

From Containment to Rationalization: Increasing Public Expenditure Efficiency in France



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by Jean-Jacques Hallaert and Maximilien Queyranne

***IMF Working Papers* describe research in progress by the author(s) and are published to elicit comments and to encourage debate.** The views expressed in IMF Working Papers are those of the author(s) and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

I N T E R N A T I O N A L M O N E T A R Y F U N D

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European Department and Fiscal Affairs Department

**From Containment to Rationalization:
Increasing Public Expenditure Efficiency in France****Prepared by Jean-Jacques Hallaert (EUR) and Maximilien Queyranne (FAD)¹**

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Abstract

Achieving France's medium-term fiscal targets will require significant expenditure efforts. This paper identifies areas where there is scope for increasing expenditure efficiency, with a view to achieving higher quality and more sustainable fiscal consolidation. The methodology is based on a triple benchmarking. First, the level of public expenditure in different categories is compared to other European countries. Second, the impact of spending is assessed against other European countries. Third, the input mix is analyzed to understand what components are responsible for the level of spending and for the quality of outcomes. This is done for various categories of spending and policies. Based on these results, the paper then provides policy options for expenditure reform in each of these areas, drawing on successful reform episodes in other countries.

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I. EXECUTIVE SUMMARY

At 57½ percent of GDP, public expenditure in France is among the highest in the world. Spending has outpaced GDP growth for over three decades. Notwithstanding successive tax increases, France experienced chronically large fiscal deficit and a growing debt burden, approaching 100 percent of GDP. The high levels of government spending and debt are limiting the fiscal room for maneuver and imposing a substantial tax burden on the economy.

The fiscal consolidation that started in 2011 was initially supported by revenue-raising measures but is now intended to be fully expenditure-based. It aims to bring the overall deficit below 3 percent of GDP by 2017, turn around the growth in public debt, and achieve structural fiscal balance over the medium term.

Identifying areas for savings has proved difficult, and there is no clearly articulated consensus on where spending is too high or inefficient. This is in part because of concerns about the social and economic impact of specific spending cuts, in particular the impact on inequality. Spending measures have thus mainly relied on across-the-board measures to limit nominal spending growth. They have focused on central government and health, while local governments and social security funds spending -including health- have continued to grow faster than GDP.

A shift from this containment approach to broader and deeper efficiency-oriented reforms would increase the chance of success and the sustainability of the ongoing fiscal consolidation, while protecting the French social model. France has recently initiated some steps for structural savings e.g., family allowances, health, and pension.

This paper identifies areas where there is scope for greater expenditure efficiency in France, while maintaining or even improving social and economic outcomes consistent with social preferences. By nature, this requires an assessment not only of fiscal costs but also the intended results, such as the achievement of social objectives, and the provision of high quality public goods and services.

We rely on a three-step benchmarking. First, the level of public expenditure is compared to other European countries with a focus on Germany, Italy, and the United Kingdom. They are large economies with comparable income levels per capita with France. Second, social and economic outcomes in each spending area are assessed against the performance in European peers. Third, the input mix is analyzed to understand what components are responsible for the level of spending and for the quality of outcomes.

This exercise leads to several conclusions:

- Shifting from containment to deeper efficiency-oriented reforms could yield significant fiscal savings. Most could be achieved by rationalizing social benefits and the wage bill, which explain about 90 percent of the difference in the expenditure ratio between France and the EU average as well as the average for Germany, Italy, and the United Kingdom.

- The wage bill accounts for 13 percent of GDP and almost one quarter of public spending. Recent efforts have focused on a wage-scale freeze, but low inflation has limited the effectiveness of this approach. Employment reduction (notably at the local level) and measures to limit the wage drift would promise greater scope for efficiency gains.
- At over 8 percent of GDP, health spending is high by EU standards. While health outcomes are good, they are similar to comparator countries whose health spending is lower. Building on the National Health Strategy of 2014, France could consider reforms implemented in other countries such as further improving generics market penetration, rationalizing hospital services and streamline costs, and strengthening cost-effectiveness evaluations to decide which services should be covered by public insurance.
- There is significant scope to improve the impact of fiscal redistribution on inequalities and poverty through reforms of the welfare and pension systems. France has the largest social spending in Europe and the second highest tax-to-GDP ratio, but the reduction in inequality due to transfers is only slightly above the EU average. If the redistributive power of social benefits was at EU average, France could achieve the same reduction in income inequality at a fiscal cost lower by 3.5 points of GDP. Moreover, the social outcomes and poverty impact are uneven. Social protection benefits mostly the elderly due to a generous pension regime. While long-term demographic trends are more favorable than in many European countries, additional pension reforms would support consolidation and, together with a further increase in means-testing of family-related spending, make room for more resources to address child and youth poverty.
- The unemployment benefits system, which accounts for about two-third of labor market policy spending, is comparatively generous.
- The allocation of resources in education is less efficient than in many European countries, particularly at the secondary level, and has failed to address deteriorating test scores and rising educational inequalities. Organizational reforms could help improve both education quality and social outcomes, for instance by better allocating teaching resources to the neediest, rationalizing inefficient spending (especially in secondary education), and improving the targeting of vocational education and training for those who have difficulties getting a job.
- Public investment spending, which is at the European average, should focus more on maintenance rather than expansion given France's high quality and quantity of infrastructure. Rationalizing local and state-owned enterprises investment would avoid duplication.
- Spending on housing is higher in France than in other European countries but outcomes do not appear much better than in other EU countries. This suggests potential for higher means-testing and lower institutional fragmentation and duplication.

II. INTRODUCTION

1. **Public expenditure reached 57½ percent of GDP in 2014; about 11 percentage points (ppts) above the EU average² and the second largest after Finland.** The reason is high current spending (notably social benefits and the wage bill), while public investment is in line with the EU average.
2. **As a result, and despite a high tax ratio, France has experienced persistent fiscal deficits and rising public debt.** Therefore, France has little fiscal space to cope with unexpected needs or economic shocks, including a possible rebound of interest rates from their currently historically low level.³ It also limits the scope for reducing the tax burden on firms and households, as planned by the government and as may be necessary to raise potential growth, estimated by IMF staff at 1 ½ percent over the medium term.
3. **The fiscal consolidation, initiated in 2011, was initially revenue-based.** Revenue, which had been stable at about 49 ½ percent of GDP in the 2000s, increased by about 4 points between 2010 and 2014 to reach 53.6 percent of GDP (8 ppts higher than EU average). France, who had the fourth highest tax ratio in the EU in 2009, now ranks second.
4. **In 2014, the government announced a shift to expenditure-based consolidation while simultaneously reducing taxes.** Identifying areas for savings proved difficult however, and spending measures have so far relied on across-the-board measures to limit nominal spending growth, especially for the central government and health. Social security funds have continued to grow faster than GDP. A shift from this partial containment approach to broader and deeper efficiency-oriented reforms would increase the chance of success of the planned fiscal consolidation, while protecting the French social model. However, at this point, there is still no clearly articulated consensus on where spending is too high or inefficient.
5. **This paper aims to identify areas where significant efficiency gains may be achieved and thus where spending reform could have a large pay off.** By nature, it will focus on areas where improvements are possible or desirable but little will be said of areas where public expenditure achieves good results by international standards. To estimate efficiency gains various methods are possible. Rather than relying on econometric measures, our approach is to focus on a more in-depth analysis to identify spending drivers in each sector. More precisely, our analysis relies on a benchmarking for both spending and outcomes leading to policy recommendations that draw on lessons from successful

² In this paper, unless otherwise specified, a simple average is used.

³ Though the debt-to-GDP ratio has increased by almost 28 ppts of GDP during the crisis (2008-14), the debt service fell from 2.8 percent of GDP to 2.2 percent of GDP thanks to historically low interest rates. The implicit interest rate dropped from 4.5 percent in 2008 to 2.5 percent in 2014. If the implicit interest rate had rebounded in 2014 to its 2008 level, general government spending (and thus the fiscal deficit) would have been 2 ppts of GDP higher in 2014.

expenditure reforms in other advanced countries. We compare France to other EU countries with a focus on three peers: Germany, Italy, and the United Kingdom. Then, the input mix is analyzed to understand what components are responsible for the level of spending and for the quality of outcomes. To the best of our knowledge, this paper represents the first comprehensive and in-depth comparative study on public expenditure efficiency in France. As a result, it does not present a literature review section but each section reviews sector-specific literature, drawing from a large array of both country-specific and international sources.

6. **The outline of the paper is as follows.** The first section examines France's recent expenditure containment approach comparing its results with the fiscal consolidation carried in the EU. The next section focuses on the composition of public expenditure in economic and functional terms, and identifies areas where there is scope for reforms to improve efficiency and equity. The final section discusses reform priorities and offers policy conclusions.

III. LIMITATION OF THE EXPENDITURE CONTAINMENT APPROACH

A. Expenditures Trends across Europe

7. **General government expenditure in France is significantly above the European average and comparators** (Germany, Italy, and the United Kingdom).⁴ In 2014, France spent about 11 ppts of GDP more than the European average. At about 13 ppts, the gap is wider for Germany and the United Kingdom. Apart from France, only Finland and Denmark's public expenditure is above 55 percent of GDP (Figure 1).

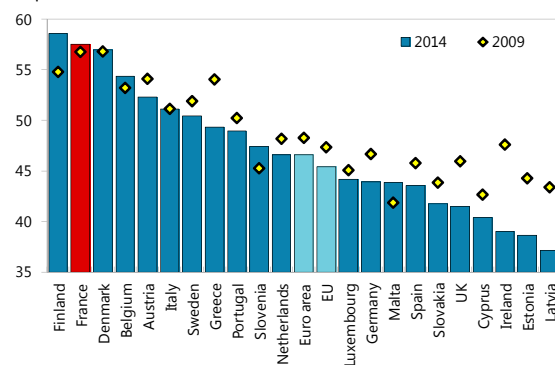
8. **Spending has outpaced GDP growth for decades** (Figure 1). This trend has become more pronounced since the early 2000s. Spending growth remained well above EU rates even as it slowed down in the post-crisis consolidation period (Table 1). By contrast, spending growth became negative in comparator countries such as the United Kingdom and Italy, as well as the euro area on average.

9. **Spending growth was primarily driven by local governments and social security funds** (Table 1). In the 2000s, spending containment has been largely limited to the central government in France. In fact, until 2010, France's central government spending grew in real terms more slowly than in euro area comparators. In recent years, central government spending continued to grow, albeit more slowly, while other countries were cutting spending to support large fiscal consolidation. By contrast, at the local government and social security levels, spending growth has continued to outpace GDP and most comparators.

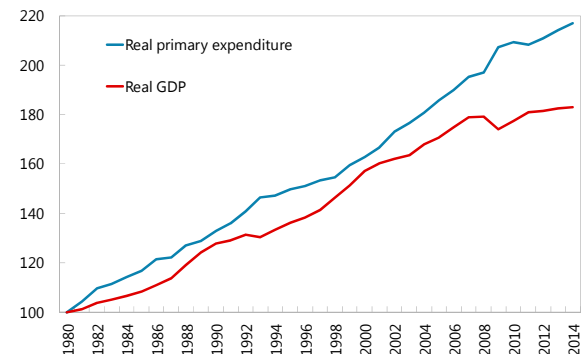
⁴ Comparator countries were chosen to be EU members with a population size and per capita income comparable to France.

Figure 1. Evolution of General Government Expenditure**General Government Expenditure, 2014**

(In percent of GDP)

**Real Primary Spending and Economic Growth**

(In index, 1980 = 100)



Sources: IMF World Economic Outlook and Staff calculations.

- *For local governments, the substantial increase in spending has been a long term trend, which is only partially related to successive waves of fiscal decentralization.* Local governments' spending increased by 3.2 ppts of GDP from 1983-2014, of which 1.65 ppt is due to fiscal decentralization (Draft 2016 budget law, 2015). Spending growth at the local governments level decelerated during 2010-14, while it was reduced in other European countries (except Germany).
- *Social security funds' spending has been growing at around twice the rate of GDP*, and well above euro area average and comparators since the early 2000s.

10. While public spending increased less in France in the immediate response to the crisis, it continued to grow afterwards as consolidation was initially revenue-based. Many European countries saw a jump in spending during the crisis as a result of discretionary stimulus measures, the impact of automatic stabilizers, and in

Table 1. Real Primary Expenditure and GDP Growth ^{1/}

	Average over 2001-2010	Average over 2010-2014
	Real Growth in Primary Spending	
General Government		
France	2.4%	1.4%
Germany	1.7%	0.7%
Italy	1.8%	-0.6%
Euro Area 18	0.9%	-0.1%
Central Government		
France	2.2%	0.5%
Germany	5.4%	-0.1%
Italy	2.6%	-1.1%
Euro Area 18	2.1%	-0.9%
Local Governments		
France	3.2%	1.0%
Germany	1.1%	1.4%
Italy	1.7%	-2.7%
Euro Area 18	0.6%	-0.6%
Social Security Funds		
France	2.7%	2.0%
Germany	0.6%	0.4%
Italy	2.0%	0.8%
Euro Area 18	0.1%	1.0%
	Real GDP Growth	
France	1.2%	1.0%
Germany	0.9%	2.0%
Italy	0.3%	-0.5%
EU-18	0.7%	1.7%

Sources: Eurostat and IMF staff calculation.

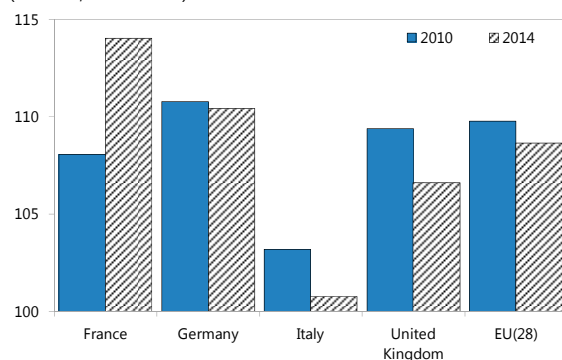
^{1/} Deflated by GDP deflators. Spending by levels of government includes transfers across levels of government, which are netted in general government data.

some cases the cost of bank bailouts. However, they reverted to cutting primary spending in the post-crisis consolidation period (Figure 2 and Table 1). Although structural adjustment was similar to the EU average, expenditures in France increased during the whole period as the consolidation strategy relied initially on raising revenue (Figure 2). The expenditure *containment* started in earnest in 2013 and fiscal consolidation is now expected to be fully expenditure-based.

Figure 2. Fiscal Developments During the Crisis

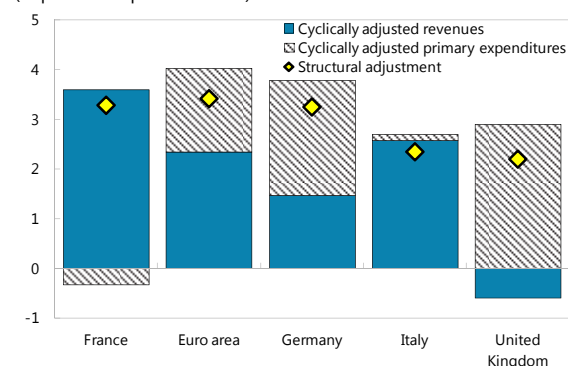
Real Primary Expenditure During the Crisis

(In index, 1997 = 100)



Structural Fiscal Adjustment

(In percent of potential GDP)



Sources: Eurostat and IMF Staff calculations.

B. The Expenditure Containment Approach

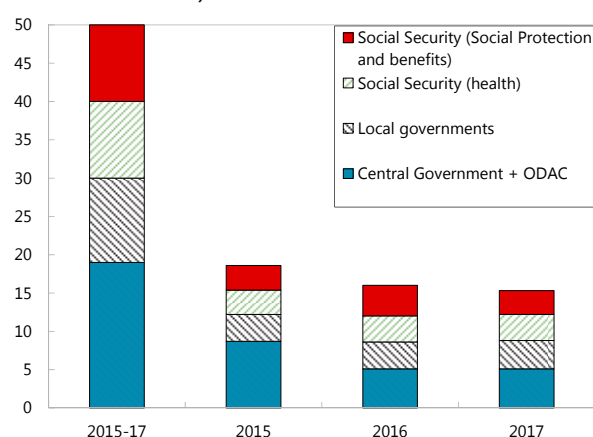
11. France relied on spending containment rather than on spending reforms.

Spending containment was largely implemented across the board. These measures include the freezing of the public wage scale and of some social benefits. Among European countries, France was the least selective both in implementing its fiscal stimulus in response to the crisis and in carrying its spending containment (Table 2).

12. In 2014, France announced an expenditure saving plan that would however maintain its public spending above comparator countries. The planned savings of €50 billion relative to trend over 2015-17 would imply an effort of 2.2 percent of GDP distributed at all levels of government (Figure 3). Cumulatively, the cuts represent about 4 percent of spending for each level of government (central, sub-national, and social security). Over 2014-18, the authorities project the spending-to-GDP ratio to decline by 2.4 ppts of

Figure 3. Distribution of the Expenditure Containment Plan by Level of Government

(In billions of Euros)



Source: Draft 2016 budget law.

GDP to 54.8 percent of GDP. However, spending would remain high compared to other countries, and the gap with Italy and the United Kingdom would further increase, as these countries are planning to reduce spending by 3.1 and 8.1 ppts of GDP over the same period.

13. **The proposed savings are at different stages of identification.** First, the wage freeze, de-indexation of social benefits, and impact of recent reforms in social benefits are well identified. Second, central government savings (outside of wage-scale freeze) are announced on a yearly basis as part of the budget. Third, savings in health spending are identified and rationing mechanisms are in place to ensure execution, although health spending is subject to several factors that fall outside the control of the authorities. Fourth, of the social spending saving, about €4 billion are predicated upon the recent reform of supplementary pensions and the forthcoming reform of unemployment. Fifth, indicative saving targets are set for local governments. However, the degree to which the cut in the state transfers will translate in spending cuts or will be offset by an increase in taxes or debt is uncertain.

Table 2. Selectivity in Spending Cuts/Increases

	Pre crisis	Crisis		Number of Cofog categories considered ^{3/}			Primary spending considered (in percent)		
	2000-07	"stimulus" 2007-10	"Consolidation" 2010-13	2000-07	2007-10	2010-13	2000-07	2007-10	2010-13
Hungary	25.9	17.5	17.6	58	57	59	97.2	97.1	95.5
Portugal	29.5	15.2	17.4	62	61	61	97.8	98.7	99.3
Ireland	45.9	27.8	17.0	58	58	59	98.7	80.3	80.3
Czech Rep.	25.0	17.0	14.8	64	65	65	97.0	97.8	98.1
United Kingdom	27.3	10.6	12.3	62	64	62	98.6	98.6	98.4
Slovenia	21.0	16.8	11.7	63	62	60	98.7	98.3	88.9
Spain ^{1/}	20.0	11.5	11.0	60	61	61	96.7	96.7	92.8
Japan	n.a.	8.4	10.5	n.a.	56	57	n.a.	93.7	93.9
Slovak Rep.	n.a.	25.3	9.2	n.a.	64	62	n.a.	97.8	98.6
Luxemburg	13.5	11.4	9.2	55	56	56	99.4	99.3	99.3
Netherlands	17.9	8.0	8.9	62	63	62	98.2	97.7	98.5
Italy ^{2/}	8.6	7.2	7.6	63	63	63	99.1	99.2	99.2
Germany	9.1	8.5	7.5	64	64	64	100.0	96.3	96.4
Norway	n.a.	12.7	7.4	n.a.	63	62	n.a.	98.2	98.3
Denmark	16.7	8.2	6.9	60	59	58	98.1	98.6	98.6
Austria	11.6	6.2	6.5	64	64	64	96.9	96.7	96.3
Belgium ^{2/}	11.4	6.9	5.6	62	64	63	95.3	94.2	93.5
Sweden ^{2/}	17.1	8.6	4.6	59	60	59	98.3	98.2	98.0
France	11.7	6.5	3.7	60	61	60	98.4	98.1	98.0

Sources: OECD and IMF staff calculation.

Note: Countries are ranked according to the value of the selectivity in 2010-13. Spending is in national currency deflated by the GDP deflator. The closer to 0 the indicator the more spending change was similar across classifications. For details on the methodology, see Lorach and Sode (2015).

^{1/} For Spain up to 2010-12.

^{2/} For Belgium, Italy, and Sweden: 2001-07.

^{3/} Out of a maximum of 66 COFOG categories as three categories are excluded (0107, 0401, 0407).

14. **Deeper spending reforms are needed to underpin fiscal consolidation and eventually create space for alleviating France's high tax burden** (IMF, 2015a). To achieve the significant reduction in public expenditure needed to reach the fiscal targets, the containment strategy may prove insufficient. Without deeper reforms, it will be difficult to make the most efficient use of public resources and there are significant risks that savings fall short of the intended targets.

IV. BENCHMARKING PUBLIC SPENDING EFFICIENCY

15. **Benchmarking public expenditure helps identify areas where France diverges from comparators.** Based on both economic and functional classifications, this paper benchmarks France's public spending against the European average and comparators. These areas constitute either sources of possible savings or risks when further rationalization may unnecessarily lower the quality of services provided. In economic terms, we focus on social benefits, goods and services, the wage bill, and capital spending. In functional terms, we benchmark pensions, health, unemployment, education and vocational training, and housing.

16. **Evaluating public expenditure efficiency requires benchmarking both spending and related outcomes.** Comparing the levels of public spending across countries is insufficient to determine areas in which expenditure rationalization is desirable. Public spending levels and the role of the public sector are determined by social preferences, and reflect countries economic and demographic characteristics. For some policies, such as education, pensions, and health, countries may have different approaches to involving the private sector. Looking at public spending-related outcomes allows a more informed judgment on their efficiency and realistic approaches to spending rationalization. A particular attention will be given to equity considerations and the redistributive impact of public spending.

A. Public Expenditure from an Economic Classification Perspective

17. **Public expenditure is much larger in France than on average in the EU because of current spending** High public expenditure in France is not driven by public investment, which is at the EU average, though higher than comparator countries. The key to understanding France's public expenditure is current spending (Figure 4), which is in the vicinity of Nordic levels and exceeds the EU median by about 11 ½ percentage points of GDP. Moreover, this gap has widened: the share of primary current spending in GDP has increased by 1.4 ppt since 2010 while it declined in the EU by 0.8 ppt (Table 3).

18. **Spending on social benefits and on civil servants accounts for 90 percent of the difference between France and comparators.** In 2014, the share of social benefits in GDP was 43 percent higher than the EU average and the wage bill ratio was 20 percent higher.

Table 3. France and EU General Government Expenditure by Economic Classification^{1/}

	2008	2009	2010	2011	2012	2013	2014	Difference (2014-2010)	
	(percent of GDP)							(ppts of GDP)	(share of total exp consolidation (%))
France									
Total expenditure	53.0	56.8	56.4	55.9	56.8	57.0	57.2	0.8	100.0
Current spending	47.5	50.7	50.7	50.4	51.1	51.3	51.9	1.2	150.0
Compensation of employees	12.4	13.1	13.0	12.8	12.9	12.9	13.0	0.0	0.0
Goods and services	4.7	5.1	5.1	5.1	5.1	5.2	5.1	0.0	0.0
Interest payments	2.8	2.4	2.4	2.6	2.6	2.3	2.2	-0.2	-25.0
Subsidies	1.5	1.8	1.8	1.7	1.7	1.7	2.2	0.4	50.0
Current transfers	3.1	3.4	3.4	3.3	3.4	3.5	3.4	0.0	0.0
Social benefits	23.0	24.9	25.0	24.9	25.4	25.7	26.0	1.0	125.0
Capital spending	5.1	5.4	5.2	4.9	5.2	5.0	4.7	-0.5	-62.5
Gross fixed capital formation	3.9	4.3	4.1	4.0	4.1	4.0	3.7	-0.4	-50.0
EU Average									
Total expenditure	44.0	48.1	48.0	46.4	46.2	46.7	46.2	-1.7	100.0
Current spending	38.7	42.5	41.9	41.1	41.2	41.4	41.2	-0.7	39.9
Compensation of employees	10.9	11.8	11.3	11.0	10.9	10.9	10.8	-0.5	30.2
Goods and services	6.2	6.5	6.5	6.3	6.2	6.2	6.2	-0.2	13.0
Interest payments	2.0	2.2	2.2	2.5	2.5	2.4	2.3	0.1	-6.0
Subsidies	1.3	1.3	1.3	1.2	1.2	1.2	1.3	0.0	1.4
Current transfers	2.2	2.4	2.3	2.2	2.3	2.4	2.3	0.1	-3.9
Social benefits	16.1	18.3	18.3	18.0	18.1	18.2	18.2	-0.1	5.1
Capital spending	5.2	5.4	5.9	5.1	4.8	5.1	4.9	-1.0	60.3
Gross fixed capital formation	4.1	4.2	4.0	3.7	3.5	3.4	3.6	-0.4	25.3
Germany									
Total expenditure	43.5	47.4	47.2	44.6	44.2	44.3	43.9	-3.3	100.0
Current spending	40.0	43.8	42.7	41.1	41.0	41.2	40.9	-1.8	54.5
Compensation of employees	7.4	8.1	7.9	7.7	7.7	7.7	7.7	-0.2	6.1
Goods and services	4.0	4.5	4.6	4.5	4.6	4.7	4.6	0.0	0.0
Interest payments	2.7	2.6	2.5	2.5	2.3	2.0	1.7	-0.8	24.2
Subsidies	0.9	1.3	1.1	1.0	0.9	0.9	0.9	-0.2	6.1
Current transfers	1.8	1.9	2.0	1.9	2.0	2.2	2.2	0.2	-6.1
Social benefits	23.2	25.4	24.6	23.5	23.5	23.7	23.8	-0.8	24.2
Capital spending	3.5	3.6	4.7	3.4	3.3	3.1	3.0	-1.7	51.5
Gross fixed capital formation	2.1	2.3	2.3	2.3	2.3	2.2	2.2	-0.1	3.0
Italy									
Total expenditure	47.8	51.1	49.9	49.1	50.8	50.9	51.1	1.2	100.0
Current spending	42.8	45.2	44.9	44.6	46.1	46.6	46.8	1.9	158.3
Compensation of employees	10.4	10.9	10.7	10.3	10.3	10.2	10.1	-0.6	-50.0
Goods and services	5.1	5.4	5.4	5.3	5.4	5.6	5.6	0.2	16.7
Interest payments	4.9	4.4	4.3	4.7	5.2	4.8	4.7	0.4	33.3
Subsidies	1.2	1.4	1.4	1.4	1.6	1.7	1.8	0.4	33.3
Current transfers	1.6	1.7	1.6	1.6	1.6	1.7	1.6	0.0	0.0
Social benefits	19.6	21.4	21.5	21.3	22.0	22.6	23.0	1.5	125.0
Capital spending	4.4	5.1	4.1	4.1	4.0	3.6	3.6	-0.5	-41.7
Gross fixed capital formation	3.0	3.4	2.9	2.8	2.6	2.4	2.2	-0.7	-58.3
United Kingdom									
Total expenditure	46.6	49.7	48.7	46.9	47.0	45.5	44.4	-4.3	100.0
Current spending	40.6	44.1	44.3	43.1	42.8	42.0	40.9	-3.4	79.1
Compensation of employees	10.6	11.2	11.1	10.6	10.4	9.7	9.5	-1.6	37.2
Goods and services	11.6	12.6	12.0	11.5	11.4	11.5	11.3	-0.7	16.3
Interest payments	2.2	1.9	2.9	3.2	2.9	2.9	2.7	-0.2	4.7
Subsidies	0.6	0.7	0.6	0.5	0.6	0.5	0.6	0.0	0.0
Current transfers	2.7	3.0	3.1	2.8	2.7	2.8	2.5	-0.6	14.0
Social benefits	12.9	14.7	14.6	14.5	14.8	14.6	14.3	-0.3	7.0
Capital spending	5.9	5.6	4.4	3.9	4.2	3.4	3.6	-0.8	18.6
Gross fixed capital formation	3.1	3.4	3.2	3.0	2.8	2.6	2.8	-0.4	9.3

Source: Eurostat.

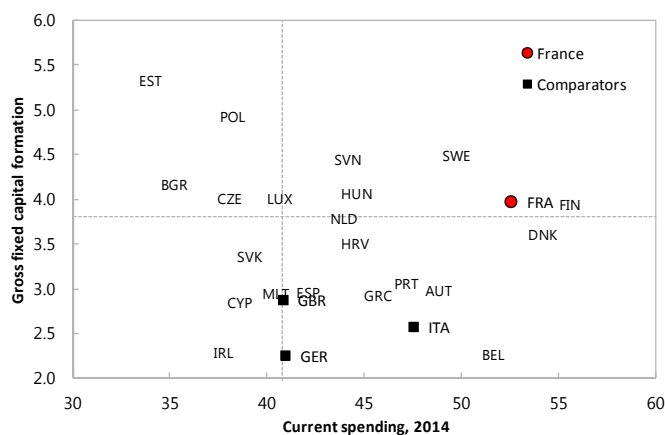
^{1/} When the analysis was undertaken, Eurostat data differed slightly from INSEE in 2014. According to INSEE, expenditures reached 57.5 percent in 2014.

While the comparators and the EU as a whole reduced spending in these two categories during the fiscal consolidation, France made no savings on the wage bill and spending on social benefits increased by 1 ppt. This suggests significant efficiency gains, which we will explore below.

Social Benefits and the Reduction in Inequalities and Poverty

19. **Social benefits constitute half of current spending.**⁵ Social benefits are 7.8 ppts of GDP larger in France than on average in the EU, explaining almost three quarters of the difference in total expenditure-to-GDP ratio (Table 3).⁶ France spending in this area is above countries with similar income per capita (Figure 5) and even countries with higher income, including the Nordic countries.

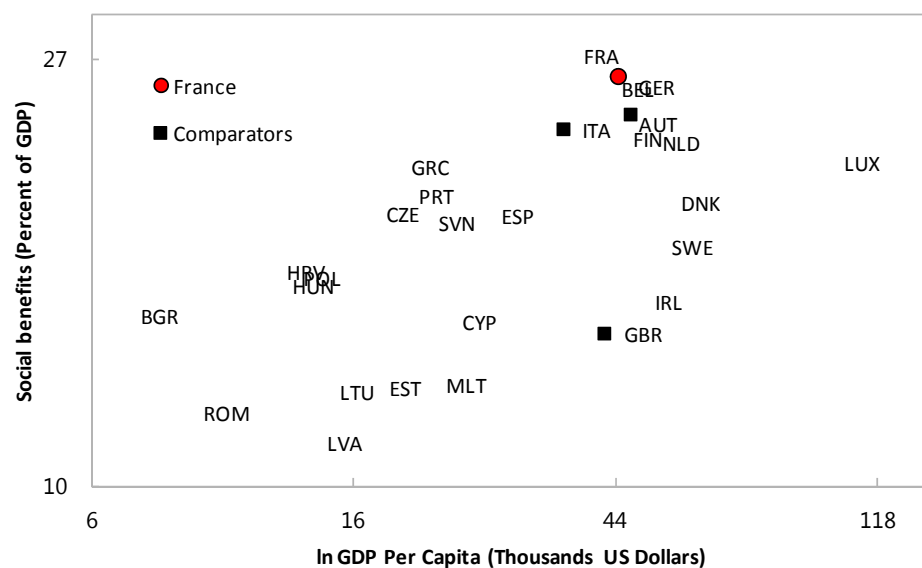
Figure 4. Public Capital and Current Spending in EU Countries, 2014



Source: Eurostat.

Note: Dashed lines indicate medians.

Figure 5. Social Benefits in European Countries, 2014



Sources: Eurostat and IMF staff calculations.

⁵ Social benefits are current transfers received by households intended to provide for the needs that arise from certain events or circumstances, for example, sickness, unemployment, retirement, housing, education or family circumstances.

⁶ Social benefits are 5.6 ppts higher than the average for the three comparators; explaining more than half the difference in the total expenditure ratio.

20. **High spending on social benefits translates into sizable levels of fiscal redistribution.** Fiscal redistribution increases the income of the bottom quintile, does not affect income of the second quintile, and reduces the income of the three highest quintiles. As reported in Table 4, the benefit of fiscal redistribution concentrates on the lowest quintile, whose income increases by 60 percent (by 164 percent for the lowest decile). The cost of fiscal redistribution increases with income, with the revenue of the two top quintiles being reduced by more than 10 percent.

Table 4. Impact of Fiscal Redistribution by Income Level, 2014 (In Euros by consumption unit and by quintile before redistribution)						
	Q1	Q2	Q3	Q4	Q5	Total
Income before fiscal redistribution (A)	7080	15940	22060	29470	56880	26280
Taxes and contributions	-350	-1090	-2250	-3850	-11690	-3840
Social Security contributions	-370	-890	-1490	-2170	-4540	-1890
Direct taxes	20	-200	-760	-1680	-7150	-1950
o/w PIT including PPE	80	30	-410	-1230	-6480	-1600
o/w Taxe d'habitation	-70	-220	-350	-450	-670	-350
Transfers	4540	1270	710	470	320	1450
Family	1670	820	560	400	260	740
Housing	1440	230	60	20	20	350
Social minimum including RSA	1430	220	90	50	40	360
Income after fiscal redistribution (B)	11270	16120	20520	26090	45510	23890
Redistribution rate ((B-A)/A)*100	59.2	1.1	-7.0	-11.5	-20.0	-9.1

Source: INSEE (2015).
Excludes transfers in kind and contributions to and transfers from pensions and unemployment benefits.

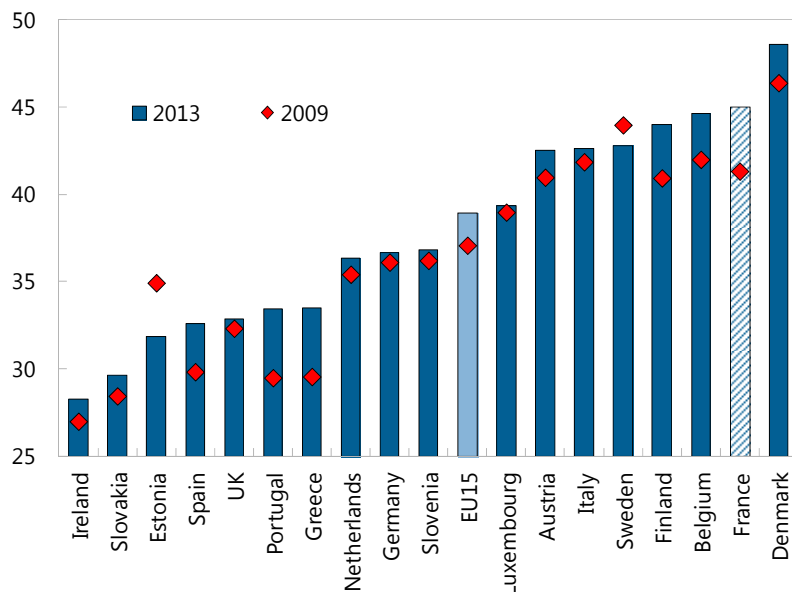
21. **Though France has the highest level of social expenditure and the second largest tax-to-GDP ratio in Europe, it does not achieve the largest reduction in inequality** (Figures 6, 7, and 8).⁷ Taxes and transfers reduce inequality (Gini coefficient) by almost 45 percent. In the EU, France appears in an intermediate position both for market (i.e., pre-tax-and-transfer) and disposable (i.e., post-tax-and-transfer) income inequalities. While market income inequality is below the three comparators, they are above other EU countries with similar level of income per capita (Belgium, Denmark, Finland, the Netherlands, and

⁷ Social expenditure is the provision of benefits to, and financial contributions targeted at, households and individuals in order to provide support during circumstances which adversely affect their welfare, provided that the provision of the benefits and financial contributions constitutes neither a direct payment for a particular good or service nor an individual contract or transfer. Such benefits can be cash transfers, or can be the direct (“in-kind”) provision of goods and services.

Sweden). After fiscal redistribution, disposable income inequality remains higher in France, despite a higher level of public spending than in Belgium, the Netherlands, and Sweden.

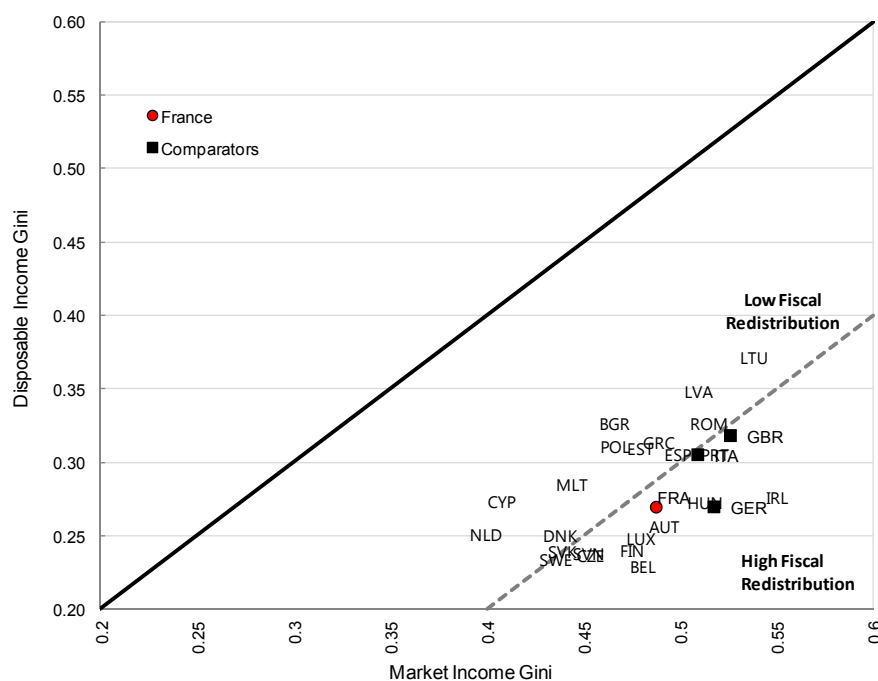
Figure 6. Tax Revenue

(2009-2013, in percent of GDP)



Sources: OECD.

Figure 7. Market and Disposable Income Inequality in Europe, 2013

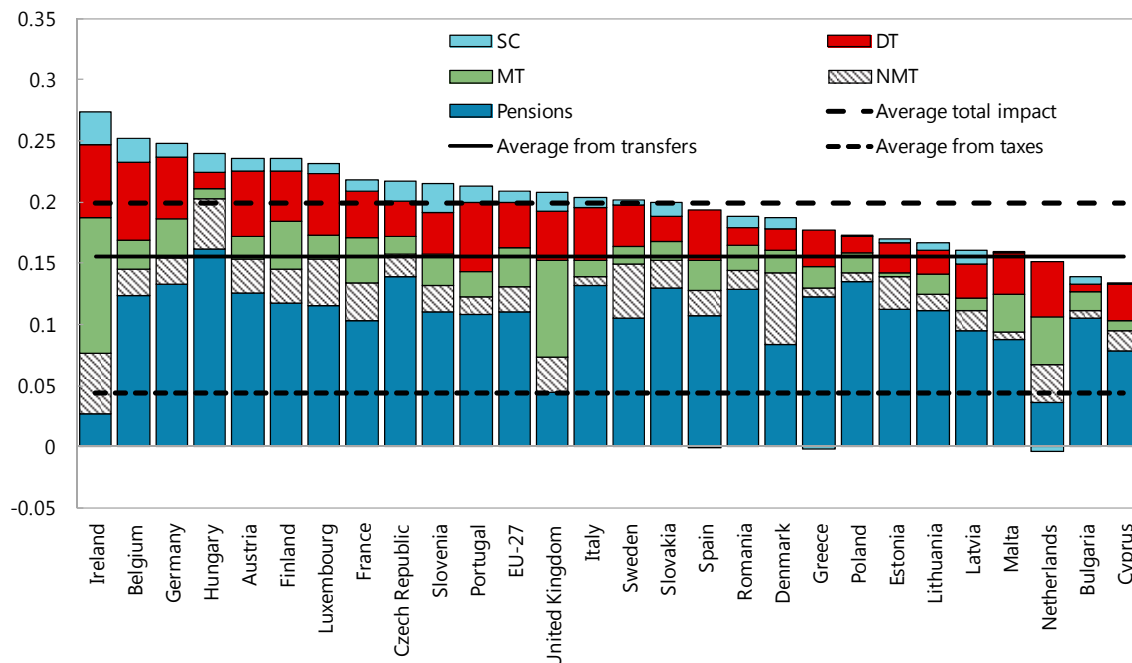


Sources: Eurostat and IMF staff calculations.

Figure 8. Contributions of Fiscal Policy to the Reduction of Income Inequality in Europe, 2013

Though France has the largest social spending in Europe and one of the highest tax-to-GDP ratios, it does not achieve the largest fiscal redistribution.

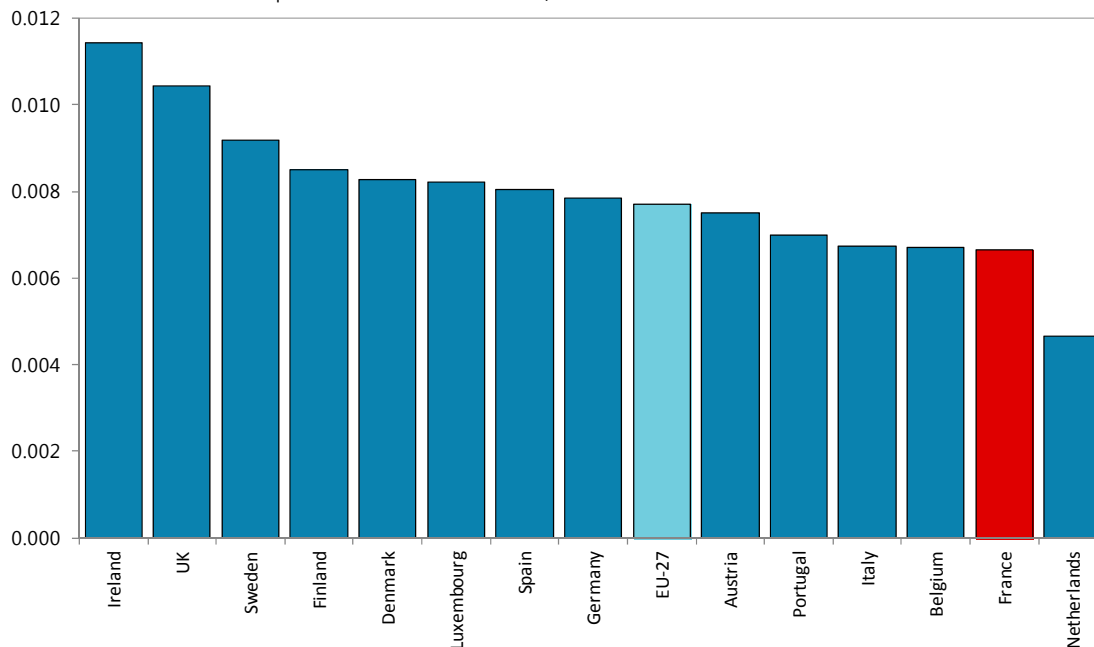
Taxation and Spending: Contributions to the Reduction in the Gini



In fact, the redistributive power of social benefits is one of the lowest in Europe.

The Redistributive Power of Public Spending

(Reduction of the GINI coefficient due to 1 percent of GDP of social benefits)



Sources: Eurostat and IMF Staff calculations.

Note: SC= Social Contributions; DT=Direct Taxes; MT=Means-tested social spending; NMT=Non-means-tested social spending.

22. **The redistributive power of social spending (i.e., the reduction in income inequality due to 1 percent of GDP in social spending) is low by European standards** (Figure 8). Fiscal redistribution achieves a smaller reduction in inequality than in Ireland and Germany, where total public spending is significantly below France. If France could raise the redistributive power of social spending to the EU (weighted) average, it could achieve the same reduction in inequality with 3.5 points of GDP lower spending. This would require deeper reforms in a number of programs (see next section).

23. **Particular emphasis should be placed on means-testing of benefits and on better targeting the poor.** The low redistributive impact is explained by a high share of social spending benefits the richer households: 27 percent of social cash benefits go to the highest income quintile, and less than 17 percent to the lowest income quintile. Among EU (21),⁸ only Portugal, Greece, and Italy have a higher share of social benefits going to the highest income quintile (OECD, 2014b). The large share of social benefits received by richer household is mostly accounted for by the large pension payments (see below), and by relatively low means-testing. About 11 percent of total social expenditures (in kind or in cash) is means-tested. This is slightly more than EU average but less than in Germany and the United Kingdom (Figure 9). The reason is that a large share of family-related spending is not targeted, but accounts for a significant share of fiscal redistribution because of the sheer size of the amount involved (Table 5).⁹ The 2014-15 reform increased the means-testing of family transfers and should improve its efficiency though there remains scope for increased targeting.

24. **Much of France's social spending benefits the elderly.** The OECD (2012) calculates that, while the elderly (65 year old and more) accounts for slightly less than 17 percent of the population, they receive 48 ½ percent of public social and education expenditures (or above 18 percent of GDP) in 2009 (Table 6). This is 10 ppts higher than the OECD average (and the second largest share in the EU after Italy) despite the share of elderly in the population being only 3 ppts higher in France. In addition, the tax wedge on the elderly is below other age groups, even when excluding social contributions, which are mostly paid by in-work population (Conseil des prélèvements obligatoires, 2008).

⁸ EU(21) refers to the EU members of the OECD

⁹ In 2012, 19.2 percent of family and child related spending was targeted. This is lower than the EU average (24 percent), Germany (37.5 percent), and Italy (71.4 percent) but higher than the UK (10.5 percent).

Table 5. Contribution of Taxes and Transfers to the Reduction of Inequalities ^{1/}
(In percent)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Taxes and contributions	41.3	41.9	42.3	35.4	37.1	36.8	33.8	33.8	37.0	36.7	37.6
Social Security contributions	9.7	10.0	8.5	5.7	5.5	7.3	7.9	5.4	5.9	5.9	5.9
Direct taxes	31.6	31.8	33.7	29.6	31.6	29.5	25.9	28.3	31.1	30.8	31.7
o/w PIT including PPE	31.3	31.7	33.6	29.7	31.9	29.7	26.2	28.7	31.6	...	32.1
o/w Taxe d'habitation	0.3	0.1	0.1	-0.1	-0.3	-0.2	-0.3	-0.4	-0.5	...	-0.5
Transfers	58.7	58.1	57.7	64.6	62.9	63.2	66.2	66.2	63.0	63.3	62.4
Family	29.8	28.8	28.2	29.2	28.5	27.1	25.8	27.7	25.3	25.0	25.5
o/w non means-tested	20.3	19.2	...	18.5	17.5	16.9	15.9	17.3	...	...	...
Housing	14.7	15.7	16.1	16.2	17.8	16.8	18.5	17.7	18.5	18.4	18.3
Social minimum including RSA	14.2	13.7	13.4	22.3	16.6	19.3	22.0	20.8	19.2	19.9	18.5

Source: INSEE, "France, Portrait social," various years.

^{1/} Excludes transfers in kind and contributions to and transfers from pensions and unemployment benefits.

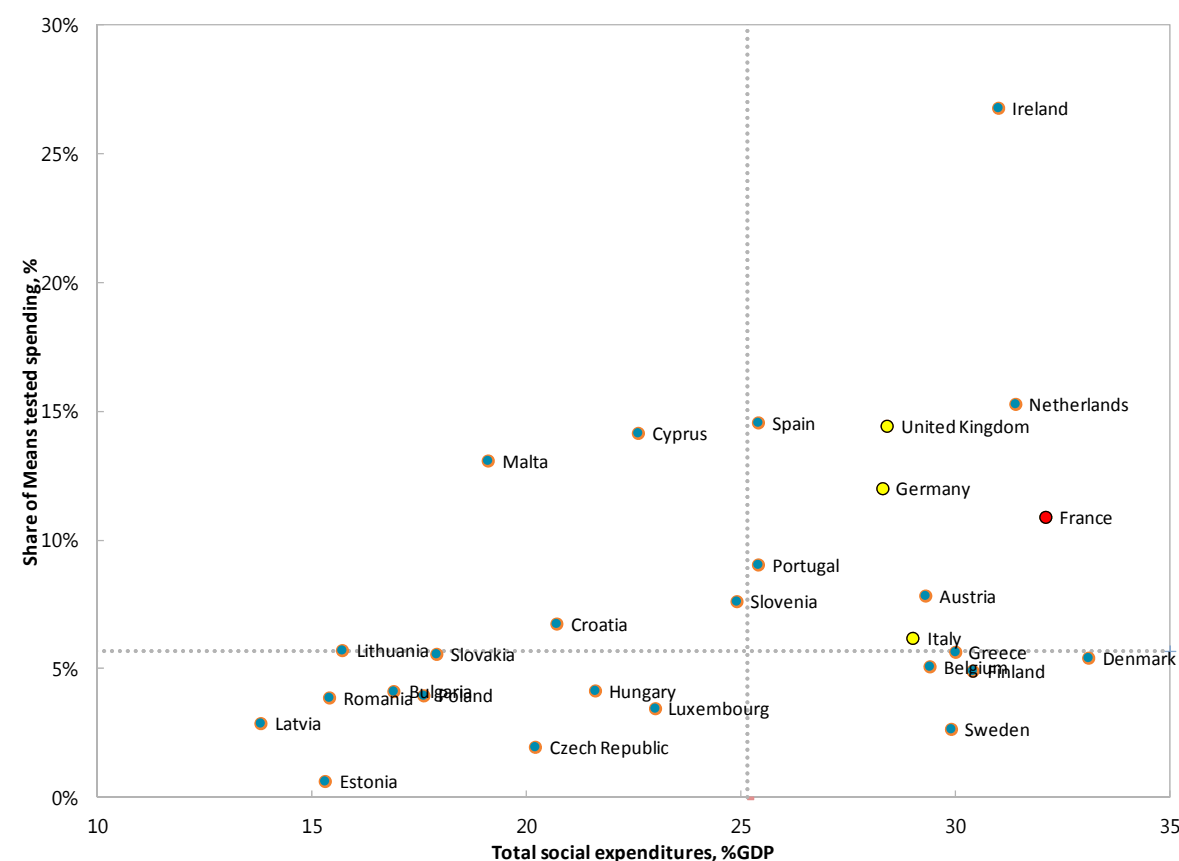
Table 6. The Focus of Social and Education Spending on the Elderly, 2009
(In percent of GDP)

	Share of the population aged 65+ (%)	Public social and education expenditures dedicated to the elderly	
		In percent of public social and education expenditures	In percent of GDP
France	16.7	48.4	18.1
Germany	20.5	47.7	15.5
Italy ^{1/}	20.2	59.0	18.9
United Kingdom	15.8	35.8	10.5
Memorandum item			
OECD	14.7	38.8	10.8
Japan ^{2/}	22.7	59.2	15.4

Source: OECD (2012).

^{1/} Italy is the OECD country that dedicates the largest share of GDP in public social and education spending to elderly, and is second after Japan for the share of public social and education spending dedicated to elderly.

^{2/} Japan has both the largest share of elderly in the population and the largest share of public spending dedicated to elderly.

Figure 9. Share of Means-tested Social Expenditures in Europe, 2012

Sources: Eurostat and IMF staff calculations.

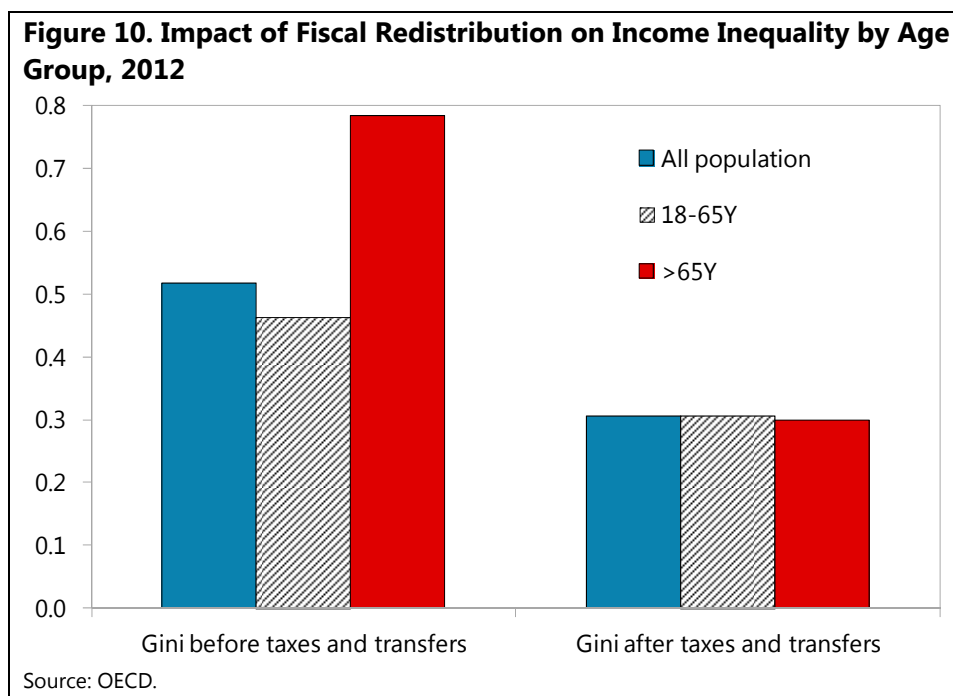
Note: Dashed lines represent EU medians.

25. **This leads to some intergenerational issues.** Through fiscal redistribution, France achieves a uniform rate of inequalities between working age population and retirees. As market inequality is the stronger among the senior, this implies that fiscal redistribution focuses on the elderly (Figure 10). This is mainly achieved through public pension spending, which have a larger redistributive impact than non-pensions transfers (Figure 8).

26. **France achieves better distributive outcomes for the elderly poor, than for the rest of its population.** Reflecting the stronger focus of redistribution on the elderly, the poverty rate of elderly as well as their at-risk-of-poverty rate after social transfers (an indicator for the most vulnerable households at the lower end of the income distribution) is lower than in other European countries. In contrast, the risk-of-poverty rate for the population under 65 is comparable to the EU median and only slightly below comparators (Figure 11).

27. **Poverty risk is particularly acute for the young.** Their relative poverty rate is increasing and is larger than in other European countries (Figure 11). In contrast with Germany and the United Kingdom (but not Italy), the poverty rate is much higher for children than for the elderly and this gap has been widening during the crisis. France is also

poorly positioned in the OECD index on child well-being relative to comparators, particularly for health and safety, and quality of school life (OECD, 2009). Problems of inequalities and poverty are particularly prevalent in poor urban areas, despite significant public spending and support (Box 1).



28. **Social spending has not adapted to new forms of poverty.** In 2013, the poverty rate of retirees was 7.9 percent compared to 19.6 percent for the population below 18 and 37.3 percent for unemployed 18 year old or older (INSEE, 2015). Low poverty rate among the elderly has been achieved by developing a social benefits system to address old-age poverty from the mid-1950s up to now (the minimum pension scheme increased by 25 percent over 2009-12 and was raised again in 2014). Yet, social spending has not adapted to the rising poverty of children and the young that is largely explained by the increase in parents' and youth unemployment, notably long-term unemployment and inactivity. The unemployment rate of the 15-24 year old was close to 24 percent in the first half of 2015, more than twice the national average of 10 percent, and their underemployment rate,¹⁰ at 12 percent of employment in 2014, was more than twice the level for 25–64 year old (DARES, 2015).

29. **As many EU countries, France should step up its efforts to reduce child poverty.** The government has recently announced a national strategy in this area (Commission Enfance et Adolescence, 2015). Some EU countries, such as Belgium and the United Kingdom, have implemented specific strategies that integrate various forms of social

¹⁰ The ILO defines underemployment as involuntary part time and temporary layoff or short time working.

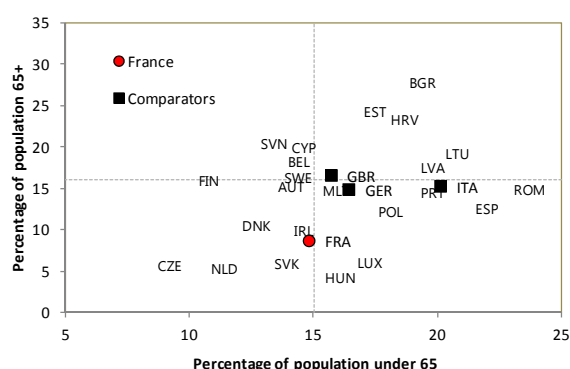
interventions and benefits to effectively tackle the causes of child poverty. They include improving parents' participation in the labor market, improving living standards of poor families through better targeted social transfers, and raising educational attainment of poor children by investing in early childhood education. In France, further increasing the means-testing of family-related spending could help reduce child poverty and a reform of pension spending (see below) could provide fiscal room for additional spending in this area.

Figure 11. Poverty in France and in Europe

The risk-of-poverty rate for the population over 65 is below the EU median, while the risk-of poverty of the rest of the population is at the EU median.

Risk of Poverty by Age Group¹, 2013

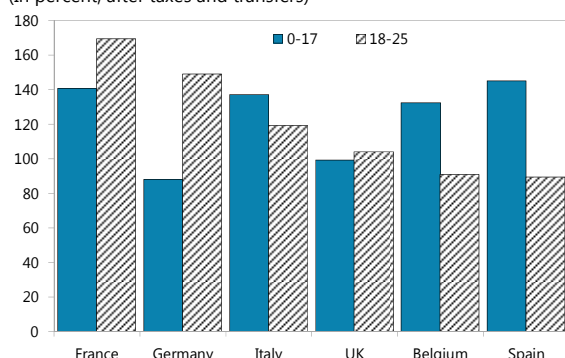
(In percent of population under 65 and over 65, after social transfers and pensions)



The relative poverty of the young is higher than in the rest of Europe.

Relative Poverty for the Young², 2012

(In percent, after taxes and transfers)



Sources: Eurostat, OECD, and IMF Staff calculations.

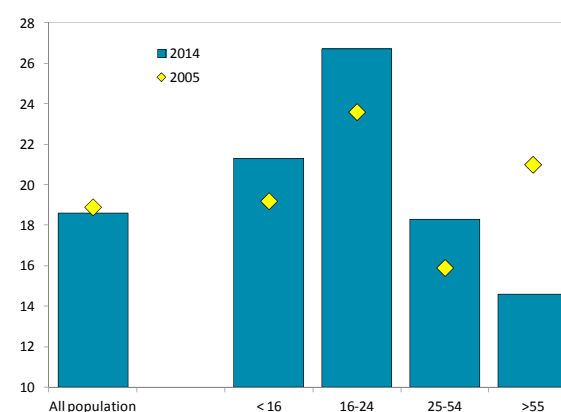
¹/ Dashed lines represent EU medians. For the sake of clarity, Ireland has been excluded from the chart.

²/ Poverty rate of an age group relative to the poverty rate of the entire population = 100.

Moreover, the risk-of poverty of seniors has declined while it increased for all other age groups, notably the young.

People at risk of poverty

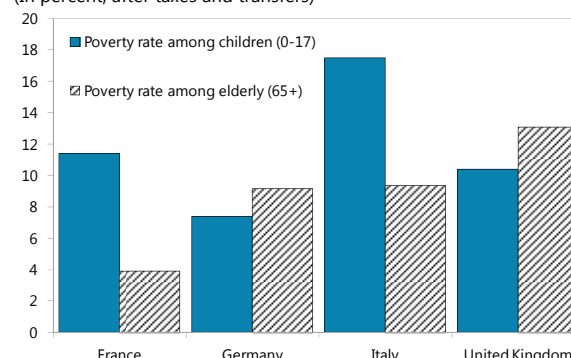
(In percent of population)



In contrast with Germany and the UK, the poverty rate of children is much larger than for the elderly.

Poverty Rate, 2012

(In percent, after taxes and transfers)



30. **Rather than increasing social benefits for the young working age population, France should aim at providing them with more job opportunities.** Income instability is a major source of income inequality and plays a stronger role for the young (Ceci-Renaud *et*

al., 2015)¹¹ and the unemployed who are 5 times more at risk of poverty than people in work (DARES, 2015). Therefore, a crucial way to reduce the youth's poverty is to implement labor market reforms that would improve their job situation notably reducing their comparatively higher unemployment rate.

Box 1. Urban Development Spending and Social Outcomes

About 7 percent (4.4 million people) of France's population live in 751 poor urban areas (*zones urbaines sensibles*) that benefit from targeted public supports. While no consolidated data is available for general government, central government spending earmarked on these areas is estimated at about €7 billion (0.3 percent of GDP) in 2014, including transfers to local governments (Draft 2015 budget law, 2014b). It finances additional services aiming at providing more education resources (*zones d'éducation prioritaires*), improving social outcomes, and public safety. These urban areas have also benefited from a large urban development investment plan (of about 2 percent of GDP for the period 2003–13, and projected 0.2 percent of GDP planned from 2014–20), and EU social and structural funds. Despite these efforts, social outcomes are poor (*Observatoire national des zones urbaines sensibles*, 2015). The rates of poverty are threefold in poor urban areas compared to average (38.4 percent at 60 percent of the national median disposable income, and 10.1 percent at 40 percent). They are even higher for the young: 51.4 percent at 60 percent of the national median income for 18 years of age and below (19.6 percent on average), and 48.0 for the 18–24 years-old (23.3 percent on average). The unemployment rate culminates at 23.2 percent in 2014, compared to 9.3 percent outside these areas. And the participation rate in the labor market is 10 ppts below average. Education outcomes are also much lower in these poor urban areas, in relation to higher education inequalities in France than in most advanced countries (see paragraph 70).

Layers of Government

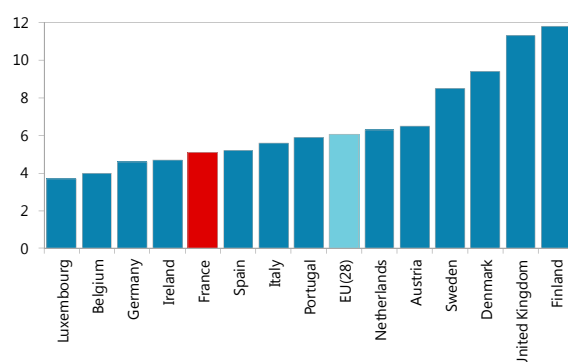
31. **Expenditure containment has been largely focused on consumption of goods and services at the central government level.** France spends 1 percent of GDP less on goods and services than the European average (Figure 12). Containment of the consumption of goods and services has been the priority of successive governments and remains an important part of the saving plan for 2015–17. As a result, it was stabilized in percent of GDP for the general government over the last thirty years. However, this containment strategy has been focused on the central government which has halved its consumption of goods and services over the last 30 years (Figure 12). Going forward, limited additional savings can be expected in this area without reducing the quality of services provided by the central government.

32. **By contrast, local governments' spending on goods and services more than doubled in the last three decades** (Figure 12). This is only partly due to large transfers of responsibilities from the central government as it also reflects insufficient spending constraints at this level of government. From 1980–2013, when controlling for the impact of fiscal decentralization, local governments' current spending increased threefold.

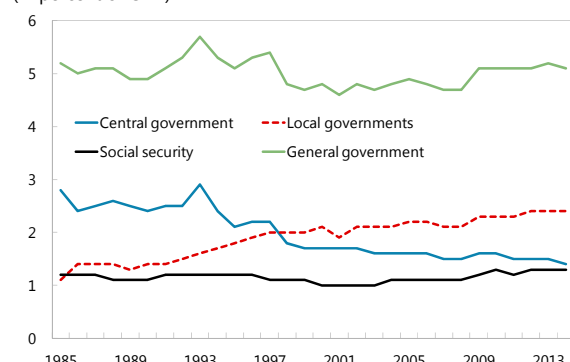
¹¹ Income instability (due to job mobility, short period of work, etc.) explains 44 percent of income inequality among the 26–35 year old male working in the private sector but less than 35 percent for 35–54 year old. Differences in career path explain the remaining income inequality.

Figure 12. Spending on Goods and Services

Spending on Goods and Services in Europe, 2014
(In percent of GDP)



Spending on Goods and Services by Levels of Government in France
(In percent of GDP)



Sources: Eurostat and IMF Staff calculations.

33. **France is gradually stepping up efforts to contain local spending.** In addition to the “golden rule” for local governments (under which they can only borrow to finance investment), France has started designing an indicative national expenditure growth target for local governments (*objectif d'évolution de la dépense publique locale*, ODEDEL) aiming at emulating the success of the health expenditure target (ONDAM described below). In addition, cuts in transfers from the central government (by €12.2 billion or 0.5 percent of GDP over 2014–17) are expected to reduce local governments’ spending (provided that local taxation is not increased). However, in the first year, local government chose to reduce public investment (-10 percent in nominal terms) rather than current spending (+3 percent) magnifying the political cycle of investment in 2014 (see below section on public investment). The increase in current spending was due to both the increase in consumption of goods and services (+1 percent) and to the wage bill (+4 percent).

34. **Other EU countries have implemented more ambitious reforms of their fiscal decentralization and local governance frameworks.** Spain has improved fiscal coordination and incentives for national governments to consolidate. Fiscal targets have been discussed among central and local governments prior to approval within intergovernmental fiscal bodies, with specific measures on the expenditure side (IMF, 2015b). A new Budget Stability Law approved in 2012 has introduced structural budget balance, expenditure, and debt rules at the regional level, with preventive and corrective mechanisms to penalize deviations from fiscal rules and targets. Italy enforces since 1999 a domestic stability pact that sets expenditure and balance targets, and sanctions including through reduction in total expenditure, and hiring (Chiades and Mengotto, 2013). And in Portugal, central government transfers are now conditional on the achievement of expenditure reduction targets by local governments. These reforms were implemented in countries where local governments have, like in France, considerable fiscal autonomy guaranteed by the Constitution.

35. **Reducing duplication of spending and public interventions at different levels of governments remains a challenge.** France has more layers of governments (State,

Departments, Regions, and municipalities) than other EU countries. While the number of regions will be reduced, through merger, from 22 to 13 in 2016, the municipal levels remains highly fragmented in France (58 municipalities per 100 000 inhabitants), compared to the EU average (18 municipalities) (Malvy and Lambert, 2014). To limit duplication, the “general competency clause”, which allows local governments to spend in all areas in which a local interest can be justified (even if it is an area where the local government has not an explicit competency), was eliminated at regional and departmental level in 2015 but still remains in place at municipal level. Other European countries have recently more drastically rationalized their local governments. Portugal has privatized or dissolved about half of local SOEs, and reduced by nearly one third the number of parishes responsible for public services at the municipal level (IMF, 2015c). Italy has also reformed the organization of its provinces, as a first set before abolishing this administrative unit between municipalities and regions through Constitutional amendment.

36. Despite recent reforms, containing spending at the local level, particularly at the municipal level, remains challenging. Because of the constitutional fiscal autonomy of local governments, the government has relied on indirect measures to contain local government spending (reduction in transfers, rationalization of structures of regional governments, elimination of the general competency clause, and creation of a new indicative target for the evolution of local public expenditure, the ODEDEL). However, the reduction in transfers should not be offset by an increase in local taxation or results in cut in investment spending rather than in current spending. In this context, it could be useful considering (i) curtailing the general competencies of municipalities; (ii) developing further the ODEDEL to incentivize reductions in areas of inefficient spending, especially staffing, and preserving growth-friendly expenditures, such as infrastructure investment; and (iii) tightening the rules on possible variations on local taxes.

The Wage Bill

37. The wage bill has proved difficult to contain across general government (Figure 13). The wage bill is 2.2 ppts of GDP larger in France than on average in the EU, explaining almost 20 percent of the difference in total expenditure-to-GDP ratio (Table 3).¹² The wage bill for the central government has declined over the last twenty years, owing to: (i) the decentralization process, (ii) employment reduction with the introduction of employment caps from 2006, and natural attrition targets (replacing only 1 of 2 retiring civil servants) from 2007-12, and (iii) the wage-scale freeze since 2010. Some of the reduction is also explained by the transfer of public employees to autonomous entities (ODAC)¹³ boosting the ODAC wage bill between 2008 and 2013. Local governments’ wage spending was also

¹² The wage bill is 3.9 percent higher than on average in the 3 comparators explaining one-third in the difference in total expenditure ratio.

¹³ From 2009, about 150,000 employees were transferred to ODAC, particularly universities (Cour des comptes, 2015b).

dynamic. From 1996 to 2008, local government employment increased by 24.6 percent, and by 64.5 percent in their autonomous entities. This surge is only partly the result of the decentralization process: between 2002 and 2009, local governments created over a quarter million jobs (about 5 percent of public employment) in addition to the job creation related to the decentralization process (Cour des comptes, 2009 and 2012a). The rapid increase in local governments' wage bill at was also related to loose hiring practices and rapid promotions, particularly at the municipal level.

38. The wage bill exceeds EU averages in almost all sectors, with social sectors contributing the most. Public compensation spending is higher in eight sectors relative to the European average and only below in two sectors (public order and safety and economic affairs). Social sectors explain more than half of the overall difference of 2.1 ppts of GDP in the wage bill between France and the EU average: education (+0.5 ppts of GDP), health (+0.4 ppts of GDP), and social protection (+0.3 ppts). Both the general public services and defense sectors also contribute significantly (+0.3 ppts each).

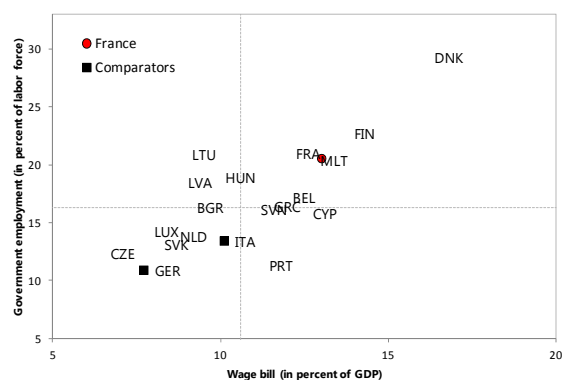
39. France's follows a model of high public employment and relatively modest public wages. Stable at about 20 percent of the total labor force since the early 2000's, government employment in France is among the highest in Europe (Figure 13). In contrast, there is no wage premium for the public sector in France on average as evidenced by a lower public-private compensation gap than EU average, and comparators (Figure 14). When controlling for differences in the structure in employment between the private and the public sector, public wages are 3 ½ percent lower than in private sector. However, highly educated employees in the public sector have a negative wage gap of about 10 percent, while the less educated benefit from higher wages (of about 6 percent) than in the private sector (de Castro et al., 2013). For example, experienced teachers receive comparatively lower salaries than the European average (Figure 14), and comparators (except Italy). The combination of relatively high employment and low wages partly reflects political choices (e.g., to reduce unemployment), but also the fact that the wage evolution decided by the state applies to all levels of government while, because of constitutionally-guaranteed fiscal autonomy, local governments can freely decide on their level of employment (within the constraints of the golden rule).

40. The wage-scale freeze, implemented since 2010, has had only limited effect on the wage bill-to-GDP ratio. Since 2010, successive governments have frozen the public sector wage-scale for all levels of government, though wage increases were granted at the lower levels of the wage scale (*garantie du pouvoir d'achat*, GIPA, and alignment of the gross public minimum wage with the gross private minimum wage), for equity reasons. This approach has proven less effective than anticipated for generating savings, given low levels

Figure 13. General Government Wages and Employment

France's wage bill spending and public employment are well above EU averages and comparators

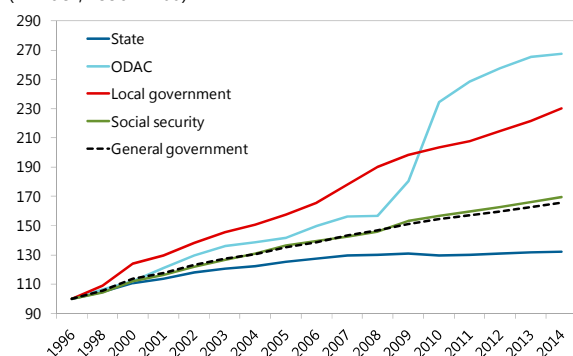
General Government Wages and Employment
(2013 or most recent)



The dynamism in local governments' and Social Security Fund's wage bill...

Wage Bill by Levels of Government

(In index, 1996 = 100)



Sources: Eurostat, INSEE, WEO database, and IMF Staff calculation.

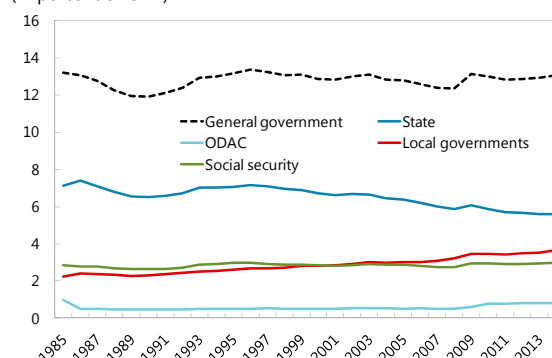
¹ / 2014 data for wages, 2012 or latest data for employment. Dashed lines represent the European median.

² / Excludes the "contrats aidés."

Wage bill has shifted from central to local government.

Wage Bill by Levels of Government

(In percent of GDP)



... and employment was partly offset by containment at the central government's level.

Employment by Levels of Government²

(In index, 1996 = 100)

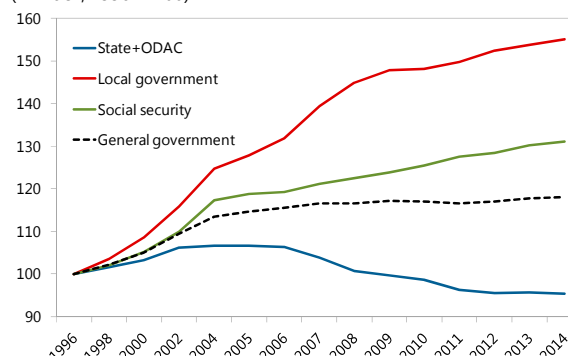
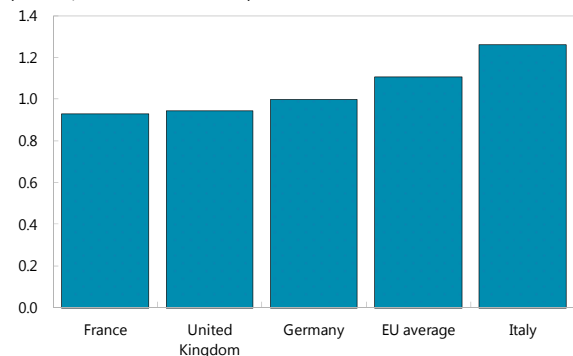


Figure 14. Public Sector Wage Level

Ratio of Public to Private Compensation of Employees

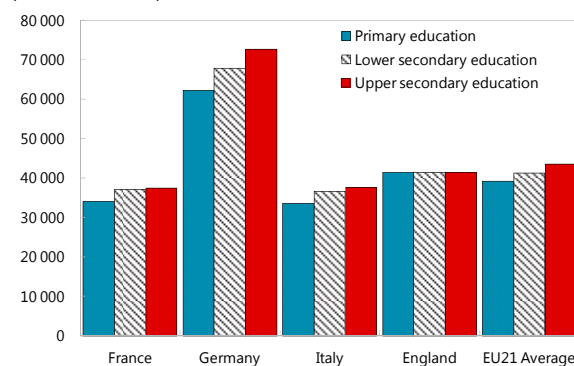
(In ratio, 2013 or most recent)



Sources: Eurostat, OECD, and IMF Staff calculations.

Teachers' Statutory Salaries After 15 Years, 2012

(In PPP US dollars)



of inflation and the significant wage drift embedded in the current system.¹⁴ When progression is automatic, average wage levels rise as the public sector workforce becomes more experienced, even in the absence of wage and employment increases.¹⁵ In past years, France has been characterized by a powerful automatic progression system, which has translated into an early attainment of a high level wage in most occupational careers, and particularly for high-skilled workers. As a result of this mechanism and of recent increase in employment, the wage bill which had declined from 13.1 percent of GDP in 2009 to 12.8 percent in 2011 as since increased and reached 13 percent in 2014. This ratio may further increase in light of the 2015 decision to cancel a large share of the planned reduction in public employment for security reasons and to increase temporary hiring in the public sector to reduce unemployment.

41. Structural measures have a more durable impact in reducing the public wage bill. An analysis of recent consolidation episodes in advanced economies concludes that the reduction of the government wage bill has been larger and more durable when the adjustment included structural measures (Figure 15 and IMF, 2014). Structural reforms include rationalizing the size and structure of government, outsourcing non-core functions, and improving the efficiency of the wage formation and hiring processes. Short term measures such as wage or hiring freezes have generally expired within a few years, and generated less durable reduction in the wage bill.

42. The analysis suggests that, for France, priority could be given to reducing public employment, rather than freezing wages. Given that the public sector has no wage premium in France, the current wage-scale freeze can only help containing the wage bill in the short run, but is not sustainable in the long run. A durable and sustainable containment of the wage bill requires a reduction in public employment, which would also provide room for targeted salary increases to attract qualified staff. This will require thorough reviews of staffing in administration, underpinned by streamlining of processes. Employment practices in labor-intensive public sectors such as health and education should also be assessed. Employment should also be rationalized especially at the municipal level supported by reforms to streamline and remove overlap (*intercommunalités*). Other EU countries have succeeded in reducing public employment (Table 7), both at the central and local governments' levels, particularly by setting binding entry-to-exit ratio, but also through voluntary departures schemes and mobility pools. Ensuring that working hours are effectively not lower than the 35 hour work week, particularly the impact of the reduction in employment (Cour des comptes, 2015a). This would require a more stringent legal control of

¹⁴ There are usually two components in the wage drift: a positive one which increases wage spending (impact of discretionary promotion, automatic progression, and promotion related to civil servants passing competitive exams), and a negative one which reduces wage spending (savings due to lower level of compensation for new employees compared to higher level of compensation for employees retiring).

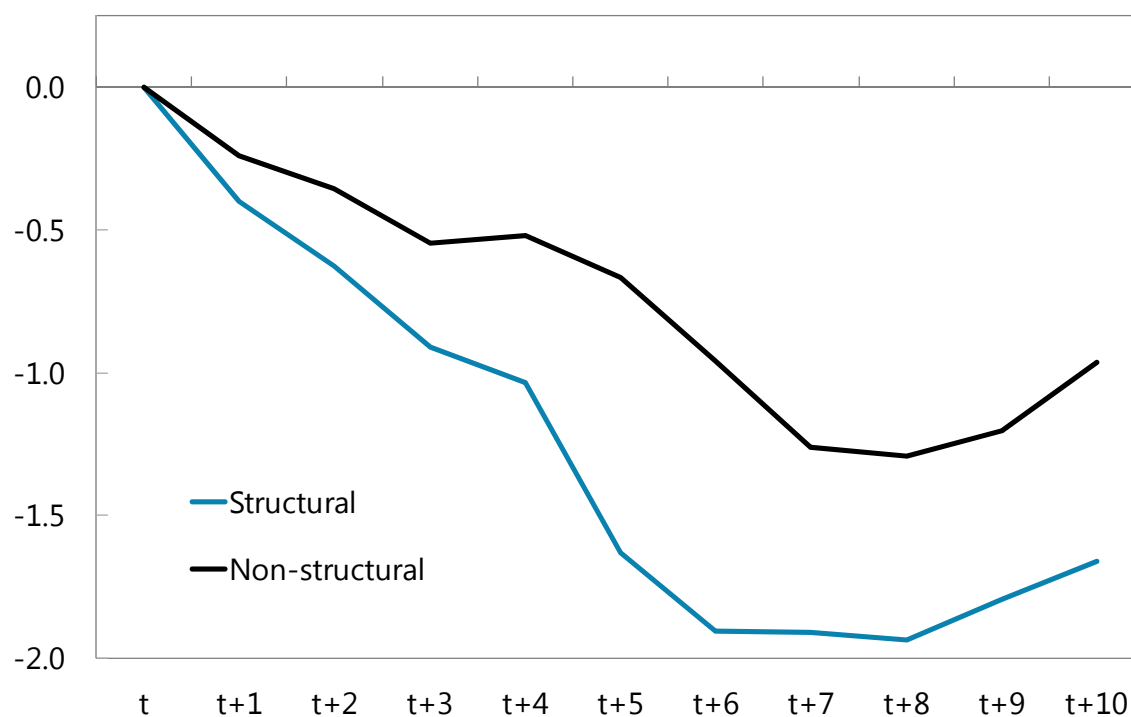
¹⁵ The positive wage drift was estimated to about 2 percent per year in 2007, with 1.2 percent due to the aging of automatic progression, and 0.8 percent to promotions (Inspection Générale des Finances, 2007).

local governments' employment practices by the central government offices at the local level (*préfectures*).

43. **Measures are also needed to contain the wage drift embedded in the current system.** The authorities could slow down automatic progression by lengthening the maximum duration for a civil servant in each scale level. This could be anchored on the extension of the retirement age that will be progressively implemented, and would make career progression more gradual to avoid an early attainment of high level wages that are detrimental to productivity.

Figure 15. Cumulative Change in the Public Wage Bill Ten Years after the First Year of Measures

(In percent of GDP)



Source: IMF (2014).

Note: t indicates the year of introduction of the wage bill measure. Episodes with structural measures are: Austria (1996–97), Belgium (1982), Canada (1991–92), Italy (1993), Portugal (2005–07), the United Kingdom (1994). Those without are: Belgium (1992, 1994), Denmark (1983–84), Germany (1983–84), Germany (1995, 1997, 2000), Ireland (1982), Ireland (1987–88), the Netherlands (1984–86), the Netherlands (2005), Portugal (2000, 2003), Spain (1997).

Table 7. Reduction in Public Employment, 2010–14

	In percentage	In Number of Positions/Employees
France 1/		
General Government	0.7	37429
of which Central Government	-2.9	-72,398
of which Local Governments	3.7	67,676
Italy 2/		
General Government	-5.0	-176400
of which Central Government	-3.9	-76200
of which Local Governments	-6.2	-94000
United Kingdom		
General Government	-9.3	-539000
of which Central Government	0.5	15000
of which Local Governments	-19.1	-554000
Germany		
General Government		
of which Federal Level	-3.7	-26800
of which Local Governments		n.a.
Portugal 3/4/		
General Government	-9.8	-71474
of which Central Government	-9.9	-54353
of which Local Governments	-9.3	-15100

1/ 2010-2013

2/ In Employment positions

3/ In Full time equivalent

4/ 2011-2014

Sources: Portugal: Direção-Geral da Administração Pública ; Germany: Statistisches Bundesamt; Italy: Istituto Nazionale di Statistica; United Kingdom: Office for National Statistics.

Public investment

45. **France's infrastructure and facilities are widely available and of excellent quality by international standards** (Figure 16 and Table 8). Capital stock is above the European average in terms of quantity, and superior in terms of quality. In addition, France managed to stabilize its capital stock in percent of GDP over the last fifty years, while other advanced countries reduced it sharply. In real per capita terms, France also managed to increase its public capital stock, as in other advanced economies. Finally, France is among the best performers in terms of public investment efficiency and above advanced countries' median.

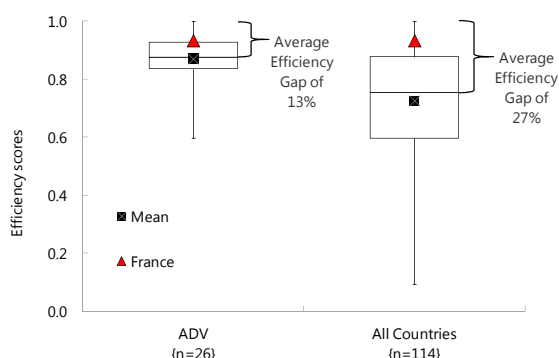
46. **Over the medium term, public investment could be rationalized at the local level and for public corporations.** Given its large and high quality public capital stock, France does not have pressing needs for large aggregate additional investment in order to fill a void or to massively upgrade infrastructure. Priority should be given to maintaining the stock of

capital and its quality.¹⁶ Moreover, given duplication, there is room for rationalizing investment further, notably at the level of local governments which account for about 58 percent of general government investment.¹⁷ The elimination in July 2015 of the

Figure 16. Public Investment and Capital Stock

Public investment is comparatively more efficient in France than in other advanced economies ...

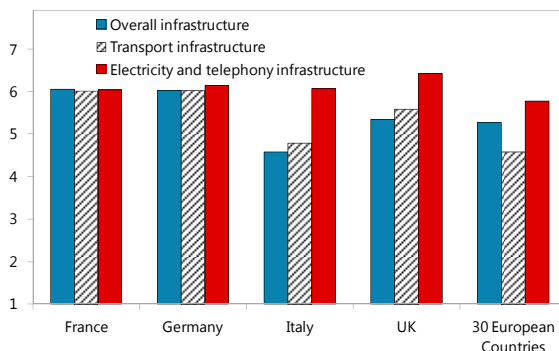
Public Investment Efficiency^{1,2}



The quality of various infrastructure is perceived as high in France compared to EU average ...

Perceived Quality of Infrastructures, 2014

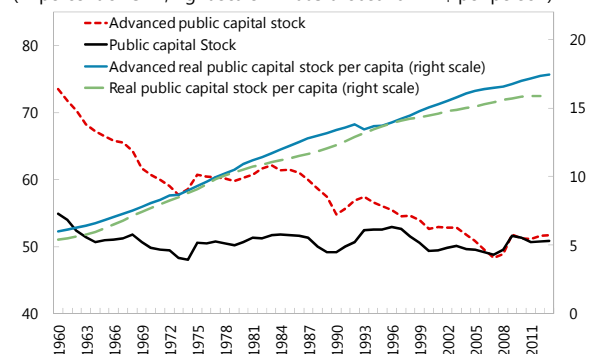
(In index, 1 to 7, is best)



... and allowed to maintain France's capital stock.

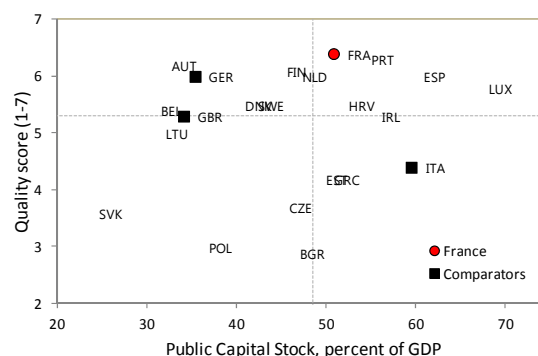
Real and Nominal Public Capital Stock per Person³

(In percent of GDP; right scale in 2005 thousand PPP\$ per person)



... particularly in road infrastructure in Europe.

Public Capital Stock and Quality of Roads⁴, 2012



Sources: Center for International Comparisons (2013), OECD (2014a), World Economic Forum (2011–12 and 2014–15), IMF (2015d), and IMF Staff calculations.

^{1/} The index ranges between 0 and 1. It provides an estimate of the relationship between the public capital stock and indicators of access to and the quality of infrastructure assets. Countries with the highest levels of infrastructure coverage and quality (output) for given levels of public capital stock and income (inputs) form the basis of an efficiency frontier and are given a score of 1.

^{2/} The box shows the median as well as the 25th and 75th percentile while whiskers show the maximum and minimum values.

^{3/} Public capital stock was constructed using the perpetual inventory method. Quality of roads index is based on a survey from the World Economic Forum's Global Competitiveness Report (2011–12).

^{4/} Quality of roads index is based on a survey from the World Economic Forum.

¹⁶ For illustrative purpose, the share of maintenance in total investment (private and public) in road infrastructure is relatively low: it averaged 15 percent in France, during the period 2004–11, 46 percent in Italy (2004–10) and 51 percent in the United Kingdom. The average for the 23 EU members for which data is available is 29 percent (OECD, 2015c).

¹⁷ 44 percent if investment subsidies provided by the general government to SOEs and private sector are considered. For more details, on public investment, see Cour des comptes (2015).

Table 8. Availability of and Access to Infrastructure

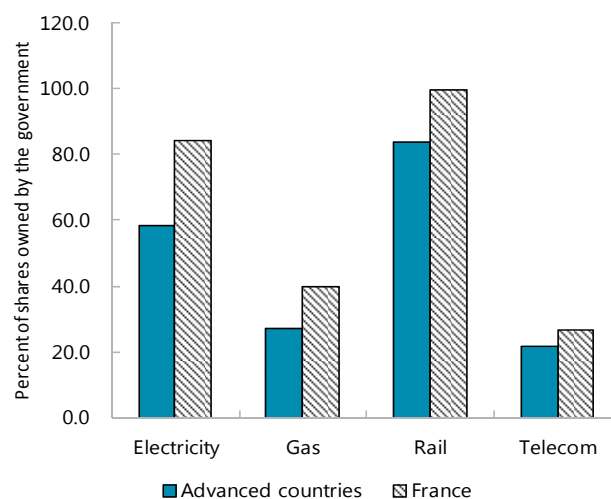
	Health	Water		Transport		Electricity
	MRI units in hospital	Improved water source (% of population with access)	Improved sanitation facilities (% of population with access)	Road density (km of road per 100 sq. km of land area)	Rail density (km of road per 100 sq. km of land area)	Electric power transmission and distribution losses (% of output)
	2012 (or nearest year)	2012	2012	2011	2012	2012
France	6.8	100	100	191.6	5.5	6.7
Germany	11.3	100	100	180.2	9.6	3.9
Italy	15.7	100	n.a.	172.3	5.8	7.1
UK	6.8	100	100	136.6	6.8	7.9
EU28 average ^{1/}	8.5	92.5	99.4	145.9	5.7	7.7
Maximum in EU	21.6	100	100	504.5	12.3	19.5

Sources: World Bank and IMF Staff calculation.

^{1/} For MRI Units: EU 27

Note: Telecommunication infrastructure is not reported as they have been mostly privatized.

general competency clause for *Régions* and *Départements* will contribute to this rationalization. However, the measure does not cover the municipal level where rationalization is also needed and where anecdotal evidence of duplication and inadequate budgeting of maintenance costs suggest scope for rationalization. Rationalization of investment spending needs also to cover SOEs, which accounted for 1.4 percent of investment (net of government capital transfers) in addition to general government investment in 2013 (Figure 17 and Table 9), in particular for high speed rail transportation (Cour des comptes, 2014b). Finally, to increase public investment efficiency, there is scope to improve and expand, at least to large local governments, the ex-ante cost-benefit evaluation of public investment created by the multi-year budget law 2012-17 which is currently limited to large investments and does not cover any local investment (Draft 2015 budget law, OECD 2014a, and Cour des comptes 2015b).

Figure 17. The Role of State Owned Enterprises in Infrastructure Sectors, 2013^{1/}

Sources: IMF staff estimates based on OECD Product Market Regulation Database.

^{1/} The indicator measures the state ownership of the largest firm in each sector.

Table 9. Public Sector Investment, 2013

(In percent of GDP)

	France	UK
General government public investment	4.1	2.6
General government investment grants to private entities	0.5	0.6
State-owned enterprise investment*	1.4	0.3
Public entities' investment in social housing*	0.3	n.a.
Public Sector Support to Investment (consolidated)	6.3	3.5

Sources: For France: Eurostat, Agence des participations de l'Etat, and Union sociale de l'habitat; For UK: HM Treasury and ONS; and IMF staff calculations.

* Net of capital transfers.

B. Public Expenditure by Sector

47. **High total public spending is reflected across most functional categories, but especially for social protection and health** (Table 10).¹⁸ France spends less on public order and safety, and is close to the European average for general public services sector (which includes interest payments). Spending is substantially above the EU average on defense (by 0.6 ppts of GDP), housing (by 0.7 ppts of GDP, i.e. twice the EU average), health (by 1.7 ppts of GDP), and social protection (by 7.3 ppts of GDP). To some extent, this reflects the broader issues identified in the previous section: (i) high social spending that is not always well targeted on poverty reduction; (ii) a wage bill driven by high public employment; and (iii) high spending by many layers of local government. However, to identify specific efficiency gains, it is necessary to look much deeper into individual functional spending categories and economic policies.

48. **Social spending (health and social protection) has been a key driver behind France's rapid growth in public expenditure over the past decades.** From about 25 percent of GDP in 1990, social spending reached 30 percent before the crisis and almost 32 percent in 2014 (accounting for more than half of total public spending). As indicated in Table 10, social spending continued to grow as a share of GDP in the post-crisis fiscal consolidation period, partly reflecting age-related spending pressure. While spending was contained in most sectors from 2010-2013, the social protection sector continued to increase (+0.9 ppts of GDP) and health (+0.2 ppts of GDP), highlighting challenges associated with spending pressures in these sectors (Table 10).

¹⁸ Whereas spending by economic classification is available from Eurostat for 2014, functional spending is only available up to 2013.

Table 10. General Government Expenditure by Functional Classification^{1/}

	2008	2009	2010	2011	2012	2013	Difference (2013-2010)	
	(percent of GDP)						(ppts of GDP)	Share of total exp consolidation (%)
France								
Total expenditure	53.0	56.8	56.4	55.9	56.7	57.1	0.7	100.0
General public services	7.2	7.2	6.8	6.8	6.8	6.8	0.0	0.0
Defence	1.7	1.9	1.9	1.8	1.8	1.8	-0.1	-14.3
Public order and safety	1.5	1.7	1.7	1.6	1.6	1.6	-0.1	-14.3
Economic affairs	4.5	4.9	5.1	4.8	5.0	4.9	-0.2	-28.6
Environment protection	0.9	1.0	1.0	1.0	1.0	1.0	0.0	0.0
Housing and community amenities	1.2	1.5	1.4	1.4	1.4	1.4	0.0	0.0
Health	7.4	7.9	7.9	7.9	8.0	8.1	0.2	28.6
Recreation, culture and religion	1.3	1.4	1.4	1.4	1.4	1.5	0.1	14.3
Education	5.4	5.7	5.6	5.5	5.5	5.5	-0.1	-14.3
Social protection	21.8	23.7	23.6	23.7	24.1	24.5	0.9	128.6
EU Average								
Total expenditure	44.0	48.1	48.0	46.4	46.2	46.6	-1.3	100.0
General public services	6.3	6.8	6.6	6.9	7.0	6.9	0.3	-18.7
Defence	1.4	1.4	1.4	1.2	1.2	1.2	-0.2	15.5
Public order and safety	1.8	1.9	1.9	1.9	1.8	1.9	-0.1	4.0
Economic affairs	5.2	5.4	5.9	5.0	4.9	5.3	-0.7	49.6
Environment protection	0.8	0.8	0.8	0.7	0.8	0.8	0.0	0.5
Housing and community amenities	0.9	0.9	0.8	0.8	0.7	0.7	-0.1	8.3
Health	6.0	6.6	6.5	6.4	6.4	6.4	-0.1	8.5
Recreation, culture and religion	1.2	1.3	1.3	1.2	1.2	1.2	-0.1	6.1
Education	5.3	5.7	5.6	5.5	5.3	5.3	-0.2	16.5
Social protection	15.2	17.3	17.3	16.9	17.1	17.2	-0.1	7.2
Germany								
Total expenditure	43.5	47.4	47.2	44.6	44.2	44.3	-2.9	100.0
General public services	6.4	6.6	6.5	6.6	6.4	6.4	-0.1	3.4
Defence	1.0	1.1	1.1	1.1	1.1	1.1	0.0	0.0
Public order and safety	1.5	1.6	1.6	1.6	1.5	1.6	0.0	0.0
Economic affairs	3.5	3.9	4.7	3.4	3.4	3.3	-1.4	48.3
Environment protection	0.5	0.7	0.6	0.6	0.6	0.6	0.0	0.0
Housing and community amenities	0.7	0.7	0.6	0.5	0.4	0.4	-0.2	6.9
Health	6.4	7.1	7.0	6.8	6.8	7.0	0.0	0.0
Recreation, culture and religion	0.8	0.8	0.8	0.8	0.8	0.8	0.0	0.0
Education	3.9	4.3	4.4	4.3	4.3	4.3	-0.1	3.4
Social protection	18.7	20.6	19.9	18.9	18.8	18.9	-1.0	34.5
Italy								
Total expenditure	47.8	51.1	49.9	49.1	50.8	50.8	0.9	100.0
General public services	8.9	8.6	8.3	8.6	9.3	8.9	0.6	66.7
Defence	1.3	1.4	1.3	1.3	1.3	1.2	-0.1	-11.1
Public order and safety	1.8	2.0	2.0	2.0	2.0	2.0	0.0	0.0
Economic affairs	4.0	4.6	4.1	4.2	4.1	4.2	0.1	11.1
Environment protection	0.9	0.9	0.9	0.9	1.0	0.9	0.0	0.0
Housing and community amenities	0.7	0.8	0.7	0.6	0.8	0.7	0.0	0.0
Health	7.0	7.5	7.4	7.1	7.2	7.2	-0.2	-22.2
Recreation, culture and religion	0.8	0.9	0.8	0.5	0.7	0.7	-0.1	-11.1
Education	4.4	4.6	4.4	4.1	4.1	4.1	-0.3	-33.3
Social protection	18.1	19.8	19.8	19.8	20.5	21.0	1.2	133.3
United Kingdom								
Total expenditure	46.6	49.7	48.6	46.8	47.0	45.5	-3.1	100.0
General public services	4.7	4.7	5.5	5.7	5.4	5.7	0.2	-6.5
Defence	2.5	2.6	2.6	2.5	2.4	2.3	-0.3	9.7
Public order and safety	2.5	2.7	2.5	2.4	2.3	2.2	-0.3	9.7
Economic affairs	5.1	4.5	3.3	2.9	3.6	3.1	-0.2	6.5
Environment protection	0.9	1.0	1.0	0.9	0.9	0.8	-0.2	6.5
Housing and community amenities	1.1	1.3	1.0	0.8	0.8	0.7	-0.3	9.7
Health	7.2	8.0	7.8	7.6	7.5	7.6	-0.2	6.5
Recreation, culture and religion	1.0	1.0	1.0	0.9	0.9	0.8	-0.2	6.5
Education	6.2	6.6	6.6	6.0	5.8	5.5	-1.1	35.5
Social protection	15.5	17.3	17.3	17.1	17.4	16.9	-0.4	12.9

Sources: Eurostat and IMF staff calculations.

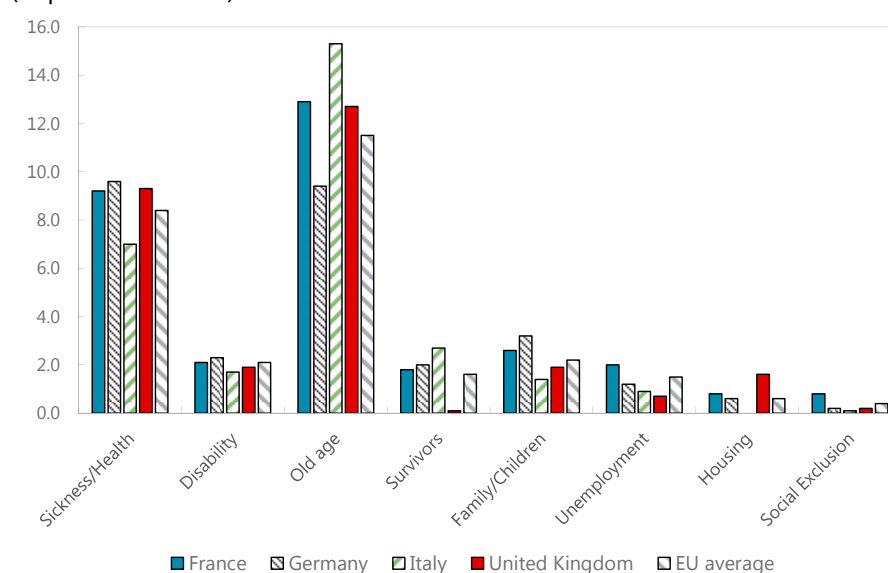
^{1/} When the analysis was undertaken, Eurostat data differed slightly from INSEE in 2014. According to INSEE, expenditures reached 57.5 percent in 2014.

49. **France's social spending is among the highest in Europe and the OECD both for the public sector, and even when accounting for the role of private sector provision** (Figure 19). At about 32 percent of GDP, public social expenditures are 6 percent of GDP higher than in Germany, 4 percent of GDP higher than in Sweden and Austria, and 10.5 percent of GDP higher than the OECD average. When private spending is added, to take into account differences in financing system, France ranks second after Denmark.

50. **France is above EU average across all social risks** (Figure 18). Levels of social benefits spending

by risks vary across EU countries, based on historical and demographic circumstances, as well as social preferences. France's spending is above the EU average for each social risk, namely health, disability, old age, survivors, family, unemployment, housing and social exclusion (Haut Conseil de

Figure 18. Social Protection Spending by Functions, 2012
(In percent of GDP)



Source: Eurostat.

financement de la protection sociale, 2015). Spending is also above all comparators for unemployment and social exclusion, and France is outspent by only one comparator country in all other categories (except survivors for which Germany and Italy spend more).

Pensions

51. **At 13 percent of GDP, pension spending is among the highest in the world.** This is true even when controlling for income and the involvement of the private sector, and whether (or not) early retirement schemes and disabilities are taken into account (Figures 19 and 20). France has the largest spending on pension in the OECD. When early retirement schemes are added, only Italy and Greece spend more on pension.

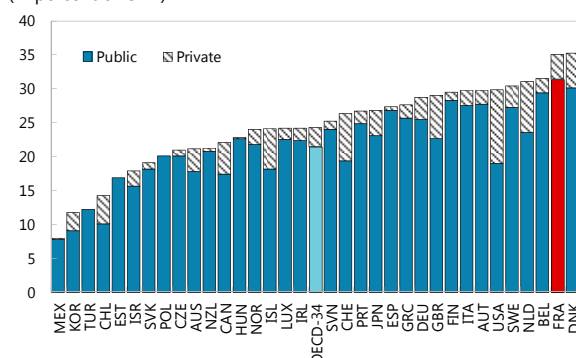
52. **The reason is not demographic but a relatively generous regime.** The share of population of 65 and more is relatively low by European standards. The reason for the high level of pension spending instead reflects three main factors.

Figure 19. Social Expenditure in the OECD, 2011 ^{1/}

Public social expenditure in France is the largest in the OECD...

Total Public and Private Social Expenditure

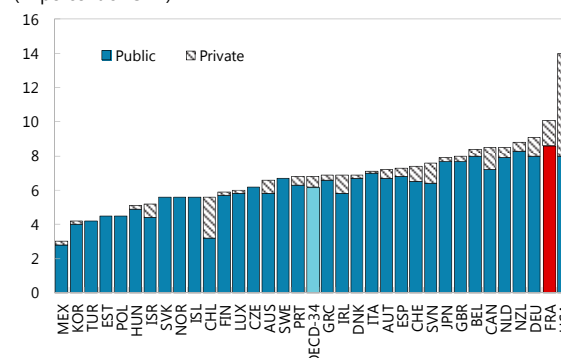
(In percent of GDP)



... due to the largest public spending on health ...

Public and Private Social Expenditure on Health

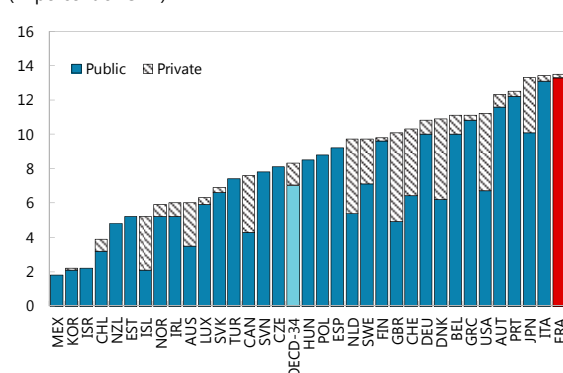
(In percent of GDP)



... and on pensions.

Public and Private Social Expenditure on Pensions ^{2/}

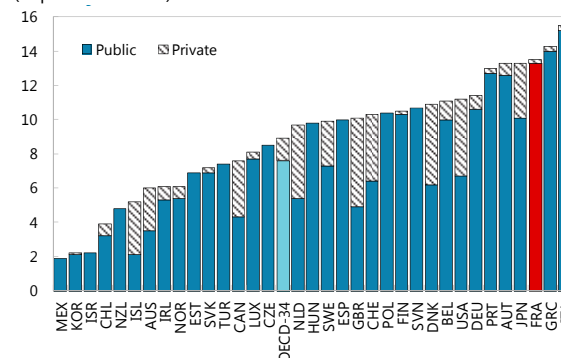
(In percent of GDP)



Though, when early retirement schemes are added, public spending on pensions is higher in Greece and Italy.

Public and Private Social Expenditure on Pensions and Early Retirement Schemes ^{2/}

(In percent of GDP)



Source: OECD.

1/ Total public social expenditure reached 31.9 percent of GDP in 2014. The breakdown by categories is only available up to 2011.

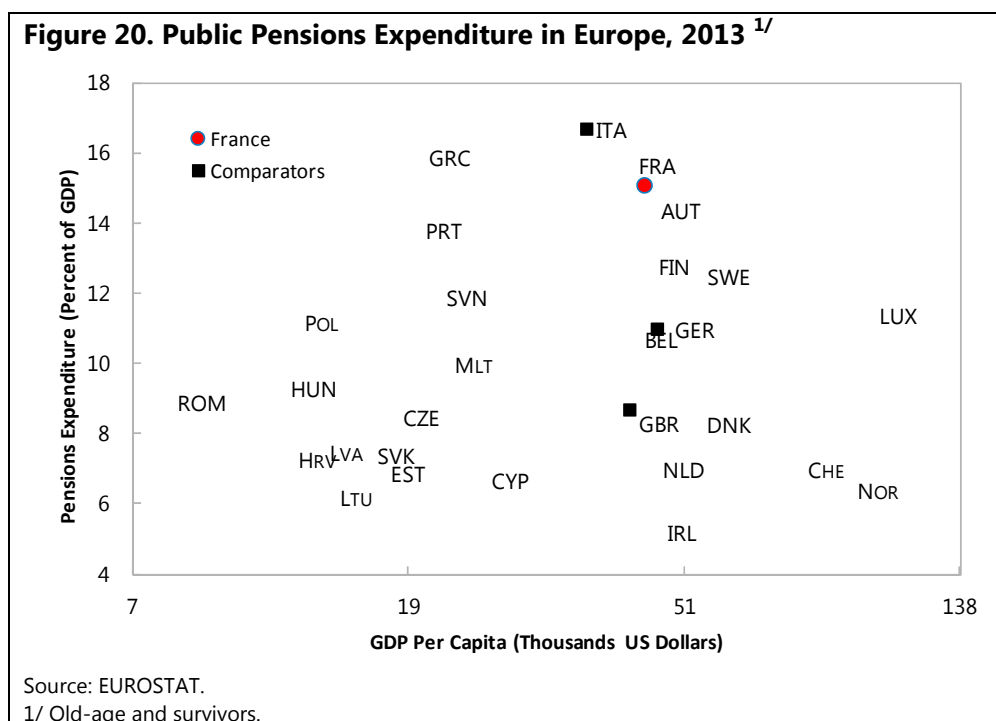
2/ Pensions are defined as in cash spending for old age and survivors. Private expenditure includes both mandatory and voluntary schemes.

- ***The retirement age remains below other countries, while life expectancy is higher.***
At 62,¹⁹ the legal retirement age is the lowest in the OECD although some retirees receive full pension only at 65 (rising to 67 in 2022). Reforms implemented in 1993, 2003, 2010, and 2014 rose both the pensionable age and the contribution period necessary to reach full pension and eliminated most early retirement schemes (Duc, 2015). As a result, the effective retirement age rose from 58.5 years in 2002 to 59.9 years in 2012 and is expected to continue increasing following the 2014 reform. However, it remains one of the lowest in the OECD. In addition, life expectancy after pensionable age is the longest in the OECD reaching 23 years in 2014 for men and 27.2 years for women, more than 5 years longer than the OECD average (OECD,

¹⁹ Following the 2010 reform, the legal age will gradually increase from 60 to 62 in 2017.

2015d). And, as in the past, part of the fiscal saving generated by successive reforms will be offset by a further increase in life expectancy.²⁰

- ***The replacement rate is high*** (Table 11). Both in gross and in net terms, replacement rates in percent of pre-retirement earnings are higher than in the OECD and in comparators countries (except Italy).
- ***The pension system structure is complex and leading to inefficiencies and fiscal costs.*** There are about 40 different compulsory schemes with different eligibility criteria and benefits (OECD, 2013). Simplifying the complex structure of the pension system would provide additional savings without reducing the social outcome.²¹



54. According to the EC's 2015 *Ageing Report*, public pension spending will remain at a high level until 2025 before declining thereafter (European Commission, 2015). In its baseline scenario, the report projects that, absent further reforms, public pensions will not contribute to expenditure reduction over the decade. From 2025, it projects a gradual decrease in gross public pension in France, falling by 2.8 ppts of GDP by 2060. This profile

²⁰ For example, between 1993 and 2010, the fiscal impact of the 1993 and 2003 pension reforms was partly offset by a two-year increase in the life expectancy after pensionable age.

²¹ Part of the fiscal cost of pension are the direct subsidies to some special regimes such as SNCF (railway) or RATP (Paris area public transport) or an "implicit contribution" to the regime for civil servant in order to ensure their financial balance (Conseil d'orientation des retraites, 2012).

differs substantially from the one in the 2012 *Ageing Report*, which anticipated an increase by 0.5 ppt of GDP by 2060. The downward revision is among the largest across EU countries, and much larger than EU average (-1.3 ppts), and comparators.^{22,23} Overall, the expected evolution of public pension spending is more favorable than EU average (-0.2 ppt from 2013-2060), as well as in Germany (+2.7 ppts of GDP), Italy (-1.9 ppt) and the United Kingdom (+0.7 ppt).

55. Reducing pension spending in the medium run would require a mix of increase in retirement age and reduction in benefits.

Three main policy options can reduce pension spending in the medium term (Figure 21): (i) a reduction in benefits (whether through nominal pension cuts or lower indexation of benefits); (ii) an increase in the statutory retirement age; and (iii) an increase in payroll taxes. The last option is less attractive from an efficiency point of view, given already high level of payroll taxes in France that tend to reduce labor demand and supply. It would also be inconsistent with the authorities' policy aiming at reducing the labor cost to boost employment and restore competitiveness.

56. An increase in the legal retirement age to 65 in line with most EU countries would lead to a significant reduction in public pension spending, and lift employment levels and economic growth (IMF, 2014). It would address the fiscal impact of the projected increase in life expectancy, which is expected to increase the share of adult life spent in retirement in France, already above EU average and comparators.²⁴ For equity considerations, earlier retirement age for contributors with shorter life expectancy, in particular justified for dangerous or heavy manual work, could be combined with the increase in the statutory retirement age. More specifically, all other things equal, an increase in the statutory

Table 11. Pension Replacement Rates, 2012
(In percent of pre-retirement earnings)

	Gross	Net
France	58.8	71.4
Germany	42.0	57.1
Italy	71.2	81.5
United Kingdom	32.6	41.8
OECD ^{1/}	54.5/53.8	65.9/65.2

Source: OECD, Pension replacement rates (indicator).

^{1/} In France and in the comparators, the rate is similar for men and women. This is not the case in all OECD members. Thus, the ratios for the OECD is reported as follows: men/women

²² Germany (-0.2 ppt), Italy (-1.3 ppt), and the United Kingdom (-0.9 ppt).

²³ The main contributor to this downward revision is the decline in the benefit ratio (-2.0 ppts of GDP) and the decline in the dependency ratio (-1.1 ppts of GDP) as in many other European countries (-0.8 ppts on average). Policy changes have a limited impact on this ratio (-0.2 ppts). The retirement behavior assumption embedded in the baseline is that people retire only when they reach the full rate pension. Hence, this would reduce the share of pensioners in the age group 60-64. In terms of public pension expenditure, the results are close to those of the baseline scenario if people retire as soon as they leave the labor market, without waiting for the full rate.

²⁴ In 2014, 34.0 percent of adult life was spent at retirement for men in France, compared to an EU average of 28.3 percent. For women, France (38.2 percent) is again above EU average (33.6 percent) in 2014.

retirement age from 62 to 65 years old would reduce public pension spending by about 2.2 percent in 2030 (Figure 21). Lower indexation of the formula for annual increases in pensions (currently based on CPI), for example from 2 percent to 1 percent per year, would also have a large impact of about 1.4 percent. Finally, reducing across the board benefits by 3 percent would only generate savings of 0.2 percent of GDP in 2030.

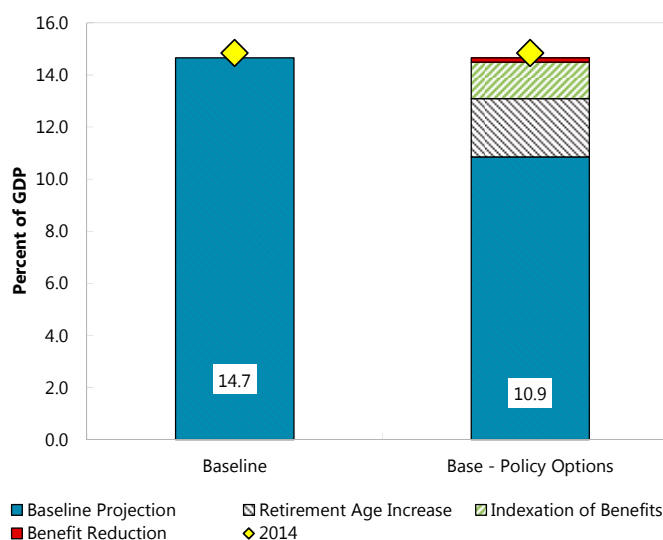
Health

57. Access to health insurance and care and health outcomes are good in France. In

2013, public health insurance covers almost all inhabitants (99.9 percent), above EU(21) average (96.3 percent), and Germany (88.9 percent), where private insurance for primary care plays a significant role (10.9 percent of population). In addition, 95 percent of the population has a complementary private health insurance in France, significantly above other EU countries with similar insurance schemes. Hence, private insurance spending amounts to 2.3 percent of GDP, above EU average (2.1 percent of GDP). As a consequence, households out-of-pocket health spending is on average among the lowest in the EU (Table 12). Moreover, France has one of the highest Health-Adjusted Life Expectancy (HALE) in the EU and other health outcomes are also better than the European average (Figures 22 and 23).

58. However, these good health outcomes are not evenly distributed within the French population. The self-perceived level of good health exceeds that of other EU countries across different personal income levels except the highest quintile, but available comparative data indicates that health inequalities are also higher (Figure 24), particularly for men (Mackenbach, 2008). Access to dental and medical examination for the poorer

Figure 21. Estimated Impact of Pension Reforms Options in 2030 ^{1/2/3/4/}



Sources: European Commission (2015) and IMF staff estimates.

^{1/} Gross public pensions. Tax and compulsory social security contributions paid on benefits by pensioners are excluded. Spending includes minimum, old-age, early retirement, disability and survivors' pensions.

^{2/} Gross public pension spending is 14.8 percent of GDP in 2014 (yellow diamond), and is projected at 14.7 percent of GDP in 2030 (bars).

^{3/} Left bar represents gross public pension spending without reform; right bar illustrates the impact of three policy options on the projected level of spending.

^{4/} Results are based on simplified assumptions, and don't substitute for actuarial analysis.

Table 12. Households Out-of-Pocket Expenditure

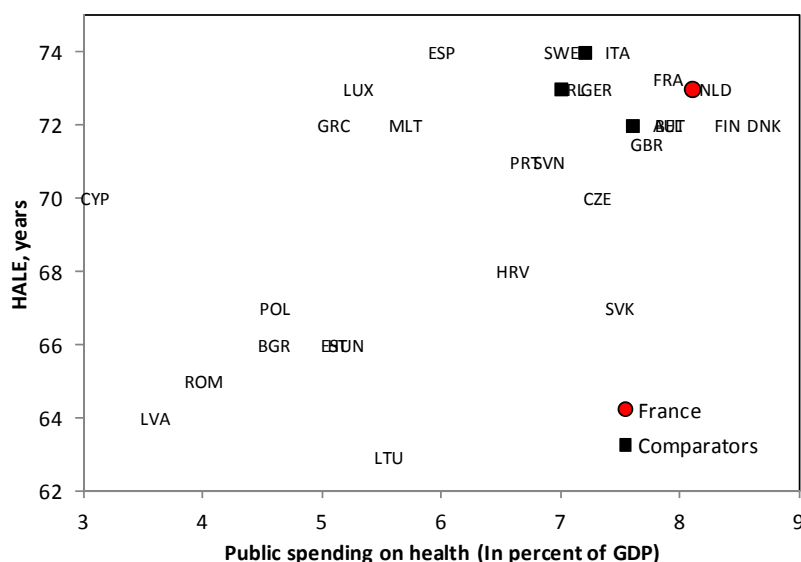
(2012 or latest, in percent of total health expenditure)

France	7.5
Germany	13
Italy	18.8
United Kingdom	9.0
EU average	17.2

Source: OECD.

(first quintile) in France is slightly worse than EU average and comparators, except Italy (Figure 25). Moreover, France is, with Spain, the most inequitable country in the OECD, when it comes to specialist visits (Devaux and de Looper, 2012). France dedicated only 2.1 percent of its total health spending in 2010 to preventive care, substantially below OECD average and Germany (both at 3.1). Preventive care can help mitigate health inequalities by reducing unhealthy behaviors which tend to be more prevalent at lower income levels.

Figure 22. Health-Adjusted Life Expectancy and Public Spending on Health, 2012 ^{1/}



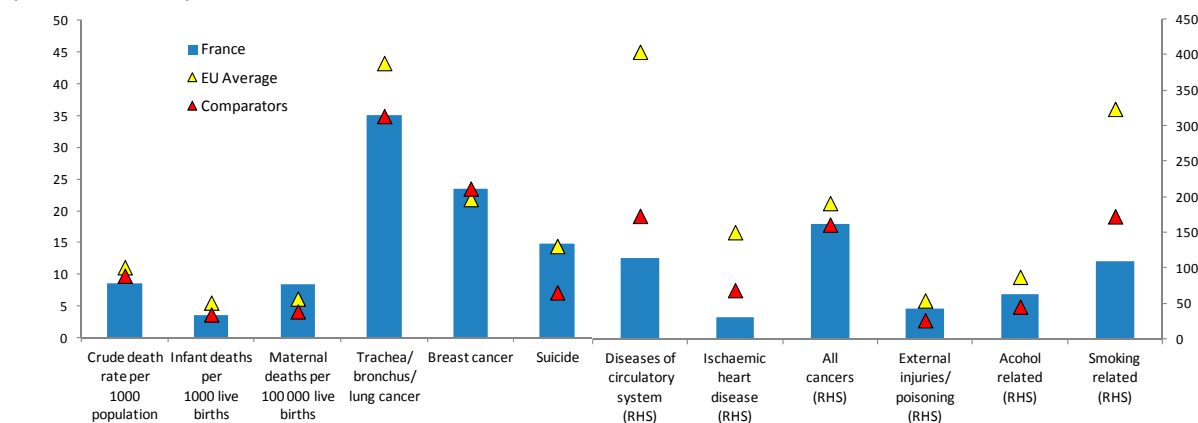
Source: Eurostat and WHO.

^{1/} Health-Adjusted Life Expectancy at birth is the average number of years a person can expect to live in good health or free of disease and injury.

59. **The good overall health outcomes have come at a high fiscal cost** (Figure 22). Total spending on health is higher than the EU average and comparator countries when private health spending is taken into account (Table 10 and Figure 19). About 90 percent of this difference is due to public spending, as by 2013, in share of GDP, public health spending was 27 percent larger than on average in the EU (Tables 10 and 13). The high level of spending partly reflects social benefits (at 4.3 percent of GDP vs. 2.7 percent of GDP on average in the EU (Table 13) and administrative costs, which are well above the OECD average and comparators (Figure 26).

60. **Over the last two decades, the ratio of public health spending to GDP increased in all European countries including in France.** Spending increased more rapidly in Greece, Portugal, Ireland, and the United Kingdom, which had low initial health spending ratios - below 5 percent of GDP in 1990-, (Figure 26). In France, the increase in the health spending ratio exceeded 2.5 ppt of GDP. This is the strongest increase among countries with a high initial health spending ratio (above 6 percent of GDP in 1990). This trend continued during

Figure 23. Health Outcomes in France, EU, and Comparator Countries
(2012 or latest)

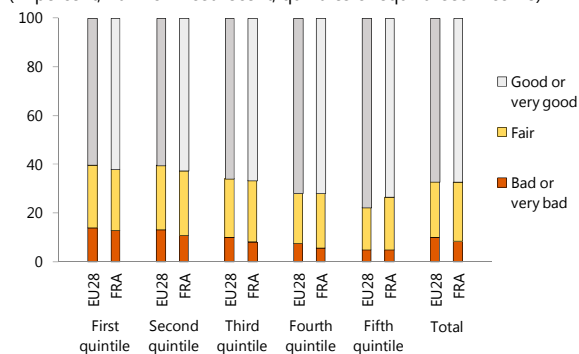


Sources: Eurostat and IMF staff calculation.

Figure 24. Social Outcomes of Health Spending

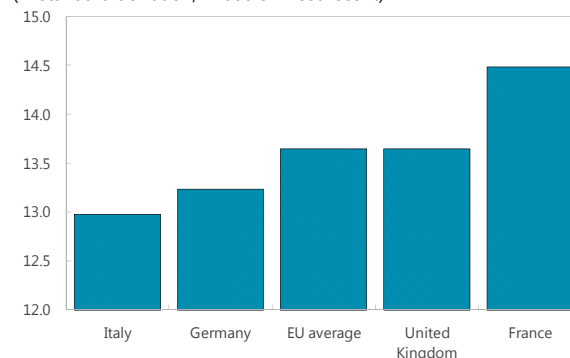
Perception of Health by Levels of Income

(In percent, 2012 or most recent; quintiles of equivalised income)



Inequalities in Health Status

(In standard deviation, ^{1/} 2006 or most recent)



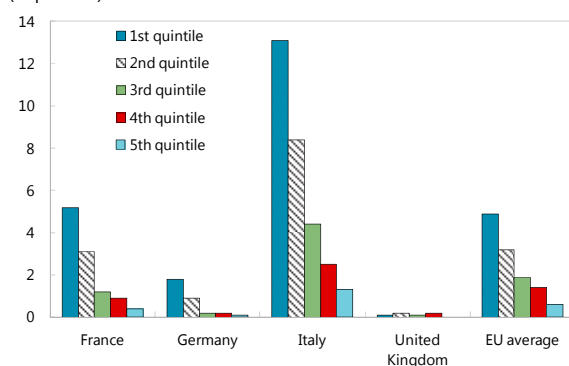
Sources: Eurostat, OECD, and IMF Staff calculations.

^{1/} Standard deviation in mortality for population older than 10. EU average for OECD members only (excluding Greece).

Figure 25. Unmet Needs for Medical and Dental Examinations, 2013

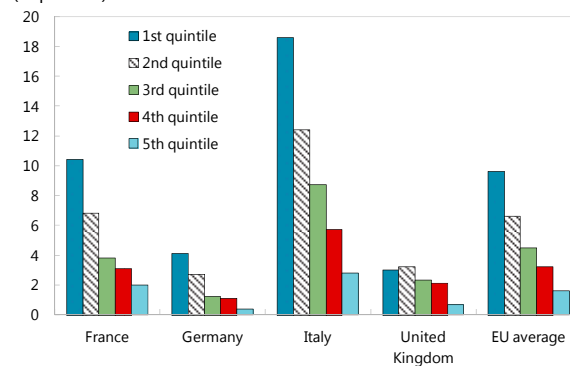
Self-Reported Unmet Needs for Medical Examination by Income Levels

(In percent)



Self-Reported Unmet Needs for Dental Examination by Income Levels

(In percent)



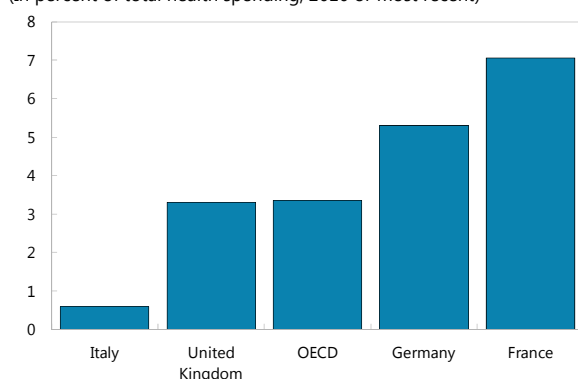
Source: Eurostat.

the crisis, public health spending increased by 0.7 ppt to 8.1 percent during 2008–13, more than on average in the EU (+0.4 ppt to 6.4 percent) and the three comparators. This reflects growing costs of healthcare against a backdrop of low GDP growth and low overall inflation.

Figure 26. Public Health Spending in Europe

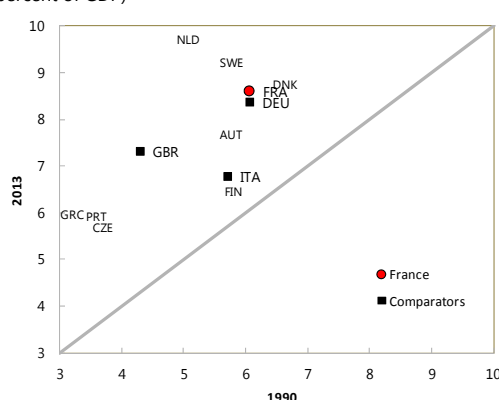
Health Administrative Costs

(In percent of total health spending, 2010 or most recent)



Public Health Spending in Europe

(In percent of GDP)



Source: OECD and Eurostat.

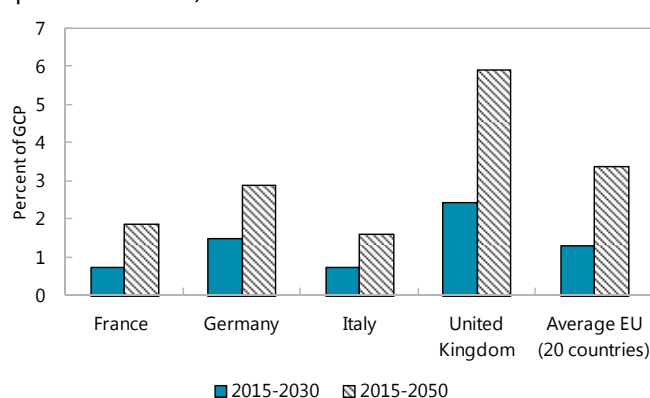
Note: The health spending definitions of Eurostat and OECD differ.

61. There will be substantial longer-term cost pressures from ageing and medical progress.

Health spending pressures is expected to build up. Health expenditure is projected to increase by about 0.8 ppt of GDP from 2015–30, and up to 1.9 ppts by 2050 (Figure 27), due to the effect of population ageing and the impact of technological advances that will drive up costs.²⁵

Figure 27. Projected Increase in Public Health Spending

(In percent of GDP)



Source: IMF (2015e).

²⁵ In its baseline scenario, the European Commission projects a smaller increase of 0.6 ppt of GDP by 2030, and 1 ppt of GDP by 2050 (European Commission, 2015). The European Commission also estimates long-term care spending change over the same period. For France, it would increase by 0.2 ppt of GDP in 2030 and 0.7 ppt in 2050, below EU average (0.4 and 1.2 ppt of GDP respectively).

Table 13. Benchmarking Public Health Spending^{1/}
(In percent of GDP)

Year	Threshold 1/	Total expenditure	Current spending	Compensation of employees	Goods and services	Interest payments	Subsidies	Current transfers	Social benefits	Capital spending	Grossed fixed capital formation
2000	120	6.9	6.5	2.2	0.6	0	0	0.1	3.5	0.4	n.a.
2001	120	7.0	6.7	2.2	0.6	0	0	0.1	3.6	0.3	n.a.
2002	120	7.2	6.9	2.3	0.7	0	0	0.1	3.7	0.3	n.a.
2003	130	7.5	7.1	2.3	0.7	0	0	0.1	3.9	0.4	n.a.
2004	130	7.5	7.1	2.3	0.7	0	0	0.1	3.9	0.4	n.a.
2005	130	7.6	7.2	2.3	0.7	0	0	0.1	3.9	0.4	n.a.
2006	130	7.6	7.2	2.2	0.7	0	0	0.1	3.9	0.4	n.a.
2007	120	7.4	7.0	2.2	0.7	0	0	0.0	3.9	0.4	n.a.
2008	120	7.4	7.1	2.2	0.7	0	0	0.0	3.9	0.3	n.a.
2009	110	7.9	7.5	2.3	0.8	0	0	0.1	4.2	0.4	0.4
2010	120	7.9	7.5	2.3	0.8	0	0	0.1	4.2	0.4	0.4
2011	120	7.9	7.5	2.3	0.9	0	0	0.1	4.2	0.4	0.4
2012	120	8.0	7.6	2.3	0.9	0	0	0.1	4.2	0.4	0.4
2013	120	8.1	7.7	2.3	0.9	0	0	0.1	4.3	0.4	0.4

Source: Eurostat.

1/ Cells are in red if spending is higher in France than in the EU by the threshold (in percent) and in green if less than 70 (threshold of 130) / 80 (threshold of 120) / 90 (threshold of 110) percent of EU average.

62. **Over the last 25 years, health care reforms in France relied on a mix of macro- and micro-level instruments.** Reforms to contain health can be grouped in two categories (IMF, 2012):

- **Budget controls and other macro-level instruments.** Both have progressively become more effective in containing health spending. In 1996, France created the National health spending objective (ONDAM), a non-binding budget cap for health spending, which was initially routinely missed. However, since 2010, after some institutional reform, notably the establishment of the in-year monitoring and alert mechanisms, the ONDAM has always been met (Table 14). Other controls took the forms of supply constraints (limiting admittance to physician and paramedics colleges, defining a list of drugs eligible for reimbursement), as well as price controls for healthcare professionals fees and wages, or medicines.
- **Demand-side reforms** have increased cost sharing, while specific measures have protected poor households and patients with serious diseases. To contain public health spending, successive reforms have increased households' out-of-pocket payments for primary and hospital care and pharmaceuticals. For equity consideration, poor households have benefited from subsidies to pay for a complementary health insurance. Recent reforms have also aimed at limiting non-reimbursable medical fees (*dépassements d'honoraires*). In addition, patients suffering from serious non-communicable long-term diseases (NCDs) are exempted from cost-sharing arrangements (*affections de longue durée*). This exemption generated a significant (and rising) fiscal costs of about 0.6 percent of GDP in 2011 (Direction Générale du Trésor,

2015) and resulted in an increase in the cost sharing for patients that are not covered by the NCD scheme (Cour des comptes, 2015c).

Table 14. ONDAM (In percent, and euro billion)									
	2009	2010	2011	2012	2013	2014	2015	2016	2017
Growth in percent									
Trend Growth (initial budget)	4.7	4.4	4.4	4.1	4.1	3.8	3.9	3.6	...
ONDAM (initial budget)	3.3	3.0	2.9	2.8	2.7	2.4	2.1	1%	1%
ONDAM (actual) ^{1/}	3.7	2.3	2.8	2.3	2.2	2.4	2.2	...	...
In billions euros									
ONDAM (initial budget)	157.6	162.4	167.1	171.1	175.4	179.1	182.3	185.2	...
ONDAM (actual) ^{1/}	158.1	161.8	166.3	170.1	173.8	178.0	181.9	...	...
Overperformance (actual vs. latest budget) 2/	-0.5	0.6	0.8	1.0	1.7	0.3	0.4	...	...
Overperformance (in percent of GDP)	-0.03	0.03	0.04	0.05	0.08	0.01	0.02	...	...

Source: Draft social security budget laws (annex 7) and IMF staff calculations.
1/ Preliminary data for 2015.
2/ Latest budget is the revised budget or, if there is none, the initial budget.

63. **More recently, healthcare reforms have aimed at improving incentive structures in the sector to reinforce its efficiency.** For primary care, gate keeping arrangements were created in the mid-2000s to better coordinate referrals to secondary and tertiary levels (*médecin traitant*), and contracting arrangements have been put in place to allow case-based payments to reinforce preventive care and better coordinate patients' health care services. In addition, more market-oriented mechanisms have been put in place in hospitals by moving from global budgets to activity-based financing (*tarification à l'activité*).

64. **The National Health Strategy adopted in 2014 is expected to scale up efforts to increase efficiency and reduce costs.** With health spending dynamics having picked up recently,²⁶ the strategy is expected to deliver a €10 billion (0.4 percent of GDP) saving compared to trend over 2015–17, contributing to 1/5 to the spending saving plan underpinning the authorities' fiscal consolidation over this period. It rests on four pillars: (i) develop ambulatory care; (ii) increase hospital efficiency; (iii) reduce the cost of pharmaceuticals through a promotion of generic medicine; and (iv) reduce redundant and useless medical services in and outside hospital.

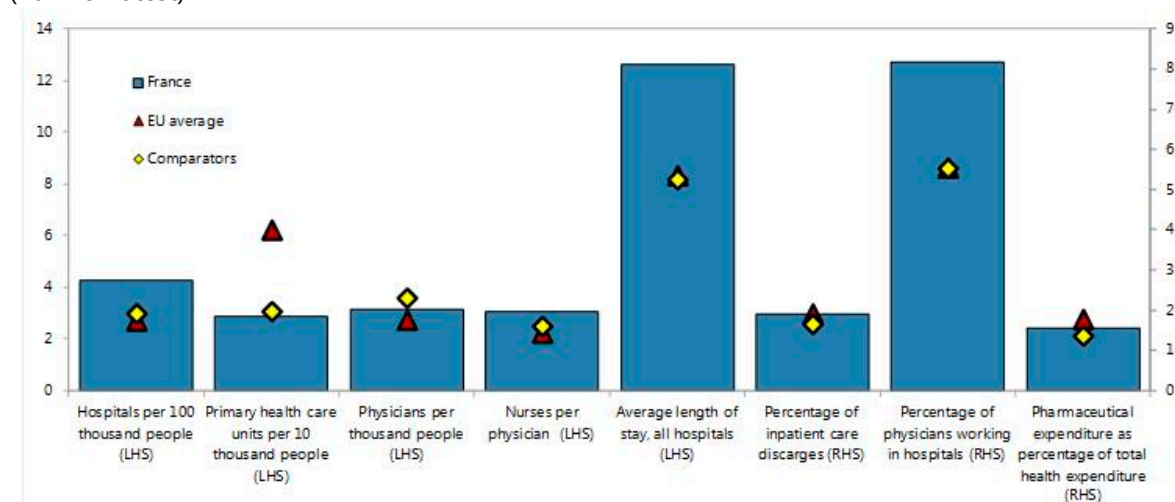
65. **Reducing the cost of hospitals is an important source of expected saving.** France hospital care health consumption is comparatively higher than European average. While the

²⁶ Recent efforts to regulate prices of health inputs or outputs, in particular on pharmaceuticals, were insufficient to contain health spending growth in 2014, which has accelerated compared to 2012–13, despite a favorable environment with low inflation, and the absence of increase in doctors' fee and hospital staff salaries (Cour des comptes, 2015c).

number of outpatient consultations is comparable to the European average, and below Germany, France has a higher consumption of hospital services, except when compared to Germany (Table 15). Health inputs are excessively geared toward hospitals, particularly in terms of the number of hospitals, length of stay in hospital, and percentage of physicians working in hospitals. Moreover, about one fifth of hospital admissions in emergency care could be avoided (Cour des comptes, 2014c). And the length of hospital stay is higher in France than in comparators and in the EU on average (Figure 28).²⁷

66. **The promotion of generics is the largest source of saving (35 percent of expected savings over 2015-17).** While pharmaceutical consumption is similar to comparators (except Italy), the share of generics in volume and value is lower (Table 15). The Cour des comptes (2014a) calculates that if the market share of generics was similar to the one in Germany or in the UK, the saving would range between €2 and 5 billion (0.1 to 0.2 percent of GDP), broadly in line with the objective of the National Health Strategy of a saving of €3.5 billion in this area. Expanding the use of generics will require changing in hospital's purchasing policies, which lags behind in terms of generics consumption, and further increasing generics prescription in primary health care.

Figure 28. Health Services in France, EU, and Comparator Countries
(2012 or latest)



Sources: WHO and OECD.

²⁷ Differences depend on the specific medical condition. The length of hospital stays for acute diseases appears low by international standard (Table 15). By contrast, the length of stay for childbirth is long despite a smaller number of caesarean sections (208 per 1 000 live births in 2013 versus 230 in the United Kingdom, 361 in Italy and an average of 245 in the 15 EU members of the OECD for which data are available) and does not translate into a lower infant mortality rate (3.6 death of children below 1 year per 1000 living birth in 2013 vs. 3.3 in Germany, 2.9 in Italy, 3.8 in the United Kingdom, and 3.4 in the 21 EU members of the OECD) or maternal death (Figure 28, data not available for Germany in 2012).

Table 15. Health Indicators in France, EU and Comparator Countries
(2013 or latest)

	Number of consultations (per capita)	Number of hospital discharges (per 100,000)	Average length of stay for childbirth (in days)	Average length of stay for acute disease (in days)	Number of standard units of pharmaceutical (per inhabitant)	Percentage share of generics in reimbursed pharmaceuticals (in value)	Percentage share of generics in reimbursed pharmaceuticals (in volume)
France	6.4	16633	4.1	5.7	1132	15.5	30.2
Germany	9.9	25224	2.9	7.7	1339	37.0	79.5
Italy	6.8	12377	3.4	6.8	783	12.2	20.3
United Kingdom	8.2	12902	1.5	5.9	1283	33.4	83.4
EU(21)	6.3	16865	3.2	6.2	NA	21.7	45.5

Sources: OECD and DREES.

67. **Beyond these efforts, deeper structural reforms will be needed to mitigate long-term public health-spending pressures.** While budget caps and other macro-levels controls can reduce spending in the short term, they usually do not directly address the underlying causes of spending and are thus unlikely to be sustainable in the longer term. Going forward, France should strengthen micro-level reforms to increase the efficiency of spending. Some advanced countries have undertaken reforms that could inform France on how to contain health spending (IMF, 2012), such as:

- Reforms should be based on cost-effectiveness evaluations to determine what health services should be financed by public funds (as in Australia, Finland, the Netherlands, Sweden and the United Kingdom). Reform in this area includes delisting ineffective drugs (as in Germany) and treatments (as in the Netherlands).
- Making generics prescription compulsory, impose electronic prescribing, and further develop clinical guidelines to cover a large share of drug prescribing, as in Portugal (OECD, 2015). This would require progress in unifying patients' health electronic records, and in ensuring a full integration of electronic systems on personal health records.
- To reduce hospital costs, developing more vigorously primary care group practices to increase ambulatory treatments (as envisaged in the National Health Strategy), and rationalizing hospital services, particularly emergency rooms.
- Substituting more case-based payments and pay-for-performance schemes for primary care to current fee for service payments (OECD, 2015).
- A specific attention to health inequalities would also be warranted to improve outcomes for low income populations Labor Market Spending

Labor Market Policies

68. **At 2.3 percent of GDP, spending on labor market policies is high by EU standards.** Spending is higher in France for both unemployment spending and active labor

market policies, which cannot be explained solely by differences in the level of unemployment (Table 16). The gap is particularly pronounced when measured in purchasing power standard, to control for differences in income (Figure 29).²⁸ In particular activation measures²⁹ and financial assistance³⁰ to targeted groups are above comparators, as well as employment services. The same conclusion applies when one considers only unemployment benefits per inhabitant in purchasing power standard (PPS) are considered (Figure 30).³¹

69. The high spending in this area is largely explained by the relatively generous unemployment insurance scheme (Unédic, 2012 and OECD³²):

- Workers become eligible for unemployment benefits after only 4 months of work over a 28 month period (the shortest time to reach eligibility in Europe) and qualify for up to 24 months of benefits after working for just 2 years (the fastest among the largest European countries).
- While the replacement rate is broadly on a par with other European countries, the maximum monthly benefit is capped at about €7,000, well above peers.
- The system also does not provide for a progressive reduction in benefits (degressivity) for long-term unemployed to encourage their rapid return to the labor market.
- In the first year of unemployment, the salary of a “reasonable job offer” that the unemployed should accept is set as high as 85–100 percent of the previous salary (at 57–75 percent in the second year of unemployment). Moreover, the unemployed can reject the first such offer without penalties. While benefit recipients are required to conduct an active job search, this condition is not always strictly enforced for either welfare or unemployment benefits. Since September 2015, controls have been strengthened to ensure that job seekers are conducting an active job search.

²⁸ The European Commission’s Labor Market Policy database covers general government expenditure and foregone revenue targeted at groups of persons with difficulties in the labor market, either unemployed, at risk of unemployment, or inactive.

²⁹ They include training, employment incentives, sheltered and supported employment and rehabilitation, direct job creation, and start-up incentives.

³⁰ They include in cash-benefits for unemployed and early retirement.

³¹ The ESSPROS reports benefits that (i) replace in whole or in part income lost by a worker due to the loss of gainful employment; (ii) provide a subsistence (or better) income to persons entering or re-entering the labor market; (iii) compensate for the loss of earnings due to partial unemployment; (iv) replace in whole or in part income lost by an older worker who retires from gainful employment before the legal retirement age because of job reductions for economic reasons; (v) contribute to the cost of training or re-training people looking for employment; (vi) help unemployed persons meet the cost of travelling or relocating to obtain employment; (vii) provide help and relief by providing appropriate goods and services.

³² See <http://www.oecd.org/els/soc/unemployment%20benefits.xlsx>.

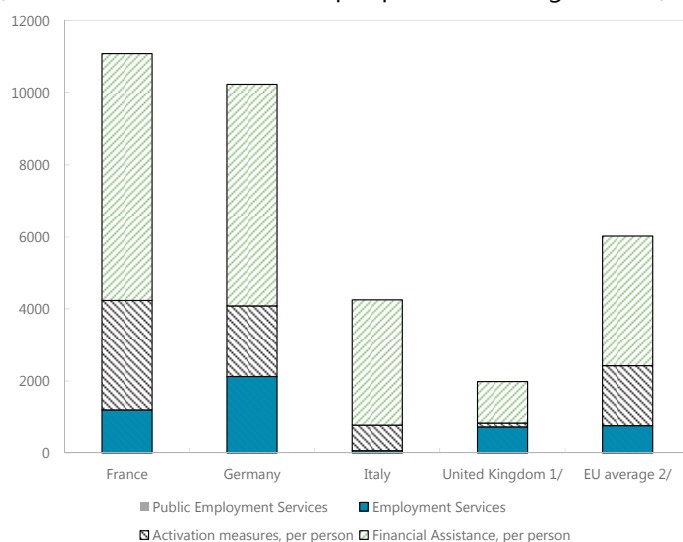
Table 16. Labor Market Policies, 2012

(In percent of GDP unless otherwise specified)

	TOTAL Labor Market Policies	Unemployment		Active labor market policies	Unemployment rate (in percent)
		Out-of-work income maintenance and support	Early retirement for labor market reasons		
Spain	3.6	3.0	0.0	0.6	25.2
Denmark	3.4	1.4	0.3	1.7	7.5
Ireland	3.3	2.4	0.0	0.9	14.7
Belgium	2.8	1.4	0.7	0.8	7.5
Netherlands	2.5	1.6	...	0.9	5.3
Finland	2.4	1.3	0.1	1.0	7.6
France	2.3	1.4	0.0	0.9	9.9
Portugal	2.1	1.5	0.1	0.5	15.6
Austria	2.0	1.1	0.1	0.7	4.3
Italy	1.9	1.5	0.1	0.4	10.7
EU (15)	1.9	1.2	0.1	0.7	10.6
Sweden	1.9	0.6	...	1.2	8.1
EU (28)	1.8	1.1	0.1	0.7	10.8
Germany	1.6	0.9	0.0	0.7	5.4
Luxembourg	1.3	0.6	0.2	0.5	5.1
United Kingdom	0.7	0.3	...	0.4	8.0

Sources: European Commission (Labor Market Policy database) and ILO.

Note: Except for unemployment rate, for the United Kingdom and Greece: 2010, for EU (28) and EU (15): 2011. Unemployment rate for the EU is the simple average of members' unemployment rates.

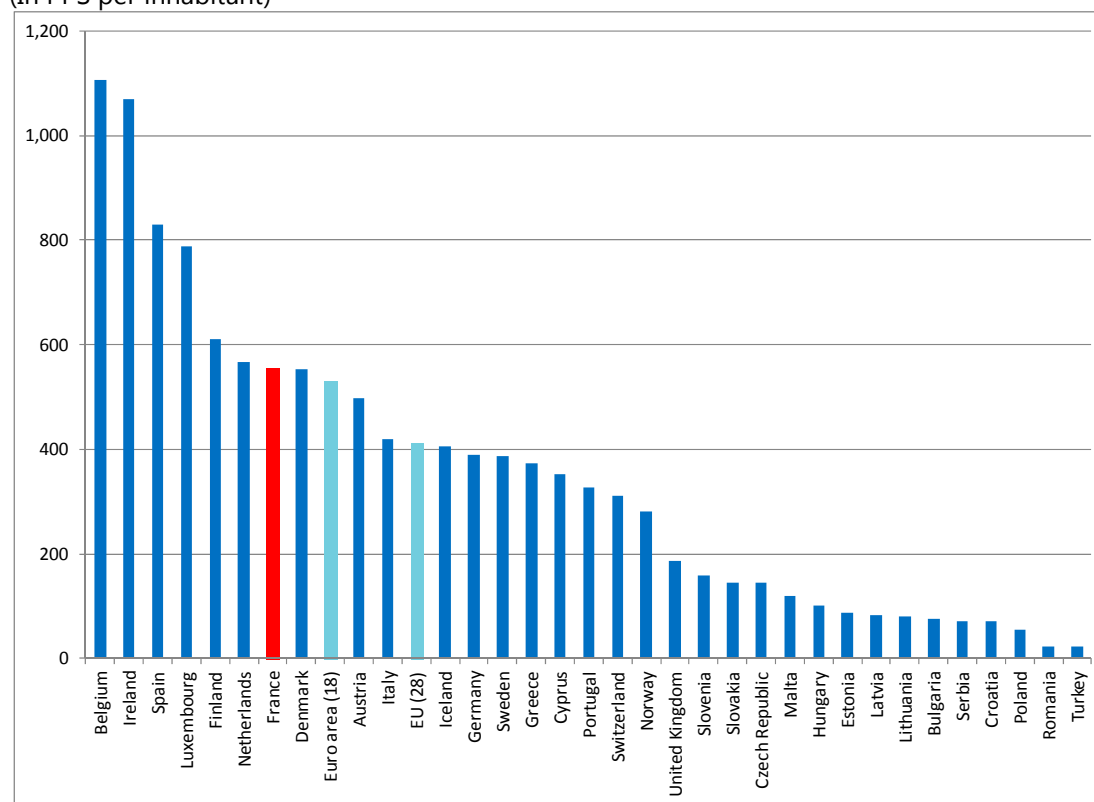
Figure 29. Labor Market Policies Spending
(2013 or most recent, in PPS per person wanting to work)

Source: European Commission (Labor Market Policy database).

¹2011 data.² EU average, excluding Greece.

Figure 30. Unemployment Benefits, 2012

(In PPS per inhabitant)



Source: Eurostat.

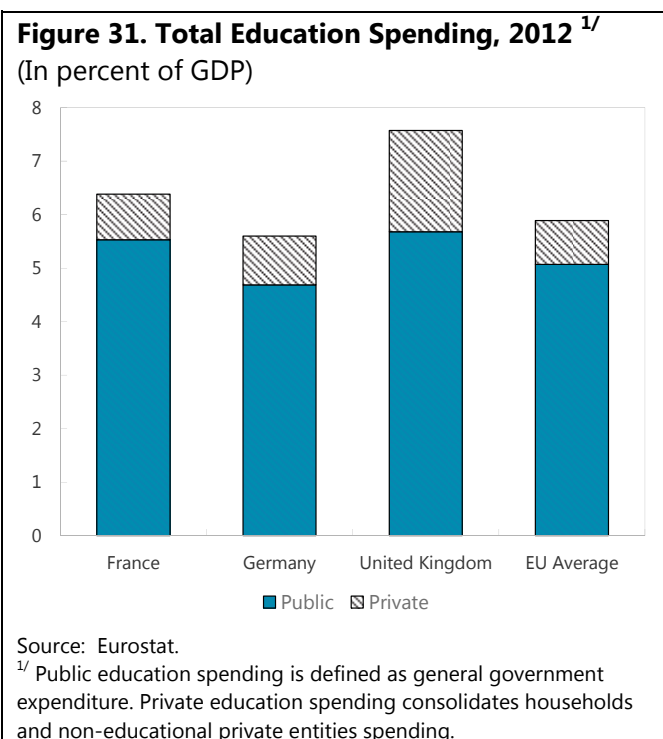
70. **Any reform of the unemployment insurance scheme should take into account the impact on the functioning of the labor market.** In this context, eligibility criteria defined as entitlement conditions, strictness of job search and availability, monitoring, and sanctions, can partly offset the negative impact of generous benefits on employment incentives. A recent study by the OECD (Venn, 2012) suggests that eligibility criteria are relatively less strict than in most OECD countries, including Italy and the United Kingdom but broadly as strict as in Germany. There is thus scope for a reform of the unemployment insurance that would both reduce the cost and improve its impact on work incentives, notably the enforcement of stronger job retirement and the introduction some degressivity in unemployment allowance.

Education and Vocational Training

71. **At 5.5 percent of GDP, France's public spending on education is in line with the EU average (Table 10), and in an intermediate position when controlling for income (Figure 32).** Total education spending (including private) is slightly above the EU average and Germany, but below the UK (Figures 31). Public education spending is comparable to the UK (5.5 percent), but notably above Germany (4.3 percent) and Italy (4.1 percent). Education spending was stable in France and Germany during 2010-13, while they declined

with fiscal consolidation in Italy (-0.3 pts) and the United Kingdom (-1.1 pts).

72. **Education spending is more geared toward pre-primary and secondary schools** (Figure 32). By contrast, expenditure per student for primary education is 20 percent below the EU(21) average (OECD, 2014c). Total spending (public and private) per student is also below par for primary education, while it is above in secondary education. France stands out for early childhood education, with an enrollment rate of 98 percent in 2012, compared to the EU average (79 percent).



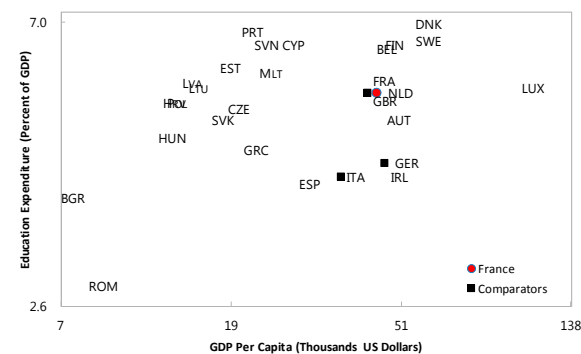
73. **Organizational inefficiencies and rigidities affect in particular the upper secondary level.** Across all levels of education below tertiary, France has a higher student-teacher ratio (15.4) than the EU (14.3). But the student-teacher ratio is higher in primary and lower secondary, while lower in upper secondary schools (Figure 32). As a consequence, the annual cost of upper secondary education per student is 38 percent higher than the OECD average (Cour des comptes, 2015d), which offsets comparatively low level of teachers' 'wages (Figure 14). There are other inefficiencies such as lower teaching hours in secondary public school in France (648 hours) than the EU (21) average (657 hours), and limited versatility of academic staff to teach in different areas. French schools also have one of the lowest levels of autonomy over resource allocation (OECD, 2015b).³³

74. **Student test scores are close to European averages, but have deteriorated in mathematics and science.** In 2012, overall PISA scores were higher than the EU average but somewhat below Germany. The PISA scores in math and science declined from 2003 to 2012, while they increased sharply in Germany and Italy (Figure 33). However, while France performance appears mediocre relative to spending-per-student, its evolution over the past decade compares relatively favorably to other European countries except Italy (Figure 34).

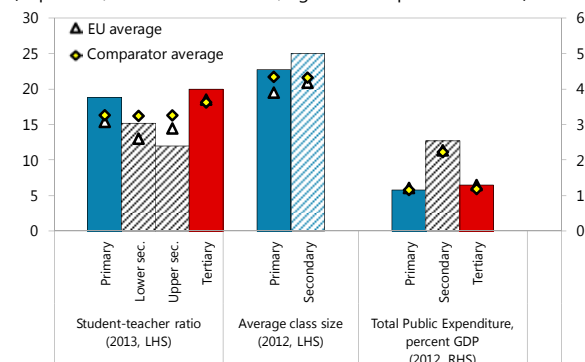
³³ Allocation of teachers is made on the basis of seniority, with priority given to the more senior teachers rather than the more qualified.

Figure 32. Educational Input in Europe**Public Education Spending, 2013**

(In percent of GDP)

**Educational Inputs**

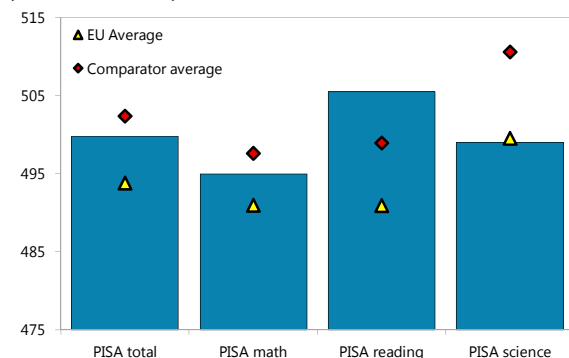
(In persons, 2013 or most recent; right scale in percent of GDP)



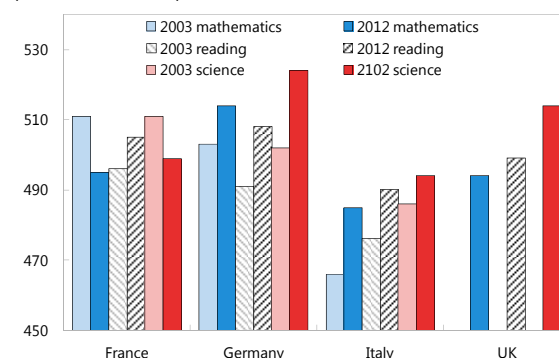
Sources: Eurostat, UNESCO, and IMF Staff calculations.

Figure 33. Education Outcomes**Student Performance, 2012**

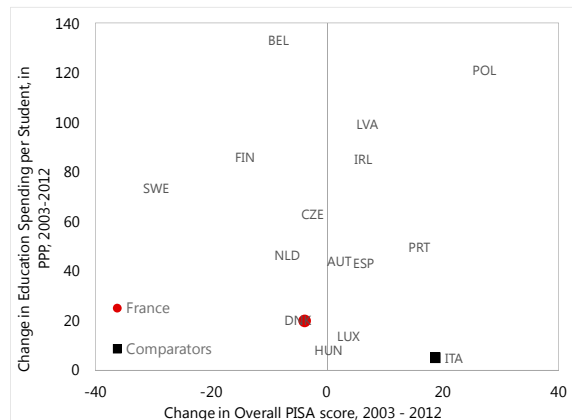
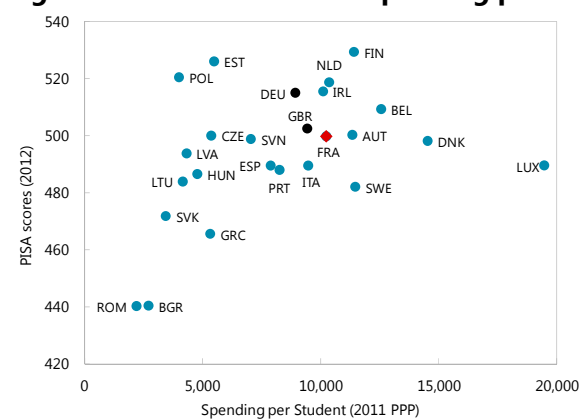
(In mean PISA score)

**Change in Student Performance**

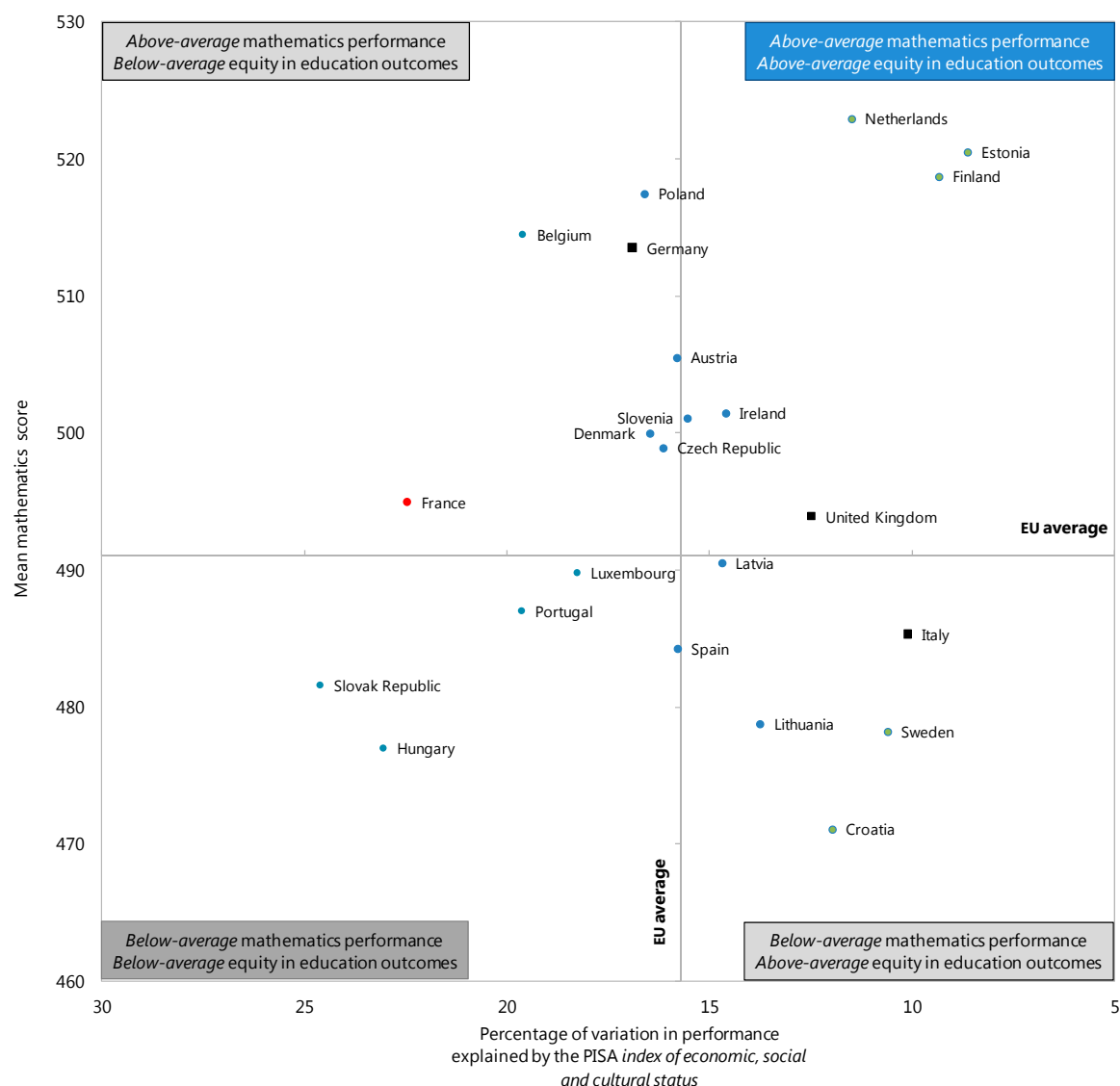
(In mean PISA score)



Sources: OECD and IMF Staff calculations.

Figure 34. PISA Scores and Spending per Student

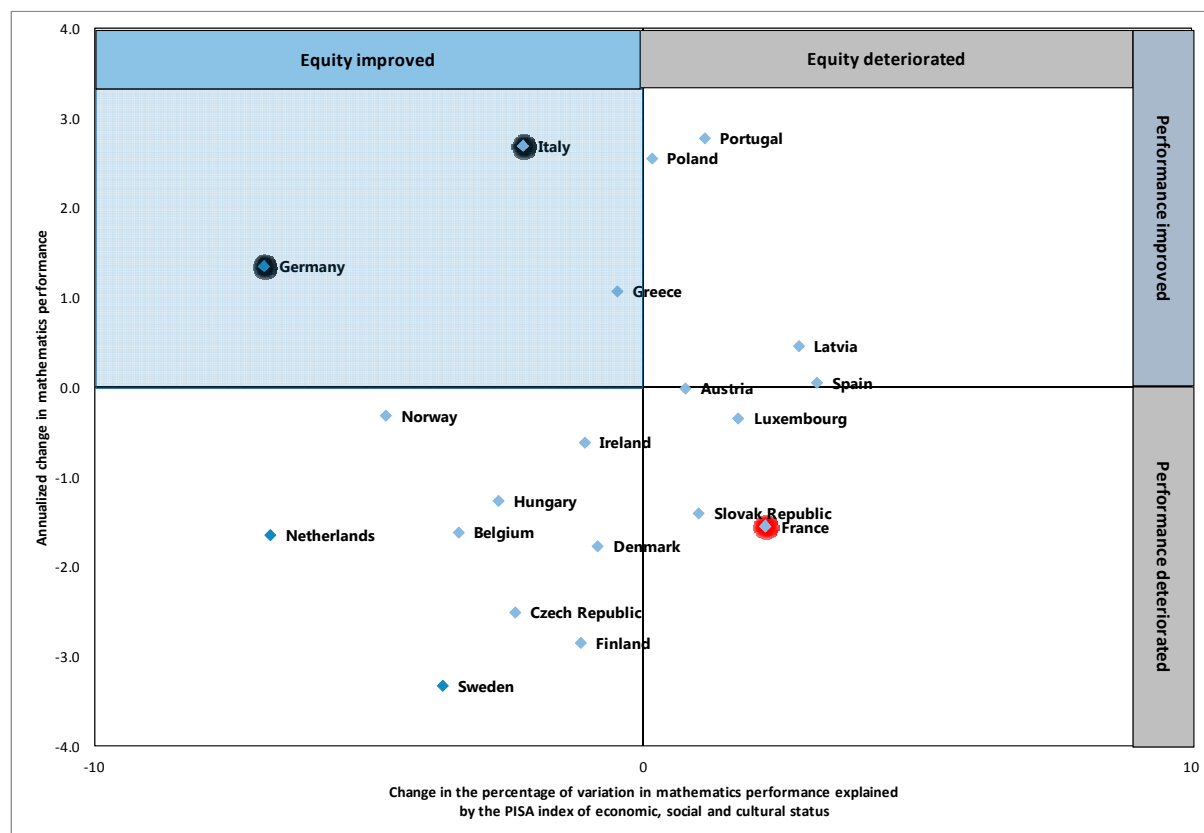
Sources: OECD and Staff calculations.

Figure 35. Student Performance and Equity, 2012

75. **In addition, educational inequalities are more pronounced in France than in other advanced countries, particularly among EU comparators.** The 2012 PISA finds that the link between students' socio-economic status and student performance is much stronger in France than most OECD and EU countries (Figure 35). All comparators are achieving better socio-economic outcomes, and particularly the United Kingdom and Italy. In addition, France scores in math deteriorated in terms of both performance and equity between 2003 and 2012 (Figure 36). This is despite the significant efforts to provide disadvantaged areas with additional education resources (Box 1), translating in a lower student-teacher ratio in these areas (20.6 students per teacher) than outside (23.3). However, the quality of education resources remains low in poor urban areas (ZUS) as the share of teachers with less than two years of experience is higher (31.1 percent, compared to 28.1 percent outside ZUS).

By contrast, student performance and equity improved in Germany, supported by the National Strategy adopted in the year 2000 aimed at developing full-day schools with supplementary education and instruction for disadvantaged children, binding standards and performance evaluation, and in-service teacher training (OECD, 2012c).

Figure 36. Change in Performance and Equity, 2003-12



Source: OECD.

76. **France has tried to improve the organization and quality of its education system in areas where it was diverging from other advanced economies.** To improve equity, it has reduced the repetition rate, and is expanding early childhood education, particularly for disadvantaged children. France has also redistributed learning time in primary education to better manage learning time across the week and year (OECD, 2015). It has reorganized teachers' initial education requirements and training, to improve teaching quality. After a few years of employment reduction through natural attrition, the authorities recruitment policy changed, with the objectives of increasing the number of teachers by 60,000 people from 2012–17.

77. **Overall, education spending should be maintained, but more ambitious structural reforms are needed to address inequities and contain spending pressures.** Priority should be given to better use education resources, rather than increasing overall education expenditure. The challenge for the education sector will be to address

Box 2. Vocational Training and Education

Large public and quasi-public spending support vocational training in France. Vocational training (for people in-job or looking for work) is not a COFOG category, and limited comparative data is available in this area. The European Commission Labor Market policy database provides data on training targeted at groups with specific difficulties in the labor market. It shows that France spends about 0.3 percent of GDP, compared to around 0.1 percent on average in the EU, and 0.2 percent in Germany. However, this database does not take into account all public spending, as well as private spending financed through a mandatory contribution that is classified outside general government revenues as it is not unrequited. In 2012, total vocational spending in France (including vocational training for general government employees) was estimated at 1.5 percent of GDP, of which 0.8 percent of GDP was financed by the general government (Draft 2015 budget law, 2014c).

Vocational education (for students) is considered instrumental for improving employment opportunities for young people, particularly those who do not access tertiary education. General government spending is predominant in this area reaching about 0.3 percent of GDP.

High spending has not translated into social outcomes compared to other European countries, for both vocational education and training. The share of vocational students is below the European average, and they have lower access to work-based education than in Germany (Table below). Vocational education is more costly than the European average, and Germany. Finally, social outcomes are relatively poor for low-skilled youth unemployment, as France is above the EU average, and performs poorly compared to Germany and the United Kingdom. As regards vocational training, while the levels of supply and access for employees are above EU average, they insufficiently benefits groups with significant difficulties in accessing the job market (low educated adults, unemployed adults). Finally, inequalities in access to vocational training are large in France, with a ratio of 2.5 between managers and workers in 2012 (INSEE).

While recent reforms are expected to address weaknesses, further structural reforms will be needed to improve social outcomes in these sectors. This sector is highly fragmented both on the public sector side, with almost each layers of the general government contributing, and the private sector side, as there is a wide dispersion of revenue collection and training entities. The December 2013 National Agreement on vocational training (transposed in the March 5, 2014 law) is expected to address some of the structural weaknesses, in particular by rationalizing revenue collection entities, providing regional governments with a leading role to coordinate efforts, and better targeting vocational education and training on those who have difficulties getting a job. However, further structural reforms will be needed to reduce duplication and overlaps, support vocational education, and reorient vocational training to low-skilled adults and the long-term unemployed.

Vocational Education and Training Inputs and Outputs in EU countries

	Vocational Education				
	Youth unemployment rate, less than primary and lower secondary education, 2014 Q4	Youth unemployment rate, upper secondary and post-secondary non-tertiary education, 2014 Q4	Vocational students as % of all upper secondary students, 2012	Vocational work-based students, in percent of all vocational students, 2012	Public Expenditure on Vocational Education per Student, 2010 (in euros)
France	40.6	24.9	44.6	26.9	14813
Germany	11.1	5.0	48.6	88.2	7847
Italy	47.7	42.4	60		
United Kingdom	20.7	15.0	36.0		
EU average	28.1	19.6	50.3	27.0	8549
	Vocational training				
	Employees participating in vocational training	Enterprises providing training, 2010	Low-educated adults in lifelong learning (in	Unemployed adults in lifelong learning, 2012	Cost of CVT per participant (in 2010, PPS)
France	45	76	2.5	5.3	2,057
Germany	39	73	3.1	5.6	1,499
Italy	36	56	1.6	6.2	1,227
United Kingdom	31	80	7.6	15	872
EU average	38	66	3.9	9.0	1,357

Sources: CEDEFOP database and Eurostat.

inefficiencies to contain spending, while reducing inequalities. Structural reforms can help achieving both outcomes, such as:

- ***Restructuring upper secondary education.*** Education resources are excessively geared toward upper secondary education, due to large organizational inefficiencies. This could be addressed through rationalization the school network (class and school mergers), as well as streamlining the number of options available for students, and increase the versatility of teachers to teach different subjects.
- ***Enhancing equity.*** This requires a combination of system-level policies and more targeted interventions for disadvantaged students (OECD, 2015b). Particular emphasis should be placed on improving the allocation of teachers, including ensuring good teaching quality at disadvantaged schools.
- ***Increase the autonomy of schools to foster teaching innovations.*** This would allow schools to adapt the National Curriculum to disadvantaged students and students with immigrant backgrounds (as in Finland, Ireland or Germany) that are not proficient in French or lack other abilities could also improve education equity.

Housing

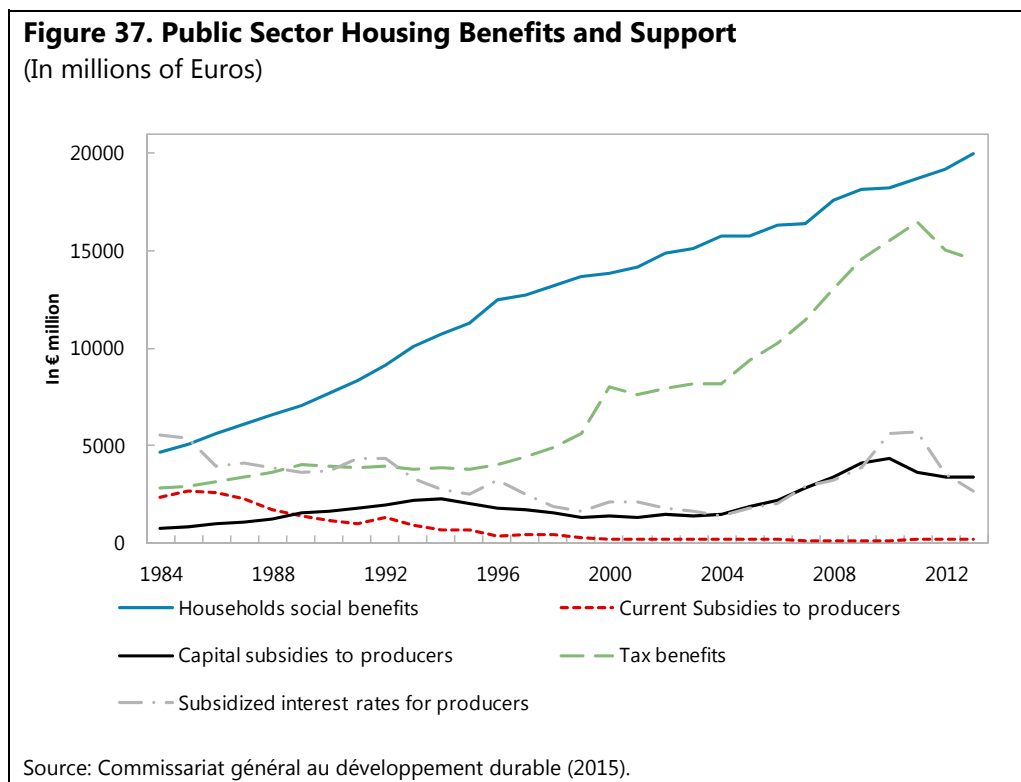
78. **At 2.3 percent of GDP, spending on housing is noticeably higher in France than elsewhere.** This includes expenditure on both housing and community amenities (1.4 percent of GDP) and housing benefits classified in the social protection sector (0.9 percent) (Figure 37). This spending is at twice the European average, and three times the spending level of Germany and Italy. It is also slightly above the United Kingdom (2.1 percent of GDP) where data has a broader coverage as they include public entities and corporations classified outside the general government perimeter.³⁴ France offers more social housing than other countries: social housing accounts for 17 percent of total rental housing stock more than twice the EU(27) average of 8.6 percent, and much more than in Italy (5.3 percent) and Germany (4.6 percent) and only slightly less than in the United Kingdom (18 percent) (CECODHAS, 2011).

79. **Recent containment focused on reducing tax incentives and subsidized interest rates for producers, while social benefits for households continued to increase** (Figure 37). Total public sector spending benefiting to households and producers increased sharply during the 2000's (6.2 percent average growth rate), before declining in 2012–13 (by -4.4 percent on average).³⁵ The reduction is due to cut in subsidies to housing production: subsidized interest rates for producers and tax incentives have been sharply reduced since

³⁴ To be comparable with the UK data, data for France should be increased by about 0.2 percent of GDP which is housing spending of entities outside the general government such as public financial institutions (*Caisse des dépôts et consignations*), and social housing entities (*Action Logement*) financed by a contribution on private sector salaries.

³⁵ Commissariat général au développement durable (2015).

their peak in 2011 (by 52.6 percent and 11.9 percent, respectively). However, households' social benefits have continued to increase over the same period (+6.2 percent), due to an increase in the number of beneficiaries (Figure 37). The *aides personnelles au logement* (APLs) are a major subsidy accounting for 0.8 percent of GDP. They benefit to about one fifth of all households in France (Cour des comptes, 2015d). However, these housing benefits are better targeted on low-income households than they used to be, as they have been indexed on CPI, which grew more slowly than households' income (Commission des comptes de la sécurité sociale, 2014). But students' housing benefits remain largely non means-tested. As a consequence, richer families benefit both from social transfers for their children for paying housing costs, and personal income tax family allowance, making the system particularly regressive. The 2016 budget reforms the APLs to better take into account the financial situation of beneficiaries and introduce some degressivity for rents above a threshold, but did not reform students' benefits. Overall, this reform remains limited as it would yield a saving of only 0.01 percent of GDP.



80. **Despite much higher spending, housing outcomes do not appear much better than in other EU countries, suggesting potential for higher efficiency of spending and for fiscal saving.** While it is difficult to isolate the direct impact of public spending on housing prices and quantity as well as on access to housing, selected indicators and studies offer a comparative view in these areas.

- **Housing prices and quality.** Owing to the large numbers of households benefiting from social housing (16.3 percent vs. 11.0 percent on average in the EU), and large housing social transfers, housing overburden cost rate³⁶ for the first two income quintiles is lower in France than EU average and comparators (Figure 38). However, empirical evidence suggests that the APLs fueled rent inflation and thus are somewhat self-defeating as the purpose of the APL is to reduce the housing payment for low-income household. For example Grislain-Letrémy and Trevien (2014) show that the APL contributed to the rent inflation and that this inflationist impact is stronger for low-income households. Moreover, and it is a crucial point, the inflationist impact of the APLs is not associated with any effect on housing quality.³⁷ Therefore there is reason to believe that housing policy targeting demand contributed to the sharply faster increase in house prices in France compared to other European countries, except the United Kingdom (Figure 38).
- **Access to housing.** While the share of people affected by severe housing deprivation is lower than the EU average, many countries with lower housing public spending have better social outcomes.³⁸ France is in an intermediate position in Europe for housing overcrowding (Figure 38), and performs better for social housing than for rentals at market price.³⁹ While it is better than in South European countries, it is comparable to UK, but worse than in Germany. In any event, it seems that the deprivation rate in France is not related to the APL as Grislain-Letrémy and Trevien (2014) show they have no impact on the offer of rental dwelling.

81. **Reforming housing benefits policies would include increasing means-testing for students.** Overall, while the targeting of housing benefits of households has improved, means-testing for students remains limited. Reform could be taking into account their parents' financial support, or by excluding personal income tax family allowance for students benefiting from housing benefits.

³⁶ The housing cost overburden rate is the percentage of the population living in households where the total housing costs ('net' of housing allowances) represent more than 40 percent of disposable income ('net' of housing allowances).

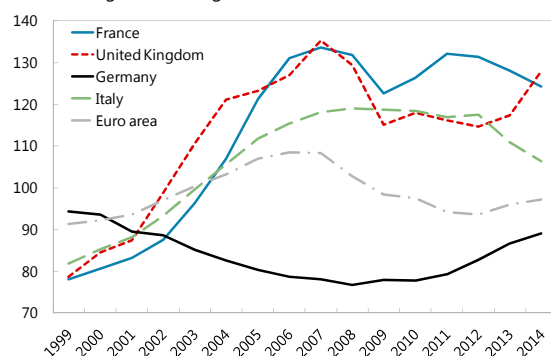
³⁷ Laferrère and Leblanc (2002) and Fack (2005) also conclude that the APLs have an inflationist impact. Fack also concludes that 80 percent of the rent increase is not related to improvement in housing quality. For a critical review of these two studies, see Friggitt (2012).

³⁸ It is defined as the percentage of population living in a dwelling which is considered as overcrowded, and exhibiting at least one of the housing deprivation measures (leaking roof, no bath/shower and no indoor toilet, or a dwelling considered too dark).

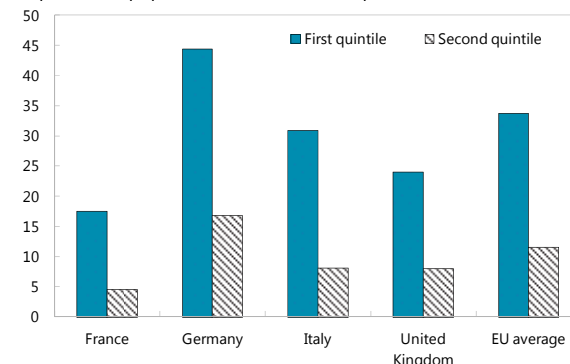
³⁹ A person is considered as living in an overcrowded household if the household does not have at its disposal a minimum number of rooms equal to: one room for the household; one room per couple in the household; one room for each single person aged 18 or more; one room per pair of single people of the same gender between 12 and 17 years of age; one room for each single person between 12 and 17 years of age and not included in the previous category; one room per pair of children under 12 years of age.

Figure 38. Indicators of Housing Tensions**House Price to Income Ratio**

(In index, long-term average = 100)

**Housing Cost Overburden by Income Levels, 2013**

(In percent of population for the first two quintiles)

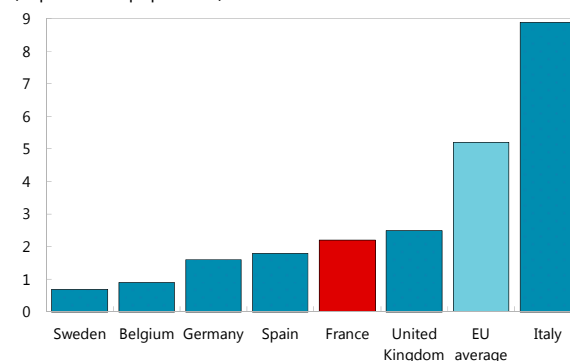
**Overcrowding Rate by Tenure Status, 2013**

(In percent of population)

	Owner, with mortgage or loan	Owner, no outstanding mortgage or housing loan	Tenant, rent at market price	Tenant, rent at reduced price or free
France	4.8	1.5	16.7	14.5
Germany	3.1	1.1	12.0	10.9
Italy	27.0	20.2	44.8	38.9
United Kingdom	4.3	1.6	16.2	17.5
EU average	8.0	20.0	19.7	25.1

Severe Housing Deprivation Rate, 2013

(In percent of population)



Sources: Eurostat, OECD, and IMF Staff calculations.

V. CONCLUSION

82. Public expenditure achieves good outcome in some areas, notably public investment, but there is scope to rationalize public expenditures, beyond the reforms that have recently been implemented or decided (e.g., pension, family allowances, health).

83. The benchmarking exercise demonstrates that there is significant scope for increasing the efficiency of public expenditure in France. We do not propose possible sequencing or design of reforms but, we identify priority areas where deeper reforms could achieve a significant and sustainable reduction in public spending without adversely affecting social and economic outcomes. This would help place France's planned expenditure-based fiscal consolidation on a more sustainable footing.

84. Increasing the efficiency of public expenditure would require a strategic approach to expenditure reform in order to identify and follow through policy priorities beyond the annual budget cycle. A strategic approach is also needed because the expected impact differs across spending categories (Table 17). This paper identifies the following key policy options:

Table 17. Impact of Public Expenditure Reforms by Areas

Expenditure reform of / in order to	Fiscal saving	Improve outcome	Address long-term pressure
Social Benefits	√	√	√
Civil service employment	√		
Health	√	√	√
Labor market policies	√	√	
Education		√	√
Housing	√	√	
Public investment	√		

85. ***Social spending*** is the main reason for the higher spending level in France than in other European countries. It explains almost three quarters of the difference in total expenditure ratio between France and the EU average. While social spending is a major tool for reducing inequality and poverty in France, its redistributive power is low by European standards. If it was at the EU average, the same reduction in equality could be achieved at a fiscal cost of lower by 3.5 points of GDP. To increase the reduction of inequality and poverty, while reducing fiscal cost, the focus should be on:

- Expanding means-testing of social benefits, including family and housing;
- Reducing pensions spending by raising the statutory retirement age and reviewing the replacement rate; and
- This would allow stepping up efforts against child poverty and strengthening the impact of fiscal redistribution on inequalities and poverty.

86. ***Wage bill*** explains over one fifth of the difference in total expenditure ratio between France and the EU average. Wage bill containment will be critical for a successful fiscal consolidation and needs to be implemented at all level of governments, especially at the local level.

- The strategy should shift from the current wage-scale freeze to reforms that allow a significant reduction in public employment levels, especially at the local level. France could draw on successful recent employment reduction episodes achieved in other European countries.

- Reform are needed to slow the wage drift while allowing greater differentiation of salaries, especially where it is necessary for attracting high quality staff in priority areas.

87. **Local government spending** has grown beyond what the decentralization implied. Apart from a strategy to contain the wage bill, a number of steps could help contain the sub-national spending:

- Limiting duplication of functions between layers of government, including by curtailing the general competency clause for the municipal level, and further rationalizing the number of local government, particularly at the municipal level.
- Strengthening incentives to comply with ODEDEL targets.
- Limiting the scope for local tax increases.

88. **Health** outcomes and access to healthcare are good. However, this is achieved at a high and rising fiscal cost. The ONDAM has allowed containing health spending growth and the 2014 National Health Strategy is an additional step toward greater efficiency. Deeper reforms are needed address structural factors underlying the rising healthcare cost, especially in light of ageing costs:

- Strengthening cost benefit analysis in order to limit the range of non-essential healthcare and long-term care services covered by public insurance.
- Increasing the use of generics, including by making their prescription compulsory in hospitals and under public funded health and requiring electronic prescribing in primary health care.
- Reducing health costs, including by rationalizing hospital services, promoting primary care practices, and developing case-based and performance payments for primary care.

89. **Labor market policies.** The unemployment benefit scheme is relatively generous, which entails fiscal costs and may weaken the functioning of the labor market.

- Increasing the minimum work period to qualify for unemployment benefit.
- Reducing the maximum monthly benefit cap.
- Introducing a progressive reduction in benefits (degressivity) for long-term unemployed.
- Tightening and better enforcing the active job search requirements.

90. **Education spending** delivers mixed results. Academic achievements are deteriorating and the efficiency in reducing social inequalities is limited. Key reform option includes:

- Rationalizing upper secondary schools network and organization, to increase spending efficiency.
- Improving teaching quality in disadvantaged schools, by ensuring that more experienced teachers are allocated in these areas.
- Providing schools with more freedom to innovate, in order to better support disadvantaged students that are not proficient in French or lack other abilities.
- Focusing vocational education and training on the low skilled and longer-term unemployed.

91. **Housing** spending is comparatively high while delivering only limited economic and social benefits. Reforms options include:

- Reinforcing the targeting of housing allowances notably with a better means-testing.
- Rebalancing the housing policies from supporting demand to expanding the supply of housing in areas where shortages are the worst.

92. **Public investment** is highly efficient by international standards, providing high quality and widely available infrastructure. However, some rationalization would allow some fiscal saving such as:

- Reducing the duplication of public investment notably at the level of local governments.
- Focusing public investment on maintenance rather than on the expansion of infrastructure.

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