FRANCE
Structural reforms: impact on growth and options for the future
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Structural reforms in France: impact on growth and options for the future

Key findings

France is one of the world’s five leading economies, as measured by GDP, a position that it owes in particular to its strength in a number of knowledge-intensive sectors (defence, high and medium-technology manufacturing, aeronautics, the nuclear industry etc.). Several of its industries have a secure technological advantage worldwide. France is also a country with a highly developed social model, the achievements of which are undeniable. The education level of the French population has risen sharply over the last three decades. Income inequality is relatively low in comparison to other OECD countries, thanks to redistribution mechanisms, and it has been relatively stable for a long time. Lastly, France scores well against numerous indicators of well-being.

Yet today, six years after the onset of the economic crisis, French growth remains weak – 0.4% this year, and at best 1% in 2015, according to the latest OECD projections. By contrast, potential growth (excluding cyclical effects) for 2008-2013 is estimated to have been 1.25%. France thus now faces great challenges as it seeks to boost its competitiveness and its medium-term growth potential and to transform its economic and social structures so as to preserve all that it has achieved in a context of heavy pressure on the public finances. The reforms that it undertakes today will determine its productivity tomorrow and its place in the world economy.

Studies consistently show that, in order to improve business competitiveness, France should give priority to reforms in four areas:

(i) **Optimise competition on the goods and services market.** Poorly designed regulations for certain products and services can lead to lower competition and higher prices, not only for final consumers but also for the businesses that use them in their production process. This can be the case, for example, with energy, transport, retail trade, as well as legal, accounting and architecture services. Some regulations intended to protect the exercise of a profession or to allow a monopoly in a given sector can also impede efforts to enhance competitiveness throughout the industrial chain.

(ii) **Improve the functioning of the labour market** by encouraging the supply of labour and reducing the cost of labour. These reforms will require a reduction in the "tax wedge", i.e. labour costs imposed in the form of taxes and social contributions. But reforms are also needed to improve the supply of labour, by reinforcing the incentives to work and boosting the quality of the workforce. France needs to make a special effort to foster youth employment.

(iii) **Purge the overall tax structure of the distortions** that now weigh upon the productive apparatus and the productivity of businesses.

(iv) **Simplify France’s territorial organisation**, which is not only costly to the public budget but results in the segmentation of policies and impedes the proper functioning of local labour markets.
Since 2012, the government has undertaken or announced some important reforms in these four areas. For example, significant results can be expected from the measures taken to reduce labour costs and the taxation burden through the "Responsibility and Solidarity Pact" as well as the "Competitiveness and Employment Tax Credit" (CECI). Efforts to alleviate the bureaucratic red tape that now weighs upon businesses, competition and productivity are also a step in the right direction. In addition, reforms are being made in the areas of vocational education, apprenticeship and retraining, and these should be continued in order to ensure that the mechanisms are effective. Lastly, the local governance reforms now under way, and in particular the creation of metropolitan areas (métropoles) could also have a positive impact on growth, if they are implemented so as to favour the productivity of coherent local labour markets.

OECD estimates suggest that these reforms, taken together, could raise the potential growth rate progressively by an additional one quarter over the next 5 years and one third at a 10 year horizon. This would represent an average annual growth increase of around 0.3 percentage point over five years and nearly 0.4 percentage point over 10 years. Some of this higher growth would come through an increase in employment.

To achieve such an increase in growth will require prompt implementation of the measures contained in the Responsibility and Solidarity Pact and the tax reforms, as well as effective introduction of the urban governance reforms, the benefits of which will depend heavily on the way those reforms are designed and carried out. It is crucial for France to continue to reform and rationalise responsibilities at the different territorial levels.

It will also be important for the government to move forward with its proposals concerning regulated professions, as intended in the government bill entitled “pour l’activité” that was presented in general terms on October 15th, and the energy sector. Without these reforms, growth gains will be more modest, at perhaps 0.25 percentage point annually over 5 years and 0.3 point over 10 years.

Finally, substantial growth gains can be expected from more ambitious reforms in all the four areas mentioned. The main reforms outlined in the government bill entitled “pour l’activité” that was presented on October 15th are going in this direction, and could be reinforced, for example, by making further efforts to make the labour market function more smoothly. In addition, it will be essential for the country, over the short, medium and long term, to implement a set of reforms to improve the education system and to encourage labour force participation and employment for young people. Only a small portion of these reforms – those that have a direct impact on the quantity and quality of the labour supply – can be quantified. Yet France should treat all of these reforms today as priorities. For the most disadvantaged young people, progressive implementation of the "youth" guarantee, with enhanced and closely targeted benefits and mutual obligations, is essential to help them find stable employment and to boost economic growth.

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1 The quantification exercise presented in this note takes into account the expected reforms of the regulated professions, even if their details are not yet fully known. However, it does not take into account the following reforms that have been announced as part of the bill “pour l’activité” that concern: the liberalisation of coach and bus services, improvement of the control of motorway companies, reforms regarding the social dialogue, the professionalisation of labour courts, employee savings schemes, employee shareholding schemes, the modernisation of the State as shareholder, and more flexible opening hours for selected businesses, notably on Sundays.
### Table 1. The percentage impact on gross domestic product over 5 years

<table>
<thead>
<tr>
<th>Reforms undertaken:</th>
<th>GDP</th>
<th>Of which due to employment</th>
<th>Of which due to productivity</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Reducing regulatory barriers to competition</strong> (simplification shock, initial measures affecting regulated professions)</td>
<td>0.2</td>
<td></td>
<td>0.2</td>
</tr>
<tr>
<td><strong>Improving the labour market</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Reduction of the tax wedge through the CICE and the Responsibility and Solidarity Pact</td>
<td>0.5</td>
<td>0.8</td>
<td>-0.3</td>
</tr>
<tr>
<td>- Unemployment insurance reform</td>
<td>0.0</td>
<td>0.0</td>
<td></td>
</tr>
<tr>
<td>- Active labour market policies</td>
<td>0.1</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td><strong>Improving the structure of the tax system</strong> (corporate taxation, carbon tax, VAT increase, income tax relief)</td>
<td>0.1</td>
<td></td>
<td>0.1</td>
</tr>
<tr>
<td><strong>Potential for reforming metropolitan governance</strong>³ (Paris, Aix-Marseille)</td>
<td>0.3</td>
<td></td>
<td>0.3</td>
</tr>
<tr>
<td><strong>Total over five years</strong></td>
<td>1.2</td>
<td>0.9</td>
<td>0.3</td>
</tr>
<tr>
<td><em>Annualised impact on growth (percentage points)</em></td>
<td>0.2</td>
<td>0.2</td>
<td>0.1</td>
</tr>
</tbody>
</table>

| Reforms announced:                                       |     |                            |                              |
| **Reduction of regulatory barriers to competition in the network industries (gas and electricity) and announced reforms to the regulated professions** | 0.4 |                            | 0.4                          |
| **Total over five years**                                | 1.6 | 0.9                        | 0.7                          |
| *Annualised impact on growth (percentage points)*        | 0.3 | 0.2                        | 0.1                          |

² All figures are rounded to the nearest decimal point.

³ The metropolitan areas of Paris and Aix-Marseille are based on a functional definition of urban areas in the OECD database, which includes 275 cities with more than 500,000 inhabitants. The areas covered by this definition differ slightly from those affected by the planned reform.
### Table 2. The percentage impact on gross domestic product over 10 years²

<table>
<thead>
<tr>
<th>Reforms undertaken:</th>
<th>GDP</th>
<th>Of which due to employment</th>
<th>Of which due to productivity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reducing regulatory barriers to competition (simplification shock, initial measures affecting regulated professions)</td>
<td>0.3</td>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td><strong>Improving the labour market</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Reduction of the tax wedge through the CICE and the Responsibility and Solidarity Pact</td>
<td>1.1</td>
<td>1.6</td>
<td>-0.5</td>
</tr>
<tr>
<td>- Unemployment insurance reform</td>
<td>0.1</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>- Active labour market policies</td>
<td>0.1</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td><strong>Improving the structure of the tax system</strong> (corporate taxation, carbon tax, VAT increase, income tax relief)</td>
<td>0.4</td>
<td></td>
<td>0.4</td>
</tr>
<tr>
<td><strong>Potential for reforming metropolitan governance</strong> (Paris, Aix-Marseille)</td>
<td>1.0</td>
<td></td>
<td>1.0</td>
</tr>
<tr>
<td><strong>Total over 10 years</strong></td>
<td>3.0</td>
<td>1.8</td>
<td>1.2</td>
</tr>
<tr>
<td><strong>Annualised impact on growth (percentage points)</strong></td>
<td>0.3</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td><strong>Reforms announced:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reduction of regulatory barriers to competition in the network industries (gas and electricity) and announced reforms to the regulated professions</td>
<td>0.7</td>
<td></td>
<td>0.7</td>
</tr>
<tr>
<td><strong>Total over 10 years</strong></td>
<td>3.7</td>
<td>1.8</td>
<td>1.9</td>
</tr>
<tr>
<td><strong>Annualised impact on growth (percentage points)</strong></td>
<td>0.4</td>
<td>0.2</td>
<td>0.2</td>
</tr>
</tbody>
</table>
Quantifying the effects of the reforms: details and analyses

After identifying the expected impacts of the reforms on the goods and services markets and on the labour market, this paper offers an estimate of the impact of improving the taxation structure and the country’s territorial organisation (in the latter case, limited to the reform of metropolitan governance). The details of the reforms considered are found in Annex 1. The methodological details are found in Annexes 2 and 3.

Reforms to the markets for goods and services and administrative simplification

Context

The reforms to goods and services markets now under way and the initiatives to simplify the business climate could have a major impact on French productivity and competitiveness. In particular, regulations affecting services (conditions for exercising certain professions, regulated opening hours, installation licenses, competitiveness in the network industries, etc.) are less conducive to competition than they are in many OECD countries (Figure 1), and this is an important consideration given that services are a key input throughout the production process of the manufacturing sector, and value-added services account for a high and growing proportion of French exports (50% in 2009). The conditions governing entry into and exercise of the legal, accounting and architectural professions, for example, are more restrictive than in many OECD countries4 (Figure 2), which suggests that there is considerable room to develop competition while preserving the quality of these services. Moreover, barriers to business creation exceed those in most OECD countries: they include a heavy minimum capital requirement, a plethora of procedures involved and institutions that must be contacted to register a corporation, to file a company’s name, to open a bank account or to draw up a formal partnership contract. In fact, while it is relatively easy to carry out the procedures following the initial application for registration, such as notifying creation of the company to the tax authorities or the national statistics agency, the preparation of the application itself can take up to 12 days, compared to a single day in Germany, Canada and the United Kingdom (Koske et al., 2014).

4 In Figure 2, engineering services do not appear because they are subject to little regulation. Apart from engineering services, French regulations on other services are restrictive.
Figure 1. Services Trade Restrictiveness Index (STRI), by sector and regulatory field: France

Source: OECD STRI Database 2014.

Figure 2. Regulation of professional services
(Index scale 0 to 6 from least to most restrictive)

Source: OECD Product Market Database (2013)
Under these circumstances, reducing the constraints that limit competition and simplifying administrative procedures for businesses could enhance productivity not only in those sectors of the economy where they are applied but also in other sectors that use these goods and services in their production process (Bourlès et al., 2013). For example, greater availability and better quality for certain goods and services used by one industry will tend to reduce entry costs to that market for new firms, thereby stimulating competition and productivity. Moreover, firms whose suppliers are in a dominant position have less interest in innovating, as the bulk of the expected rents from those innovations are likely to be captured by the suppliers themselves. While there is a great deal of uncertainty about the impact of reform measures and their pace of implementation, simulations of the impact of current reforms give an idea of their effects on productivity across the economy as a whole, taking into account the structure of the production chains in the French economy.

**Results of the quantification**

The simulations show that the current efforts to strengthen competition by reducing the constraints on businesses could serve to boost total factor productivity by 0.6% over five years and by 1% over 10 years, representing an annual growth increase of 0.10 percentage points over those two time horizons. This finding takes into account the "simplification shock" announced by the government in July 2013 and the supplementary actions taken by the Simplification Board created in January 2014. For example, 124 measures were announced in July 2013, while the Board announced a further 50 measures in April 2014 and is planning to issue 10 new measures per month. The first effective measures include simplification of financial statements and tax declarations for SMEs. As well, the January 2014 law on consumption introduced partial reforms to certain regulated professions (pharmacists, notaries, opticians), and these effects are integrated into the estimates.

The measures expected this fall concerning regulated professions and the commitments to reform in the electricity and gas sectors should do much to boost productivity. Indeed, if these measures were not to be implemented, the expected productivity impact of the reforms to goods and services markets would be lower by about one third of a percentage point over 10 years. Under that scenario, productivity would rise by 0.2% in five years and 0.3% in 10 years.

**Comparison with the effects of similar reforms in OECD countries**

The reforms to goods and services markets now under way should be pursued and accelerated. In effect, the estimated impact of the current French reforms, including the planned measures concerning regulated professions and the electricity and gas sectors, is only one third as great as that of the reforms in the same sectors that were carried out in Italy between 2008 and November 2012 (OECD, 2013) or the reforms conducted in Portugal between 2008 and the beginning of 2014 (OECD, 2014a). This discrepancy is explained in part by the fact that in these countries the measures were effectively making up for lost ground by strengthening competition in major sectors of the economy (especially in energy,) where France was already further ahead. Portugal and Italy have made more substantial reforms to their network industries, for example. Nevertheless, Portugal’s simplification of administrative procedures and Italy’s measures affecting retail trade have also gone further than the measures taken in France, and this helps again to explain the difference in estimated outcomes.
Conclusions for future reforms

It is essential, then, to move forward with the "growth law" (loi croissance), the deeper reform of the regulated professions, scheduled for the beginning of 2015. Its importance can be recognised by the fact that professional services\(^5\) play a key role in the market for business services, and they represent 12.4% of GDP and 13.5% of employment in France, or more than the manufacturing sector (which is increasingly reliant on these professional services for its output). A thorough and swift implementation of the reform could serve to boost productivity and growth significantly, as demonstrated by experience in Australia and New Zealand in the 1980s and 1990s. Although the announced reform is reflected in the above figures, its details remain uncertain, and the reforms in the regulated professions could turn out to be less ambitious than those assumed for purposes of quantifying the gains presented in table 1.

Reforms to the labour market (including the cost of labour) and the training system

Context

Labour market reform is a fundamental component of any growth strategy. France suffers from a low employment rate for young people and for older workers and a high rate of long-term unemployment, all of which, besides exacerbating inequalities, weighs heavily on economic growth, both actual and potential. Its social charges and taxes on labour are among the highest in the OECD (Figure 3). With a high minimum wage, the cost of labour resulting from all these factors, especially at the low-wage end, has a depressing effect on labour supply and demand alike. Labour legislation effectively discourages permanent hiring and thus contributes to segmentation of the labour market and to weak employment. The labour market reform must therefore seek to reduce labour costs and to reconsider certain aspects of employment protection, while promoting qualification and employability in order to enhance the competitiveness of businesses and boost growth.

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\(^{5}\) Professional services are a sub-category of services to businesses or individuals and include professions that impose high demands in terms of qualifications and expertise (accountants, lawyers, architects and engineers).
Figure 3. Average tax wedge\(^1\) on labour for an employee earning 67% of average income (A) and an employee at average income (B)

As a percentage of total remuneration from work, 2013

A. Evaluated at 67% of the average worker's wage, for a single person without children

B. Evaluated at 100% of the average worker's wage, for a single person without children

1. Measures the gap between total remuneration from work paid by the employer and take-home pay received by the employee, as a percentage of total remuneration from work. Employer and employee contributions to Social Security are thus taken into account.

Note: Private spending on social protection is important in many OECD countries. Under these circumstances, the differences in the level of the tax wedge may also reflect the differing degree to which social protection is publicly supported.

Source: OECD Database on taxation of wage income (2014).
Results of the quantification

There is a built-in dynamic to the labour market reforms now under way (reducing labour costs through the CICE and the Responsibility and Solidarity Pact, reform of professional development and apprenticeship, reform of unemployment insurance with an increase in the waiting period for employees in receipt of a generous separation allowance). The simulations illustrate the effects of these reforms, which, by stimulating both the supply of labour (by potential employees) and the demand for labour (by businesses), will help to increase employment and potential growth. Generally speaking, as the labour force rises the stock of physical capital adjusts only slowly, and the cumulative effect of these reforms takes time to materialise. Overall, these measures should boost GDP by 0.6% over 5 years and by 1.3% over 10 years.

This estimate is based in particular on several reforms that have limited the cost of labour, in particular for those on low wages. The existing exemptions from employer social contributions, targeted at low wage earners, have been supplemented by the Competitiveness and Employment Tax Credit (CICE), which was progressively implemented in 2013-14, and various measures under the Responsibility and Solidarity Pact, which will come into force in 2015 and 2016. The government plans to reduce employer social contributions below 1.6 times the minimum wage, and it will make a more general cut to family contributions (cotisations famille) for incomes up to 3.5 times the minimum wage. Reducing the cost of work for low-wage earners is certain to have a positive impact on employment in the short term, particularly for unskilled and younger workers. In fact, reducing the tax wedge will help to align labour costs more closely with worker productivity, thus reducing the risk of unemployment and encouraging greater participation in the labour market. However, the contribution exemptions targeted at low-wage earners also have an impact on the makeup of the workforce and on the public finances. By encouraging greater participation by unskilled workers in the labour market they tend to diminish productivity, but they also stimulate employment and thereby help to improve the public accounts (OECD, 2014b).

The other labour market reforms considered in the simulations involve, first, extending the benefits waiting period for laid-off employees in receipt of a generous separation allowance, which should encourage greater activity by older workers, which has hitherto been limited. The reforms planned for 2015 in the vocational training and apprenticeship systems have also been integrated into the exercise, as they will help to improve the public accounts.

Conclusions for future reforms

Labour market reforms should be pursued and their pace accelerated with a view to making that market function better, especially for unskilled workers, and also to reduce the duality between fixed-term and open-ended contracts, to boost workforce participation at the two extremes of the age distribution and to upgrade the skills of the working population. This should in time lead to synergies with progress on the goods and services markets.

With a youth unemployment rate of around 23%, France needs to place greater stress on policies to encourage the integration of young people into the job market. France has some 2 million young people between the ages of 15 and 29 who are neither employed nor engaged in education or training (NEET). For many of these people this situation is likely to be permanent, as they lack the skills needed to find a job, and the system does not provide sufficient incentives for them to seek one. To help these young people become economically independent will require significant and targeted resources. Those resources must go well beyond what is provided by the public employment service, and they will require coordination between the education system and social action and alternative forms of training. Gradual introduction of the "youth guarantee" should offer effective support to the most disadvantaged young people (those between 18 and 25 years, neither working nor studying, and living in great insecurity). This mechanism offers both a guarantee of resources and a guaranteed first job, together with individualised coaching based on alternating...
periods of training and work. As a counterpart, the young participants undertake to follow the course proposed by their adviser, or to see their allowance suspended. Coaching lasts for one year, renewable in principle for further 12 month sessions. This mechanism has been operating on an experimental basis for the last year in 10 departments. It currently involves 20 000 young people, and it is supposed to be extended gradually to cover the whole country, with an objective of covering 50 000 participants by 2015, and 100 000 by 2017.

Improving the structure of the tax system (excluding social contributions)

Context
The reforms to the taxation system should also yield productivity gains. There is in France a glaring discrepancy between the high rate of corporate taxation and the modest revenues that flow from it. This discrepancy can be laid to a narrow tax base, which tends to favour large businesses and certain sectors and creates distortions that hamper production.

Apart from reducing taxes based on labour incomes (previous section), the Responsibility and Solidarity Pact includes a tax reduction for businesses, accompanied by an increase in consumption taxes and environmental charges. By alleviating the constraints on companies’ resource allocation, this improvement to the tax structure should serve to stimulate investment, innovation and productivity.

Results of the quantification
All told, the current taxation reforms (gradual reduction in corporate taxes as called for in the Responsibility and Solidarity Pact, implementation of the carbon tax, an increase in VAT, and lower income taxes) should serve to raise GDP by 0.1% in five years and by 0.4% in 10 years.

Conclusions for future reforms
The business taxation reforms now under way are positive, and the progressive reduction in the corporation tax and elimination of the Contribution sociale de solidarité des sociétés (C3S) are welcome initiatives. France could still benefit from a further reorientation of the tax structure towards less distorting levies (a greater reduction in labour and corporate taxation with a concomitant increase in environmental taxes and succession duties and a reconsideration of VAT reduced rates and exemptions).

Territorial reform (metropolitan areas)

Context
With the reform of territorial governance, under way since 2013, the government has tackled a long-standing and complex problem. France has a uniquely large number of communes or municipalities: at 36 700, there are more of them than in the United States, and in 2012 they accounted for nearly 41% of all municipalities in the European Union and 27% of those in the OECD area. The degree of municipal fragmentation – 16.5 local governments for every 100 000 inhabitants in metropolitan areas – is one of the highest in the OECD (where the average is 3.7), ranking just after the Czech Republic, the Slovak Republic and Switzerland. This fragmentation tends to segment local labour markets and the industrial fabric, it reduces the effectiveness of public policies and thus has a negative impact on economic growth. The authorities therefore deserve credit for their determination to review the boundaries of government action across the national territory and to make decentralisation work more effectively.
Historically, the French authorities have relied heavily on inter-municipal co-operation in order to make these many local entities perform more efficiently, without merging them. Yet in many respects the 2 145 intercommunalités now in existence simply represent an additional layer to the territorial millefeuille, and they have done little to make the system function more rationally.

The current territorial reform is being implemented in several stages: the law reforming metropolitan areas governance was adopted by Parliament in January 2014, and two bills reducing the number of regions, rationalising the intercommunalité structure and clarifying powers and responsibilities among the different levels of government have been under debate in Parliament since July 2014. The current reforms seek, first, to give new impetus to economic development and to address the challenges of sustainable and inclusive growth, relying on the metropolitan cities and the regions as the two main levers. While the new regional map cannot be evaluated, and notably since the allocation of responsibilities is not yet known, the reform of metropolitan governance could yield some significant benefits.

**Results**

There are few empirical studies available for measuring the impact of territorial reforms. Nevertheless, in the case of the urban government reform, the estimates prepared by Ahrend et al. (2014) offer an idea of its potential benefits for productivity (through a proxy of the metropolitan areas concerned). Thus, applying these results to the case of France, GDP could rise by just under 4% over the long term, following governance reforms in the metropolitan areas of Paris and Aix-Marseille alone, if the new governance model leads to better spatial planning, including that of the transportation network, and to better co-ordination of local public policies. The reform announced by the government is to be introduced gradually (it will not be implemented until 1 January 2016 in Paris and Aix-Marseille), and it is estimated that over the time horizons of five and 10 years considered here, the reform will not yet have borne all its fruits. It is reasonable to suggest that it could boost GDP by 0.1 percentage point a year over the next 10 years.

The impact of the metropolitan governance reforms could be even more important in the case of the other 12 metropolitan areas that are included in the reform (Lyon, Toulouse, Lille, Bordeaux, Nantes, Strasbourg, Rennes, Rouen, Grenoble. Montpellier, Nice and Brest). These 14 metropolitan areas together represent nearly 4,000 municipalities with a total of 24.5 million inhabitants, and 51% of national GDP (according to the OECD Metropolitan database).

Nevertheless, these figures must be taken with a degree of caution, as the effects of these measures will depend heavily on how the reforms are implemented, on the powers exercised by the new metropolitan authorities (which vary from one territory to the next), on the appropriateness of their administrative boundaries (in terms of the employment catchment area), and on the capacity of the new institutions to organise urban economic development in an integrated manner. It must also be stressed that this quantification does not take account of the quality of the governance process in implementing the reform, which alone can ensure that the expected impact will be achieved.

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6 This methodology is based on the functional urban areas defined by the OECD in terms of employment basins, and not on the administrative boundaries taken as the framework for the MAPAM reform law. OECD metropolitan areas are larger than the administrative boundaries of the new métropoles, but an adjustment has been made to approximate the impact on productivity.

7 With 13.4 million inhabitants, these two urban areas represent 21% of France's population and 33% of its GDP.

8 Aix-Marseille Provence will have much broader transport responsibilities than does Paris, for example.
Conclusions for future reforms

The metropolitan reform which has been engaged could have a significant impact on long-term GDP growth if it is implemented effectively without recreating intermediate layers that could diminish its impact (OECD, 2013b). The planned measures for rationalising territorial administration in the context of reforming the intercommunalités, the departments and the regions could also have a beneficial impact in terms of the efficiency of public expenditure and growth, and they should be pursued. The elimination of cumul des mandats (simultaneous holding of multiple elective offices) as of 2017 will contribute to remove an important obstacle to the pursuit of this agenda.

In the course of these reforms, more systematic reconsideration should be given to the commune-intercommunalité pairing and the urban departments, particularly where métropoles are being created. This would surely have a considerable impact in terms of reducing the overlapping of powers and responsibilities, cutting costs, and enhancing the efficiency of public expenditure.

Reforms not taken into account

A number of reforms were left out of the simulations because they were still preliminary or because their effects were too uncertain. The housing market reforms, for example, are still uncertain and were excluded. This was also the case with the rationalisation of the territorial organisation of the regions, departments and intercommunalités, even though this can be expected to result, in due course, in less costly and more efficient public policy. There are other reforms that represent moves in the right direction but cannot be readily quantified as to their scope. For example, the time limit for appealing against a layoff or dismissal was shortened from five years to two years, thereby reducing procedural uncertainty. This is a significant reduction but it is hard to put a figure to it, as France is one of the few countries where that time limit exceeds one year.

Nevertheless, in a context where several major reforms are introduced simultaneously, such a reduction in uncertainty could help ensure that the labour cost reductions will have their full effect. Even if the synergies between reforms are hard to quantify, experience in countries that have introduced policy changes on several fronts at once (for example Germany, Australia and Canada) suggests that they should be significant, and to some extent mutually reinforcing. As another reform that was not considered here, management of the new Single Training Account has been entrusted to the Caisse des Dépôts et Consignations, a move that should shorten the eligibility period to obtain training. While this will no doubt be beneficial, it is hard to quantify the impact of this reduction on growth.
References


OECD (2013b), Towards more inclusive growth in the metropolitan area of Aix-Marseille, OECD Publishing


OECD (2014b), Portugal, Deepening structural reform to support growth and competitiveness, OECD Publishing.

## Annex 1. Confirmed reforms considered in the simulation exercise

<table>
<thead>
<tr>
<th>Type of reform</th>
<th>Details of the reform</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Reforms to goods and services markets</strong></td>
<td></td>
</tr>
<tr>
<td>Simplification shock</td>
<td>The government announced a simplifications shock in July 2013, and supplementary measures were taken by the Simplification Board created in January 2014. 124 measures were announced in July 2013, while the Board announced a further 50 measures in April 2014 and is planning to issue 10 new measures per month. The first effective measures include simplification of financial statements and tax declarations for SMEs.</td>
</tr>
<tr>
<td>Consumption law</td>
<td>In regulated professions, the law does away with the limit on the number of salaried notaries and on pharmacists’ monopoly over the sale of certain products (e.g. pregnancy tests). It also liberalises the sale of optical products, in part, authorising online sales of eyeglasses and corrective lenses and ending opticians’ and pharmacies’ monopoly over the sale of optical maintenance products.</td>
</tr>
<tr>
<td><strong>Reforms to the labour market and the training system</strong></td>
<td></td>
</tr>
<tr>
<td>Unemployment insurance</td>
<td>The increase in the benefits waiting period for laid-off employees in receipt of a generous separation allowance will encourage participation by older workers.</td>
</tr>
<tr>
<td>Competitiveness and Employment Tax Credit (CICE)</td>
<td>The Competitiveness and Employment Tax Credit (CICE) of January 2013 (National Pact for Growth, Competitiveness and Employment of November 2012) has reduced the cost of labour for low-wage earners. The provision comes into full effect in the second half of 2014 and will in time represent a €20 billion reduction in the cost of labour (cutting that cost by 6% for workers earning less than 2.5 times the minimum wage in 2014).</td>
</tr>
<tr>
<td>Responsibility and Solidarity Pact</td>
<td>A gradual reduction in employer social contributions, particularly for low-wage earners. The pact reduces by two percentage points the employer social contributions that were still based on the minimum wage, and it reduces employers’ family contributions by 1.8 percentage points for wages between 1.6 and 3.5 times the minimum wage in January 2015. Self-employed workers and artisans will also see a drop of more than 3 percentage points in their family contributions as of 2015.</td>
</tr>
<tr>
<td>Active labour market policies: reform of professional development training</td>
<td>The reform introduces a single training account (CPF) of 150 hours, managed by the <em>Caisse des Dépôts et Consignations</em>, but it retains previous training provisions and does not really simplify the system. Moreover, it caps financing of the CPF and additional hours for long training assignments (beyond 150 hours) and thus limits individual initiative.</td>
</tr>
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</table>
Active labour market policies: apprenticeship reform

During the closing statement at the July 2014 social conference, additional subsidies (€200 million) were promised for apprenticeship training. A target of 500,000 apprentice positions in 2017 was announced (versus 415,000 in 2013).

Reforms to the taxation system

Responsibility and Solidarity Pact

A progressive reduction in business taxes has been announced. The Responsibility and Solidarity Pact will gradually eliminate the C3S from 2015 to 2017. The corporate tax rate, currently 33.3%, will be cut in 2017 and will be lowered to 28% in 2020. The 10.7% corporate income surtax implemented in 2011 will be eliminated as of 2016.

Carbon tax

A carbon tax (contribution climat énergie) was introduced in October 2013. The value of a tonne of carbon will be set at 7 euros in 2014, 14.50 euros in 2015 and 22 euros in 2016.

VAT increase

A VAT increase came into effect on 1 January 2014 under the Responsibility and Solidarity Pact. The normal rate was raised from 19.6% to 20% and the intermediate rate from 7% to 10%, while the reduced rate remained at 5.5%.

Income tax relief

An income tax reduction for lower-income families will come into effect in the fall of 2014 for the 2013 tax year, and will be made permanent. It will lower income taxes for 4.2 million households.

Territorial reforms

Reform of metropolitan management

The reform adopted in January 2014 institutes a new approach to the governance of big cities, the métropoles. The reform applies to the metropolitan areas of Paris, Lyon and Aix-Marseille, and will create metropolitan authorities covering several intercommunautés. Varied institutional arrangements are proposed for Paris, Lyon and Aix-Marseille. The law also calls for the creation, by decree, of metropolitan authorities for the urban areas of Toulouse, Lille, Bordeaux, Nantes, Strasbourg, Rennes, Rouen, Grenoble, Montpellier and Brest.

The estimates in this report in terms of GDP growth impact consider only the reforms affecting Paris and Aix Marseille.
Proposed reforms considered in the simulation exercise

<table>
<thead>
<tr>
<th>Type of reform</th>
<th>Details of the reform</th>
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<tbody>
<tr>
<td>Reforms to goods and services markets</td>
<td></td>
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<tr>
<td>Reform of regulated professions</td>
<td>For the regulated professions, the government is planning a general and regular review of their service charges. Conditions of entry and exercise in a broad range of professions will also be reviewed in order to boost competition.</td>
</tr>
<tr>
<td>Reform of the electricity and gas sectors</td>
<td>Regulated gas prices will be gradually eliminated for businesses and local authorities. At the same time, regulated electricity rates will now apply only to the smallest customers. Hydroelectric operating concessions will be renewed through competitive procedures.</td>
</tr>
</tbody>
</table>
Annex 2: The quantitative method for estimating the impact of reforms to product and labour markets

The impact of reforms to goods and services markets

Stiffer competition on goods and services markets can enhance productivity through various mechanisms. For example, firms subject to competition will be inclined to pay greater attention to managing their costs in order to preserve their profit margins. Similarly, competition can encourage them to undertake technology-intensive investments and to innovate constantly in order to remain at the technological leading edge and to preserve an advantage over new-entrant start-ups.

The regulation of goods and services markets can constitute a barrier to competition if it is poorly designed in terms of its objectives, whether they relate to protecting consumers or enforcing security, health or environmental standards. To measure the orientation of regulation in member countries and to track progress with reforms over time, in 1998 the OECD developed a set of indicators for product market regulation (PMR) covering the entire economy. The underlying purpose of these PMR indicators is to assess the extent to which public policies promote or dampen competition on product markets where competition is feasible.

The PMR indicators cover the entire business economy, with a particular focus on the regulation of the non-manufacturing sectors, and especially of the network industries in the energy, communications (including postal services) and transportation sectors. One reason for this focus has to do with the fact that output in these sectors often represents essential input for production by firms in downstream sectors. Consequently, poorly designed regulation and weak competition in network industries can translate into higher prices for energy, communication and transport services, with significant spillover effects for the competitiveness of firms producing final goods and services.

Beyond the network industries, particular importance is also given to professional services and retail trade. The strength of competition in legal services, accounting, engineering and architecture can also have significant spillover effects on the performance of firms that rely on these services as inputs for their own production. Moreover, as the services sectors are generally less exposed to foreign competition than is the manufacturing sector, regulation can have a major impact on service quality, variety and pricing by reinforcing competition.

The effects of reforms to the labour market and the taxation system

Reducing employer social contributions has a positive impact on employment, particularly for low-wage earners, the unskilled and young workers in a context where the minimum wage is high and constraining. Reducing labour costs helps to align them more closely with labour productivity, thereby limiting the risk of unemployment and fostering labour force participation. Moreover, reducing the cost of labour can lower the price of locally produced goods and can make exports more competitive. However, these positive impacts are dependent not only on the manner of financing the cuts in social contributions and on the overall structure of the tax system, but also on the bargaining power of employees, who may try to negotiate higher wages, which would limit the positive impact of these measures on employment. In theory, the potential employment benefits from reforms will be maximised if the measures are financed through efficiency gains and through a shift in the tax structure towards sources of revenue, such as environmental charges and consumption taxes, which are less distortive of the choices made by firms and households.

The structure of taxation of incomes from work also has an impact on productivity. Shifts in the makeup of the workforce can imply changes in aggregate productivity as well (Boulhol and Turner, 2009). For example, cuts to employer social charges targeted at low-wage earners will encourage more unskilled workers to enter the labour market and may thereby reduce aggregate productivity.
even if, by promoting employment, they also have a positive effect on the public finances (OECD, 2014c).

The OECD indicators measure the trend of the tax wedge on wages, i.e. the portion of total labour costs represented by taxes and social security contributions net of cash benefits paid for different levels of qualifications. Simulations of the impact of labour market reforms utilise estimates of the sensitivity of the employment rate and of productivity to the size of the tax wedge (Bouis and Duval, 2011; Murtin et al., 2014). These estimates, which are based on employment policy trends over time in a set of OECD countries, also identify the differentiated impact of the tax wedge by level of wage. In particular, employment seems to be more sensitive to the cost of labour in the case of unskilled workers.

Apart from the effects of the tax wedge, the trends of two other OECD indicators have also been quantified. These are, respectively, the level of income that a worker receives in unemployment insurance benefits following layoff or dismissal (compared to his working income), and the training and education policy. The first indicator captures the impact of the unemployment insurance reform, which has extended the eligibility waiting period for laid-off employees in receipt of generous separation allowances, thereby stimulating the supply of labour and employment, in particular for older workers. The second indicator is used to quantify the impact of reforms to the apprenticeship and professional development systems. In effect, these reforms to the training system should make unskilled job seekers more employable and should improve the match between the skills acquired by young people leaving the school system and the demands of business. As with the impact of the tax wedge, the simulations make use of previous OECD studies estimating the sensitivity of employment to these indicators.
Annex 3: The quantitative method for estimating the impact of territorial reforms

The estimation of the impact of metropolitan governance reforms in Paris and Aix-Marseille is based on an econometric model of labour productivity determinants covering 140 metropolitan areas in five OECD countries (cf. Ahrend et al, 2014). The estimation follows a methodology that was developed by Combes et al. (2011) to quantify agglomeration economies, and that now constitutes the leading edge of research in this field.

There are several reasons why different metropolitan areas may have different levels of labour productivity. On one hand, these differences may be linked to domestic policies, such as the regulation of labour or goods markets, or the tax system. On the other hand, differences may also result from characteristics specific to a given metropolitan area, such as its size and its governance structure. Productivity differences may depend as well on the composition of the workforce.

The estimates presented here are only based on the changes occurring within countries, and only implicitly take into account changes in productivity levels between countries. In order to determine the factors explaining the differences between metropolitan areas within the same country, a two-stage process has been followed:

1. The first stage involves analysing the factors linked to the composition of the workforce, using individual data. A worker’s productivity level is explained by observable characteristics such as education, type of work, and sector9. In addition, the estimates include an indicative (or fixed-effect) variable for each metropolitan area. This variable captures all the systematic differences that are not explained by the characteristics of workers living in the metropolitan area. Thanks to all these controls, this first stage can explain part of the variation in labour productivity levels for the metropolitan areas in the sample analysed.

2. In the second stage, labour productivity differences that cannot be explained by the composition of the workforce and domestic factors are explained by the factors specific to each metropolitan area. The dependent variable is the fixed-effect coefficient for each city, as estimated during the first stage. In turn, this variable is explained by factors linked to governance of the metropolitan area, and it is subjected to a number of controls, including population density, surface area, and industrial composition by sector.

The impact of metropolitan reforms is based on an estimate of the productivity impact of the forms of governance prevailing in the metropolitan area. The effect is captured by an indicative variable that takes the value 1 if there is a single authority for the entire metropolitan area, and 0 if there is not. The impact of the reform is modelled by the variation in this indicative variable from 0 to 1.

The impact of an organisational change in governance is likely to be greater if a metropolitan area is more highly fragmented administratively (i.e. if it contains more municipalities). To take account of this effect, the estimate incorporates an interaction effect between the indicator variable and the fragmentation index. As would be expected, the coefficient on the interaction term is positive, indicating that the effect of the reform is greater when the metropolitan area is initially more fragmented.

By using the coefficients estimated in the second stage, it is possible to calculate for each metropolitan area the change in labour productivity resulting from the establishment of a metropolitan-wide governance authority. Thus, in the metropolitan area of Paris the impact is especially strong because of its very high degree of fragmentation.

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9 As there are no direct data on workers’ productivity, their wage level has been taken as a proxy. This is an approximation commonly used in the academic literature on labour productivity.
To measure the aggregate effect of the reform, the increase in labour productivity within the metropolitan area is weighted by the relative share of the metropolitan area in national GDP. The estimated effect of the reform in the Paris metropolitan area is 11%, and that for Aix-Marseille is 8%. Given the weight of these metropolitan areas in the French GDP, these changes amount to an increase of somewhat below 4% in national GDP.

It must be noted that these estimates are based on cross-sectional data, and therefore the time dimension is not taken into account. As a consequence, it is not possible to estimate the time needed for the reforms to achieve their full effect. This would likely take several decades, and the effect could also vary over time. Even assuming a fairly long time horizon, the impact in terms of growth appears to be significant, especially in a base scenario of low growth in the coming years.

A number of transmission mechanisms may explain the impact of a territorial reform on productivity. Typically, urban planning is facilitated when there is a metropolitan-wide co-ordination body that can combine land use planning with the planning of transport networks and other forms of regional planning. There are important synergies between these different forms of planning. Consequently, better co-ordination among them can enhance the functioning of the metropolitan area and take greater advantage of complementarities between sector policies.

In addition, the economies of scale resulting from such a reform can enhance efficiency in the delivery of public goods and can thereby boost labour productivity. The time needed for the reform to yield its benefits may be shorter in this case. In effect, more inertia can be expected when changes to the urban structure are implemented over a longer time horizon.
Examples of metropolitan reforms

A number of major cities in the OECD have undertaken reforms of their metropolitan governance in recent years. The list includes Barcelona, London, Manchester, Seoul, Busan, Copenhagen, Oslo, Perth, Portland, Porto and Lisbon, Frankfurt, Stuttgart, Rotterdam-The Hague, Turin, Bologna, Montreal, Vancouver and Auckland.

Although they differ in their specifics, some of these metropolitan reforms can be considered to represent good practice (OECD 2013, Aix-Marseille), with respect for example to:

1. Ensuring an optimal process for designing and implementing the reform (Barcelona, Bologna) by involving all stakeholders (in particular local authorities and elected officials) (Vancouver, Barcelona, Turin, Rotterdam-The Hague), by seeking consent and legitimacy among the citizens (Montreal, Stuttgart, Portland/Metro Oregon), by not creating opposition to the reform that could revive pre-existing disputes (Barcelona), or by forging partnerships with those who support the metropolis (London, Turin);

2. Creating added value in institutional and operational terms (Portland/Metro Oregon, Frankfurt, London, Vancouver, Stuttgart);

3. Creating financial value added through new resources or savings (Minneapolis-St. Paul, Stockholm, Busan).

Metro Oregon (Portland) is one of the few metropolitan authorities in the OECD that has been in existence long enough to be evaluated over a long-term horizon. Created in 1979, it has a popularly elected government at the Portland metropolitan level. The Metropolitan Council has powers and responsibilities that were formerly exercised by the municipalities and other local authorities. The main function of Metro Oregon is land-use planning and transport development. However, it has a number of other responsibilities such as garbage collection and recycling, recreation and regional parks. Metro Oregon also manages business centres and facilities, including the Oregon Convention Center and the Portland Exhibition Center. It currently employs 1700 people.

Thanks to this innovative and efficient governance structure, Metro Portland is considered an exemplary success. This is also reflected in the figures, particularly for productivity. From 1979 to 1999, the annual growth rate of productivity in the metropolitan area of Portland was almost 0.3 percentage points higher than the average for metropolitan areas in the United States. Over 20 years, these differences have translated into a positive growth differential of more than six percentage points between Portland and the average of US metropolitan areas.

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10 Productivity is estimated here by rising wages
Specific points to be considered in evaluating the metropolitan areas of Paris and Aix-Marseille

The estimates present a scenario in which it is assumed that the reforms will have the anticipated impact on the co-ordination of public policies. Some further caveats are needed when it comes to interpreting the results:

- The average number of municipalities within a metropolitan area typically varies between 10 and 200. Nowhere within the OECD is there a metropolitan area as fragmented as that of the Paris metropolitan area. Consequently, the results have had to be extrapolated from estimates based on a sample of metropolitan areas with lower degrees of fragmentation, and this could generate an estimation bias.

- The estimates are based on the "functional" definition of metropolitan areas used by the OECD. In the case of Aix-Marseille, the number of inhabitants in the functional reform area is very close to that of the metropolitan area as defined by the OECD. In the case of Paris, the percentage of the population affected by the reform under way is 34% smaller than that of the OECD functional metropolitan area. The estimate presented here has been adjusted to account for the scope of the reform.

- It is also important to note that the estimates are confined to the metropolitan areas of Paris and Aix-Marseille. Reforms in these two regions could however have repercussions on other French regions and cities. These indirect effects are not taken into account in the analysis.

- The methodology described here focuses on the impact of governance structures in relation to the size and fragmentation of metropolitan areas. For this reason, there was no attempt to measure the impact of metropolitan reform in the case of Lyon, as its boundaries will remain largely unchanged, and its integrated governance structure has been in place for a long time (with the "urban community of Lyon"). Nevertheless, the new metropolitan area that will be created on 1 January 2015 will have expanded powers, particularly in terms of social action and education, which will be transferred from the Department of the Rhône.
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