

How to reform the reduction on payroll taxes?

By Mathieu Bunel, Céline Emond, Yannick L'Horty

More than 20 billion euros are spent every year by the State to compensate the general exemptions from social security contributions, making this the leading employment policy plank in France, both in terms of the total budget and the numbers concerned – more than one employee out of two benefits from the reduction in contributions. In these times of fiscal pressure and the inexorable upward trend in unemployment, questions are being raised about the sustainability of such a scheme, whose scale, which was unified by the 2003 Fillon reform, consists of a reduction that shrinks as the wage rises, up to the level of 1.6 times the minimum wage (SMIC). At the level of the SMIC, the reduction comes to 26 points (28 points for firms with fewer than 20 employees).

In an article published in the [*Revue de l'OFCE \(Varia, no. 126, 2012\)*](#), we evaluate the impact of a complete removal of the general exemptions as well as of a number of partial reforms of the thresholds for exemption from social security contributions, using the latest data suited to the analysis. In our estimate, the simple elimination of all general exemptions would lead to the destruction of about 500,000 jobs. We also explore the effects of reorganising the exemption thresholds, by screening a number of possibilities that would affect the various parameters that define the exemption arrangements. In every case, a reduction in the amount of exemptions would have a negative impact on employment, but the extent of the job losses would vary from simple to double depending on the terms of the reform. To ensure the least negative effect would require that the reductions in the exemptions spare the sectors that are most labour-intensive, which means better treatment for the

exemption schedules that are most targeted at low wages. Since the goal is to improve the unemployment figures, it is important to concentrate the exemptions on lower wages, and thus to give a boost to the sectors that are richest in terms of labour.

However, concentrating exemptions too much in the vicinity of the minimum wage would increase the cost to employers of granting wage rises, which would be favourable neither to purchasing power nor to the quality of the jobs that condition future employment. While a new balance can always be sought in order to meet the urgent budget situation, to be sustainable it must be good for today's jobs without neglecting those of the future.

The taxation of family benefits – is this the right debate?

By [Hélène Périvier](#) and François de Singly

Debate on the taxation of the family allowance has begun once again. Faced with a deficit in the government's family accounts of about 2.5 billion euros in 2012, the idea of taxing the allowance has resurfaced as a way to refill coffers that have emptied, in particular as a result of the economic crisis. The debate often pits an accounting logic that aims to make up the deficits quickly against the logic of a conservative family policy. This post offers a broader perspective that goes beyond this binary approach to the issue.

From family accounts that were balanced...

In the current period, dealing with the budget involves squaring a circle: less tax revenue and greater social spending because of the economic crisis. The temptation is to solve this equation by reducing social spending to make up for declining revenues. It is in this context that the proposal to subject the family allowance to income tax has resurfaced.

During economic crises, the automatic stabilizer role played by social welfare, including family policy, is fundamental. It limits the effects of the crisis on the living standards of those who are most at risk, and therefore also helps to contain the rise in inequality. By supporting household income, it prevents a collapse of economic activity. During the kind of economic downturn we are experiencing today, cutting social spending is not desirable and can be [counter-productive macroeconomically](#).

However, it is not absurd to try to balance the budget for family expenditure over the medium and long term, as this ensures that public action to support families will be sustainable. The deficit in the family accounts comes to 2.5 billion euros. But this is mainly because of the crisis and the consequent reduction in revenues, and is thus cyclical. Mechanically, with legislation unchanged, the family accounts should balance again within a few years if economic growth returns (these assumptions are based on [an annual growth rate of 2% from 2014](#)). Although a debt would still exist due to the accumulation of deficits in 2012 and the following years [\[1\]](#), this could be gradually eliminated using the surpluses generated after the return to equilibrium. But the outlook changes if there is no return to growth or if recovery takes longer than expected, in which case questions about the family budget allocation could be raised with regard to its redistribution or its level. The CNAF pays more than 12 billion euros for the family allowance [\[2\]](#), regardless of the parents' income. Families with two children receive 127 euros

per month for the two children and 163 euros for each additional child. These family benefits are not taxed. Taxing them would reduce the amount of post-tax benefits paid to families, progressively in line with income. This would generate additional tax revenue of approximately 800 million euros. It might seem fairer if families with higher incomes bore more of the burden of budget cutbacks than families on lower incomes. But this issue is more complex than it appears.

The taxation of family benefits might seem to be a way to make up for the loss in the progressivity of the tax system that has occurred over the years, which is mainly due to lower marginal rates in the income tax system, and thereby make things more equitable. But this answer is only a race to the bottom socially, a headlong rush by our welfare state that would lead to reducing its scope of action.

Taxing the family allowance reduces the level of transfers from households without children to families with children, *i.e.* it violates the principle of horizontal equity. Of course, it also helps in particular to increase the level of transfers from the best-off families with children to those less well-off. But to strengthen the overall degree of vertical redistribution (that is to say, to increase the level of transfers from the richest households to the poorest), the tax system has to be made more progressive, which is what was done with the latest fiscal adjustments ([introduction of a 45% tax bracket in particular](#)). In this context, the universality of family allowances could then be maintained, which has the advantage of consolidating the support of high-income households for the principle of the welfare state: they pay more taxes, but they receive the same amount of family benefits when they have children.

The taxation of the family allowance is not simply an adjustment in family policy, it also affects its values — and in particular the principle of horizontal equity. While it may be necessary to rethink the objectives of family policy, which

are now outdated in many respects, as we show in the next section, the current period is probably not the best for conducting this debate, because the urgency of the situation and the desire to find more room for fiscal manoeuvring would lead to the adoption of a short-term vision, whereas family policy is intrinsically long-term policy.

...to a balanced family policy

Nevertheless, this debate on the relevance of taxing the family allowance should not lead to policy paralysis. The principles of current family policy were established based on the way society was viewed over 70 years ago. Although adjustments have been made, the principles remain. Yesterday's objectives do not reflect tomorrow's challenges. It is thus essential to renegotiate the foundations of family policy. How should the welfare state's family activities be reoriented? What compass should be followed? This is the question we need to answer.

One of the goals of contemporary family policy is to prop up the birth-rate. State support increases with the birth order of the child, for example, by granting an additional one-half personal allowance on taxation per child, starting from the third child. When considering how to redeploy spending on family policy, removing the one-half personal allowance should be a top priority for proposals to rebalance the accounts. Similarly, the family allowance is paid only from the second child. France is one of the only countries in Europe not to grant an allowance from the first child. But the dynamic fertility rate found in France is not the result of pro-childbirth family policies like this; instead, it has more to do with the support given for working women with children: kindergarten, extracurricular childcare, care in early childhood, as well as support for mothers in the workforce (rather than stigmatizing this, as is the case in Germany). Family policy needs to be reoriented towards an objective that respects the rights of every child regardless of their birth

order. It should focus on the social citizenship of the individual (that is to say, a more individually-based method of acquiring social rights) from birth to death (while taking into account longer life spans).

A renovated family policy would reflect the principle of equality between children and equality between women and men, including in particular an overhaul of early childhood support, a massive increase in childcare and changes in the system of parental leave. The cost of dealing with early childhood support would be about [an additional 5 billion euros per year](#). Furthermore, the latest publication of the OECD, [Education at a Glance 2012](#), shows that in France children's academic success is strongly correlated with the level of the parents' education. Finally, the [level of child poverty is disturbing](#). These are all major challenges we must meet.

The rise of partnerships outside marriage but also of divorces (and separations more generally) and family recompositions are a sign of greater individual freedom with regard to life choices. This constitutes a progressive step in the way our society functions. But separations are often accompanied by a decline in living standards and often are not financially possible for individuals on low incomes. In addition, the economic consequences when the couple breaks down hit women harder than men. [\[3\] Single-parent families](#), most often mothers with the children in their care, are more exposed to poverty than other households. A family policy that is more in line with these new living arrangements, and which would accompany changes in the family structure over the life cycle, needs to be considered.

It is necessary to redefine the content and contours of our future family policy, but the desire to balance the family accounts cannot be the sole engine driving this process. We must stop thinking about this kind of change in a narrow way, as we need to reform the very foundations of the system based on new needs and on the principles of justice and solidarity

that underpin our social welfare state.

[1] In 2011, the debt in the family accounts was transferred to the Caisse d'amortissement de la dette sociale (CADES), ([Organic Law 2010-1380 – in French](#)).

[2] Which represents about 15% of the total amount of benefits paid out of the family accounts.

[3] Jeandidier Bruno and Cécile Bourreau-Dubois, 2005, “Les conséquences microéconomiques de la disunion”, In Joël M.-E. and Wittwer J., *Economie du vieillissement. Age et protection sociale*, Ed. L'Harmattan,, Vol. 2, pp. 335-351.

Should family benefits be cut? Should they be taxed?

By [Henri Sterdyniak](#)

The government has set a target of balancing the public accounts by 2017, which would require cutting public spending by about 60 billion euros. The Prime Minister, Jean-Marc Ayrault, has given Bernard Fragonard, President of the Haut Conseil à la Famille, France's advisory body on the family, a deadline of end March to propose ways to restructure family policy so as to balance the budget for the family accounts by 2016. Aid to families thus has to be cut, by 2.5 billion euros (6.25% of family benefits), *i.e.* the equivalent of the 2012 deficit for the CNAF, the French national family allowances fund. Is this justified from an economic perspective and a

social perspective?

The CNAF accounts have been hit by the recession, as the amount of social security contributions and CSG tax that it receives has gone down. Based on an estimate that total payroll is 5% below its normal level, the loss of revenue for the CNAF can be estimated at 2.5 billion euros. The CNAF deficit as a whole is thus cyclical. Arguing that the way to cut the deficit is by reducing benefits undermines the stabilizing role of public finances. Consider a fall in private demand of 1% of GDP; assuming a multiplier equal to 1, GDP also shrinks by 1%; the deficit in the public finances will then increase by 0.5%. If you want to avoid this deficit, then government spending would need to be cut by 0.5% of GDP, which would then reduce GDP, and consequently tax revenue, thereby requiring further reductions. *Ex post*, public spending would fall by 1% and GDP by 2%. Fiscal policy would then be playing a destabilizing role. The CNAF therefore needs to be managed based on looking at its structural dimension, which was in fact balanced in 2012. On the economic front, in a situation of a deep depression, when consumption and activity are stagnant, nothing can justify undermining the purchasing power of families [\[i\]](#).

Moreover, successive governments have gradually made the CNAF responsible for both pension benefits for stay-at-home parents (4.4 billion euros in 2012) and increases in family pensions (4.5 billion in 2012). Thus, of the CNAF's 54 billion euros in funds, nearly 9 billion is being diverted into the pension scheme and does not directly benefit children.



This diversion has been possible because family benefits have risen only slightly in the past, as they are generally indexed to prices, not wages. Worse, in some years, benefits have not even risen at the same pace as inflation. Finally, from 1984 to 2012, the monthly basis for calculating the family

allowance (the BMAF) lost 5.7% in absolute purchasing power (column 1 of the table), but 25% in purchasing power relative to median household income (column 2). Should we perpetuate and even widen this growing gap?

Young people under age 20 represent 25% of the population. Using the INSEE's equivalence scale, 12.5% of household income should be provided by the family benefits that go to families with children in order to ensure that they have the same standard of living as people without children. Yet the totality of family benefits represents only 4.2% of household income [\[ii\]](#).

The RSA income support is significantly lower than the pension minimum under the pretext of encouraging RSA beneficiaries to work, but this is hurting the living standards of children, who usually live with people in the workforce, not with pensioners. The creation of the RSA *activité* [the income supplement for the working poor] could have provided significant additional resources for many families of low-wage workers, but it is poorly designed: many potential beneficiaries don't even apply for it. Moreover, it does not benefit the unemployed (and thus their children). In 2010, the poverty rate of children (at the 60% threshold) was 19.8%, compared with 14.1% for the population as a whole. At the 50% threshold, it was 11.1%, against 7.8% for the general population. This means that 2.7 million children are below the 60% poverty line, with 1.5 million even below the 50% line.

A family with three children has a lower standard of living than a childless couple earning the same wages: by 16% at the level of two times the minimum wage, and by 30% at the level of five times the minimum wage. Family allowances have become very low for the middle classes; the family quotient simply takes into account the reduction in living standards caused by the presence of children, but it does not provide specific assistance to families. Aid to children is not excessive at any level of income. In 2010, the average standard of living

was 10% lower for children than for the average population. The opposite should be the case, since children need a decent standard of living to develop their full potential, and parents who raise their children play a fundamental social role, in addition to their role in the workforce.

Should the family allowance be taxed? This would mean ignoring that the amount is already very low compared to the cost of children. Median income per consumption unit was around 1 660 euros in 2012; the average cost of a child, who represents 0.3 consumption unit, is thus about 500 euros. Yet the allowance amounts to 64 euros per child for a family with two children and 97 euros per child for a family with three children. The allowance would thus have to be at least multiplied by 5 before taxing it became a legitimate question.

Making progress toward the goals on French family policy proclaimed in the Social Security Financing Act (LFSS) [\[iii\]](#) – reducing disparities in living standards due to family structure, lifting all children out of poverty, increasing the number of places in childcare – would require devoting greater resources to family policy. This is a burden that should be borne by all taxpayers, not just by middle-class families, who are not the ones most favoured under the existing system.

Cutting the amount that the nation spends on its children by 2.5 billion euros would be a mistake in terms of both macroeconomic policy and social policy. As Charles Gide observed, “Of all the investments a country can make, it is the education of the children that is the most profitable.”

[\[i\]](#) For a similar argument, see Gérard Cornilleau, 2013, “Should spending on unemployment benefits be cut?”, *OFCE blog*, 6 February.

[\[ii\]](#) See Henri Sterdyniak, 2011, “Faut-il remettre en cause la politique familiale française”, *Revue de l’OFCE*, no. 116.

[\[iii\]](#) See the PLFSS, 2013, *Programme de qualité et d’efficience, Famille*.

Should spending on unemployment benefits be cut?

By [Gérard Cornilleau](#)

The Cour des comptes [Court of Auditors] has presented a [report on the labour market](#) which proposes that policy should be better “targeted”. With regard to unemployment benefits in particular, it focuses on the non-sustainability of expenditure and suggests certain cost-saving measures. Some of these are familiar and affect the rules on the entertainment industry and compensation for interim employees. We will not go into this here since the subject is well known [\[1\]](#). But the Cour also proposes cutting unemployment benefits, which it says are (too) generous at the top and the bottom of the pay scale. In particular, it proposes reducing the maximum benefit level and establishing a digressive system, as some unemployed executives now receive benefits of over 6,000 euros per month. The reasoning in support of these proposals seems wrong on two counts.

In the first place, the diagnosis of the system’s lack of sustainability fails to take the crisis into account: if

Unedic is now facing a difficult financial situation, this is above all because of falling employment and rising unemployment. It is of course natural that a social protection system designed to support employees' income in times of crisis is running a deficit at the peak of a crisis. Seeking to rebalance Unedic's finances today by cutting benefits would abandon the system's countercyclical role. This would be unfair to the unemployed and economically absurd, as reducing revenues in a period of an economic downturn can only aggravate the situation. In such circumstances, it is also easy to understand that arguments for work incentives are of little value: it is at the top of the cycle, when the economy is approaching full employment, that it makes sense to raise the issue of back-to-work incentives. When the economy is bumping along the bottom, encouraging a more active job search may change the distribution of unemployment, but certainly not its level.

The current deficit in the unemployment insurance system simply reflects the situation of the labour market. A few calculations can help to show that the system's generosity is fully compatible with financial stability in "normal" times. To establish this, we simply measure the impact of economic growth, employment and unemployment on the system's deficit since 2009. In 2008, Unedic was running a financial surplus of nearly 5 billion euros [2]. This turned into a deficit of 1.2 billion euros in 2009 and 3 billion in 2010, before recovering somewhat in 2011 with a deficit of only 1.5 billion, which then rose to 2.7 billion in 2012. For 2013, the deficit is expected to reach 5 billion. The Table shows our estimates of the impact of the crisis on the system's revenues and expenditures since 2009. The estimated revenue lost due to the crisis is based on the assumption of an increase in annual payroll of 3.5% per year (which breaks down into 2.9% for increases in the average wage and 0.6% for rises in employment) if the crisis had not occurred in 2008-2009. On the expenditure side, the estimated increase in benefits due

to the crisis is based on the assumption of a stable level of “non-crisis” unemployment, with spending in this case being indexed on the trend in the average wage.

Table. Impact of the crisis on Unedic's accounts

In billions of euros

	Impact of the crisis...		Impact on the balance
	... on revenue	... on expenditure	
2009	-1,8	+4,1	-5,9
2010	-2,1	+5,1	-7,2
2011	-2,6	+5,5	-8,1
2012	-3,1	+6,5	-9,6

Source : Author's calculations.

The results of this estimation clearly show that the crisis is solely responsible for the emergence of the substantial deficit run up by the unemployment insurance system. Without rising unemployment and falling employment, the system would have continued with a structural surplus, and the reform of 2009, which allowed compensation for unemployed people with shorter work references (4 months instead of 6 months), would have had only a minimal effect on its financial situation. There was no breakdown of the system, which was in fact perfectly sustainable in the long term ... so long as counter-cyclical economic policies are implemented that prevent a surge in unemployment, whose sustainability is now undoubtedly more of a concern than the finances of Unedic [\[3\]](#).

Based on a diagnosis that is thus very questionable, the Cour des comptes has proposed reducing the generosity of unemployment benefits. Since it is difficult to put forward proposals for cutting lower benefit levels, the Cour put more emphasis on the savings that could be achieved by limiting very high benefits, which in France may exceed 6,000 euros per month for executives on high-level salaries that are up to 4 times the maximum social security cap, which in 2013 was 12,344 euros gross per month. In reality, from a strictly accounting perspective, it is not even certain that this will have positive effects on Unedic's finances. Indeed, few people benefit from these top benefit levels, because executives are

much less likely to be unemployed than are other employees. On the other hand, their higher salaries are charged at the same contribution rates, meaning that they make a net positive contribution to financing the scheme. Calculations based on the distribution of wages and of the benefits currently received by unemployed people insured by Unedic show that employees who earn more than 5,000 euros gross per month receive about 7% of unemployment benefits but provide nearly 20% of the contributions. For example, we simulated a reform that would bring French unemployment insurance into line with the German system, which is much more severely capped than the French system. The German ceiling is 5,500 euros gross per month (former Länder), against 12,344 in the French system. By retaining a cap of 5,000 euros gross per month, the maximum net benefit level in France would be around 2,800 euros. Based on this assumption, the benefits received by the unemployed in excess of the ceiling would be reduced by nearly 20%, but the savings would barely amount to more than 1% of total benefits. On the revenue side, the lower limit would result in a reduction in revenue of about 5%. The existence of a high ceiling in the French unemployment insurance system actually allows a significant vertical redistribution because of the differences in unemployment rates. Paradoxically, reducing insurance for the most privileged would lead to reducing this redistribution and undermining the system's financial stability. Based on the above assumptions, shifting to a ceiling of 5,000 euros would increase the deficit by about 1.2 billion euros (1.6 billion revenue – 400 million expenditure).

This initial calculation does not take into account the potential impact on those whose unemployment benefits would be greatly reduced. To clarify the order of magnitude of this effect, which is, by the way, unlikely, we simulated a situation in which the number of recipients of the highest benefits would be cut in half (e.g. by a reduction in the same proportion of the time they remain unemployed). Between the new ceiling and the highest level of the reference salaries,

we estimated that the incentive effect increased linearly (10% fewer unemployed in the first tranche above the ceiling, then 20% fewer, etc., up to -50%). Using this hypothesis of a high impact of benefit levels on unemployment, the additional savings on benefits would be close to 1 billion euros. In this case, the reform of the ceiling would virtually balance (with an added potential cost [not significant] of 200 million euros). But we did not include the fact that the shortening of the duration of unemployment compensation for unemployed people on high benefits could increase the duration of the unemployed on lower benefits. In a situation of near full employment, it is possible to consider that the rationing of employment results from the rationing of the supply of work; in the current situation of a generalized crisis, the more realistic case involves the opposite situation of a rationing of demand for labour. Achieving budget savings by cutting high benefit levels is not credible, at least if we stick to a reform that does not change the very nature of the system.

One could of course obtain a more favourable result by reducing only the cap on benefits and not the cap on contributions. This would be very destabilizing for the system, since it would strongly encourage executives to try to pull out of a unified solidarity system that provides them with reasonable assurances today through the acceptance of a high level of vertical redistribution, while lowering the cap on benefits alone would force them to insure themselves individually while continuing to pay high mandatory fees. This type of change would inevitably call into question the basic principle of social insurance: contributions based on each person's means in return for benefits based on need.

The general economics in the Cour's report on unemployment benefits thus seem highly questionable because, by not taking into account the effect of the crisis, it winds up proposing a pro-cyclical policy that puts additional burdens on the unemployed at a time when it is less possible than ever to

make them bear the responsibility for underemployment. As for the key measure that challenges the compromise on high level benefits, it would at best be budget neutral and at worst destroy the social contract that today makes possible strong vertical redistribution within the unemployment insurance system.

[\[1\]](#) Unemployment insurance has a special scheme for interim workers in the entertainment industry worth a billion euros per year. It would obviously be sensible for this expenditure to be borne by the general budget and not by Unedic.

[\[2\]](#) Excluding exceptional operations.

[\[3\]](#) On economic policy in Europe and the lack of macroeconomic sustainability, see the initial [report of the Independent Annual Growth Survey project \(IAGS\)](#).

Should households pay for a competitiveness shock?

By [Henri Sterdyniak](#)

France is suffering from an industrial problem. Its current account balance went from a surplus of 2.6% of GDP in 1997 to a deficit of 1% in 2007 and then 2% in 2012, while Germany went from a deficit of 0.4% of GDP in 1997 to a surplus of 5.7%. This raises the issue of France's industrial recovery. Should a major transfer take place from households to large companies for the purpose of a competitiveness shock or to

redress business margins? There are many who advocate such a shock (including the MEDEF, but also the CFDT). This would reduce employers' social contributions (by at least 30 billion euros) and in return increase levies on households. The issue of France's industrial recovery is discussed in detail in the latest [*Note de l'OFCE \(No. 24 of 30 October 2012\)*](#).

It is out of the question to reduce the social security contributions of employees, as these finance only retirement and unemployment benefits, and thus contributory benefits that depend on the contributions paid and that cannot be financed through taxes. Only employer contributions intended for the family or health insurance can be reduced. And then it's necessary to find a substitute resource: VAT or the CSG wealth tax?

In fact, there is little difference between an increase in the CSG tax and an increase in VAT. In both cases, households will lose purchasing power. In the case of a VAT increase, this would involve higher prices. However, inflation is automatically reflected in the minimum wage and social benefits, and after wage bargaining, in salaries too, so any gain in business competitiveness / profitability is likely to be temporary unless indexing is suspended. In contrast, the victims of a higher CSG would not enjoy automatic indexing mechanisms and would have to accept a reduction in purchasing power. Using the CSG thus makes for a more long-term option.

The big issue at the macroeconomic level is the reaction of companies, which will have to arbitrate between maintaining their prices to rebuild their margins or lowering their prices to become more competitive.

Let's imagine ourselves in a country with a GDP of 100 and exports and imports of 25. The share of wages (including employer contributions) and consumption is 80, and the share of profits and investment is 20. In the short run, wages and pensions are fixed. The reform consists of reducing the amount

of employer contributions by 5 (*i.e.* 5% of GDP), while increasing the CSG tax by the same amount. Two scenarios can be adopted based on the pricing policy chosen by companies.

In the first case, the companies maintain their prices and increase their margins. There is no *ex post* gain in business competitiveness, but profitability rises. Wages suffer a loss of 6.25% of their purchasing power (*i.e.* $5/80$). Will the revival in investment offset the fall in consumption? Let's use standard assumptions, *i.e.* a propensity to consume wages of 0.8 and to invest profits of 0.4, with a multiplier of 1. GDP falls in the short term by 2% and employment first drops and then eventually recovers due to the substitution of labour for capital. The measure is costly in terms of purchasing power, and higher employment is not ensured.

In the second case, the companies fully pass on the reduction in charges in their producer prices, which fall by 5%, with consumer prices decreasing by 4% (as the prices of imported goods remain stable). The purchasing power of wages is down by only 1%. The gains in competitiveness come to 5%. Will the gains in foreign trade offset the reduction in consumption? With a price elasticity of exports of 1 and of imports of 0.5, GDP increases by 1.25%. The measure is less painful.

Should it be done?

The government needs to ask households to accept a reduction in their income, even though they have already lost 0.5% in purchasing power in 2012, consumption stagnated in 2011 and 2012, France is in a state of recession, and demand is already too low.

Should France adopt Germany's strategy: to gain competitiveness at the expense of household purchasing power, knowing that this strategy is a losing one at the level of the euro zone as a whole? Admittedly, this would replace the devaluation that is impossible today in the euro zone, but it

would hurt our European partners (which could even respond, to our detriment) and it does not guarantee gains in competitiveness vis-à-vis countries outside the euro zone, which depends primarily on changes in the exchange rate for the euro. Nor would a measure like this replace a reform of the zone's economic policy. Finally, it takes time for gains in competitiveness to translate into renewed growth. For instance, from 2000 to 2005, French growth came to 7.8% (1.55% per year), and German growth to 2.7% (0.55% per year). Can France afford to lose another 5 percentage points of GDP?

France is in an intermediate position between the Northern countries which have made strong gains in competitiveness at the expense of purchasing power and the Southern countries which have experienced excessive wage increases. On a base of 100 in 2000, the level of real wages in 2011 was 97.9 in Germany and 111.2 in France (an increase of 1% per year, corresponding to trend gains in labour competitiveness). Who is wrong? Should we ask the employees in the euro zone countries, first one then another, to become more competitive than the employees of their partner countries by accepting wage cuts?

The margin of French companies was 29.6% in 1973. This fell to 23.1% in 1982, rebounded to 30.2% in 1987, and was 30.8% in 2006, *i.e.* a satisfactory level. The decline occurring since then (28.6% in 2011) can be explained by the drop-off in activity and the retention of labour. It was not caused by higher taxation nor by excessive wage increases. Overall, the share of profits has returned to a satisfactory level historically. But in 1973 gross fixed capital formation was around the level of profits, while it is lower by 3 points of added value today and the share of net dividends paid has increased significantly. What commitments would business make in terms of investment and employment in France in exchange for a measure that would greatly boost profits? How could companies be prevented from increasing their dividends or

their investments abroad?

Making use of an internal devaluation like this implies that France is suffering primarily from a lack of price competitiveness. However, deindustrialization undoubtedly has other deeper causes. Companies prefer to develop in the emerging countries; young people are rejecting poorly paid industrial careers with an uncertain future; France is failing to protect its traditional industries or to develop in innovative sectors; the financial sector has favoured the joys of speculation over financing production and innovation; and so forth. All this will not be solved by an internal devaluation.

France needs a big industrial leap forward. It needs to carry out a different strategy: it is growth that must rebuild business margins, and it is industrial policy (via France's Public Bank Investment [the BPI], research tax credits, competitiveness clusters, support for innovative companies and for certain threatened sectors, and industrial planning) that must ensure an industrial recovery. This should be funded by the BPI, which needs to have sufficient capacity for action and specific criteria for its interventions.

Rent control: What is the expected impact?

Sabine Le Bayon, Pierre Madec and Christine Rifflart

[The decree on rent control](#), which was published in the *Journal officiel* on 21 July, takes effect on 1 August 2012 for one

year. The measure was announced in January 2012 during François Hollande's presidential campaign. It has now been adopted, while awaiting the major reform of landlord-tenant rental relations that is scheduled for 2013.

Difficulties in finding housing and deteriorating living conditions for an increasing share of the population point to growing inequality in housing. This inequality is undermining social cohesion, which is already being hit by the economic crisis. For many people, homeownership is becoming a problematic proposition due to the rising cost of buying, while applications for the allocation of social housing remain on hold for lack of space, and the private rental market is becoming increasingly expensive in large cities because of the soaring price of property. Rent control in these cities is serving as an emergency measure to slow the price increases. This poses a challenge of keeping investors in the private rental market, which is already characterized by a shortage in housing supply and very low rental returns (1.3% in Paris after capital depreciation).

The decree aims to significantly lower market rents [2], which are being driven up by rents at the time of re-letting, *i.e.* during a change of tenant. Unlike rent during the lease period or upon renewal of a lease, which are indexed to the IRL rental benchmark, until 31 July 2012 rents for new tenants were set freely. In 2010, this applied to nearly 50% of re-lettings in the Paris area (60% in Paris). Now, in the absence of major renovations, these will be subject to control. Only rents for new housing that is being let for the first time or renovated properties (where the renovation represents more than one year's rent) will remain uncontrolled (Table 1).

Table 1. The method of setting rent under current law

Legal framework set by	Renewal of lease	Re-letting	First letting and new housing
Act of 6 July 1989 as modified	<ul style="list-style-type: none"> - Indexed to the IRL - In case of obvious under valuation, re-evaluation over 3 years or 6 years if the difference is greater than 10% - In case of renovations, increase agreed in advance between the landlord and tenant 	Uncontrôle	Uncontrôle
Decree for the Paris region	<ul style="list-style-type: none"> - Indexed to the IRL - In case of obvious under-or renovation for an amount at least greater than 1 year's rent, authorized increase of half the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.) 	Uncontrôle	Uncontrôle
Decree of 21 July 2012 (applicable in the relevant municipalities)	<ul style="list-style-type: none"> - Indexed to the IRL - In case of obvious under-valuation or of renovation for an amount at least greater than 1 year's rent in the private or common areas, authorized increase of either half of the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.) 	<ul style="list-style-type: none"> - Indexed to the IRL - In case of an obvious under-valuation or of renovation for an amount between 6 month's rent and 1 years' rent in the private or common areas, authorized increase either of half of the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.) - Uncontrolled if renovation of at least 1 year's rent 	Uncontrôle

By using the [data from the Observatoire des Loyers de l'Agglomération Parisienne](#), along with the hypotheses set out in the [OFCE Note \(no. 23 of 26 July 2012\)](#), "Rent control: what is the expected impact?", we evaluated the impact this decree would have had if it had been implemented on 1 January 2007 and made permanent until 2010. According to our calculations, this decree would have resulted not only in sharply slowing increases in rents for re-lettings during the first year it was applied (+1.3% in the Paris area, against 6.4% observed), but also in stabilizing or even reducing rents at the time of the next re-letting, *i.e.* in our example, three years later (in 2010, 0% in Paris and -0.6% in the Paris region). Finally, in 2010, rents would have been 12.4% lower in Paris and 10.7% lower in the Paris region than they would have been in the absence of the measure. This means that in Paris, rents would have been about €20.1 per sq.m instead of the rate of €22.6 per sq.m actually observed (Table 2). For an average size dwelling (46 sq.m) re-let in Paris, the monthly rent would thus have been €924 instead of €1,039, a savings for the tenant of €115 per month. For the Paris region as a whole, using the same assumptions, the rent upon re-letting would have fallen on average to €15.9 per sq.m, instead of the

actual €17.8 per sq.m. For an average rental area upon re-letting of 50 sq.m, the gain would be €95 per month!

Over the longer term, the decree would make it possible to reduce the gap between sitting tenants in place for more than 10 years and new tenants (a gap of 30% in 2010 in the Paris region and 38% in Paris itself), and to improve market fluidity.

Currently, what possibility is there of moving if the mere fact that a couple has children increases the price per sq.m by over 15% in the Paris region? Similarly, the financial incentive to move for a couple living in a four-room 80 sq.m dwelling whose children have left home is zero, because the rent for a 60 sq.m unit with 3 rooms would cost just as much. This premium on being sedentary increases the pressure on the rental market and encourages households to stay in properties that are not suited to their needs, and even hampers labour market mobility.

Can this measure encourage mobility and restore household purchasing power? In the short term, it will certainly benefit the most mobile households by limiting the increase in the share of their budget spent on housing [3]. But these are the households facing the least constraints on income, that is to say, those with high incomes or a relatively low share of income spent on housing. It will also benefit households that are forced to move or those who are running up against the limits on their finances. For all these households, the increase in the share of income on housing will be lower than it would have been without the decree. In contrast, for low-income households whose share is already high [4], the decree won't change anything, because they can ill afford the additional cost of re-letting.

Table 2. Simulated change in rents upon re-letting in the Paris region using the hypothesis that the decree took effect on 01 Jan 2007

	Rents noted letting on 31/12/2006	Rents after re-letting on 01/01/2007	Change in 2007	Rents on 31/12/2009 after indexing to IRL and before re-letting	Rents on 01/01/2010 after letting	Change in 2010	Gap between observed and simulated rents upon re-letting in 2010
PARIS		19 €/m ²	2.2 %	20.1 €/m ²	20.1 €/m ²	0 %	-12.4 %
Actual	18.6 €/m ²	(20.1 €/m ²)	(+ 8.3 %)	(20,9 €/m ²)	(22,6 €/m ²)	(+8,3 %)	
PARIS REGION		15.4	1.3%	16 €/m ²	15.9 €/m ²	-0.6 %	-10.7 %
Actual	15.2 €/m ²	(16.2 €/m ²)	(+ 6.4)	(16.9 €/m ²)	(17.8 €/m ²)	(+5.7 %)	

What are the risks?

While there are real benefits to be expected, these would still need to be made viable by the application of this decree, or at least by the next Act. Besides the difficulty of implementing the decree (absence both of reliable mechanisms to monitor rents in the areas concerned and of a legal framework to allow tenants to assert their new rights), the impact of this measure will be positive for tenants only if the rental supply does not shrink (by maintaining current investors in the market and continued new investment) and if landlords do not seek to offset future rent control by raising the rent at the time of the first let.

Likewise, the realization of improvements in line with the Grenelle 2 environmental consultation or simply maintenance work could wind up being abandoned due to the lengthening of the amortization period for landlords compared with the previous situation. Conversely, some owners might be encouraged to carry out major renovations (in excess of one year's rent) and "to upgrade the dwelling" in order to be able to freely determine the rent. This would give the landlord a margin of safety to offset any subsequent shortfall. These increases, if they occurred, would penalize less creditworthy tenants and would promote the process of gentrification already at work in the areas under greatest pressure. We could then see increasing differences between the market for

“rundown housing” and that for renovated housing.

This decree should in the short term limit the extent of disparities in the areas under greatest pressure, at no cost to the government. But it will not solve the problem for the poorest households of the share of income going to housing: to do this, it is necessary to increase the stock of social housing, to improve its fluidity and to significantly upgrade housing subsidies [5], which would require a major financial effort. The fundamental problem remains the lack of supply, particularly in urban areas, where by definition the available land is scarce and expensive, with higher rents simply passing on the price of property. However, to ease housing prices, more land needs to be available, with a greater density where possible, transport needs to be developed to facilitate the greater distance travelled between residential areas and workplaces, and so on. These are the levers that need to be used if we are to improve the housing conditions of less well-off households.

[1] The decree applies in municipalities where the rent increases seen over the period 2002-2010 were more than double the increase in the IRL benchmark (*i.e.* 3.2% per year) and the market rent per sq.m exceeds the national average outside the Paris region (€11.1 /sq.m) by 5%. This includes nearly 1,400 communes in 38 cities (27 in metropolitan France and 11 in overseas departments).

[2] There are two types of rent: the average rent is the rent of all rental housing, whether vacant or occupied; and the market rent is the rent of all dwellings available on the rental market, *i.e.* new rental accommodation and re-lettings. This is very close to the rent for re-lettings, as residences for first-time lets represent only a small portion of the

available supply.

[3] This share has increased for 15 years for households in the private rental sector, and particularly the less well-off.

[4] In 2010, more than half of private sector tenants spent an income share on housing (net of housing benefit) of over 26.9%, but above all, the share was 33.6% for the poorest 25% of households.

[5] According to the IGAS report "Evaluation of personal housing assistance", in 2010, 86.3% of rents in the private rental sector were greater than the maximum rent taken into account for calculating housing benefit. Any increase in rent is thus borne entirely by the tenant.

Financing higher education: Should students have to pay?

By [Guillaume Allègre](#) and [Xavier Timbeau](#)

Is it necessary to ensure that a greater portion of the cost of higher education is borne by students in the form of higher tuition fees, which might or might not be coupled with loans? It is often argued that financing higher education through taxes is anti-redistributive. We show in a [working document](#) that from a life cycle perspective proportional taxation is not anti-redistributive.

While raising higher education fees is not on the political agenda in France, it is a subject of intense fighting, not only in Quebec, but also in Spain and Great Britain, where student protests erupted at the end of 2010. Reports in France

regularly propose raising tuition fees: recently (2011), in a note by the [Institut de l'Entreprise](#) [in French] on the role of business in financing higher education, Pierre-André Chiappori proposes “lifting the taboo on tuition fees”. In a [contribution to Terra Nova](#) [in French] published in 2011, Yves Lichtenberger and Alexandre Aïdara propose raising annual university tuition fees by about 1000 euros. Paradoxically, the authors also propose creating a study allowance that could be used anytime in a person’s life. The authors are attempting to deal with two contradictory economic dynamics. On the one hand, a study allowance would help raise the general level of education, a factor in innovation and growth, while simultaneously fighting against social self-selection in higher education:

In countries that have adopted it [the study allowance], disadvantaged social strata may have an opportunity to undertake lengthier studies even though their social origins have predestined them to short-term courses that provide quick entry into salaried employment. This is an important means of raising the general level of education and the qualifications of young people, which is a central concern of this report. (Lichtenberger and Aïdara, [p.82](#))

But on the other hand, education benefits better-off strata, and being free makes it anti-redistributive:

The fact that public higher education is virtually free leads, first, to a transfer of resources (the public cost of education) to young people who are in education the longest. This overwhelmingly means young people from better-off strata. This transfer is reflected ultimately in private returns to the beneficiaries: higher wages and then pensions, which benefit the most highly educated throughout their lives.... As things stand, higher education’s free character has no redistributive value and even aggravates inequalities. (Lichtenberger and Aïdara, [p.84](#))

Indeed, even if the anti-redistributive character of free higher education is not the only argument made by advocates of higher tuition, it is one of their main arguments. This

argument relies on a static and familialist vision of redistribution. We adopt a life cycle perspective instead.

As highlighted in the second excerpt above, on average the beneficiaries of education spending enjoy a significant private benefit: they will have higher wages and pensions throughout their lives. Even assuming that tax (on income) is proportional to income (which is not the case: in reality, it is progressive), they will pay much more tax, in absolute terms, than individuals who have completed shorter studies. Above all, tax allows for the financing of education by individuals who actually receive significant private benefits, and in proportion to this benefit. People who suffer discrimination in the labour market or who were oriented towards less profitable sectors and benefit from low returns to education reimburse society a lesser amount through their taxes than those who benefit more. Financing through income tax leads people with higher incomes to contribute even when they have not had a lengthy education. The injustice would therefore lie in the transfer between persons with high incomes who are not highly educated and those who are highly educated. But if education is characterized to a great extent by significant social returns, thanks to its impact on growth ([see Aghion and Cohen](#)), then people with high incomes are actually beneficiaries of spending on education, whether or not they are highly educated themselves (for instance, self-taught entrepreneurs benefit from the availability of skilled labour).

Adopting a life cycle perspective, we show in a [working document](#) that financing spending on non-compulsory education (beyond 16 years) by a proportional tax represents a net transfer from those with higher incomes during their careers to those with lower incomes during their careers. From a life cycle perspective, free non-compulsory education financed by taxes does not benefit individuals with more affluent parents (the transfer from individuals from better-off households to those from poorer households is not significantly different from zero). If individuals from the poorest households react

to the increase in tuition fees by reducing their investment in education, even when this is financed by loans, then there can be little doubt that they will be the first victims of this type of reform. Advocates of tuition increases generally argue for small increases in tuition fees and exemptions based on means-testing the parents. But recent developments in Australia, the United Kingdom and Canada show that, once the fees have been introduced, it is difficult to prevent governments that are seeking new funds from increasing the fees and reducing the exemption thresholds.

In higher education, the leading injustice is the lack of access to people from modest backgrounds. The surest way to ensure equity in education is still to fund it through income tax and to reform education so that it is targeted at academic success for all rather than at selection.

A boost for the minimum wage or for income support?

By [Guillaume Allègre](#)

The government has made a commitment to an exceptional, “reasonable” boost to the French minimum wage, the “SMIC”, and to indexation based on growth, and no longer just on workers’ purchasing power. In [Les Echos](#), Martin Hirsch has argued for strengthening the RSA [the French income support scheme] rather than the SMIC. The point is not to oppose the working poor, the target of the RSA, and low wages: redistribution policies need to attack, not just poverty, but inequality throughout the income chain.

In terms of reducing inequalities, there are several

strategies: one strategy aims to reduce inequality in individual earnings; a second aims to reduce inequalities in living standards between households, the level at which people are presumed to live in solidarity. There are legitimate grounds for both these strategies. The RSA *activité* [the income supplement for the working poor] and the SMIC are thus not substitutable (see also [“le SMIC ou le RSA?”](#) in French). Unlike the RSA, the fight against poverty is not the objective of the SMIC. The SMIC aims “to ensure that employees with the lowest salaries share in the country’s economic development”. A high minimum wage has the effect of reducing inequalities across the bottom of the wage scale, with increases in the minimum wage [impacting up to two times the SMIC](#). Given the increase in unemployment, in precarious jobs and in part-time work, full-time employees on the minimum wage are certainly not the poorest in society, but they are far from well-off. The SMIC reduces the income gap between the working class and the middle class, which is an objective in itself (though some in the middle class may take a dim view of this: by its very nature, reducing inequality isn’t going to satisfy everyone). In particular, it is not the same thing to receive a high salary or to receive a low salary supplemented by targeted social benefits. These benefits do not confer any rights to a pension or to unemployment benefits. In terms of dignity, the minimum wage level is the value that a society places on work. Social benefits targeted at the poorest people put them in a position of being assisted, which has consequences in terms of social representations (individual and collective). As work is performed by individuals, it is not illegitimate to try to reduce inequalities between employees and not only between the employees’ households.

The proposed boost to the RSA is ambiguous, as the term “RSA” designates both the minimum social benefits for the unemployed and the inactive population (the “base” RSA, formerly the RMI and API benefits) and the income supplement for the working poor (RSA *activité*). If the proposal for a boost applies only

to the RSA *activité*, it would then be inconsistent with the objective of targeting the most disadvantaged households. If, on the contrary, it concerns the RSA as a whole, which would be legitimate, then it is necessary to be more explicit and to assume that it will benefit mainly the unemployed and the inactive [1]. In March 2012, there were 1.59 million people receiving just the base RSA, and 689,000 the RSA *activité* (all France), *i.e.* only one-third of RSA recipients received the *activité* component.

The implementation of the RSA *activité* has up to now failed in two ways (“[The failings of the RSA income support scheme](#)”): according to the [final report of the National Evaluation Committee](#), it has had no discernible impact on employment, and poverty reduction has been severely limited because of a major lack of take-up of the RSA *activité* component. We can move quickly over the first point, as there is little emphasis these days on the incentive aspect of the RSA. The main problem of a boost to the RSA *activité* is indeed the lack of take-up: in the report, take-up for the RSA *activité* component alone is estimated at 68% in December 2010 [2]. And this is not a matter of the programme coming on line: between December 2010 and March 2012, the number of RSA *activité* beneficiaries increased only marginally in mainland France, from 446 000 to 447 000. Linking eligibility for the RSA *activité* to both earned income and family expenses and mixing into a single instrument beneficiaries of a social minimum and the working poor, who are sometimes very well integrated into the labour market, poses problems both in terms of improper assessment of eligibility for the provision and stigmatization. This highlights two causes of the lack-of take-up of the RSA *activité*: insufficient awareness of the scheme, on the one hand, and voluntary lack of take-up, on the other: 42% of non-applications who do not exclude themselves from eligibility declare that they did not file a claim because they “get by financially otherwise”, and 30% did not file a claim because they did “not want to depend on welfare, to owe something to

the state" ([p.61](#)). Better information would not be sufficient to solve the problem of lack of take-up. Increasing the minimum wage, on the contrary, has the great advantage of automatically benefitting those affected without fear of stigmatization, since it involves labour income.

Unlike the RSA, increasing the gross SMIC increases labour costs. However, there are several strategies to raise the minimum wage that would not have a net effect on labour costs: the increase could be offset by a reduction in employers' social contributions. One could also ease employee social security contributions on low wages. But this proposal would probably be censured by the Constitutional Council, which in 2000 knocked down the exemption of the CSG tax on low wages on the grounds that the progressivity of the CSG would then no longer depend on the household's ability to pay [\[3\]](#). Finally, a more extensive reform aimed at merging the CSG tax and the income tax would make it possible to reduce taxes on low wages and thus increase the net minimum wage. The integration of the PPE in-work negative income tax would also make it possible to show the amounts involved directly on the payslip.

The fight against inequality clearly should not stop with inequalities in wages between full-time workers. It is also necessary to attack involuntary part-time work, by enabling the workers concerned to move into full-time work and/or by making part-time work more costly by lowering the rate of general tax relief on employer social contributions.

Basically, there is no reason to want to vary the level of the base RSA relative to the minimum wage. However, since the base RSA is indexed to prices, its level has fallen sharply relative to the minimum wage since the early 1990s (see [Périvier](#), 2007). It would therefore be legitimate to significantly raise the base RSA (even if this means reducing the rate of accumulation of the RSA *activité* component) and to index it to the minimum wage level. This would definitively solve the question of whether to boost the minimum wage or the

RSA.

[\[1\]](#) Here it can be seen that the “simplification”, which consists of combining two instruments into one, is not facilitating public debate.

[\[2\]](#) This lack of take-up is partially due to the fact that, for some of those who are eligible (about a third), the potential gains are very low or even non-existent due to the deduction of the sums paid under the RSA *activité* from the PPE in-work negative income tax. But the lack of take-up is nevertheless high even when looking at the potential gainers (and not simply all those eligible).

[\[3\] Decision No. 2000-437 DC dated 19 December 2000](#): “Whereas, while the legislature has the right to change the base of the general social contribution to alleviate the burden on the poorest taxpayers, this is subject to the condition that it does not undermine the existence of conditions of equality between taxpayers; that the provision in question does not take account of the taxpayer’s income other than from an activity or of income of other household members or of dependents within it; that the choice made by the legislature to not take into consideration all the contributory capacities does not create, between the taxpayers concerned, a manifest inequality that violates Article 13 of the Declaration of 1789.”

Towards a major tax reform?

By [Guillaume Allègre](#) and [Mathieu Plane](#) (eds.)

Taxation is more at the heart of the current election campaign and public debate than ever before. The economic and financial crisis, coupled with the goal of rapidly reducing the deficit, is inevitably shaking up the electoral discourse and forcing us to confront the complexity of our tax system. How do taxes interact with each other? What are the effects? How are they measured? What kind of consensual basis and constraints does taxation require? How should the tax burden be distributed among the economic actors? How should social welfare be financed? Should we advocate a “tax revolution” or incremental reform? The contributions to [a special “Tax Reform” issue of the Revue de l’OFCE – Débats et Politiques](#) aim to clarify and enrich this discussion.

The first section of the special issue deals with the requirements and principles of a tax system. In an introductory article, [Jacques Le Cacheux](#) considers the main principles that should underpin any necessary tax reform from the viewpoint of economic theory. In a historical analysis, [Nicolas Delalande](#) emphasizes the role of political resources, institutional constraints and social compromises in drawing up tax policy. [Mathieu Plane](#) considers past trends in taxation from a budgetary framework and analyzes the constraints on public finances today. In response to the problem of imported carbon emissions, [Eloi Laurent and Jacques Le Cacheux](#) propose the implementation of a carbon-added tax.

The second section deals with the issue of how the tax burden is distributed among households. [Camille Landais, Thomas Piketty and Emmanuel Saez](#) respond to the important article by [Henri Sterdyniak](#) in which he recommends a “tax revolution”. [Clément Schaff and Mahdi Ben Jelloul](#) propose a complete overhaul of family policy. [Guillaume Allègre](#) attempts to shed light on the debate over France’s “family quotient” policy. Finally, [Guillaume Allègre, Mathieu Plane and Xavier Timbeau](#) propose a reform of taxation on wealth.

The third section concerns the financing of social protection.

In a sweeping review of the literature, [Mireille Elbaum](#) examines changes in the financing of social protection since the early 1980s, and considers the alternatives that have been proposed and their limits. [Eric Heyer, Mathieu Plane and Xavier Timbeau](#) analyze the impact of the implementation of the “quasi-social VAT” approved by the French Parliament. [Frédéric Gannon and Vincent Touzé](#) present an estimate of the marginal tax rate implicit in the country’s pension system.

Is government expenditure in France too high?

By [Xavier Timbeau](#)

Since 2005, France has vied with Denmark for first place in terms of government expenditure as reported by the OECD. Since the ratio of “government expenditure” to GDP reached 56.6% in 2010, it has been necessary, according to a widely held view, to “deflate” a State that is taking up “too much” space in the economy. First place would thus be, not a badge of honour, but a sign that we have reached an unsustainable level of “government expenditure”. Since, moreover, it is essential to reduce the public deficit, the path ahead is clear: reducing public spending is the only way to bring public finances under control. But this simplistic analysis is wrong.

This analysis is based on a poor use of the statistics on [government expenditure reported by the OECD](#) and flows from an inadequate understanding of what the term “government expenditure” means. This term, it must be recognized, can be confusing.

What is called “government expenditure” combines, on the one

hand, collective expenditures (e.g. from maintenance of the security forces to public administration and the fight against poverty) and, on the other, insurance-related transfer expenditures. This transfer spending covers pension insurance and health insurance. These are individualizable in the sense that we know the direct beneficiary of the expense (which is not the case for administrative expenditures, for which the benefits are diffuse), and they are funded by contributory schemes: to qualify for coverage, it is necessary to have contributed. In most countries, the pension system is almost completely contributory, in the sense that the relative level of benefits for individuals of the same age is related to their relative contributions. The rate of return on the contributions (which relates the expected present value of the flow of pension benefits to the present value of the contributions) is comparable to that obtainable over a long period by capitalizing savings. The minimum pension payment, family benefits and survivor benefits might seem to deviate from this contributory principle, but in practice these "benefits" compensate for short careers that have been interrupted by the accidents of life and do not differ much from a contributory scheme. With regard to health, another pillar of the modern welfare State, the contributory aspect is mitigated by the redistribution effected by a contribution that is proportional to income and an expense that depends on age and not much on income (with the exception of daily allowances). When health care provision is universal, some people benefit without having contributed, but these cases are marginal and do not alter the quasi-contributory character of our health systems.

Depending on the country, the pooling of transfer expenditures takes various organizational forms. It may be done inside the company, within sector-wide organizations, or by management and trade union bodies or it may be mediated by central government. The particularity of France is that social protection is mainly organized through the State's

intermediation. This is not the case in other countries like the United Kingdom, the United States or Germany. Even unemployment insurance, which is handled by management/union bodies, is treated by the national accounts as pertaining to the public sector, and UI contributions are considered compulsory levies (automobile insurance premiums, although imposed on anyone who uses the roads, are not classed as levies).

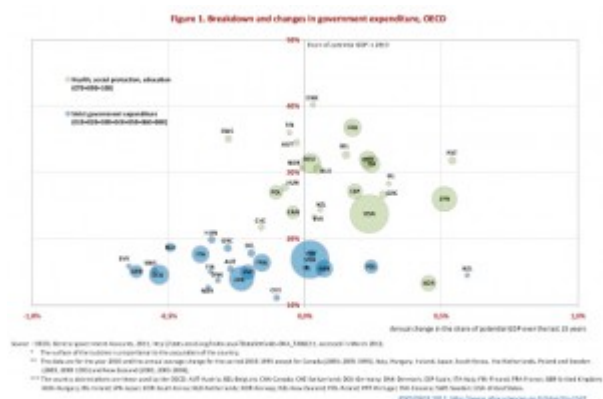
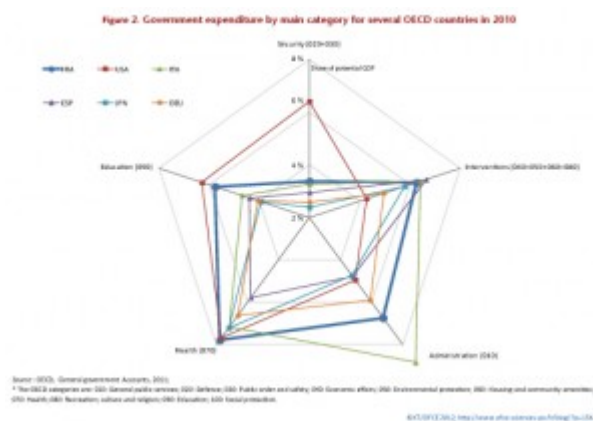


Figure 1 shows the unique position of France. In 2010, “government expenditure” in the strict sense (that is to say, not individualizable, such as domestic and foreign security, administration, miscellaneous expenditure on interventions) represented 18.2% of the country’s GDP. In terms of this “strict government expenditure”, in 2009 France ranked 10th among the OECD countries (see also Figure 2). If the “competition for being thin” covered only expenditure in this narrower sense, France would be relatively average compared to other bigger-spending countries like the United States, Portugal and Italy. Moreover, unlike the UK, the US or Ireland, over the last 20 years France has cut “strict government expenditure”, in a rather unexpected demonstration of fiscal control.

Figure 1 also shows that there is not great variation among the OECD countries with respect to the hard core of “government expenditure”. A developed country needs security, public administration and expenditure on interventions. It is difficult to compress this kind of State spending; the

difference between the State with the largest expenditure (Hungary) and that with the smallest (Switzerland) is 8 GDP points. If we limit ourselves to large States, the gap is smaller (a difference of 3.6 GDP points between Japan and Italy). In contrast, with respect to “government social expenditure”, the differences between countries are major: the gap between Korea and Denmark is 27 GDP points, and, among the major countries, 13 GDP points between the United States and France. This makes France, along with Denmark, Sweden, Austria and Finland, a country where “government social expenditure” in relation to GDP is high.



Can we conclude from these data that the French system of social protection is more generous than in other countries? And that this is the cause of an unsustainable public debt (Figure 3)? Can we say that the system is too generous and that we must reverse the course of the past 20 years by reducing the share of social spending in GDP? No, the data tell us only one thing: that social welfare, health and education in France are dispensed directly by the State, which provides funding for these through the tax system. In other countries, intervention by the State (or by local authorities) may be just as massive (for instance, by defining specifications for education, prices of treatments or medications, or obligations to take out health or retirement insurance), but the performance of the service or the distribution of the benefit may be delegated to a non-public entity. In some countries, only a portion of health or

retirement coverage is mandatory, and individuals are then “free” to choose the level of spending they want. This freedom is relative, as people can be steered by tax incentives (instead of “government expenditure”, we speak of a “tax expenditure”, since it implies a shortfall in tax revenue for the State) or by necessity.

Total spending on health care and education is, for example, higher in the US than it is in France, relative to GDP, although the share directly distributed by the State is lower. How is it that expenditures deemed characteristic of a welfare State are higher in a more individualistic society? Are tax incentives and social norms being taken sufficiently into account? Another example: the introduction of the premium and the discount (*surcote* and *décote*) into the French pension system has changed individual incentives, and therefore individual returns (towards greater “actuarial neutrality”). But this did not affect the GDP share of “government expenditure” on pensions. In the future, the establishment of long-term care insurance may increase “government social expenditure” by a few GDP points. The right question is not the legal personality of the distributing entity, but rather, what are the incentives that individuals perceive, and what kind of inter- or intra-generational support will this long-term care insurance involve.

A social system must be judged on the rights it confers and the duties it entails, and thus on the extent to which it is more contributory or more solidarity-oriented and redistributive. To this end, we need to look at the benefits and the levies, as well as the implicit or explicit guarantees given in case of a shock to the private or public institutions that provide the benefits. A private system can be very redistributive (when the pricing of certain risks is prohibited, when there is a full State guarantee), and a public system can be very contributory and more neutral from an intergenerational perspective than a private system, as

illustrated by Swedish pensions.

A simple review of the aggregate data is not enough to settle this debate, which is why the argument that cutting “government social expenditure” on the grounds that it is higher than in any other country simply makes no sense.



Figures in.pdf:

[Figures_government_expenditures](#)