

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.



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