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French Public Finances through the Financial Crisis: It's a Long Way to Recovery*

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Abstract

France was modestly hit by the financial crisis compared with its neighbours but the recovery has been particularly slow. The shock to the public finances was nonetheless significant, and came on top of an already weak pre-crisis fiscal position. Part of this shock is expected to be permanent and the French government has so far mostly used increases in taxation to bring borrowing under control. However, in 2014, spending cuts took over as the main tool for balancing the public finances. Despite the significant fiscal adjustments that have been required, the crisis has not been used as an opportunity for

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reforms. Some reforms to labour and service markets have been carried out, but there have been no radical changes. While some tax changes, such as cuts to employer social security contributions and an increase in reduced rates of VAT, have improved the efficiency of the tax system, overall the tax and benefit system continues to be plagued by complexity and a sheer lack of transparency. As the remaining effort for balancing the public finances seems likely to rely on spending cuts, the overall efficiency of the policy response to the crisis will depend in large part on how these are done.

Policy points

- Although the French tax system is still plagued with complexity and inefficiencies, revenues have proved to be remarkably resilient during the crisis, remaining constant as a share of national income.
- The overall impact of tax and benefit changes from 2010 to 2014 has largely been progressive, with greater reductions in disposable income for higher-income households.
- The use of tax increases rather than spending cuts to reduce the deficit post-crisis has typically been characterised as a policy choice. However, this choice seems in part to have been driven by the imperfect control that the French government has over growth in spending.
- The government's current plan is to rely mostly on spending cuts to reduce the deficit from 2014 onwards. As a result, the biggest challenge facing the French public finances remains the ability of the government to control public spending.

I. Introduction

Even before the financial crisis hit, France's economic situation was worrying: the long-term unemployment rate was high, the public finances were weak and the growth rate of the economy was below what many countries in Europe were enjoying. French policymakers were obsessed by the example (or counter-example for some) of Germany, which had implemented tough labour market reforms and had a balanced budget and low unemployment. But there was no consensus on the policies needed in France. Because the financial crisis has affected France less than its neighbours, it has not acted as the impetus for structural reforms that some expected. In a sense, France stands midway between the experience of southern European countries – where the crisis led to a massive recession and dramatic reforms – and northern European countries, which were in a much better position to absorb the shock of the crisis.

This paper describes the French experience of the financial crisis, setting out the long-term evolution of the economy and public finances and the recent policy measures that have been implemented. Section II presents the macroeconomic situation and how the crisis unfolded in France. Section III focuses on the public finance situation before and during the crisis and what the overall fiscal response has been, while Section IV describes in more detail the specific policy measures that have been taken. Section V concludes.

II. Impact of the financial crisis: the macro picture

1. National income

A very short overview of growth in France since the end of the Second World War will highlight '*les Trente Glorieuses*' (i.e. the Glorious Thirty), the period between 1946 and 1975 when growth in France was strong and above the European average. The causes have been much discussed and explanations range from technological catch-up to a large demographic shock (the baby boom), but the period has framed many French policymakers' attitudes towards macroeconomic conditions, with an almost endless aspiration to return to these 'golden years'. From 1979 onwards, the second oil shock led to a marked slowdown of growth. Since that time, the country's economy has more often been described as in 'crisis' than back on the trend from the previous period. But that gloomy perception – compared with the idealised vision of the 1960s – puts aside two periods of higher growth in the late 1980s and again in the late 1990s; these periods were then followed by periods of stagnation.

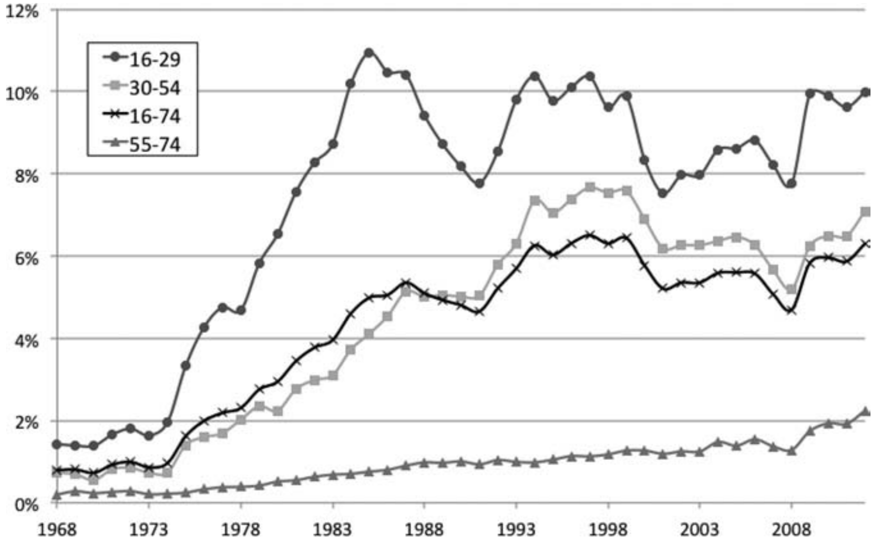
In historical perspective, the financial crisis of 2008–09 led to a dramatic drop in national income, on a scale not seen since the end of the Second World War: between 2007 and 2009, real GDP fell by 3.2 per cent, while real GDP per capita fell by 4.2 per cent. Perhaps more worryingly for the French economy, the stagnation seems to be lasting, as national income per head is still below the pre-crisis peak – something not uncommon in the experience of the other eurozone members – and is expected to decline further over the next few years, falling (by 2017) to a level 4.6 per cent below the 2007 peak.

2. Labour markets

Even more than the growth experience, the situation in the labour market has been the major cause for concern for French policymakers. Unemployment has repeatedly been ranked in opinion polls as the top priority for French voters. Figure 1 presents the share of the population unemployed (using the International Labour Organisation (ILO) definition) by age group – this metric is different from the more usual ILO unemployment rate defined as a share of the active labour force. The impact of macroeconomic trends is clear, with a massive increase in unemployment in the 1970s and early 1980s and again in the early 1990s. The recent crisis has led to a marked increase in unemployment

FIGURE 1

Evolution of unemployment rate by age group



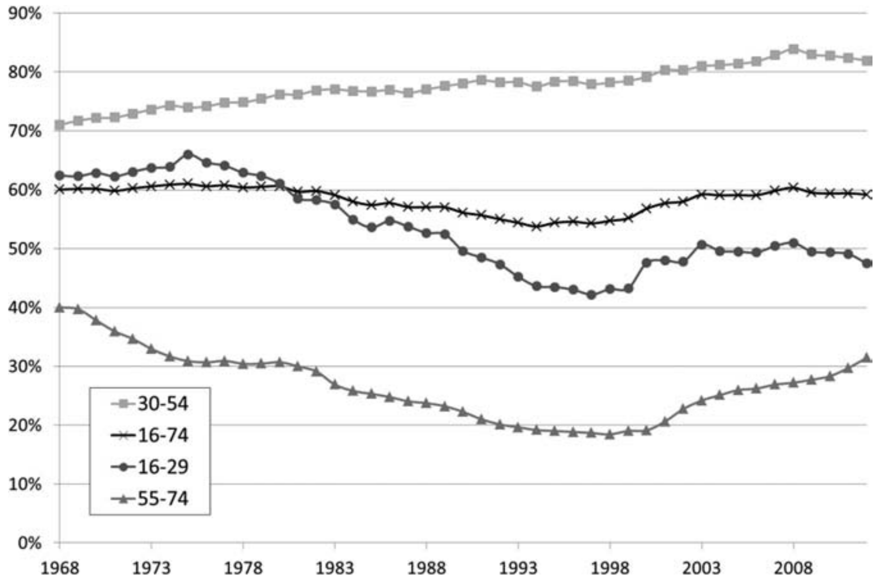
Note: The graph shows the fraction of the population of a given age who were unemployed (using the ILO definition) in a given year. There is a break in the series in 2003 (start of the continuous labour force survey); the break has been corrected here.
Source: Insee, *Enquête emploi* (i.e. French labour force survey).

back to levels not seen since the mid 1990s. It has almost entirely removed the drop in unemployment rate that occurred in the pre-crisis years. Youth unemployment, which was already very high, rocketed to 9.9 per cent of the 16–29 age group in 2012.

The share of the population unemployed does not offer a complete picture of the long-term trends in labour markets, especially in France, where policies aimed at reducing the labour force participation of older people have long been in place (in particular, early retirement policies in the 1970s and 1980s). Figure 2 presents the employment rates for different age groups across the last 40 years. Prime-aged adults in France (i.e. those aged 30–54) have seen their employment rate increase steadily over time due to the increase in female labour market participation. However, the picture is radically different for the young and the old. Both these groups experienced a major decline in their employment until the late 1990s, when the situation somewhat reversed. The reversal in trend for the older workers reflects a change in policies targeted at this group: for example, abandoning early retirement policies aimed at ‘releasing jobs for the young’ and introducing pension reforms to incentivise

FIGURE 2

Employment rate by age group



Source: Blundell, Bozio and Laroque (2013), updated to 2012.

older workers to postpone retirement. The upward trend in employment of older workers has continued since the crisis started – in fact, if anything, it has been reinforced. The young, on the other hand, have been most hit by the crisis, seeing not only an increase in unemployment but also a reduction in their labour market participation.

An important feature of the French labour market since the financial crisis has been the dynamics of unit labour costs, which have grown at a much more rapid pace than productivity. This has caused concerns in France as it implied a significant detrimental impact on unemployment. The causes behind this feature of French labour markets have been much discussed[1] and are best understood by comparing with other countries. Within the eurozone, with low inflation and no ability to devalue the currency, even small nominal wage growth translates into high unit labour cost increases. With little flexibility to reduce nominal wages (for example, because of legal barriers to renegotiating contracts or laying off workers, and multiple-year wage bargaining agreements), French firms preferred to stop recruiting and not to renew short-term contracts. Furthermore, unlike Germany, France had

[1] See, for instance, Askenazy, Bozio and García-Peñalosa (2013).

not experienced a prolonged period of wage moderation before the crisis; this low wage growth prior to the crisis allowed France's neighbour to absorb the productivity shock. It is in this context that some of the French policy response (such as cutting employer social security contributions) can be understood.

III. Public finance responses

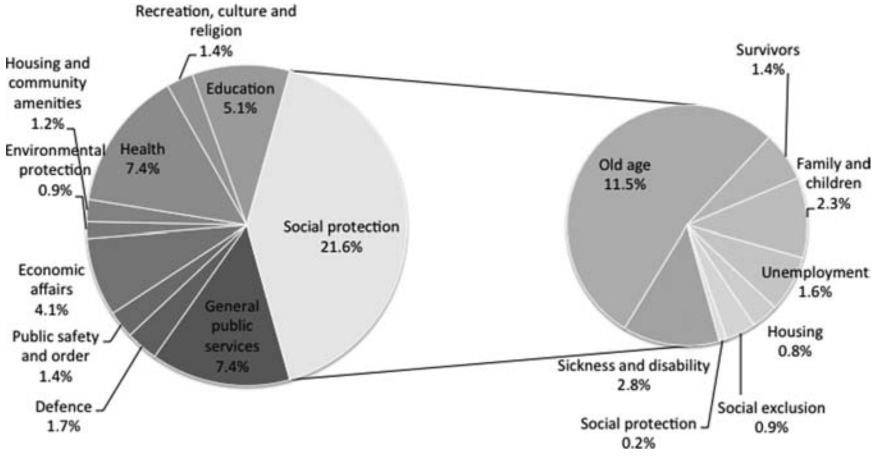
1. Fiscal stance before the crisis

On the eve of the crisis, France was a relatively high-tax country (42.1 per cent of GDP in 2007) with an even higher level of spending (52.2 per cent of GDP in 2007), part of which was funded by significant revenues from dividends and other non-tax sources (7.6 per cent of GDP in 2007). The difference was made up by borrowing (2.5 per cent of GDP in 2007). France's relatively high level of spending compared with most other European countries can mostly be accounted for by its higher level of social security spending (see Figure 3), in particular spending on pensions (12.9 per cent of GDP in 2007).

The high level of coverage and the strong contributory links inherent in the French pension and unemployment systems have limited the development of private insurance in France and partly explain the current structure of French public spending, although spending is also high in other domains (such as health care and defence).

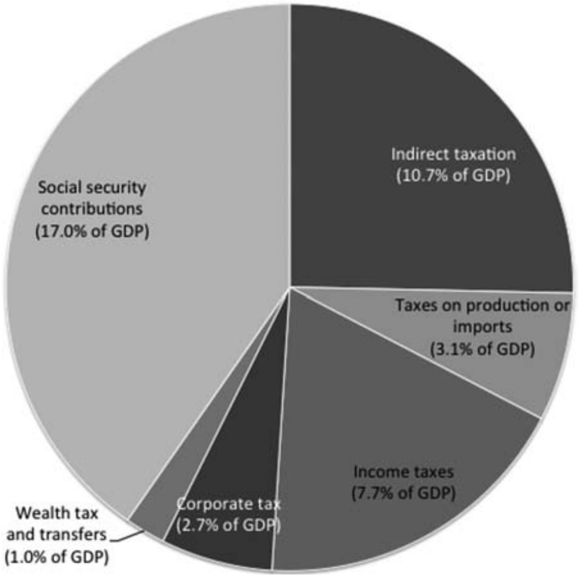
FIGURE 3

Composition of public spending in 2007 (% of GDP)



Note: The graph represents the structure of public spending in 2007; data labels show the share of GDP spent on each item.
Source: National Accounts (account of public administration), Insee base 2010.

FIGURE 4
Structure of taxation in 2007



Note: The graph represents the structure of compulsory taxes and social contributions in 2007; data labels show the share of GDP raised in revenue by each tax.
Source: National Accounts (account of public administration), Insee base 2005.

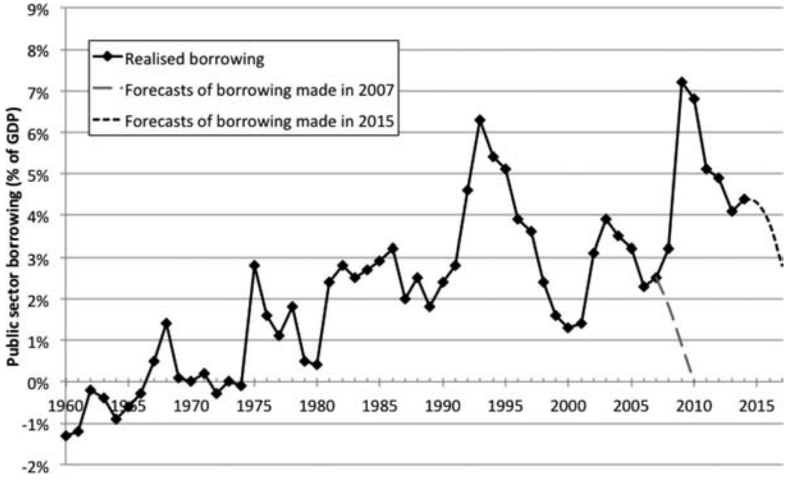
The structure of taxation in France pre-crisis reflected the emphasis on social insurance: a large share of tax revenue came from social security contributions (17.0 per cent of GDP), while income taxes only amounted to 7.7 per cent of GDP (Figure 4). VAT and other indirect taxes represented a smaller share of taxes than they do in other high-tax countries, such as the Nordic countries, but still amounted to 10.7 per cent of GDP.

Before the crisis hit, France was already in the red (with borrowing at 2.5 per cent of GDP), although still within the limit of the Maastricht Treaty target of 3 per cent of GDP. France had experienced deficits in every year since the first oil crisis hit in 1974. The Maastricht rules were only met in five out of the nine years in which they were in place before the crisis. This happened because the official public finance forecasts were repeatedly too optimistic about the prospects for economic growth (see Box 1). The forecast before the crisis, in 2007, was an expected strengthening of the public finance position until a balanced budget was expected to be achieved in 2010 (see Figure 5).

Figure 6 shows the cumulative impact of repeated borrowing, and weak economic performance, on public sector debt. From a low of 11.8 per cent of GDP in 1973, public debt rose quickly to 60 per cent in the mid 1990s, when it

FIGURE 5

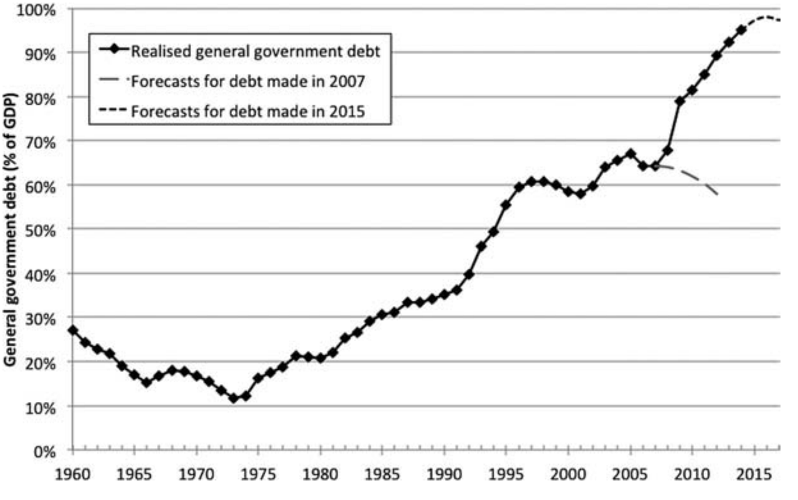
Borrowing as a share of GDP



Source: The borrowing series comes from the National Accounts (Insee base 2010); the 2007 forecasts for borrowing are the last pre-crisis forecasts made by the Stability Programme 2009–12 in November 2007; the forecast for borrowing made in 2015 comes from the *Loi de finances* for 2015.

FIGURE 6

Debt as a share of GDP



Source: The public debt series comes from the National Accounts (Insee base 2010) for the years 1978 to 2013; the series from 1950 to 1977 comes from Pierre Villa's series (CEPII); the 2014 number is the Insee 3rd quarter estimation; the forecasts of public debt from 2007 are the last pre-crisis forecasts made by the Stability Programme 2009–12 in November 2007; the 2015 debt forecast was made by the *Loi de finances* for 2015.

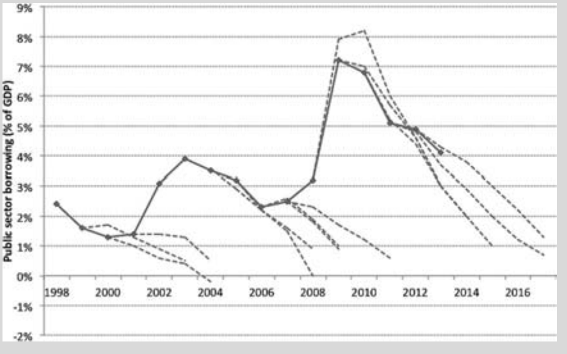
BOX 1

The French budgetary process

The French budget is discussed at the French Parliament using two separate documents, one for the state (*Loi de finances*) and one for social security administrations (*Loi de financement de la sécurité sociale*). The two parts of the French budget are discussed sequentially by Members of Parliament although the overall position of the public finances hinges on tax and spending measures contained in both documents. They also both rely on common macroeconomic forecasts, devised by the French Treasury under the control of the Finance Minister. It has often been argued that boosting the expected rate of growth used in preparing the budget has been an easy way to balance the budget. As can be seen in Figure 7, prior to the crisis the expected balance of the French budget exhibited a systematic optimistic bias, with deficits always being higher than envisaged in previous budgets, even during the period 2001 to 2007 when macroeconomic conditions were relatively good.

FIGURE 7

Expected public sector borrowing versus realised borrowing



Note: Realised borrowing is represented by the solid line, while forecasted public sector borrowing is represented by the dashed lines.
Source: National Accounts (Insee base 2010) and forecasts presented in the *Lois de finances*.

This situation has raised concerns both in France and at the European Commission. In 2012, a new independent body, the *Haut conseil pour les finances publiques* (HCFP), was created with the aim of increasing external scrutiny of the budgeting process. Its mission is to make an external assessment of the macroeconomic forecasts embedded in the French budget and examine the coherence of French public finance plans. The existence of the HCFP is likely to improve the growth forecast underpinning the budgeting process. However, for the costing – or scoring – of policy measures, the French Treasury is still almost unchallenged by external scrutiny.

reached the Maastricht Treaty debt ceiling. An effort was then made to remain under this ceiling for a few years, until it was broken in 2003, and then debt reached 64.2 per cent of GDP in 2007. The Stability Programme pre-crisis forecasted a progressive decrease in the level of public debt, aiming for a level below the 60 per cent ceiling by 2012.

2. How did the crisis affect the public finances?

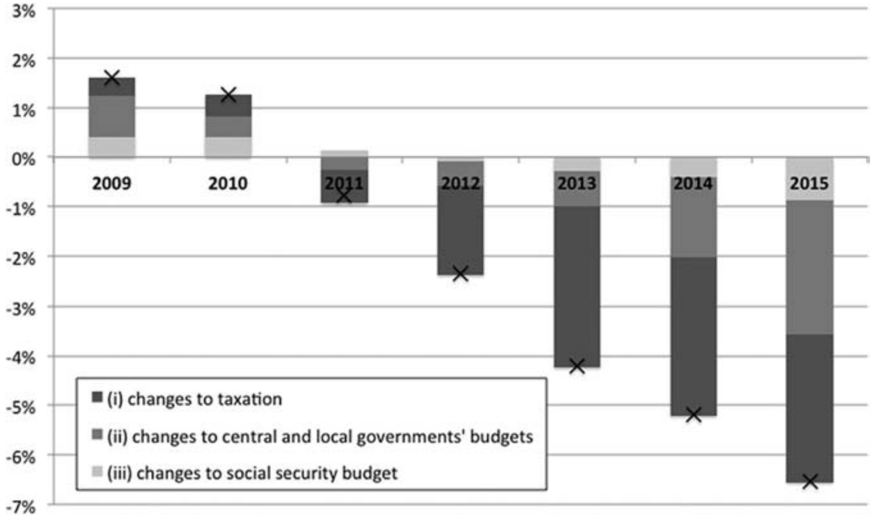
The crisis has affected France's public finances through a sizeable negative shock to national income, leading to an increase in spending measured as a share of national income, causing public sector borrowing to soar. Figure 9 later highlights the key figures showing how the crisis has affected France's public finances, by reconstructing counterfactual revenues, spending and borrowing in the absence of the estimated direct effect of policy responses. The macroeconomic shock can be decomposed into a permanent shock to national income, mostly visible in 2009, and a change in growth pattern leading to a progressive drift in spending as a share of GDP. Without policy response, we estimate that the public sector deficit would have reached 9 per cent of GDP by 2014.

3. What was the fiscal response to the crisis?

The first part of the fiscal response to the crisis was a stimulus package – mainly in 2009 – comprising increased spending and tax cuts. The size of this stimulus was relatively modest compared with what some other countries undertook: the total fiscal expansion was 1.6 per cent of GDP in 2009. The extra spending in 2009 took the form of large public works (high-speed train lines, tunnels, etc.) and funds directed at firms. In 2010, additional spending took the form of investment spending for higher education and research (*Plan campus* and *Investissement d'avenir*) funded through extra borrowing. There was also some limited government intervention to support the financial sector, mostly in the form of loans to troubled banks.

After this period of measured fiscal stimulus, the French government decided to tighten fiscal policy, mostly through increased taxation: in 2011 the reversal of the temporary stimulus measures and new tax rises amounted to 1.1 per cent of GDP, with a further 1.1 per cent of GDP tax rise implemented in 2012, while in 2013 another tax hike added a further 1.4 per cent of GDP. Figure 8 presents the composition of fiscal changes from 2009 to 2015, showing changes to taxation and spending, split into central and local government budgets and social security (pensions, health care, work-related accident and child benefits). By 2014, 61 per cent of the fiscal tightening had been done through increased taxation, while public spending cuts only represented 39 per cent of the total effort.

FIGURE 8
Composition of the public finances responses (% of GDP)



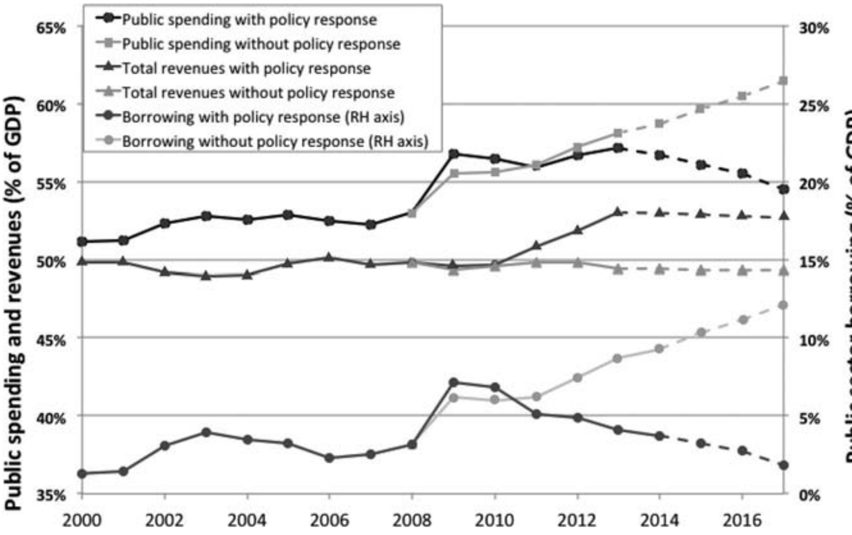
Note: The cross, ×, indicates the total impact of public finances responses.
Source: National Accounts (Insee base 2010) and *Lois de finances* from 2009 to 2014.

Since 2014, the French government has decided to stop increasing taxation and, therefore, mostly use reductions in public spending as a way to balance the public finances. Reductions in public spending reached 2 per cent of GDP in 2014 and a further 1.5 per cent of GDP is planned for 2015. Within public spending, social security spending has contributed little to the overall cuts in public spending, while most of the cuts have been delivered by cuts to central and local government budgets. By 2015, according to government plans, the fiscal tightening will have been done 46 per cent through net tax rises and 54 per cent through net spending cuts. It is important to note, however, that these estimates of spending 'cuts' are relative to the counterfactual spending trends shown in Figure 9. In the French case, the increase in counterfactual public spending is largely driven by expected increases in health care and old-age pension spending (see Section IV.2).

In 2009 and 2010, public policies were countercyclical (increasing public spending and borrowing compared with the situation without any response). From 2011 onwards, policy responses have reduced borrowing to below 5 per cent of GDP. So far this has mostly been done through significant increases in taxation, as shown in Figure 9, but over the next two years spending cuts are expected to deliver further borrowing reductions while no further tax increases are currently planned.

FIGURE 9

Taxation, spending and borrowing with policy responses



Source: National Accounts (Insee base 2010) and *Lois de finances* from 2009 to 2015. The dashed lines for policy response come from the 2014–17 public finance programming law.

IV. Policy responses: an opportunity for reform?

1. Changes to tax and benefits

This section presents micro analysis of changes to the tax and benefit system introduced after the crisis. These have been almost entirely on the tax side, with increases in taxes that started in 2011 and 2012 with the centre-right government being added to by the centre-left government in 2012 and 2013, before being halted in 2014.

Detailing all the tax changes over the period is outside the scope of this paper, since the increase in the tax burden has taken the form of numerous small changes, but Table 1 summarises the main changes.

Income taxation has been increased by three main measures. First, by failing to uprate tax thresholds, the French government has caused a general increase in income taxation, using an effect known as fiscal drag or bracket creep. Second, by increasing top income tax rates, high incomes have been particularly targeted by these tax increases.[2] The increase in top marginal tax rates has happened in three steps: first in 2011 with an additional tax on incomes above €150,000, then with the increase in the top marginal tax rate from

[2]Bozio et al., 2012.

TABLE 1

Major tax changes post-crisis

	Year(s) of implementation	*Change in total revenues (% of GDP)*
Household income taxation		
Increase in top marginal rates of income tax	2009 to 2013	0.05%
Additional tax on incomes above €150,000	2011	0.04%
Increase in the discount to the tax schedule (*Décote*)	2013 and 2014	–0.03%
Reduction of *Quotient familial* maximum tax reduction	2013 and 2014	0.08%
Reduction of the tax loopholes	2012 and 2013	0.04%
Changes in wealth taxation	2011 to 2013	–0.03%
Freeze of the income tax brackets	2012 and 2013	0.17%
Capital gains taxation	2010 to 2013	0.29%
Changes in flat-rate income tax (CSG)	2009 to 2012	0.04%
Income tax reduction for low-income households	2015	–0.13%
Social security contributions (SSCs)		
Increase in pension SSCs	2014	0.13%
Increase in SSCs on capital income	2009 to 2013	0.33%
Creation and increase of the *Forfait social*, an employer contribution on earnings not previously subject to SSCs	Since 2009	0.28%
Reduction in SSCs	2015	–0.27%
Firm taxation		
Increase in payroll tax (*Taxe sur les salaires*)	2013 and 2014	0.02%
Reform of the corporate tax (*Impôt sur les sociétés*)	2012 to 2014	0.14%
Tax credit for competitiveness and employment (CICE)	2013 and 2014	–0.47%
Reform to business rates (*Taxe professionnelle*)	2010 and 2011	–0.35%
Research tax credit	Since 2009	–0.04%
Anti tax evasion and exile of firm taxation	Since 2011	0.15%
A new social solidarity contribution on firms	Since 2011	0.07%
Other fiscal measures on firms	Since 2010	0.16%
Employer levy on earnings above €1 million ('75% tax')	2013 and 2014	0.01%
Indirect taxation		
VAT: creation of a new category, increase in VAT rates and changes to the tax base	2012 and 2014	0.40%
Increase in rates on tobacco and alcohol; creation of a tax on fizzy drinks; food taxation	2009 to 2011	0.07%
Pigouvian taxes for ecological concerns	2009 to 2015	0.17%
Other indirect taxes	2010 and 2013	0.02%
Total of selected tax measures		**1.34%**

Source: Rapports des prélèvements obligatoires, 2009–13 and *Rapports économique, social et financier*, 2014–15.

BOX 2
The '75 per cent tax'

During the 2012 presidential election, François Hollande promised to introduce a 75 per cent tax on annual incomes above €1 million. This announcement made international headlines at the time. The introduction of the tax, however, has been convoluted, with a first attempt declared unconstitutional by the Constitutional Court in 2012 because it failed to take into account family composition. The final version of the tax voted in by the French Parliament took the form of an employer tax on earnings above €1 million at the rate of 50 per cent, which when added to existing income taxation amounted to a marginal tax rate of 75.7 per cent (see below). The tax is temporary – only for two years from 2012 to 2014, and therefore no longer in place – and also has a cap at 5 per cent of turnover.

This reform changed the marginal tax rate for those on the very highest salaries subject to this tax. The marginal rate can be calculated for an individual receiving only salary-related income (see Bozio, Guillot and Tenand (2013)): for such a person, the '75 per cent tax' increases the top marginal rate on net income from 66.1 per cent to 75.7 per cent.

While this tax is notionally paid by employers, the effective incidence is still unknown. We do not know by how much employers adjusted for it in salaries (by lowering them), in relation to shareholders (by reducing dividends) or consumers (by increasing prices). The government hoped to discourage firms from offering salaries of more than €1 million but, since the tax is temporary, it is difficult to imagine it having a lasting effect on remuneration policies.

Above all, this tax is liable to entail a multitude of evasion tactics, whether delocalisation (making use of tax havens or shifting financial operations offshore) or tax avoidance (changes to salary reporting, forms of remuneration, etc.), all of which lead to a reduction of receipts from the tax. The government estimated that it would raise a relatively small €260 million in 2014, and even that is probably an overestimate.

40 per cent to 45 per cent, and finally – and largely symbolically – with the temporary 75 per cent tax rate on incomes above €1 million (see Box 2 for more details).

Tax increases have also been concentrated on capital incomes. These increases first took the form of an increase in the flat rate of income tax charged on capital incomes, which was raised from 20.1 per cent to 36.5 per cent between 2009 and 2012. Then the government decided, from 2013 onwards, to incorporate most capital income into the progressive income tax schedule (from which it had previously been exempted). This led to further increases in capital income taxation for households whose income put them in the top marginal tax bracket.

A second set of changes were those made to firm taxation. In 2012, the government announced a major expansion of the corporate tax base, before announcing a major reduction of corporate tax through a tax credit (*Crédit d'impôt compétitivité emploi*, CICE) computed on earnings paid by firms. This tax credit is in effect a reduction in employer social security contributions of 6 per cent of gross earnings under 2.6 times the minimum wage (i.e. earnings up to around the eighth decile of earnings).

In order to fund this tax credit, the government increased VAT rates, with the normal rate going from 19.6 per cent to 20 per cent and the intermediate rate from 7 per cent to 10 per cent. This increase in the intermediate rate happened five years after its introduction for hotels and restaurants.

Finally, there have been significant increases in mandatory pension contributions, for both public and private sector employees.

Assessing the efficiency effects of these various tax changes is difficult as many of the changes have had contradictory effects which may offset each other. The increases in income tax have led to an increase in marginal tax rates for the richest households, but most of the increase has been directed towards the taxation of capital, rather than labour, income. On the downside, these changes will have reduced economic efficiency by reducing marginal incentives to work and save. However, on the upside, they have had the positive effect of reducing the difference in marginal taxation across different types of income – hence moving to a more neutral tax system, albeit one with higher marginal rates. The increases in pension contributions may also have reduced labour supply if wage earners do not realise that these contributions help fund their pension benefits – although one should note that the recent increases in contributions have not been matched by benefit increases, but rather by a reduction in the pension system's long-term liability.

Two other measures that improved the efficiency of the tax system were the tax credit for competitiveness, the CICE, which effectively reduced employer social security contributions, and the increase in reduced rates of VAT. As presented in the previous section, the structure of French taxation puts high weight, and perhaps too much weight, on raising revenues from employer social security contributions. These contributions, in combination with a high gross minimum wage, have been criticised for likely reducing labour demand, and thus increasing the structural unemployment rate. The tax credit that was implemented, which reduced these contributions for 80 per cent of wage earners, is likely to have a positive impact on employment and reduce the efficiency cost of these contributions. However, using a tax credit in corporate tax to offset high levels of social security contributions is far from optimal, and may well be much less efficient than directly reducing social security contributions. Increasing the reduced rate of VAT could also be assessed as

TABLE 2

Major benefit changes post-crisis

	Year(s) of implementation	*Change in total spending (% of GDP)*
Temporary measure for low-income households (2010 only)	2010	0.05%
Freeze of family benefits	2010	–0.05%
Increase of disability benefits (AAH)	2010 to 2012	0.04%
Increase of RSA of 2% more than inflation	2013 and 2014	0.02%
Freeze on the uprating of pensions	2014	–0.05%
Reform of family allowances	2015	–0.02%

being positive. There has been much discussion of the efficiency costs of the large range of products that can benefit from reduced VAT rates in France, particularly since the reduced rate was expanded to cover restaurants and hotels in 2009. There are likely to be efficiency gains from reducing the gap between the full and reduced rates of VAT.

However, taken as a whole, the need for significant changes to the tax system over the last few years has not been used as an opportunity to improve the coherency or simplicity of income taxation or social security contributions. French taxation continues to have two separate income taxes and more than 17 different social security contributions. Complexity still plagues the French tax system but an overhaul has definitely not been on the agenda during the post-crisis period, even though it was discussed by François Hollande during the 2012 presidential election campaign.

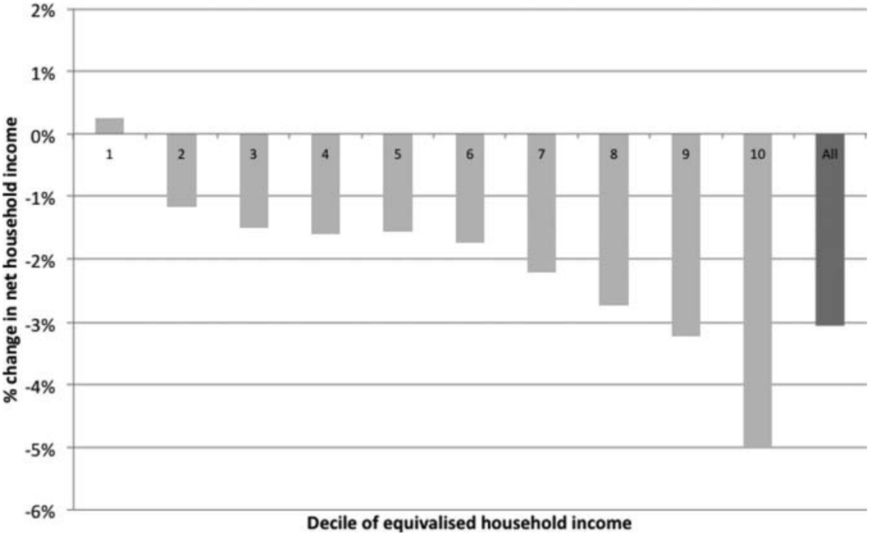
Changes in benefits (see Table 2) have been much smaller than changes in taxes. Similar to the bracket creep that affected tax thresholds, some benefits were frozen – for example, family benefits in 2010 and the uprating of pensions. But partially offsetting this was an above-inflation increase in the *Revenu de solidarité active* (RSA) and the *Allocation aux adultes handicapés* (AAH), which was intended to compensate the poorest households for the rise in indirect taxation; RSA is an income support programme for households with no or very limited resources, while AAH is a disability benefit.

Figure 10 shows the net change in household disposable income from the tax and benefit measures implemented between 2010 and 2014.[3] It is worth noting that these simulations exclude some tax changes, such as changes to

[3]The redistributive impact of the tax and benefit changes has been estimated using TAXIPP, the IPP's microsimulation model.

FIGURE 10

Redistributive impact of tax and benefit changes by decile of equivalised household income



Note: Redistributive impact of tax and benefit changes, 2010–14.
Source: TAXIPP 0.3.

firm taxation.[4] Overall, we have simulated 60 per cent of all tax and benefit changes implemented during this period.

On average, French households experienced a reduction in disposable income of 3.0 per cent. The total impact of these changes is continuously progressive, with the bottom 10 per cent of the income distribution having marginally benefited from them, while the rest have seen their net incomes reduced by tax increases. Deciles 2 to 8 have been affected to a lesser extent than the overall population. The richest decile of French households saw a reduction in disposable income of 5.0 per cent on average.

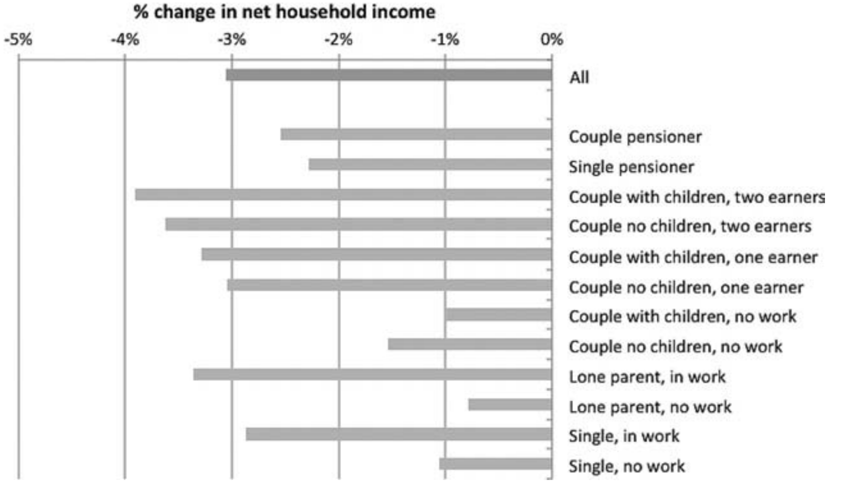
As Table 2 made clear, the changes to benefits have been minimal in France over the period and it is changes to taxation that explain the majority of the distributional effects. The only exception to this is the small gain observed for the first decile, which is mainly driven by the increase in the RSA of 2 per cent above inflation.

Figure 11 presents a similar picture decomposing the impact of tax and benefit changes by family type. Both the working-age population and

[4]One can make assumptions about the long-run incidence of various changes to firm taxation and estimate the likely impact on household disposable income, but for comparability between countries the estimates presented here only capture changes to household taxation. To be more precise, VAT changes have been incorporated assuming that the incidence will largely be on consumers, but the reduction of employer contributions in the form of the CICE has not been imputed to wage earners.

FIGURE 11

Redistributive impact of tax and benefit changes by family type



Note: Redistributive impact of tax and benefit changes, 2010–14.
Source: TAXIPP 0.3.

pensioners have been affected negatively on average. However, pensioners have lost less on average than the overall population, while working people with children have tended to lose more than otherwise-similar working people without children; the latter is mainly because of the decrease in the *Quotient familial*, the cap on income tax reductions that children can provide.

2. Changes to public spending

As highlighted by Figure 8, the fiscal tightening coming from cuts to central and local government budgets is planned to amount to 2.7 per cent of GDP by 2015, with an additional 0.9 per cent coming from social security budgets. Most of this reduction will be achieved simply by maintaining spending at the 2008 real-terms level – compared with a counterfactual of no policy change, which would imply an increase in public spending in real terms. By 2017, according to the 2014–17 public finance programming law, real-terms reductions in central government spending (i.e. expenditure by the French state) will amount to 8.7 per cent, or a contraction of 0.9 per cent of GDP compared with a real-terms freeze.

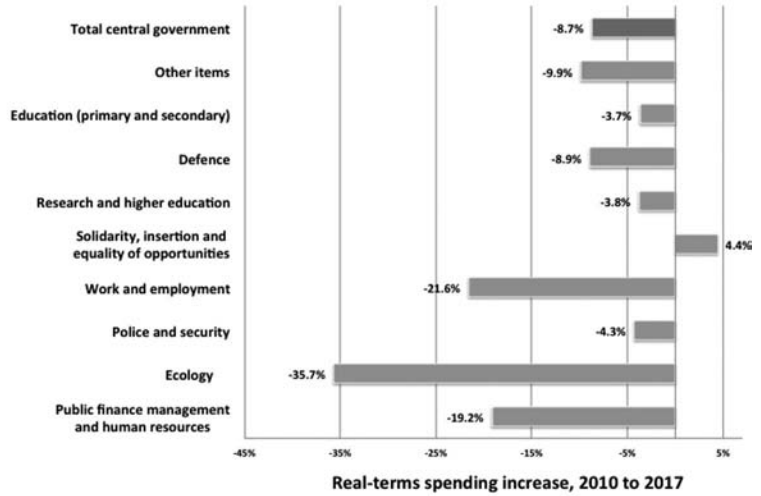
Using these spending plans up to 2017, we can decompose the planned cuts to the major areas of central government spending between 2010 and 2017 (see panel a of Figure 12).[5] Planned cuts are mainly targeted on general

[5]Central government spending accounts for 56 per cent of total local and central government budgets.

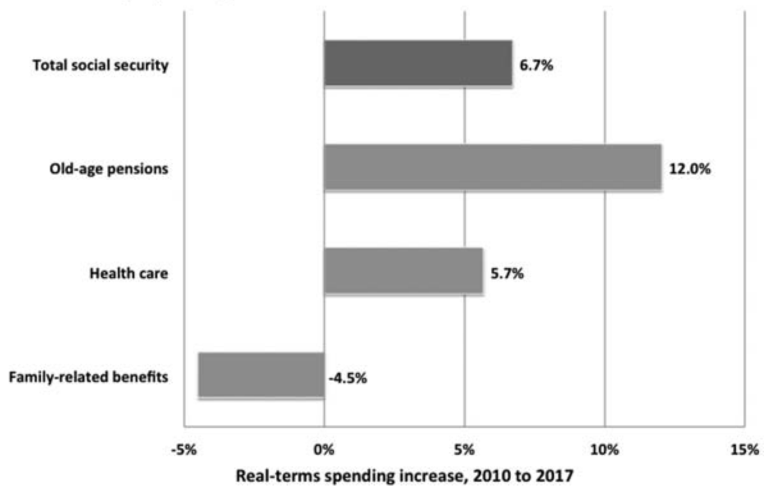
FIGURE 12

Real-terms increase in central government and social security spending by major function, 2010 to 2017

a) Central government spending



b) Social security spending



Note: Panel a shows total spending within central government and its decomposition between the eight biggest items and the sum of all the other items, ranked from the biggest to the smallest (in amount). These items include both benefits and public services. Panel b presents all spending within the social security budget; work-related accident benefits have been incorporated in the 'health care' item.
Source: Panel a – *Loi de finances* for 2010 and the 2014–17 public finance programming law; panel b – *Lois de financement de la sécurité sociale* for 2012 and 2015.

administration (labour, finance and ecology ministries), defence and other smaller areas (for example, culture and public aid to development). Spending on schools, police and research has been relatively protected from the cuts, with an average real-terms cut of less than 4 per cent compared with 8.7 per cent for all central government spending. Within the state budget, the main spending area that is not cut is the programme named ‘solidarity, insertion and equality of opportunity’, which exhibits a real increase in spending over the period, mostly accounted for by an increase in incapacity benefits and income support (AAH and RSA).

Panel b of Figure 12 presents similar numbers for the social security budget (included in *Lois de financement de la sécurité sociale*).[6] Overall, the social security budget is still expected to increase in real terms over the period from 2010 to 2017, especially for old-age pensions (+12.0 per cent) and health care (+5.7 per cent). Nevertheless, these increases are below counterfactual spending trends and represent a policy tightening relative to pre-crisis plans in the case of health care, which would have seen a 22 per cent increase by 2017 in the absence of policy change (according to 2014–15 social security budget laws). In contrast, old-age pensions have been largely protected from spending cuts. Spending on family-related benefits (child benefit, childcare subsidies, etc.) is planned to be reduced in real terms (–4.5 per cent) – similar to other relatively-protected items in the central government budget – compared with a counterfactual 8 per cent real-terms increase by 2017.

3. Other structural reforms

France has introduced a number of structural reforms since the financial crisis hit, albeit timid ones. There are three notable categories of reforms: changes to labour market rules, changes to the structure of local government and changes to market regulations.

There has been much discussion in France of the need for reform of labour market regulations. Some economists have argued that one of the sources of high unemployment in France is regulations that prevent firms from terminating employees’ contracts for economic reasons.[7] In January 2013, employee and employer unions signed an agreement (*Accord interprofessionnel sur la sécurisation de l’emploi*) aiming to facilitate mass redundancies and to reduce the possibility of judicial interference with firms’ decisions to reduce the size of their workforce. This agreement was judged to be too timid by proponents of further reforms of the French labour market, but was nonetheless criticised by

[6]The social security budget does not encompass all social security public spending as defined by National Accounts. For instance, it does not include complementary pension schemes or unemployment insurance, both of which are mandatory schemes (included by National Accounts in public spending) but managed by representatives of employers’ and employees’ unions, with no overseeing from the French Parliament.

[7]See, for instance, Cahuc and Kramarz (2005).

others as being an attack on employees' legal protections. Overall, the reform has the benefit of reducing the legal uncertainties around mass redundancies, but it remains to be seen whether this can have a significant impact on the efficiency of labour markets. Another agreement (reached in December 2013) led to a reform of the funding and organisation of on-the-job training by firms. This might also have a beneficial impact, although it is likely to be small.

The administrative map of France is complex, with multiple different layers of administration – state, regions, *départements*, *cantons* and *communes*. This administrative structure was originally set up during the French Revolution and Napoleonic years – splitting between a highly-centralised state and the local authorities, which were divided into the *département* and the smaller *communes*. A major reform in the early 1980s created larger local entities (regions). Over time, these have gathered more and more powers and greater control over spending. However, in recent years, it has been recognised that simplifying the administrative map further could lead to substantial savings by cutting duplicate administrations. Options put forward ranged from removing *départements* to merging *communes*, but the reform that was finally adopted led to the merging of regions. The 22 original regions were reduced to 13 new regions by a law passed in 2014. The reform is clearly a step towards a better and more efficient administrative map, but the savings will not materialise for a few years (as merging administration takes time), and the latest reforms only go part of the way to simplifying France's complex administrative structure: 36,660 *communes* and 101 separate *départements* remain.

Finally, a law passed in Summer 2015 aims to remove barriers to entry into, and deregulate the practice of, a number of protected trades and professions (*Loi pour la croissance, l'activité et l'égalité des chances économiques*). In particular, the law removes legal barriers to creating bus links between French towns (these were previously banned if there was a public train service operating on the same route), gives more power to the competition authority to address firms' abuse of a dominant position on the high street, extends Sunday trading, and sets a process to review the tariffs of regulated legal professionals (including notaries). Most of these reforms are small steps towards facilitating business and trade in France, but they do not constitute a radical reform as the list of caveats and conditions for each measure makes it difficult to envisage them having a large overall impact.

V. Conclusion

Although France was not severely affected by the crisis – at least compared with many other countries – the recovery has been particularly slow, with GDP per head still below its peak in 2007 and expected to remain so up to, and probably beyond, 2017. Borrowing is not expected to be back to pre-crisis levels until 2016 and public sector debt is likely to remain at a higher level than before the crisis throughout the next decade.

The crisis has so far pushed France's public finances towards a higher level of taxation and a higher level of public spending as a share of GDP. Over the three years from 2011 to 2014, new policies have been introduced – by both centre-left and centre-right governments – that increase tax revenues by 3.0 per cent of GDP. This is a very significant tax increase, which has led to public anger in France. From 2014, further consolidation of France's public finances will rely mostly on reductions in public spending, with the stated aim of returning spending to pre-crisis levels as a share of GDP. This will be achieved through real-terms cuts to many areas of central government spending – including education and defence – and through limitations to health care spending growth in the social security budget. Overall, the spending squeeze is expected to reduce spending by 3.5 per cent of GDP, meaning that spending cuts will account for just over half (54 per cent) of the fiscal consolidation measures by 2015.

The large increase in taxation has not been used as an opportunity to simplify the structure of French taxation, but there have been some improvements. The reduction in employer social security contributions and the increase in the reduced rate of VAT are positive steps towards a more balanced structure of taxation, even if the implementation lacks simplicity and transparency. There have also been various positive attempts to reform French labour markets, removing barriers to trade and opening up some protected professions to competition. But these positive steps are all relatively small and are unlikely to bring decisive change to the prospects for France's public finances.

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