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OECD Reviews of Regulatory Reform: France
Charting a Clearer Way Forward

PART I

Chapter 1

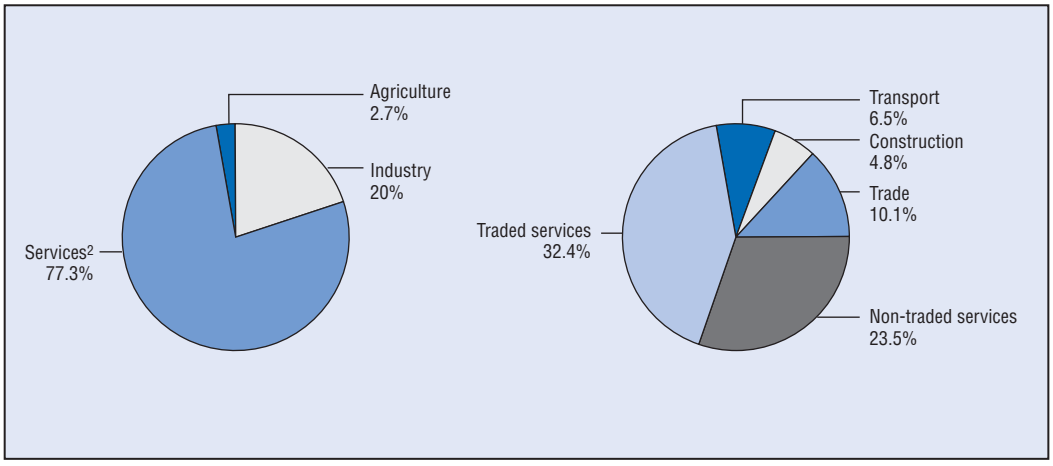
Performance and Appraisal

Introduction

Depending upon how it is measured, the French economy is the fourth or fifth largest in the world in terms of GDP. It enjoys a high standard of living, with a GDP per capita of USD 24 759 in 2002. With 59.3 million inhabitants it is the third largest country in the EU. Paris and its surrounding area remains by far the most important economic and population hub of the country, though there are a significant number of dynamic regional cities.

France has a diversified economy (Figure 1.1). Manufacturing accounts for 20% of value added and in particular steel, aluminium, chemicals, pharmaceuticals, motor vehicles, rail transport equipment, telecommunications equipment and aerospace (civil and military). Services account for 77% of value added, which is high compared with the EU average. Agriculture and the agro-food industry represent 5% of economic activity, more than in other EU countries, and the sector plays an important social role. France has the largest agricultural sector in the EU, and is the second largest exporter of agricultural goods after the US. Tourist activities are a significant component of the services sector and the economy as a whole and are favoured as much by France's warm temperate climate as its geographical or cultural diversity.

Figure 1.1. **Structure of the economy**
Share of value added, 2001[1]



1. The chart on the right represents the breakdown of value added in services.
2. Services include construction.

Source: OECD national annual accounts, 2003.

The French economy is largely open to foreign trade and trade is an important part of the economy. In 2000 exports of goods and services amounted to 29% of GDP. Manufacturing accounts for most exports of goods. Germany is France's main partner for both imports and exports, followed (equally) by the UK and Spain.

The French governance and regulatory framework has deep historical roots. Although some of the premises of the modern State of law first started to be put in place under the *Ancien Régime*, a large part of the highly centralised legal and administrative system dates from the Napoleonic era. The role of the State has also been strengthened at certain periods in France's history, as was the case during the 1930s and the period immediately after the Second World War when the State acquired greater power through nationalisations and the indicative planning process. While other periods were marked by more liberal phases, both in the 19th century and in recent decades, from a historical standpoint public governance in France has been deeply marked by prerogatives and the defining of a strong unitary State.

Over the past twenty years the role of the State in the economy and society has been significantly reduced in response to three major developments:

- The first is *decentralisation*. The State is seeking to modify the centralist character of the country, still though within a unitary context. This has affected institutional relationships, responsibilities and powers across the four levels of government (State, regions, departments, and communes).
- The second concerns *markets*. Partly under the impetus of EU liberalising measures and the commercial pressures of globalisation, the State has started to distance itself from direct intervention in markets, and State ownership of companies has declined significantly. The majority of product markets are now open to competition. The definition and management of public services (service public) is being adjusted to this new context.
- The third relates to *legal changes*, with the blurring of the traditional boundaries between administrative law (which governs the actions of public authorities) and private law. Recognition of the principles of competition is becoming an important factor in State actions and decisions.

Table 1.1 provides a series of practical definitions of the terms "State", "administration" and "public sector" that have been used in the analysis presented in this report. Boxes 1.3, 1.4 and 1.11 below provide more information on the legal framework, decentralisation and public service.

The French economy has recently enjoyed a period of relative success, following slow growth and a recession in the early 1990s. This was supported by important structural, regulatory and other reforms. But growth has slowed, and at the same time the economy faces the big challenge of population ageing (shared with many other OECD countries). The current outlook is uncertain because the reforms needed to meet this challenge are mostly still work-in-progress, or have not yet been addressed with complete success. Further reforms are needed to sustain progress, help the French economy reach its potential and create a more positive outlook.

This part of the report is structured as follows. It starts by considering the key issues that are shaping the overall development and performance of the French economy and the particular characteristics of the economy that have a strong link with regulatory reform. It then considers the contribution which regulatory reform has already made to performance, before addressing the question of where further regulatory reform might continue to boost performance and the achievement of policy goals. A number of issues – labour markets, network industries, the role of the State, competition policy, administrative reforms, and decentralisation – are treated in both of these sections. This is because these areas are still work-in-progress; the report seeks to distinguish the

Table 1.1. **Organisation and definition of the public sector in France**

Public sector	**General government**	**Central government**	**State**	*Directions d'administration centrale* (Central administrative directorates) and *Services à compétence nationale* (Administrations under national competence). The main responsibilities of the *Directions* are analysis and projections of public needs; drafting of regulations and laws, including the Budget; management, co-ordination and supervision of the local administrative branches of the state; evaluation of public policy impacts. The responsibilities of the *services à compétence nationale* are: criminal records, management of national museums, fight against illegal immigration, production of specialised studies. They also ensure the provision of numerous operational services. *Services déconcentrés de l'État* (local state services). These provide services for the *préfets* (prefects) who are directly appointed by the government. They are responsible for the implementation of all national civil policies (education, culture, agriculture, etc.), and for the police.
			Other entities of the central government	*Établissements publics à caractère administratif, EPA*, with a strong service and administrative vocation (COB – Commissions des opérations de bourse, ENA (École nationale d'administration, etc.).
				Établissements publics à caractère scientifique et technologique EPST, with a scientific and technological vocation (*CNRS*, national research institute, etc)
				Établissements publics à caractère scientifique culturel and professionnel, *EPSCP* (universities, national museums, etc.).
		Regional and local governments	**Local administrations**	They include municipalities (*communes*), departments (*départements*), regions (*régions*) and various entities responsible for local co-operation initiatives.
			Other local entities	Locally financed non-market entities (for example, primary and high schools, Chambers of commerce, etc.).
		Social security	**Social insurance schemes**	They include 37 mandatory schemes, or *régimes*, each managing at least one of the following classes of risks: healthcare (both medical treatment and per diem sickness benefits to compensate for loss of earnings); retirement and survivors' pensions (including complementary regimes); family and maternity allowances; housing benefits; poverty and social exclusion. There are also special funds (FSV, FFR, etc.). Though administratively and financially more independent, *UNEDIC* (*Union nationale inter-professionnelle pour l'emploi dans l'industrie et le commerce*), responsible for covering the unemployment risk, is also part of the social insurance system in the national accounts classification.
			Entities administered by the social insurance schemes	Example: public hospitals (financed but not administered by the social security system).
	Large publicly owned enterprises	*RFF*, railway infrastructure, SNCF, railway services, *ADP*, Paris airports, *RATP*, Paris transport network, *France Télécom, La Poste,* EDF*, Gaz de France,* energy network. Some of these enterprises have the status of *Établissements publics à caractère industriel et commercial (EPIC). La Poste* is an *Établissement autonome de droit public.* Other companies, such as *France Télécom* since 1966, are limited companies.		

Note: This classification of public administrations, which is partly based on the national accounts, should also include *autorités administratives indépendantes* which have a special status (see Box 1.3 on independent regulatory authorities).

Source: OECD.

achievements so far, from the challenges for the future. The conclusions drawn from the analysis end this part of the report. Part two of the report provides supporting material and a deeper analysis for regulatory quality, competition policy, international market openness, and reform in two sectors, civil aviation and telecommunications.

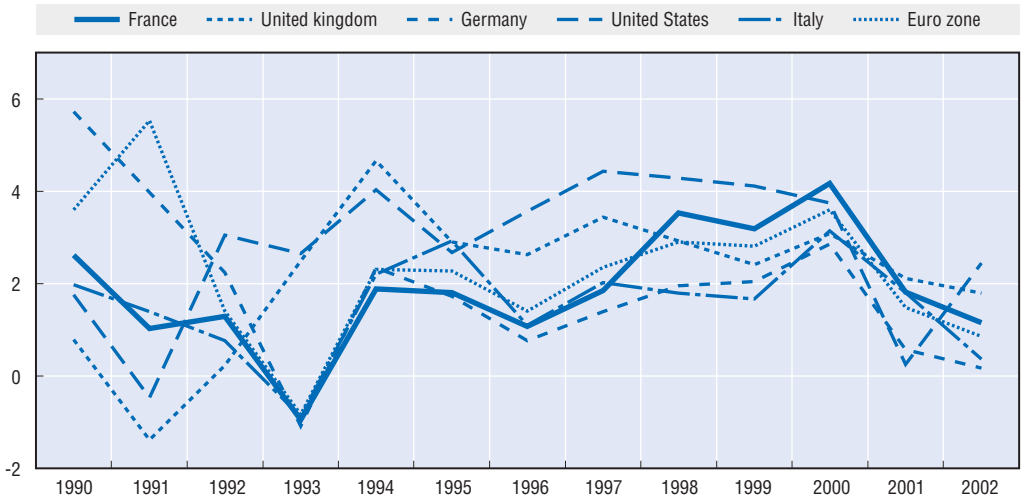
Setting the scene: the macroeconomic background to regulatory reform

The French economy's performance has improved recently

France entered the 1980s suffering from high unemployment, slowing growth and high inflation. Following a spectacular decline in inflation during the first half of the 1980s and a period of rapid expansion in the second half, the economy entered a period of slow growth and recession in the first half of the 1990s. The slowdown was much more pronounced in France than in the rest of the OECD area, with the economy developing less rapidly than in some of France's European partners, even though the growth rate was on the whole comparable to that of the other major countries in continental Europe. After 1995, growth picked up and France has outperformed all the large continental European countries and the euro-zone average Figure 1.2), reflecting in part the larger than average output gap that had accumulated in the first half of the decade. This good performance was achieved without sparking a burst in inflation and was accompanied by rising exports, falling unemployment and relatively strong employment growth.

Figure 1.2. **Real GDP growth in France, the euro zone and elsewhere in the OECD**

Per cent



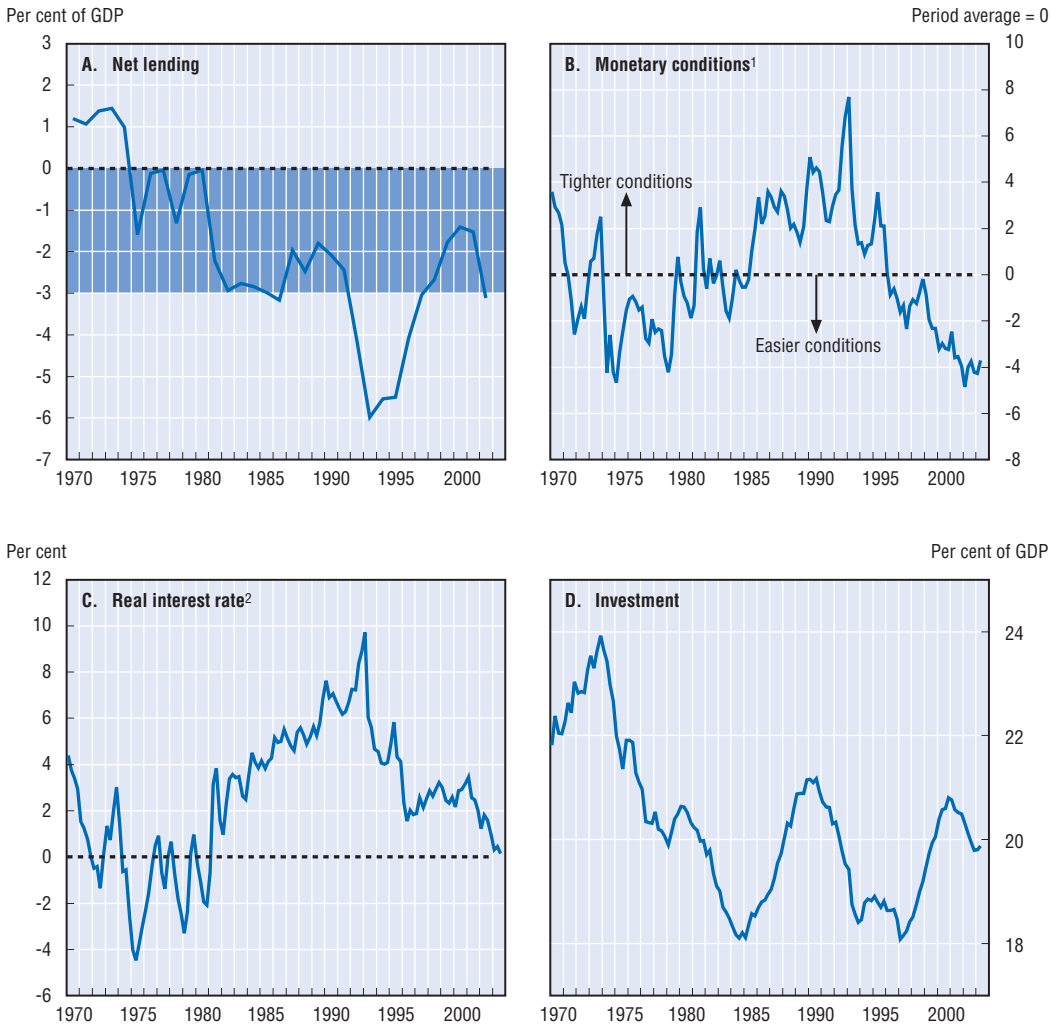
Source: OECD, *Economic Outlook* No. 73.

Though activity has slowed substantially and actually declined in the second quarter of 2003, growth continues to be stronger than in some of the other large economies. Also, employment has continued to grow and unemployment has been rising slowly.

Efforts have been made to consolidate the macroeconomic situation

Efforts were made during this period to strengthen macroeconomic fundamentals in the run up to and subsequent adoption of, the euro. During the first half of the 1990s a relatively tight monetary policy and a process of fiscal consolidation slowed growth. Several years of low and falling inflation, the adoption of the euro and a stronger fiscal position (declining public spending, deficit and debt) helped reassure financial markets. The establishment of these macroeconomic fundamentals and the adoption of the euro had important positive effects, not least of which was a substantial fall in interest rates, which helped provoke a rapid increase in investment levels and strong growth (Figure 1.3).

Figure 1.3. **Macroeconomic policy, interest rates and investment**



1. The monetary conditions index is defined as:
   MCI = MCI[t – 1]* (1 + (r – r[t – 1]) + w* (e/e[t – 1] – 1)).
   r = real short-term interest rate, CPI deflated,
   e = real effective exchange rate, based on CPI,
   w= weight based on share of imports to GDP.
   The index is shown as a percentage deviation from the period average. A value higher than zero indicates tighter conditions than on average.
2. Three-month treasury bill, CPI deflated.

Source: OECD.

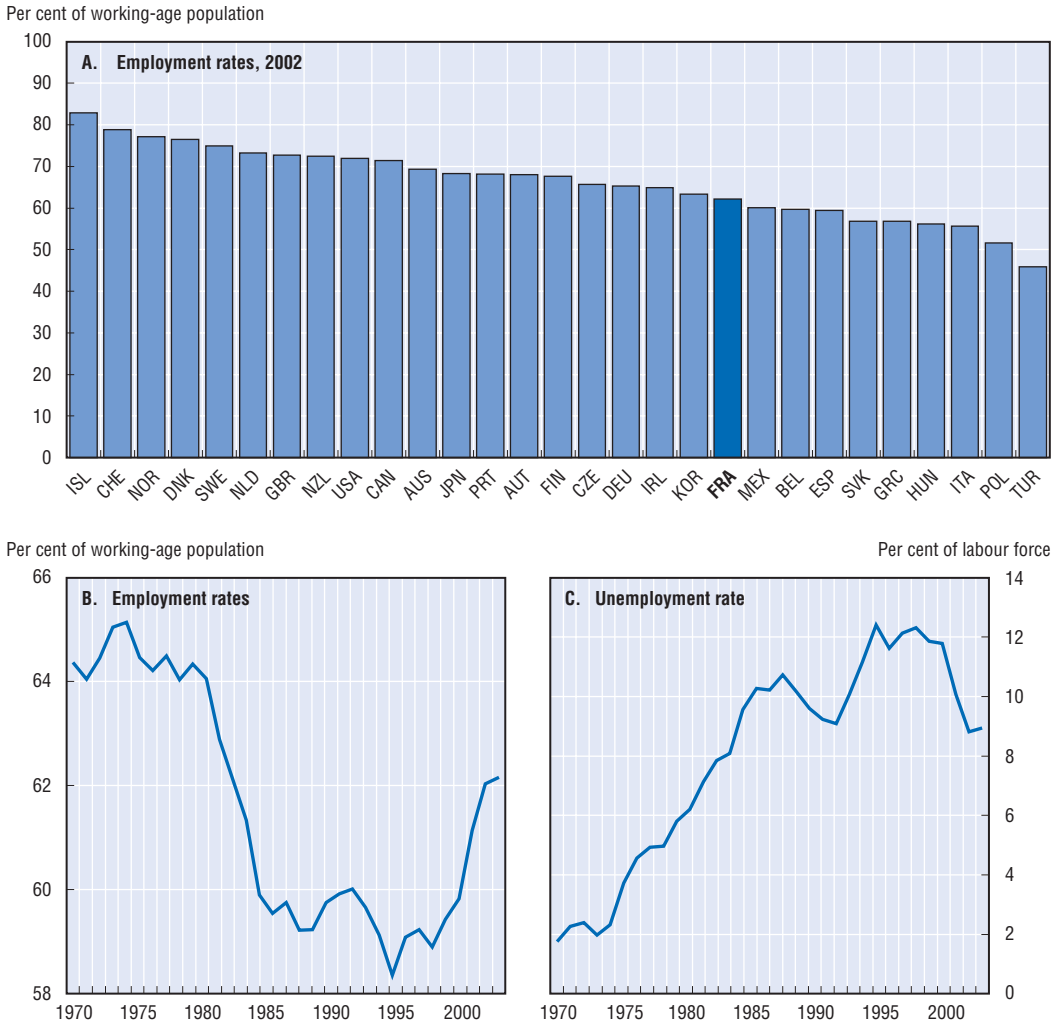
Structural and regulatory reforms contributed to the successes of the economy

Improved economic performance during the latter part of the 1990s was also underpinned by a wide range of structural and regulatory reforms undertaken in the 1980s and 1990s. Major structural adjustments were made to product markets. A long and ongoing process of privatisation saw the direct ownership role of the State fall substantially, bringing into private sector hands virtually all the banking, insurance and manufacturing sectors. Severing these firms' linkages to the State helped them access

private savings more easily and exploit opportunities both within France and abroad, which was also helped by the development of the EU single market. The liberalisation of network industries and the introduction of new pro-competition regulatory frameworks were also begun. Competition policy started to have a stronger influence, following the abolition of price controls in 1986 and the establishment of an independent competition authority.

These developments have yielded substantial benefits: lower prices, improved services and a strengthening of France's world economic position. Evaluating the precise impact of regulatory reform on economic performance is difficult. However, research (Nicoletti and Scarpetta, 2003) suggests that product market reforms undertaken in France during the 1990s have had significant impacts on productivity, overall economic activity and not least, the labour market. The OECD estimates that product market liberalisation helped raise employment rates in France by some 1½% over the period 1978-1998 (Nicoletti, 2001).

Figure 1.4. **Labour market developments**



Source: OECD.

Important labour market reforms have also been carried out

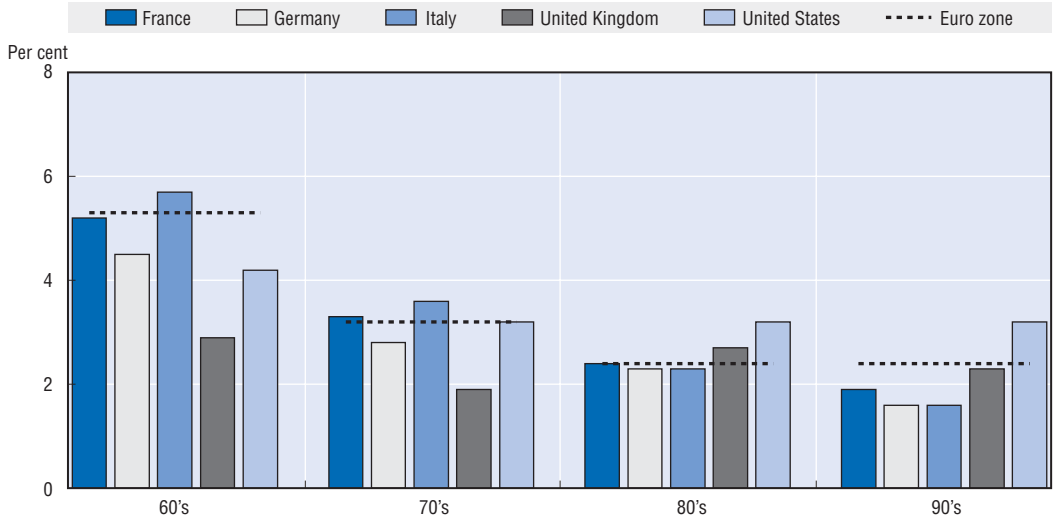
Throughout the 1970s and 1980s, the performance of the French labour market deteriorated, with an employment rate plummeting from 65% in 1975 to just over 60% by the end of the 1980s, and an unemployment rate rising from less than 3% in 1970 to a cyclical peak of more than 12% in the first half of the 1990s. While much of the OECD suffered a similar deterioration, this was more pronounced in France.

While unemployment remains high (structural unemployment is estimated to be some 9% of the labour force, and joblessness among the young and older workers is high), the 1990s saw a substantial recovery in labour market performance. A series of reforms aimed at reducing the labour cost of low-wage workers helped to reverse the long-run trend of declining employment rates and rising unemployment that had plagued the French economy during the 1970s and 1980s. These reforms were supplemented by efforts to promote part-time working and the annualisation of working hours. For the first time in 30 years the unemployment rate during the peak of the cycle fell below the level it reached at the peak of the previous cycle. As important, growth since 1990 has been much richer in jobs than during the previous decades.

But some important aspects of current performance raise concerns

Trend growth is well below the levels seen during the 1960s and 1970s. The slower pace of economic growth from decade to decade (Figure 1.2) has been observed in most OECD countries. One major factor behind the slowdown has been declining productivity growth. In part, this reflects a weakening of the catch-up process that has seen the gap between US, French and European productivity levels close during the post-war period. As opportunities for catch-up diminished, average productivity growth has slowed from decade to decade. Most recently France's average productivity performance, like that of many European countries, has suffered in comparison with the US.[1] This also likely reflects the economy's relatively limited participation in the ICT revolution that was boosting both

Figure 1.5. **Long-term growth trends**
10 year averages



Source: OECD, *Economic Outlook* No. 73.

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productivity and investment levels in the US. Finally, the rising share of lower skilled and youth workers as a result of reforms destined to improve the access of such individuals to the labour market likely contributed to a fall in the rate of growth of measured productivity.

Unemployment remains high and the share of the working-age population that actually have jobs is one of the lowest in the OECD area.

The fiscal deficit is an important source of concern. Fiscal policy has been significantly relaxed in recent years. With the general government deficit having reached almost 4.1% of GDP in 2003 and overall debt having exceeded 60% of GDP, action is going to be needed to curb the deficit and put public finances on a sounder footing.

Meeting the ageing challenge

The need to deal with these issues is pressing given the ageing of the French population. Between now and 2030, the ratio of retired people to those employed is expected to double, leaving only one worker to support a retired person. The effect of this will be to slow down the rate of growth in per capita gross domestic product. Long-term simulations by the OECD suggest that in the absence of further reforms to boost productivity, employment rates and investment activity, GDP growth can be expected to slow even further to around 1.6% pa over the next ten to fifteen years. This has important implications for future French living standards. The ageing of the population will also put substantial pressure on social services. The rate of increase of per capita health and pension expenditures is set to rise, but slower growth will mean slower increases in the tax revenues necessary to pay for these services. Though French ageing is not the highest in the OECD area, France is one of the most exposed OECD countries in terms of the sustainability of its pension schemes, especially as regards future public pension liabilities (even allowing for the recent reforms).

Regulatory reform: its contribution so far

Regulatory reform is an important part of governments' toolkit for improving economic performance and meeting public policy goals (Box 1.1).

As already noted, considerable structural and regulatory reforms have been implemented over the last twenty years. Some striking changes have taken place in an economy and society which nevertheless remain, in many respects, based on deep-rooted values and structures. Reforms have helped to open up the economy, now largely (though not wholly) based on competition.

The following sections review the major areas of change and reform: labour and product market reforms, and especially network industry reform, the rise of independent regulators, developments in competition policy and in the legal system, decentralisation and the reform of government and, lastly, market openness. This part focuses first on the reforms and successes to date. Future challenges are picked up afterwards. Some issues (for example the labour market) are therefore covered in two different parts of the text.

Labour market reforms: a prolonged and partly successful effort to reduce rigidities and increase labour participation

The strong growth of employment during the 1990s owes much to a prolonged effort to reduce the labour market rigidities which had accumulated during the post-war period, giving rise to three separate problems: falling rates of youth employment, falling rates of

Box 1.1. **What is regulation and regulatory reform?**

There is no generally accepted definition of regulation applicable to the very different regulatory systems in OECD countries. In the OECD work, regulation refers to the diverse set of instruments by which governments set requirements on enterprises and citizens.Regulations include laws, formal and informal orders and subordinate rules issued by all levels of government, and rules issued by non-governmental or self-regulatory bodies to whom governments have delegated regulatory powers.Regulations fall into three categories:

1. ***Economic regulations*** intervene directly in market decisions such as pricing, competition, market entry, or exit. Reform aims to increase economic efficiency by reducing barriers to competition and innovation, often through deregulation and use of efficiency-promoting regulation, and by improving regulatory frameworks for market functioning and prudential oversight.
2. ***Social regulations*** protect public interests such as health, safety, the environment, and social cohesion. The economic effects of social regulations may be secondary concerns or even unexpected, but can be substantial.Reform aims to verify that regulation is needed, and to design regulatory and other instruments, such as market incentives and goal-based approaches, that are more flexible, simpler, and more effective at lower cost.
3. ***Administrative regulations*** are paperwork and administrative formalities – so-called "red tape" – through which governments collect information and intervene in individual economic decisions. They can have substantial impacts on private sector performance. Reform aims at eliminating those no longer needed, streamlining and simplifying those that are needed, and improving the transparency of application.

Regulatory reform is used in the OECD work to refer to changes that improve regulatory quality, that is, enhance the performance, cost-effectiveness, or legal quality of regulations and related government formalities. Reform can mean revision of a single regulation, the scrapping and rebuilding of an entire regulatory regime and its institutions, or improvement of processes for making regulations and managing reform. Deregulation is a subset of regulatory reform and refers to complete or partial elimination of regulation in a sector to improve economic performance.

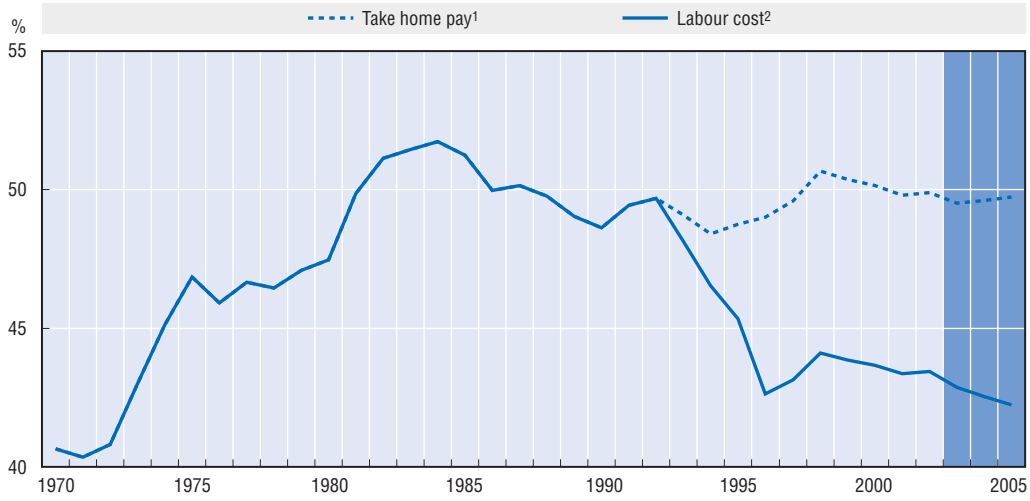
Source: OECD (1997), *The OECD Report on Regulatory Reform*, Paris.

employment among older workers and rising unemployment. Over the past two decades the government has sought to address these issues by reducing the cost to firms of inexperienced and often unskilled workers (Figure 1.6); by expanding opportunities for part-time work; and by working to improve the school-to-work transition through the expansion of apprenticeship programmes. The recent pension reform takes some steps to reduce the incentives for older workers to retire early.

Youth unemployment: reasonably successful but expensive efforts to create job opportunities

While the 1990s saw a reversal in the trend decline in youth employment rates, the current rate remains low. Policies that sought to reduce labour costs of low-skilled workers and the expansion of programmes to facilitate hiring them for short-term contracts were partly responsible for this improvement. Cuts in social security charges were started in 1993, reducing the labour cost of low-wage earners without affecting the politically

Figure 1.6. **Relative labour cost and take-home pay at the SMIC**



1. After tax earnings of a person earning the SMIC as a per cent of the after tax earnings of an APW;
2. Labour cost including social charges of hiring a worker at the SMIC as a per cent of the same costs for an APW.

Source: OECD calculations using INSEE data.

sensitive minimum wage. While expensive for the public purse (the cost in 2002 was estimated at approximately 1% of GDP), these changes permitted youth and other less skilled workers to price themselves more easily into the labour market. As a result, the employment rates for these workers increased. Overall the cuts introduced between 1993 and 1997 are estimated to have increased employment by 250 000 to 500 000 during the 1990s. While further cuts to social charges have been introduced since 1997, these were to compensate for the additional costs imposed on firms by the introduction of the 35 hour work week and consequent increases in the minimum wage. These reductions are not therefore expected to have an important impact on employment.

In this respect, efforts over the past ten years to remove the impediments to the use of interim and fixed-term contracts have helped to improve the functioning of the labour market for young market. These types of contract allow the workers concerned to try out different occupations and firms while at the same time allowing the latter to assess whether a potential employee is properly suited to a given job. In fact, such contracts account for 75% of total youth employment and, according to official estimates, serve as a stepping stone to a permanent contract in 25 to 33% of cases.

Older workers: efforts to cut back on early retirement, with very limited results so far

Much of the decline in older worker employment levels between 1970 and 1985 reflected conscious public policies to encourage early labour market withdrawal, either through explicit government-financed early retirement programmes or through extended unemployment insurance mechanisms put in place by the social partners. These policies were based on the erroneous assumption that removing older workers from the labour force would free up space for younger workers and they are now largely being put into reverse. Since 1985 the government has sought to eliminate some of its early retirement programmes and reduce access to others. The total number of individuals on such programmes declined from 700 000 in 1985 to 500 000 in 1990 and since then has remained

stable. Even so, more workers in the 55-60 age group are withdrawing permanently from the labour force with the help of mechanisms financed by UNEDIC (unemployment insurance scheme) than under government early retirement programmes. The political challenge involves doing away with these programmes as a source of erosion of employment, while at the same time keeping supplementary benefits for workers who are genuinely unemployed.

Low employment rates for older workers also reflect strong financial disincentives to continue working once they qualify for a pension. The recent pension reform took some steps to partially address this. But the changes have yet to come into effect, and have had little impact so far on employment levels among older workers.

Working hours rigidities: important steps have been taken but the effects of the 35 hour working week are still unclear

A number of steps have been taken to reduce rigidities in working hours. The increase in youth employment during the 1990s can be partly put down to growth in part-time employment, often in the form of fixed-term and interim contracts, which had been encouraged in the latter half of the 1990s through reductions in specific charges. Such contracts accounted for most of the net employment creation observed since 1990. While the 35 hour work week legislation introduced a further constraint on working hours, it was accompanied by measures designed to allow firms to annualise working hours (that is, to use an annual basis for calculating the number of hours worked over the year). It is still unclear how far the scope for annualisation has reduced rigidities. Early evidence suggests that firms have been able to cut back on overtime, which suggests that they are now better able to adapt production levels to fluctuations in demand. The relaxation of some of the more rigid elements of the 35 hour work week legislation has made it possible to mitigate some of the more pernicious effects of this system by limiting induced rigidities. Box 1.2 presents an initial brief estimate of the potential impact of this legislation.

The positive changes in the labour market stimulated by reforms must, however, be set against the fact that the overall performance in terms of employment, and particularly the actual labour force participation rate, remains poor. As discussed later, further reforms are needed.

Product market reforms: the privatisation programme continues

The 1980s privatisation programme, which reduced the State's role in the business sector (some 2 000 firms were privatised, or their State ownership was reduced to less than half) is continuing. The role of the State in the economy continues to diminish with the sale of the State's remaining 10% holding in *Crédit Lyonnais*, a further sale of *Renault* and *Air France* shares, the sale of *Thomson Multimedia*, and the opening to private investors of the capital of *Autoroutes du Sud*. Plans are underway to further reduce the State's shareholdings in some network industries, and to prepare the ground for privatisation in others.

Privatisation offers benefits to firms. Generally, and especially in periods of budget restraint, privatised firms have easier access to capital than State-owned firms. The government's recent decisions to allow its share of *France Télécom* to go below 50%, and to further dilute its holdings in *Air France*, were motivated at least in part by a desire to allow the companies access to international savings. This had previously been denied to them, and in the case of *France Télécom*, it created a serious debt problem.

Box 1.2. **Evaluating the potential impact of 35 hour work week legislation**

Evaluating the impact of the 35-hour working week is complicated because the reform is recent and also because it did not consist solely in a reduction in statutory working hours but was made of several separate initiatives, each of which could affect employment.

These include:

- The reduction in statutory working hours.
- The associated reduction in social charges.
- The purely Keynesian demand component of these tax reductions.
- The attenuation of rigidities in the organisation of working time (*e.g.* annualisation).

There are few detailed quantitative studies available at present that seek to isolate the impact and influence of each of these effects by also taking account of the additional complications introduced by the fact that the policy was introduced during a Europe-wide cyclical upswing. Nevertheless, a consensus of sorts has emerged concerning the short-term effects of the policy:

- Initial expectations for the reform were greatly exaggerated. According to the DARES, somewhere between 150 000 and 350 000 new jobs can be attributed to the programme between 1997 and 2001. However, there is no guarantee that the new jobs created will be lasting.
- Firms that adopted the new work norm first – mainly large and heavily unionised firms – were those that benefited most from the various incentives offered, while those that remained on the previous norm (39 hours) – mainly smaller firms – would have been most penalised – making extrapolations from those that did change very difficult.
- The move to a shorter work week during a strong cyclical upturn helped increase the speed at which cyclical unemployment was reabsorbed but also increased labour market tensions and contributed to production bottlenecks, although only temporarily.
- For the moment, the impact of the reform on the long-term structural rate of unemployment is uncertain and there is no evidence that the latter has fallen.
- In contrast to the reduction of social charges prior to 1997 which helped to raise employment levels, those introduced with the 35 hour work week served to offset the additional costs associated with higher hourly earnings.

Network industry liberalisation: important developments

Reform has progressed in some key network sectors

Network industries play a key role in the costs and efficiency of other sectors, as well as making a major direct contribution in their own right to GDP. Efficient, good quality telecommunications, energy and other services are important for the competitiveness and economic performance of other sectors, and consumers gain from the significant price reductions that generally accompany liberalisation. This section reviews developments in three sectors which have experienced significant reforms – telecommunications, civil aviation and electricity. Other sectors which have experienced very little change are reviewed later.

Structural and regulatory reforms leading to competition have progressed in these sectors, usually promoted by EU legislation. This has involved both some capital-opening and a reshaping of the regulatory framework to encourage competition, not least access to the

networks or essential facilities which are still owned by the historic incumbents. In telecommunications and civil aviation, privatisation (progressive, as the State retains a significant share of the incumbents' capital) has been an important development. Competition, sometimes strong, has emerged in all three sectors. Performance has also improved, for example with lower prices and a wider range of better quality services. Developments, however, have been uneven across the three sectors, and also within them.

Telecommunications: substantial progress and an improved performance though France Télécom remains largely dominant

Liberalisation started in 1996 with the implementation of EU directives which promoted strong market opening. An independent regulator (*ART* – see Box 1.3 below) was set up at the same time. Prices for still-regulated services and for universal services are proposed by *ART* and approved by the Minister. The final decision in most areas (drafting legislation, awarding licences, tariffs, universal service) lies with the Minister, with the *ART* acting in an advisory role by issuing opinions that are then made public. However, the decisions taken by the *ART* are usually endorsed by the Minister. The new draft legislation will strengthen the powers of the *ART*, which will be able to determine which operators dominate these markets and the obligations that will be imposed on them. *France Télécom* has been progressively privatised since 1997: the State retains 58.9% of the shares, but there is legal scope for this to be further reduced to less than 50%.

Competition has developed, although unevenly. The sector remains dominated by the historical operator (see Chapter 6) whose market share in June 2003, calculated on the basis of revenue, amounted to 77.8% of local call services, 63.3% long-distance call services and 49.7% of mobile telephony services. Furthermore, the unbundling of the local loop, as in other OECD countries, has been resisted by the historical operator in order to gain an advantage in the DSL market. The cost of fixed-line telephony services remains reasonable in France, with costs slightly below the OECD average in both residential and business baskets. In contrast, the number of mobile telephony subscribers is below the OECD as well as the European average, although the percentage of pre-paid mobile telephony services is also lower. The prices of long-distance and international services, where new entrants have been very successful, have fallen substantially and among the lowest in the OECD area.[2] Mobile telephony tariffs are relatively cheap for medium and large-scale users. In contrast, the rate of Internet penetration, according to 2002 data, remained below, particularly in the area of high-speed services, the average in both the OECD area and Europe. However, the latter market is currently developing extremely rapidly in many countries.

Civil aviation: important changes, but the State remains very engaged and internal competition is weak

Liberalisation in this sector also closely tracks EU requirements and the development of a single EU market. Since 1997 all EU airlines have legal access to all internal routes, domestic and international, across the EU. Prices may be set freely, subject only to an *ex ante* monitoring by the competition authorities. Outside the EU area, liberalisation of the air transport sector has primarily been pursued within the framework of the ICAO which has made it the central theme of the 5th Air Transport Conference held in Montreal in spring 2003. In addition, it is worth noting that in the case of the United States the EU Council of Ministers has given the Commission a mandate to negotiate a liberalised

Box 1.3. **Independent regulators in France**

The term "independent regulator" in France refers to "*Autorité Administrative Indépendante*" (*AAI*). These are created by law, and their existence may be formally confirmed by the *Conseil Constitutionnel*. *AAI*s share three common criteria. Their independence flows from the fact that they are not directly accountable to the government, which cannot retract their mandate. They must have certain powers and cannot just be consultative. These powers may include rule-making (*réglementation,* the development of rules)as well as the application of rules *(régulation)*, authorisations (for example the issue of licences), the enforcement of rules and the application of sanctions for non-compliance. Finally, they are part of the administration, that is, they do not normally have a separate legal identity (though the new Financial Markets Authority has a "*personnalité morale*").

*AAI*s are both part of, and are influencing, the important changes which are taking place in the French legal framework and administrative traditions, discussed below. Part of the activity of the sectoral regulators is under the jurisdiction of private rather than public law, which is handled by the *Cour d'Appel de Paris* (and ultimately the *Cour de Cassation*), rather than the *Conseil D'État*. The fact that they are not directly accountable to the government is an important break with administrative tradition, which normally subordinates all administrative entities with delegated public authority to ministers.

*AAI*s have been established across a range of sectors. Though their development may appear to be *ad hoc,* two major influences have been at work. *AAI*s were developed in the first place to answer a need in the area of civil liberties and administrative transparency. This led to the creation of the *Commission Nationale Informatique et Liberté* (CNIL), and the *Commission d'Accès aux Documents Administratifs* (CADA) in the late 1980s. The EU-driven liberalisation of network sectors gave *AAI*s a further impetus, with the establishment of the *Autorité de Régulation des Télécommunications* (*ART*) and of the *Commission de Régulation de l'Énergie* (*CRE*). There are some 25 to 35 *AAI*s today, covering a wide range of sectors including audiovisual, competition (the *Conseil* is an *AAI*), the network industries and financial markets.

The economic regulators have generally been given a very broad regulatory scope, which includes powers of investigation, licence oversight, and sanctions. Their rule-making powers, by contrast, and as might be expected (since regulators' main role is not to make the rules but to enforce them) remain circumscribed, following decisions taken by the *Conseil Constitutionnel*. They may propose new rules, but the relevant minister is responsible for confirming these. Most have a collegial governing body overseen by a president, all of whom are appointed by the *Conseil des ministres* for a fixed term (which may in some cases be renewed). There are rules to secure their independence from political and other "capture" (for example they cannot be dismissed for political reasons). Their decisions are published in the Official Journal, and the main regulators run extensive, informative, and largely multilingual Web sites.

"open-skies agreement" between the EU and the US to replace the current bilateral agreements with member States including that between France and the US.

The main benefits have been in international traffic. The major European and non-European airlines have increased their flights to and from France, and the incumbent, *Air France*, has had to squeeze its prices. Low-cost airlines have entered the market. Prices on the routes they operate have fallen substantially, sometimes by over a half. Their market share, despite growing strongly in 2001 and 2002, remains low at 5% of passenger traffic in

2002. Meanwhile *Air France* has shown a capacity to adapt too: it has seized the opportunities of competition by growing its activities and market share. The continued privatisation of *Air France* is on track: the State's shareholding (currently 54.4%) is due to be reduced to less than 20%. Competition is developing in airport management, which may be underpinned by the development of competitive tenders for concessions to run the airports. The decentralisation of airport management to the *collectivités locales* is underway too. The sell-off of shares in *ADP* (Paris airport management, currently 100% State-owned) is on the agenda.

This is an impressive field of action, but there are weaknesses, especially as regards the allocation of airport take-off and landing slots, without which competitors to the incumbents cannot offer services even if the market is technically open. The carrier *Air France* remains dominant. In 2002 it was the third largest airline in the world, and the second in Europe. This carrier benefits from a favourable European regulatory framework which protects it, not least in the allocation of airport slots as is the case for all the carriers in place in Europe. The airport network is very dense, State-owned, and managed by public entities. Public aid is also an issue. *Air France*'s good recent financial performance has partly been helped by significant State aid: recapitalisation in the 1990s, then aid following the 11 September attack. However, *Air France*'s efficiency can be improved in certain areas: it has one of the highest staff-revenue ratios among the large airlines (agreements to promote staff rationalisation are being taken forward) and labour productivity is weaker than that of several large EU competitors. Also, prices have remained high in the domestic market (apart from the relatively few routes subject to competition).

The traditional close association of *service public* (see Box 1.11 later)with civil aviation makes further reform complicated. The main civil aviation activities are subject to government prerogatives regarding "*missions de service public*" in view of the need to achieve balanced regional development and safety objectives. This means that although air transport is subject to competition rules, the competition law process is counterbalanced by considerations relating to public service objectives (see the discussion on competition policy below). Merger decisions are with the Finance Minister so the *Conseil de la Concurrence* has not asked to rule on recent concentration operations, for example *Air France*'s buy-out of small regional companies.

Electricity: a slow start to reform, but further developments are in prospect

Here too liberalisation has been led by the EU. The latest (2003) directive provides for full market opening (all consumers will be able to choose their supplier by July 2007, a freedom currently restricted in France to large users). An independent regulator (*CRE* – see Box 1.3 below) was set up in 2000 to oversee the market and especially, regulated third party access to the network. *CRE* proposes network usage charges. Tariffs for captive clients are proposed by the *CRE* and set under Orders issued by the Ministry of the Economy and Finance. Significant changes have already taken place in this very traditional market. Since 2000 EDF has lost a quarter of its French market share (not least, to foreign companies); this has been facilitated by reasonably low network charges, and an important minority of eligible consumers have switched supplier. This has led to substantial price cuts for these clients.

These developments reflect a gradual opening of the sector to competition in that all the institutional impediments to opening the market have been removed. EDF remains 100% State-owned and certainly still remains by far the dominant company. While generation remains highly concentrated (a single company, EDF represents almost 91% of

generating capacity), several advances are worth noting: the partnership between *Suez* and the *Compagnie nationale du Rhône;* the share acquired by *Endesa* in the capital of *SNET*; and above all the auctioning-off by EDF of generating capacity (a total of 6 000 MW). This progress is in addition to a high capacity for energy imports which allows foreign operators to export power to France. Unbundling of the network from competitive activities is so far through accounting and management separation (rather than stronger structural separation or even divestiture) with the creation of *RTE (Réseau de Transport d'Électricité)*, a business unit of EDF. *RTE* has issued a call for bids for the purchase of its losses and has retained over ten or so suppliers. France argued in Brussels that the deadline for full market opening should be extended. In 2002, it was estimated that 30% of the French market had been opened. At that time, five European countries had already fully opened their markets. The share of the French market that had been opened rose to 37% in 2003. Unbundling of the network has been stronger in many other countries. Electricity prices for captive clients remain lower than the EU average, but this reflects power generation costs based on the marginal cost of nuclear power production (which accounts for nearly 80% of generation): capital costs have been amortised.

Further plans are, however, on the table. Privatisation is a longer term possibility, even though commitments in form of pension liabilities (estimated at some EUR 52 billion) and nuclear decommissioning liabilities (which according to some estimates will amount to EUR 26 billion), together with EDF's current financial position (revenues of EUR 48.4 billion compared with EUR 25.89 billion), may present obstacles along the way. Draft legislation is currently being prepared to modify the legal status of *Électricité de France* and turn it into a joint stock company whose capital could be opened. This draft legislation has not yet been brought before Parliament

Independent regulators: institutions that modify the institutional edifice and that also promote transparency and market competition

Independent regulators – part of the institutional apparatus of a modern "regulatory State" – have been implanted into the French institutional landscape over the last decade or so (Box 1.3).

The development of these regulators has contributed to a better quality of regulation in important sectors of the French economy, as well as promoting transparency and individual citizens' rights in a culture which has traditionally given priority to the perspective of the administration as guardian and promoter of the collective public interest. The independence of the economic regulators plays a key role: protecting markets from inappropriate political intervention and enabling a long term perspective to be taken of market development.

French regulators appear to have earned considerable respect in the international regulatory community for their integrity, over a short time. But they should be formally accountable for their actions, and this needs serious attention. They are entities with significant powers (often combining the usually separate executive and judiciary functions). They are part of the executive but do not report to ministers. And as yet, evaluation of their efficiency remains piecemeal, despite efforts by the *Cour des Comptes* (national audit office).

French regulators are also, inevitably, constrained in their field of action by the extent (often limited in the network industries) to which the government has allowed market

opening. Yet they have been able to do some useful work to promote the conditions for more effective competition. For example, the *CRE* has been developing a very necessary framework (in the absence of structural separation) for the allocation of costs between electricity generation and transmission.

The recent rationalisation of financial sector regulation under one authority was a necessary response to the links between different financial activities, echoed in other OECD countries, though insurance remains separate. There is scope for further rationalisation elsewhere. For example five regulators cover the audiovisual sector.

Competition policy: after a modest start, has made important and steady progress to become an important element of decision making in the economy

After the war, the role of competition policy in France initially remained fairly limited in that French administrative law restricted the scope of application of competition law to price control. In the later 1970s price controls were reduced and the framework for competition law strengthened. The mid-1980s marked a turning point. A consensus was reached to promote competition and curtail price controls. A stronger competition law framework was devised, in which the *Commission de la Concurrence* was upgraded to become the *Conseil de la Concurrence* (with powers to initiate proceedings, issue orders, and impose fines). It was at this time that the main competition provisions of the EU Treaty of Rome (covering restrictive agreements and dominant firms) were adopted. In 2001 the competition law was comprehensively restated and codified. There are some significant differences between the French and EU law. Notably, because the criteria for exemption of restrictive agreements apply directly the French competition processes are well suited to the EU Commission's new approach of decentralised *ex post* enforcement through national institutions.

France is now equipped with a reasonably effective and comprehensive system for the promotion of competition policy. It includes many of the features of other well-functioning competition systems around the OECD. The provisions for abuse of dominance are strong, sanctions and criminal penalties are in line with the European norm, and a leniency programme has been set up. The approach to market definition is up-to-date, European and even global markets being taken as the benchmark where necessary. Within France, the *Conseil* has served as a model for the establishment of other independent decision-making agencies in France, and works well with the independent sectoral agencies, developing a consistent approach to shared issues. Transparency is good. The decisions and official documents (basic legislation, decisions of the competition institutions and the courts, press notices, annual reports) of both the *Conseil de la concurrence* and the other main competition institution, the Directorate for Competition and Consumer Affairs (DGCCF) which is part of the Ministry of Economy, Finance and Industry, are publicly accessible on their Web sites. The *Conseil de la concurrence* has a good record of resisting legal challenges to its decisions, which promotes stability: some 80% of its decisions are confirmed by the courts.

The *Conseil de la concurrence* has consolidated its position across a number of fronts. It has scored a notable success against a "non-aggression" pact by banks. They were found to have agreed not to offer to renegotiate mortgages, except for their own customers, and a substantial fine was imposed, several times larger than previous fines (though in line with fines levied by other OECD jurisdictions in equivalent cases). This was a tough case, hard to prove and difficult to take forward in a context of earlier regulatory tolerance of such

habits, and a lack of full appreciation of the harm that such agreements can cause. The *Conseil*'s most important battlefield, however, is the application of competition law principles to those parts of the economy – which are very significant – linked to public services. It has been a major player in the evolution of legal changes which are increasing the scope of competition policy in the economy.

The legal system: an important evolution is taking place, which echoes the growing freedom of the economy and of previously sheltered public services

Recent years have seen major developments in the workings of the French legal system (Box 1.4), with important repercussions on the management of the economy and society. The change, in brief, is that the traditional distinction between administrative and private law in regulating the economy and society has become blurred. This development was initially prompted by the need to adjust to EU laws and policies which were difficult to reconcile with the traditional French view of the State's role in overseeing the economy and especially, public services. The privatisations of the 1980s and 1990s also changed the situation by removing a large number of companies out of the direct ambit of State control. However key French institutions, notably the *Conseil d'État* (see Box 1.4 below) as well as the *Conseil* and the new sectoral regulators for telecommunications and energy, started to take the initiative too.

The boundaries between administrative and private law are becoming blurred: administrative law now recognises and may act on principles of competition

The blurring of the boundary between administrative and private law is an important development. This boundary has in the past ring – fenced actions and functions related to the exercise of public authority. Today the principles of private law are increasingly applied to administrative decisions.

In 1989, separation of the two branches of the law was still being formally underlined: the *Tribunal des Conflits* (which determines which branch of the law should be applied in uncertain cases) ruled that administrative judges could not apply competition law, and that the *Conseil* could not apply competition law to public services. But in 1996 the *Conseil d'État* annulled a decree on the grounds that it necessarily created a dominant position (following a principle of EU competition law). And in 1997, the *Conseil d'État* overturned the 1989 position by referring to general legal principles, and by incorporating the competition dimension into those principles, with regard to abuse of a dominant position in a ruling it gave on the terms of a public contract. This marked a turning point, as from then on the exercise of public authority could be tested against the principle of competition. The *Conseil d'État* has since stated that "competition is a component of the public interest which needs to be supported by the public authorities". And in 1999 for the first time, it asked the *Conseil* for a view on one of its decisions. Consultations between the two bodies are now commonplace in relation to competition issues arising in public services. The *Conseil d'État* takes a strong interest today in potential abuses by public entities and private firms performing public service missions.

Administrative law has therefore started to integrate competition principles in its decisions, and private law is increasingly involved in administrative decisions. However the situation is complicated. This is partly because of a complicated competition law relationship with public services. The relationships between private parties and the administration which relate to functions performed under a public law regime fall within

Box 1.4. **The French legal system and the *Conseil d'État***

The French legal system is based on written Roman law and is made up of two, traditionally distinct, branches: public (administrative) law (*droit public*) and private law (*droit privé*).

Public law supports the traditional French concept of the State, which exercises authority (*puissance publique*) over the economy and society in the public interest, and is the guarantor of basic freedoms and as the promoter of national solidarity. Public law thus developed as the vehicle for asserting public authority over those aspects of the French economy and society which were considered especially relevant to the promotion of the public interest – not least of which has been "*service public*" (see Box 1.11 below). Public law covers all administrative decisions which are taken to support State actions. Private law covers what is left over, *i.e.* private conduct. The practical effect has been to give public law a very wide-ranging field of competence, extending deeply into issues affecting the economy as well as social affairs. Key principles of private law, notably competition principles (the competition law is part of *droit privé*) do not traditionally have to be taken into account in the field of actions covered by public law.

The *Conseil d'État* is the supreme jurisdictional authority for public law. It also has a central role in the legislative process and exerts a pervasive influence over the affairs of the State. It was set up in 1799 and performs a number of important functions. The first relates to the legislative and regulatory process. It must be consulted on all draft laws and many decrees (see Part two, Chapter 2 for a definition of French legal instruments). These are checked for legal quality and consistency, as well as for their appropriateness in the administrative context. Though the government does not have to follow the advice of the *Conseil d'État* it can only adopt either the original text or the text proposed by the *Conseil,* and the risk of legal challenge is high if it ignores the *Conseil* advice, as the *Conseil* is also the legal appeal body where decrees and administrative actions can be challenged. The *Conseil* must also be consulted on all draft EU laws, in terms of how these should be transposed into the French legal/regulatory structure. It draws up a public annual report addressed to the President of the Republic which sets out suggested reforms to the legal/regulatory and administrative systems.

The *Conseil d'État* has a much broader influence, extending beyond its specific legal duties. It is the highest legal instance for litigation concerning public officials and the performance of public service functions which flow from the exercise of *puissance publique*. It is therefore of central importance in shaping the role of the State and the public administration. It is often consulted by the government, and often represented on official bodies. Many of its members serve on key central government bodies (ministries, the Prime Minister's office, etc.).

It should also be noted that the *Conseil d'État* has a role in merger control under the competition law (which is interesting in the context of an otherwise powerful historic separation of competition principles from public law). This flows from the fact that decisions about mergers are prepared by the DGCCRF and taken by the Minister of Economic Affairs, Finance and Industry, which are within the administrative law jurisdiction of the *Conseil d'État*. Merger decisions may be either initially or ultimately appealed to the *Conseil d'État*.

the competence of administrative law and therefore the *Conseil d'État*. However, French competition law applies to the production, distribution and service activities of public entities. It is not the nature of the entity but that of the act which determines whether competition law is applicable. The law on competition and the implementing mechanism therefore do not apply to the provision of public services under the authority of the State. Acts of this nature fall solely within the competence of administrative tribunals. The practical application of these principles has often been uncertain and contentious. Which branch of the law will be applied? For example challenges to the decisions of sectoral regulators can be caught between the two systems: that part of a decision clearly related to market conduct and competitive effects may be processed by the private law courts, whilst other parts (for example administrative sanctions) go to the administrative judges. Also, public entities may now seek protection in the administrative jurisdiction on competition matters because (unlike the *Conseil de la Concurrence*) it does not have the power to exact financial sanctions. This may undermine the effectiveness of competition policy.

However the notion that public authority should have primacy over competition remains strong

France still accords a certain primacy to the notion of public power. There is therefore some reluctance to apply the solution of complete structural separation to the firms in place in network industries, that is to say a separation of competitive and non-competitive activities. This solution is designed to remove the incentive and capacity to distort competition through cross-subsidies. Instead, France prefers to exercise controls of a behavioural nature over historical monopolies in the infrastructure. This choice reflects the importance France attaches to other aspects of public service. Public entities occupying dominant positions in markets are authorised to enter into other competitive markets provided that they comply with the law on abuse of a dominant position. This means that competition law is used as a regulatory instrument to control their prices and supply of products so that their financing costs remain low. Their image or other attributes deriving from their missions and status as providers of public service give them no advantages over private enterprises in terms of commercial competition in the market. Nevertheless, in the power generating sector, the transmission grid will be operated by a legal entity independent of EDF by as early as 1 July 2004, in accordance with the European directive. Even before this date, however, the managerial independence of *RTE* within EDF has been recognised by all actors in the power generating sector.

Competition policy has had to adjust to this situation in which the firms in place are still in a position to discriminate against their competitors, in either original or new markets. The main preoccupation in relation to public services has therefore been the effects of cross-subsidy by entities which have not been structurally separated. France endeavours to prevent former monopolies from using their advantages via pricing or product strategies (such as predatory pricing based on cross-subsidy, or playing on the recognition of their name) to enter new markets, through application of the abuse of dominance provisions of the competition law. The *Conseil de la Concurrence* has sought to establish a definition of what would be considered abuse of dominance by public service operators in new markets. This underlines that any profits used to facilitate such market entry must not be the profits that are supposed to support performance of the public service obligation.

Box 1.5. **The decentralised French State**

The structure of sub-national government

France has three levels of local government, generically known as the "*collectivités locales*". There are 36 700 communes, 100 departments (of which four overseas), and 26 regions. However, the different levels do not have any authority vis-à-vis one another. The *collectivités locales* each have a directly elected (universal suffrage) assembly. This elects an executive to which it delegates some of its powers.

Local authorities' areas of competence

The decentralisation of competences mostly took place through several laws adopted in the early 1980s, which appreciably extended their earlier competences. The communes have responsibilities *inter alia* covering the administrative police and local security as well as the management of "*état civil*" issues such as registration of births (these predate the reforms), primary schools, local road maintenance, and the management of local public services (which can range very broadly to include network services such as electricity and water), as well as local land use planning and some social services. The *départements* have responsibilities *inter alia* for local road maintenance, secondary schools (colleges), certain health and social services, as well as culture and tourism issues, and they may also offer aid to enterprises. The regions have responsibilities *inter alia* for regional development and infrastructure strategy (*aménagement du territoire*), secondary education (*lycées*), and some aspects of professional training, as well as some economic aid schemes (*e.g.* job subsidies, loan guarantees).

Central State authority

It should be underlined that the State (central government), which has decentralised these competences, retains a general prerogative of control. Also, laws put forward by the executive and voted by Parliament may modify, add or withdraw decentralised competences, even if the Constitution recognizes at present that France is a decentralised Republic. It also exercises significant influence over some aspects of the judiciary process. This may be contrasted with the situation in federal countries where sub-national governments may exercise more permanent powers which cannot be changed by the central government without their consent. In short, French decentralisation, notwithstanding far-reaching changes, has not fundamentally put into question the concept of the unitary state.

Follow-up and oversight by the central State

The exercise of decentralised competences also remain subject to *ex post* legality checks. The *préfet*, representative of the State, monitors legality and generally co-ordinates the relationship between the State and the *collectivités* locales. The latter's decisions are only enforceable after transmission to the *préfet*. The latter cannot annul or change the decisions, but may subject them to review by the administrative tribunal which itself can annul them. Certain contractual decisions (*e.g.* relating to public procurement) can be suspended as a matter of urgency if they are found in breach of the competition law. *Ex post* budgetary controls are also applied by regional courts of auditors. These controls have a mainly technical focus (legality, proper application of the procedures).

Deconcentration

Alongside the process of decentralisation, a parallel process of "*déconcentration*" was initiated in 1992. Some of the powers retained by the State have been delegated to local State representatives, co-ordinated by the *préfet* and others such as the heads of the educational administrative regions: they exercise these State powers at a sub-national level whilst remaining subservient to the central authorities. The guiding principle for identifying what should be deconcentrated is subsidiarity. Deconcentration also importantly offers the *collectivités locales* State interlocutors in respect of deconcentrated State services.

Box 1.5. **The decentralised French State** *(cont.)*

Co-ordination

Various co-ordination mechanisms exist to manage the relationship between the different layers of government. "*Contrats de plan*" have been established between the State and the regions. Some of these have specific aims such as the management of *services publics* in rural areas with a low population density. Agreements have also been set up to manage shared projects. Intercommunal groups (*syndicats intercommunaux*) have existed since the 1930s for the shared management of public services such as water or refuse collection. 1990s legislation sought to address the problems generated by the small size of many communes. The closer integration of adjoining areas into *pays*, *territoires*, *communautés d'agglomération* to promote a common purpose has been encouraged, as well as stronger intercommunal co-operation.

Decentralisation: a far-reaching reform

France was – and remains – a unitary State, with a tradition of centralised government. This background is important in order to appreciate the significance and implications of the reforms started some twenty years ago, to decentralise central State powers to sub-national levels of government (the *collectivités locales,* or *collectivités territoriales* following the 2003 constitutional reform). Starting with the formal creation of the regions in 1964, the process of change moved into gear in the early 1980s when certain competences of the State were decentralised to the *collectivités locales*, giving the local executives of the newly elected local assemblies significant decision-making powers as well as increased autonomy in the preparation of budgets. Box 1.5 sets out the current arrangements.

Decentralisation was motivated by a need to modernise the institutional apparatus in order to release local initiative in the management of the economy and society, and to bring government closer to the citizen. The OECD recommendations on regulatory quality underline the importance of identifying and deploying appropriate levels of government in carrying through policies and regulations. This is important both for the efficiency of the economy, and the effectiveness of government action.

That said, decentralisation is a complex process that has also created other types of problem, notably in terms of clarifying how decentralised areas of competence are to be shared.

Reform of the administration: a process that started over twenty years ago, has covered a wide field of action, and continues today

A better relationship with users

Awareness of the need for reform of the administration started in the 1970s and gathered momentum in the 1980s. How should the State's role and in particular, its relationships with the economy and society, be modernised? The first phase started by emphasising the importance of greater transparency with users of the administration and a better awareness of their needs. The French tradition has tended to focus on the internal workings of the administration more than its impact on users, so this was an important development. France recognized that a modern State needed a stronger relationship with its users and the administration needed to be more approachable; that it needed to

abandon the secrecy and opacity that characterised administrative acts, and that arrangements to deal with excessively complex or inappropriate administrative acts should be put in place.

The French ombudsman (*Médiateur de la République*) was created in 1973 to offer an easily accessible means of redress against such acts. This was followed by laws in 1978 and 1979 to improve access to administrative documents and to ensure that administrative acts were properly justified (Box 1.6).

Box 1.6. **Improving the State-citizen relationship**

Two laws (1978 and 1979) significantly improved access to administrative documents and generally improved relations between citizens and the State. The 1978 law put an end to a long tradition of secrecy and created an independent authority, the *Commission d'accès aux documents administratifs* (CADA), to facilitate transparency. The law states that all non-personal administrative documents issued by the State, regional authorities and various public bodies must be accessible, with some exceptions (including papers related to national defence or secret government discussions). The CADA oversees the application of the law by issuing recommendations when it is approached by a member of the public. It can propose legislative and regulatory amendments. Any refusal to communicate papers must be substantiated in writing and the appeal decision must be taken in less than six months. The annual number of recommendations made by the CADA has gone from less than 500 a year after it was set up to nearly 3 000 a year, half being favourable.

The 1979 law, amended in January 1986, requires the government to substantiate any individual administrative decisions that reduce public liberties, impose a sanction, repeal rights, or refuse permission or an advantage provided by the law. These decisions can only be taken when the interested party has been able to present their written and oral observations (April 2000 law). The notification of decisions must be accompanied by an indication that appeal procedures are available. Replies must note the possibility of appeal as well as the existence of a rule that silence implies consent. Prime Minister's circulars dated January 1985 and February 1989 require the anonymity of officials to be lifted in their contacts with citizens, to personalise the relationship. This circular may not always be fully respected at present. But the requirement in future is for most written documents on everyday, social or tax matters to be signed personally.

These laws were supplemented by the April 2000 law on the rights of citizens in their relations with government departments (DCRA). It requires a department to send an acknowledgement of every request. This acknowledgement must indicate the time that must elapse before silence implies that the department has tacitly rejected or accepted a decision, as well as any appeal procedures. The period after which silence implies rejection is reduced from four to two months. Any department receiving a request in error must pass it on to the relevant department.

Administrative simplification

Efforts to tackle administrative simplification started in 1953. A number of initiatives were taken over the 1960s and 1970s, for example the *Centre pour l'Enregistrement des Formulaires Administratifs* (CERFA). 1983 saw the work gather momentum with the government campaign "*Administration Portes Ouvertes*" and the establishment of a commission for simplification, COSIFORM, but this proved a relative failure in practical terms. The government

relaunched the process in the mid-1990s with the *Commission pour la Simplification Administrative* (COSA), attached to the Prime Minister, which has made considerable headway with the elimination or simplification of forms. The work was extended to cover the administration beyond central government in 2000. 2003 has seen the launch of a further, wide-ranging programme (Box 1.7).

Box 1.7. **Administrative simplification reforms in 2003**

These cover six main areas:

1. Simplification of everyday administrative procedures (proxy votes, access to old-age pension benefits, etc.).
2. Modernisation of relations between government departments and citizens.
   - Reduction in the number of administrative advisory boards.
   - Reduction in departments' response time. Indication of application processing time.
   - Replacement of documentary evidence with declarations on trust, supplemented by *ex post* verification.
   - Exchange of information between government departments to reduce the production of supporting documents
   - Facilitating proof of possession of French nationality for citizens born abroad.
   - Arranging free access to administrative justice
   - Facilitating the creation of joint-owner associations by revising a law of 21 June 1865 and 27 July 1930.
3. Simplification of the organisation and management of the health system (modernisation of hospital management, simplifying access to health benefits of other EU members, devolution of powers to the regions).
4. Modernisation of public procurement (revival of private-public partnerships, with global contracts (design/completion/maintenance). Simplification of legislative measures relating to public works or supply contracts, to make them compatible with EU law.
5. Simplification of the law: six new codes, four of which are "non-established" law (monetary, financial, public ownership, defence, trades, artisans)
6. Simplification of the daily running of companies (creation of a "simplified single employment document", one-stop shop for certain professions, harmonisation of exemption from social security contributions, choice of membership fund for workers, either salaried or non-salaried, paying social security contributions).

A second simplification law under preparation, which covers all ministerial sectors, was made public in early 2004. It aims at facilitating users' access to public services and to simplify their use by simple measures. Access to Internet and the more widespread establishment of call centres capable of dealing with telephone enquiries will supplement the development of "public service centres". This will enable ministries to bring together a number of services for citizens. A smart card for daily life will also enable procedures to be simplified on a local level: use of day care centres, access to sports and cultural facilities, transport, public parking. The development of this smart card draws on France's established technological leadership in this area.

The work so far has yielded some important results. Some 2 600 forms existed in 1997. By 2003, 583 had been removed, and 1 123 were available online. The main target has been *ex post* efforts (that is, efforts made *after* the adoption of laws or regulations) to reduce the number of forms and simplify declarations. The law codification initiative launched in 1989 has proceeded in parallel. Carried out *ex post,* this work has its limits: a deeper reform requires *ex ante* efforts to promote simpler and better laws and regulations.

The needs of the business community were understood but the means of promoting them was sometimes less well handled. For example COSA was made up entirely of representatives from the administration, who could not be expected to have much insight into business problems. This has now been changed, as the new COSA, established in 2003, now includes representatives of civil society and business. Also one stop shops have been established for fiscal matters in the Ministry of Finance, with a special unit for the 24 000 largest firms. The same is planned for smaller firms by 2004. Measures have been taken to simplify starting up in business (such as the reduction of capital requirements to one symbolic euro).

The use of new communication technologies

The use of new communication technologies can be a powerful motor for the promotion of regulatory reform. As well as the real benefits which it can deliver, it can help to mitigate the difficulty of tackling fundamental reforms head-on and provide a means of progressing that may help overcome resistance to change (Box 1.8).

France has put considerable effort into rolling out e-government. According to a study by *Accenture*, France would be ranked 12th in the world, which is roughly on a level with the UK and Germany, better than Japan, but worse than the US. The problem is that the functionality of these services still requires further development and that in general France has suffered until recently from a delay in the provision of general access for the population to the Internet and in the use of high-speed connections, as mentioned earlier.

Information. Information and consultation on the web was the first to be developed. *Site Légifrance* allows legislative documents to be consulted, including draft laws, reports on them and the views of parliamentary commissions, as well as parliamentary debates (it would be even better if it covered lower level regulations too). The *Vie publique* Web site gives a broad access to government information and the latest news (for example it contains the first official report on summer 2003's public health problems). Specific Web sites can be very informative. For example the AFNOR Web site contains the inventory of national standards-making with proposed publication dates, and the relationship with EU and international standards.

Consultation. The Internet is increasingly used to promote upstream contacts and consultation between the administration and the general public. Internet fora have been established to collect views and to give the public a chance to react to projects or general political issues. "Notice and comment" procedures for consultation started in France through the Internet. Since 2001, every national public Internet site is supposed to have a debating forum on specific issues, as well as access to a portal which goes through to a list of other fora and consultation exercises as well as public documents and data. This is a good start, but the sites tend not to include arguments to help inform debate, nor an explanation of outcomes and of how comments were taken into account.

Box 1.8. **E-government: what it can do for better government**

The OECD defines e-government as the use of ICT (Information and Communication Technologies), and especially the Internet, as a tool to achieve better government. It enables better policy outcomes, higher quality services and greater engagement with citizens.

E-government can:

- *Improve efficiency*. It can enable efficiency improvements, both for government and for business. It can simplify public administration processing tasks and other operations, and promote collaboration within government. Greater sharing of information within government can generate savings on data collection and processing, provision of information to customers, and communication with them. At the same time it can help business efficiency and help reduce administrative burdens. A good example is customs procedures, where a number of OECD countries are rolling out e-based initiatives with the ultimate aim of eliminating paper-based procedures for customs declarations, saving traders valuable time and raising business as well as government productivity.
- *Improve services to the user.* Successful government services are built on an understanding of user needs: a user should not have to understand complex internal government structures and relationships. The Internet can help to provide a simpler or even single government window for users. This helps to improve the quality as well as efficiency of government services.
- *Improve communication and consultation*. The Internet provides a powerful means of communicating information to stakeholders, reaching out to the general public. Transparency is enhanced. Consultation on the development of new regulation may be facilitated, and the government has a new means of gathering valuable *ex ante* and *ex post* information on regulation, which can for example be fed into more effective Regulatory Impact Analysis (RIA).
- *Build trust between government and citizens*. It can do this by enabling citizen engagement in the policy process and promoting a greater understanding of important reforms. Citizens may be encouraged to think more constructively about difficult issues, because they are drawn into the debate.

E-government will not replace all the traditional ways (paper-based procedures will still be necessary). It also requires good leadership and careful handling, for example in respect of the "digital divide" (not everyone is yet connected to the Internet), technical vulnerability and privacy.

Administrative procedures. These have also been developed. The aim is to make access to administrative procedures easier and more transparent, as well as improve internal management. Internalising administrative complexities within the administration itself so that these do not affect users is the priority. The information Web sites and portals were the first stage. The second stage is the development of teleprocedures for administrative obligations. For example fiscal declarations can now be made on the Internet, without any prior obligation to produce justifying documents.

Managing change. E-government is being deployed to help manage change in difficult areas. The financial management reforms (the 2001 LOLF law) are an example. Part of this vast project is the development, by 2008, of a "single window" (*guichet unique*) for fiscal services. The aim is to merge the management of all fiscal services for taxpayers, from

fiscal declarations to tax payments. An interconnected electronic file, accessible to taxpayers, will cover all the necessary information for processing their fiscal affairs. As well as improving administrative efficiency, life should become much simpler for citizens too.

At the same time, there is awareness of the need for a stronger and more coherent strategy

The 1994 *Picq* report underlined the need for stronger, more coherent reform which tackled the roots, not just the effects, of problems such as administrative complexity. Managing the effects of a rapidly growing stock of rules was neither effective modernisation of the State, nor effective control of the direction the State should take in its relationship with the economy and society. Since then reform of the State has developed a greater coherence, centred on three fields of action. The first is regulatory quality: the 2001 *Mandelkern* report has made a number of proposals which pick up OECD recommendations. The second is financial management, with the 2001 organic law on State finances (LOLF). The third is to improve human resource management in the administration.

The financial management reforms should promote very significant changes over time, though major cultural changes will be needed in the French administration to implement these new rules. The 2001 LOLF law will become fully operational by 2006. It introduces the concepts of objective-setting and *ex post* evaluation of outcomes, within a new context which allows managers greater freedom in the handling of their budget allocations. Programme budgets become indicative, though subject to a ceiling for staff overheads, and rules to favour investment over staff expenditure. Tax and fiscal reforms are also included in the law, aimed at reducing the tax burden on citizens as well as firms.

Market openness: positive reforms for trade

The wide-ranging reforms that have changed the outlook for France's domestic stakeholders have also been generally positive for international trade and market openness. The efforts at administrative simplification (including the simplification of language) and the growing use of e-administration have been especially helpful. The OECD has identified six "efficient regulation principles" which are important for ensuring that domestic markets are open to international as well as domestic competition (Box 1.9).

These principles reflect the fundamental bases of the system of multilateral trade under which most countries accept certain obligations, notably in the WTO context. France has generally been successful in adopting these principles into its regulatory system. They are not expressly codified but efforts are generally made at giving them practical effect. There are many sources of information on regulations, including sector-specific ones. Some issues are particularly well handled. This is partly true as regards the management of international standards in relation to remaining national standards. Within the context of a system in which EU and international harmonisation set the scene, France encourages the use of flexible approaches to technical standards and conformity testing. Specific national standards are developed in France only in areas not covered by European standards. France has accepted the WTO code of practice on standard-setting and the French standard-setting body AFNOR is an active member of the ISO. A central organisation, SQUALPI, monitors the standards-making process to ensure it follows the rules and is the focal point for comments and consultations.

Problems remain, however. These tend to reflect the weaknesses in reform for the domestic market, discussed later. The continuing overall complexity of the regulatory

Box 1.9. **The six "efficient regulation principles"**

OECD trade policy makers have developed six "efficient regulation principles" that should be built into domestic regulations and administrative practices to ensure that they do not unnecessarily reduce the openness of the market to international competition. They are:

- *Non-discrimination*. This refers to equality of competitive opportunities between like products and services, irrespective of the country of origin.
- *Transparency and openness of decision making*. This is the ability of market participants – including foreign investors – to understand fully the regulatory environment in which they operate, and to be heard in regulatory decision making.
- *Avoidance of unnecessary trade restrictiveness*. Governments should use regulations that are no more trade restrictive than necessary to fulfil the objectives of the regulations.
- *Use of harmonised standards and measures*. To minimise the costs of compliance with multiple regulatory standards, domestic regulations should be based on internationally harmonised measures, or accept as equivalent foreign measures that meet the underlying regulatory objective.
- *Streamlining conformity assessment processes*. Governments should avoid duplicative conformity assessment requirements and use of alternative procedures, including mutual recognition of conformity assessment results or the supplier's declaration of conformity.
- *Application of competition principles*. Market access can be reduced by regulatory action condoning anti-competitive conduct or by failure to correct anti-competitive private actions.

structure, a level of State involvement in the economy that remains high and that can lead to discrimination, complex and sometimes opaque consultation procedures, the general absence of analysis of the regulatory impact of new rules, and the still uncertain application of competition principles across the economy are fields for further work, as much for the benefit of international as domestic stakeholders. In relation to trade in services, France maintains an approach limited to that adopted at the European level with regard to the General Agreement on Trade in Services (GATS). Yet France's position as the second largest services exporter in the world could have led to a more open stance in favour of the liberalisation numerous services markets.

Regulatory reform: the challenges

The challenge posed by the ageing of France's population is likely to result in the ratio of people retired to those employed doubling by 2030. This has obvious implications for the viability of the pay-as-you-go pension system, and is also going to accentuate the trend increase in health spending which has already risen sharply as a percentage of GDP. The challenge is all the greater in that, just as ageing is increasing the pressure on spending, the withdrawal from working life of large numbers of the baby-boom generation is going to reduce the rate of growth of labour supply and hence potential output – thereby slowing the increase in the tax base needed to pay for these services. Despite continuous improvements in productivity and income levels, the deficit on the health and pension systems can be expected to reach 5% of GDP by 2030 (COR, 2001),[3] failing far-reaching policy changes. It is therefore all the more important to introduce structural reforms designed to

increase the rate of growth of potential output. Allowing such deficits to accumulate over time is not a realistic option because the resulting build-up of debt would be unsustainable. While the ageing challenge is over the long run, actions to slow the rate of increase in expenditure to deal with it are nonetheless urgent in that deep reforms, even if introduced now, can only yield results over time. In addition, any additional delay will reduce the number of potential reform options, thereby making them all the more expensive.

Where can further regulatory reform help?

Regulatory reform is, of course, not the whole answer to tackling the issues which are important for growth prospects. Renewed efforts are required to maintain a healthy macroeconomic environment. Low inflation, coupled with a low public deficit and debt levels help create a stable environment in which firms can seek out new opportunities, and invest and hire with confidence. But regulatory reform can make an important, even essential, contribution to containing costs and raising output. Both are needed to promote stronger growth so that France can face its ageing problem with greater confidence.

Containing costs means improving the efficiency of government, but it also means containing costs for the business sector: minimising burdens on business, ensuring that regulation works effectively, and that the administration is fully responsive to user needs. Key issues related to this are discussed below: public expenditure management and control, the problems with decentralisation, administrative and regulatory quality reforms, and the handling of the relationship with the EU. Many of these issues have already been the subject of important reforms, but more are needed.

Raising output also involves a number of interlocking measures to promote investment and raise productivity growth. Labour participation in the economy needs to be raised. A higher rate of growth may well be held back by a low rate of labour participation that precludes any additional labour supply input. Half finished product market reforms and continuing State involvement in the economy (especially in the network industries) do not permit as great an improvement in performance and productivity as would be desirable. Table 1.2 shows that the decline in trend growth in France reflects slowing productivity growth as well as declining levels of employment and hours worked. The need for further labour and network sector reforms, the role of the State in the economy, and the need to further strengthen competition policy in support of a stronger future output are discussed below. Reforms that are important for containing costs, such as administrative and regulatory quality reforms, are also important for helping to raise output.

Table 1.2. **Gross domestic product per capita breakdown**

	GDP per capita	Hourly productivity	Employment rate	Participation rate	Dependency ratio	Hours worked
	Average annual growth rates					
1970-1975	2.7	4.0	–0.4	0.0	0.1	–1.0
1975-1980	2.6	3.3	–0.5	0.2	0.4	–0.7
1980-1985	1.0	3.1	–0.8	–0.6	0.7	–1.3
1985-1990	2.7	2.7	0.3	0.1	0.0	–0.3
1990-1995	0.6	1.7	–0.6	0.2	–0.1	–0.5
1995-2000	2.4	1.6	0.4	0.7	–0.1	–0.3

Source: OECD.

In summary, the need for further reforms is discussed below in relation to the following areas:

- The labour market.
- Competition policy.
- The State in the economy.
- Network industries.
- The impact of European rules.
- Administrative and regulatory reforms.
- Decentralisation.
- Public expenditure management and control.

The political economy of reform is also considered.

Labour market: employment rates must be raised to counter the effects of ageing

Although employment has risen recently, the medium to long-term outlook for the labour market is constrained. Further regulatory reform to reduce rigidities could raise employment and hence output and GDP growth (Box 1.10).

Box 1.10. **What are the likely benefits of further labour market reform?**

While any estimate is subject to uncertainty, the benefits of further labour market reforms are potentially very large. OECD research suggests that for France, a relaxation of rigid labour market rules could yield as much as a 2.3% increase in employment, 4.5% if efforts reduce the tax wedge on labour were also included. Moreover, the increased economic activity that could be expected from reducing administrative burdens and restraints on competition in product markets could raise employment rates by as much as a further 1.4% (OECD, 2002).

Similarly, less constraining product and labour market regulations would have important impacts on productivity growth. Research suggests that further reducing rigid labour market rules would help increase R&D spending in the business sector. Excessive employment protection legislation appears to work to the detriment of highly innovative firms, whose labour requirements tend to fluctuate more rapidly than those of firms in more mature sectors. As a result, countries like France where rules governing layoffs and labour relations are particularly protective tend to specialise in sectors that benefit most from a stable employee-employer relationship. Unfortunately such firms tend to operate in mature sectors where productivity growth is lower. This may help explain why France benefited less from the ICT investment and productivity boom and why, in contrast to the US and some other OECD countries, productivity growth continues to lag. Relaxing labour market regulations is not only likely to have a positive employment effect. It may well also help promote the development of innovative sectors which would permanently boost growth potential.

France's labour market has an unusual structure, with low employment rates at both ends of the age spectrum. Employment rates for 35- 50 year olds are above European and OECD averages, but fewer than one in four younger people are in work (compared with 50% elsewhere in the OECD) and only one in three 55-65 year olds works. Despite unusually job-rich

growth during the second half of the 1990s, unemployment remains excessive at more than 9% of the labour force. This is costly in human and social terms. In addition, the ageing of the population means that unless important steps are taken to improve employment prospects for older and younger workers, the labour force is likely to shrink, with damaging implications for GDP growth and the sustainability of the pension and healthcare schemes. As outlined in its 2003 Budget, one of the main challenges facing France is to put in place a set of policies that ensure that those who wish to work can. At the same time, the administrative burdens imposed by labour market regulations need attention.

Policies to improve job prospects for the young and low-skilled need to be intensified

The relatively good performance of the labour market in recent years owes much to past policy efforts to reduce labour costs for the young and low-skilled. This policy needs to be intensified. The best results are likely to come from expanding access to apprenticeship and qualification contract schemes. Providing inexperienced and low-skilled workers with private sector job experience in exchange for lower wages has often proven to be a means of significantly and durably improving the employability of low-skilled workers. In contrast, many State-funded programmes have limited impacts on job prospects and have proved to be expensive. More effective policies in this area therefore require actions to be rationalised, notably by subjecting all programmes to a more rigorous and regular evaluation and reform process.

Reducing the labour costs of low-paid workers by reducing their social charges has been a successful strategy for raising employment. However, most of the cuts in charges implemented since 1997 and those planned for the period 2003 to 2005 have not reduced labour costs, but have (or will) only offset the additional hourly costs imposed by the 35 hour work week and the multiple minimum wages created in its wake. The 11% real hike in the *SMIC* thus generated[4] risks having a negative impact on employment. To minimise these, and to re-establish a downward trend in labour costs for low-skilled workers, further increases in the *SMIC* should be restricted to the bottom end of scales set out in adjustment mechanisms, even if the need to withdraw from the dual adjustment mechanism introduced by the 35-hour system has led to a temporary discrepancy. Instead of continuing to reduce social charges, which is costly, the authorities should seek to combine moderate increases in the SMIC with further rises in the employment premium (*Prime pour l'emploi – PPE*). As long as these measures target households that are genuinely in need of assistance in social terms, this sort of combination would be less costly than an equivalent reduction in social charges. A reform of this sort would allow all young people and all low-skilled workers to enjoy greater employment opportunities, while at the same time guaranteeing all worker households a socially acceptable level of income.

Policy also needs to focus on combating inactivity traps, and the effectiveness of locally administered public employment services needs to be improved. Thus the draft legislation presented in November 2003 on vocational training and social dialogue will put an end to the legal monopoly enjoyed by the *Agence Nationale pour l'Emploi,* with regard to job-placement services. Private firms will now be able to propose their services to get unemployed workers back into work. Similarly, the draft legislation presented in November 2003 addresses the decentralisation of the minimum income scheme and creation of a minimum activity scheme. Under this legislation, financial responsibility for the minimum income scheme (*Revenu minimum d'insertion – RMI*) would be devolved to the level of the *département* and would focus on local factors, that is to say close management of local beneficiaries and

actors as a means of providing more effective incentives to get individuals off income support and into work. The second part of this draft legislation is aimed at making it easier for beneficiaries to leave the *RMI* scheme by allowing firms to hire, for a limited period, those beneficiaries that have already been in the scheme for some time by paying them the difference between the minimum wage and their benefit. This should encourage the creation of job opportunities and allow such individuals to rejoin the labour force.

Restoring the financial incentives for older workers to remain in or seek employment

If it is to promote more older worker participation, the government must cut back sharply on various state and unemployment insurance measures that subsidise early labour withdrawal, and restore financial incentives to those that wish to continue working beyond the retirement age. Existing rules account very largely for the low rate of employment among older workers. They reflect several decades of policy that explicitly sought to encourage early labour force withdrawal in the mistaken hope that this would help reduce unemployment. Recent efforts to shrink state-subsidised early retirement programmes should help reduce premature labour market exit. However, firmer action needs to be taken to remove the incentive that unemployment benefits offer workers to retire early. The current system can make non-employment a viable alternative to work for older workers and gives an implicit incentive to firms to lay off older employees. The authorities might consider introducing a system whereby the social costs of laying off older workers would be internalised by weighting unemployment insurance contributions by disproportionate lay-offs of this category of worker. The aim is to do away with the current incentives which discourage the employment of older workers, while preserving extended benefits for older workers who genuinely lose their jobs (the Delalande contribution, which was designed to address this issue, has been eased to avoid its potentially disastrous impacts on employment). The authorities could also cease subsidising the scheme by no longer paying the pension contributions of new entrants. Finally, the money currently spent on subsidising the non-employment of older workers could be redirected towards programmes that would reduce the labour costs of this category of worker, for example by reducing the weight of certain charges.

Recent efforts to raise the official retirement age and to eliminate financial incentives to stop working as soon as this age is reached are welcome and should be pursued. International experience suggests that when financial incentives are actuarially neutral in terms of the decision whether or not to continue to work, a significant share of people 60 years or older choose to continue working, leading to higher levels of output and higher tax revenues. Proposals to extend "standard" contribution periods in line with improvements in life expectancy go in the right direction and should be implemented.

The administrative burdens of labour market regulation need attention

Little attention has been paid to reducing the labour market related administrative burden facing firms. Indeed the *loi d'initiative sociale* introduced in 2001 went a considerable way in the opposite direction by increasing the steps that firms had to go through in order to make adjustments to their labour force. While the most onerous of these additional measures were repealed or not implemented, the law remains on the books and could be enforced at a later date. Moreover, the state of regulation prior to this law was already very restrictive. Substantial benefits both for labour and product markets could be garnered if existing rules took better account of firms' legitimate need to be able to adjust their labour

supply according to market conditions, while nevertheless protecting workers from abusive conduct.

Competition policy: its coherence could be improved and its influence across the whole economy needs to be consolidated

The coherence of competition policy could be improved

Free and fair competition are the implied goals of competition policy. However the law seeks to promote "effective" competition that leaves room for criteria that may not be directly related to competition at all. Thus, the law does not prohibit agreements (or other conduct) that have the effect of ensuring "economic progress", provided that a fair share of the benefit goes to customers, and that competition is not eliminated for a substantial part of the market. However, the *Conseil* interprets these criteria narrowly, demanding that progress must benefit the economy as a whole and not just the parties to the restrictive agreement. Yet this very legislation makes provisions that relate to most types of unfair competition and that it is the responsibility of the DGCCRF to implement. There is a tension between this part of the law (to protect competitors from each other and especially, address the abuse of economic dependence) and the legal principles that support open competition.

This ambiguity emerges most clearly in the wholesale and retail distribution sector (notably large supermarket chains – *grandes surfaces*) where the rules to deal with unfair competition are both complex and constraining. The DGCCRF – reflecting its responsibilities for consumer matters and for enforcing laws aimed at combating the abuse of economic dependency – combines measures to protect consumers with elaborate rules that control relations among businesses. The law has even been reinforced in this area – the *loi Galland* of 1996 extended the powers of the *Conseil* to cover abusively low prices. Large supermarkets are subject to an array of regulations which are aimed in particular at promoting the local retail trade and at ensuring the diversity of supply (see Chapter 3). These rules designed to safeguard small businesses against competition from large supermarkets have probably also had the unintentional effect of reducing competition between large supermarkets. The creation of large supermarkets must be approved by a *commission départementale*. The initial applicants seeking such authorisation can support their request for a building permit by demonstrating that there is insufficient competition within the area. However, since the law entered into force once there were already a large number of such supermarkets already in place, it probably serves to protect existing supermarkets against fresh competition in this segment of commercial strategy.

Though French businesses have learnt how to operate within the rules, this must be at some cost to them, incumbents may end up overprotected from competition, and foreigners may be discouraged from putting a foot in the market because of the complexities that first need to be mastered. There is also an important question of priorities in the allocation of resources for the purpose of fostering competition. Another issue is bid rigging (especially in public procurement – *marchés publics*), which is widespread and imperfectly controlled. Shifting some of the resources currently allocated to the detection of unfair practices in supply chains to efforts to combat bid rigging and cartel cases in general would promote a better balance.

Some tensions exist between the two bodies responsible for competition, which share certain functions but have different responsibilities and may have diverging points of view

and priorities. The differences between the *Conseil* and the DGCCRF over priorities and perhaps even principles illustrate the inherent risks, but also the potential benefits, of the growing integration of competition into the legislation governing the actions of public authorities. There is a price to pay for such differences in terms of job duplication, conflicts of jurisdiction and possibly even legal inconsistencies should both the *Conseil de la concurrence* and the administration jurisdiction claim competence to develop the scope and contents of the law and of competition policy; and yet there could well be many benefits to be gained were the legal basis of oversight through administrative law to take account of the notion of market competition.

Decisions regarding mergers are taken by the Minister of the Economy, Finance and Industry. A merger can be reviewed in two stages. In stage I, the Minister has 5 weeks in which to approve the merger or search for voluntary undertakings, generally of a structural nature, with a view to remedying any possible problems. During this stage the Minister may decide that competition issues warrant initiation of the stage II procedure, either to rule against the merger or to impose conditions, which will require the *Conseil* to give an opinion. This opinion is given in an advisory capacity and is only mandatory in cases where the Minister vetoes a merger; it is not given systematically in other cases. The Minister has in the past approved mergers which the *Conseil* had advised against and can also halt a merger or impose specific conditions even in cases where the *Conseil* has made no objection. The DGCCRF has occasionally been at odds with the *Conseil* in cases where approval was sought for mergers between suppliers in order to offset the purchasing power of major retail distribution chains. However, there is a risk in systems such as the French one, in which the Minister takes the decision and is free to decide whether or not to seek the opinion of the independent public body responsible for implementing competition policy, that the reasons for the decision may be unclear. Transparency could be improved without completely recasting the decision-making process if the *Conseil* were to have the possibility of commenting on a given operation of which it had been notified without having to wait for the Minister to ask it for its opinion.

The oversight of mergers now has its place in administrative law. The *Conseil d'État* is asked with increasing frequency to examine competition policy within the framework of merger disputes. However, it might reasonably be asked whether competition policy regarding mergers needs to have a separate legal regime and standards to that regarding abuse of a dominant position and restrictions to competition.

The impact of competition law and policy across the whole economy needs further strengthening

The impact of competition legislation on the economy as a whole can be strengthened further. This is particularly the case in the area of public services which is currently in transition. The *Conseil de la concurrence* and the *Conseil d'État* are testing the limits of what can be done under the legal framework. France is therefore adapting by extending the scope of its competition law to include the principle of promoting competition. This principle is being cautiously pursued.

The analysis of these regulatory issues from the standpoint of competition is thorough but is not widely known to the public. The *Conseil de la concurrence* is regularly asked for its opinion on major reform projects and its replies are detailed, analytical and meticulously presented. It acts solely in an advisory capacity, however, and its advice is not always followed.

The State in the economy: this remains strong and needs a more coherent approach

The role of the State in the economy remains strong

France retains a strong approach to the role of State in the economy, including the State's role in sustaining *service public* (Box 1.11). Despite significant privatisations in the 1980s and 1990s the State and other levels of government retain a major direct stake in the economy. In 2001 they still owned over 1 500 companies or *entités économiques publiques* (entities with some financial and management autonomy but which remain accountable to the government at national or sub-national level: EDF is one). These have 1m employees among them, represent 8% of employment in the non-financial sector, and 30% of assets. Heavyweights in the list (Table 1.3 below) include EDF and *Gaz de France* (electricity and gas), *La Poste*, SNCF and *RATP* (rail and metro), GIAT industries (a defense equipment munitions manufacturer), *SNECMA* (an aircraft engine manufacturer), and ADP (Paris airport management). The State also retains a controlling (though not necessarily majority) interest in a number of listed companies including *Air France*, *France Télécom*, *Renault* and *Thales* (communications) as well as unlisted ones. There are quotas for foreign investments in sensitive industries such as the audiovisual sector, and foreign investments in the aerospace and financial sectors need special authorisation as well as reciprocity provisions.

The list shows that the State's interest is not just confined to entities with network or natural monopoly characteristics. Companies in sectors which might be considered wholly commercial and unrelated to public policy goals (such as the automobile industry and transport equipment) also feature. The State, in short, still plays a central role in key aspects of the economy and society, paying particular attention to the evolution of leading sectors of the economy and key companies within those sectors, which sometimes spills over into the active promotion of national champions or the rescue of failing companies. France is not alone in this respect among its OECD peers. But the risk that the intervention might not be neutral may be increased by personal relationships which link the heads of large companies and senior civil servants, rooted (in many cases) in a shared elite education.

Service public: further adjustment is needed to fit the competitive environment

The State's role has traditionally been perceived to be especially strong in relation to "*service public*" (Box 1.11).

Fitting the delivery of public services into a competitive context is still "work-in-progress", and the overall picture is not yet coherent. There are some encouraging developments. For example, in telecommunications, a parliamentary debate on setting up a system of competitive tendering for universal service provision will take place in late 2003 (see Chapter 6). In the late 1990s several regions started to negotiate directly with the SNCF for the type of rail service they wanted and how to handle the costs. Regional traffic grew nearly twice as fast in these regions as elsewhere, and bus-rail competition started. The experiment was extended to the whole country in 2000. But elsewhere the picture is more contrasted and a more competitive approach might be considered to the provision of certain types of public service. In civil aviation, carriers have *service public* mandates related to balanced regional development (*aménagement du territoire*). However, these mandates are limited to certain routes and subsidies are marginal (less than 1% of revenue, see Chapter 5). In electricity, EDF and the 170 non-nationalised distributors still remain responsible for meeting certain public service requirements.

Box 1.11. **Public service**

Background and history

The notion of *service public* first took shape toward the end of the nineteenth century. Its essence was initially defined as those tasks serving the general interest (*missions d'intérêt general*) which it was the responsibility of the State to organise. The definition of the tasks was not specified, but rested instead on certain criteria which would be applied by the State and other public bodies, under the ambit of administrative law (confirming the link with the State and underlining the difference with activities under the ambit of private law). As the jurisprudence developed, the meaning of *service public* took further shape but remained very flexible. In those early days its characteristics were defined as continuity (strikes should be circumscribed), adaptability (the maintenance of a particular service was not guaranteed) and equality (notably the principle of *péréquation* – equalisation of tariffs). A *service public* could be, and was, delivered by a variety of means (from publicly owned entities to private sector concessions, which have been a standard means of delivering many local services), even if this was usually not clearly understood by the general public, which associated it with the public sector, especially after the second world war when national publicly-owned monopolies became the most visible means of delivery of many services.

In 1994, analyses by the *Conseil d'État* linked the concept of *service public* to two main characteristics. The first was its relationship with the State, seen as directly responsible for sustaining it because of its central importance to society. The second was its relationship with republican society and citizenship: it was the material expression of essential values which connect everyone, without exception, into social and economic life. It was in the first place a means of promoting social cohesion, solidarity, and a sense of citizenship, but it also contributed to the productive efficiency of the economy, for example by ensuring effective regional development.

Perspectives, however, have evolved over the past few years against the background of EU-led market liberalization, especially of the network sectors. Debate has broadened into consideration of how *service public* can be maintained in a competitive environment. This has led to a break with some aspects of the traditional view of *service public*, in that a clear distinction started to be made between the *mission de service public* (a definition based on universal service is emerging), and the means of achieving this *mission* (the mechanism does not necessarily have to be the State directly, but could for example be taxation). The review of the State's role has engendered an important institutional change (see also Box 1.3 above) with the emergence of independent regulators with a delegated authority from the State to oversee the liberalised network sectors.

Current challenges

The debate generated by the advent of liberalisation in the network industries on the definition and maintenance of *service public* in the new environment is still work-in-progress. Reform is in practice complicated by the French public's deep attachment to *service public*. The public associates *service public* very strongly with certain sectors such as electricity and the postal service as well as passenger train services, but its understanding is sometimes out of date with current realities (SNCF for example no longer offers the same service country-wide).

Service public has not yet acquired a firm and clear definition (such that activity x or y could be clearly defined as part of it, though the network industries are an implicit natural core). It is, however, in need of a clearer definition: public policy objectives and services need to become more explicit in a competitive environment, and can no longer be pursued

Box 1.11. **Public service** *(cont.)*

implicitly under cover of direct State control. At the same time, it is important and legitimate to carry through a definition of *service public* that supports key goals and values. Combining the enduring values promoted by the traditional view with the context of today's competitive environment, French *service public* should now seek to identify the set of specific, clearly identified public services which are considered to be of central importance to society, and which are the material expression of essential values which connect everyone into economic and social life.

This concept can certainly find its place in a competitive environment, so long as the relevant public services are clearly identified, and funded transparently and directly rather than implicitly. The aim should be to 1) clarify the definition of public services in the context of the goals they need to support 2) ensure that they are funded transparently 3) identify the lowest-cost funding approach, which implies mechanisms other than the State acting directly or via State-owned firms.

Table 1.3. **Public enterprises in 2000**

Traded enterprises with State holdings	Principal activity	State holding (as a percentage)[2]
Air France	Transportation	54.4
France Télécom	Telecommunications	64
Aérospatial-Matra	Aerospace	
Renault	Automobiles	44
Thales	Electronics	33
Bull[1]	Information technology	17
Crédit Lyonnais	Finance	13
Altadis	Tobacco	2.5
Caisse nationale de prévoyance	Finance	2
Main non-traded enterprises with State holdings	**Principal activity**	**State holding (as a percentage)[2]**
EDF	Electricity	100
Gaz de France	Gas	100
La Poste	Postal services	100
SNCF	Transportation	100
RATP	Transportation	100
Commissariat à l'énergie atomique	Research and development	100
GIAT Industries	Machinery and equipment	100
SNECMA	Manufacture of transportation equipment	100
Aéroports de Paris	Airport services	100
Cie financière Hervet	Finance	100

1. Public institutions other than the State retain a large shareholding interest.
2. State holdings include distribution of "free shares".

Source: Ministry of the Economy, Finance and Industry.

Competition means that the State's different roles need to be clarified and disaggregated

A competitive environment requires that the role of the State be reviewed, and that previously seamless responsibilities be clarified and disaggregated.

The State cannot set public policy goals to be met by the market overall, given its position as owner/shareholder of a service (usually the historic and still-dominant incumbent) in that market, as direct operator and regulator of the sector, without raising problems for effective competition. This therefore leads to conflicts of interest between the various mandates that need to be jointly fulfilled by the State. As owner/shareholder the State is bound to be motivated by a desire for the company to thrive, which jeopardises an even-handed oversight of the market. If it retains a direct role in the company's operation, this adds to the problem of potential discrimination against competitors but also raises the issue of how to maintain pressure for the company to be efficient (the company may be cushioned by various advantages such as a loose budget constraint, state guarantees and subsidies). If the State also retains direct responsibility for regulation of the market this is especially damaging for competitive neutrality. However, independent regulators have been introduced in the energy (CRD) and telecommunications (ART) sectors, with areas of competence that will soon be extended to postal services. Furthermore, to ensure better governance in the public sector, in 2003 the State set up an agency for State holdings, even though the conditions under which this agency will operate have yet to be finalised. The agency will be attached administratively to the Treasury Directorate in the Ministry of the Economy, Finance and Industry.

The last few years in France have seen a considerable adaptation to a more market-driven context. The significant progress which has been made in the liberalisation of several network industries, and the competition which has emerged in sectors such as telecommunications and civil aviation, show that France has already moved a long way from the traditionally powerful direct State control of key activities. Box 1.12 reviews the issues.

It is important to sustain further progress, as the costs of the traditional approach can be high, and are likely to weigh heavily on the French economy and public finances. Two issues stand out. The first is the need for a more rational approach to managing the finances of State-owned companies. Considerable public aid, direct and indirect, supports many entities charged with a *mission de service public*. A more prudent and transparent management of costs to meet liabilities, such as the (EUR 40 billion) SNCF track system debt, could help to minimise the burden on public expenditure and the taxpayer, and to avoid giving incumbents an unfair competitive advantage where competition is introduced. The second issue is the reluctance of the French authorities to implement structural separation in the network industries between competitive and non-competitive activities. This tends to sustain the conditions in which an historic incumbent can abuse its dominant position by subsidisation and cross-subsidisation (Chapter 3).

Policy on cultural goods: a significant public intervention, but does it work?

France, like some other OECD countries (Canada for example), promotes the notion of culture and cultural diversity as a form of public good, for which ordinary market competition is not appropriate. Culture is a means of promoting a shared identity and shared values, which also contribute to the quality of life. Beyond audiovisual services, where the EU as a whole has made no commitment to liberalization, France applies specific measures to cultural products. For example, books are not considered ordinary market products, and have a nationwide single price to support varied authors and a dense bookstore network, aimed at encouraging culture through "good" reading.

Box 1.12. **The State and the economy: progress towards the "regulatory State"**

This box reviews issues, shared across most OECD countries and based on their experiences, which are important for the development of strong and sustainable competition.

Privatisation. Privatisation is likely to be an important, though not the only, element of an effective policy to promote competition in previously closed sectors. There has already been significant privatization in France, and there are further plans for a number of firms including *France Télécom, Air France*, and EDF and *Gaz de France* (for example the decision to change the legal status of the latter two as a first potential step in opening their capital). But there is scope for further rationalisation of State ownership by opening the capital of certain entities more widely, or even through full privatisation, based on a reasoned general analysis and debate of what should remain under public ownership, and of the arguments for and against maintaining such ownership.

Independent regulation. The establishment of independent regulators signals that the State has understood the importance of leaving the enforcement of regulation to distinct neutral bodies. Significant progress has been made with the establishment of independent regulators for telecommunications and more recently, electricity and gas. This is an important institutional development, closely linked to the equally important legal evolution in the scope of competition law and the growing role of competition policy. The telecommunications regulator (*ART*) has successfully carved out its role as independent overseer of the market, an authority with competence to apply all legal, economic and technical provisions that allow telecommunications activities to be freely pursued in the market. The electricity and gas regulator (*CRE*) is also making progress. Other network sectors such as postal services and rail transport still have a long way to go in liberalization. While a bill extending the authority of the *ART* to the postal service is under discussion, the railways do not yet have a regulator.

Corporate governance of State entities. State-owned firms need defined objectives, their performance needs to be measured, and managerial incentives need to be in place to help them achieve objectives efficiently. The government has set up an agency charged with better managing state-owned assets (*Agence des participations de l'État – APE*). The impetus for its creation was concerns over the State's capacity to provide effective governance over State-owned enterprises, following the accumulation of large debts by *France Télécom* over the past few years, and a series of unsuccessful foreign investments by EDF. A report commissioned by the Minister of Finance concluded that "the State does not exercise its stockholder role effectively" and criticised the inherent conflicts in its efforts to act simultaneously as stockholder, strategist, regulator and client of state-owned firms. It was particularly critical of the effectiveness with which the State managed its ownership role, arguing that it gave unclear guidance to managers, that State-owned firms had poorly functioning boards of directors, and that the State played an excessive role in day-to-day management. However it is not yet clear to what extent the *APE* will have the authority to pursue its mandate as it is administratively attached to the Treasury and operationally attached to the Ministry of Finance, to which it will be ultimately responsible. Also, the ownership of companies stays with the sectoral ministry, which leaves open the possibility of inappropriate oversight based on ownership interests which may not be in the best commercial interests of the firm or of the wider market.

Box 1.12. **The State and the economy: progress towards the "regulatory State"** *(cont.)*

Competitive neutrality framework. Together with independent regulation and effective corporate governance, this can help to ensure that State-owned firms do not enjoy an unfair competitive advantage relative to their private sector competitors. Explicit competitive neutrality frameworks have been set up in some other OECD countries (including the Netherlands and Australia) covering issues such as taxation, State guarantees, subsidies and initial balance sheets. France does not have such a framework. Indeed it often continues to support the historic incumbents of monopoly sectors against competitors to ensure that one company (under State control) can still deliver public services. Where network sectors have been opened up, the State has tended to support company ventures into international markets at the expense of developing a more competitive internal French market. This strategy can backfire: other countries may apply reciprocity provisions for access to their markets, and the relative lack of internal competition may hold back the development of French firms' international competitiveness.

Separation of activities. This is a particular issue with the network sectors, where competitive activities need to be separated from non-competitive activities to avoid the problem of unfair cross-subsidisation. France has opted for accounting and management separation, rather than stronger structural separation, on the basis that firms must still comply with the law about abuse of dominance. This may not be enough.

The question is whether the cultural policy works: does it meet its objectives of maintaining quality, diversity, innovation, etc.? For example in the case of books it is possible that a high fixed price might lead to more titles being published, but fewer books being sold. Protecting a market is not usually the best way to encourage innovation – unless one wants to ensure that the innovation is all "home-grown" as may be the case here. A critical examination of the tools used to support cultural diversity, informed by an understanding of how markets work for these goods, would be helpful. This would, not least, ensure that the current rules do not engender perverse effects which are contrary to the original objective. Are there special characteristics of cultural products in a market context that would justify differences of treatment from other goods? If so what are the best tools to ensure that these products thrive?

Network industries: liberalisation in some important sectors

The incumbents of important sectors such as energy, transport and postal services remain fully State-owned, and liberalisation in these sectors is slow and incomplete, if not extremely timid. Where the association with *service public* is strong, resistance to change is also strong, and hampered by a possibly over-generous definition of what *service public* should provide (broadly speaking, services over the whole territory at identical prices).

Natural gas: limited developments, against a background of supply security concerns

The 1998 EU directive on the opening of the domestic gas market was implemented late, being transposed in 2003, *i.e.* two and a half years after the deadline for transposition and following a ruling by the European Court of Justice. However, as early as 10 August 2000, France had set up its own transitional regime for a very gradual market opening. As for the

electricity sector, market opening is so far confined to large clients: full market opening is not planned until 2007 after the market has initially been opened to all professional clients in July 2004 (60% of the market). Foreign suppliers have made some headway in the open market, capturing some 14% of contracts. Prices are reasonable relative to the EU average (lower for the large consumers), but perhaps not surprisingly, it is not clear what impact competition has yet made on prices. Gas supply security concerns inevitably loom large in a country which is 97% dependent on imported gas (mainly from Norway, Russia, Algeria and the Netherlands). This generates caution in the path to reform, which moves faster and more easily in producing countries such as the US and UK. The security issue, rather than *service public* (there is no universal service requirement) is a complicating factor in reform for this sector, one that is generally shared by other non-producing OECD countries.

Gaz de France, 100% State-owned, remains the dominant company in the gas sector. With exclusive rights to gas imports until 2000, *Gaz de France* owns more than 80% of the pipelines and 12 out of the 15 storage sites. Until 2000 the market had been divided into geographical supply monopolies with the *Compagnie Française du Méthane* (CFM) and *Gaz du Sud-Ouest* (GSO). GDF is a majority shareholder in the *Compagnie Française du Méthane* which accounts for nearly 20% of the market, and has a minority holding in the shares of *Gaz du Sud-Ouest* (a 70% subsidiary of Total) which accounts for less than 10% of the gas market. However, some significant changes are under way or in prospect. Accounting and management were separated in 2000 and the basic accounting principles approved by the regulator in 2003. The legal separation of the management of the transport network is scheduled for 2004. The electricity regulator's jurisdiction has been extended to gas, with oversight of third party access to the network and notably the power to propose network access charges. The aim is to promote a market in France that will work in favour of consumers. A draft law is being prepared to change the legal status of *Gaz de France* and EDF (which currently are *EPICs*) to that of limited liability companies whose capital could in time be opened. The draft law has not as yet been brought before Parliament (for further details see Chapter 3).

Postal services: deep reluctance to change in a sector closely associated with service public

Liberalisation is also slow in this sector as a result of institutional and social constraints. Unlike gas, the main difficulty is public, employee and municipality concern over *service public*, with which the sector is very closely associated. Reform is less advanced than for gas. Minimal market opening (the least allowed by EU law) was implemented in 1999 and was extended by the draft law on postal regulation in 2003 under the revised postal directive of 2002, which means that the 100% State-owned incumbent, *La Poste*, retains a very significant reserved domain (mail under 350g). Mandatory separate accounting for the activities of *La Poste* was introduced into its service obligation in 2001 and the accounting principles were laid down by the Minister of Finance in 2002. From 2003 onwards, the accounts of *La Poste* will give details of the results of each of its activities. *La Poste* also runs an extensive banking network, which is especially important in rural areas, as well as a significant insurance business, using the advantages of its geographical coverage and its public image. Competition has emerged in the non-reserved services (parcel and express services) but letter post for the most part remains a monopoly. *La Poste* is also the largest single employer in the country. It is planned to entrust the regulation of postal services to the ART which under the 2003 draft law on the regulation of postal services would become the regulatory authority (ARTP), with powers to supervise

accounting, settle disputes and impose penalties. The price of an ordinary stamp is around the EU average, though higher than in more liberalised countries.

Railways: difficulty in envisaging reform

Here too liberalisation is only partially engaged but does meet EU requirements for market opening and has led to some limited market opening for freight services. Since the EU law made no provision for the opening of passenger transport services to competition, there is no competition for these services. SNCF, the 100% State-owned incumbent, has been reorganised, with the creation of a new entity in 1997, *Réseau Ferré de France (RFF)*: the mandates for infrastructure management have been legally entrusted to *RFF* without reorganising the railway company and without any transfer of services. Most of SNCF's debt has also been transferred to *RFF*. SNCF remains responsible for passenger and national freight services (given that international freight services have been open to competition since 8 March 2003) and for the stations. The handling of SNCF's very large debt raises issues. Offloading the debt to *RFF* in 1997 (EUR 20.5 billion) has made it possible to remedy SNCF's cost structure. *RFF* pays SNCF to maintain the track, while SNCF pays usage fees to *RFF*. This arrangement comes at a price for public finances, however, because the usage fees do not cover the cost of track maintenance and, as a result, the gap is filled by public subsidies to *RFF*. SNCF's freight services appear to be inefficient and are in deficit (around EUR 386 million in 2002). The recent strikes to protest against reform were also costly (EUR 250 million in 2003). SNCF's pension liabilities are an estimated EUR 2.3 billion, and 50% of its turnover goes on staff overheads.

The outlook for further reform is therefore difficult. The entrenched opposition to reform and the complexity of the financial mechanisms in place may slow down the opening to competition. Like *La Poste*, SNCF is closely associated with *service public*. This is despite the fact that SNCF has abandoned efforts at providing a certain commercial services and uniform fares nationwide.

The impact of European rules

The development of the EU single market has brought France important benefits

The development of the EU single market has been beneficial for France. It has contributed to substantial inflows of foreign direct investment (FDI). France was the number one destination for FDI in the OECD in 2002. It has also opened up foreign markets to French firms, which is reflected in even stronger outflows of FDI. Exports' share of output increased substantially during the 1990s and since 1992 France has moved from consistently running a current account deficit to running a substantial surplus. Of course, not all of this export strength was the result of the single market. The initial depreciation of the euro had beneficial impacts on exports outside the Euro-zone. Favourable developments in unit labour costs also had beneficial impacts, mainly because of real wage moderation during much of the 1990s which saw productivity improvements exceed real wage demands – reversing the previous tendency.

Many rules come from the EU: they need careful assessment and management, as for domestic rules

The European Union plays an important role in regulatory reform in member States. Nearly half of all new French regulations come via the EU. French co-ordination

mechanisms in relation to the European Union therefore have a key role to play and are briefly described in Box 1.13 below.

Box 1.13. **French co-ordination mechanisms for the EU**

France has a longstanding mechanism for co-ordinating EU affairs. This is vested in the *Secrétariat Général du Comité Interministériel* (SGCI), attached to the Prime Minister's office. Draft EU directives are notified to the SGCI, which in turn notifies relevant ministries and other relevant entities, to prepare their transposition. The *Conseil d'État* is consulted on the legal aspects of transposition (see also Box 1.4 on the *Conseil d'État* above). A *circulaire* from the SGCI (information document which explains how laws should be applied) focuses on the need for a legal impact assessment of draft EU legislation. There is no requirement for a broader *ex ante* impact assessment. The Parliament is also formally consulted, though unlike some other EU countries, it does not have a special committee on EU affairs. Public consultation on EU directives is minimal. The question of the prior assessment of the legal and also the economic impacts of EU directives at the national level therefore remains open.

The procedures regarding consultation, analysis and communication could be strengthened. *Ex ante* evaluation of EU law tends to focus on the legal aspects. The lack of systematic and wider *ex ante* efforts to evaluate the costs and benefits of EU laws is likely to make identification and prioritisation of issues that need to be promoted or opposed in Brussels a difficult task. A greater public awareness of developments might – possibly – help to better control public reactions to reforms, as well as help in the identification of likely costs and benefits. An informed public which has the opportunity to participate in discussion will not necessarily like what is happening but might more easily accept the outcome, because it understands better the constraints of the EU process. At times the public authorities can see opportunities in this for "backdoor" reform via Brussels which would not otherwise succeed at the national level. However, lack of transparency can have a long-term cost. Accordingly, for the mechanism to work effectively, the public also needs the benefit of wider *ex ante* assessments, so that it can take a more informed view of the issues.

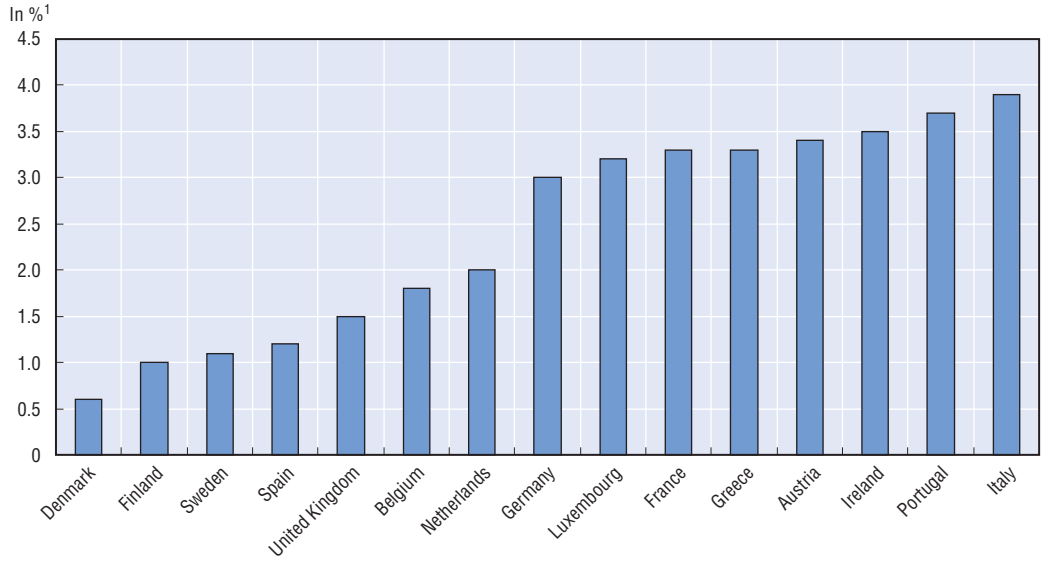
Transposition of EU rules into national law: this must be timely, to avoid disadvantaging the French business community

A particular problem is the difficulties experienced by the administration in transposing agreed EU legislation within the set time limits. France was tenth out of the EU fifteen in early 2003, according to the EU Commission (Figure 1.7).

This is damaging because of the uncertainty that it creates, especially in the business community. What is the legal position if a directive (not transposed, yet past the date this should have happened) contradicts national law? Perhaps more important, since many directives are part of the construction of the single EU market, delay can put French companies at a disadvantage in this wider market, particularly if reciprocity is applied (that is, if a country chooses to deny access to another country's goods or services until the latter has complied with the EU law).

The current phase of adjustment to the competitive context promoted by Brussels may be part of the problem. But also, the French legal structure finds it hard to accommodate EU law without, every time, triggering a heavy-handed process in which the

Figure 1.7. **Delay in transposing directives regarding the single market**



1. Percentage of directives that have not yet been transposed.

Source: European Commission, May 2003.

whole existing body of law is re-examined, and then adapting the legislation almost too perfectly ("gold plating") when a quicker and more "rough and ready" approach would probably do. This at all events is what the business community believes. The government is aware of the problem and has taken steps to deal with it. The Ministry of Foreign Affairs has adopted an emergency plan (based on the UK approach) which makes individual ministers responsible for the rate of transposition and for informing Parliament of progress. This seems to be meeting with some success.

Conversely, and given the importance of EU regulations, it might be asked whether France has always succeeded in influencing the EU in a way that allows it to maintain some of its approaches. A big obstacle is, to be sure, the opposition of two systems of economic oversight. The EU system which is predicated on the assumption (anchored in the founding Treaty of Rome) that social goals such as peace and prosperity are best achieved through competition and market openness with relatively limited State interference. This contrasts with the French tradition of a much more central role for the State and for public service, and a more limited role for competition in the promotion of economic success and social progress. Perhaps this explains why France has taken some time to table formal proposals for an EU-wide approach to the handling of services of general economic interest (SGEI) (Box 1.14).

This debate is open, difficult but necessary. The EU Commission has its own idea of what should be understood by SGEI – a relatively narrow definition of "universal service" which may be assured by different methods. France sometimes tends to have a broader view, stemming from the national approach to public service. However, some of France's European partners do not share the same opinion on this issue. These countries tend to think, to some extent, that French companies hide behind their public service obligations in order to confound efforts by competitors to enter French markets, whilst pushing their

Box 1.14. **Services of General Economic Interest: the French proposals**

In spring 2003 a letter signed by the French, UK and German heads of government, was sent to the President of the EU Council of Ministers. This addressed the need for measures to strengthen EU economies. It underlined that Services of General Economic Interest (SGEI) were an essential part of European economic and social development. It engaged the three countries to develop the analysis of what should be understood by SGEI, in the context of a better mutual understanding of how each country understood its own public services. It also engaged them to guarantee the financing of SGEI, noting that the application of EU state aid and competition rules must not be allowed to endanger the functioning of public services.

way into others' markets. They also feel that the links between public service and the special status of employees are open to question. These reactions could therefore place France in a delicate position. However France is not the only country seeking to preserve approaches of this nature and might consider doing more to promote a constructive dialogue with EU partners, most of whom have an equally strong attachment to their own brand of public policy goals, which may indeed be quite similar to French preoccupations (for example Germany's strong attachment to balanced regional development). There is a need across the EU (and beyond) for a debate on public services. The letter sent to the EU Council by France, Germany and the United Kingdom (Box 1.14) is a good start.

Reforms in the administration and of regulatory systems: some way to go yet

Despite the work of recent years, the French regulatory system remains complex, a weight on the economy and society. Regulatory quality is not as good as it might be. These two issues are related.

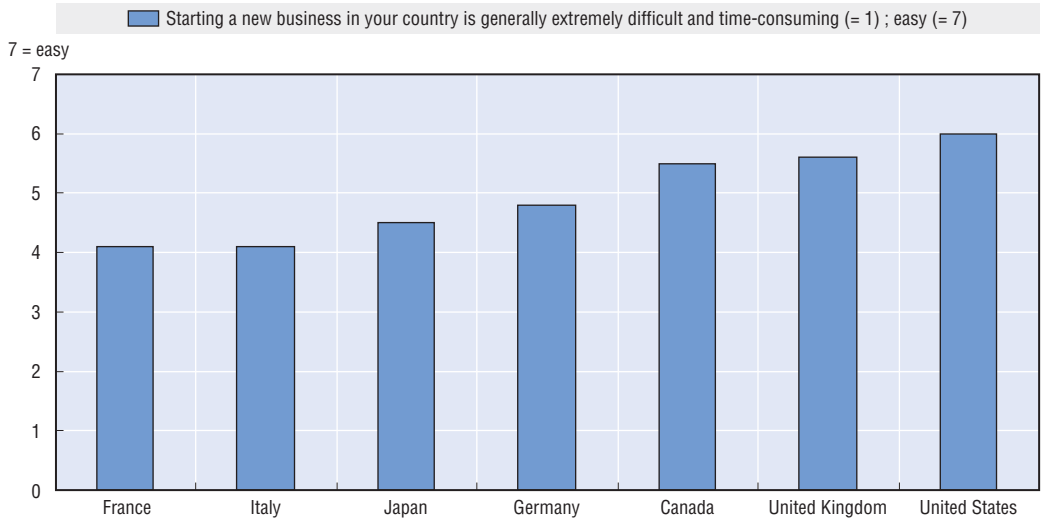
Administrative simplification: it is not enough to master the problem of cumulative administrative burdens

The longstanding efforts at administrative simplification and the related law codification initiative are not in themselves sufficient to make long term and sustainable headway on the problem of complexity and its attendant burdens. The lack of a sunsetting mechanism for laws (*caducité*) poses a problem.Laws remain valid in perpetuity, so they pile up. In addition, as in most OECD member countries, the State's range of action has widened considerably over the years. For example, while environmental regulation was a minor affair a couple of decades ago, it is now a major source of new rules and constraints. Measures to simplify and codify the law can therefore be seen not so much as great step forward, but as a necessary albeit insufficient counterweight to these underlying trends.

The costs of regulatory inflation have gradually become apparent. The average annual number of new laws grew by 35% over the last thirty years. And this is not the whole picture, as it does not include all the lesser forms of regulation (*décrets, arrêtés, circulaires*). The length of legal texts has also grown: the Official Journal is now well over twice the size it was in the 1970s. There is, surprisingly, no data on the total amount of legislation, but estimates put the number of laws at around 8 000, and the number of subsidiary regulatory texts at around 400 000. Paperwork and administrative procedures arising from this vast array of rules are an important source of discontent for market players. The 2002 Global

Competitiveness Report, reflecting the perceptions of the business community, ranks France 60th out of 75 countries for regulatory burdens. Setting up a new firm appears to be especially burdensome compared with other OECD countries (Figure 1.8).

Figure 1.8. **Administrative burdens on start-ups**



Source: Global competitiveness report 2002.

The July 2003 administrative simplification law makes an important change to the process. Past efforts have focused on the codification of laws and legal provisions, and on the simplification of administrative forms (*formulaires*), without actually changing the upstream legislative and administrative texts. The considerably more ambitious focus now is simplification through actual changes in the underlying legal provisions. Laws adopted in the past will be simplified, not just codified as before. A sunsetting process for new laws (*caducité automatique*) should also be considered.

Regulatory quality: this needs to be improved, not least by applying more rigorous Regulatory Impact Analysis to proposed rules

Current measures to promote regulatory quality are primarily focused on administrative simplification and on ensuring legal quality, that is, coherence within the legal structure. But simplification and codification measures so far only rationalise the structure of the law. Administrative simplification has allowed France to preserve the coherence and functionality of its existing administrative apparatus, which is very complex. It has not reduced its inherent complexity and the substance of the law is not affected. The promotion of legal quality is well and carefully managed, not least through the involvement of the *Conseil d'État*, an established expert institution (see Box 1.4). This, however, sidesteps the question of whether the rules are actually "fit for the purpose", and whether they impose unnecessary burdens on the economy.

A key tool in the development of quality regulation is the *Étude d'Impact* (Regulatory Impact Analysis-RIA). It is one of the most important regulatory tools available to governments, as its aim is to ensure that the most efficient and effective regulatory options are systematically chosen. It is a challenging process which needs to be built up over time.

It combines good habits of consultation with a rigorous review of the impact of prospective rules through a clear and balanced assessment of costs and benefits. The 1995 *Picq* report triggered the process of developing RIA in France. A formal RIA process is now required for the most important laws and rules. But eight years on and despite damning reports by the *Conseil d'État* and others, it still does not appear to be taken seriously. The most serious criticism is that it tends to be used at the end of the process of developing new rules, as *ex post* justification for rules, after they have been prepared and discussed, rather at the start of the process as a serious contribution to good rule-making. It also seems to be indifferently applied, and its use is not systematic: it is often treated as a formal but empty obligation. Each ministry or agency is responsible for the arrangements to apply it. Quantitative and economic analysis is very undeveloped.

Consultation: this needs to be better structured and more systematic

Effective consultation of stakeholders helps to shape effective regulations. It gives regulators valuable feedback on potential costs as well as benefits of regulation, as well as prospects for successful compliance and enforcement, and provides a safety net against capture by particular interest groups. It is, not least, an essential component of successful RIA.

France has a wide but eclectic and unsystematic range of arrangements in place for consultation on draft laws and regulations. The approach depends on the type of rule: stronger procedures allowing for significant interactive debate in the case of government-inspired draft laws for example, much weaker procedures elsewhere (for example for *décrets*). Though formal consultation of certain bodies such as the *Conseil économique et social* is mandatory, considerable use is made of a range of more informal committees, commissions and *ad hoc* groups that allow stakeholders who are not part of the formal apparatus their say. Bilateral consultations also take place (the employers' association MEDEF is consulted for example on fiscal rules). Commissions may also be formed to offer views on a broad subject of reform. As well, several thousand specialised consultative bodies drawing on government outsiders (such as the *Comité national de l'eau*) have been set up by the government to provide *ex post* feedback and a debating forum with the administration on specific legislation. For issues covered at the local level, the national arrangements are reflected at the local level too. The Internet is increasingly being used for consultation.

This wide range of possibilities may suggest that consultation is fully and effectively embedded in the French rule-making system. But its breadth and eclecticism generates weaknesses. There can be "consultation fatigue", especially at the local level. Paradoxically but even more important, there are failures to consult effectively at a sufficiently early stage, because the arrangements are not systematic and can be opaque and confusing for non-insiders. This may generate awkward problems down the line which might have been avoided: late parliamentary amendments inspired by excluded interests, union protests sometimes leading to strikes, unhelpful press comment on the government's reform efforts.

The French approach contrasts with the approach of some other OECD countries, such as Canada, which has implemented systematic "notice and comment" procedures, and the Netherlands, which has drastically trimmed its consultative apparatus (Box 1.15). France is aware of the problem, and the latest draft administrative simplification law proposes some rationalisation. Making consultation obligatory for all draft rules, using a streamlined

Box 1.15. **Consultation and transparency in Canada**

In Canada, government regulatory policy stipulates that "all partners, industry, workers' consumer groups, professional organisations, other levels of government and interested individuals", must be consulted at all stages when problems justifying regulatory intervention are identified. The law on "Statutory Instruments" states that government or ministerial regulations must be subject to prior systematic consultation with interested parties. The result of this must be included in the Regulatory Impact Analysis (impact study) which must be attached to the law before it is passed on to central government. The regulations must be "pre-published" after they have been examined by the Privy Council Office, with at least a 30 day period for public comments. These comments must be taken into account by ministers in the revised version or else they must justify the reasons for not taking the comments into account. It is only then that the law can be examined for final validation by the Privy Council Office Committee Secretariat and can be approved by ministers to be signed by the Governor General.

public process, and ensuring that the arrangements dovetail with RIA (the quality of which depends largely on good consultation) should be taken forward.

The civil service: highly competent but is it sufficiently tuned in to business and citizen needs?

The French administration is based on a system of republican meritocracy which fosters high levels of competence and integrity among civil servants. But it also suffers from a number of rigidities. External recruitment to senior posts is virtually impossible (unlike some other OECD countries like the UK). Many civil servants have a legal training, and economic expertise within the administration, instead of making a broader contribution, is often channelled to work on specialist issues. The system is fragmented into a vast number of *corps* (estimates put the current number at 1 500-1 700) which compartmentalises the management of regulatory issues, and slows the process of modernisation. The system as a whole generates an inward-looking perspective, in which the views and interests of the administration are more easily identified and often better served than those of citizens and businesses as users of the administration. It makes the State (keeper of traditional values, guardian of *service public,* and employer of a large number of people with a civil service *statut*) vulnerable to isolation, by fostering a disconnection between it and the wider world (businesses operating in the global economy, and citizens who are not part of the administration).

Decentralisation: a complex process which needs a clearer strategy, simplification and stronger management control

The OECD stresses the need to pay careful attention to the way in which decentralisation is actually conducted by drawing attention to the importance of making effective use of appropriate levels of government. This includes an appropriate structuring and division of responsibilities, effective co-ordination between the different levels, and the promotion of regulatory quality at all levels of government. High quality regulation at one level can be undermined by poor quality regulatory policies and practices at other levels.

Decentralisation has created a complex framework

The way in which the co-ordination of competences between central government and territorial bodies has been organised reflects the ambiguities and difficult abandonment of prerogatives that must be faced by a unitary State which commits itself to a process of decentralisation without that State or some of the actors in the institutional game having necessarily accepted the full consequences of such a commitment. The organisation of French decentralisation has created a complex set of overlapping structures, and set in motion a process which is today imperfectly controlled and lacks a sense of strategic direction. In some cases the State has not decentralised where it should have. In other cases, decentralisation has not been accompanied by effective control mechanisms. This gives rise to inefficiency and a diminished capacity to promote effective management and reform of key areas of the economy and society such as education or health and social issues. This may also affect regional development.

Responsibilities are often unclear

A central issue is partial overlapping, unclear or inappropriately divided competences. The *Cour des Comptes* (audit office) has expressed considerable concern over this. One example is social services. Efforts to clarify responsibilities have not yet succeeded, because of vague criteria for their allocation, and the continuation of overlapping or shared responsibilities. Also, the State has retained competences in important areas that should be more appropriately decentralised (evidence that the commitment to decentralisation may be less than wholehearted, or that political obstacles to decentralisation still loom very large). Thus in education, the State – for the present – retains control of human resources connected with education and determines the curriculum, and the government has encountered huge opposition in its efforts to decentralize management of part of the support staff. Yet tight central control runs counter to the conclusions of the recent OECD PISA study which suggests that successful education systems are those that combine standardised targets for educational outcomes with the flexibility and responsibility that decentralisation permits.

Some overlaps are probably unavoidable. This, however, reinforces the importance of effective co-ordination mechanisms. Despite the development of an array of mechanisms, these do not always work well. For example, the *contrats* – which account for some 10 to 20% of State investments in the regions – are not always given the priority they deserve by the State. Evaluation of these *contrats* is also difficult. Absent politically difficult mergers, more effective co-operation is needed between communes, many of which are too small to cope effectively alone with their tasks.

Guidance and control mechanisms are weak

The lack of effective guidance and control mechanisms to support the decentralisation of competences is another important weak spot. This has also been underlined by the *Cour des Comptes*. It highlights a number of problems with local public services: opaque management and decision making, the circumvention of competition rules in the contracting-out of services, poor control of franchisees, as well problems of effective overall management due to lack of resources. These weaknesses matter as key services are involved: water management and decontamination have frequently been delegated to private operators. *Ex post* controls are not sufficient. Measures to forestall problems by promoting regulatory quality practices at the local level appear to be absent. Regulatory inflation is a further problem, linked to a lack of

resources and training to promote more effective rule-making. Over the last ten years, the number of regulatory actions by sub-national governments has risen by 40%.

The government's recent decentralisation reforms acknowledge many of the issues, but still fail to promote regulatory quality sufficiently at all levels of the administration

The government is aware that action is needed and a new framework law was adopted in 2003 (Box 1.16) which proposes significant reforms. It clarifies the status, rights and responsibilities of the *collectivités locales vis-à-vis* central government in a decentralised State. It proposes measures for the more active engagement of citizens in local decision making. It also proposes changes to revenue-raising and revenue-sharing. Without eliminating overlaps, it goes some way towards a clearer allocation of responsibilities. Efforts are made to rationalise responsibilities for health and social services but this remains complex. It also attempted to decentralise some staff in the education sector, but faced with massive opposition from the teaching establishment, this part of the reform had to be slightly amended. The reform has sought to target key issues. But it does not include mechanisms to promote regulatory quality at local level and best practice at all levels of government – an issue (see *Cour des Comptes* comments above) that needs serious attention too. The responsibilities of the *collectivités locales* are now far too important for this to be neglected. It is also premature to assess the law's real impact until the subsidiary legislation is in place and has had a chance to take effect.

Public expenditure management and control: this needs stronger reform to improve efficiency and contain costs

Public expenditure is high by OECD standards and its growth is unsustainable in the long term

France has a large public sector (Figure 1.9). Measured in terms of expenditure as a share of GDP it is the fifth largest in the OECD, and on a cyclically-adjusted basis it is the third highest in the OECD, 16% higher than the OECD average and 8% above the EU average. Nearly one in four French employees works for the government. There is a tendency to equate the public sector with central government, but the State Budget accounts for only 37% of all government spending, with sub-national levels accounting for 19% and the remainder, some 45%, accounted for by the social security system.

Public spending is weighted towards the provision of public services and income distribution. France spends more on income transfers than any OECD country except Switzerland, and total public spending as a percentage of GDP on the combined sectors of education, health and social services is the fifth highest among OECD countries. Other spending levels are also high. Even if a narrower definition of public expenditure is used, excluding spending on health, education and pension services, which in many OECD countries comes under the private sector, France still ranks seventh highest in the OECD.

Efforts to contain public expenditure have so far met with little success

The ageing of France's population carries a risk that public expenditure will be unsustainable in the long term. Efforts to set and meet spending targets have not so far been successful. Despite producing a multi-year budgetary forecast each year, the government has repeatedly missed its targets Figure 1.10). The overall budgetary shortfall is now expected to reach or exceed 4% of GDP in 2003.

Box 1.16. **The 2003 decentralisation reform**

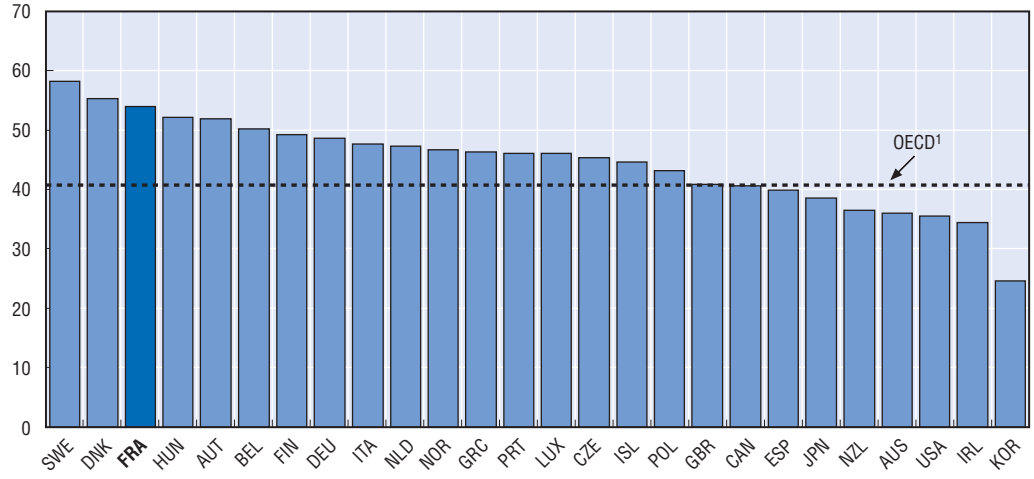
This constitutional reform specifies the decentralised organisational status of the Republic and increases all local authorities' regulatory freedom by extending the exercise of their powers. As an experiment they may even disregard legal and regulatory provisions which govern their powers if an *organic* law has provided for this. This reform, which recognises that no local authority has any power over another, nevertheless sanctions the possibility of a leading role for an activity in a municipality within a consistent framework. The reform introduces the possibility of a locally organised referendum and the right to petition citizens to get them more involved in setting the agenda for the deliberating assemblies. This reform also confirms the possibility of fixing the base and the rate of some taxes as well as the principle of adjusting resources. In short, any project relating to the organisation of local authorities must first of all be submitted to the Senate.

The reforms put forward in 2003 aimed at clarifying these duties, particularly by specifying that some authorities may exercise leading functions: the region for economic development and occupational training, the department for social services. But the overlaps remain. As far as the police is concerned, the mayor essentially retains his powers whereas the department is responsible for traffic police on departmental roads and the State co-ordinates the two police services active in France, with the national police and the "gendarmerie". When this reform is complete, if the department sees its powers increased with responsibility for all social assistance, managing the "medico-social" sector remains complex with a role also retained for the municipality which is social measures and exercising social duties delegated by the department. The State retains overall legislative powers for health policy, whereas the mayor remains the chairman of hospital and related health institutions.

As far as education is concerned, it was envisaged that every authority would be responsible in future for both building and running all educational establishments under its responsibility. The State would set educational policy targets and would be responsible for the salaries of teaching and non-teaching personnel. However, this reform, which assumed that the management of 100 000 officials would be transferred to local authorities, was slightly amended in response to social unrest. In addition this plan would mean that the municipality and the department would have to be consulted to build higher education establishments. As far as young people and sports are concerned, the municipality retains responsibility for facilities for very young children, local sporting facilities and subsidies to clubs and associations while the department pays rent to the municipalities for the use of local authority equipment (for secondary schools up to age 16). The region does the same for secondary schools for 15-18 year olds. The State also manages national funds for developing sports and training at regional centre level. In cultural matters the complete overlap of powers is retained.

In economics, the situation is clear since only the region may determine and provide part of public aid. It may delegate by agreement to the municipalities or the departments. The municipalities, the department and the region may have shares in the capital of a guarantee company or investment companies by decree of the Council of State and may contribute to the upkeep of services in rural areas. Aid to businesses in difficulties may be granted by the region and the department. Municipalities, departments and regions may set up telecommunications infrastructures. Municipalities may contract out the distribution of electricity or gas or may manage it directly. Municipalities retain management of marinas, while commercial sea and fishing ports are under the departments, river ports under the region and major waterways under the state. Airports remain principally the responsibility of the State but anybody may build an aerodrome subject to the agreement of the ministry involved. Some local authorities may experiment with the management, maintenance and running of aerodromes prior to decentralisation.

Figure 1.9. **Public spending in the international perspective**



1. Weighted average

Source: OECD, *Economic Outlook*, No. 71, June 2002.

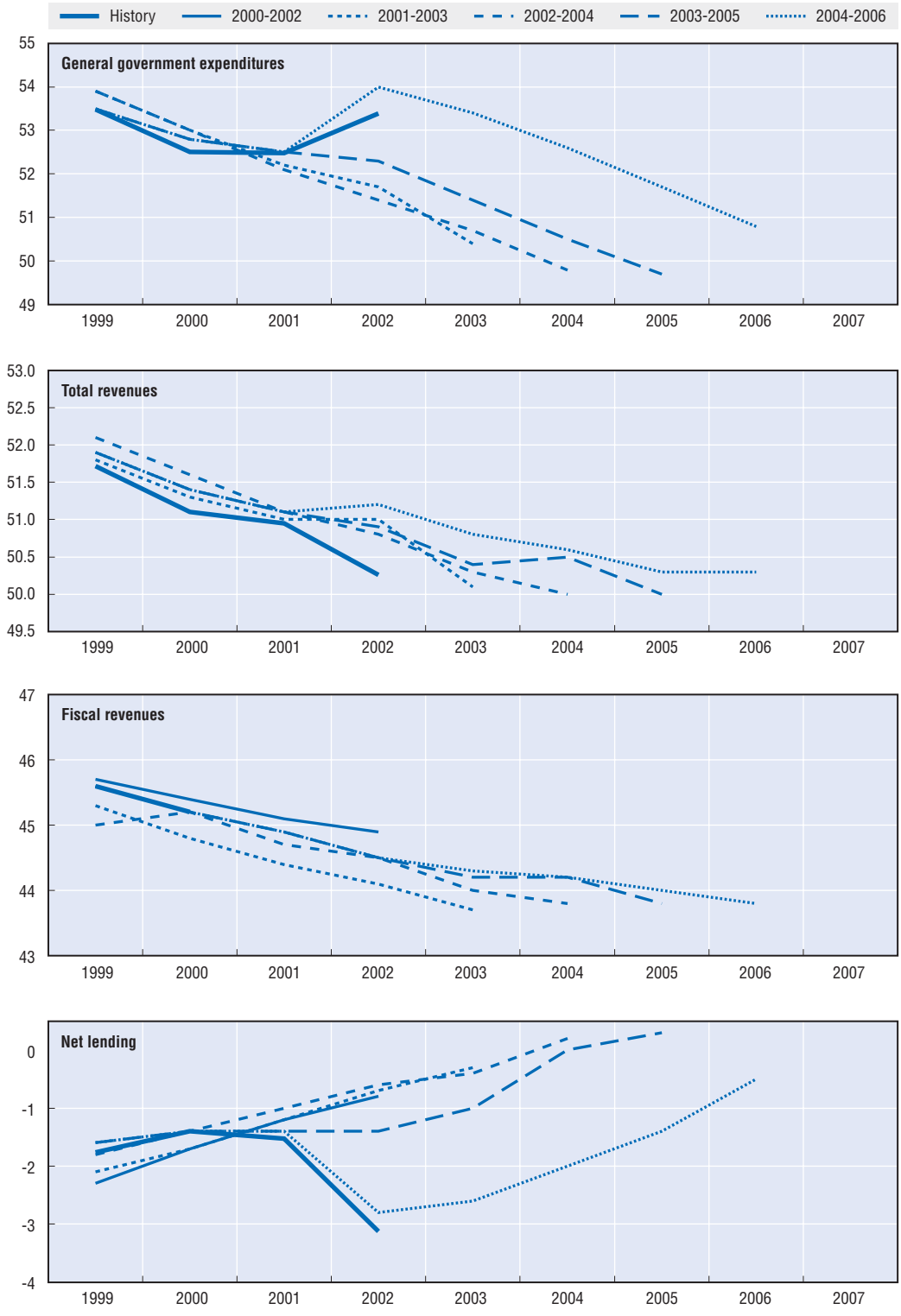
The repeated failure to respect multiyear budgetary spending objectives reflects several factors. The government has managed to meet its budgetary objectives for the State budget, but has had much more difficulty exercising effective control over that share of general government spending that lies outside the State budget, notably social security (health, pensions and unemployment insurance) expenditures. Most recently, spending has also exceeded projections in the State budget, and overly optimistic growth assumptions in the multi-year plans, during a period of economic slowdown, have contributed to a systematic undershooting on the revenue side.

Important steps have been taken to strengthen public expenditure management, though more is needed

The government has taken a number of important steps to strengthen the management of public expenditure. As already noted, the 2001 financial management law (LOLF), which is to be progressively phased in over the next few years, introduces output orientated budgeting and emphasizes regular evaluation of programme outcomes. It also gives parliament a greater policy-making role and responsibility for ensuring that spending is efficient. This law represents a potentially powerful tool for increasing the effectiveness of public expenditure.

While social security spending remains outside the State budget (and so outside the scope of LOLF) important efforts have been made to improve oversight and governance in these areas as well. The introduction of a social security budget in 1996 has helped to strengthen recognition of the economic and fiscal consequences of these spending categories. The more or less simultaneous debate of the State and social security budgets helps to highlight the implicit tradeoffs between them. However, additional steps need to be taken to ensure that spending outside the State sector is subject to more effective budget constraints. Greater use of performance contracts in the social domain would ensure that government priorities, particularly in relation to health, were better respected.

Figure 1.10. **Slippage in multiyear targets**
Per cent of GDP



Source: Various issues of Projet de loi de finances; INSEE and OECD.

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Overall fiscal sustainability could be ensured by *ex ante* mechanisms designed to correct any eventual overruns.

The progressive integration of the medium-term projections conducted in the context of the Stability and Growth Pact has served to raise the visibility of the tradeoffs between State budget and other general government expenditures. These are now included as annex to the State budget and though it remains a strictly annual exercise, both the parliamentary and public debate now focuses on the medium term consequences of policy. This medium-term focus can help prevent pro-cyclical and unfinanced permanent increases in spending. But in order to ensure that this happens, the past tendency to base future outcomes on optimistic growth outcomes should be avoided.

Steps have also been taken to slow the growth of public expenditure, though again more is needed

As well as reforms to the mechanisms with which spending is managed, the government has taken steps to slow the pace at which expenditures are increasing, not least steps to improve the sustainability of the pension system. The pension reforms occurred in two stages. The first, in 1993, revised the basis on which benefits were calculated by making benefits depend on the forty year average of a pensioner's salary and indexing benefits on the basis of inflation rather than wage growth. A second major reform in 2003 introduced similar changes to the public sector pension scheme. While significant further reform will be required before the pension system is placed on a sustainable track, these two reforms are expected to generate substantial savings. The reform process has also raised public awareness of the importance of the issue and the continuing need for reform. Further efforts have concentrated on reducing the rate of increase in public medical insurance expenditures. This includes encouraging the use of generic drugs, lowering the rate of reimbursement of pharmaceuticals with limited medical performance, and ongoing efforts to rationalise hospital-based expenditures.

Other reforms are needed in the pensions and health sectors. Recent measures are a step in the right direction, but further similar action is still required. Where pensions are concerned, what is needed is to lengthen the contribution period further, do away with the incentive to stop working immediately on reaching retirement age and apply stricter controls on access to early retirement schemes. As regards health, what is really important is to make decision makers more answerable for the financial consequences of the measures they take. The proposals to extend universal cover, while at the same time increasing the share of sickness insurance covered by voluntary complementary insurance schemes, would tend to make people in need of health care more sensitive to the costs of various options – though ensuring at the same time that all citizens would continue to have access to a high level of care. In the same way, introducing a mechanism whereby future payment for ambulatory care would be dependent on the previous year's targets being met should help to limit the incentives for medical practitioners to provide increasing amounts of treatment.

Improving communication

A central element of any successful regulatory reform is bringing key stakeholders in the economy and society on board and promoting a shared responsibility for necessary reforms (*responsabilisation*). Substantial efforts are needed in France not only to bring the general public on board, but also to persuade government officials of the need for reforms and of

their benefits. Also, are established stakeholders (such as consumer groups) underexploited in terms of their ability and willingness to be part of a more constructive debate? Government could communicate more effectively in order to achieve a consensus on the benefits of reform. The government's recent success in the case of pension reform is encouraging, even though it follows on from over ten years of analysis and publishing of reports. It is also important to establish a clear course of action with regard to key issues such as the role of public service in liberalised markets.

But effective communication is still occasionally lacking. The general public's understanding of reforms and their effects does not reflect reality. Fears about the future of *service public* remain strong with the public, despite evidence that reform has often improved public services. The promotion of a better understanding of the facts and the issues at stake would therefore be very helpful. In terms of political economics, the situation is complicated by the fact that nearly a quarter of the workforce are public sector employees. If their dependents are also taken into account, the French population may collectively have a vested interest in the continuation of the traditional State and administrative apparatus. The human resource aspects of managing change is therefore an important issue. Nonetheless, the recent and admittedly differing examples of *Air France* and *France Télécom* show that it is possible to approach such issues in a positive light in France giving employees a greater say and stake in the future of the firms concerned.

Conclusion

France has undergone some striking changes over the past few years, and a wide field of important reforms has been set in motion, ranging from decentralisation to the liberalisation of network industries and internal changes to the management of public expenditure, among others. These reforms have contributed to the country's economic success. The opening-up of Europe has encouraged some of these changes. However, a growing school of thought at national level currently believes that a review of the role of State and a renewal of the governance and regulatory framework is essential if France wishes to remain a leader, even perhaps a role-model in terms of economical and social development.

The last ten years have allowed the missions and the new role of the State to be cast in a new light. However, the transition from tradition, which emphasises a powerful and centralised State, to a more decentralised, pluralist and competition-influenced framework, is complex as well as incomplete. The process is currently at the half-way stage and leaves many questions unanswered. Where next? Do some current reforms really have to be taken further? Can a mid-way course be maintained on issues such as public services and the development of network industries? A stronger and clearer strategic direction is needed. This will not be easy, partly because reforms such as decentralisation have sapped some of the driving force behind action by central government: the levers of power are less concentrated than in the past. But the problem is perhaps more that the emergence of a new consensus is proving particularly problematic. Debate therefore continues on the role of competition in encouraging more efficient economic behaviour. The issue of insiders and outsiders may also complicate a fuller understanding of the real needs of citizens and the business community: the insiders who are currently relatively sheltered, the administration and public employees, have one perspective, which may not (or sometimes will not) fully comprehend the others, who need to make their way in the exposed world of global competition. Economic constraints can put the republican virtue of solidarity severely to the test.

The government does, however, need to find a clearer path with a more strategically coherent trajectory. Admittedly the lack of an immediate crisis is a positive factor but one which sometimes can paradoxically help to slow down reforms, which seem to lose their urgency. France is currently at a crossroads. Further regulatory reforms are an essential component of the actions needed now to ensure that the rapid ageing of the population can be handled effectively while continuing to raise the living standards of future generations. Economic growth has slowed, notably compared with the US over the past ten years. There is a risk that public expenditure may not be sustainable in the long term. Steady growth in productive activities is needed to ensure that the economy remains dynamic. None of these goals can be achieved without further reform of the labour and product markets as well as the system of governance.

Better communication by the authorities of their strategy and the reasons for it would seem advisable with regard not only to the administration itself and specific organised stakeholders, but also to the general public. Vigorous action has been taken in recent years. However, there is still a long way to go in improving the management of change and allowing all actors to participate fully and responsibly in the development of further reforms.

Notes

1. This is primarily due to the lower number of hours worked in that productivity per hour worked is one of the highest in the OECD area and comparable to levels in the US.
2. Data for August/September 2002.
3. Conseil d'Orientation des Retraites (2001).
4. Given that the level of remuneration has been maintained and has not been adjusted on the basis of the reduction in working hours.

Table of Contents

List of Boxes

List of Tables

List of Figures

ISBN 92-64-01546-9
OECD Reviews of Regulatory Reform: France
Charting a Clearer Way Forward

Bibliography

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