, on student selection and on the allocation of greater resources, thereby making up for universities' weaknesses in those areas. Plans have been mooted to encourage or force the IUT and STS to admit more students from vocational and technological secondary education streams, although the priority for the latter is to improve guidance and training upstream (see below) and forge links with industry. Moreover, some courses do not give students enough job-related skills (Arts and Human Science graduates, for example, find it very difficult to enter the labour market, according to DARES, 2011) and need to be made more attractive to businesses.

Fostering links between universities and industry

Despite recent efforts, the higher education system has formed limited links with industry. As a general rule, while students receive good academic training, progress must still be made in preparing them for contact with the world of industry. The practice of work placements in firms must continue to be further developed. Increasing the contribution made by firms to the financing of universities is another major challenge. Amounting to a mere 7% in France, the contribution by firms to the funding of higher education establishments is over 10% in many other countries (OECD, 2012d). Making universities more independent could increase their attractiveness to industry. Some recent initiatives are moving in this direction: the LRU of 2007 provides for the appointment of a manager from the firm to the governing board of tertiary establishments and for the creation within each university of platforms providing information, advice and support for the transition from university to work. Furthermore, the public career guidance service (see below) should provide detailed information on the job opportunities for the courses proposed by higher education establishments in order to improve post-secondary course choices.

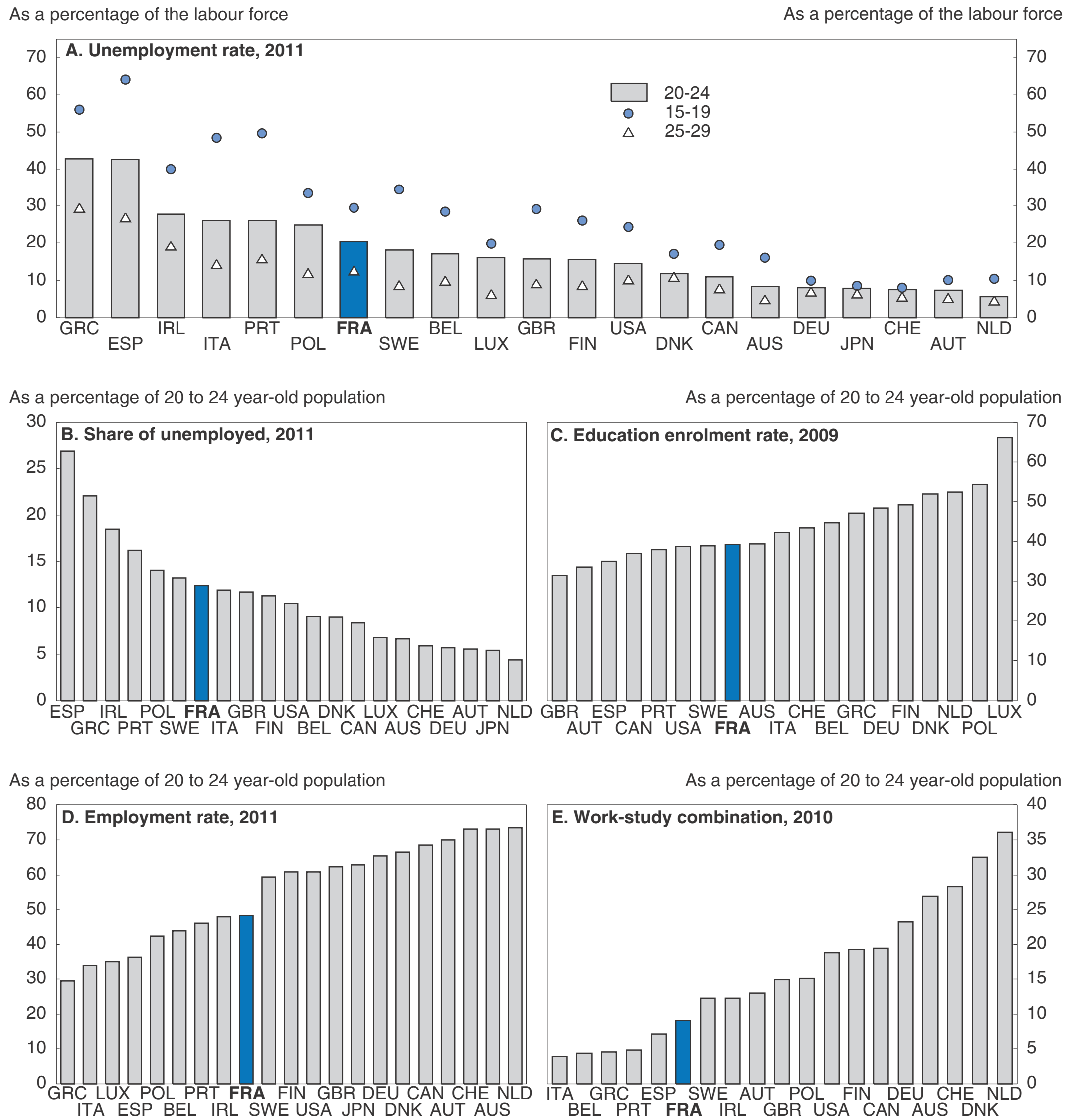
Promoting youth employment and facilitating school-to-work transition

France has had poor performance on the youth labour market for a long time

Unemployment rates exceeding 20% among youths aged 20-24 are found only in a handful of OECD member countries, including France and the countries of Southern Europe (Figure 2.25, Panels A and B). This high rate is not an artefact of a greater propensity to study, which would reduce the labour force in the denominator of the unemployment rate, given that, at approximately 40%, the proportion of the 20-24 cohort pursuing studies is relatively small, well below that observed in the countries of Northern and Eastern Europe and Germany (Figure 2.25, Panel C). The employment rate is low for this age group (slightly below 50%, Figure 2.25, Panel D), combining studies and work is uncommon, and approximately 20% of French youths aged 20-24 are NEET and thus structurally at risk of social marginalisation (Figure 2.1).

Comparing with the Netherlands, Denmark and Germany, which report strong performance on the youth labour market, reveals that more French youths aged 20-24 are NEET (by approximately 10 percentage points) and experience great difficulties in the school-to-work transition: fewer of them are in school (approximately 10 points), far fewer are working (10 to 30 points), far fewer are combining work and studies (15 to 25 points, Figure 2.25, Panel E) and thus more are studying without working (5 to 15 points). The

Figure 2.25. **Youth labour market indicators**



Source: OECD, Labour Force Statistics 2012 and *Education 2012 Databases*.

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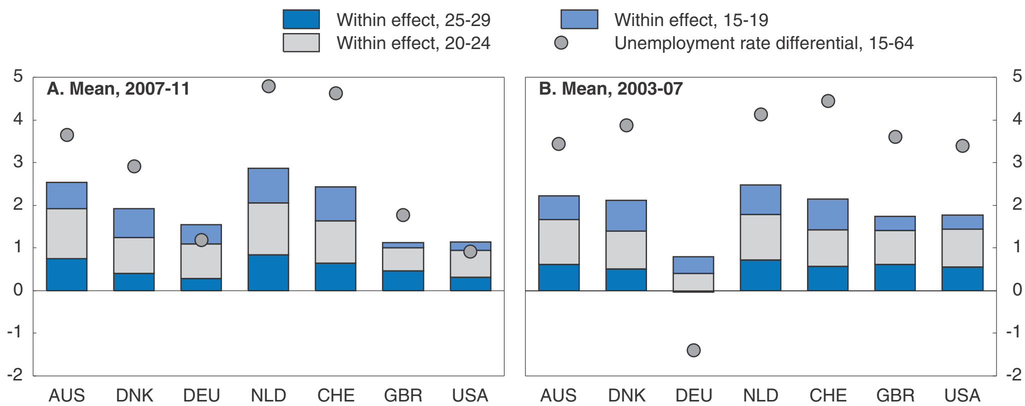
15-29 age group accounts for over half of the total unemployment rate differential with countries that could serve as a reference (Figure 2.26), though their share in the labour force is only 22% (see Boulhol and Sicari, 2013b for more details).

Examining the age-based structure of employment rates shows that the low employment rate of 20-24 year olds improves rapidly, reaching a relatively high level of approximately 80% for the 30-34 age group, a stable feature in recent decades. However, this does not mean that the age 20-24 NEET cohort eventually transitions into the labour force successfully. Rather, the increase in employment rates is primarily reflects a structural effect, as the most educated enter the labour market later (Batard and Saillard, 2011), especially in France where combining work and studies remains less common. In a highly stylised representation, the 30 percentage point difference between the employment rate of the 25-29 and the 20-24 cohorts corresponds to the proportion of

Figure 2.26. **Explaining the gap between the unemployment rate in France versus other OECD members**

Structural-residual analysis in percentage points, by age group



Source: Boulhol and Sicari (2013b).

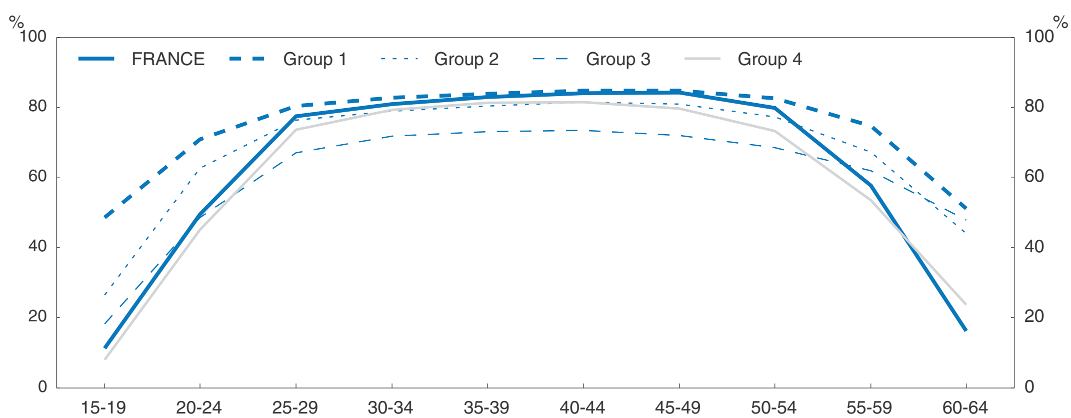
How to read this figure: On average over 2007-11, France's unemployment rate was 3.7 percentage points higher than Australia's. The "within" component was equal to 4.8 points. for this pair of countries, of which the 15-19, the 20-24 and the 25-29 age groups contributed 0.6, 1.2 and 0.7 points, respectively.

StatLink http://dx.doi.org/10.1787/888932790982

20-24 year-olds who are studying and not working. Conversely, NEETs account for one fifth of both the 25-29 and the 20-24 cohort (Figure 2.1). As in Belgium, but more than in Spain, Italy and Poland, which also report low youth employment rates, the employment rates of 35-39 year olds are similar to those of Northern Europe, Switzerland and Austria (Figure 2.28, and Boulhol and Sicari, 2013b). Overall, France is the OECD country with the largest employment-rate differentials across age groups.

Figure 2.27. **Employment rate by age bracket, ranked classification**[1]

2005-11 mean, as a percentage of the population by age bracket



1. A ranked classification was used to identify groups of OECD countries by the structure of employment rates by cohort. Group 1 includes: Australia, Canada, the United Kingdom, Denmark, the Netherlands, Iceland, New Zealand, Norway and Switzerland. Group 2 includes: Austria, Finland, Germany, Japan, Sweden, Ireland, the United States and Mexico. Group 3 includes: Chili, Israel and Korea. Group 4 includes: Belgium, Luxembourg, Poland, Slovenia, Greece, Spain, Hungary, Italy, Slovakia, the Czech Republic, France, Estonia and Portugal. The composition of these groups varies with the period. For example, considering only the pre-crisis period (2005-07), Austria, the United States and Sweden were in Group 1, Estonia and Portugal in Group 2, and Mexico in Group 4.

Source: Boulhol and Sicari (2013b).

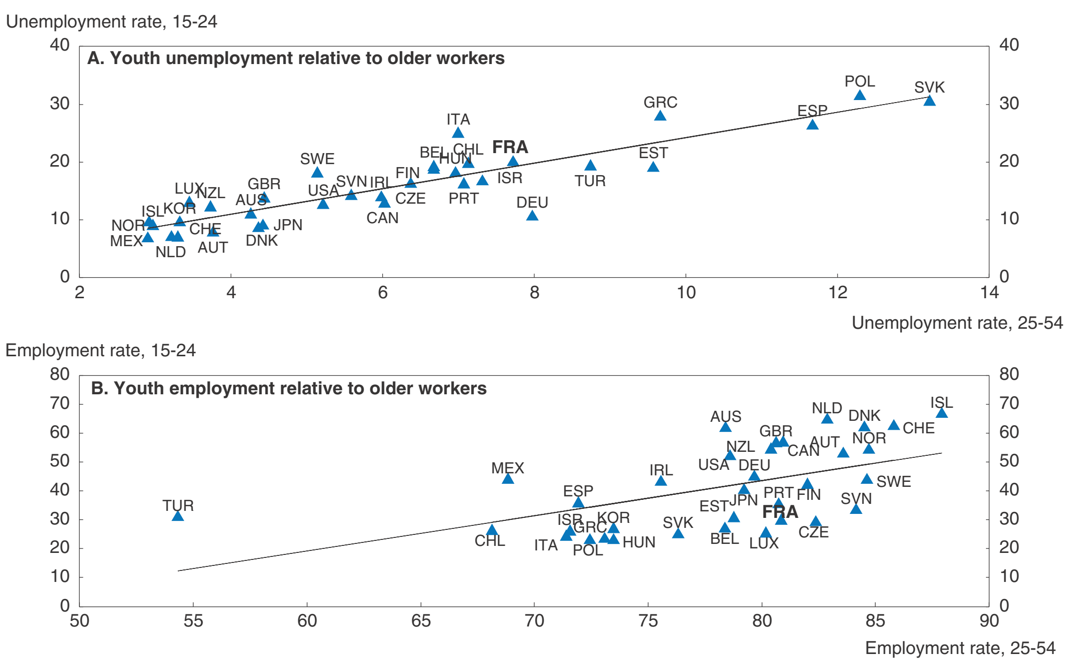
StatLink http://dx.doi.org/10.1787/888932791001

Simultaneously acting on labour demand and supply

Youths are affected by difficulties weighing on the labour market generally, and their average unemployment rate relative to that of the 25-54 age group is consistent with its value in other countries (Figure 2.28). This overall weakness (resulting from a tax structure that is inimical to job creation, inefficient public spending, an unproductive social dialogue, cumbersome regulations facing some professions, etc.) is analysed in the Assessment and Recommendations. Other factors primarily affect youths, through effects on either demand (job protection, minimum wage, subsidised contracts) or supply (job-search support, educational system). However, the current public support for youths (scant access to *revenu de solidarité active*, or RSA; the short actual duration of unemployment benefits) is unlikely to reduce their labour supply to any great extent, in contrast to what happens more generally (Chapter 1).

Figure 2.28. **The difficulties confronting youths reflect a broader problem with the labour market**

Mean 2000-11



Source: OECD, *Labour Force Statistics 2012 Database*.

StatLink http://dx.doi.org/10.1787/888932791020

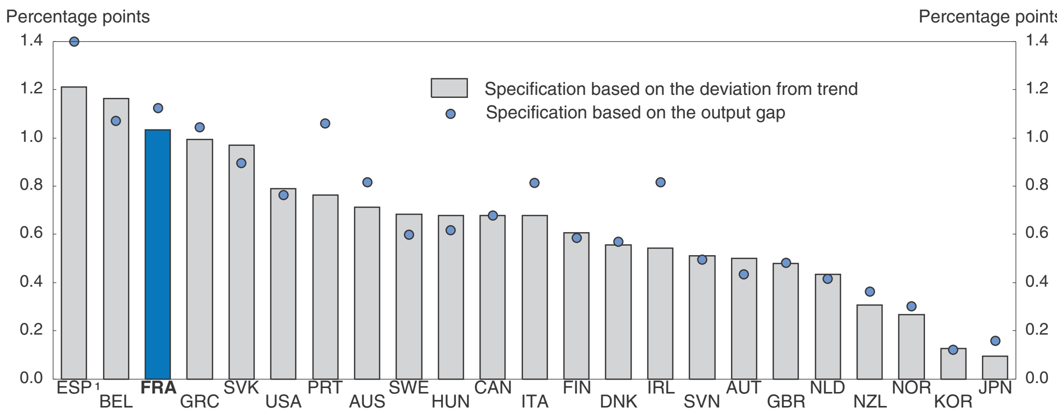
The duality of labour contracts penalises youths

The French labour market is sharply segmented, employees with permanent contracts benefiting from strong employment protection. This system may be detrimental to the job prospects of new entrants by protecting workers with seniority. On the other hand, however, the low cost of dismissing young employees (especially when they have temporary contracts, which is often the case in France) does not create a barrier to hiring. Thus, protection has an impact on youth employment that is theoretically ambiguous. Empirically, Bassanini and Duval (2006) find that employment protection significantly reduces youth employment in OECD countries.

Nonetheless, a segmented labour market unambiguously causes the adjustments required to absorb shocks to fall disproportionately on those who are vulnerable, primarily youths, and especially the unskilled. France, along with Spain and Belgium, seems to be one of the OECD countries in which the sensitivity of youth unemployment to the business cycle is greatest (in absolute terms and relative to all ages combined): after one year, a one point GDP shock translates into an estimated increase of over 1 point in the unemployment rate of 15-24 year-olds, versus an average of 0.6 for the OECD and 0.3 in France for the age 25-54 cohort (Figure 2.29 and Boulhol and Sicari, 2013b).

Figure 2.29. **Sensitivity of the youth unemployment rate to economic fluctuations, 15-24 years**

Estimated unemployment rate variation one year after a one-point negative GDP shock



1. For the specification based on the output gap, the change in the youth unemployment rate has been capped to 1.4 to improve the readability of the graph, the true value being 2.4.

Source: Boulhol and Sicari (2013b).

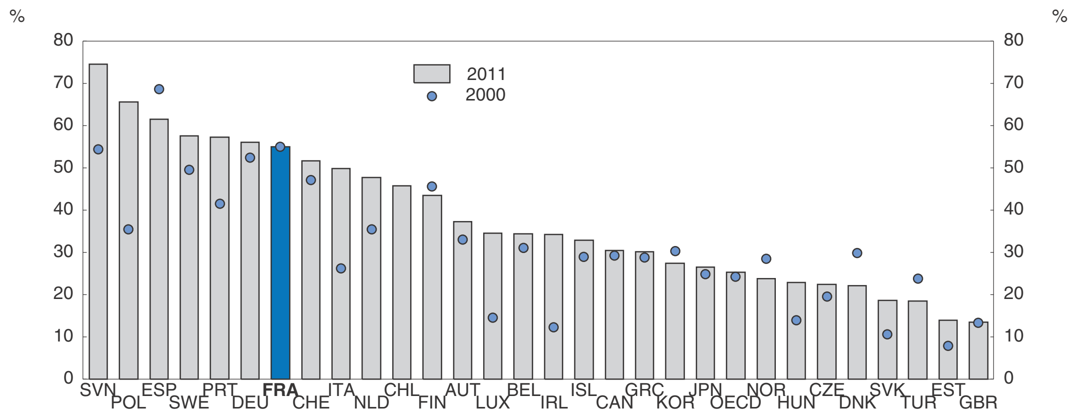
Note: To download the data corresponding to this graph, refer to figure 28.

Yet without question young people's efforts to integrate into the labour market through stable contracts are stymied in countries with a dual labour market. Quintini and Martin (2006) find a significant positive correlation between job protection and the length of time it takes to obtain a first job, Austria and Germany faring better thanks to apprenticeships. Furthermore, the school-to-work transition is more arduous in countries in which studies and work are rarely combined (OECD, 2009). In France, as in the countries of Southern Europe, an underdeveloped system of connections to business coexists with labour market rigidities (job protection, minimum wage). Consequently, the school-to-work transition is drawn out.

A number of indicators reveal that this duality is very detrimental to French youths. Among those aged 15 to 29, 34% of jobs are temporary, versus 13% for the working population as a whole (DARES, 2012). Temporary work is also much more prevalent for youths than in most OECD countries (Figure 2.30). In France it is increasingly rare for these contracts to serve as a springboard to stable employment: between 1996 and 2006, the probability of having a permanent contract within one year of having a fixed-term contract fell from 43% to 18% for 15-24 year olds (OECD, 2009). According to the EU-SILC panel, only 14% of all employees with temporary contracts have a permanent contract one year later. This is the lowest rate in all of Europe (Table 2.3). Other sources cite slightly higher transition rates, however: for instance, based on the employment survey, it has been estimated that 8% of workers on temporary contracts end up on permanent contracts three

Figure 2.30. **Youth temporary work, 2000-11**[1]

Temporary jobs as a percentage of total employment of youths aged 15-24



1. 2000 data replaced with 2001 data for Poland; 2002 for Slovenia and Estonia; 2004 for Korea.

Source: OECD, *Labour Force Statistics 2012 Database*.

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Table 2.3. **Mobility of temporary workers in one year**

	Temporary workers on path to:			
	Permanent work	Unemployment	Temporary work	Other[1]
Slovak Republic	52.4	6.1	32.6	9.0
Hungary	46.9	11.0	25.0	17.0
United Kingdom	45.1	2.5	28.9	23.5
Norway	43.5	4.9	36.7	14.9
Austria	41.6	5.6	30.8	21.9
Sweden	41.2	10.4	36.3	12.0
Luxembourg	40.1	10.4	40.7	8.7
Slovenia	38.8	9.6	43.3	8.3
Ireland	38.1	7.4	35.3	19.2
Czech Republic	37.3	5.0	48.3	9.4
Belgium	35.8	8.4	42.8	12.9
Italy	29.7	8.1	47.0	15.2
Poland	26.9	8.9	54.7	9.5
Iceland	24.7	2.6	38.2	34.5
Germany	23.0	0.7	53.9	22.4
Netherlands	22.9	1.6	65.5	10.0
Spain	22.6	14.0	49.4	13.9
Greece	21.4	9.1	59.1	10.3
Portugal	21.0	11.4	57.0	10.7
Finland	20.3	9.9	48.0	21.8
France[2]	**13.8**	**9.2**	**71.6**	**5.4**
Mean	**29.0**	**9.1**	**49.5**	**12.4**

Note: Probability of transition from a temporary job within one year, between 2003 and 2009. For example, the probability of moving from a temporary job to a permanent job is computed as follows: number of persons occupying a temporary job within a given year and a permanent job one year later, divided by the total number of transitions.

1. Including self-employed persons, students and other inactive categories.
2. According to INSEE, based on data from Labour Force Surveys, the rate of transition from temporary to permanent employment after one year – over the same period – was 15.8%. This is anyway an underestimate, as 26.6% of employees with temporary contracts are not observed one year later.

Source: Longitudinal EU-SILC data and OECD calculations.

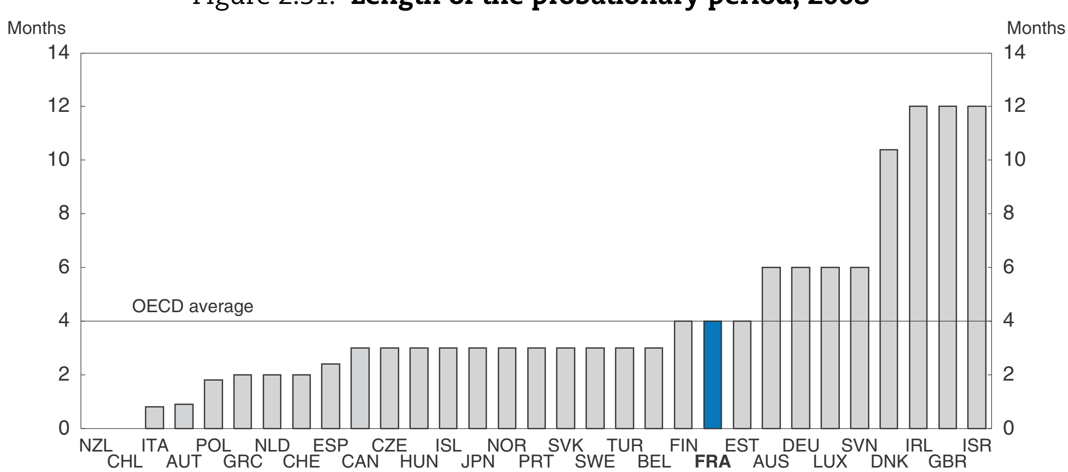
months down the road (DARES, 2012a). Since the beginning of the 1980s, interruptions in employment have also become more commonplace among youths (Cordelier, 2006). These erratic career paths may result in underinvestment in human capital by both employers and youths. The national inter-industry agreement of 11 January 2013 (see Assessment and Recommendations) provides a three-month exemption from employer-paid unemployment insurance premiums (i.e. 4 percentage points) for any hiring on a permanent contract of a youth under age 26.

This agreement constitutes an important first step that can give businesses more flexibility (see Assessment and Recommendations). To further reduce duality, the definition of "economic dismissals" should be expanded, employer redeployment obligations reduced and dismissal procedures simplified. Regarding economic dismissal, one of the major objectives would be to limit the courts' authority to assess intent. In Australia, for example, economic dismissal is deemed to have a real and serious cause if it follows the elimination of a job that does not mask a personal motivation. This easing could be combined with higher employer payroll taxes on temporary contracts and with effective limits on abusive use thereof (as in Finland and Norway). Finally, the probationary period could be extended to provide employers with an incentive to more readily offer permanent contracts to newcomers (Figure 2.31). In Denmark, in particular, the length of the probationary period is an integral part of the "flexicurity" strategy (OECD, 2009).

The level of the minimum wage tends to exclude unskilled youths from employment

Approximately 30% of employees under 25 are paid the minimum wage (*salaire minimum interprofessionnel de croissance*, or SMIC), versus 11% for all employees (and an OECD average of 5%). Despite an easing of the payroll tax burden on low-wage earners, the cost of labour at the minimum wage is relatively high in relation to its cost at the median wage, and close to the average for OECD countries that have a legal minimum wage (see Figure 21 in the Assessment and Recommendations section). The demand for labour is particularly sensitive to cost in terms of the minimum wage for youths and low-skill workers. Moreover, in light of its effects in terms of involuntary part-time work and

Figure 2.31. **Length of the probationary period, 2008**[1]



1. 2009 for France and Portugal.

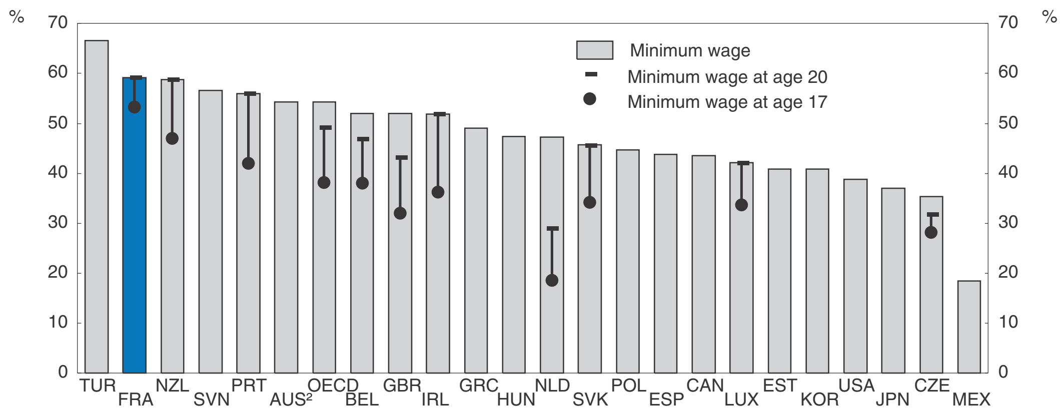
Source: D. Venn (2009), "Legislation, Collective Bargaining and Enforcement: Updating the OECD Employment Protection Indicators", *OECD Social, Employment and Migration Working Papers*, No. 89.

StatLink http://dx.doi.org/10.1787/888932791058 unemployment, especially for these two population groups, the minimum wage is inefficient for reducing overall income inequality and poverty, even if it allows earnings inequalities among full-time workers to be contained.

Many OECD countries have adopted a lower minimum wage for youths (Figure 2.32). In particular, Australia and the Netherlands, which also have high minimum wages, have introduced broad exemptions for them. In France, the regulation allows only a 10% abatement for youths under 17 having less than six months experience, and 20% for those less than 16. Compared to other countries, relative wages in France are high for youths and seniors, categories with depressed employment rates (Figure 2.33). Thus, in France more

Figure 2.32. **Minimum wage and age, 2010**[1]

As a percentage of median wage



1. Gross amount excluding potential payroll tax reductions.
2. Young Australians can benefit from a reduced minimum wage thanks to their collective agreements. In July 2012 Australian authorities introduced a minimum wage of 58% and 98% of the regular minimum wage for youths aged 17 and 20 years, respectively, applicable to youths and apprentices excluded from collective agreements.

Source: OECD, OECD Minimum Wage database 2012.

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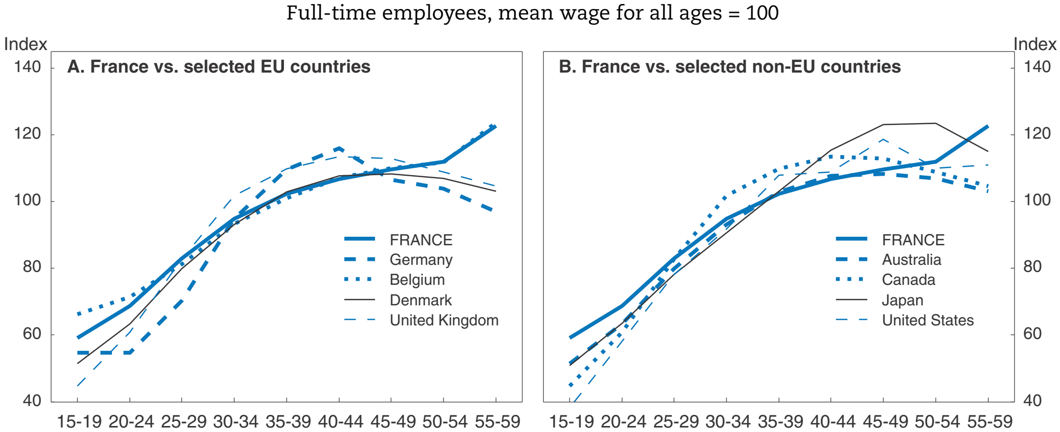
Figure 2.33. **Distribution of mean wages by age bracket, 2009**

Full-time employees, mean wage for all ages = 100



Note: These figures should be interpreted cautiously since they may reflect composition effects, for example if the lowest-skilled workers leave the labour market earlier in France. Endeavouring to correct endogeneity biases, Aubert and Crépon (2004) showed, however, that in France there was a decoupling of productivity from wages as from age 50, even if the estimations may lack precision (Aubert, P. and B. Crépon, 2004,"Age, salaire et productivité: la productivité des salariés décline-t-elle en fin de carrière ?" in *Economie et Statistique*).

Source: OECD, *Wages and Earnings Database*.

Note: To download the data corresponding to this graph, refer to figure 26.

than elsewhere, (unskilled) youths find themselves competing with experienced adults without the benefit of a cost advantage. This also gives rise to an inefficient reliance on internships designed to subvert the minimum-wage provisions. An age-related lower minimum wage for youths could be considered in conjunction with measures designed to reduce duality (higher payroll taxes on temporary contracts, extension of the probationary period of indefinite-term contracts) and the progressive extension of the RSA to youths under certain conditions. Different arrangements could be tested in regions suffering from varying degrees of youth unemployment.

In 2013 the government is implementing "generational contracts". This new provision consists of granting a lump-sum subsidy to businesses with fewer than 300 employees that sign a permanent contract with a youth aged below 26 while retaining a senior aged over 57. The amount of the subsidy is equal to EUR 2 000 annually for the young worker and EUR 2 000 for the senior. Businesses with 300 or more employees, which do not qualify for these subsidies, will need to sign agreements or institute age management action plans aiming to promote both the hiring of young people on permanent contracts and keeping seniors on the job. According to the government, this measure also meets the challenge posed by the transmission of know-how and abilities with a view to the massive retirement of baby boom cohorts.

While the provision does not specifically target the least qualified, the subsidy decreases with earnings in percentage because it is a lump sum. This type of measure is, however, like most for-profit-sector hiring subsidies, vulnerable to potentially substantial deadweight losses and substitution effects. Allègre et al. (2012) estimate on the basis of a similar measure that, for every 500 000 contracts signed, fewer than 100 000 permanent net positions will be created. The 300-employee threshold will, however, allow these losses to be mitigated. This measure can cut the cost of employing young people and seniors, although that is not the government's primary stated objective for it. However, it would be better to directly address the negative impacts of how wages are set for these groups of workers to avoid the depletion of government coffers. Low employment rates of youths and seniors are likely to have shared causes, linked, for example, to the poor functioning of the labour market overall (Figure 2.4).

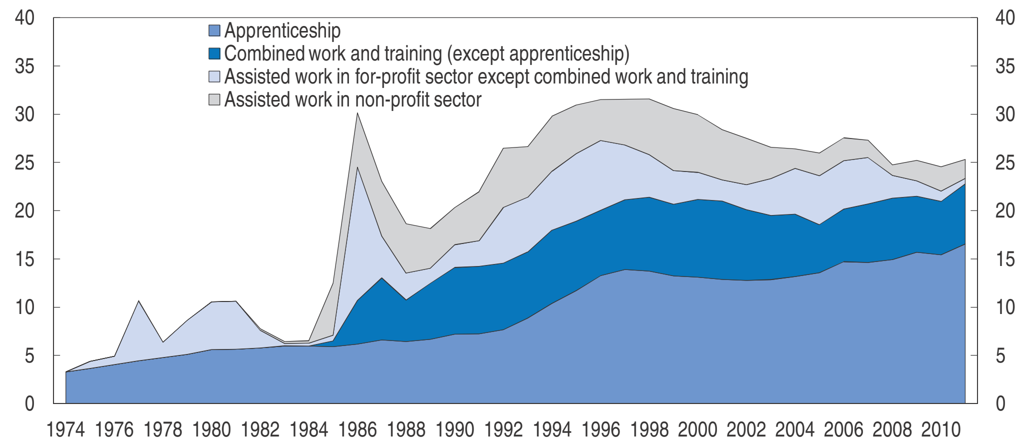
Subsidised work contracts: promoting a work-study approach for the least skilled

Assisted work contracts (including apprenticeships), which are heavily subsidised (up to 90% of the minimum wage for the non-market sector), are primarily targeted at youths under 26 years of age (70%, approximately). They represent about one-quarter of the jobs occupied by youths – down from the peak of nearly one-third in 1997-98 but up significantly from the 5 to 10% levels that prevailed prior to their widespread adoption during the mid-1980s (Figure 2.34). Approximately 50% of youths without a secondary school diploma are on subsidised contracts (DARES, 2011). In response to the ongoing crisis, the authorities boosted the share of non-profit organisations in subsidised jobs from 4% in 2008 to 10% in 2010, and it will probably exceed 20% in 2013. During the second quarter of 2012 the government created 80 000 subsidised jobs, primarily in the non-profit sector, and it intends to create 100 000 "jobs for the future" (*emplois d'avenir*) in 2013 (and 50 000 more in 2014) targeted at the least skilled workers and the non-profit sector, and including a training component, for a total budgetary cost of EUR 2.3 billion in 2013.

In France, approximately one youth in two attending upper secondary school is in a vocational programme – this ratio is close to the OECD average (Figure 2.35). As in Norway and the Netherlands, for example, vocational training is delivered either purely by

Figure 2.34. **Share of assisted jobs in the employment of youths under 26**

In percentages



Source: DARES, mesures pour l'emploi; INSEE, Employment surveys.

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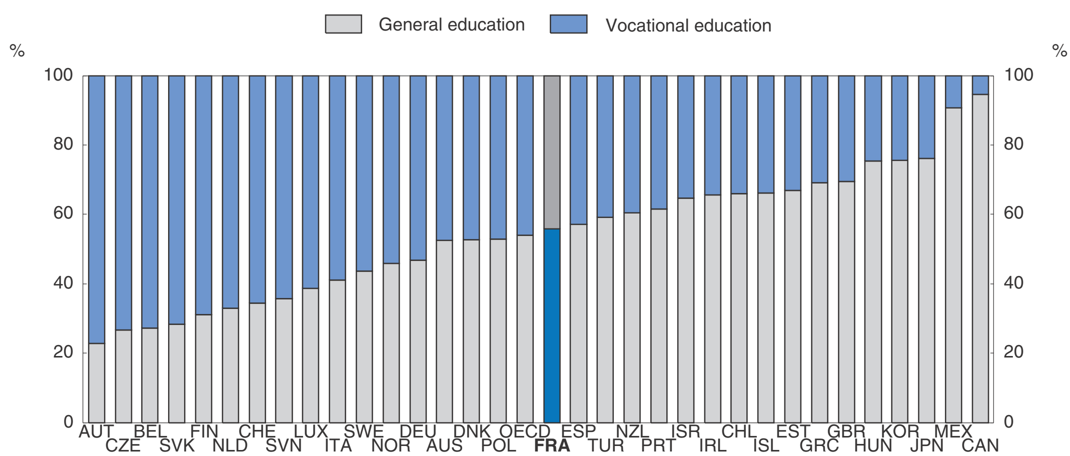
Figure 2.35. **Enrolment in upper secondary education, 2009**



Source: OECD (2012), Equity and Quality in Education.

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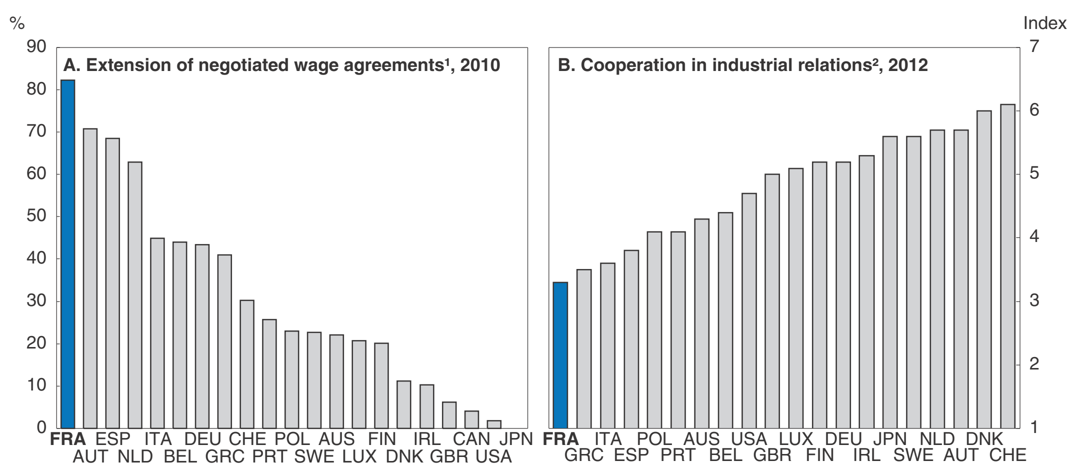
academic programmes or by apprenticeship. Other countries, including Germany, Austria, Denmark, Ireland and Switzerland, have almost exclusively opted for the apprenticeship path. By means of comparison, apprenticeship often permits a more fluid transition to employment, but it provides more specialised qualifications that may limit the worker's ability to adapt to technological change (Quintini et al., 2007). Most French vocational training centres (CFAs) are managed by local chambers of commerce and industry or chambers of trades and crafts. According to the Cour des comptes (2008), these two streams of vocational training are juxtaposed with no real co-ordination between the CFAs and the Ministry of Education. In Norway and the Netherlands, on the other hand, close co-operation between these two streams allows the right training to be found immediately for students unable to find an apprenticeship, which plays a useful countercyclical role (OECD, 2009). No real assessment has been conducted of the operations of CFAs.

Studies of the impacts of subsidised employment conducted since the 1980s have yielded a certain consensus (Fougère et al., 2000; OECD, 2008 (Box 4.1); Aeberhardt et al., 2011). First, assistance to non-profit employment may provide a rapid countercyclical response, but it does not have a lasting impact on the school-to-work transition. Second, a high training content promotes labour market integration: this is the case for combined work and training contracts. Third, all other things equal, relative to professional training that is purely academic, apprenticeship provides a seven-percentage point edge in terms of employment rates in the short term, and slightly higher earnings (Abriac et al., 2009). From this perspective, the upward trend in the apprenticeship share of these subsidised arrangements is welcome.

Despite the substantial subsidies, many youths cannot find a company for their apprenticeship, while many others drop out of the programme. One way to improve both incentives to take training and its attractiveness to business might be to make a non-negligible share of the apprentice's salary contingent on results. In addition to its institutional organisation, which is not readily reproducible, one of the keys to Germany's successful apprenticeship programme has been the quality of social dialogue (Quintini et al., 2007), in particular with regards to the flexibility of the apprenticeship schemes. Constructive social dialogue would help in attaining a better balance in France in areas extending far beyond the issue of apprenticeship (Cahuc and Zylberbeg, 2009; OECD, 2011b, Figure 2.36).

In addition, in France the trend in apprenticeships has been to offer contracts to apprentices with increasingly higher levels of education (Abriac et al., 2009), which tends to marginalise the youths who experience the greatest difficulties finding work. While the number of apprentices has nearly doubled in the past 20 years, that of the least skilled has remained stable (Figure 2.37). Deadweight losses in the for-profit sector are quite large when programmes are not targeted at those furthest from employment (Martin and Grubb, 2001). Thus, it is important to prevent combined work and training contracts from simply being

Figure 2.36. **Labour-management relations do not seem to be of good quality**

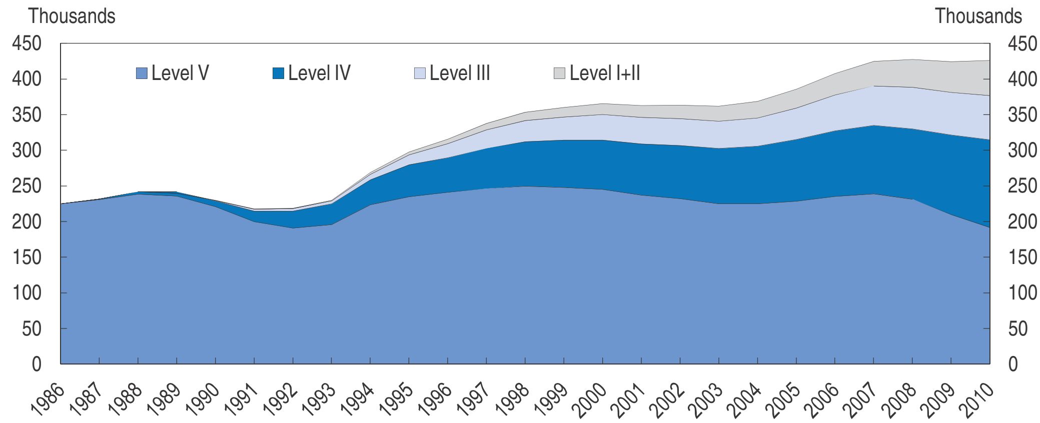


1. Arithmetic difference between the rate of coverage of collective agreements and the unionisation rate.
2. Index ranging from 1 to 7, based on a question posed to 14 000 business leaders (of which 129 in France), with 7 indicating the greatest possible level of co-operation.

Source: OECD, Going for Growth 2012; World Economic Forum, Global Competitiveness Report 2012-13.

Note: To download the data corresponding to this graph, refer to figure 23.

Figure 2.37. **Number of apprentices at year end by level of diploma**[1]



1. *Certificat d'aptitude professionnelle* (CAP), *brevet d'études professionnelles* (BEP) with additional module (MC) for level V; *brevet professionnel* (BP), professional baccalaureat (Bac pro) with additional module (MC) for level IV; *brevet de technicien supérieur* (BTS), *diplôme universitaire de technologie* (DUT) for level III; bachelor's degree, master's degree for level II; engineering diploma, diploma in specialised higher studies (DESS), master's degree for level I.

Source: Ministry of Education, DEPP.

Note: To download the data corresponding to this graph, refer to figure 29.

used to reduce labour costs and to clearly differentiate between types of assistance based on the skill level. Furthermore, for students in vocational upper-secondary schools, apprenticeship becomes a complement to professional training, rather than the substitute it was meant to be: this duplication draws out the process and is inefficient and costly for the public purse.

Combating ethnic discrimination on the job market

Relative to other countries of the OECD, in France children of immigrants make up a relatively small proportion of youths aged 20-29, in particular owing to the limited flows of young immigrants (Table 2.4). The differential between the unemployment rates of children of immigrants and children of the native born is large, as in most European countries aside from the United Kingdom and Switzerland, but it is smaller than in Belgium and the Netherlands (Figure 2.38).

Table 2.4. **Share of children of immigrants not in education among those aged 20-29, around 2007**

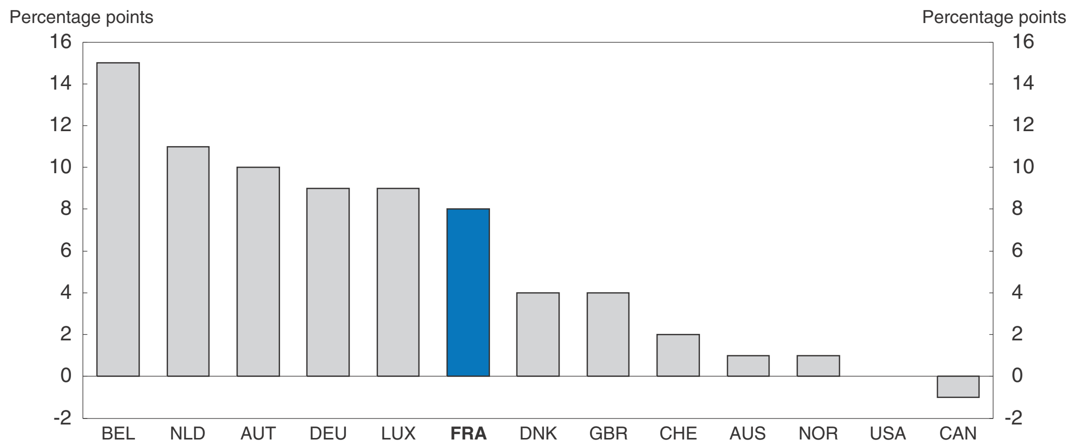
Per cent

	FRA	AUS	AUT	BEL	CAN[1]	DNK	DEU	LUX	NLD	NZL[1]	NOR	SWE	CHE	GBR	USA	**OECD**
Native born-children of immigrants (%)	**5.8**	10.7	5.0	7.1	9.7	2.3	4.8	21.6	5.0	-	1.7	5.1	9.6	12.2	6.5	**7.4**
Of which: non-OECD/TUR/MEX	**66**	-	*94*	*68*	*48*	*87*	*89*	*0*	*92*	-	*90*	*45*	*32*	*48*	*91*	**65**
Young immigrants	**3.4**	-	9.2	5.2	8.9	-	10.0	18.8	6.3	9.3	4.9	8.8	17.0	4.7	9.7	**8.9**
Of which: non-OECD/TUR/MEX	**87**	-	*86*	*62*	*76*	-	*84*	*2*	*83*	*6*	*92*	*84*	*75*	*70*	*94*	**69**
Total children of immigrants	**9.2**	-	14.1	12.3	18.6	-	14.8	40.4	11.3	-	6.6	13.9	26.6	16.9	16.2	**16.3**
Pro memoria[2]	**12**	28	17	11	22	9	15	42	13	24	9	16	27	14	16	**18**

1. Data for Canada refer to the 2006 census and for New Zealand to the percentage of the foreign-born labour force from the 2006 census.
2. Share of foreign-born in total population aged 15-64 (2008, %).

Source: OECD (2010), Equal Opportunities? The labour market performance of children of immigrants.

Figure 2.38. **Gap between unemployment rates of children of immigrants and native-born aged 20-29, 2007**



Source: OECD (2010), Equal Opportunities? The labour market performance of children of immigrants.

StatLink *http://dx.doi.org/10.1787/888932791134*

It is now well documented that in France individuals of foreign origin suffer widespread discrimination by employers and that youths are particularly affected (Cédiey and Foroni, 2007 and 2008; OECD, 2008a and 2008b). Differences between the education levels of the children of immigrants and those of the native-born account for less than one-third of the employment rate differential for 20-29 year-olds (OECD, 2010). For the population as a whole, individual characteristics explain only 4 of the 18 percentage point differential between the employment rates of French with at least one immigrant parent from the Maghreb and those with both parents born in France (Aeberhardt et al., 2010a). Conversely, they fully explain earnings gaps (13%). The essential difference in treatment penalising youths with origins in the Maghreb or sub-Saharan Africa is apparent even before they have a job interview – children of African immigrants need to apply three to fifteen times as often as French candidates with identical profiles to get their foot in the door (OECD, 2008b).

Combating discrimination is not easy. France has already implemented many measures (OECD, 2008b). The most cost-effective approach throughout the OECD is probably mentoring, in which volunteers who have extensive knowledge of the worlds of business or administration help youths from immigrant families forge links with business (OECD, 2008b). However, there is also merit in directly tackling overt discrimination. Finally, from a pool of equally qualified candidates, government bureaucracies could preferentially select the children of immigrants who are French citizens, since they are largely underrepresented in the civil service (OECD, 2009).

Better co-ordination of support for youth

In France, the main function of "local missions" is to promote the professional and social integration of youths. They are now an integral part of the public employment service (PES), Pôle emploi, but multiple players are involved in their funding, with contributions from the central government (40%) and sub-national levels of government (46%-from the regions for training, from departments for social action and from municipalities and their agglomerations for the *maisons de l'emploi*), from the European Union (7%) and from other sources (7%, including the PES). *A priori*, having an institution dedicated to youths' school-to-work transition is an asset. However, many co-ordination failures undermine the consistency and efficiency of the effort.

More than 80 employment policy measures have been implemented since 1977 (Sylla, 2008). The Cour des comptes (2012b) relates the story of a delegation from the prefect who identified at least 21 job-search schemes in a municipality in the Rhône-Alpes region. With so many actors involved, navigating the school-to-work transition is a labyrinthine task that lacks transparency for both youths and companies (OECD, 2009). Issues of co-ordination are generally attributable to the absence of a consistent transition policy for youths.

These disparate stakeholders are poorly co-ordinated within jurisdictions that sometimes overlap and may be governed by different sub-national levels of government. They encounter difficulties exchanging data (often because of incompatible computer systems, but sometimes because of privacy concerns), such as between adjacent local missions in different departments, and sometimes they even compete with one another. With regard to local missions, for example, the obstacle to data transmission is above all a legal one, since each local mission is a distinct entity – hence the advantage of consolidating them into a single structure. A key point is that spheres of competency and co-contracting procedures between Pôle emploi and local missions are vague. Similarly, CFAs are often poorly connected to the "network" of local missions, which is characterised by inconsistent administration in its 468 establishments.

These co-ordination failures create efficiency losses that are probably considerable. The Cour des comptes and the Ministry of the Economy and Finance have, moreover, identified shortcomings in the budgeting and accounting practices of the local missions. Measuring their performance is impossible owing to the complexity of their financing arrangements and their failure to adopt budgeting standards that are consistent with the LOLF (Cour des comptes, 2007). While the regions play an increasingly important role in apprenticeships, local missions are governed by officials elected locally. Shifting their governance up to the regional level (while retaining their involvement in local labour markets), whose role in labour-market integration should be strengthened, would yield economies of scale and better co-ordination. Since 2008, the funding has been overhauled in compliance with the budgetary requirements stemming from the LOLF through multi-year objective-setting agreements.

Intervening at the time of dropping out

Integrating youths who leave the school system without completing their programmes is a difficult task that most OECD member countries have to address; countries in Northern Europe, Luxembourg, Switzerland, Slovenia, Austria and Australia fare quite well in this respect (see Figure 2.1). Intervening after the student has left school is very costly, and the results are often disappointing, so it is important to wage this battle earlier to prevent dropping out (see above). While there is no panacea, an analysis of policies implemented in this area in recent decades (Quintini et al., 2007) reveals those courses of action yielding the best cost-benefit ratio, which should be the focus of government efforts.

The challenge is to pre-empt loss of contact with the world of work after leaving school, and the key is to detect signs of loss of labour-market attachment and to intervene rapidly, because course corrections become complicated when the youth is socially marginalised (Quintini et al., 2007). The best cost-efficiency ratios are obtained by targeting support to job-search strategies that are based on a reciprocal respect for obligations. Training, which is generally less effective in the case of dropouts, must be tailored and calibrated to labour-market needs as much as possible. In that vein, social-partner involvement may prove beneficial (Quintini et al., 2007). Many countries – notably Australia, Denmark and the United Kingdom – have set up programmes that allow them to intervene at an early stage of unemployment. For example, in Denmark, a pioneer in youth activation strategies since the mid-1990s, some of the resources provided are conditional on youths' active participation in these measures (OECD, 2009). Expansion of the RSA, as is recommended in this chapter, may be conducive to the creation of activation strategies. In general, the PES must be resolutely oriented toward an approach based on activation and respect for reciprocal obligations (see Assessment and Recommendations and Chapter 1), for which Australia provides a good example (OECD, 2009).

Co-ordination between the PES and the Ministry of Education's General Integration Mission (MGI) is central to rapid intervention with youths who are in danger of losing their bearings. However, the interface between the educational system and the PES is defective, in particular with regard to the exchange of information and establishing contact as soon as the student leaves school (CERC, 2008): the MGI appears ineffectual, engaging with barely half of those who leave school without a diploma, while approximately half the youths who are in contact with local missions made their first contact more than one year after leaving the school system, and one in five more than three years later (Bonnevialle, 2008a and 2008b). The Netherlands, Norway and the United Kingdom have recently bolstered the co-ordination between the PES and educational authorities in order to more quickly identify and offer a solution to youths quitting school prematurely (OECD, 2011a).

Monitoring and support platforms for dropouts have been progressively implemented since 2011. They are primarily designed to provide a personalised and rapid response to all youths over 16 with no diploma or strategy, and to offer them a second chance. These platforms benefit from a unique information system that allows educational establishments, CFAs, local missions and sub-national levels of government to better identify problem cases – they are likely to significantly improve co-ordination among different players. One example of sound practice may also be found in the Commission on youth unemployment in the Netherlands, which, between 2004 and 2007, brought together representatives of business groups, unions and the educational sector and gave rise to initiatives that allowed co-ordination between the various stakeholders to be improved and youths in the process of dropping out to be flagged (OECD, 2008a).

Second-chance schools appear to yield promising results, which should be assessed

The main mechanisms for supporting youths include the "social integration contract" (*contrat d'insertion dans la vie sociale*, or CIVIS) and "second chance" training provided to youths with serious transition difficulties. CIVIS, created in 2005, are intended for youths with an education level lower than a secondary school diploma plus two years. The autonomy contract that ended in 2012 had been created in 2008 along with the *dynamique Espoir Banlieues* to facilitate access to employment for the 60 000 youths living in disadvantaged neighbourhoods (approximately one third of NEETs aged 15 to 24 living in a ZUS).

Two second-chance provisions are targeted at young dropouts under 26 and having no diploma or professional qualifications: second-chance schools (E2C) and *Défense deuxième chance* (for *Établissement public d'insertion de la défense dit Défense deuxième chance*, Epide).

They offer a fresh start by providing basic skills in the three Rs, and support youths as they lay out their own personal and professional paths. The former emphasises developing autonomy and self-confidence, and provides for a personalised trajectory in small groups and combining work and training; the second targets young people on their way to marginalisation, allowing them to receive behavioural, general and occupational training in highly disciplined residential centres – provisions that are analogous to the US Job Corps, an expensive programme but with a high social payoff (OECD, 2009).

Springing from a European initiative adopted in 1995 and based on a pedagogical paradigm that differs from classical educational models, E2C are created on the initiative of sub-national levels of government and those who work on the school-to-work transition issue. Business involvement in these programmes ensures account is taken of the local labour market. The proliferation of E2C was a cornerstone of the government's 2009 emergency plan to combat youth unemployment. In 2012, the network had over one hundred establishments in nearly half of all departments (versus one-quarter in 2008) and serviced approximately 12 000 interns. The average cost of a youth's involvement with an E2C, the mean duration of which is seven months, is approximately EUR 6 000. While E2Cs do obtain promising results in terms of the school-to-work transition, the actual efficiency of this arrangement has never been assessed, limiting its further expansion (Cahuc et al., 2011). An evaluation is underway at the Ministry of Labour and will be published in 2013. The Epide comprise 20 establishments and provide 2 300 places for youths who live in dormitories and receive behavioural, general and vocational training (business internships). Their annual budget is EUR 84 million, or approximately EUR 39 000 per participant.

In 2012, EUR 419 million was allocated to delivering such support (CIVIS allocation, *Fonds pour l'insertion professionnelle des jeunes*, E2C, Epide and autonomy contracts). As a percentage of GDP (0.02%), this is equivalent to approximately one-sixth of mean annual government expenditures over the past forty years on subsidised contracts other than apprenticeships, the efficiency of which is very low – indicating a poor allocation of resources.

Territorialisation of the issues affecting youths

The spatial concentration of difficulties

The challenges facing French youth have a marked territorial aspect. Approximately 7% of the population of France lives in one of 751 ZUS, which are "characterised by the presence of large clusters or neighbourhoods that are degraded and by a pronounced disequilibrium between housing and employment" (ONZUS, 2011). ZUS residents are younger on average than those in neighbouring areas: nearly one in three is less than 20, versus one in four in their agglomerations and the overall population (ONZUS, 2011). However, these territories concentrate socio-economic difficulties: the mean standard of living is lower than in their agglomerations (by approximately 45%), the poverty rate is 2.5-3 times higher, the population is less educated, unemployment twice as pervasive, housing of poorer quality, insecurity more prevalent, etc. (ONZUS, 2011). Poverty is particularly common among youths from these neighbourhoods, with an unemployment rate of 15-24 year-olds over 40%. Overall, approximately one NEET in seven between the ages of 15 and 24 lives in a ZUS. These conditions of extremely precarious subsistence have festered for several decades.

The spatial mechanisms of exclusion in these French *banlieues* may result from the negative impact of social segregation (acquisition of human capital, networks allowing access to jobs, stigmatisation of the neighbourhoods and discrimination by some employers), ghettoisation (spatial mismatch) (Gobillon and Selod, 2007), which increases frictional unemployment, and lack of support from employment services. Several lessons can be learnt from the analysis that has been conducted of this issue:

- in addition to individual characteristics neighbourhood effects appear to contribute to educational failure (Goux and Maurin, 2007);
- education level and family background remain the most important factors determining access to jobs and the wage level;
- if observed individual characteristics are carefully accounted for, the fact of living in a ZUS is negatively correlated with the likelihood of finding a job (Aeberhardt et al., 2010a and 2010b; Couppié and Gasquet, 2011);
- conditional on having a job, the fact of living in a ZUS affects neither the nature of the job nor earnings (Couppié et al., 2010): once employed, neighbourhood externalities and discrimination practically vanish;
- since the choice of where to live is endogenous, location variables in econometric estimations in fact reflect unobserved attributes and the effect generally observed is not causal; "residential environment matters most to an individual's mental health and exposure to crime" (Oreopoulos, 2008, for a summary);
- experiments indicate that a random relocation of individuals outside of a segregated residential environment does not affect their outcomes with respect to education level, employment or earnings (Oreopoulos, 2008); and
- experiments that involved subsidising activities in some ZUS in France (416 urban renewal zones and 100 urban tax-free zones) were inconclusive: poor targeting of the local population, massive deadweight losses, weak overall impact (OECD, 2008a).

More research to corroborate the analysis and inform policy choices is needed in this area. However, some lessons can be gleaned from these results. Priority should be given to bolstering the educational system in these territories (see supra) and supporting young jobseekers while ensuring that the quality of housing and transportation does not hamper access to work.

Piecemeal zoning policy

The inter-ministerial urban policy implemented since the 1980s has been designed to break the dynamic of urban decay that pervades some areas. General issues regarding urban policy and its effectiveness fall well outside of the scope of this chapter. One finding is, however, indisputable: the difficulties in these neighbourhoods have not abated. It has not been demonstrated that targeting social policy on zones rather than directly at individuals is effective (OECD, 2007c). The means deployed in these target areas often run up against thorny co-ordination problems that sap their effectiveness and create a climate of stigmatisation. Indeed, the population living in ZUS has been falling by approximately 0.5% annually since 1990, with the poorest tending to remain (OECD, 2007c), exacerbating the existing problems.

Urban policy is based on a priority geography built around zones that are juxtaposed in an inconsistent fashion and dilute government intervention (OECD, 2007c). As is often the case in France, responsibilities are scattered across numerous jurisdictions, and inter-communal co-operation is minimal (Cour des comptes, 2012b). Since 2006, urban policy has designated 2493 priority neighbourhoods (*Contrats urbains de cohésion sociale*, or CUCS) covering approximately 12% of the population of France (approximately 7.7 million inhabitants); 1 752 are not in a ZUS. Conversely, of the 751 ZUS (4.4 million inhabitants), ten do not fall within a CUCS neighbourhood. The National Urban Regeneration Agency (Agence nationale pour la rénovation urbaine, or ANRU), which receives a large share of the urban policy credits, covers a total of 542 neighbourhoods, of which 112 are non-ZUS. As to priority education, 40% of ECLAIR and 75% of RRS lie outside of ZUS. Also, approximately 40% of lower-secondary schools located within ZUS are not classified as priority education. Priority geography was to be overhauled in 2010, but the reform has been delayed until 2014. It should be done as soon as possible. In addition, it is questionable whether strict neighbourhood-by-neighbourhood zoning should be maintained, or resources allocated on the basis of precise criteria (unemployment rate, the proportion of youths without professional qualifications, the proportion of social assistance recipients, etc.), while granting more authority to prefects and local representatives (cf. Hamel and André, 2009).

No affirmative action in support of employment in problem neighbourhoods

As to the matter of support for employment in struggling neighbourhoods, the previously identified co-ordination issues crop up with the same urgency. Before the introduction of "jobs for the future", the principal measure targeted on the ZUS was the creation of autonomy contracts launched in 2008 (see above) with the *dynamique Espoir banlieues*. Aside from this action, data incompatibility issues make it difficult to estimate to what extent employment policy targets priority neighbourhoods. According to IGAS (2010) and Cour des comptes (2012b), the means are inadequate to the task. Plus, Pôle emploi is encountering difficulties assigning staff to these places, resulting in an inadequate monitoring of jobseekers. OECD (2008b) observed that youths in the ZUS have a hard time accessing the PES. Approximately 17% of employment policy credits and 10% of subsidised contracts go to the ZUS (Cour des comptes, 2012b). Inasmuch as approximately 14% of the unemployed and 14% of NEET aged 15-24 live in ZUS, this does not suggest that there is underinvestment in ZUS by employment policies, but there does not appear to be any affirmative action in this area either.

Box 2.1. **Recommendations to improve the economic situation of young people**

Concentrate educational resources on primary schooling and students from disadvantaged backgrounds

- Transfer funding from secondary to primary schooling in a budget-neutral manner. Achieve economies of scale by speeding up the merger of small schools.
- Use the surplus public financing allocated to education to make priority education a genuine priority. Use these resources to develop the specific skills needed to develop priority education networks and attract experienced teachers. Give these schools greater autonomy in terms of recruitment and tailored support to individual students, and develop parental involvement in these schools.
- Allow primary schools and their principals at least as much authority as at secondary-school level by changing their status into public teaching establishments and by giving their principals clear-cut line responsibilities.
- Improve teacher training by placing the emphasis on teaching practices and by making greater use of programmes alternating academic training and vocational experience. Rationalise non-wage costs in order to be able to increase teachers' pay.
- Drastically and swiftly reduce the use of year repetition, and introduce teaching practices that are better tailored to individual students in order to reduce dropout rates.

Box 2.1. **Recommendations to improve the economic situation of young people** *(cont.)*

- Reform the functions and inspect more closely the activity of career guidance counsellors/psychologists. Draw a clear distinction between, and give priority to, their specific guidance functions to be developed by forging closer links with firms. Increase the involvement of teachers in pupils' career guidance through tailored instruction. Introduce an initial foundation course year in upper-secondary technology and professional studies. Provide, through the public careers guidance service, detailed information on job opportunities resulting from the courses offered by higher education establishments.

Improve the equity and efficiency of higher education

- Reduce the segmentation of higher education by shifting the public financing of higher education institutions in favour of universities in a budget-neutral way. Develop courses at degree level that are valued in the labour market.
- Give universities greater autonomy in terms of financial management, human resources and curriculum (including student selection). Make part of funding awards contingent on mergers between establishments and on strengthening the effective role of research and higher education centres (PRES). Increase tuition fees and introduce student loans with repayment conditional on future earnings.

Develop the independence of young people, and increase youth employment

- Facilitate access for young people to social housing by increasing the supply of small dwellings and better targeting. Develop student accommodation.
- Extend the RSA to young adults who have completed their studies according to an age-dependent progressive scale, strictly conditional on implementing an effective activation strategy comprising participation in a training programme or active job search. At the same time bring down all age limits to 18 years of age in all legislation. In particular, abolish the inclusion of adult children in the household for tax assessment purposes, as well as the family benefits to which they provide entitlement, and if necessary increase means-tested grants for students. Use the same (relative) scale as for the RSA to fix the minimum age according to age.
- Reduce the minimum wage relative to the average wage and reduce the use of labour-market dualism (Assessment and Recommendations, Box 5).
- Continue to focus subsidised contracts on combined work-study programmes, grants for which should be redirected towards the low-skilled. Improve the co-ordination of, or even close the gap between, school-based vocational training and apprenticeship. Assess the performance of apprentice training centres. Severely restrict the use of subsidised contracts for non-combined work-study programmes to emergency countercyclical policy.
- Improve the co-ordination of the many actors involved in securing entry into employment, in particular to take charge of young dropouts at an early stage by concentrating resources on activation strategies (which will be facilitated by the introduction of a genuine RSA for young people). Rationalise the support to help youths find employment by limiting the number of schemes, by shifting the oversight of local initiatives to the regional level and by creating regional structures that include the various actors concerned (local missions, general social integration mission run by the Ministry of Education, information and guidance centres, etc.).
- Consider extending the second-chance schools, depending on the results of the government's ongoing evaluation of the scheme.

Rationalise zoning policies

- Rethink the positive discrimination based on geographical criteria by making municipal zoning policy more transparent and by ensuring its consistency with priority education. A more radical reform aimed at avoiding the stigma from zoning might replace policies aimed directly at given territories by resource allocation based on the characteristics of the individuals composing the target population (education, housing, transport, support for entry into employment, etc.).

Notes

1. According to OECD estimates, the structural unemployment (NAIRU) for the entire labour force is about 90% of the total unemployment rate and the ratio of youth to total unemployment rate has been roughly stable since the mid-2000s.
2. Since the mid-1990s, average income for the 18 to 25 year-old age bracket has been a fairly constant 14% below that for all ages combined.
3. Assuming that roughly 120 000 additional two-year-olds should be enrolled in priority education zones would entail creating about 6 000 jobs, i.e. a gross cost of approximately EUR 500 million. From this amount, the cost to government of current day care programmes for these children should be deducted.
4. The current average cost per pupil is roughly EUR 6 000, and the current additional cost for priority education has been estimated at 10%. Each cohort comprises roughly 800 000 pupils, i.e. a population of 3.2 million between 4/5 and 7/8 years of age. The additional cost per pupil is therefore (12 000 – 6 000*1.10)*3 200 000*15% = EUR 2.6 billion.
5. For a full year in 2017 according to estimates of François Hollande's presidential programme.
6. *www.assemblee-nationale.fr/13/rap-info/i4033.asp*.
7. The 78 000 students enrolled in CPGE benefit from an average advantage of around EUR 5 000 compared to university students. 240 000 students are enrolled in STS and have additional funding of EUR 3 600 a year on average, i.e. an envelope of EUR 860 million.

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