EUROPEAN
COMMISSION

Brussels, 22.2.2017
SWD(2017) 75 final

COMMISSION STAFF WORKING DOCUMENT

Country Report France 2017
Including an In-Depth Review on the prevention and correction of macroeconomic imbalances

Accompanying the document

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK AND THE EUROGROUP

2017 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011

{COM(2017) 90 final}
{SWD(2017) 67 final to SWD(2017) 93 final}

CONTENTS

LIST OF TABLES

LIST OF GRAPHS

LIST OF BOXES

EXECUTIVE SUMMARY

This report assesses France's economy in the light of the European Commission's Annual Growth Survey published on 16 November 2016. In the survey the Commission calls on EU Member States to redouble their efforts on the three elements of the virtuous triangle of economic policy — boosting investment, pursuing structural reforms and ensuring responsible fiscal policies. In so doing, Member States should focus on improving social fairness in order to deliver more inclusive growth. At the same time, the Commission published the Alert Mechanism Report (AMR) that initiated the sixth round of the macroeconomic imbalance procedure. The in-depth review, which the 2017 AMR concluded should be undertaken for the French economy, is presented in this report.

Economic growth is forecast to accelerate moderately. GDP growth declined slightly to 1.2% in 2016 from 1.3% in 2015, despite the acceleration in domestic demand, as net exports represented a drag on growth of almost 1 pp. of GDP growth. The Commission 2017 winter forecast projects French GDP to grow by 1.4 % in 2017 and 1.7 % in 2018. The recovery in exports is expected to rebalance growth away from private consumption and help sustain the recovery, although net exports are forecast to continue to be a drag on growth. Inflation is expected to moderate gradually, as the effects of past oil price increases fade. In the long term, growth is expected to remain moderate, as, in line with an EU wide trend, France's potential growth has been eroded since the 2008 financial crisis, to 0.9 % in 2015.

Export performance remains subdued. Export market shares have stabilised since 2012 but exports barely grew in 2016. The trade deficit deteriorated in 2016 and is expected to widen further, as imports remain more vigorous than exports and oil prices rebound. While external sustainability is not a concern for France in the short term, the weak export performance weighs on growth prospects.

Cost competitiveness is improving without having fully regained past losses, while substantial improvements in non-cost competitiveness are still to materialise. The growth of unit labour costs has slowed down thanks to labour tax cuts and continued wage moderation, but low productivity growth prevents a faster recovery of France's competitiveness. Low levels of product market competition and slow adoption of technology hamper productivity growth. Incentives for employers to hire on open-ended contracts have been introduced. In addition, derogations through firm-level agreements from branch-wide and general legal provisions are becoming more systematic. However, the minimum wage indexation mechanism has not been revised and the labour market remains segmented holding back the improvement of the labour force's skills. Finally, the tax burden for companies is high compared to other EU countries.

France's public indebtedness is high. The deficit is expected to decline below the threshold value of 3 % of GDP in 2017, but the pace of fiscal adjustment is slow as the adjustment of government spending proves difficult. This raises concerns about the durability of the deficit correction. The still comparatively high deficit - coupled with the low inflation environment and low growth - indicates that debt, expected at 96.4 % of GDP in 2016, continues to increase. More progress has been made on fiscal structural reforms: the sustainability of the pension system has been improved, territorial reform is allowing local government to make efficiency gains and setting-up the High Council of Public Finances has strengthened fiscal governance.

Unemployment is falling from the peak reached in 2015, while long-term unemployment continues to rise in contrast with the EU trend. After increasing steadily since 2008, unemployment started to fall, from 10.4 % in 2015 to 10.0 % in 2016, and is forecast to fall further in the coming years. Yet, unemployment for young people and low-qualified remains high and, as a percentage of total unemployment, long-term unemployment reached 44.2 % in the third quarter of 2016, contrary to the decreasing trend in the EU.

Overall, France has made some progress in addressing the 2016 country-specific recommendations. Substantial progress has been made in ensuring that labour cost reductions are sustained and in reforming the labour law. The 2016 Labour Act paves the way for a comprehensive review of the Labour Code and introduced measures aimed at improving firms' capacity to adjust. However, no progress has been

made on reforming the unemployment benefit system. Some progress has been made in improving the system of vocational education and training. Also, some progress has been made on removing barriers to activity in the services sector and in simplifying administrative, accounting and fiscal rules for companies. By contrast, limited progress has been made in reducing taxes on production and the corporate income tax, simplifying innovation policy schemes and boosting the savings identified by the spending reviews. No progress has been made in alleviating the effects on firms of size-related legal thresholds. Although the deficit is projected to decline below the 3 % Treaty threshold, the limited progress made in taking the required structural budgetary measures means that there are no fiscal buffers against unforeseen circumstances.

Regarding progress in reaching national targets under the Europe 2020 Strategy, France is performing well in decreasing greenhouse gas emissions, improving energy efficiency and reducing early school leaving. At the same time, more action is needed to increase the employment rate, R&D intensity, use of renewable energy, and to reduce poverty.

The main findings of the in-depth review contained in this report, and the related policy challenges, are as follows:

- **French exports continue to suffer from weak competitiveness.** The increased specialisation of goods exports on a few sectors makes France's export performance more vulnerable to negative developments in these sectors. Moreover, the quality of goods exports has declined slightly in recent years. Export market shares in services have been more resilient than those in goods since 2008.

- **Cost competitiveness has improved in recent years.** Since 2013, unit labour cost growth has been lower in France than in the rest of the euro area, in particular thanks to measures taken to reduce the labour tax wedge, but accumulated past losses have not been made up for yet. Wage moderation continues, but low productivity growth is preventing cost competitiveness from recovering faster.

- **France performs well in terms of investment levels**. Productive investment in machinery and equipment has started to pick up supported by fiscal measures. The quality of investment is however uneven. Investment in R&D is mainly in sectors whose relative weight is declining, and businesses are relatively slow to take up digital technologies. While barriers to investment are overall moderate, investment is highly concentrated around a limited number of larger firms. These investment patterns weigh on labour productivity and competitiveness and affect the long-term growth potential of the whole French economy.

- **The design of the tax system weighs on competitiveness.** The high tax burden on companies may be an obstacle to investment and firms' growth. It is combined with a relatively low level of consumption taxes. The tax wedge on labour is being reduced but remains above EU average at the average wage. In addition, the complexity of the tax system may also be a barrier to a well-functioning business environment.

- **The French business environment is middle-ranking in comparison to major competitors.** While the government has tried to simplify the regulatory burden for businesses, the latter are still faced with a high regulatory burden and fast-changing legislation. Size-related thresholds in social and tax legislation also continue to weigh on firms' growth. Competition has improved in some service sectors, but is still weak in several sectors of major economic importance. Given the targeted scope of already adopted reforms, serious barriers remain in place.

- **High public debt coupled with low growth could be a source of significant risks for public finances in future**. Short term sustainability risks remain low. In the long term, risks are also contained, notably due to pension indexation rules and favourable demographic developments compared to the rest of the EU. Nonetheless, there are significant consolidation needs in the coming years to bring down the public debt. The debt burden for the private sector is stabilising albeit

at a high level. The combination of high public and private debt is an additional risk factor.

- **The expenditure-based consolidation strategy has relied mainly on declining interest rates and cuts in public investment**. The already very high revenue-to-GDP ratio leaves little margin for further tax hikes, suggesting that further consolidation needs to be expenditure-based. However, it is unlikely that the low interest rate environment will prevail in the medium term and if productive investment is cut the economic potential could be harmed. In contrast, the spending reviews have identified a number of possible efficiency gains, most of which have not been implemented yet.

- **Its large economy and close integration with the rest of the euro area makes France a potentially significant source of cross-border spillovers.** Structural reforms in France can have positive spill-over effects in other Member States. Model simulations suggest that product and labour market reforms or a growth-friendly tax shift in France can yield positive GDP effects for both France and for the rest of the euro area. These effects should remain in the long-term.

Other key economic issues analysed in this report that point to particular challenges facing France's economy are the following:

- **Measures to reduce the cost of labour have had an effect on employment.** The recent evaluations of the *crédit d'impôt pour la compétitivité et l'emploi* (CICE) highlighted its positive effect on employment, although an increase in its credit rate was not found to have an increased impact on employment. The Labour Act also aims to reduce labour market rigidities. Nonetheless, the French labour market remains segmented, while women and people from a migrant background continue to be affected by lower employment rates. The unemployment benefit system continues to be in deficit and its rules reinforce the labour market segmentation by favouring successive short periods of work.

- **Educational inequalities remain high and the vocational education and training system is not sufficiently adjusted to labour market needs.** France performs well with respect to the Europe 2020 indicators concerning education. However, educational inequalities linked to socioeconomic background are among the highest in the OECD. The system of initial vocational education and training does not lead to a satisfactory integration of young people in the labour market. Access to the continuous vocational training system is uneven for different categories of workers.

- **France scores better than the EU average in relation to poverty, social exclusion and inequality.** Social situation indicators show no major changes. Yet, some population groups remain more exposed to poverty, notably part-time workers and single-parent families. For very low income earners, access to affordable housing remains challenging.

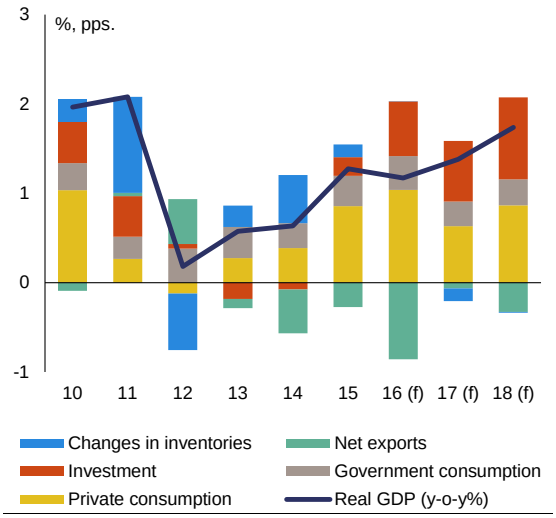
- **The French national innovation system does not match the performance of Europe's innovation leaders.** A high degree of complexity remains and overall coordination is a challenge. The discrepancy between the amount of public support granted and France's middling innovation performance raises questions about the efficiency of public support schemes.

1. ECONOMIC SITUATION AND OUTLOOK

GDP growth

Economic growth is forecast to accelerate moderately. GDP growth declined slightly to 1.2% in 2016 from 1.3% in 2015, despite growth reaching 0.4% in the fourth quarter. Private consumption accelerated on the back of dynamic household purchasing power, while investment growth has been boosted by anticipation of the end of the over-amortisation scheme, a fiscal incentive for firms to invest. However, after an exceptional performance in 2015, export growth fell to 1.0% in 2016, due to several temporary factors, while imports remained relatively dynamic. As a result, net exports represented a drag on growth of almost 1 pp. of GDP growth in 2016. According to the Commission 2017 winter forecast, GDP is projected to pick up to 1.4 % in 2017 and 1.7 % in 2018 under the usual no-policy-change assumption (Graph 1.1).

Graph 1.1: **Contributions to GDP growth (2010-2018)**



Source: Commission 2017 winter forecast

The recovery in exports is expected to rebalance growth away from private consumption and help sustain the recovery, although net exports are forecast to continue to be a drag on growth. Private consumption is expected to decelerate in line with purchasing power, as the tailwinds from lower oil prices fade out. Also, the recovery in investment is gaining momentum, particularly in the construction sector. After the strong growth observed in 2016, equipment investment growth is set to moderate somewhat. However, the prolongation of the over-amortisation scheme until 14 April 2017, rising profit margins and easy financing conditions are expected to sustain robust growth rates. Export growth is expected to gradually normalise in 2017 and 2018, in line with the moderate recovery projected in French export markets. Meanwhile, imports are forecast to moderate somewhat in 2017, in a context of decelerating domestic demand, allowing for a more balanced contribution of net exports to GDP growth.

The unemployment rate has been declining since mid-2015, supported by the labour market measures adopted since 2013. Employment is forecast to continue growing at a sustained pace, supported by the ongoing economic recovery and by policy measures to encourage job creation by reducing the labour tax wedge (the Tax Credit for Competitiveness and Employment, the Responsibility and Solidarity Pact, and the Hiring Subsidy). Moreover, the emergency plan for employment announced in January 2016 is further decreasing the unemployment rate by providing training to unemployed people who subsequently do not appear as unemployed any more. Consequently, the unemployment rate is forecast to decline to 9.9% in 2017 and 9.6% in 2018.

Inflation is set to moderate gradually. Inflation rose sharply to 1.6% in January 2017, from 0.8% in December 2016. Overall, HICP is expected to average 1.5% in 2017, before declining slightly to 1.3%, as the strong positive contribution from recent oil price increases fades out and domestic price pressures increase only gradually.

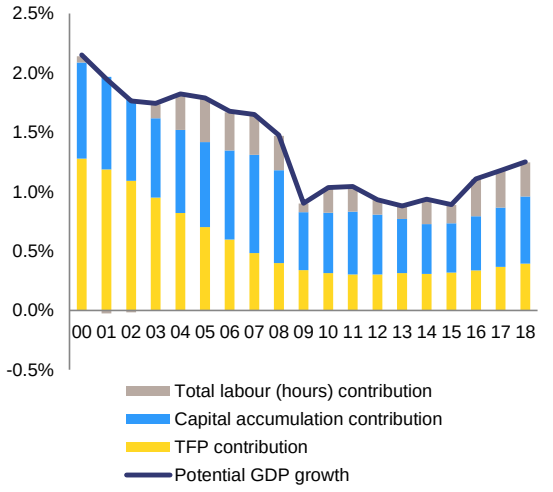
Risks to the outlook are more balanced. Despite continued global uncertainty, risks to the forecast for France are less tilted to the downside than in the autumn. The improvement of labour market conditions could allow for a more significant drop in the household saving rate and thus stronger private consumption.

Potential growth

In the long term, growth is expected to remain moderate as potential growth has slowed since the 2008 financial crisis. Averaging 1.8 % from 2000 to 2008, France's potential GDP growth declined to 0.9 % on average from 2009 to 2015

and is expected to pick up only moderately, to 1.3 % by 2018. While this decline has been observed in all major euro area economies, France is characterised by a stronger decline in total factor productivity (TFP) growth, while capital accumulation and labour force remained relatively dynamic ([1]). France's decline in total factor productivity (TFP) growth, at −0.5 pp. from 2000-2008 to 2009-2015 (Graph 1.2), is larger than that of Germany (−0.3 pp.), Italy (−0.2 pp.) or Spain (+0.1 pp.). As a result, potential TFP growth in France has decoupled from Germany, although it remained higher than in Spain and Italy.

Graph 1.2: **Potential GDP growth breakdown in France**



Source: Commission 2017 winter forecast

The decline in total factor productivity growth contributes to the weak competitiveness and exacerbates the challenges linked to the high public debt. Although wage increases have moderated in recent years, the slowdown of labour productivity growth, largely due to a decline in TFP growth despite a continued increase in capital intensity, prevents a faster recovery of cost competitiveness (see Section 4.4). The decline in potential GDP also makes it more difficult for France to bring down its public debt without greater fiscal consolidation efforts (see Section 4.1).

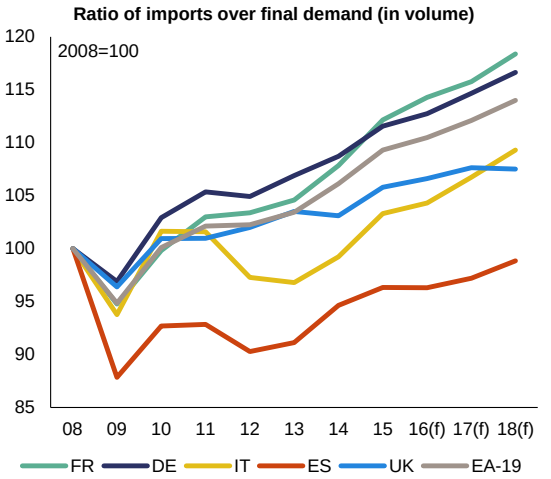
Structural reforms are key to addressing the economic challenges associated with the declining potential growth. Labour and product market rigidities weigh on total factor productivity by hampering resource reallocation. Labour market segmentation limits the improvement of labour force's skills (see Section 4.3). Moreover size-related social and tax thresholds and slow adoption of technology also weigh on total factor productivity growth (see Section 4.5). Finally, the tax structure is not growth-friendly.

([1]) European Commission (2016c).

Imports

Imports have been relatively more dynamic than final demand since 2008. The increase in import penetration reflects first and foremost general trends in world trade as a result of globalisation. However, import penetration has increased relatively more in France than in other major EU economies (Graph 1.3). This deterioration in the French market shares in the domestic market reflects the weak cost and non-cost competitiveness of the French economy.

Graph 1.3: **Import penetration in selected EU countries**

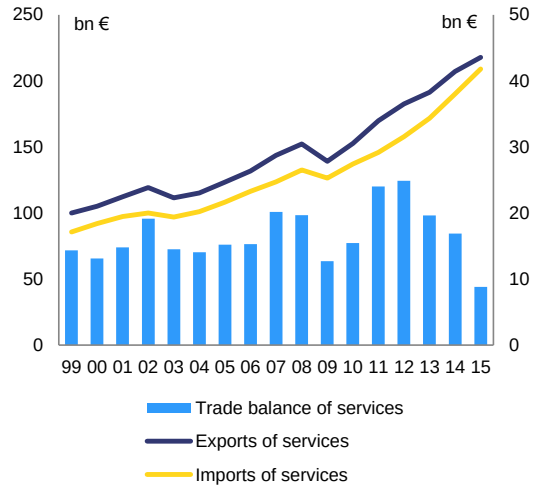


Source: European Commission

France has been increasingly importing intermediate goods, which currently represent half of all imports of goods. The import content of its goods exports has also been growing over the years (from 33 % in 1995 to 39 % in 2009). Yet, French companies seem to be less integrated in global value chains, certainly less so than German companies. France's goods imports remain mostly downstream in the production chain (i.e. near final demand). Based on Andras 'upstreamness indicators', 46.3 % of French goods imports are

near final demand against 39.7 % of German imports. Additionally, the ratio of domestic added value in French exports to foreign added value in its imports fell between 1995 and 2011 (from 51 % to 43 %), while again increasing in Germany (from 59 % to 67 %) in the same period.

Graph 1.4: **Trade in services – France**



Source: Eurostat – Balance of payments

In addition, the fast–rising imports of services are eroding the trade surplus in services. While still on the positive side, the trade balance in services declined by EUR 16 billion (0.7 % of GDP) from 2012 to 2015 to reach its lowest value since 1999 (Graph 1.4) ([2]). This decline occurred because, while exports of services grew fast (see Section 4.4), imports were growing even faster, accounting for the bulk of the change in the trade balance developments in recent years. Imports have been growing particularly fast in technical, trade-related and other business services since 2013, while the balance in tourism has deteriorated since 2014, presumably as a consequence of the recent terrorist attacks. Tourism is the service sector where France has the highest revealed comparative advantage ([3]). Thus, developments in this sector have a large impact on the overall trade balance in services. The trend in transport services is also negative: this sector has been running a deficit since 2013, mainly driven by a deteriorating balance in freight road transport and passenger air transport.

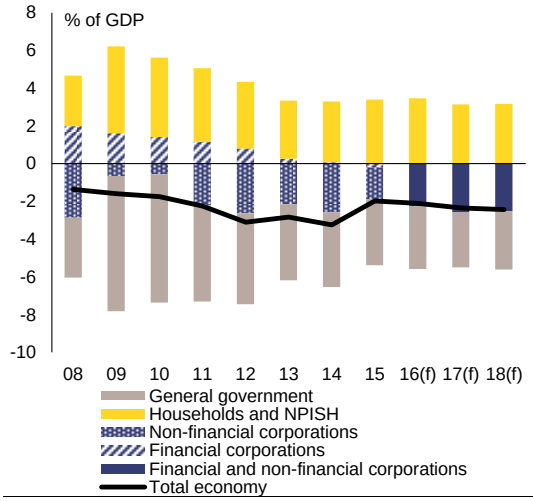
([2]) According to national accounts statistics the trade balance in services has even turned negative since 2014 and stood at EUR −8.8 bn in 2015.

([3]) Revealed comparative advantages are calculated based on a formula developed by Balassa (1966) which indicates a country's relative advantages or disadvantages in exports by sector. It reflects the contribution to the trade balance of each sector, on the scale of total trade in goods and services in value, corrected by the overall trade balance.

External position

The trade deficit reached a trough in 2011 at −2.6 % of GDP. The trade balance has been steadily improving since then and reached −1.4 % of GDP in 2015. A significant part of this improvement is due to lower oil prices, as the trade balance excluding energy products has been deteriorating again since 2013. As oil prices rebound, the total trade deficit is forecast to increase. According to the Commission 2017 winter forecast, the trade deficit is set to reach −2.3 % of GDP in 2018.

Graph 1.5: **Net lending/borrowing by institutional sectors – France**



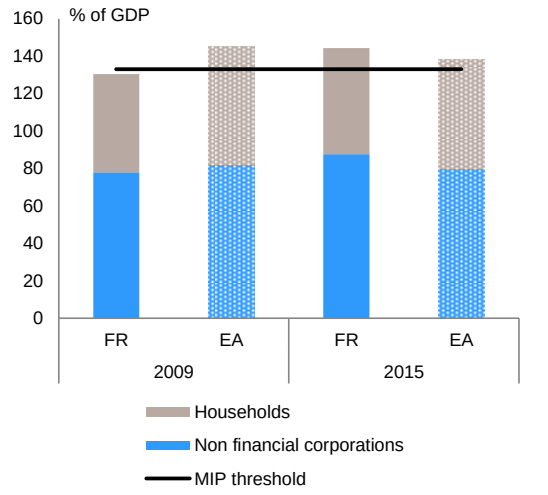
Source: Eurostat, Commission 2017 winter forecast

Net borrowing of the nation is also set to deteriorate, to −2.4 % of GDP in 2018. In France, all institutional sectors except households were net borrowers in 2015 (Graph 1.5). The net lending of households remains insufficient to fully finance net borrowing by the general government and by corporations. In particular, France is the only major EU economy in which non-financial corporations are net borrowers, while the net borrowing of the public sector is higher than in the euro area as a whole. Over the forecast period, the deterioration in the net borrowing of the total

economy stems from a fall in the net lending of households and a rise in net borrowing by corporations.

Private indebtedness

Graph 1.6: **Private debt in France and in the euro area**



Source: Eurostat

The level of consolidated private debt has steadily increased since 1998 to reach 144.3 % of GDP in 2015. Both household debt and non-financial corporation debt continued to grow at a relatively rapid pace throughout the crisis and beyond. By contrast, in the euro area, private debt has been falling since 2009, as a number of European economies have experienced significant deleveraging. As a result, private debt in France now exceeds the euro area average. While household debt remains below that of the euro area, the debt of French non-financial corporations exceeded the euro area average by 7.5 pps. in 2015. Non-financial corporation debt, combined with still low profitability, is a potential source of concern for France, should this trend persist.

Public finances

The general government deficit is projected to fall below the 3 % of GDP reference value in 2017, although its durable correction is at risk. According to the Commission 2017 winter forecast, the general government deficit is expected to decrease from 3.5 % of GDP in 2015 to 3.3 % in 2016 due to slow expenditure growth contained by low inflation and low interest rates. Based on the measures presented in the draft budgetary plan, the government deficit is expected to further decrease to 2.9 % of GDP in 2017. The structural balance is projected to improve by only 0.2 % of GDP in both 2016 and 2017, well below the recommended efforts in March 2015 (Council of the European Union, 2015). Moreover, at unchanged policy the deficit is projected to increase to 3.1 % of GDP in 2018.

The general government debt is projected to keep rising until 2018. The public debt-to-GDP ratio reached 96.2 % of GDP in 2015, compared with 92.6 % for the euro area on average. Such difference is expected to widen further in the coming years (see Section 4.1). Despite this trend, sovereign yields remain very close to historical lows driven by the expansionary monetary policy of the ECB. These low yields have resulted in interest expenditure decreases while preventing negative spillovers to the financial sector and the real economy.

Social developments

Modest economic growth has led to a stagnation of real household income in France. Between 2012 and 2015, real GDP per capita grew more slowly in France than in the EU and in the euro area (0.43 %, against 1.16 % in the EU and 0.81 % in the euro area). The poverty rate stabilised at 13.5 % in 2015 and the population at risk of poverty or social exclusion reached 17.7 % of the total population, below the level observed in the EU and the euro area. Also, the intensity of poverty, as calculated by national figures, has recorded a slight increase to 20.1 % in 2014 after having decreased from a peak of 21.2 % in 2012 to 19.8 % in 2013.

Income inequality remains relatively low in France compared to the EU average ([4]). It has slightly decreased since 2011, partly reversing an upward trend since 2007 ([5]). This decrease has

([4]) As measured by the Gini index and by the income quintile share ratio. The Gini index considers the shape of the whole income distribution and takes values between 0 and 1 with higher values indicating a higher degree of income inequality. The income quintile share ratio is the ratio of total income received by the 20 % of the population with the highest income to that received by the 20 % of the population with the lowest income.

([5]) The Gini index of disposable income went down from 30.8 in 2011 to 29.2 in 2015, while the income quintile share

been due to the tax benefit system, whilst market income inequality — that is inequality of incomes before taxes and transfers including pensions — has been rising since 2012 and is now somewhat above the EU average ([6]). Over the same period, the lower 10 % of income earners have benefitted from slightly better income developments than the median household — contrary to what happened between 2000 and 2012 — and their income gap with median earners is smaller than in many other EU countries ([7]). The French benefit system has also helped to reduce the risk of relative poverty, which is close to the EU average before social transfers and rather low after transfers ([8]). By contrast, households' net wealth ([9]) inequality is relatively higher than income inequality and was among the highest in the EU (ECB, 2016).

The significant rise in youth unemployment and long-term unemployment over the past 10 years, however, may increase the risks for the economic performance of France stemming from higher inequality. The segmentation of the labour market and inequalities in access to education (see also Section 4.3) play an important role in inequality outcomes and perceptions. This raises concerns about possible risks of hysteresis effects and further pain for low income earners.

---

ratio fell from 4.6 in 2011 to 4.3 in 2015. The 2015 EU average is 31.0 and 5.2 for the Gini index and the income quintile share ratio respectively.

([6]) The difference between the Gini coefficient before and after taxes and transfers was 50.2 in 2015 before social transfers and pensions were taken into account, and 29.2 after social transfers and pensions – a gap of 21. This gap exceeds the EU average of 19.9.

([7]) The real S10 income growth was significantly lower than the real mean income growth between 2000 and 2012, but higher since 2012. For the latest year available, the ratio S50/S10 is below the EU average.

([8]) The relative poverty is measured by the at-risk-of-poverty rate, defined as the share of individuals whose equivalised disposable income falls below 60 % of the median income.

([9]) Difference between total assets and total liabilities.

Table 1.1: **Key economic, financial and social indicators – France**

	2004-2008	2009	2010	2011	2012	2013	2014	2015	forecast 2016	forecast 2017	forecast 2018
Real GDP (y-o-y)	1.9	-2.9	2.0	2.1	0.2	0.6	0.6	1.3	1.2	1.4	1.7
Private consumption (y-o-y)	1.9	0.2	1.8	0.5	-0.2	0.5	0.7	1.5	1.9	1.2	1.6
Public consumption (y-o-y)	1.6	2.4	1.3	1.0	1.6	1.5	1.2	1.4	1.6	1.2	1.2
Gross fixed capital formation (y-o-y)	3.3	-9.1	2.1	2.1	0.2	-0.8	-0.3	1.0	2.8	3.1	4.1
Exports of goods and services (y-o-y)	3.5	-11.3	9.0	6.9	2.5	1.9	3.3	6.1	1.0	3.1	4.0
Imports of goods and services (y-o-y)	5.0	-9.4	8.9	6.3	0.7	2.1	4.7	6.6	3.7	3.1	4.8
Output gap	2.0	-2.3	-1.4	-0.4	-1.1	-1.4	-1.7	-1.3	-1.3	-1.1	-0.6
Potential growth (y-o-y)	1.7	0.9	1.0	1.0	0.9	0.9	0.9	0.9	1.1	1.2	1.3
Contribution to GDP growth:											
Domestic demand (y-o-y)	2.1	-1.5	1.8	1.0	0.3	0.4	0.6	1.4	2.0	1.6	2.1
Inventories (y-o-y)	0.1	-1.1	0.3	1.1	-0.6	0.2	0.5	0.1	0.0	-0.1	0.0
Net exports (y-o-y)	-0.4	-0.3	-0.1	0.0	0.5	-0.1	-0.5	-0.3	-0.9	-0.1	-0.3
Contribution to potential GDP growth:											
Total Labour (hours) (y-o-y)	0.3	0.1	0.2	0.2	0.1	0.1	0.2	0.2	0.3	0.3	0.3
Capital accumulation (y-o-y)	0.8	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.5	0.5	0.6
Total factor productivity (y-o-y)	0.6	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4
Current account balance (% of GDP), balance of payments	-0.2	-0.8	-0.8	-1.0	-1.2	-0.9	-1.1	-0.2	.	.	.
Trade balance (% of GDP), balance of payments	-0.3	-1.2	-1.6	-2.0	-1.4	-1.1	-1.1	-0.7	.	.	.
Terms of trade of goods and services (y-o-y)	-0.6	2.6	-1.4	-2.4	-0.3	1.1	1.1	2.6	1.2	-0.9	0.3
Capital account balance (% of GDP)	0.1	0.1	0.1	0.1	0.0	0.1	0.1	0.1	.	.	.
Net international investment position (% of GDP)	-6.6	-14.8	-9.3	-8.7	-12.8	-16.6	-16.9	-16.4	.	.	.
Net marketable external debt (% of GDP) (1)	-19.2	-21.6	-23.1	-22.3	-26.4	-26.2	-30.8	-32.3	.	.	.
Gross marketable external debt (% of GDP) (1)	169.9	181.6	190.5	182.9	182.0	176.3	192.5	192.8	.	.	.
Export performance vs. advanced countries (% change over 5 years)	-5.7	-7.2	-10.7	-7.7	-8.9	-6.7	-7.7	-3.42	.	.	.
Export market share, goods and services (y-o-y)	-4.1	0.4	-10.1	-2.5	-4.5	1.9	0.6	-1.0	.	.	.
Net FDI flows (% of GDP)	1.8	2.6	1.3	0.7	0.7	-0.5	1.7	-0.1	.	.	.
Savings rate of households (net saving as percentage of net disposable income)	9.8	10.8	10.4	10.0	9.5	8.7	8.7	8.9	.	.	.
Private credit flow, consolidated (% of GDP)	8.8	3.3	4.6	6.4	4.4	2.2	2.9	4.5	.	.	.
Private sector debt, consolidated (% of GDP)	112.8	130.4	131.9	135.3	138.5	137.8	142.4	144.3	.	.	.
of which household debt, consolidated (% of GDP)	43.9	52.5	53.7	54.8	55.2	55.7	56.0	56.6	.	.	.
of which non-financial corporate debt, consolidated (% of GDP)	68.9	77.9	78.2	80.5	83.3	82.1	86.4	87.7	.	.	.
Corporations, net lending (+) or net borrowing (-) (% of GDP)	-0.4	1.0	0.9	-1.0	-1.8	-1.9	-2.5	-1.9	-1.9	-2.3	-2.4
Corporations, gross operating surplus (% of GDP)	18.1	17.0	17.8	17.5	16.8	16.8	17.1	17.7	18.1	18.0	18.1
Households, net lending (+) or net borrowing (-) (% of GDP)	2.8	4.6	4.2	3.9	3.5	3.1	3.2	3.4	3.5	3.2	3.1
Deflated house price index (y-o-y)	7.5	-4.9	3.6	3.9	-1.9	-2.6	-1.7	-1.3	.	.	.
Residential investment (% of GDP)	6.4	6.3	6.3	6.4	6.2	6.1	6.0	5.8	.	.	.
GDP deflator (y-o-y)	2.1	0.1	1.1	0.9	1.2	0.8	0.5	0.6	0.8	0.9	1.2
Harmonised index of consumer prices (HICP, y-o-y)	2.2	0.1	1.7	2.3	2.2	1.0	0.6	0.1	0.3	1.5	1.3
Nominal compensation per employee (y-o-y)	3.0	1.8	3.1	2.5	2.4	1.6	1.2	1.1	0.9	1.5	1.9
Labour productivity (real, person employed, y-o-y)	1.1	-1.8	1.8	1.3	-0.1	0.3	0.2	0.8	.	.	.
Unit labour costs (ULC, whole economy, y-o-y)	1.8	3.5	1.0	1.0	2.3	1.1	0.8	0.2	0.5	0.7	1.1
Real unit labour costs (y-o-y)	-0.3	3.4	-0.1	0.0	1.1	0.3	0.3	-0.4	-0.4	-0.2	-0.2
Real effective exchange rate (ULC, y-o-y)	0.9	0.5	-1.6	0.2	-1.9	3.1	0.6	-4.2	0.0	-0.4	-0.7
Real effective exchange rate (HICP, y-o-y)	0.3	0.4	-4.1	-0.7	-3.2	1.6	0.3	-4.5	1.2	-1.1	.
Tax rate for a single person earning the average wage (%)	28.5	27.7	27.8	28.0	28.2	28.4	28.7	28.9	.	.	.
Tax rate for a single person earning 50% of the average wage (%)	18.3*	17.5	18.4	20.1	20.3	19.1	19.5	22.1	.	.	.
Total Financial sector liabilities, non-consolidated (y-o-y)	10.7	1.6	5.7	0.7	2.1	1.8	5.4	3.1	.	.	.
Tier 1 ratio (%) (2)	.	10.1	10.7	10.9	13.3	13.1	13.1	13.8	.	.	.
Return on equity (%) (3)	.	4.6	8.3	5.6	3.4	6.0	4.6	6.8	.	.	.
Gross non-performing debt (% of total debt instruments and total loans and advances) (4)	.	4.3	4.5	4.6	4.5	4.6	3.6	3.5	.	.	.
Unemployment rate	8.4	9.1	9.3	9.2	9.8	10.3	10.3	10.4	9.9	9.9	9.6
Long-term unemployment rate (% of active population)	3.2	3.0	3.5	3.6	3.7	4.0	4.2	4.3	.	.	.
Youth unemployment rate (% of active population in the same age group)	20.4	23.6	23.3	22.7	24.4	24.9	24.2	24.7	25.2	.	.
Activity rate (15-64 year-olds)	69.7	70.3	70.3	70.1	70.7	71.1	71.1	71.3	.	.	.
People at risk of poverty or social exclusion (% total population)	19.0	18.5	19.2	19.3	19.1	18.1	18.5	17.7	.	.	.
Persons living in households with very low work intensity (% of total population aged below 60)	9.3	8.4	9.9	9.4	8.4	8.1	9.6	8.6	.	.	.
General government balance (% of GDP)	-2.9	-7.2	-6.8	-5.1	-4.8	-4.0	-4.0	-3.5	-3.3	-2.9	-3.1
Tax-to-GDP ratio (%)	44.4	43.9	44.1	45.2	46.5	47.4	47.8	47.9	47.6	47.7	47.5
Structural budget balance (% of GDP)	.	.	-5.8	-5.0	-4.2	-3.4	-3.0	-2.7	-2.5	-2.3	-2.7
General government gross debt (% of GDP)	66.0	79.0	81.7	85.2	89.5	92.3	95.3	96.2	96.4	96.7	97.0

(1) Sum of portfolio debt instruments, other investment and reserve assets
(2,3) Domestic banking groups and stand-alone banks
(4) Domestic banking groups and stand-alone banks, EU and non-EU foreign-controlled subsidiaries and EU and non-EU foreign-controlled branches
(*) Indicates BPM5 and/or ESA95
Source: European Commission

2. PROGRESS WITH COUNTRY-SPECIFIC RECOMMENDATIONS

Progress with implementing the recommendations addressed to France in 2016 ([10]) has to be seen in a longer-term perspective since the introduction of the European Semester in 2011. As regards public finances, the general government deficit was reduced from 4.8 % of GDP in 2012 to 3.3 % in 2016 and was 1.5 pp. higher than in the rest of the euro area in 2016. In terms of fiscal structural reforms the sustainability of the pension schemes has been improved, the territorial reform has provided a framework to realise efficiency gains at local level and the fiscal governance has been strengthened with the setting-up of the High Council of Public Finances. However, less progress has been made concerning the identification of efficiency gains in public spending, raising concerns about the durability of the deficit correction.

Measures have been adopted to improve the functioning of the labour market. The cost of labour has been reduced, notably thanks to some fiscal measures (Sections 4.3 and 4.4). At the same time, the 2013 *accord national interprofessionnel* (ANI), the 2014 reform of the unemployment benefit system, and the Labour Act of 8 August 2016 have aimed to tackle some of the major rigidities hampering the good functioning of the labour market, although the social partners' take-up of the flexibility they offer is key in determining their impact on the labour market segmentation. Moreover, no ad-hoc increases of the minimum wage have been adopted since 2012, although its indexation mechanism has not been reviewed. The implementation of the 2014 reform of the vocational training system is ongoing.

The French authorities have taken some action to improve the middle-ranking business environment. A number of service sectors have been reformed and access to regulated professions has been eased in some cases. Efforts to reduce red tape for firms have been stepped up, notably through the multi-year simplification programme which has been in effect since 2013. The social dialogue law of 2015 and the 2016 budget law have attempted to soften the impact on firms' growth of size-related regulations, but their scope has been limited overall.

The composition of the tax burden has somewhat improved, but distortive features remain and the potential for simplifying the tax system remains largely untapped. The total tax burden on companies increased between 2010 and 2013, with policy measures such as the CICE, the responsibility and solidarity pact and the phase-out of the C3S started to reverse the trend in 2014. These measures have been partly financed by an increase in VAT rates and environmental taxation, but the burden of taxation continues to fall less on consumption than it does in other EU countries. While some tax expenditures were phased out at the beginning of the period, overall the tax system has not been simplified, with tax expenditures rising as a share of GDP.

Overall, France has made some ([11]) progress in addressing the 2016 country-specific recommendations, which are all relevant to the macroeconomic imbalance procedure (MIP). Since the publication of the CSRs, few consolidation strategy measures have been taken on the expenditure side and tools to rein in spending growth have not been strengthened significantly. Progress in addressing CSR 1 has therefore been limited. The continued implementation of the CICE and the responsibility and solidarity pact (RSP) and the adoption in August 2016 of the Labour Act suggest substantial progress with CSR 2. Progress in implementing CSR 3 has been limited. Employment prospects offered by the initial vocational training system are not satisfactory, while the reform of the unemployment benefit system is still pending. Some progress has been made in improving the business environment (CSR 4). Competition has improved in some service sectors, some very preliminary steps are being taken to rationalise the innovation support system and the simplification of companies administrative, fiscal and accounting rules is ongoing. By contrast, no action has been taken since the end of 2015 to further reform size-related criteria in business regulations. Finally,

([10]) For the assessment of other reforms implemented in the past, see in particular section 4.

([11]) Information on the level of progress and actions taken to address the policy advice in each respective subpart of a CSR is presented in the Overview Table in the Annex. This overall assessment does not include an assessment of compliance with the Stability and Growth Pact.

progress in improving the efficiency of the tax system as called for by CSR 5 has been limited. The statutory corporate income tax rate is starting to be reduced in 2017 for some SMEs, but the turnover tax (C3S) has not been entirely phased out and no further steps have been taken to broaden the tax base on consumption. Apart from government plans to introduce a withholding tax for personal income tax, very little has been done to streamline the tax system or to broaden the tax base on consumption. The scrapping of taxes yielding little or no revenue continues to progress at a very slow pace while tax expenditures keep increasing in number and in value.

Table 2.1: **Summary Table on 2016 CSR assessment**

France	**Overall assessment of progress with 2016 CSRs: Some**
CSR 1: *Ensure a durable correction of the excessive deficit by 2017 by taking the required structural measures and by using all windfall gains for deficit and debt reduction. Specify the expenditure cuts planned for the coming years and step up efforts to increase the amount of savings generated by the spending reviews, including on local government spending, by the end of 2016. Reinforce independent public policy evaluations in order to identify efficiency gains across all sub-sectors of general government. (MIP relevant)*	**Limited progress** • Limited progress in reinforcing and identifying savings and efficiency gains generated by the spending reviews and public policy evaluations.(1)
CSR 2: *Ensure that the labour cost reductions are sustained and that minimum wage developments are consistent with job creation and competitiveness. Reform the labour law to provide more incentives for employers to hire on open-ended contracts. (MIP relevant)*	**Substantial progress** • Substantial progress in ensuring that labour cost reductions are sustained. • Some progress in ensuring that minimum wage developments are consistent with job creation and competitiveness. • Substantial progress in reforming the labour law to provide more incentives for employers to hire on open-ended contracts.
CSR 3: *Improve the links between the education sector and the labour market, in particular by reforming apprenticeships and vocational training, with emphasis on the low-skilled. By the end of 2016, take action to reform the unemployment benefit system in order to bring the system back to budgetary sustainability and to provide more incentives to return to work. (MIP relevant)*	**Limited progress** • Some progress in improving the links between the education sector and the labour market. • No progress in reforming the unemployment benefit system.
CSR 4: *Remove barriers to activity in the services sector, in particular in business services and regulated professions. Take steps to simplify and improve the efficiency of innovation policy schemes. By the end of 2016, further reform the size-related criteria in regulations that impede companies' growth and continue to simplify companies' administrative, fiscal and accounting rules by pursuing the simplification programme. (MIP relevant)*	**Some progress** • Some progress in easing access to and exercise of activity in the services sectors. • Limited progress in improving the efficiency of innovation policy schemes. • No progress in reforming the size-related criteria in regulations that impede companies' growth. • Some progress in pursuing the simplification programme.
CSR 5: *Take action to reduce the taxes on production and the corporate income statutory rate while broadening the tax base on consumption, in particular as regards VAT. Remove inefficient tax expenditures, remove taxes that are yielding little or no revenue and adopt the withholding personal income tax reform by the end of 2016. (MIP relevant)*	**Limited progress** • Limited progress in reducing taxes on production and the corporate income tax while broadening the tax base on consumption. • Some progress in modernizing the tax system, mainly through adopting the withholding personal income tax. The phasing out of tax expenditure and taxes yielding little or no revenue is progressing very slowly.

(1) The overall assessment of CSR1 does not include an assessment of compliance with the Stability and Growth Pact.
Source: European Commission

Box 2.1: **Contribution of the EU budget to structural change**

The total allocation of the European Structural and Investment Funds (ESI funds) in France amounts to EUR 28 billion under the current financial framework 2014-2020. This is equivalent to around 0.2 % of annual GDP (calculated over the period 2014-2017) and to 4.7% of the expected national public investment ([1]). By 31 December 2016, an estimated EUR 6.8 billion were allocated to concrete projects. This represents around 25 % of the total allocation of ESI funds.

Financing under the European Fund for Strategic Investments (EFSI), Horizon 2020, the Connecting Europe Facility and other directly managed EU funds is additional to the ESI funds. By end 2016, France has signed agreements for EUR 1.9 billion for projects under the Connecting Europe Facility. The European Investment Bank Group approved financing under EFSI amounts to EUR 4 billion as of end-2016, which is expected to trigger nearly EUR 21 billion in total investments.

In 2015 and 2016, ESI Funds supported progress in a number of structural reforms via ex-ante conditionalities ([2]) and targeted investment. Examples include smart specialisation strategies in the area of research and innovation, in ultra-peripheral regions, the existence of waste management and the water sector actions plans.

The relevant CSRs focusing on structural issues were taken into account when designing the 2014-2020 programmes. These included improving access and quality of initial and continuous education and training; reinforcing active labour market policy for the most vulnerable; addressing early-school leaving; reducing poverty and social exclusion; and increasing investment in research and innovation in the specialisation domains identified in regional innovation strategies. To date, almost 199 000 young people have been supported under measures financed under the Youth Employment Initiative (YEI); of whom nearly 52 000 are in employment, education or training after the end of the YEI support. The YEI supported in particular the *Garantie Jeunes*, a specific intensive counselling and training scheme that targeted people who are not in education, employment, or training (NEETS).

([1]) National public investment is defined as the sum of gross capital formation, investment grants, and national expenditure on agriculture and fisheries.

([2]) Before programmes are adopted, Member States are required to comply with a number of ex-ante conditionalities, which aim at improving framework and conditions for the majority of public investments areas. For Members States that did not fulfil all the ex-ante conditionalities by the end 2016, the Commission has the possibility to propose the temporary suspension of all or part of interim payments.

3. SUMMARY OF THE MAIN FINDINGS FROM THE MIP IN-DEPTH REVIEW

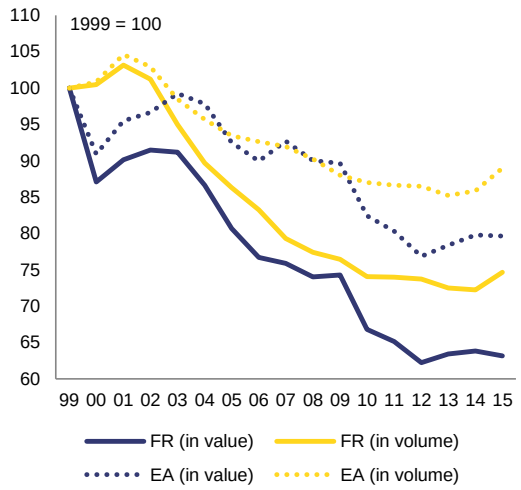
The 2017 Alert Mechanism Report (European Commission, 2016b) called for further in-depth analysis to monitor progress in the unwinding of the excessive imbalances identified in the 2016 MIP cycle. The selection was motivated by the fact that France was identified with excessive imbalances in spring 2016 after an in-depth analysis, so that a new in-depth review is needed to assess how these imbalances evolve. The identified excessive macroeconomic imbalances related to a weak competitiveness and a high and increasing public debt, in a context of low productivity growth. Other vulnerabilities were identified, including as regards the segmentation of the labour market, the innovation capacity, the limited efficiency of public spending and the complex tax system, which weighs significantly on production factors, as highlighted in the Review of progress on policy measures relevant for the correction of macroeconomic imbalances (European Commission, 2017c). These vulnerabilities have cross-border relevance.

Analyses included in this Country Report provide an In-Depth Review (IDR) into how the identified imbalances have developed. In particular, IDR-relevant analysis is found in the following sections: sources of imbalances related to public debt are covered in section 4.1; the situation of the financial sector in section 4.2; sources of imbalances related to competitiveness in section 4.4; and vulnerabilities associated with market performance of the services sector in section 4.5. Potential spillovers to the rest of the euro area are discussed in box 3.1.

Imbalances and their gravity

French export performance has deteriorated significantly over the past 15 years. Since 1999, its export market shares have fallen by 36.8 % in value (Graph 3.1), compared to 20.4 % for the euro area as a whole. In volume, the decline is also significant (−25.4 %, against −11.0 % in the euro area). This loss in export market share, linked to a deterioration of both cost and non-cost competitiveness, has weighed on growth outcomes. At the same time, external sustainability is not a concern for France in the near term as its net international investment position remains contained at −16 % of GDP (after −17 % in 2014).

Graph 3.1: **Export market shares in value and in volume – France and euro area**



Source: Eurostat, IMF

Cost competitiveness deteriorated markedly from 1999 to 2013. Unit labour costs increased at a faster pace in France in both nominal and real terms. From 1999 to 2008, the loss of cost competitiveness was largely due to containment of unit labour costs in the rest of the euro area, in particular in Germany. From 2008 to 2013, there was a disconnection between the trend in nominal unit labour costs and the GDP deflator in France, in a context of low productivity growth. This resulted in a further decline in the relative cost competitiveness in that period, this time for domestic reasons.

Weak non-cost competitiveness has also weighed on export performance. Despite reform efforts, the French business environment continues to be characterised by a relatively high regulatory burden. Complex labour regulations, high corporate tax rates and a complex tax system continue to weigh on firms. Rigidities persist in a number of sectors and prevent the downward adjustment of tariffs to the detriment of downstream industries that use these services. Increased size-related social and fiscal obligations give rise to threshold effects and discourage firms from growing with implications for labour

productivity and competitiveness. The low profitability of non-financial corporations also weighs on France's non-cost competitiveness, through its impact on the quality of investment. Although corporate investment is relatively high and supported by favourable macroeconomic and framework conditions, it tends to be concentrated in less productive purposes thereby weighing on productivity growth.

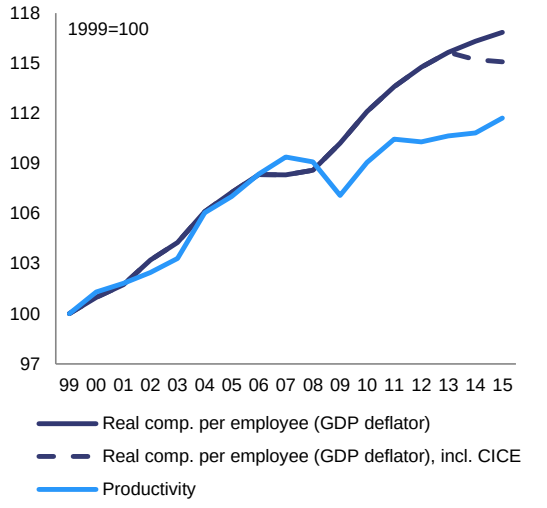
The high public debt-to-GDP ratio is a major source of vulnerability and compounds the risks stemming from the weak competitiveness of the French economy. High public debt weighs on growth prospects by crowding out productive public expenditure and requiring a higher tax burden. However, in the current context of also high (though stable) private sector debt, still weak growth, low inflation and heightened uncertainty, not only is public deleveraging more difficult, but also high public debt makes France more vulnerable as it might give rise to negative feedback loops to the real economy and the financial sector should a new wave of negative shocks materialise. Moreover, sustainability risks in the medium term are high, partly due to the projected increase in age-related expenditure. Given the size of the French economy, such a situation could also entail potentially negative spillovers to the rest of the euro area (see also Box 3.1 on euro area spillovers).

Evolution, prospects and policy responses

Export performance remains subdued. Export market shares have stabilised since 2012 but export growth stalled in 2016 and is expected to fall well short of both world trade and French export market growth. The current account deficit rose to −1.2 % of GDP in 2016 according to annualised monthly data (after −0.2 % in 2015) and is expected to deteriorate further. Taking into account the relative position of the French economy in the business cycle, the cyclically-adjusted current account deficit is worse than the headline indicator.

Cost competitiveness is improving without having fully regained past losses. The labour tax cuts and continued wage moderation have allowed a slowdown of labour costs, but low productivity growth is preventing cost competitiveness from recovering faster. In 2015, unit labour costs rose by 2.5 % over 3 years and 0.9 % once the Tax credit for competitiveness and employment (CICE) is taken into account, compared to 2.1 % in the rest of the euro area. Productivity picked up slightly in 2015 (rising by 0.8 %), but remained below both long-term trends and the euro area average. Part of the decline in productivity growth can be explained by the measures aimed at boosting employment growth, which often focused on low-qualified employment. However, potential growth has also declined since 2008.

Graph 3.2: **Real compensation per employee and productivity in France**



Source: Eurostat

Despite recent reforms, substantial improvements in non-cost competitiveness are still to materialise. Although France has improved its overall regulatory performance, its business environment continues to be middle-ranking. In the Doing Business survey (World Bank, 2017), France fell from 28th to the 29th position (out of 190 economies assessed), and ongoing reforms do not appear to be significantly improving business perceptions. Regulatory bottlenecks continue to affect firms' economic performance. As regards investment, equipment investment is slowly gaining ground supported by fiscal incentives for amortisation, but R&D investment continues to be concentrated in sectors of declining economic importance as measured by their share in total value added (motor vehicles, computers, electronics, and pharmaceuticals), which has implications for the long-term growth potential of the whole economy. Non-financial corporate profit

margins have somewhat recovered since 2013, in part due to the labour tax wedge cuts and to lower oil prices, but they remain below their pre-crisis level.

Some action has been taken to improve competitiveness. France has taken some measures to address the rigidity of the wage setting process through the labour law adopted in 2016, which provides for company-level majority agreements on working time. The impact of this law on the competitiveness of the French economy, however, will depend on its implementation and the extent to which the social dialogue at firm level will be able to transform the new legal possibilities granted by law into tangible action. Also, while no ad-hoc increase in the minimum wage has been adopted since 2012, no revision of its indexation mechanism has been undertaken and the French labour market remains both segmented and insufficiently linked with the vocational training system. As regards the business environment, competition has been improved in a number of services sectors, including legal professions, retail trade and passenger transport services. Some effort is also being made to simplify firms' administrative, fiscal and accounting rules through the multiannual simplification programme. However, the tax system remains a drag on competitiveness despite recent reforms. Corporate taxes are still high and France has abandoned the phase-out of the last tranche of the turnover tax (C3S), while the tax base on consumption remains narrow.

Public debt is projected to keep rising due to still high deficits. The general government debt-to-GDP ratio is expected to increase to 97 % of GDP in 2018, which implies growing divergence in indebtedness vis-à-vis the euro area due to a slower pace of deficit reduction than in the rest of the EU (see Sections 1 and 4). The budgetary strategy, which is to meet just the nominal headline deficit targets, basically relies on favourable macroeconomic conditions and interest rate windfalls. Such a strategy is risky as, on the one hand, it does not ensure durable correction of the excessive deficit and, on the other hand, there are significant consolidation needs in the coming years to bring down the public debt.

Spending dynamics prove hard to contain. Despite France's efforts to contain spending increases in recent years, the consolidation measures in the 2017 budget law have been scaled down compared to the plans included in the April 2016 stability programme. Overall, the current primary expenditure ratio, this is expenditure minus the interest burden and public investment, has continued increasing since 2012. While spending reviews identified a considerable amount of potential saving measures, the budgetary measures adopted as a result of the spending reviews have had a limited yield and have not contributed so far to significantly improve public spending efficiency. Furthermore, as demonstrated in last year's country report, in key areas of public policy, e.g. pensions and healthcare, France achieves good results but other Member States reach same or better outcomes at a lower cost. In turn, the tax burden is high, with the tax system remaining too complex and heavily reliant on production factors, which reins in growth.

High sustainability risks show up in the medium term mainly due to the high initial deficit and debt ratio. Despite the high debt ratio, short term sustainability risks are considered as low (see section 4.1). France is able to issue long-term debt at very low rates also bearing in mind the expansionary monetary policy stance of the ECB. However, the high initial deficit and debt and the projected increase in age-related expenditure over the next 15 years lead to a significant sustainability gap in the medium term.

Overall assessment

France faces important sources of imbalances related to a weak competitiveness and high and increasing public debt, in a context of low productivity growth. The substantial improvement in export performance in 2015 has proved short-lived. The current account, close to balance in 2015, is expected to deteriorate significantly in the coming years. Cost competitiveness is improving but has not regained past losses. Wage moderation continues, but the decline in productivity growth prevents a faster recovery of France's cost competitiveness. The product market reforms of the last years and continued efforts to reduce red tape on firms could contribute to an improvement of non-cost competitiveness but there is still substantial scope to increase market competition, simplify regulation, and reduce the tax burden for

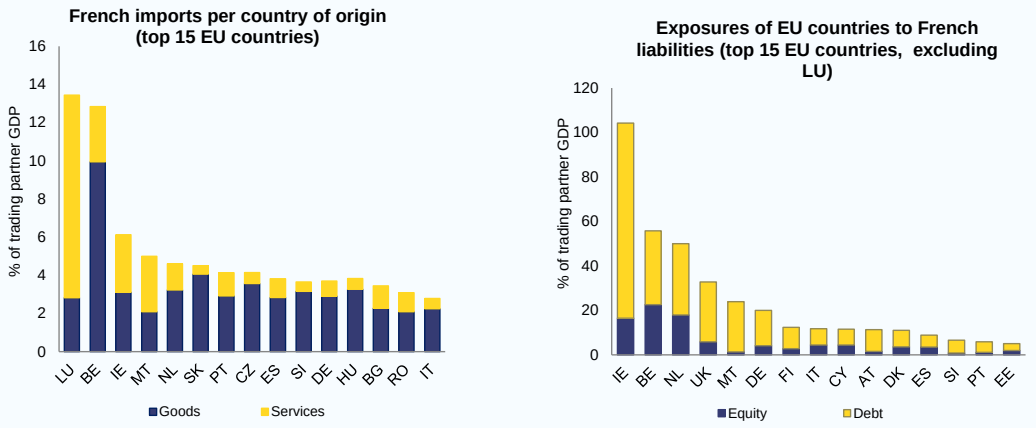
companies. Public debt remains high and increasing, which represents a major imbalance, as it weighs on growth prospects and reduces the fiscal space to offset adverse macroeconomic shocks. Public debt reduction is thus important to help improve overall French macroeconomic performance and avert medium-term sustainability risks.

Policy measures have been taken in recent years in particular to reduce the labour tax wedge. However, policy challenges remain, in particular as regards the regulatory impediments to firms' growth, the initial and continuous system of vocational training and the reform of the unemployment benefit system. In addition, the spending review has not delivered the expected results to address the growing public debt-to-GDP ratio.

Box 3.1: **Euro area spillovers**

The large size of the French economy and its strong trade and financial integration with the rest of the euro area, in particular with neighbouring countries, makes France a potentially important source of spillovers for several other Member States. France represents an important export destination and import partner for many EU countries. Exports to France account for almost 13 % of the GDPs of Belgium and Luxembourg, while in the case of Ireland, Malta, the Netherlands, Slovakia, Portugal and the Czech Republic the same indicator ranges between 4 % to 7 %. Trade integration with large euro area economies such as Germany, Spain and Italy is likewise significant (Graph 1, lhs). Financial linkages between France and the euro area are likewise strong (Graph 1, rhs). In 2014, Ireland, Belgium and the Netherlands had gross financial exposures to France via equity and debt instruments totalling 50 % or more of their respective GDP. The large economies of the UK, Italy and Germany also had large financial exposures to France in the range of 10 % to 30% of their GDP. Overall, the euro area shows total financial exposures to France worth more than 25% of GDP, mostly through the form of debt.

Graph 1: **Trade and financial linkages between France and other EU countries**



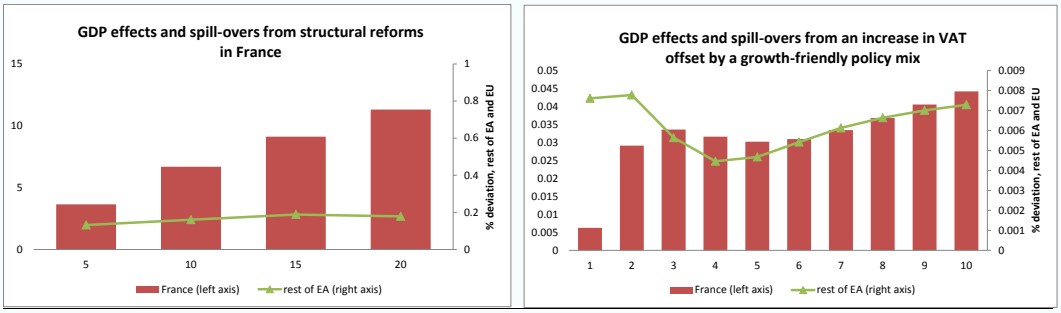
(1) Data for goods correspond to 2014. Data for services correspond to 2012. Data for financial exposures are European Commission 2014 bilateral data covering all economic sector, based on correspond to 2014 based on Hobza and Zeugner (2014).
Source: United Nations (lhs), Hobza and Zeugner (2014) (rhs).

Structural reforms in France can have positive cross-border economic effects. Model simulations suggest that product and labour market reforms in France can have important domestic and cross-border macroeconomic effects by boosting productivity and employment. By bridging half of the gap with the three best EU performers in these reform areas, France can raise GDP by 3.7% after 5 years, and by 6.7% after 10 years based on the Commission's QUEST model. At the same time, spillovers to the rest of the euro area would be positive, even in the short run. GDP in the rest of the euro area would increase by 0.1% relative to the baseline after 5 years and by 0.2% after 10 years. The simulated structural reforms focused on decreasing mark-ups and entry barriers in services and manufacturing, increasing the labour market participation rate for the elderly, the low-skilled and female workers, raising the share of medium- and high-skilled labour force, tax and unemployment benefit reforms, active labour market policies and innovation subsidies. (Varga and in 't Veld, 2014). This positive effect would remain in the long run (Graph 1, lhs).

(Continued on the next page)

Box (continued)

Graph 2: **Macroeconomic effects of structural reforms in France**



(1) Left-hand side simulations are based on Varga and in't Veld (2014), percentage deviations from baseline
Source: European Commission

A growth-friendly tax shift as discussed in Section 4, can also yield positive effects for both France and the rest of the euro area. Graph 2 (rhs) shows the effects on GDP of a tax shift whereby an increase in VAT worth 0.4% of GDP is fully offset by an equivalent reduction in social security contributions and corporate income taxes, as well as an increase in transfers to liquidity-constrained households. The weights on the three offsetting components are 71%, 25% and 4% respectively, in line with the simulations shown in Box 4.1.1. While in absolute terms the effects are overall small owing to the small size of the shock, euro area spill-overs are positive and felt immediately on the first year of the reform. In relative terms, spill-over effects to the rest of the euro area can represent close to one fifth of the domestic effect when measured in terms of the GDP of the respective geographical areas. More generally, addressing existing economic and fiscal challenges in France would not only benefit the domestic economy but also feed into the euro area confidence cycle and provide a stimulus to the fragile and slowing-recovering euro area economy. Conversely, France's economic prospects largely depend on developments in its main trade and financial partners in the euro area, which underlines the need for coordinated policy action and rebalancing efforts at euro area level.

Table 3.1: **MIP Assessment Matrix (*) – France 2017**

	Gravity of the challenge	Evolution and prospects	Policy response
	Imbalances (unsustainable trends, vulnerabilities and associated risks)		
Competitiveness	Since 1999, France lost export market shares by 36.8 %. External sustainability is not a concern for France in the near term as its NIIP remains contained at −16 % of GDP (after −17 % in 2014). Cost competitiveness is improving but has not yet regained past losses (see Section 4.4). Over the past ten years, ULC increased at a slightly higher pace in France relative to other EA countries. The structural decline in productivity growth reinforces the challenges associated with a weak competitiveness. The low profitability of non-financial corporations also weighs on non-cost competitiveness, through its impact on the quality of investment.	Similarly to other EU economies, export market shares have stabilised in recent years (+1.5 % from 2012 to 2015 in cumulated terms). Export performance improved substantially in 2015, but this improvement has proved short-lived in 2016 (see Section 4.4). The current account, close to balance in 2015 (−0.2 % of GDP), is expected to deteriorate significantly over the coming years. Annual ULC growth has kept decelerating since 2012 thanks to labour tax cuts and continued wage moderation (see Section 4.4). In 2015, the depreciation of the euro, combined with subdued HICP inflation developments, led to a renewed decrease of the REER headline indicator. While labour productivity picked up in 2015 (+0.8 %), it remained below both long-term trends and the euro area average, preventing a faster recovery of France's cost competitiveness (see Section 4.4). Despite a recent increase, the corporate profit share of the French non-financial companies remains below its pre-crisis level.	The French authorities implemented the CICE and the Responsibility and Solidarity Pact (RSP). Both measures should lower labour taxes by EUR 30 bn by 2017 and corporate taxes by EUR 10 bn. Studies using firm-level data for the period 2013-2014 found a positive effect of the CICE on profit margins and employment, while an impact on investment, R&D and exports is expected to materialise over the medium-term (see Section 2 and Section 4.3). The CICE transformation in permanent reductions in employers' social security contributions is announced for 2018, while its rate applicable on the 2017 payroll with budgetary implications in 2018 has been extended from 6 % to7 %. France has taken some measures to address the rigidity of the wage setting process, notably through the El Khomri law adopted in 2016. The impact of this law on the competitiveness of the French economy, however, will depend on its implementation and if the social dialogue within firms will be able to transform into concrete actions the new legal possibilities granted by the El Khomri law (see Section 2 and Section 4.3). While no ad-hoc increase in the minimum wage has been adopted since 2012, no revision of its indexation mechanism has been undertaken (see Section 2).

(Continued on the next page)

Table (continued)

Public debt	Already at a very high level, government debt continued to increase to 96.2 % of GDP in 2015. Such a high debt level and its upward trend constitute a vulnerability for the economy and reduce the fiscal space available to respond to future shocks. The high public debt also weighs on growth prospects by crowding out productive public expenditure and requiring a higher tax burden. Potential growth is estimated at 0.9 % in 2015 while inflation is also low. Low nominal growth makes it also more difficult for France to bring down its public debt. Although the financial sector does not face immediate risks, pressures from the combination of a high public and private debt may increase in the future under adverse economic conditions. The government has used low government bond yields to lengthen the maturity of sovereign bonds by around 5 months, which is a mild mitigating factor for refinancing problems. The widely diversified French debt investor base in terms of type of investors as well as geographically could also be a mitigating factor.	Public debt is projected to increase to 97.0 % by 2018. The structure of public debt financing, both in terms of maturity and diversification, does not give rise to short-term risks. France is able to issue long-term debt at very low rates. However, in a somewhat longer perspective, debt dynamics between France and the rest of the euro area are diverging, mainly due to the higher French primary deficit. The debt trajectory and the sustainability gap at horizon 2031 point to high indebtedness risks in the medium term. The Commission 2017 winter forecast projects the headline deficit target to be met in 2016. For 2017, the Commission projects a headline deficit of 2.9 % of GDP. While slightly below the 3 % reference value in the Treaty, this is 0.2 pp. higher than planned by the French authorities and 0.1 pp. higher than the deficit target recommended by the Council.	The budgetary strategy envisaged by France is risky. It relies mainly on cyclical factors and lower interests payments on government debt. Therefore, the projected structural efforts for 2016 and 2017 fall clearly short of the recommended effort set by the Council. Moreover, not all measures are sufficiently specified resulting in a higher Commission deficit forecast for 2017. Expenditure-based consolidation has seen a setback in the course of 2016 and expenditure trends could rise again in the future showing the limit of the across-the-board spending cuts and expenditure containments based on norms.

Conclusions from IDR analysis

- France is characterised by a weak competitiveness and a high and increasing public debt, in a context of low productivity growth. Associated vulnerabilities have cross-border relevance.
- The substantial improvement in export performance in 2015 has proved short-lived and the current account, close to balance in 2015, is expected to deteriorate significantly over the coming years. Cost competitiveness is improving but has not yet regained past losses. Wage moderation continues, but the decline in productivity growth prevents a faster recovery of France's cost competitiveness. Non-financial corporate profit margins have somewhat recovered since 2013, but remain below their pre-crisis level, weighing on non-cost competitiveness. Besides, public debt is projected to reach 97.0 % of GDP in 2018. The spending reviews have not contributed so far to significantly improve public spending efficiency, necessary to alleviate the tax burden and improve the efficiency of the rest of the economy.
- Policy measures have been taken in recent years, in particular to reduce the labour tax wedge. However, policy challenges remain, in particular as regards the regulatory impediments to firms' growth, the initial and continuous system of vocational training and the reform of the unemployment benefit system. In addition, the spending review has not delivered the expected results to address the growing public debt-to-GDP ratio.

(*) The first column summarises "gravity" issues which aim at providing an order of magnitude of the level of imbalances. The second column reports findings concerning the "evolution and prospects" of imbalances. The third column reports recent and planned relevant measures. Findings are reported for each source of imbalance and adjustment issue. The final three paragraphs of the matrix summarise the overall challenges, in terms of their gravity, developments and prospects, policy response.
Source: European Commission

4. REFORM PRIORITIES

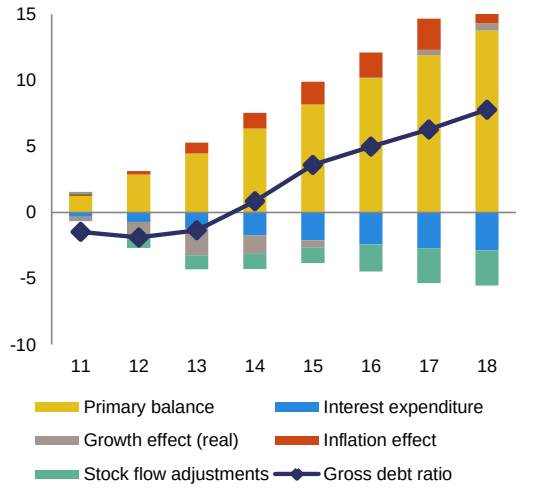
4.1. PUBLIC FINANCES AND TAXATION

General government debt sustainability ([12])*

Debt dynamics between France and the rest of the euro area continue to diverge although the increase in French debt is slowing. The Commission 2017 winter forecast puts the general government debt in France at about 8 pp above the euro area level. The higher general government deficit in France explains most of this difference, although real economic growth, interest expenditure and stock-flow adjustments have partly compensated for the higher primary deficits in recent years (Graph 4.1.1). The lower interest expenditure has contributed significantly to reducing the deficit and debt since 2011 and this is expected to continue over 2016 and 2017. However, the declining interest rate burden is expected to come to a halt once interest rates and inflation normalize. Therefore, without further consolidation and sustained growth, the reduction in the public debt-to-GDP ratio is not guaranteed and debt dynamics between France and the euro area will continue to diverge.

The high public debt ratio does not seem to pose significant sustainability challenges in the short term. The short-term sustainability indicator S0 ([13]) does not flag any significant risk overall, although the short-term fiscal sub-index flags high risk due to the high level of gross financing needs, of the primary deficit and of public debt. In spite of the weaknesses revealed by the fiscal sub-index of the S0 indicator, the rating outlook for French government debt is AA stable for the three major rating agencies.

Graph 4.1.1: **Difference in debt dynamics between France and the euro area**



Source: European Commission, 2017 winter forecast

Sound debt management strategies reduce the short term risks. All French debt is denominated in euro so there is no currency risk. Moreover, the average maturity of debt instruments has increased to nearly 7.5 years, reflecting longer issuance maturities, which allows securing low interest rates over the coming years. While the share of short-term debt has declined, it remains relatively high (8.3 % of total). The investor base is diverse and broadly equally distributed between residents, the euro area and the rest of the world. While holdings by foreign investors have slightly declined to 60 % of total French debt, the high share held by non-residents could be a source of vulnerability. However, investor appetite is still high. Traditional investors in search of higher yields have turned to riskier investments, but are expected to readjust their holdings once interest rates increase. French debt is a sought-after investment for capital and liquidity requirements reasons and diversification purposes, as it offers the possibility of holding nominal and inflation linked bonds issued in euros.

However, France's public debt faces high sustainability risks in the medium term. The debt sustainability analysis for France shows that in the baseline scenario assuming no policy change public debt would be roughly stable at some 97 % of GDP until 2021. However, it would begin to

([12]) This section is based on the 2015 Ageing Report (European Commission, 2015a) and the Debt Sustainability Monitor 2016 (European Commission, 2017a).

* An asterisk indicates that the analysis in the section contributes to the in-depth review under the MIP (see section 3 for an overall summary of main findings).

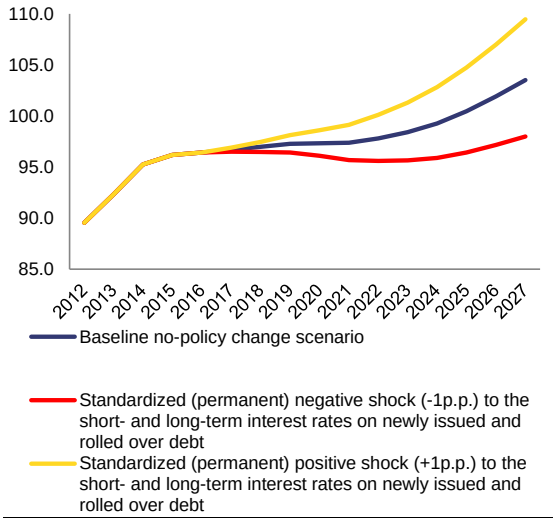
([13]) S0 is a composite indicator aimed at evaluating the extent to which there might be a fiscal stress risk in the upcoming year, stemming from the fiscal, as well as the macro-financial and competitiveness sides of the economy. A set of 25 fiscal and financial-competitiveness variables proven to perform well in detecting fiscal stress in the past is used to construct the indicator. Countries are deemed to face potential high short-term risks of fiscal stress, whenever S0 is above an estimated critical threshold.

rise again thereafter, to reach 103.5 % of GDP in 2027, the last projection year. This public debt shows that the fiscal effort is insufficient to offset the increasing costs of an ageing population and the unfavourable snow-ball effect, mainly due to the rising interest rate burden. Based on these projections, the S1 sustainability indicator, which measures sustainability risks at horizon 2031, flags a high medium-term risk. This indicator implies that a cumulative gradual improvement in the French structural primary balance of 4.7 pps. of GDP, relative to the baseline scenario, would be required over 5 years to reduce the debt ratio to 60 % of GDP by 2031.

The high medium-term sustainability risks are primarily due to high initial indebtedness and unfavourable initial budgetary position. Specifically, 2.8 pps. of the required fiscal adjustment would be due to debt ratio's distance from the 60 % reference value, 1.5 pps. to the unfavourable initial budgetary position (defined as the gap to the debt-stabilising primary balance) and the remaining 0.3 pps. to the projected increase in age-related public spending. Public debt projections are especially sensitive to interest rate developments: a 1 pp. increase in the interest rate of newly issued bonds and rolled-over debt, other things being equal, would lead to a 6-point increase in the public debt-to-GDP ratio (around EUR 190 bn.) compared to the baseline projection by 2027 (Graph 4.1.2), thereby aggravating the sustainability gap significantly.

Despite medium-term challenges, sustainability risks appear contained in the long run. The S2 indicator, which measures sustainability risks at an infinite horizon, calculated under a baseline no-fiscal policy change scenario, indeed points to a relatively small required fiscal adjustment (0.8 pp. of GDP), to ensure that the debt ratio remains on a sustainable path over the long run horizon. This is primarily due to the projected fall in age-related spending from the late 2030s (contribution of -1.0 pp. of GDP to S2), offset by the unfavourable initial budgetary position (1.8 pp. of GDP). It is the projected decrease of public pension expenditure, in particular, that drives down ageing costs (- 1.7 pp. of GDP), given the reforms implemented in this area in the past. However, the adjustment implied by the S2 indicator could lead to debt stabilising at relatively high levels. Consequently, the indicator has to be treated with caution for high-debt countries in relation to the SGP requirements. Moreover, long-term risks could arise under more adverse scenarios, such as in the lower total factor productivity growth scenario for pension expenditures, or the Ageing Working Group risk scenario for healthcare and long-term care expenditures.

Graph 4.1.2: **Public debt projections of French public debt under different scenarios**



Source: European Commission, Debt Sustainability Monitor 2016.

Favourable demographic dynamics and past reforms mean that pension expenditure is projected to decline in the long run. Pension spending in France is among the highest in the EU, at 14.9 % of GDP versus 11.3 % in the EU in 2013, and so is the benefit ratio, 51.3 % in France versus 46.9 % in the EU, defined as the average pension as a share of the economy-wide average wage. Pension expenditures are projected to remain broadly constant at a high level in the medium-term and to decline only in the long term. A relatively moderate increase in the old-age dependency ratio (by 14.9 pps.) represents a relatively favourable demographic trend compared to other EU countries that allows containing pressure on pension expenditure. The average effective exit age from the labour market (61 in 2014), which is low in a EU perspective, is also projected to increase progressively to 63 in 2060 as a result of recent reforms described in the 2016 Country Report (European Commission, 2016c). However, the savings envisaged from the foreseen increase in the retirement age might be partly offset by rises in other types of public expenditure,

such as invalidity or unemployment-related expenditure in the short term. Despite the favourable long-term financial prospects of the French public pension system, some special regimes that allow early retirement continue to weigh negatively on the balance of the pension system.

Quality of fiscal consolidation*

Given the already high revenue ratio, the government adopted an expenditure based consolidation strategy. Between 2012 and 2017, the deficit is projected to decline from 4.8 % to 2.9 % of GDP according to the Commission 2017 winter forecast (*ibid.*). Over the same period, the revenue ratio is projected to increase by 1.3 % of GDP to 53.3 % of GDP. This ratio is forecast to be 8.5 % of GDP higher than the EU average in 2017, with the high tax burden weighing on economic activity (see the taxation sub-section, below). The expenditure-to-GDP ratio is set to decline by 0.6 pp over 2012-2017, helped by lower interest rates (Graph 4.1.3). A quarter of the planned deficit reduction would thus be due to changes in expenditure, in particular from the reorientation towards an expenditure-based consolidation strategy since the budget 2015. However, at 56.2 % of GDP in 2017, the expenditure ratio would remain 9.7 % of GDP higher than in the EU.

The largest contributor to the decline in the expenditure ratio is the interest burden (-0.8 pp over 2012-2017), with broadly neutral effects on economic activity. Interest rates are projected to increase somewhat in the short term but remain low by historical standards. However, the low interest rate environment is not expected to prevail in the medium term. For example, in the ageing projections, the interest burden is projected to gradually rise from 1.8 % of GDP in 2017 to 3 % of GDP by 2025.

Expenditure growth was also contained by a reduction in public investment. The second largest contributor to the fall in public expenditure is public investment which declined by 0.6 % of GDP over the same period. Public investment cuts typically have a stronger negative effect on economic activity than cuts in other expenditure items, with a multiplier for public investment of 2.5 points in the long run. However, the economic impact of the decline in public investment has likely been less strong than suggested by the normal multipliers ([14]). Public investment was mainly cut by local authorities, who are responsible for more than 50 % of total public investment, and has mainly affected the least efficient projects, thereby leaving the existing public capital stock unaffected. Local investment displays a clear cyclical pattern linked to the local electoral cycle, but this time round the cycle seems to have been amplified by the cut in the global State transfers to local authorities of 0.5 % of GDP since 2014. Nonetheless, while in a first phase the cut in global dotations has impacted investment. Since recently, operational expenditure of local authorities started declining from a growth rate of 3.0 % in 2013 to 0.9 % in 2015.

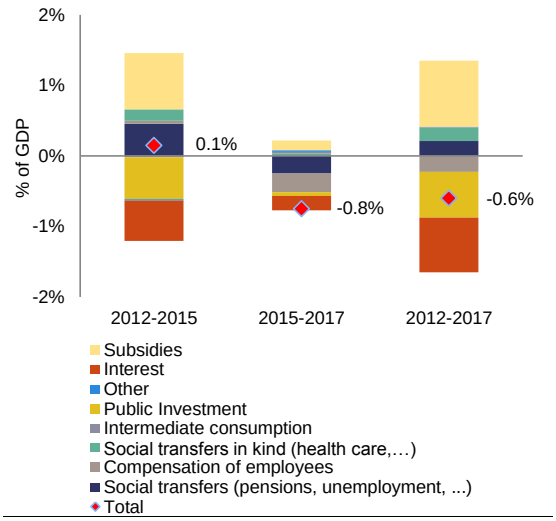
Primary current expenditure increased due to a strong increase in subsidies. The primary current expenditure ratio is projected to increase from 49.0% of GDP in 2012 to 50.1% of GDP in 2017. This increase in the expenditure ratio once the interest burden and capital expenditure is filtered out, puts into question to durability of the expenditure containment strategy. One important driver of spending has been an increase in subsidies, due to the introduction of the *crédit d'impôt pour la compétitivité et l'emploi* (CICE), which is a tax credit on the salary mass of firms introduced in 2014, focused on the lower end of the wage scale. The effect of the increase in subsidies on economic activity is closer to a targeted cut in social contributions, which is a relatively efficient way of strengthening economic activity as opposed to other types of subsidies.

The spending reviews were scaled back in 2016. In place since 2015, the spending reviews identified a fraction - less than 2 % - of the overall planned expenditure savings of EUR 50 billion over the period 2015-2017. Based on the first wave of reviews, savings with a total yield of EUR 325 million were included in the 2016 budget. The second review exercise took place in 2016, but the proposals in the draft budget 2017 relied on measures identified already in the 2015 spending review exercise. The planned savings would yield EUR 400 million. In general, it appears that only a

([14]) IMF (2014) World Economic Outlook, October 2014. For a more in-depth discussion, see Cour des Comptes (2015) *La situation et les perspectives des finances publiques*, Juin 2015.

subset of the savings identified in the spending reviews appear in the budget. This is partly because more than 50 % of the spending reviewed in 2016 concerned local authorities, and they are autonomous in managing their budgets. In general no mechanism exists to ensure that the different administrations act on the recommendations of the spending reviews.

Graph 4.1.3: **Changes in the composition of public expenditure**



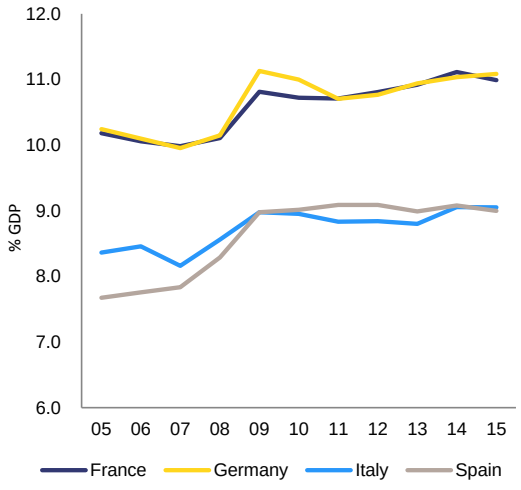
Source: Ameco database, European Commission

Efficiency and effectiveness of the health system ([15])*

The French health system performs well in a European perspective. The population enjoys high life expectancy at birth (82.3 years in 2015, one of the highest in the EU). The healthcare system performs well in terms of overall accessibility as it is characterised by fee-for-service payment of doctors, unrestricted freedom of choice for patients and a traditional focus on hospital based care.

However, healthcare spending is relatively high in a European perspective. French health expenditure was at 11 % of GDP in 2015 which is similar to the level of expenditure in Germany (Graph 4.1.4). In the long run, the increase in health care expenditure is expected to be relatively contained in comparison to other EU Member States although health care expenditure would remain one of the highest in the EU. In the light of cost pressures, an ageing population and the increased prevalence of chronic diseases, a more coordinated use of care is being encouraged. In other countries, but to some extent also in France, this is done through greater use of primary care and more effective referrals from family doctors to steer demand to other types of care and organise appropriate and cost-effective channels of treatment.

Graph 4.1.4: **Healthcare expenditure as a share of GDP in selected countries (2005-2015)**



Source: OECD Health statistics 2016

A range of reforms has been implemented in recent years to keep health care expenditure under control. Key reforms included improvements in access to health insurance for those most vulnerable, improvements in hospital efficiency, better data collection and monitoring and better control of pharmaceutical expenditure, greater use of primary care and improvements in care coordination from primary to secondary care. In tandem with the reforms, the enforcement of the healthcare expenditure norm, the ONDAM (*Objectif National de Dépenses d'Assurance Maladie)*, has allowed for a contained growth of health expenditure in recent years.

Low spending on prevention could weigh on the overall efficiency and effectiveness of the French health system. France spends 1.9% of total health resources on prevention, versus

([15]) This section is largely based on Commission services and Economic Policy Committee, Joint Report on Health Care and Long-Term Care Systems & Fiscal Sustainability (2016).

average spending on prevention of 3% in the EU. Low spending on prevention can lead to higher healthcare costs in the longer run, certainly as it is accompanied by low vaccination levels for certain preventable diseases and comparatively high prevalence of risky behaviour such as alcohol and tobacco consumption.

Fiscal frameworks*

The fiscal framework has been strengthened in the last few years, although weaknesses still remain. Since the founding in 2012, the High Council of Public Finances (HCFP) ([16]), the systematic positive bias in the macroeconomic forecasts underpinning the draft budgets has disappeared. In September 2016, the HCFP issued a more critical opinion than in previous years on the macroeconomic scenario underpinning the 2017 draft budgetary plan (Haut Conseil des Finances Publiques, 2016). There is no formal mechanism in place to reconcile divergent views between the HCPF and the Ministry of Finance, and in the that case, the Ministry of Finance did not adjust the macroeconomic scenario underpinning the 2017 DBP following the HCFP's opinion .

Although the expenditure norms are an effective means to control expenditure, they are becoming more difficult to meet. The norms are becoming more ambitious every year as expenditure growth rates for the respective spending categories decrease. At the same time, new spending announcements are projected to increase spending on a permanent basis, whereas the savings allowing the norms to be met are across-the-board spending cuts. Consequently, in 2017 the ceilings for the norms had to be raised for State and health expenditure. All these developments point to the limits of the existing rules, as they become harder to obey without taking structural measures. Furthermore, the cut in transfers from the State to local authorities has been reduced, leading to an upward revision of the indicative spending norm for local authorities (ODEDEL). At the same time, no correction mechanism or alert committee exists to oversee the ODEDEL and prevent local expenditure overruns. Finally, the ONDAM and the norm of the state cover about half of public expenditure.

([16]) Created as an independent fiscal body by the organic law of 17 December 2012

Taxation*

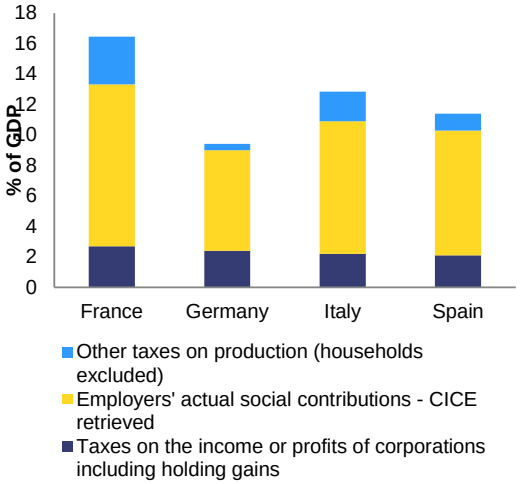
The tax wedge on labour has fallen substantially at the lower end of income distribution, but remains high at the average wage. Between 2012 and 2015, the tax wedge was reduced by around 1 ppt. at the average wage and by more than 3 pps. for workers earning 50% of the average wage. This change in trend is mainly due to the introduction of the CICE and the RSP. The tax wedge for very low income earners (50% of the average wage), at 31.6%, was below the EU average of 32.7% in 2015. For income earners at the average wage, the tax wedge, at 48.7%, remained above the EU average of 40.7% and one of the highest in the EU, which may undermine the functioning of the labour market.

Although employers' social security contributions are falling, they are still relatively high. At the average wage, France has the highest employers' social security contributions in the EU as a share of total labour costs paid by the employer, which explains the relatively high tax wedge. This partly stems from the social security system being financed through employer's contributions, which is only partially the case in other countries. High employers' social security contributions are also conducive to a large tax burden on companies.

The high level of taxes weighing on companies represents an obstacle to private investment and hampers companies' growth (European Commission, 2016e). The effective average corporate tax rate was the highest in the EU in 2016 (38.4 %) (ZEW, 2016). French corporate income tax combines a high nominal rate (38 % in 2014 including the surcharge, the highest in the EU), and relatively little revenue as a share of GDP (2.7 % of GDP in 2014, against 2.4% in the EU, for a nominal rate of 22.9% for the same year**)** because of generous tax credits and relatively low profit margins. Finally, the debt-equity tax bias in corporate financing remains the highest in the EU in 2016. Due to a less favourable tax treatment, investments financed by equity need to earn 5 percentage points more in return than investments financed by debt to yield the same after-tax return (ZEW, 2016).

Other taxes on production ([17]) are particularly high (Graph 4.1.5). They stood at 3.1 % of GDP in 2015 ([18]), above Italy (2.0%), Spain (1.1%) or Germany (0.4%), although it is generally accepted that such taxes are particularly distortive since they disregard the economic performance of the firm and directly affect profit margins. These taxes have not been curbed by recent policy measures and have continued to increase in GDP terms since 2011, in spite of the phase-out of part of the turnover tax (C3S). Local-level taxes account for roughly two thirds of such taxes and have been increasing as a share of GDP since the reform of local government taxation. However, this increase in tax revenue has stemmed mainly from a base effect in recent years (Cour des Comptes, 2016b).

Graph 4.1.5: **Composition of total taxes on companies, 2015**



Source: National Tax Lists 2016 and AMECO

Capital taxation in France is high compared to other Member States and favours "lower-risk" products investments like housing and deposits over "riskier" investments like shares. At 10.5 % in 2014, France's ratio of taxes on capital-to-GDP was the third highest in the EU, above the EU average (8.2 %). The overall tax burden on capital increased by 1.3 pp. between 2010 and 2013, then stabilised in 2014. Furthermore, capital taxation favours investment in housing and life insurance. A reduced rate of 7.5 % applies to life insurance products and implicit rents on the main property are taxed according to rental values which have not been updated since the 1970s, while real estate capital gains are not taxed. By contrast, capital gains on securities are taxed according to the progressive personal income tax regime. Furthermore, specific tax regimes such as the full exemption of savings products (e.g. *Livret A*), the deductibility of interest from the corporate income tax basis or the capital gain tax create a relative distortion between fixed-income instruments (and especially deposits) and shares. Such distortions negatively affect growth, investment and financial stability. To counterbalance some of these discrepancies, the tax system also includes a high number of tax rebates and specific schemes to encourage investment in innovation, SMEs and start-ups; one more has been introduced by the 2017 finance law.

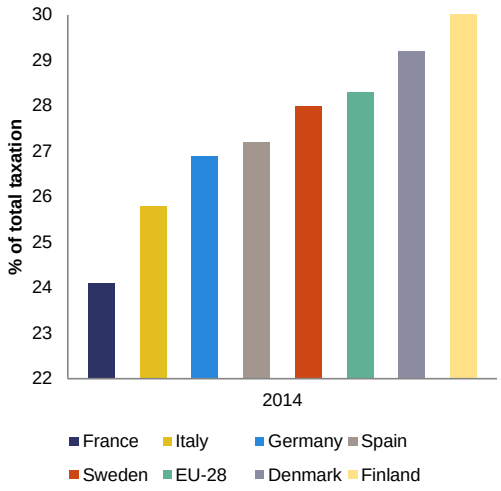
The relative complexity of the tax system is a barrier to a well-functioning business environment. France has a high tax burden coupled with many tax breaks, reduced rates and various tax schemes to address specific objectives. It results in detailed rules and derogations that may increase compliance costs and may create uncertainties (France Stratégie, 2016b; Michel Taly, 2016). Total tax expenditure is sizeable in France at more than 3 % of GDP (CICE excluded). Indicators commonly used to measure the complexity level of a tax system show a contrasting picture for France. In 2015, the country scored well in terms of the number of hours needed to comply with taxes (World Bank, 2016). However, the administrative cost to tax authorities of collecting taxes, as a percentage of tax collected, was above the EU average in 2013 (latest data available) (OECD, 2015b). Looking at trends, tax complexity has increased in recent years. The General Tax Code (*Code général des impôts*) expanded by 61 % (in number of pages) between 2002 and 2015 (Cour des Comptes, 2016c).

The burden of taxation continues to fall less on consumption than it does in other EU countries. In 2014, France ranked 27th in the EU in terms of tax revenues from consumption as a percentage of total taxation (24.1 %) below neighbouring countries such as Germany, Italy, or Spain, and the Nordic countries (Graph 4.1.7).

([17]) Other taxes on production include more than 40 taxes mainly on capital and on labour.
([18]) This figure excludes producer households.

The VAT system is characterised by middle-ranking standard rate and low reduced rates applied to a large base. France applies a standard rate (20 %) which is middle-ranking as compared with neighbouring countries (above Luxemburg (17 %) and Germany (19 %), but below Belgium (21 %), Italy (21 %) and Spain (21 %)), but relatively low reduced rates – the 5.5 % reduced rate is lower than that of neighbouring countries. In addition, reduced rates are applied to a large base, (European Commission, 2016c). In 2014, the revenue foregone from applying reduced rates represented 10 % of the theoretical total VAT liability which would have resulted from a perfectly flat system, above the 5.3 % EU average (CASE, 2016). Furthermore, VAT compliance is worsening (CASE, 2016).

Graph 4.1.6: **Taxes on consumption as percentage of total taxation in 2014**



Source: Taxation Trends in the European Union 2016

In terms of environmental taxation. recent tax increases have not yet closed the gap with the EU average. Revenues from environmental taxes steadily increased from 2009 onwards to reach 2.1% of GDP in 2014 (ranking 23rd in the EU), the level that it had back in 2004. This remains below the EU-28 average (2.5%), and, as a percentage of total taxation (4.5%), France ranked 28th in the EU in 2014. Environmental taxation is set to continue to rise as the carbon tax will increase significantly until 2030. In addition, excise duties on diesel have increased in 2017 (by 0.01 EUR per litre) while they have decreased on petrol by the same amount. As a result the taxation gap between diesel and petrol is closing but still remains.

Box 4.1.1: **Effects of a tax shift from taxes on production factors to indirect taxes**

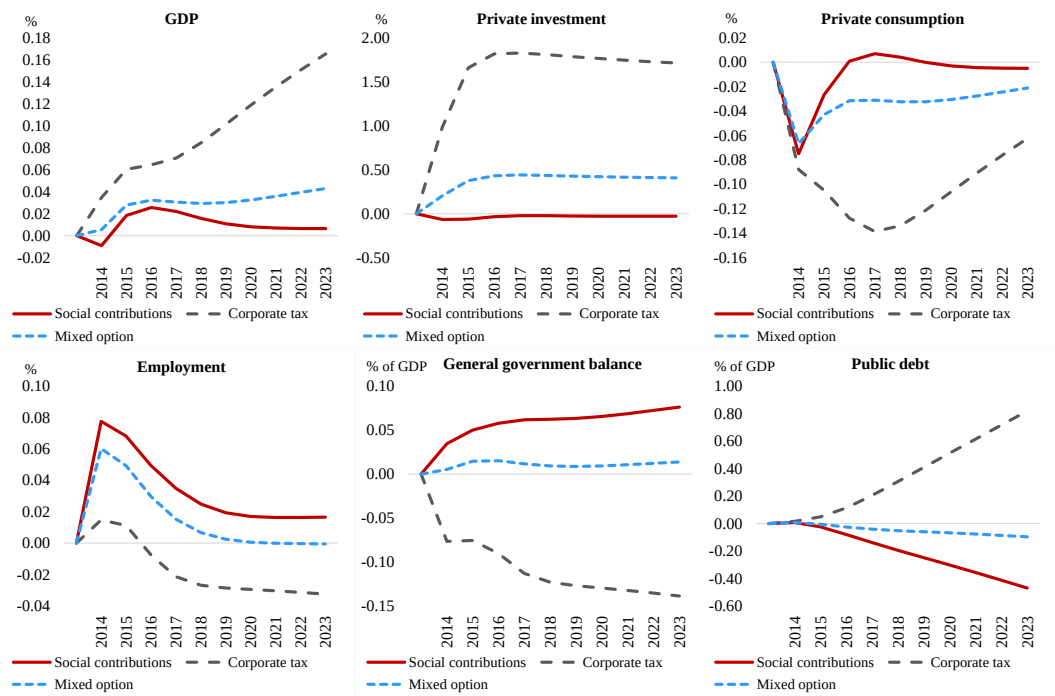
The Council recommended France to reduce taxes on companies while broadening the tax base on consumption, in particular as regards VAT. This box simulates a 0.5 point increase in the implicit VAT rate (that would yield additional revenues of 0.4 % of GDP) using the DG ECFIN's DSGE model QUEST III (Ratto *et al*., 2009), assuming that these additional revenues (excluding second-round and behavioural effects) are used to finance three policy alternatives and that VAT compliance is constant. According to the calculation performed by the Joint Research Centre using the EUROMOD model, an equivalent VAT reform has a negligible impact on tax incidence.

If the VAT increase is used to finance a reduction in social security contributions borne by entrepreneurs, a short-term negative response by private investment and consumption is observed, the latter eventually offset by an increase in employment and real wages. This tax shift brings about a long-lasting increase in GDP and a reduction in the general government deficit (Graph 1).

If the VAT increase is used to finance an equivalent reduction in corporate income tax, GDP also rises, driven by higher private investment. By contrast, private consumption and employment decline with respect to the baseline. The general government balance deteriorates persistently due to the increase in public transfers indexed to inflation.

A mixed policy option could consist of using the additional VAT revenues to finance cuts in social security contributions (by 71 % of the additional VAT revenues) and corporate income tax rates (by 25 %), while devoting the rest to raising social transfers targeted to financially-constrained consumers. In that case, persistent GDP and employment increases are observed, jointly with permanent fiscal consolidation and public-debt reduction.

Graph 1: **Impulse responses to an increase in VAT offset by three policy alternatives**



Source: European Commission

4.2. FINANCIAL SECTOR

The French banking sector seems relatively sound. Domestic banks represent more than 90 % of the French banking sectors total assets. The four largest French banking institutions are considered of global systemic importance by the Financial Stability Board. Overall, French banks appear somewhat more profitable than their counterparts in the euro area, with a return on equity which amounted to 6.8 % in 2015 compared to 4.4 % on average in the euro area. French banks rely more than their peers in the euro area on non-interest rate income given the importance of investment banking activities. They also benefit from relatively low impairments. Moreover, French banks are able to re-price liabilities more easily to lower interest rates than their euro area peers whereas asset repricing is occurring more slowly than in the rest of the euro area (see Box 1.3 in IMF 2016) implying that margins have suffered less than for euro area peers from the low interest rate environment. With a Tier 1 ratio of 13.8 %, the capitalisation of French banks appears broadly in line with that of their euro-area counterparts (14.2 %) and slowly improving over time. Their loan portfolio is less risky, with non-performing loans representing a stable 3.5 % of the total portfolio in Q1-2016 (vs. 5.6 % in the euro area). Substantial progress has been made over the last year in terms of stable funding, with a loan-to-deposit ratio close to 102.7 % in 2015. Lower dependence on short-term wholesale funding is an asset when interbank markets experience difficulties.

In an environment of low net interest income across the euro area, banks' profitability is under pressure from a structurally high cost-to-income ratio. The interest rates set by the government on regulated savings instruments like the Livret A or the "*Plan Epargne Logement*" appear relatively high and squeeze banks' interest margins. This is especially true for the latter, where the interest rate is fixed for the whole term of the contract and currently stands at 2.5 % for the existing stock of "*Plan Epargne Logement*". The overall impact on banks' profitability is however limited as deposits make up a relatively small share of total liabilities (see above). In order to address their high cost-to-income ratio, one of the highest in the EU, banks are expected to continue investing in digitalisation and to close branches, although no massive lay-offs seem to be planned in the short-term.

There has been some correction in house prices since 2011. Housing prices fell by 9 % between their peak in the third quarter of 2011 and the first

Table 4.2.1: **Financial soundness indicators, all banks in France**

(%)	2010	2011	2012	2013	2014	2015
Non-performing loans	4.5	4.6	4.5	4.6	3.6	3.5
Coverage ratio	40.8	43.8	42.0	48.7	61.1	60.9
Loan to deposit ratio*	118.0	113.4	111.2	107.8	106.7	102.7
Tier 1 ratio	10.8	10.9	13.3	13.2	13.1	13.8
Return on equity	8.3	5.6	3.4	6.0	4.4	6.8
Return on assets	0.4	0.3	0.2	0.3	0.2	0.4

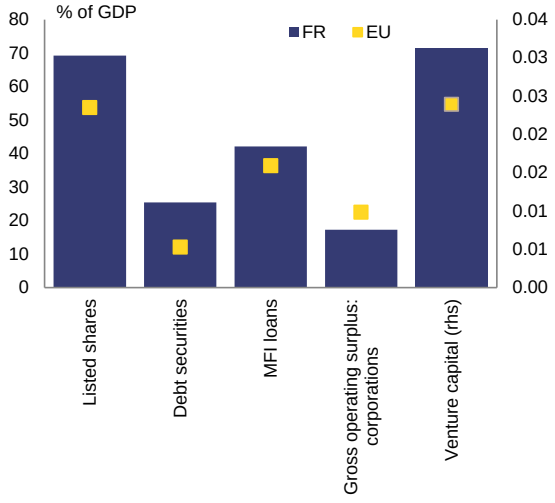
(*) ECB aggregated balance sheet: loans excl to gov and MFI / deposits excl from gov and MFI
Source: ECB CBD

quarter of 2016, although prices stabilised in recent quarters. The correction observed since 2011 has led to some correction in house prices with respect to fundamentals. However, valuation metrics continue to signal some risk of overvaluation. Compared to the historical trends, price-to-rent and price-to-income ratios suggest an overvaluation of more than 20 %. Based on rental prices per square meter, French house prices do not seem overvalued compared to other euro area markets (see Dujardin et al., 2015). Moreover, another metric based on the relationship between house price, total population, housing investment, real disposable income per capita and the real long-term interest rate suggests an overvaluation of only 3 %. The latter metric is more strongly linked to supply and demand fundamentals and confirms the qualitative analysis also made in the 2015 Country Report (European Commission, 2015c). More specifically, structurally strong demand supported by positive demographic trends and the absence of excess housing supply together with prudent credit supply by banking institutions suggest that downward price pressure is limited and further downward adjustment, if any, will be very gradual.

Mitigation measures exist to contain the impact of house price developments on the financial sector. The decline in house prices since 2011 led to a moderate rise of the loan-to-value ratio to 85 % for new loans and to 68 % for the existing stock. However, credit standards are based on revenue rather than housing value and more than half of housing loans are secured by a guarantee from a bank or an insurer, which reduces the importance of the value of the collateral when assessing credit risk. Therefore, in line with the analysis in the Country Report 2015 (*ibid.*), a moderate adjustment in house prices does not seem to pose a considerable risk to the financial sector. In contrast to residential real estate prices, commercial real estate prices have significantly increased over the past few years. As a result, the Haut Conseil de Stabilité Financière (HCSF) asked banks, insurance companies and investment funds to perform stress tests. Depending on the results, the authorities could consider macro-prudential measures where appropriate.

The relatively low guaranteed interest rate and the strong development of unit-linked business mitigate the risks of the low interest rate environment for French life insurers. In contrast to other Member States, the French insurance industry has proposed very low guaranteed interest rates on their traditional life insurance products. For many years, this rate has been as low as 0 %, so that the average guaranteed rate is now close to 0.51 %. This special circumstance has allowed French insurers to suffer much less from the fall in interest rates than insurers in other Member States, where guaranteed interest rates have been much higher. To compensate for this low guaranteed interest rate, policyholders are remunerated by a minimum mandatory profit sharing. While the average return (including profit sharing) on life insurance contracts of 2.34 % seems relatively high, the mandatory minimum for profit sharing does not seem to threaten life insurers at the moment, thanks to some flexibility in the modalities. At the same time, the surge in the unit-linked business, which accounts for the majority of new production, has allowed insurers to transfer risks to the policyholders.

Graph 4.2.1: **Funding of non-financial corporations**



Source: ECB, AMECO (December 2015)

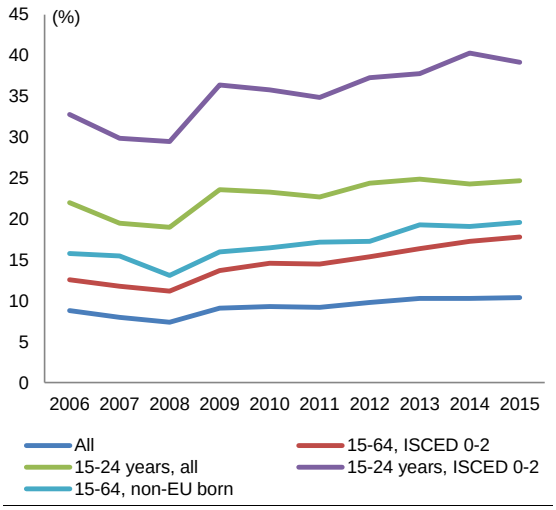
As in the rest of the euro area, SME access to capital markets remains a challenge. Capital markets for large corporations are functioning smoothly. The stock market is very deep and is dominated by non-financial corporations. Market debt funding of non-financial corporations has been increasing and reached EUR 555 billion, i.e. 25.4 % of GDP in 2015, from less than 15 % in 2008. For SMEs, access to liquidity can be more problematic as in the rest of the euro area. Banks account for 61 % of funding, excluding equity, for

all non-financial corporations in France, but this figure rises to 96 % for SMEs. The French authorities are trying to improve market access for SMEs by various means, such as ensuring that financial information requirements are proportionate, developing financial analysis on SMEs and supporting institutionalisation of crowdfunding. They are also expecting positive effects from the Capital Markets Union.

4.3. LABOUR MARKET, EDUCATION AND SOCIAL POLICIES

Unemployment is slowly decreasing from the peak reached in 2015, although it remains high for some categories of workers. Having risen steadily since 2008 (Graph 4.3.1), the unemployment rate fell in 2016 (from 10.4 % in 2015 to 10.0 % in 2016) and is forecast to decrease further in the coming years. However, in 2016 the unemployment rate remained higher than in the EU (8.6 %). Unemployment remains higher for low-skilled ([19]) workers (17.4 % against 16.3 % in the EU), especially if young (39.2 % compared to 28 % in the EU). The non-EU-born, representing 9.6 % of the working age population in 2015, are facing increasing difficulties in accessing the labour market; the unemployment rate for them was 19.4 % in 2015, up from 19.0 % in 2014 (17.9 % in the EU in 2015).

Graph 4.3.1: **Unemployment rate in France, 2006-2015**



(1) The International Standard Classification of Education (ISCED) is a statistical framework for organising information on education maintained by the United Nations Educational, Scientific and Cultural Organization (UNESCO). An ISCED level between 0 and 2 corresponds to less than primary, primary and lower secondary education.
Source: Eurostat

Long-term unemployment is still rising, in contrast with the EU trend. The average length of unemployment has kept increasing well above the 2008 level. The figure was 580 days (1 year and 7 months) in November 2016, up from close to 400 days in 2008. As a percentage of total unemployment, long-term unemployment (12 months or more) remained high at 42.6 % in 2015 compared to 42.5 % in 2014, while in both the EU and euro area it had started to fall in 2015 (48.1 % and 51.2 %). Very long–term unemployment (over two years) also keeps increasing, to 22.0 % of the unemployed in 2015, compared to 20.9 % in 2014.

There is a gender gap in the labour market. In 2015, the employment rate was higher for men (74 %) than women (66.6 %), while a higher share of women worked part-time (30 % compared to 7.3 % of men). Moreover, the gender pay gap (15.5 % in 2014) has only marginally decreased in recent years. In turn, differences in work patterns, wages and career lengths may have an impact on women's pension entitlements, which are 35 % lower than men's entitlements. The law of 4 August 2014 on real equality between women and men and the November 2016 inter-ministerial action plan aimed to promote gender equality in the labour market. However, the joint taxation system (*quotient conjugal*) creates disincentives for second earners – mainly women – to enter the labour market and to increase their working time (OECD, 2012, 2016c; Landais, Piketty and Saez, 2011).

The employment situation of the non-EU-born is deteriorating and the labour market inclusion of second generations remains challenging. The employment rate of the non-EU-born residing in France further decreased between 2014 and 2015 (from 55.4 % to 54.9 %) and the resulting employment gap with the EU-born increased (at 16.5 pp. in 2015 and at about 22 pp. if considering women alone). Their lower employment rate is explained by a lower level of education on average than native-born residents, a lower activity rate for non-EU-born women (57.8 % in 2015 vs 75 % among native-born women) and a higher unemployment rate for non-EU-born men (19.8 % in 2015 compared to 9.8 % among EU-born men). In addition, second generations (i.e. native-born with two foreign-born parents, representing 6.9 % of the working age population in 2015) remain penalised on the labour market; even when accounting for differences in individual characteristics, their chance of having a job is 15.7 pp. lower (OECD, 2014a). Indeed, in 2014, native-born residents, aged 15-64 and with two foreign-born parents, had an unemployment rate of 14.5 %, and as high as 49.6 % for young people, compared with 8.8 % and 18.7 % for native-born residents with native-born parents. Several recent

([19]) The 'low-skilled' are defined as part of the active population with a lower secondary education diploma or less (ISCED 0-2 levels).

studies have stressed the persistence of discrimination among people with a migrant background in hiring processes and the potential positive macroeconomic impact on GDP of reducing the impact of discriminations.

Labour market segmentation and rigidity

Segmentation of the labour market is entrenched. The proportion of temporary contracts has been gradually increasing, and reached 16.8 % of the total number of employees in the third quarter of 2016. While the percentage of temporary employment is slightly above the EU average, its duration has been rapidly shortening over time; at the end of 2015, almost one fifth of temporary contracts were for less than one month. On the other hand, France also appears to have one of the lowest rates of mobility according to the EU Labour Force Survey, with an average seniority of 11 years.

Rehiring and job instability are typical of temporary contracts of short duration. In 2000, temporary hires accounted for 75 % of total hirings. In 2016, they represented 86.4 % of total hirings, with temporary jobs of less than one month representing 80 % of total temporary hires. Moreover, more than two thirds of the new hires are rehires with an old employer (Unédic, 2016); about half of these were rehires with the last employer - twice the proportion in 1995. Temporary rehiring concerns both activities where the nature of the job justifies temporary employment (i.e. the so-called *contrat à durée déterminée d'usage*) and activities which have seen a recent rapid increase of temporary employment (e.g. health, construction, retail trade and public administration). The transition rate from a fixed-term contract to an open-ended contract remains very low, at 10.9 % in 2015 compared with 23 % across the EU.

Impact of labour market reforms

The Labour Act of 8 August 2016 addresses some of the rigidities of the labour market. This law paves the way for a reform of the Labour Code aiming at clearer differentiation between rules to be defined by regulation, branch-level and firm-level agreement, with the express intent to extend the perimeter of autonomous firm-level rules and to clarify individual economic dismissal rules. The law also contains measures to increase the effectiveness of collective bargaining, mainly by reducing the number of branches, introducing the majority principle for the adoption of collective agreements, reforming the rules underpinning the denunciation and revision of collective agreements, and introducing 'offensive agreements' that firms can use to adjust wages and working time arrangements, while maintaining or increasing the level of employment. In particular, firms will be able to adopt a collective agreement that will prevail over individual contracts, even in terms of working time and pay.

According to preliminary assessments, the Labour Act is expected to reduce segmentation of the labour market and to have a milder impact on the level of employment. According to Kant, Ballot and Goudet (2016) the new definition of economic dismissal would decrease unemployment by 150 000 jobseekers in the short term and create 200 000 jobs over 2 years, with strong substitution effects from short to longer-term contracts. The same study estimates that the decrease in the minimum overtime premium from 25 % to 10 % - that can now be agreed upon by social partners at firm level - will have an initial negative impact for the employment of workers aged 25-64 over the first 2 years after the adoption of the law, which would be compensated over the following 2 years.

The incentives to recruit on longer-term contracts have helped to address labour market segmentation in smaller firms. The SME recruitment incentive programme (*prime à l'embauche PME*) ([20]) had benefited about 670 000 new employees as of October 2016. Two thirds of these were on open-ended contracts, while the remaining third were fixed-term contracts of 6 or more months. According to recent French Treasury estimates, the effect of this incentive on employment would be to create or maintain, on average, up to 60 000 jobs per year.

([20]) This programme allows for an annual, lump sum, bonus of EUR 2000 paid quarterly over a two-year period to companies with fewer than 250 employees, which have hired new employees on an open-ended or fixed-term contract of more than 6 months between 18 January and 30 June 2017 for wages up to 1.3 time the statutory minimum wage.

The recent evaluations of the *'crédit d'impôt pour la compétitivité et l'emploi'* (CICE) have pointed to its positive effect on firms' profit margins and employment, while the effects on investment, R&D and exports are expected to take time to materialise. Based on the analysis of firm-level data for 2013-2014 by three groups of researchers, the CICE has been found to have a positive impact on employment and firms' profit margins, although its effect on employment did not increase when its credit rate increased from 4 % to 6 %. By contrast, no impact has been found on average wages, only on some categories of wages within certain firms. Also, no effect on investment, R&D and exports has been found, given that the period for which firm-level data are available at the moment is too short. No comprehensive evaluation of all social contribution reduction schemes is yet available to assess their architecture, socioeconomic impact or budgetary efficiency.

Unemployment benefit system

Since 2008, the deficit of the unemployment insurance organisation has been rising steadily, due to both business cycle and structural features of the unemployment insurance system. The 2008-2009 and 2011-2012 crises led to an increase in the number of jobseekers eligible for unemployment benefits from 2 million in 2008 to 2.8 million in 2016. Consequently, the budget performance of the unemployment insurance (Unédic) steadily worsened. In September 2016, the deficit in the unemployment benefit system was projected at EUR 4.3 billion in 2016 against EUR 4.4 billion in 2015, leading to a further increase in the system's debt to EUR 30 billion in 2016 and to EUR 33.8 billion in 2017 (Unédic, 2016). The dynamics of the unemployment insurance deficit and debt reflect a number of factors beyond cyclical considerations, including the design of unemployment benefits and job instability linked to widespread very short employment spells. While the replacement rate is comparable to that of countries with similar levels of GDP per capita, unemployment benefits are capped at very high levels (over EUR 7 000), the minimum contribution period is among the lowest (4 months in 28 months) and the duration of benefits is among the longest (24 months after contributing for 24 months).

In addition, the benefit calculation favours a succession of short-term work periods. The unemployment insurance system mimics the functioning of an unemployment account, whereby a worker brings with him the rights acquired and not used in previous occupations, when moving between different jobs. This feature provides incentives for the unemployed to look for work more intensively since they do not lose their entire stock of benefits by taking up a job. Yet, the method used to calculate the unemployment benefit gives employees an incentive to combine revenues from short-term employment with unemployment benefits, particularly in those sectors where the *contrats d'usage* are allowed (Cahuc and Prost, 2015). This has favoured particular schemes, such as those concerning the *contrats d'usage*, interim and entertainment sector workers, whose structural deficit is partly financed by a structural surplus in the general scheme for open-ended contracts.

The financing of unemployment insurance does not encourage firms to take into account the consequences of their high labour turnover on the deficit in the insurance funds. By levying higher contribution rates from sectors with higher turnover, the law of 14 June 2013 addresses the problem of firms with more stable recruitment patterns subsidising firms with less stable recruitment patterns ([21]). However, compared to systems where contributions are firm-specific and depend on the extent to which laid-off employees claim unemployment benefits, the French unemployment insurance does not require firms to internalise the cost that layoffs impose on unemployment insurance funds. On the contrary, it provides an incentive for those economic activities, usually characterised by low productivity, which make most use of short-term contracts interrupted by short spells of unemployment for workers.

([21]) Under the law of 14 June 2013, employers pay higher social contributions for temporary hires of less than 3 months. For standard temporary contracts, justified to meet the need for temporary increases in production, the additional contribution is 3 % for contracts of less than 1 month and 1.5 % for contracts of duration between 1 and 3 months; for the *contrats d'usage* of less than 3 months, the additional contribution is 0.5 %, while those of longer duration are not taxed more than permanent contracts.

Active labour market policies

Increased active labour market policy measures targeting low-skilled young people have succeeded in reducing low-qualified youth unemployment only slightly. The unemployment rate for low-qualified young people decreased from 40.3 % to 39.2 % between 2014 and 2015. To address their difficulties in entering the labour market the number of subsidised contracts targeting low-skilled young people — *emplois d'avenir, contrat initiative emploi (CUI-CIE)* and *contrat d'accompagnement dans l'emploi (CUI-CAE)* — has been increased to reach 45 800 in the market sector (+65 % between March 2015 and March 2016) and remain stable at 101 300 in the non-market sector. In the first quarter of 2016, 29.2 % of all young employed were on subsidised contracts, as were 51.7 % of young employed people without qualifications (DARES, 2016a). Although these contracts have a positive short-term effect on employment, they fail to foster sustainable inclusion in the labour market; only 40 % of young people in the non-market sector were employed 6 months after exiting a subsidised contract and 66 % in the market sector, where deadweight effect is more important (*Cour des Comptes*, 2016a). Also, some weaknesses were identified in Youth Guarantee implementation in terms of outreach, information and coordination between actors (European Commission, 2016c).

In a flexicurity approach, training rights and activation measures have been reinforced for the more vulnerable. The reinforcement of training rights through the personal training account for low-qualified workers and activation measures for young unemployed people in precarious situations, with the generalisation of the *Garantie Jeunes* scheme, is intended to support personal transitions and economic adaptations. Moreover, the personal activity account (*compte personnel d'activité*, CPA), introduced in January 2017, may reduce disparities related to employment status, by attaching training rights directly to workers.

Education and vocational training

France faces wide performance gaps in basic skills linked to students' socioeconomic background. Pupils with a migrant background face additional difficulties. The proportion of 15-year-old low achievers in the 2015 OECD Programme for International Student Assessment (PISA) is slightly above the EU average in all three fields (22 % in science, 21 % in reading and 23 % in mathematics). Performance somewhat worsened compared to 2012. The relationship between socioeconomic background and student performance remains strong. France shows one of the largest gaps in the proportion of low achievers in science between the lower and upper quarters on the socioeconomic index of the 2015 PISA student population (34.6 pp compared to an EU average gap of 26.2 pp). There is also a large performance gap between non-immigrants and first-generation immigrants. Second-generation immigrants are only partially catching up with non-immigrants.

There are large performance gaps between schools in France. School composition often reflects the residential concentration of people with socioeconomic difficulties and migrant background. Disadvantaged children are unevenly distributed across schools. Social diversity decreases further for upper secondary education levels (CNESCO, 2016a). Pupils with a disadvantaged background tend to be steered more often towards initial vocational education, as a remedy for school problems, without regard to their motivation. Indeed, initial vocational education pupils account for 87 % of early drop outs in France in 2013, while accounting for close to 40 % in 2015 of all secondary school enrolment (CNESCO, 2016c; DEPP, 2016d). Also, teachers in 'priority education networks' targeting schools in disadvantaged areas (*réseaux d'éducation prioritaire*) tend to be younger, less experienced and more likely not permanent appointees (OECD, 2015a).

Reform plans are being gradually implemented to address these challenges through the prevention of poor educational outcomes. Begun in 2013, the compulsory education reform seems to go in the right direction, but its impact will depend on actual implementation (MENESR, 2015; CNESCO, 2016a). Full implementation of the 2014 priority education plan, further strengthening support teaching staff among other measures, is planned for 2017 with the creation of nearly 9000 new teaching posts at early education levels. Also, to make the teaching profession more attractive, in June 2016 the government announced an overhaul of the salaries of teachers and staff to be rolled out

between 2017 and 2020 at a cost of EUR 1 billion. Measures to improve school and career guidance of pupils are being generalised, including the *'Parcours Avenir'*.

The initial system of vocational education and training (VET) does not lead to an optimal integration of young people in the labour market. France is one of the few OECD countries where opting for VET does not provide better employment outcomes than general education (CNESCO, 2016b). Production sector specialisations still offer better labour market integration outcomes, while trade & sales and even more secretarial training has a significantly lower post-diploma employment rate, translating later into a high unemployment rate (30 %). The figures above cast doubt on whether the existing national and local governance entities have been effective in defining a range of education and initial training based on economic needs and employment prospects, rather than favouring available training resources. In this respect, the 2014 VET reform establishes new national and regional-level VET and employment coordination bodies, while over 500 additional VET specialties in sectors with good employment prospects have been announced for the opening of the 2017 school year, along with the creation of 1 000 specific teaching posts. However, given the relative novelty of these measures and announcements, their impact cannot be assessed yet.

Apprenticeship presents better employment outcomes than school-based initial VET. Apprenticeship offers better labour market integration perspectives, but is constrained by its cost and its sensitivity to national and territorial economic cycles, which affect company decisions to hire apprentices ([22]). As a result, apprenticeship represents only one fourth of initial VET. The introduction of a low-qualified apprentice premium and the increased public sector commitment have recently enabled the stabilisation of apprenticeship figures. Entry into apprenticeship is also expected to be eased by its gradual opening to professional qualifications. Synergies between school and work-based VET have also been initiated to reduce the drop-out rate.

([22]) The cost of an apprentice (all levels) is 2.5 times that of a school-based VET pupil in the production sector (CNEFOP, 2016a; CNESCO, 2016b).

The continuous VET system has important imbalances. Continuous vocational training is facing challenges as shown in France's weak results in the Programme for the International Assessment of Adult Competencies (PIAAC) survey, in numeracy, literacy and ICT skills. The continuous VET system is mostly characterised by imbalances in access to training depending on the labour market status ([23]): the unemployed, low-qualified, older workers and small business employees ([24]) have less chance of receiving training while jobseekers access to training stood at 9.8 % in 2014. The reform of companies' contributions to VET financing, part of the 2014 VET reform, in increasing coverage of SME employees and the unemployed, aimed to improve access to continuous training. It remains to be seen if this law will have an impact on both access to training and governance, together with the new coordination bodies created at national (*CNEFOP*) and regional level (*CREFOP*) to develop shared diagnosis on training needs. These issues are even more important given the recent measures taken to sustain demand for training, such as the personal training account scheme (*Compte personnel de formation,* CPF) introduced on 1 January 2015, included in the personal activity account (*Compte personnel d'activité,* CPA) set up by the Labour Act of 8 August 2016 ([25]), and the *plan 500 000 formations* of January 2016 ([26]).

Social policies

France fares better than the EU average on poverty, social exclusion and inequalities, with the poverty rate steadying at around 13.6 % and decreasing to 17.7 % for the population at risk of

([23]) Workers on temporary contracts (CDD) can expect on average 8 hours of training per year, whereas workers with long-term contracts (CDI) can expect on average 19 hours of training per year.

([24]) Only 20 % of companies with 10 to 19 employees invest in training, whereas 60 % of companies with between 1 000 and 1 999 employees invest in training.

([25]) The Labour Act of 8 August 2016 created the new personal activity account, including the personal training account, extended additional training rights to 400 hours for unskilled employees (against 150 hours normally) and unlimited rights for early-school leavers. At the same time, it extended the personal training account to civil servants and independent workers.

([26]) By January 2016, 500 000 additional training courses for jobseekers were under way, with the aim of doubling their number to 1 million, with financing of EUR 1 billion from the State and local coordination by the regions. By the end of November 2016, 945 000 training courses had been run. The plan will be further pursued in the first half of 2017.

poverty or social exclusion in 2015 against respectively 17.3 % and 23.7 % for the EU. The impact of social transfers (representing 19.3 % of GDP in 2014) ([27]) on poverty reduction remains high, at 43.1 % in 2015, compared with the EU average of 33.5 %. The intensity of poverty, as calculated by national figures, increased slightly to 20.1 % in 2014 after falling from a peak of 21.3 % in 2012 to 19.8 % in 2013. Similarly to most Member States, the 2020 objective for reducing the number of people at risk of poverty or social exclusion therefore will be very difficult to reach. Inequality, as measured by the Gini index of disposable income decreased from 30.8 in 2011 to 29.2 in 2015. The ratio of average income of the bottom quintile to that of the first quintile of income distribution decreased from 4.5 in 2012 to 4.3 in 2015.

However, some more vulnerable groups are more affected. The poverty rate among unemployed people increased again in 2015 (from 31.4 % in 2014 to 37.2 % in 2015, against the EU average of 47.6 % in 2015), and the increasing proportion of part-time workers, particularly those who earn close to the minimum wage, has translated into an increased risk of in-work poverty since 2010 (from 6.5 % in 2010 to 7.5 % in 2015). Although it remains below the EU average (9.5 % in 2015), in-work poverty risk remains higher for part-time workers (13.2 % in 2015). The proportion of involuntary part-time employment — as a percentage of total part-time employment — has increased steadily in recent years and reached 43.7 % in 2015, up from 30.8 % a decade ago, with women representing a large majority of involuntary part-timers. Moreover, children, young people and single-parent families, remain at particularly high risk of poverty (18.7 %, 17.9 % and 36.7 % respectively in 2015). Non-EU born are more affected by poverty and social exclusion (33.2 % in 2015) than French native-born (15.2 %) and their in-work poverty rate (18.5 %) is three-time higher than that of native-born workers (6.5 %).

Low-income earners' access to affordable housing remains a challenge. There is a critical shortage of affordable housing, including social housing, in particular in growing urban areas. Problems related to the lack of sufficient (social) housing (Fondation Abbé Pierre, 2016; INSEE, 2016), affects more socially disadvantaged people and in particular non-EU born. Around 1.7 million people are on social housing waiting lists, including nearly 500 000 people in Ile-de-France. Homelessness levels are high and continue to rise; 141 000 homeless people were recorded in 2012, which is a 50 % increase since 2001.

Measures were taken to simplify and increase the activation component of income support and its take-up at the bottom of the wage scale ([28]). As part of the implementation of the multiannual antipoverty plan (adopted in January 2013) two wage support schemes (the *revenu de solidarité active activité* and the *prime pour l'emploi*) were merged into a single activity bonus (the *prime d'activité*) as of 1 January 2016. The latter is also open to people under 25 years of age, unlike the previous *revenu de solidarité active activité*. Data suggest that a 50 % claim rate had already been reached by the end of the first quarter of 2016 (i.e. 2 million beneficiaries), with over 3.8 million beneficiaries recorded in September 2016, one sixth of them being aged under 25. Close monitoring of the effective impact of the measures taken will be important.

([27]) This figure does not include transfers to older people, which are treated as pensions. The impact of social transfers is calculated as the percentage difference between the at-risk-of-poverty rate before and after social transfers.

([28]) Complemented by a tax credit in 2014 and by abolishing the lowest rate band in 2015, it has been further extended to benefit 12 million tax units in 2016.

Box 4.3.1: **Selected highlights: recent reforms to promote flexicurity in France**

In recent years, France has adopted a number of important reforms aimed at improving the functioning of the labour market.

Labour law has been reformed in order to increase hiring on permanent contract, by reducing legal uncertainties in case of individual dismissal (notably defining clear layoff criteria for economic reasons ([1])) and by setting indicative floors and ceilings for financial compensation in case of unfair individual dismissal. Furthermore, the functioning of individual work litigation courts (*prud'hommes*) has been reviewed to reduce the procedural length. ([2]) In case of collective dismissal, the layoff programme negotiated by social partners ([3]) now has to be simply validated by the administrative court. Flexibility has also been strengthened at company level with the set-up of '*accords de maintien de l'emploi*', which allow the employers to reduce wages and/or increase working hours in case of economic difficulties ([4]) or even, with some restrictions on wages, in case of market expansion. The possibility to sign agreements at company level derogating from branch level provisions has been reinforced in relation to the working time, including on extra hours premium. Social dialogue has been reformed with the creation of a dedicated fund for a better quality of social dialogue, the grouping of all mandatory consultations of the Work Council into three per year, respectively on the strategy, the economic situation and the social policy of the company ([5]) and the progressive application of the majority agreement at company level.

In parallel, transitions are being progressively secured. Since 2011 the professional securing contract has introduced more security for employees laid off in companies with less than 1000 employees or in bankrupt companies. The contract supports workers to get back to work by setting up specific accompanying and training measures and grants. The introduction of 'rechargeable rights' increases the incentive to return to a new job by preserving previously acquired rights. The life-long learning dimension of flexicurity has been addressed with the adoption in 2014 of the training act, ([6]) introducing a personal training account providing ([7]) rights directly attached to any active person in the private sector all along her career. Additional support is provided for low-qualified and early-school leavers through this account and a specific training action ([8]) plan has been set up for unemployed in order to improve their adaptability, with a focus on long term unemployed.

Building on the personal training account, a personal activity account is operational since January 2017. This account is accessible to all, including civil servants, unemployed and self-employed. It allows them to have access to all the rights acquired throughout their career both in terms of training and hardship (accumulation of rights for retirement). Effective access to training for the low-qualified and the unemployed remains to be further assessed, as well as the impact of increased labour market flexibility on the use of permanent contracts, while the reform of the unemployment benefit system has been delayed and is expected for 2017.

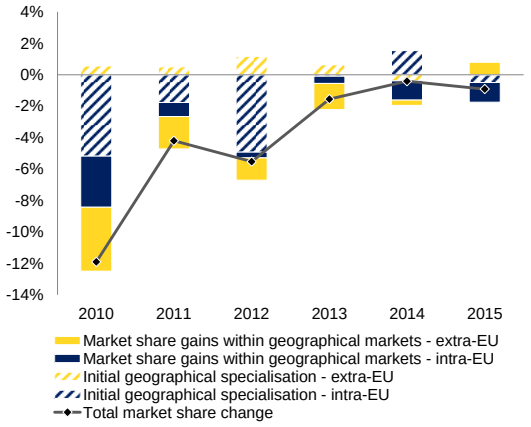
([1]) Labour Act of 8 August 2016.
([2]) Law of 6 August 2015 on economic growth and activity and decree of May 2016.
([3]) Law of 14 June 2013 on securing employment.
([4]) Law of 14 June 2013 on securing employment and Law of 6 August 2015 on economic growth and activity.
([5]) Social dialogue Act of 17 August 2015.
([6]) Law of 5 March 2014 on vocational training, employment and social democracy.
([7]) Now merged with the personal activity account.
([8]) Plan of 500 000 additional trainings to jobseekers of January 2016.

4.4. COMPETITIVENESS

Export of goods*

French export market shares of goods have stabilised in recent years. French exports accelerated from 2013 to 2015, while world trade slowed. As a result, export market shares stabilised. However, while France recorded small market share gains in countries outside the EU, it still faced losses in EU countries (Graph 4.4.1). France's initial geographical specialisation has had a broadly neutral effect in recent years.

Graph 4.4.1: **Export market share breakdown for France – Goods**

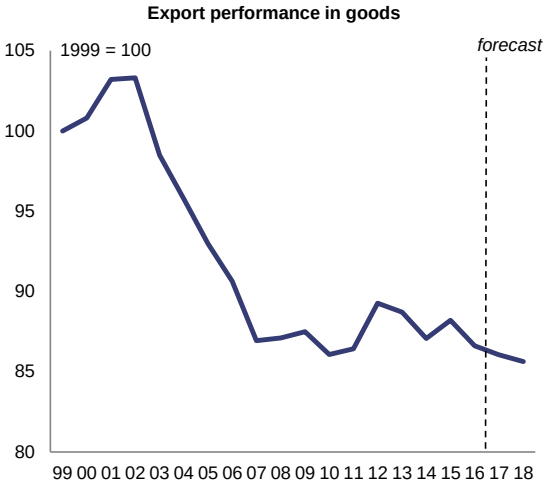


Source: COMTRADE, European Commission

Exports of goods recorded strong growth in 2015, mainly driven by transport equipment. Aircraft industry exports have posted strong growth rates since 2010 and now largely exceed their pre-crisis levels. By contrast, the motor vehicle industry had suffered dramatically from the crisis, and benefited in 2015 from the recovery of the European market in this sector. These two sectors, which represent only a sixth of total goods exports, accounted for almost half of export growth in value in 2015. They are also the sectors with the highest exchange rate elasticity (Héricourt, Martin and Orefice, 2014) and have thus gained most from the depreciation of the euro.

In 2016, exports of goods barely grew, hampered by temporary factors affecting specific sectors. Goods exports grew by 1.5 % in volume in 2016, after 6.5 % in 2015. As a result, exports fell well short of French export market growth in 2016, leading to a deterioration of export performance. According to the Commission's winter forecast (*ibid.*), export performance ([29]) is expected to further deteriorate in 2017, reaching a new historical low (Graph 4.4.2). Exports of refined petroleum products were hit by strikes in the refineries in the second quarter of 2016, while delays in Airbus deliveries affected aircraft exports, and unfavourable weather conditions weighed on agricultural crops. However, other temporary factors contributed positively in 2016, such as the delivery of the *Harmony of the sea*, the largest passenger ship in the world, which boosted exports of ships and boats.

Graph 4.4.2: **French export performance – Goods**

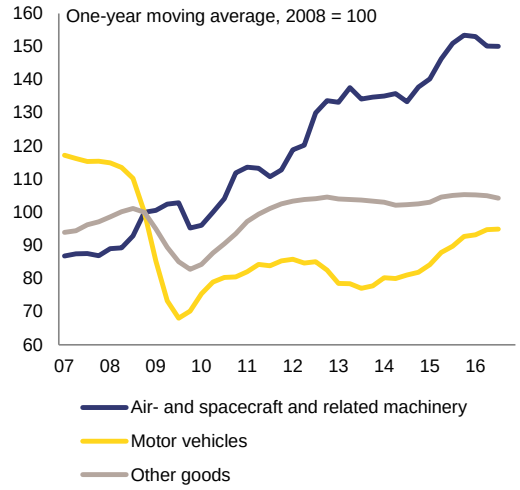


Source: Commission 2017 winter forecast

Looking beyond year-on-year volatility, French exports of goods continue to perform poorly, with the exception of the aircraft sector. Excluding the two sectors that have contributed most to export growth since 2014, namely aircrafts and motor vehicles, goods exports have been broadly flat since 2012, at a level close to their pre-crisis peak (Graph 4.4.3). For instance, France's overall share in the EU-28's increasing processed and unprocessed food exports has fallen in recent years, both for extra- and intra-EU trade. The increased reliance of export growth on a few sectors makes French export performance vulnerable to specific developments in those sectors, as seen in 2016, particularly in the aircraft sector whose share of total exports rose from 8.0 % in 2007 to 12.7 % in 2015.

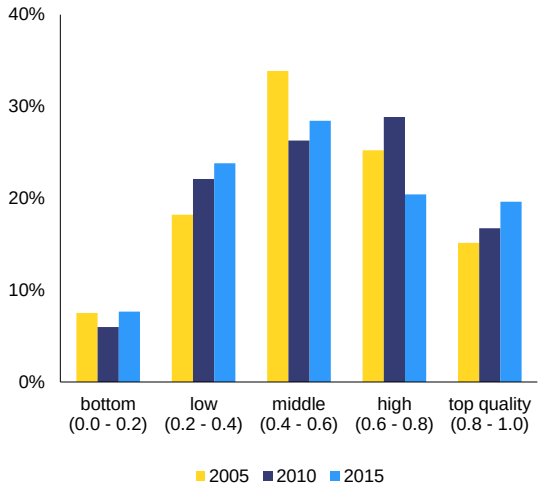
([29]) Export performance is defined as the ratio between French exports of goods and services in volume and French export markets in volume.

Graph 4.4.3: **Exports of selected sectors (in value) – France**



Source: Comext

Graph 4.4.4: **Share of export values per 5 categories of quality rank – France (% of total exports)**



Source: Comext, Orbis, European Commission

Quality of exports of goods*

The average quality of French exports ([30]) has deteriorated slightly in recent years. In particular, France's quality rank has declined markedly in the motor vehicle sector, which accounts for 16 % of total manufacturing exports to the EU and, to a lesser extent, in the chemical sector (13 % of total manufacturing exports to the EU), in which France is middle-ranking.

The share of high and middle quality exports in total goods exports has significantly decreased, while the share of both top and low quality exports has increased. The share of top quality exports in total exports is significantly larger in France than in Germany, Italy and Spain. Top quality exports are a specific feature of French exports, linked to the high performance of the aircraft industry and luxury sector. However, France has lost substantial market shares in high and middle quality exports (Graph 4.4.4). This can be linked to the deterioration of both cost and non-cost competitiveness, in particular compared to Germany which is highly specialised in this quality range. On the other hand, low quality exports are in more direct competition with Spain which benefits from substantially lower labour costs.

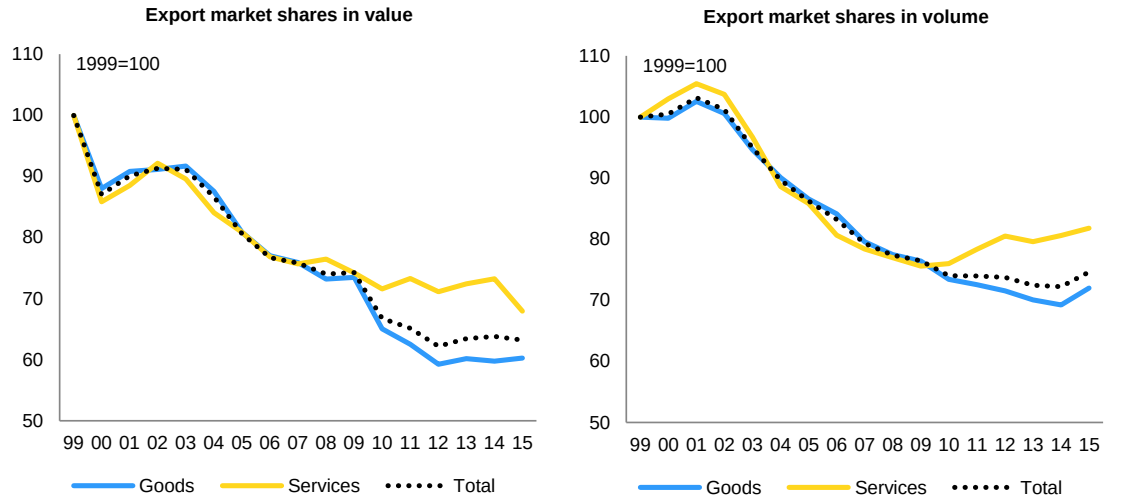
([30]) The quality of exports is defined as the normalized quality rank index based on the method explained in Vandenbussche (2014). A quality rank of 1 reflects the highest quality in the EU market for a particular 'country of origin-product', while 0 is the lowest quality rank.

Exports of services*

French exports are increasingly specialised in services. In France, exports of services represented almost a third of total exports in 2015, compared to 17 % in Germany. Among the five major EU economies, only the United Kingdom has a higher share of services in total exports, at 44 % (Graph 4.4.6) ([31]). In addition, the share of services in total exports has steadily increased over the past decade, as exports of services grew by 5.9 % per year on average in value from 2005 to 2015, compared to only 2.7 % for goods. This is also the case by volume, excluding a pure price effect. The relative evolution of exports of services is particularly important in France compared to the other countries, except the UK. The share of services has increased much less in Germany, and has even fallen slightly in Italy and Spain. France exports primarily technical, trade-related and other business services, tourism and transport services. These three sectors made up 57 % of French exports in services in 2015. While the UK is also strongly specialised in business services, its strongest exporting sector is the finance sector

([31]) This is true only according to balance of payments statistics. In the specific case of France, there is a significant discrepancy between balance of payments (BoP) and national accounts (NA) statistics concerning exports. According to BoP data, the services' share of total exports is 32 %, while it is only 28 % according to NA data. This share is 30 % for Spain, regardless of the data source.

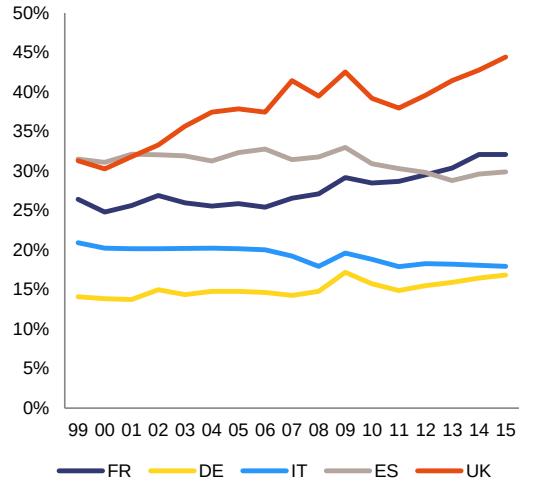
Graph 4.4.5: **Exports market shares in value and in volume – France**



Source: Eurostat, IMF

which made up 23 % of total British exports of services in 2015.

Graph 4.4.6: **Share of services in total exports in selected EU countries**



Source: Eurostat – Balance of payments

Export market shares in services have been more resilient than those in goods since 2008, indicating a growing specialisation of French exports towards services. While French export market shares in value have been on a long-term declining trend at a comparable pace for both goods and services, this decline has been more pronounced for goods since the economic crisis. The share of France in global exports of services amounted to 5.1 % in 2015 (down from 5.7 % in 2008), 2 pps. above goods (3.2 % in 2015, down from 3.8 % in 1999, Graph 4.4.5, lhs). The decline in export market shares in services in 2015 is only due to valuation effects linked to the euro depreciation. In volume, export market shares in services have even been on the rise since 2008, while export market shares in goods have continued declining until 2014. The stabilisation of export market shares in France over the past few years is thus to a large extent attributable to the good performance of exports in services (Graph 4.4.5, rhs).

Unit labour costs and productivity*

From 1999 to 2013, France lost cost competitiveness compared to the rest of the euro area, with unit labour costs increasing at a faster pace in France in both nominal and real terms. From 1999 to 2008, French nominal unit labour costs per head increased in line with the French GDP deflator, at 2.0 % per year on average ([32]). The loss of relative cost competitiveness is largely due to the containment of unit labour costs in the rest of the euro area (1.7 % per year on average) – in particular in Germany where nominal unit labour costs per head remained almost flat during this period (0.1 % per year on average). This resulted in a decline in real

([32]) HICP inflation grew by 2.1% per year on average during the same period.

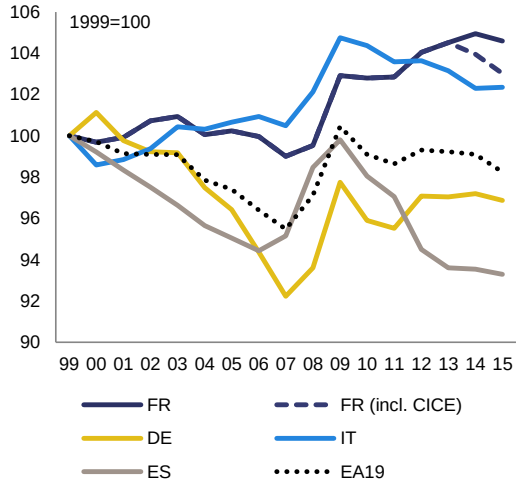
Table 4.4.1: **Labour productivity growth (per person employed) in France and in the rest of the euro area**

	95-00	00-05	05-10	11	12	13	14	15
France	1.3	1.1	0.4	1.3	-0.1	0.3	0.2	0.8
Rest of the EA	1.3	0.6	0.4	1.4	-0.6	0.3	0.7	1.1

Source: Eurostat

unit labour costs of the rest of the euro area, while real unit labour costs were stable in France (Graph 4.4.7). From 2008 to 2013, there has been a decoupling between the trend in nominal unit labour costs and the GDP deflator in France. Specifically, unit labour costs rose by 1.8 % per year on average, while HICP inflation averaged 1.5 % and the GDP deflator rose by only 0.8 %. In the rest of the euro area, unit labour costs grew by less (1.4 %) and more in line with GDP deflator inflation ([33]). This resulted in a further deterioration of France's relative cost competitiveness during this period, this time for domestic reasons.

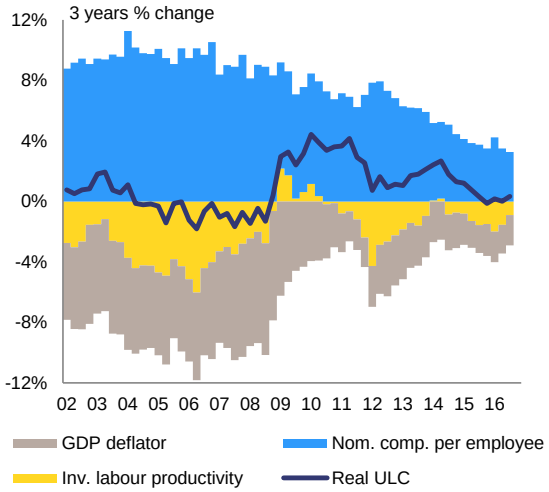
Graph 4.4.7: **Real unit labour costs in selected EA countries (deflated by GDP deflator) – whole economy**



Source: Eurostat

Cost competitiveness has improved since 2013, in particular thanks to measures taken to reduce the labour tax wedge, but accumulated past losses have still not been recovered. Over the past two years, unit labour costs per head increased by 1.2 % in France, and −0.3 % once the Tax credit for competitiveness and employment (CICE) is taken into account, compared to 1.0 % in the euro area as a whole.

Graph 4.4.8: **Breakdown of real unit labour costs in France – whole economy**



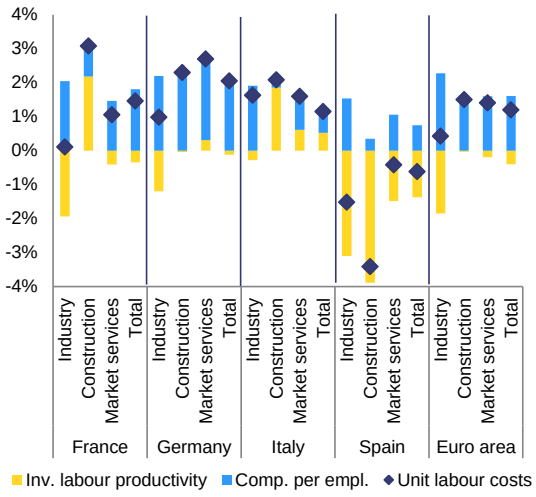
(*) Inv. labour productivity: higher productivity growth is related to a more negative contribution to real ULC growth.
Source: Eurostat

Wage moderation continues, but low productivity growth prevents a faster recovery of cost competitiveness. Labour productivity growth has slowed since the crisis (Graph 4.4.8). This is largely due to a decline in TFP growth, despite a continued increase in capital intensity (see Section 1). While averaging 1.0 % from 2000 to 2008, labour productivity growth was only 0.3 % per year from 2008 to 2015. It recovered somewhat in 2015 (+0.8 %) but remained below both pre-crisis growth rates and productivity growth in the rest of the euro area (Table 4.4.1). Productivity developments have been impacted in recent years by measures to foster higher employment growth (the Tax credit for competitiveness and employment, the Responsibility and solidarity pact, and the Hiring subsidy) but these measures cannot explain the full extent of the productivity slowdown since 2008.

([33]) Unit labour costs per hour evolved in line with unit labour costs per head. From 1999 to 2008, unit labour costs per hour increased by 1.9% on average in France, against 1.6% in the euro area and 0.0% in Germany. From 2008 to 2013, unit labour costs per hour increased by 1.7% on average in France, against 1.5% in the euro area.

Turning to a sectoral analysis, unit labour costs have increased at a slower pace than in the euro area since 2008 in industry, but have risen more substantially in the construction sector. This is due to fall in productivity in the construction sector since 2008, which may be one of the reasons why real estate prices are particularly high in France. In agriculture, productivity grew less in France than in the EU-15, as in the last 10 years capital and intermediate consumption productivity fell. By contrast, unit labour costs grew slightly less than in the euro area in both industry and market services, in particular compared to Germany and Italy while Spain experienced a decrease (Graph 4.4.9). However, in levels, while labour costs are now lower in France than in Germany in industry, they remain substantially higher in market services, in particular in transport services.

Graph 4.4.9: **Sectoral breakdown of unit labour costs (average annual growth rate 2008-2015)**



(*) Inv. labour productivity: higher productivity growth is related to a more negative contribution to ULC growth.
Source: Eurostat

Investment*

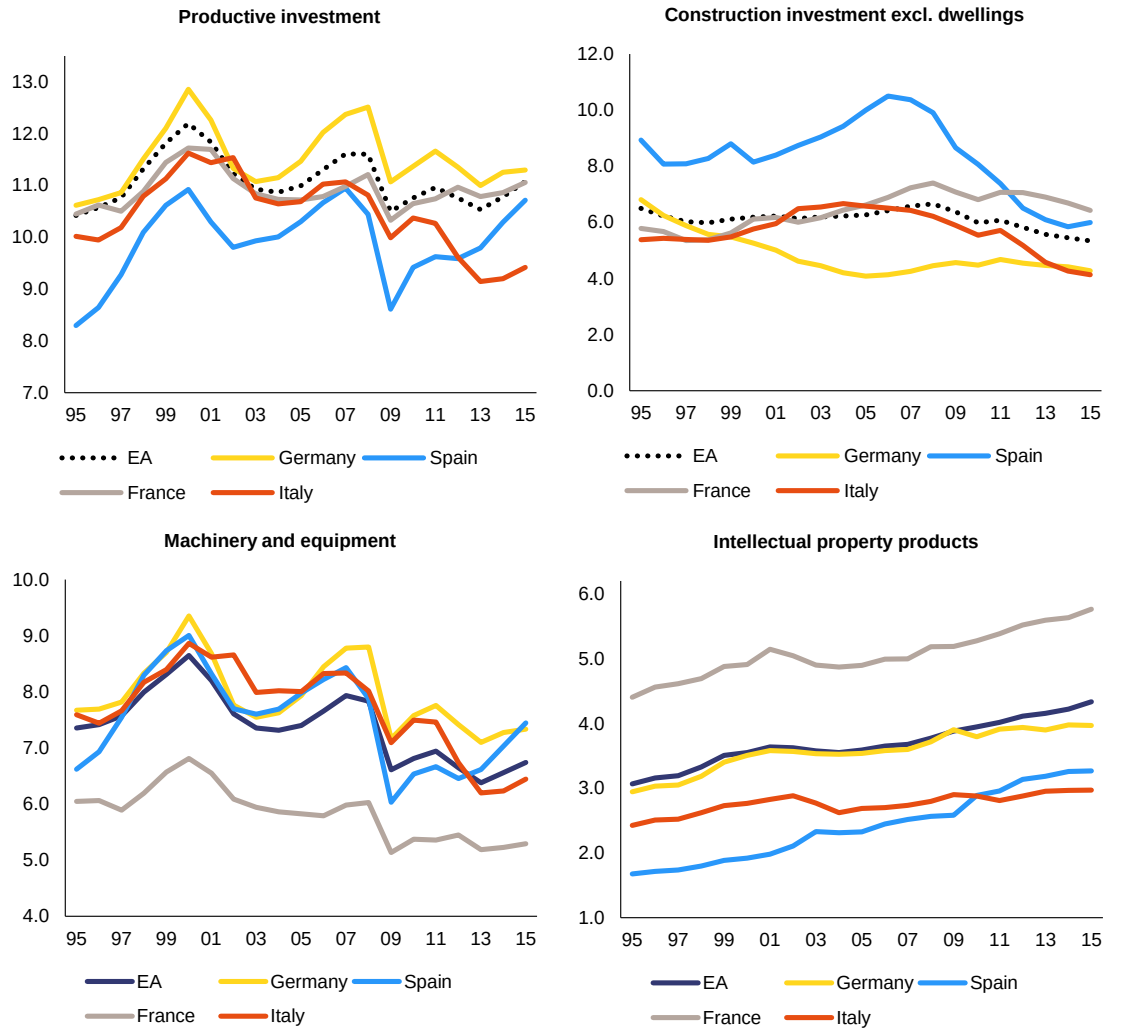
Investment in France has weathered the global financial crisis markedly well. Since 2008, investment has been broadly stable and currently stands close to its pre-crisis level, as opposed to the deep downward adjustment observed in other large economies, including Spain, Italy and the euro area as a whole. This robust investment performance has been supported by both private and public investment that amounted to about 18% and 3.5% of GDP respectively in 2015. Looking at the composition of investment, France is on a par with the rest of the euro area when it comes to productive investment, which broadly involves spending on machinery, equipment and intellectual property assets (Graph 4.4.10, upper lhs) ([34]). At the same time, France outperforms Germany, Italy, Spain and the euro area as a whole when it comes to non-productive investment in construction (Graph 4.4.10, upper rhs).

The relatively low level of machinery and equipment investment is more than offset by a markedly high level of investment in intellectual property assets. While France can be compared with the rest euro area as regards productive investment, the part of it allocated to machinery and equipment (including information and communication technologies) is relatively low (around 20% lower than the euro area average for the last twenty years, Graph4.4.10, lower lhs). This phenomenon is partly explained by the productive structure of the French economy and, in particular, by the strong weight of services. At the same time, French productive investment in intellectual property assets has been persistently high rendering France one of the best performers in this area. In 2015, investment in intellectual property represented 5.8 % of value added in France, as compared to 4.3 % in the euro area and 4 % in Germany (Graph4.4.10, lower rhs).

Investment patterns have implications for the competitiveness of French firms. Although barriers to investment are overall moderate (Box 4.4.1), investment is concentrated around a limited number of larger firms (75% of total investments was undertaken by 1% of firms in 2012) implying a positive link between the firm size and the capacity to invest. Investment in research and development in manufacturing is concentrated in subsectors of declining economic importance as measured by their value added, which has implications for the long-term growth potential of the whole economy (Section 4.5 on innovation). This is the case in particular for the R&D intensive sectors of motor vehicles, computer, electronic and optical products, and pharmaceuticals whose share

([34]) Productive investment is investment directed to machinery and equipment, including robots and equipment in information and communication technologies. It also involves intellectual property assets, including R&D and other intangible assets, while it excludes investment for construction purposes (De Galhau Report, 2015).

Graph 4.4.10: **Investment composition (% of value added) – whole economy**



Source: Eurostat

in the total value added of the economy shows a declining trend (European Commission, 2016c).

While corporate investment is high, integration of digital technologies by businesses remains low. France ranks 18th among EU Member States and is positioned below the EU average as regards the degree of business digitisation and firms' use of e-commerce activities, according to the European Commission Digital Economy and Society Index. Although the share of ICT specialists in total employment in France is comparable to the EU average (3.6% in 2015), this share is smaller in French SMEs compared to the EU average (14.5% as opposed to 20%), according to the 2016 European Commission Small Business Act report (European Commission, 2016g).

A series of policy measures have been adopted to support productive investment by firms. During the last years the authorities have taken action to improve the business environment and to address the regulatory bottlenecks that hinder investment decisions in France (Box 4.4.1). In addition, fiscal incentives and measures to facilitate financing for investors have been put in place since 2015 in the context of the French Investment Plan. The exceptional capital depreciation targeting equipment investment in the manufacturing sector in particular (over-amortisation scheme) has attempted to boost this

particular type of investment. This fiscal incentive has already shown some positive results and its validity has been extended until mid-April 2017. Meanwhile, the co-financing capacity of the public investment bank for tangible and intangible investment projects has been strengthened with a view to supporting the modernisation of French firms. Finally, access to equity for the financing of longer-term projects has been eased through measures to better link savings collected by private funds (e.g. pension or life insurance funds) with the capital market.

Business environment*

Although France has improved its overall regulatory performance, its business environment continues to be middle-ranking. According to the distance-to-frontier criterion used in World Bank surveys ([35]), since 2010 France has closed part of the gap with the best performers in business regulations. The World Bank's 2017 Doing Business survey ranks France 29th out of 190 economies assessed, one position down compared to last year. France is also 15th among the EU Member States. The 2016-2017 Global Competitiveness Report by the World Economic Forum (WEF) ranks France 21st out of 138 countries assessed, one position up compared to last year, given improvements in the macroeconomic environment and building permit procedures. According to the WEF, the three most problematic factors for doing business in France remain, as last year, the restrictive labour regulations, the high tax rates and the tax regulations. France is also in 115th place as regards the burden of government regulation. Some 89 % of the French SMEs responding to a 2016 Commission Survey find that complexity of administrative procedures is a problem for doing business in France (EU average: 62 %) and this score has fallen by six percentage points since 2013 ([36]).

Registering property, getting credit and paying taxes is more difficult or costly for businesses in France than in most other developed economies. France fell 9 places compared to last year for registering property, by the World Bank's assessment. While economies worldwide have been making it easier for entrepreneurs to register and transfer property, e.g. by introducing time limits for procedures and by setting low fixed fees, France has made transferring property more expensive by increasing the property transfer tax rate and by introducing an additional tax on businesses in Paris. Registering property in France takes 64 days and costs 7.3 % of the property value. As regards access to credit, according to the World Bank, the effectiveness of collateral and bankruptcy laws is relatively low, while weak legal rights for borrowers and lenders together with poor sharing of credit information make access to credit more difficult for businesses. Nevertheless, according to Commission surveys, French SMEs' access to finance is in line with the EU average ([37]). On the positive side, France has improved its ranking by 10 places as regards dealing with construction permits, by reducing the cost of obtaining a permit, although the time needed remains relatively long (183 days compared to around 60 in the UK and 90 in Germany). France also appears first in the worldwide classification as regards ease of trading a shipment of goods across borders.

Although trading across borders is relatively easy and cheap, French SMEs participate less than other European SMEs in the EU's Single Market ([38]). Despite the low cost and short time needed in France to trade a shipment of goods, the percentage of French SMEs exporting within the EU (7.8 %) is relatively low and largely focuses on French-speaking countries such as Belgium and Switzerland (Douanes, 2015). This trend can be explained by a number of factors, including the lesser need to export given the large domestic market, the relatively smaller proportion of medium-sized firms, language and cultural factors, and the regulatory environment for exporting firms.

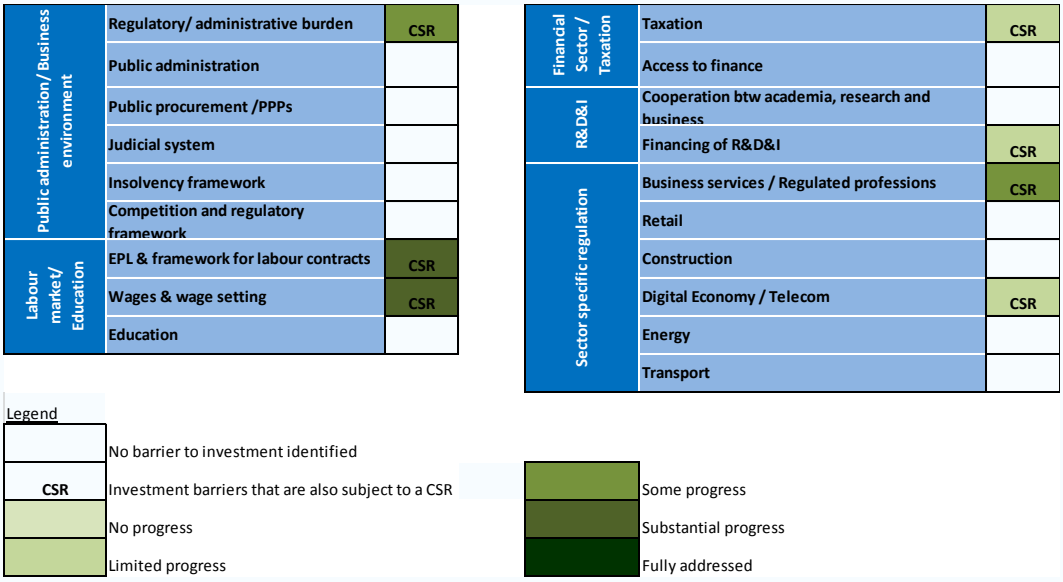
([35]) The distance to frontier (DTF) score helps assess the absolute level of regulatory performance of a country over time with higher values indicating a better performance. It measures the distance of each economy to the best performance observed on each of the indicators across all economies in the Doing Business sample.
([36]) European Commission, 2016g.
([37]) European Commission, 2016g.
([38]) European Commission, 2016g.

Box 4.4.1: Investment challenges and reforms in France

Section 1. Macroeconomic perspective

Total investment in France (measured as gross fixed capital formation) proved to be fairly resilient to the global financial crisis. Construction investment has been maintained at relatively high levels, standing at 11.6% of GDP in 2015, above the euro area average. Equipment investment is slowly gaining ground supported by fiscal incentives for amortisation, while investment in machinery and metal products has remained broadly stable following the crisis. Favourable financing conditions overall and improved profit margins continue to support investment by corporates despite their high indebtedness. All investment components are expected to contribute in 2017 to the increase in the share of investment in GDP, with a slightly stronger role played by investment in equipment.

Section 2. Assessment of barriers to investment and ongoing reforms



Barriers to private investment in France are moderate overall (European Commission, 2015b). Some progress has been made in reducing the regulatory and administrative burden on firms through continued implementation of the simplification programme. Efforts to streamline employment protection legislation and to review wages and the wage setting framework have been stepped up, notably through the 2016 labour market reform. France has also made some progress in making taxation more business-friendly, by further reducing the labour tax wedge and by allowing for a gradual reduction in corporate income taxes. Efforts to remove barriers to activity in the services sectors have resumed. However, there has been limited progress overall in improving the financing of R&D&I, supporting the digitalisation of the economy and improving the regulatory framework of the energy sector.

Main barriers to investment and priority actions underway

1. Among the main barriers to private investment, the regulatory environment remains a key aspect. Despite ongoing simplification efforts, firms are faced with a relatively heavy and complex regulatory framework while regulatory instability weighs on business perception (see Section 4.4). Regulatory bottlenecks in some network industries, notably in the energy and transport sectors, discourage investment in those sectors. Infrastructure investment faces administrative barriers such as lengthy authorisation procedures. The government has attempted to address these weaknesses, notably through the simplification programme. Among other things, the programme has eased authorisation requirements and building permits for renewable energy projects and for the deployment of broadband networks.

2. The level and complexity of the taxation system affects investment decisions. While efforts are being made to reduce the labour tax wedge and corporate income taxation, other taxes on production continue to increase, and the tax system remains complex (see section 4.1).

Regulatory instability remains high and weighs on business perceptions. Some 89 % of the French SMEs still find that fast-changing legislation is a problem for doing business in France (EU average: 64 %), in spite of the adoption of the 'regulation freeze' principle in 2013 according to which the introduction of any new rule should be followed by the removal or simplification of another rule ([39]). French firms find it crucial that the government focuses on a smaller number of changes, i.e. on those that indeed bring major simplifications, including at the level of state agencies and at local and regional levels ([40]). Impact assessments are a constitutional requirement for bill of laws and different requirements apply to decrees or by-laws. A 2015 circular ([41]) has provided guidance to the ministries on how to assess whether a regulation needs to be subject to an impact assessment and has set out the procedure to determine if the regulation must be subject to a SME panel.

Threshold effects continue to affect the evolution of firms with implications for their economic and market performance. Increased social and fiscal obligations applicable to firms above a certain number of employees may discourage them from expanding to a size that would allow them to export and innovate (Section 4.5 on innovation). These threshold effects can, in turn, affect firms' productivity, competitiveness and internationalisation. Indeed, according to empirical evidence, the 10 and 50 employee thresholds are particularly costly for employers ([42]), while the French economy is characterized by a disproportionally low share of companies above these thresholds implying a link between these two phenomena (European Commission, 2016c).

The government has taken systematic action to reduce red tape for businesses. The simplification programme, started in 2013 to simplify firms' administrative, fiscal and accounting rules (the '*choc de simplification*') and is ongoing. A new batch of 48 measures was announced on 24 October 2016, bringing the total number of business-oriented measures close to 463. Although the programme is progressing as planned, implementation is uneven with 262 business-oriented measures (63 %) currently in effect and a significant amount of measures adopted before 2016 not yet implemented ([43]). Moreover, the programme relies on a small number of measures for most of its effectiveness. While the savings for businesses from the 262 measures implemented so far are estimated at around EUR 5 billion a year ([44]), nearly EUR 3 billion of this should stem from simplifying declaration procedures linked to salaries and other social data on employees (the *declaration sociale nominative*).

New measures aim to support business creation and entrepreneurship. Among other things, the law on transparency, anti-corruption and economic modernisation of 8 November 2016 eased training requirements prior to starting a business and removed the requirement for micro-entrepreneurs to open a second bank account at least during the first year of business. The same law made it easier for growing small businesses to switch from sole trader status to another status, notably limited liability sole proprietorship status or single-member private company status. By contrast, since the end of 2015, France has not taken new initiatives to soften the impact of size-related requirements on companies' growth, while the effectiveness of the reforms that were adopted in 2015, notably the Social Dialogue law and the 2016 budget law, may be hampered by their limited scope and the temporary nature of some measures.

([39]) Under the Order of 17 July 2013 relating to the regulation chill (Circulaire du 17 juillet 2013 relative à la mise en oeuvre du gel de la réglementation).
([40]) European Commission, 2016g.
([41]) Circular of the Prime minister of 12 October 2015.
([42]) The 50 employee threshold is estimated to represent an aggregate cost of between 0.5 % and 4.5 % of GDP depending on the degree of downward wage rigidity (Garicano et al., 2016).
([43]) On 7 November 2016, France indicated that 89 measures adopted before 2016 were not in force yet. According to our estimates, this represents nearly one third of the measures adopted before 2016.
([44]) Study carried out by Ernst and Young on the basis of the French government's impact assessment analysis.

4.5. SECTORAL POLICIES

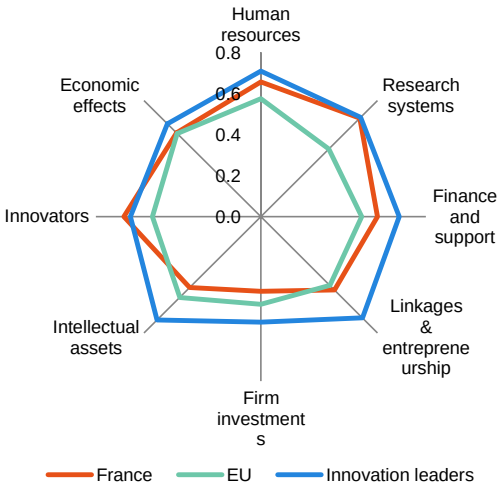
Innovation

The French national innovation system does not perform as well as Europe's innovation leaders. According to the 2016 European Innovation Scoreboard (EIS), France ranks 11th in the EU, and its performance has remained stable over time compared to the best performers: its combined performance in the scoreboard stood at 86 % of that of the innovation leaders ([45]) in 2015, against 85 % in 2008. France's strengths are in some enabling factors of innovation, such as the quality and openness of research systems ([46]) and skilled human resources ([47]). Factors linked to company activities and outputs show a contrasting picture. SMEs are rather good at introducing innovations. However, France ranks below the EU average for intellectual assets, especially trademarks and designs, despite high investment in this area (Subsection investment, Section 4.4). Finally, the performance is just above EU average for linkages (i.e. cooperation between actors in the innovation system) (Graph 4.5.1).

Private investment in R&D is just above EU average. At 1.5 % of GDP in 2015, France ranked 8th in the EU as regards private R&D spending, an intermediate position between the EU average (1.3 %), and the innovation leaders (1.8%). Furthermore, private R&D is concentrated in sectors of declining economic importance as measured by their value added (European Commission, 2016c).

In addition, private R&D comes at a high cost to public finances. France ranked 2nd in the EU in 2015 in terms of public funding of business R&D (Graph 4.5.2). The discrepancy between the amount of public support, the output in terms of private investment and its intermediate innovation performance raises questions about the efficiency of public support schemes. In particular, the research and innovation tax credit (CIR), which amounted to EUR 5.1 billion of foregone revenue in 2015 (0.3 % of GDP, and roughly three quarters of public support for private R&D) has a positive impact on corporate R&D, but its impact in terms of innovation output has yet to be proven. Its real impact may be to help firms that invest in R&D survive better than those that do not (OECD, 2014b).

Graph 4.5.1: **Performance of France's innovation system - distance to EU innovation leaders and to EU average**



(1) a score of 0 indicates the lowest performance among all countries in the sample, whereas 1 indicates the frontier of best practice.
Source: European Innovation Scoreboard (2016)

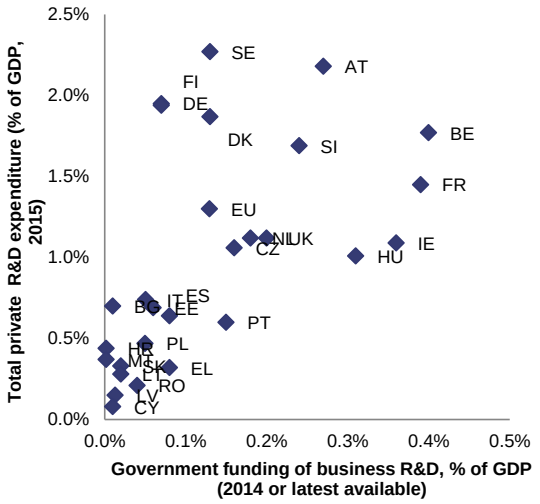
There is an increasing dispersion of public resources supporting innovation. Overall public support for innovation doubled over 15 years to 0.5 % of GDP in 2014, and the number of public schemes supporting innovation has followed a similar trend, increasing from 30 in 2000 to 62 in 2015 (Pisani-Ferry, J. *et al.*, 2016). Over the same period, the CIR was multiplied by more than 9, suggesting an important dispersion of remaining resources for other public support schemes. Regions also promote their own initiatives, coming on top of the state-supported ones.

The rising number of publicly-supported structures are challenging for overall consistency and coordination. Many structures to support innovation policy have been created in recent years. To the pre-existing competitiveness clusters (*pôles de compétitivité*), and Carnot Institutes, the Investment for the Future programme (*Programme d'Investissements d'Avenir*) has added the societies for technological transfers (SATT) and institutes for technological research (IRT). While these different structures each have their own specificities, they contribute

([45]) Sweden, Denmark, Finland, Germany and the Netherlands make up the group of innovation leaders in the European Innovation Scoreboard.
([46]) Measured by a high level of non-EU doctorate students, or a high number of international scientific co-publications
([47]) Measured by the high share of the population with upper secondary level education or completed tertiary education

to blurring the readability of the system for firms and overall coordination is a challenge (Ekeland M., Landier and Tirole, 2016). Public support schemes and structures are regularly evaluated but it is not clear how those evaluations are used to improve policies, at systemic level in particular.

Graph 4.5.2: **Efficiency of public funding of private R&D**



Source: OECD, R&D Tax Incentive Indicators and Main Science and Technology Indicators

Cooperation and transfers of competences and results between public research and companies is suboptimal, and weighs on the economic output of the innovation system. France lags behind innovation leaders in terms of public-private scientific co-publications – around 40 per million inhabitants against over 50 in Germany and above 60 in the Nordic countries (European Commission, 2016d). On the other hand, private funding of public R&D is also low by international comparison (Coordination interministérielle de l'innovation et du transfert, 2016). Generally speaking, universities and other public research organisations are weakly involved in the innovation ecosystem.

Many innovative small firms are created in France, but they have difficulties growing. The innovative landscape is dynamic, as attested by the high employment in fast-growing firms in the innovative sectors ([48]) (22 %, third highest rate in the EU). However, it might be too scattered in small entities to have a huge economic impact: although Paris counted more start-ups than London or Berlin in 2015 (Vilard, 2015), France only had 3 'unicorns', valued at EUR 6.7 bn, whereas Germany had 4 and the UK 17, valued at EUR 18 and EUR 40.4 bn respectively (GP Bullhound, 2015). While France has put in place many measures targeted at small innovative businesses (such as the tax credit for innovation), sometimes focussed on young innovative ones (such as the Young Innovative Enterprises tax scheme), the growth of small firms may still be hampered by the general business environment (section 5.4). Finally, financial capital resources to support scaling-up may not be available in sufficient quantity: venture capital as a share of GDP is twice lower than in the UK or Sweden (Ausilloux V.; Gouardo C., 2017).

([48]) Innovative sectors are defined as those having high knowledge intensity - share of employment with higher education degree larger than 33% - and innovation intensity.

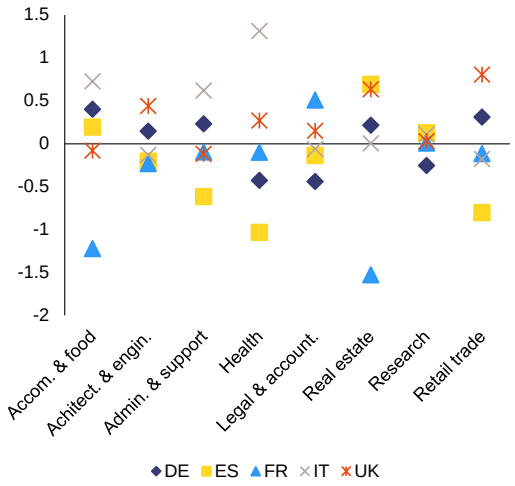
Competition in service markets*

Several service sectors of major economic importance in France are characterised by low competition compared to other service sectors in France and to the same sectors in neighbouring countries. This is the case for retail, accommodation and food services, health, architectural and engineering activities, administrative and service support activities, and real estate, according to a cross-country Commission study that compared the market performance of service sectors in France with that of other peer economies (DE, IT, ES, UK) ([49]). Competition in these sectors, as measured by trends in market concentration and profit margins (mark-ups), tends to be lower than the average

([49]) European Commission (2017), forthcoming. This two-step screening analysis aims at, first, assessing the market performance of sectors within France taking into account their economic importance, and, second, at comparing the performance of the sectors identified with that of its neighbours. The first step is based on the methodology approved and used in the 2009 Product Market Review. Market performance is captured by the level of competition (market share of the four largest firms, total number of firms, mark-ups), integration (trade openness and number of foreign affiliates over total number of firms), and innovation (labour quality, ICT contribution to value added growth and labour productivity growth). Economic importance is proxied by value added, household final consumption and investment shares. The analysis covers most of the French services sectors for the period 2010-2014 (given data availability constraints) and combines different databases (Eurostat, EU KLEMS, SPI, Orbis, World Input Output database).

level in Germany, Italy, Spain and the UK. (Graph 4.5.3).

Graph 4.5.3: **Competition per service sector and country**

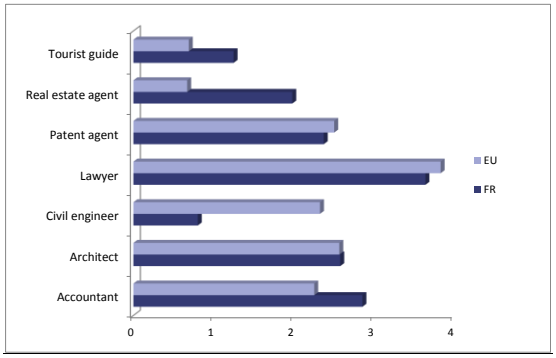


(1) The vertical axis denotes competition levels. Data reflect 2010-2014 averages.
Source: European Commission

The relatively low level of competition of French services is attributed to different sector-specific factors. In the sector of retail and, to a lesser extent, in architectural and engineering activities, newly-established companies and SMEs appear to have difficulty growing. This is shown by the lower survival rates compared to the neighbouring countries (while the birth and churn rates are relatively higher), and the significantly wider gap between SMEs and larger firms in terms of labour productivity growth. In health and in accommodation and food services, barriers to entry appear to play a role given the lower churn rates and higher survival rates of French firms. Finally, although legal and accounting services are more dynamic overall in France compared to Italy, Germany and the UK, mark-ups are higher and labour productivity growth for small firms is lower in France, implying the need to improve the market performance of these business services, notably given their stronger linkages with other economic sectors in France.

Market competition in regulated professions tends to be lower in France than in the EU generally. According to a Commission assessment which covered seven regulated professions across all 28 EU Member States (real estate agents, tourist guides, accountants, civil engineers, patent agents, lawyers and architects) (European Commission, 2017b), for all professions, market competition as proxied by the business churn (or turnover) rate is significantly lower in France than the EU average ([50]). With the exception of the construction and travel agency sectors, business churn rates in these regulated professions are also low when compared to the overall French economy. According to the same study, regulatory restrictions on real estate agents, tourist guides and accountants remain higher in France than in the rest of the EU. By contrast, restrictions are lower than the EU average for civil engineers, patent agents and lawyers, while restrictions on architects are close to the EU average.

Graph 4.5.4: **Regulatory restrictions, France and EU**



(1) For the profession of civil engineer the indicator for France measures the restrictiveness to carry the protected title
Source: European Commission

A number of legal professions are being reformed. The Growth, Activity and Equal Economic Opportunities Act (the 'Macron law') of 6 August 2015 aimed to improve competition in a number of services sectors with a particular focus on the legal professions. Among other things, the law lifted restrictions applied to legal corporate forms for a substantial number of legal professions ([51]). It also loosened ownership rules and joint practices for certain legal professions but also for accountants, architects and surveyors. For notaries, the law reviewed tariffs and established 247 free set-up zones, which could allow 1 650 additional notaries to set-up offices during the next

([50]) The business churn rate is the ratio of the sum of newly established and closed enterprises to the total number of enterprises. There are no data available for patent agent related activities.
([51]) Lawyers, lawyers before the supreme courts, notaries, court bailiffs, legal auctioneers, insolvency practitioners, and court appointed receivers.

two years, although a decree adopted in November 2016 allowed established notaries operating in professional civil partnerships from now on to open several offices. ([52]) Some of the 1 650 openings may be therefore occupied by existing notaries.

Access to professions and services in the healthcare sector is not optimal. While the Healthcare Act of 26 January 2016 (*Loi Santé*) allowed *inter alia* for an extension of the remit of certain professions that are restricted by law (such as midwives, and medical and dental assistants), it created or extended reserved activities for others (such as orthoptists and opticians). The overall impact of the law on health professions is therefore to be seen. The regulatory framework for home-care services was also reformed through the law of 28 December 2015 on the ageing society. However, the role of local authorities will be crucial to ensuring full implementation of the new common regime in order to prevent any discrimination between existing and newly authorised providers. Meanwhile, the quota on medical students (the so-called *numerus clausus*) has been increased by 11 % for 2017, with 478 additional places, 131 of them targeting regions where there are fewer doctors.

A number of passenger transport services are currently being reformed. The Macron law established a regulator for all land transport (ARAFER) and opened intercity domestic coach services to competition, which, combined with car-sharing services, has increased the range of long-distance transport services in France. According to ARAFER, as of 30 September 2016, 2050 direct jobs had been created and about 5.3 million passengers had been transported since the opening of the market in August 2015 ([53]). There are about 1 310 commercial routes serving 208 French towns outside of a public initiative. The new Public Service Obligation Regulation under the fourth European railway package is expected to increase competition in the domestic rail passenger market and improve the quality of services. The government and the association of French regions are considering setting up a legal framework (loi d'expérimentation) to allow regional authorities to award public service contracts on a competitive basis for certain regional lines or sub-networks as from 2019. On the other hand, there is no indication that France plans to review the legal monopoly of the SNCF for regional passenger rail transport before the end of the transition period in 2023.

The taxi and private hire vehicle sectors are still characterised by restrictions. Only a small number of new licences for taxis are issued every about 10 years, while the private hire vehicle sector, which pertains to the market of pre-booked rides, has grown rapidly since the relaxation of market entry rules in 2009. Nevertheless, following the adoption of sectorial legislation over the last three years, the operation of private hire vehicles is still subject to restrictions, such as the obligation to return to business premises after each ride unless the next ride is already booked. Among other things and in addition to the Thévenoud law of 2014 ([54]), a law affecting taxis and private hire vehicles was adopted on 29 December 2016 ([55]). It includes a revision of certain provisions applicable to these two sectors that aims to make the use of digital platforms more widespread, as well as some modifications concerning the provision of transport services. While the impact of the law will also depend on its implementation, it imposes some requirements which may limit the provision of reservation intermediation and transport services.

France is engaged in establishing the regulatory framework for collaborative economy activities introducing new requirements for collaborative platforms and related service providers. French consumers are particularly keen to use collaborative economy services. ([56]) These activities may have a significant potential for growth and innovation.([57]) France is a leader as regards start-up creation with more than 50 collaborative economy organisations currently

([52]) Decree 2016-1509 of 9 November 2016.

([53]) ARAFER, Analyse du marché libéralisé des services interurbains par autocar, Bilan du 3e trimestre 2016

([54]) Loi n° 2014-1104 du 1er octobre 2014 relative aux taxis et aux voitures de transport avec chauffeur.

([55]) Loi relative à la régulation, à la responsabilisation et à la simplification dans le secteur du transport public particulier de personnes (*Loi Grandguillaume*).

[56]) Eurobarometer 2016.

([57]) Together with the US, France is one of the world leaders, in terms of size and variety of collaborative economy activities (Pipame, 2015, p. 16).

founded in France ([58]).At the same time, France is engaged in establishing a specific regulatory framework for collaborative platforms and related service providers. ([59]) The rules proposed often increase the obligations and liability of collaborative economy actors, in particular collaborative platforms, with regard to the services offered by related providers.

Energy policy

Energy sector reforms have aimed to liberalise wholesale and retail markets. By progressively phasing out regulated prices for final consumers, France can help decrease market concentration, encourage competition in the energy sector and provide incentives to private consumers in terms of energy efficiency. In recent years, France has progressively phased out regulated prices for large commercial customers. Gas prices increased by 4 % and stood 2 % above the EU average in 2015. Electricity wholesale prices in France remain well below the EU average thanks to the low marginal costs of nuclear power generation (4 % below the EU average in 2015), although since 2008 this price differential has narrowed substantially. These prices remain higher than in Germany (by 22% in 2015). Meanwhile, real unit energy costs have increased and are higher in France than in the EU, reflecting not only the French industry mix and the increase in real energy prices observed over the past 10 years but also the slow improvements in energy intensity in the manufacturing sector. Undertaking new investments in generation on a pure market basis is a challenge in the current investment climate of low wholesale electricity prices and energy demand.

France is making efforts to develop a more integrated framework for addressing the 2020 climate and energy targets and other longer-term objectives. The renewable energy share in 2014 (14.3 %) is in line with the interim trajectory of 14.1% for 2013/2014, but well below the 2014 target of 16 % set by the French National Renewable Energy Plan Regarding energy efficiency, the regulatory and tax measures adopted in 2014 have not yet showed results. Energy intensity in the transport, industry and buildings sectors in France is below the EU average and has been decreasing (-0.7 %/year) over the last 10 years, although it remains above the levels of Germany, Italy and the UK. However, France would need to reduce its primary and final energy consumption further to reach its ambitious indicative national 2020 targets. Moreover, following the adoption of the Energy Transition Act on 17 August 2015, additional measures would allow for more energy savings (e.g. in buildings) and support investment in renewable energy in France partly with a view to the objective of reducing nuclear electricity's share to 50 % by 2025. As regards greenhouse gas emissions, France shows good results in terms of emission reductions in power generation, but results have not yet materialised in agriculture, which represents the second largest source of emissions, but also in industry and transport.

Regional cooperation and interconnections have improved. Overall, France is well interconnected with its neighbours. At 10.4 % in 2015, the interconnection capacity for electricity stands above the Energy Union 2020 target (10 %). In gas, output capacity has doubled and entry capacity has increased by 50 % in the last 10 years. The upcoming liquefied natural gas terminal in Dunkirk will also improve gas interconnection with Belgium.

([58]) Pricewaterhouse Coopers for the European Commission (2016), p. 8.

([59]) The 2016 budget law and the related rectifying law imposed information requirements on intermediary platforms vis-à-vis services providers concerning their social and fiscal obligations, and vis-à-vis the fiscal administration concerning the amount of revenues paid to the service providers; the 'El-Khomri' law provided for certain rights for platform workers, for instance regarding work accidents; the "*loi Lemaire*" regulated specific aspects of the collaborative economy, in particular in the accommodation sector; the 2017 draft law on financing of social welfare obliged persons who are active in short-term rental activities to declare themselves as self-employed and hence pay social security contributions once they reach an annual turnover threshold. These measures add to the reform of taxis and vehicles with drivers.

Box 4.5.1: Indebtedness of the State-owned network industries and implications for investment

The reported net debts of some State-owned energy companies and of the railway network operator are reaching high levels ([1]). The net debt of the railway infrastructure manager (SNCF *Réseau*) rose to EUR 39 billion by the end of 2015, more than doubling since the first railway reform in France in 1997, due mainly to significant investment in high-speed lines and maintenance, and to operational inefficiencies. At EUR 37 billion, the net debt of the French electric utility company EdF has also increased by a factor of 2.3 since 2007, in particular to support strong cross-border expansion of the company's activity, but also to support an ambitious investment programme and a sustained dividend policy. The net debt of AREVA, the French nuclear energy company, was EUR 6.3 billion at the end of 2015.

This indebtedness comes at a time of challenging market developments and greater need for productive investment. The average age of the railway network is about 32 years in France against 17 in Germany. The speed limit had to be reduced in 2015 for 600 km of railways due to safety reasons, bringing the total distance of the network subject to speed limits due to ageing to 4 000 km. EdF is confronted with structural changes in electricity markets, especially with a sharp fall in wholesale electricity prices in the past 5 years in Europe. AREVA is facing a market downturn following the Fukushima nuclear accident and a series of investment decisions with negative legal and economic implications. Coupled with the companies' high indebtedness, these adverse market developments accentuate the constraints on investment in maintenance and growth.

The financial situation of these state-owned companies represents a challenge for financing the necessary investments. EdF is expected to invest about EUR 10-15 billion per year for the next 10 years mostly across the EU to maintain, modernise and develop the company's productive assets. In the case of the SNCF *Réseau*, investment needs are projected at EUR 4-5 billion per year over the same period and broadly involve projects to renovate and expand the existing railway network. Investment in AREVA's new core business on nuclear fuel cycle has fallen from an annual average of EUR 1.3 billion in the period 2012-2014 to EUR 0.6 billion in 2015, reflecting the company's ongoing restructuring. Investment is expected to remain broadly at current levels for 2017-2020. Without healthy balance sheets these investment needs will not be met or will face delays with consequences for other sectors of the economy.

The French State is responding with a mix of capital increases and structural reforms, but the plans are subject to uncertainties and delays. The key measures of the 2014 railway sector reform, in particular, to manage SNCF *Réseau*'s indebtedness are being finalised. The multi-annual performance contract with the State was approved on 20 December 2016 by its Board of Directors, while ARAFER, the French transport regulator issued its opinion on the implementing decree for the investment prudential rule on 7 December 2016. The State's contribution to strengthening EdF will involve subscribing up to EUR 3 billion in a EUR 4 billion capital increase decided by EdF and the agreement to receive dividends for the fiscal years 2016 and 2017 in shares. Pushed by an unsustainable balance sheet and increasing global competition, AREVA has started a complete restructuring of its activities. The restructuring plan, formally investigated and cleared by the Commission under EU State aid rules, is a complex financing and industrial operation. Among other things, it aims at refocusing the company's core business on the nuclear fuel cycle by transferring these activities to the New AREVA Holding (*NewCo*).

([1]) The net debt (or net financial debt) corresponds to the liabilities and debts of a company minus its cash and other similar liquid assets.

ANNEX A

Overview Table

Commitments	Summary assessment ([60])
2016 Country-specific recommendations (CSRs)	
CSR 1: Ensure a durable correction of the excessive deficit by 2017 by taking the required structural measures and by using all windfall gains for deficit and debt reduction. Specify the expenditure cuts planned for the coming years and step up efforts to increase the amount of savings generated by the spending reviews, including on local government spending, by the end of 2016. Reinforce independent public policy evaluations in order to identify efficiency gains across all sub-sectors of general government.	France has made **limited progress** in addressing CSR 1 (this overall assessment of CSR 1 does not include an assessment of compliance with the Stability and Growth Pact):
• Ensure a durable correction of the excessive deficit by 2017 by taking the required structural measures and by using all windfall gains for deficit and debt reduction. Specify the expenditure cuts planned for the coming years and step up efforts to increase the amount of savings generated by the spending reviews, including on local government spending, by the end of 2016.	• The compliance assessment with the Stability and Growth Pact will be included in spring when final data for 2016 will be available.
• Reinforce independent public policy evaluations in order to identify efficiency gains across all sub-sectors of general government.	• **Limited progress** has been made in reinforcing the identification of savings and efficiency gains generated by the spending reviews and public policy evaluations. The savings made following

([60]) The following categories are used to assess progress in implementing the 2016 country-specific recommendations:

No progress: The Member State has not credibly announced or adopted any measure to address the CSR. Below a number of non-exhaustive typical situations that could be covered under this, to be interpreted on a case by case basis taking into account country-specific conditions:

• no legal, administrative, or budgetary measure has been announced in the National Reform Programme or in other official communication to the national Parliament / relevant parliamentary committees, the European Commission, or announced in public (e.g. in a press statement, information on government's website);

• no non-legislative act has been presented by the governing or legislator body;

• the Member State has taken initial steps in addressing the CSR, such as commissioning a study or setting up a study group to analyse possible measures that would need to be taken (unless the CSR explicitly asks for orientations or exploratory actions), while clearly-specified measure(s) to address the CSR has not been proposed.

Limited progress: The Member State has:

• announced certain measures but these only address the CSR to a limited extent;

and/or

• presented legislative acts in the governing or legislator body but these have not been adopted yet and substantial non-legislative further work is needed before the CSR will be implemented;

• presented non-legislative acts, yet with no further follow-up in terms of implementation which is needed to address the CSR.

Some progress: The Member State has adopted measures that partly address the CSR;

and/or

the Member State has adopted measures that address the CSR, but a fair amount of work is still needed to fully address the CSR as only a few of the adopted measures have been implemented. For instance: adopted by national parliament; by ministerial decision; but no implementing decisions are in place.

Substantial progress: The Member State has adopted measures that go a long way in addressing the CSR and most of which have been implemented.

Full implementation: The Member State has implemented all measures needed to address the CSR appropriately.

	the spending reviews in the PLF 2017 total EUR 400 million, which is a small amount given the structural efforts required. Also, the second wave of spending reviews has not resulted in any proposed savings. A number of further public policy evaluations were launched and a meta-evaluation is ongoing.
CSR 2: Ensure that the labour cost reductions are sustained and that minimum wage developments are consistent with job creation and competitiveness. Reform the labour law to provide more incentives for employers to hire on open-ended contracts.	France has made **substantial progress** in addressing CSR 2:
• Ensure that the labour cost reductions are sustained	• **Substantial progress** has been made in ensuring that labour cost reductions are sustained. The second phase of reductions in employers' social security contributions planned under the solidarity and responsibility pact started in April 2016, after the first phase introduced in 2015. In addition, the government has increased the tax credit for competitiveness and employment (CICE) from 6 % to 7 %. The 2016 national reform programme announced that the CICE would be transformed into permanent reductions in employers' social security contributions by 2018, but no details are available at the moment.
• and that minimum wage developments are consistent with job creation and competitiveness.	• **Some progress** has been made in ensuring that changes in the minimum wage are consistent with job creation and competitiveness. The minimum wage followed its indexation rule, leading to a 0.6 % increase on 1 January 2016. No intent to review the indexation mechanism has been expressed by the government.
• Reform the labour law to provide more incentives for employers to hire on open-ended contracts.	• **Substantial progress** has been made in reforming the labour law. The El Khomri law on labour, social dialogue and professional pathways was adopted in July 2016. However, its final effect will depend on its full implementation and on social partners taking ownership of the flexibility the law offers. The reform of Labour

	Courts introduced by the 2015 Macron law was completed with the adoption, in November 2016, of a decree reviewing the indicative ceilings for unjustified individual dismissals.
CSR 3: Improve the links between the education sector and the labour market, in particular by reforming apprenticeships and vocational training, with emphasis on the low-skilled. By the end of 2016, take action to reform the unemployment benefit system in order to bring the system back to budgetary sustainability and to provide more incentives to return to work.	France has made **limited progress** in addressing CSR 3:
• Improve the links between the education sector and the labour market, in particular by reforming apprenticeships and vocational training, with emphasis on the low-skilled.	• **Some progress** has been made in improving the links between the education sector and the labour market. The implementation of the 2014 vocational training reform is ongoing. Apprenticeship figures stopped decreasing in 2015. The El Khomri labour law introduces a new personal activity account (*CPA)*, entering into force in January 2017. It mostly reinforces training rights for non-qualified active workers.
• By the end of 2016, take action to reform the unemployment benefit system in order to bring the system back to budgetary sustainability and to provide more incentives to return to work.	• **No progress** has been made in reforming the unemployment benefit system. Social partners failed to agree on a new unemployment benefit convention in July, leading to an extension of the current 2014 convention. The timeline for adopting a reform of the unemployment benefit system is not clear yet.
CSR 4: Remove barriers to activity in the services sector, in particular in business services and regulated professions. Take steps to simplify and improve the efficiency of innovation policy schemes. By the end of 2016, further reform the size-related criteria in regulations that impede companies' growth and continue to simplify companies' administrative, fiscal and accounting rules by pursuing the simplification programme.	• France has made **some progress** in addressing CSR 4:
• Remove barriers to activity in the services sector, in particular in business services and regulated	• **Some progress** has been made regarding the removal of barriers to activity in the regulated professions through sectoral

professions.	legislation, notably the *Loi Macron* and the *Loi Santé*. France has adopted almost all the secondary legislation needed to implement provisions on liberalisation of professions that were not directly applicable. In other fields where reforms of the service sector were adopted in 2015 (e.g. home-care services), the legal framework was completed in 2016 and awaits implementation by local authorities. However, the ambition of measures to increase competition in regulated professions is lower than initially announced, mainly because of the implementation measures (for instance, as regards notaries). Some steps have also been taken to introduce competition in regional rail transport services for passengers on an experimental basis.
• Take steps to simplify and improve the efficiency of innovation policy schemes.	• **Limited progress** has been made to simplify and improve the efficiency of innovation policy schemes. While no recent measures have been adopted in this area, clear action to systematically evaluate innovation policy has been promoted in recent year(s), in particular by the National Commission for the Evaluation of Innovation Policies together with France Stratégie. These efforts include the evaluation of individual schemes (e.g. the CIR), and of the efficiency of the innovation policy as a whole. How these evaluations will be translated into policy practice is still to be seen.
• By the end of 2016, further reform the size-related criteria in regulations that impede companies' growth	• **No progress** to reform the size-related criteria in social and tax legislation has been made, as no new measures have been adopted in this area since the end of 2015**.**
• and continue to simplify companies' administrative, fiscal and accounting rules by pursuing the simplification programme.	• **Some progress** has been made to simplify companies' administrative, fiscal and accounting rules. The simplification programme is ongoing and encompasses

	new measures, but its implementation is slow. The 'Sapin II law' makes it easier for certain small companies to switch legal status, while it facilitates business creation by easing training requirements prior to starting a business and by removing the requirement for micro-entrepreneurs to open a second bank account at least during the first year of business.
CSR 5: Take action to reduce the taxes on production and the corporate income statutory rate while broadening the tax base on consumption, in particular as regards VAT. Remove inefficient tax expenditures, remove taxes that are yielding little or no revenue and adopt the withholding personal income tax reform by the end of 2016.	France has made **limited progress** in addressing CSR 5:
• Take action to reduce the taxes on production and the corporate income statutory rate while broadening the tax base on consumption, in particular as regards VAT.	• **Limited progress** has been made in reducing taxes on production and the corporate income. The last tranche of the turnover tax (C3S) has not been abolished and still weighs on 20 000 businesses. The statutory rate of corporate income tax will only be reduced to 28 % in 2017 for SMEs up to EUR 75 000 of profits. The objective of setting this rate at 28 % across the board by 2020 still stands. No progress on broadening the tax base on consumption, as the 2017 finance law does not remove or limit the use of reduced rates on VAT.
• Remove inefficient tax expenditures, remove taxes that are yielding little or no revenue and adopt the withholding personal income tax reform by the end of 2016.	• **Some progress** has been made in modernising the tax system. The withholding tax reform for personal income tax has been adopted by Parliament and will be introduced by 2018. However, tax expenditures keep increasing in number and in value and have exceeded the ceiling set in the 2014-2019 multiannual budgetary framework. In 2017, 14 new tax expenditures will be introduced while only 4 are to be suppressed and 5 come to an end. The removal of taxes yielding little or no revenue is progressing at a very slow pace.

Europe 2020 (national targets and progress)	
Employment rate (20-64): 75 %.	The employment rate for workers aged 20-64 was 69.5 % in 2015, a 0.2 pps. rise since 2014. This rise continued in the first half of 2016, with a 70.5 % employment rate in metropolitan France in the second quarter. Signs of improvement in job creation have been seen since the second half of 2015. Should this trend accelerate they could contribute to strengthening the employment rate. However, the 75 % target remains out of reach at this stage and could require further job-rich economic impetus.
R&D: 3.0 % of GDP.	Although there has been some progress in recent years, France is not on track to meet its target of spending 3% GDP on R&D by 2020. R&D intensity in 2015 was at 2.23 %, up from 2.02 % in 2007, with an average annual growth rate of 1.6 % in the period 2007-2015. - Public R&D intensity has been fairly stable over time, slightly decreasing to 0.74% GDP in 2015 from 0.77% in 2010. - Private R&D intensity has seen a slow but steady increase since 2008, and it stood at 1.45 % GDP in 2015.
Greenhouse gas emissions: -14 %, compared to 2005 emissions in the sectors not covered by the Emissions Trading Scheme (ETS).	Based on the latest national projections and taking into account existing measures, non-ETS emissions will fall by 18 % between 2005 and 2020. The -14 % target is thus expected to be met, by a margin of less than five percentage points. The preliminary estimates show the change in non-ETS greenhouse gas emissions between 2005 and 2014 was -17 %. The 2014 target for non-ETS emissions was achieved.
Renewable energy: 23 %, with a share of renewable energy in all modes of transport equal to 10 %.	With a renewable energy share of 14.3 % in 2014, which is slightly above its indicative interim target of 14.1 % for 2013/2014, France could reach its target for 2020 provided it taps into its renewable energy potential. However, the renewable energy share remains below the 16% target set in its National

	Renewable Energy Plan. Increased efforts are therefore needed, in particular in the heating and cooling sector and in electricity. Renewable energy developments will also need to be significant in the medium term to comply with the ambitious objectives of the Energy Transition Act.
Energy efficiency: 219.9 Mtoe in primary energy consumption and 131.4 Mtoe in final energy consumption.	France increased its primary energy consumption from 234.76 Mtoe in 2014 to 239.45 Mtoe in 2015. Final energy consumption also increased from 140.51 Mtoe in 2014 to 144.3 Mtoe in 2015. Although France has reduced the gap towards its indicative national 2020 targets, it would need to reduce its primary and final energy consumption further in order to reach these targets.
Early school leaving: 9.5 %.	The French early school leaving rate increased slightly from 9.0 % in 2014 to 9.2 % in 2015, remaining under the Europe 2020 target. Despite an early school leaving rate below the EU average, significant regional disparities remain. There are still too many young people, mainly among those with an immigrant background, who leave education with at most a lower secondary level diploma, while the labour market prospects of this group have significantly deteriorated.
Tertiary education: 50 % of the population aged 17-33 years old.	The French tertiary education attainment rate for the population aged 30-34 years was 45% in 2015 with women outperforming men (49.6 % against 40.3 %).
Target for reducing the number of people at risk of poverty or social exclusion: - 1 900 000 in cumulative terms since 2008.	The percentage of the total population at risk of poverty or social exclusion fell significantly decrease between 2014 and 2015, from 18.5 % to 17.7 %, which also led to a fall in the number of people at risk of poverty or social exclusion standing to 11 045, just below the 2008 reference figure. As for other Member States, the 2020 objective still remains out of reach.

ANNEX B
MIP Scoreboard

Table B.1: **The MIP scoreboard for France**

			Thresholds	2010	2011	2012	2013	2014	2015
External imbalances and competitiveness	Current account balance, (% of GDP)	3 year average	-4%/6%	-0.9	-0.9	-1.0	-1.0	-1.1	-0.7
	Net international investment position (% of GDP)		-35%	-9.3	-8.7	-12.8	-16.6	-16.9	-16.4
	Real effective exchange rate - 42 trading partners, HICP deflator	3 years % change	±5% & ±11%	-2.2	-4.4	-7.8	-2.3	-1.3	-2.7
	Export market share - % of world exports	5 years % change	-6%	-17.2	-15.1	-18.0	-14.3	-14.1	-5.4
	Nominal unit labour cost index (2010=100)	3 years % change	9% & 12%	7.5	5.5	4.4	4.6	4.6p	2.5p
Internal imbalances	Deflated house prices (% y-o-y change)		6%	3.6	3.9	-1.9	-2.6	-1.7	-1.3
	Private sector credit flow as % of GDP, consolidated		14%	4.6	6.4	4.4	2.1	3.0	4.4
	Private sector debt as % of GDP, consolidated		133%	131.8	135.3	138.5	137.7	142.4	144.3
	General government sector debt as % of GDP		60%	81.6	85.2	89.5	92.3	95.3	96.2
	Unemployment rate	3 year average	10%	8.6	9.2	9.4	9.8	10.1	10.3
	Total financial sector liabilities (% y-o-y change)		16.5%	3.3	6.7	1.2	0.4	4.2	1.8
New employment indicators	Activity rate - % of total population aged 15-64 (3 years change in p.p)		-0.2%	0.6	0.2	0.4	0.8	1.3	0.8
	Long-term unemployment rate - % of active population aged 15-74 (3 years change in p.p)		0.5%	0.5	1.0	0.7	0.5	0.6	0.6
	Youth unemployment rate - % of active population aged 15-24 (3 years change in p.p)		2%	3.8	3.7	0.8	1.6	1.6	0.3

(1) Figures highlighted are those falling outside the threshold established in the European Commission's Alert Mechanism Report. For REER and ULC, the first threshold applies to euro area Member States.
Flags: b: break in time series. p: provisional.
Source: European Commission

ANNEX C
Standard Tables

Table C.1: **Financial market indicators**

	2011	2012	2013	2014	2015	2016
Total assets of the banking sector (% of GDP)	407.8	387.0	372.6	382.1	373.7	390.5
Share of assets of the five largest banks (% of total assets)	48.3	44.6	46.7	47.6	47.2	-
Foreign ownership of banking system (% of total assets)	9.6	10.4	8.3	8.5	7.4	-
Financial soundness indicators:[1)]						
- non-performing loans (% of total loans)	4.6	4.5	4.6	3.6	3.5	3.4
- capital adequacy ratio (%)	12.2	14.0	15.0	15.2	16.4	16.7
- return on equity (%)[2)]	5.6	3.4	6.0	4.4	6.8	3.7
Bank loans to the private sector (year-on-year % change)	2.4	2.0	0.9	0.5	2.0	4.7
Lending for house purchase (year-on-year % change)	6.1	2.8	3.6	-2.8	3.2	4.6
Loan to deposit ratio	113.4	111.2	107.8	106.7	102.7	104.2
Central Bank liquidity as % of liabilities	4.4	4.6	2.8	2.3	2.3	1.8
Private debt (% of GDP)	135.3	138.5	137.7	142.4	144.3	-
Gross external debt (% of GDP)[1)] - public	50.5	54.6	57.2	62.7	60.8	62.7
- private	52.6	51.7	49.7	53.0	54.6	55.2
Long-term interest rate spread versus Bund (basis points)*	71.2	104.2	63.4	50.3	34.7	36.5
Credit default swap spreads for sovereign securities (5-year)*	94.9	85.7	38.9	31.0	24.4	22.7

(1) Latest data Q2 2016.
(2) Quarterly values are not annualised.
* Measured in basis points.
Source: European Commission (long-term interest rates); World Bank (gross external debt); Eurostat (private debt); ECB (all other indicators).

Table C.2: **Labour market and social indicators**

	2011	2012	2013	2014	2015	2016 [4]
Employment rate (% of population aged 20-64)	69.2	69.4	69.5	69.3	69.5	70.0
Employment growth (% change from previous year)	0.8	0.3	0.3	0.5	0.5	0.7
Employment rate of women (% of female population aged 20-64)	64.7	65.1	65.5	65.6	66.0	66.4
Employment rate of men (% of male population aged 20-64)	74.0	73.9	73.7	73.2	73.2	73.8
Employment rate of older workers (% of population aged 55-64)	41.4	44.5	45.6	46.9	48.7	49.7
Part-time employment (% of total employment, aged 15-64)	:	:	:	18.6	18.4	18.3
Fixed-term employment (% of employees with a fixed term contract, aged 15-64)	15.3	15.2	15.3	15.3	16.0	16.2
Transitions from temporary to permanent employment	11.6	10.9	11.1	7.9	10.9	:
Unemployment rate[1] (% active population, age group 15-74)	9.2	9.8	10.3	10.3	10.4	10.1
Long-term unemployment rate[2] (% of labour force)	3.6	3.7	4.0	4.2	4.3	4.3
Youth unemployment rate (% active population aged 15-24)	22.7	24.4	24.9	24.2	24.7	24.9
Youth NEET[3] rate (% of population aged 15-24)	12.3	12.5	11.2	11.4	12.0	:
Early leavers from education and training (% of pop. aged 18-24 with at most lower sec. educ. and not in further education or training)	12.3	11.8	9.7	9.0	9.2	:
Tertiary educational attainment (% of population aged 30-34 having successfully completed tertiary education)	43.1	43.3	44.0	43.7	45.0	:
Formal childcare (30 hours or over; % of population aged less than 3 years)	26.0	23.0	26.0	26.0	:	:

(1) The unemployed persons are all those who were not employed but had actively sought work and were ready to begin working immediately or within 2 weeks.
(2) Long-term unemployed are people who have been unemployed for at least 12 months.
(3) Not in education employment or training.
(4) Average of first three quarters of 2016. Data for total unemployment and youth unemployment rates are seasonally adjusted.
Source: European Commission (EU Labour Force Survey)

Table C.3: **Labour market indicators (cont.)**

Expenditure on social protection benefits (% of GDP)	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Sickness/healthcare	8.9	8.8	9.0	9.0	9.2	:
Disability	2.0	2.0	2.1	2.1	2.1	:
Old age and survivors	13.9	14.0	14.3	14.5	14.6	:
Family/children	2.5	2.5	2.5	2.5	2.5	:
Unemployment	1.9	1.9	2.0	2.0	2.0	:
Housing	0.8	0.8	0.8	0.8	0.8	:
Social exclusion n.e.c.	0.9	0.9	0.9	0.9	0.9	:
Total	30.9	30.8	31.5	31.9	32.2	:
of which: means-tested benefits	3.6	3.5	3.6	3.7	3.7	:
Social inclusion indicators	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
People at risk of poverty or social exclusion[1] (% of total population)	19.2	19.3	19.1	18.1	18.5	17.7
Children at risk of poverty or social exclusion (% of people aged 0-17)	22.9	23.0	23.2	20.8	21.6	21.2
At-risk-of-poverty rate[2] (% of total population)	13.3	14.0	14.1	13.7	13.3	13.6
Severe material deprivation rate[3] (% of total population)	5.8	5.2	5.3	4.9	4.8	4.5
Proportion of people living in low work intensity households[4] (% of people aged 0-59)	9.9	9.4	8.4	8.1	9.6	8.6
In-work at-risk-of-poverty rate (% of persons employed)	6.5	7.6	8.0	7.8	8.0	7.5
Impact of social transfers (excluding pensions) on reducing poverty	46.6	43.3	40.8	43.9	44.6	43.1
Poverty thresholds, expressed in national currency at constant prices[5]	11414	11238	11321	11248	11283	11330
Gross disposable income (households; growth %)	2.4	2.0	0.6	0.4	0.8	1.5
Inequality of income distribution (S80/S20 income quintile share ratio)	4.4	4.6	4.5	4.5	4.3	4.3
GINI coefficient before taxes and transfers	48.6	49.4	49.2	49.0	48.4	:
GINI coefficient after taxes and transfers	29.8	30.8	30.5	30.1	29.2	:

(1) People at risk of poverty or social exclusion (AROPE): individuals who are at risk of poverty and/or suffering from severe material deprivation and/or living in households with zero or very low work intensity.
(2) At-risk-of-poverty rate: proportion of people with an equivalised disposable income below 60 % of the national equivalised median income.
(3) Proportion of people who experience at least four of the following forms of deprivation: not being able to afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour TV, or ix) have a telephone.
(4) People living in households with very low work intensity: proportion of people aged 0-59 living in households where the adults (excluding dependent children) worked less than 20 % of their total work-time potential in the previous 12 months.
(5) For EE, CY, MT, SI and SK, thresholds in nominal values in euros; harmonised index of consumer prices (HICP) = 100 in 2006 (2007 survey refers to 2006 incomes)
Source: For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC

Table C.4: **Product market performance and policy indicators**

Performance indicators	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Labour productivity (real, per person employed, year-on-year % change)						
Labour productivity in industry	4.27	3.02	1.47	2.87	0.45	3.08
Labour productivity in construction	-1.46	-1.94	-4.75	2.29	-0.93	-0.97
Labour productivity in market services	1.48	1.68	0.19	1.13	0.94	0.21
Unit labour costs (ULC) (whole economy, year-on-year % change)						
ULC in industry	-0.93	-0.82	1.11	-0.31	0.68	-2.09
ULC in construction	2.39	3.99	5.85	0.91	1.08	0.21
ULC in market services	0.63	-0.27	1.75	0.87	0.45	0.50
Business environment	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Time needed to enforce contracts[1] (days)	390.0	390.0	390.0	395.0	395.0	395.0
Time needed to start a business[1] (days)	6.5	6.5	6.5	6.5	4.5	4.0
Outcome of applications by SMEs for bank loans[2]	0.54	0.46	0.59	0.60	0.53	0.51
Research and innovation	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
R&D intensity	2.18	2.19	2.23	2.24	2.24	2.23
Total public expenditure on education as % of GDP, for all levels of education combined	5.86	5.68	5.68	na	na	na
Number of science & technology people employed as % of total employment	43	46	47	47	49	49
Population having completed tertiary education[3]	26	27	28	29	30	30
Young people with upper secondary education[4]	83	84	84	86	88	87
Trade balance of high technology products as % of GDP	0.60	0.42	0.68	0.76	0.80	0.95
Product and service markets and competition				**2003**	**2008**	**2013**
OECD product market regulation (PMR)[5], overall				na	1.52	1.47
OECD PMR[5], retail				3.76	3.80	2.64
OECD PMR[5], professional services				2.20	2.45	2.34
OECD PMR[5], network industries[6]				3.37	2.77	2.51

1 The methodologies, including the assumptions, for this indicator are shown in detail at: http://www.doingbusiness.org/methodology.
2 Average of the answer to question Q7B_a. "[Bank loan]: If you applied and tried to negotiate for this type of financing over the past six months, what was the outcome?". Answers were codified as follows: zero if received everything, one if received most of it, two if only received a limited part of it, three if refused or rejected and treated as missing values if the application is still pending or if the outcome is not known.
3 Percentage population aged 15-64 having completed tertiary education.
4 Percentage population aged 20-24 having attained at least upper secondary education.
5 Index: 0 = not regulated; 6 = most regulated. The methodologies of the OECD product market regulation indicators are shown in detail at: http://www.oecd.org/competition/reform/indicatorsofproductmarketregulationhomepage.htm
6 Aggregate OECD indicators of regulation in energy, transport and communications.
Source: European Commission; World Bank — Doing Business (for enforcing contracts and time to start a business); OECD (for the product market regulation indicators); SAFE (for outcome of SMEs' applications for bank loans).

Table C.5: **Green growth**

Green growth performance		2010	2011	2012	2013	2014	2015
Macroeconomic							
Energy intensity	kgoe / €	0.13	0.13	0.13	0.13	0.12	0.12
Carbon intensity	kg / €	0.28	0.26	0.26	0.26	0.24	-
Resource intensity (reciprocal of resource productivity)	kg / €	0.43	0.43	0.42	0.41	0.40	0.39
Waste intensity	kg / €	0.19	-	0.18	-	0.17	-
Energy balance of trade	% GDP	-2.4	-3.0	-3.3	-3.1	-2.5	-
Weighting of energy in HICP	%	8.21	9.29	9.93	9.45	9.85	9.41
Difference between energy price change and inflation	%	4.9	8.0	3.3	2.9	1.3	-0.7
Real unit of energy cost	% of value added	9.6	10.8	11.2	10.9	10.9	-
Ratio of environmental taxes to labour taxes	ratio	0.08	0.08	0.08	0.08	0.08	-
Environmental taxes	% GDP	1.9	1.9	2.0	2.0	2.0	-
Sectoral							
Industry energy intensity	kgoe / €	0.12	0.11	0.11	0.12	0.11	0.11
Real unit energy cost for manufacturing industry excl. refining	% of value added	14.3	16.3	16.3	15.9	16.0	-
Share of energy-intensive industries in the economy	% GDP	6.69	6.74	6.79	6.95	6.90	6.99
Electricity prices for medium-sized industrial users	€ / kWh	0.07	0.08	0.09	0.09	0.10	0.10
Gas prices for medium-sized industrial users	€ / kWh	0.03	0.04	0.04	0.04	0.04	0.04
Public R&D for energy	% GDP	0.05	0.05	0.05	0.05	0.04	0.05
Public R&D for environmental protection	% GDP	0.02	0.01	0.01	0.01	0.01	0.02
Municipal waste recycling rate	%	34.9	36.9	37.8	38.6	39.2	39.5
Share of GHG emissions covered by ETS*	%	25.1	24.3	23.7	23.8	22.1	21.2
Transport energy intensity	kgoe / €	0.63	0.61	0.60	0.61	0.62	0.62
Transport carbon intensity	kg / €	1.70	1.66	1.61	1.64	1.65	-
Security of energy supply							
Energy import dependency	%	49.0	48.8	48.3	48.1	46.1	46.0
Aggregated supplier concentration index	HHI	7.8	7.4	7.9	8.6	9.0	-
Diversification of energy mix	HHI	0.30	0.32	0.31	0.30	0.33	-

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2005 prices)
- Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)
- Carbon intensity: greenhouse gas emissions (in kg CO2 equivalents) divided by GDP (in EUR)
- Resource intensity: domestic material consumption (in kg) divided by GDP (in EUR)
- Waste intensity: waste (in kg) divided by GDP (in EUR)

Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP
Weighting of energy in HICP: the proportion of 'energy' items in the consumption basket used for the construction of the HICP
Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual % change)
Real unit energy cost: real energy costs as a percentage of total value added for the economy
Environmental taxes over labour taxes and GDP: from European Commission's database, 'Taxation trends in the European Union'
Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)
Real unit energy costs for manufacturing industry excluding refining: real costs as a percentage of value added for manufacturing sectors
Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP
Electricity and gas prices for medium-sized industrial users: consumption band 500-20 00MWh and 10 000-100 000 GJ; figures excl. VAT.
Recycling rate of municipal waste: ratio of recycled and composted municipal waste to total municipal waste
Public R&D for energy or for the environment: government spending on R&D for these categories as % of GDP
Proportion of greenhouse gas (GHG) emissions covered by EU Emissions Trading System (ETS) (excluding aviation): based on greenhouse gas emissions (excl land use, land use change and forestry) as reported by Member States to the European Environment Agency
Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transport industry gross value added (in 2005 EUR)
Transport carbon intensity: greenhouse gas emissions in transport activity divided by gross value added of the transport sector
Energy import dependency: net energy imports divided by gross inland energy consumption incl. consumption of international bunker fuels
Aggregated supplier concentration index: covers oil, gas and coal. Smaller values indicate larger diversification and hence lower risk.
Diversification of the energy mix: Herfindahl index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels
* European Commission and European Environment Agency
Source: European Commission (Eurostat) unless indicated otherwise

REFERENCES

Ausilloux V., Gouardo C. (2017), *Mobiliser l'épargne pour le financement des startup*, France Stratégie, January.

Balassa B. (1966), *Tariff Reductions and Trade in Manufactures among the Industrial Countries*, American Economic Review 56: 466-72, 1966.

Cahuc P. and Prost C. (2015), *Améliorer l'assurance chômage pour limiter l'instabilité de l'emploi*, Note du Conseil d'Analyse Economique No. 24, September 2015.

CASE (2016), *Study and reports on the VAT Gap in the EU-28 Member States: 2016 Final report*, TAXUD/2015/CC/131, Centre for Social and Economic Research, Institute for Advances Studies Warsaw.

Comité de suivi du crédit d'impôt pour la compétitivité et l'emploi (2016), "*Rapport 2016 du Comité de suivi du crédit d'impôt pour la compétitivité et l'emploi*," France Stratégie.

Coordination interministérielle de l'innovation et du transfert (2016), *L'innovation en France, Indicateur de positionnement international*, Ministère de l'éducation nationale, de l'enseignement supérieur et de la recherhce, Ministère de l'économie, de l'Indutsrie et du numérique.

Council of the European Union (2015), *Council recommendation with a view to bringing an end to the excessive government deficit in France*. Available at: http://data.consilium.europa.eu/doc/document/ST-6704-2015-INIT/en/pdf

Cour des Comptes (2016a), *L'accès des jeunes à l'emploi*, September 2016.

Cour des Comptes (2016b), *Les finances publiques locales, Rapport sur la situation financière et la gestion des collectivités territoriales et de leurs établissements publics*, October 2016.

Cour des Comptes (2016c), *Simplifier la collecte des prélèvements versés par les entreprises*, July 2016.

CNESCO (2016a), *Inégalités sociales. Comment l'école amplifie-t-elle les inégalités sociales et migratoires ?*, September 2016.

CNESCO (2016b), *Enseignement professionnel synthèse*.

CNESCO (2016c), *Enseignement professionnel état des lieux*.

CNEFOP (2016a), *Rapport sur le financement et les effectifs de l'apprentissage en 2013*, September 2016.

CNEFOP (2016b), *1er Rapport sur la mise en œuvre du CPF et du CEP*.

DARES (2016a), *Tableau de Bord à fin mars 2016, activité des jeunes et politiques d'emploi*, August 2016.

DARES (2016b), *L'apprentissage en 2015*, DARES Analyses n.2016-044, September 2016.

De Galhau F.V. (2015), *Le financement de l'investissement des entreprises*, September 2015.

DEPP (2016a), *CEDRE 2015 Nouvelle évaluation en fin de collège: compétences langagières et littératie*, Note d'information, n°21 July 2016.

DEPP (2016b), *Évaluation numérique des compétences du socle en début de sixième: des niveaux de performance contrastés selon les académies*, Note d'information, n° 18, June 2016.

DEPP (2016c), *Parcours scolaires, diplômes, insertion*, Note d'information n° 17, June 2016.

DEPP (2016d), *Repères et références statistiques (RERS)*, 2016.

Douanes (2015), *Les opérateurs du commerce extérieur de la France – Année 2015* (*résultats révisés*), *Le chiffre du commerce extérieur*, Direction générale des douanes et droits indirects.

Dujardin, M., Kelber, A. and Lalliard, A. (2015), *Overvaluation in the housing market and returns on residential real estate in the euro area: insights from data in euro per square metre*, Banque de France Quarterly Selection of Articles, No. 37, Spring.

Ekeland M., Landier A. and Tirole J. (2016), *Renforcer le capital-risque français*, Note du Conseil d'Analyse Economique No. 33, July

European Central Bank (2016), *The Household Finance and Consumption Survey: results from the second wave*, Statistics Paper Series no. 18, December 2016.

European Commission (2015a), *Ageing Report 2015*.

European Commission (2015b), *Challenges to Member States' Investment Environments*, SWD (2015) 400 final. Available at:
http://ec.europa.eu/europe2020/challenges-to-member-states-investment-environments/index_en.htm

European Commission (2015c), *2015 Macroeconomic imbalances. Country Report – France 2015*. Available at:
http://ec.europa.eu/economy_finance/publications/occasional_paper/2015/pdf/ocp217_en.pdf

European Commission (2016b), *2017 Alert Mechanism Report*. Available at:
https://ec.europa.eu/info/publications/2017-european-semester-alert-mechanism-report_en

European Commission (2016c), *2016 Country Report for France*. Available at:
http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_france_en.pdf

European Commission (2016d), *Joint Report on Health Care and Long Term Care Systems and Fiscal Sustainability* – Vol. 2 Country Documents: Health Care Systems, France (2016), prepared by the Commission (DG ECFIN) and the Economic Policy Committee (Ageing Working Group). Available at:
http://ec.europa.eu/economy_finance/publications/eeip/pdf/ip037bycountry/joint-report_fr_en.pdf

European Commission (2016e), *EU Tax Policies: 2016 Scoreboard, Publications Office of the European Union*, Luxembourg.

European Commission (2016f), *European Innovation Scoreboard*. Available at:
https://ec.europa.eu/growth/industry/innovation/facts-figures/scoreboards_en

European Commission (2016g), *Small Business Act (SBA) Fact sheet*. Available at:
http://ec.europa.eu/growth/smes/business-friendly-environment/performance-review-2016_en#sba-fact-sheets

European Commission (2016h), *Survey on the Access to Finance and Enterprise (SAFE)*. Available at:
http://ec.europa.eu/growth/access-to-finance/data-surveys_en

European Commission (2016i), *Report on Single Market Integration and Competitiveness in the EU and its Member States*. Available at: https://ec.europa.eu/growth/industry/competitiveness/reports/single-market-integration-competitiveness_en

European Commission (2017a), *Debt Sustainability Monitor 2016*. Available at: https://ec.europa.eu/info/publications/debt-sustainability-monitor-2016_en

European Commission (2017b), *Communication of the Commission of 10 January 2017 on reform recommendations for regulation in professional services* COM(2016)820 and *accompanying staff working document* COM(2016)436

European Commission (2017c), *France – Review Of Progress On Policy Measures Relevant For The Correction Of Macroeconomic Imbalances*. Available at: https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-performance-country/france/macroeconomic-surveillance-france_en

European Commission (2017d), *Winter 2017 economic forecast*. Available at: https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-forecasts/winter-2017-economic-forecast_en

European Commission (, forthcoming), *Identifying priority sectors for reforms in services*, Institutional Papers Series.
European Commission (2016, *Taxation Trends in the European Union*, 2016 edition, Publications Office of the European Union, Luxembourg.

France Stratégie (2016a), *Le cout économique des discriminations*, September 2016.

France Stratégie (2016b), *Quels principes pour une fiscalité simplifiée*, August 2016.

Fondation Abbé Pierre (2016), *21^{e} rapport annuel l'Etat de mal-logement en France.*

Garicano L., Lelarge C., Van Reenen J. (2016), *Firm size distortions and the productivity distribution: evidence from France*, American Economic Review, Vol 11. .

GP Bullhound (2015), *European unicorns: Do they have legs?*, Independent Technology research. Available at: http://www.gpbullhound.com/wp-content/uploads/2015/06/GP-Bullhound-Research-Billion-Dollar-Companies-2015.pdf

Haut Conseil des Finances Publiques (2016), *Avis n°2016-3 relatif aux projets de lois de finances et de financement de la sécurité sociale pour l'année 2017*, 24 September 2016.

Hobza A. and Zeugner S. (2014), *Current accounts and finacial flows in the euro area*, Journal of Internation Money and Finance, vol. 48, pages 291-313.

Héricourt J., Martin P. and Orefice G. (2014), *Les exportations françaises face aux variations de change*, La Lettre du CEPII, January 2014.

Kant, J.-D., Ballot, G. and Goudet O. (2016), *Worksim project*. Available at: http://worksim.lip6.fr/

INSEE (2016), *Niveaux de vie en 2014*, INSEE Première no. 1614, September 2016.

International Monetary Fund (2016), *Global Financial Stability Report: Potent Policies for a Successful Normalization*, April 2016.

Landais C., Piketty T. and Saez E. (2011), *Pour une révolution fiscale. Un impôt sur le revenu pour le XXIe siècle*, La République des idées-Le Seuil, 2011.

MENESR (2015), *Rapport annuel au parlement*, Comité de suivi de la Loi de refondation de l'école, 13 November 2015.

National Tax Lists (2016). Available at: http://ec.europa.eu/eurostat/statistics-explained/index.php/Tax_revenue_statistics

OECD (2012), *Close the gender gap: Act now!*, Report 2012.

OECD (2014a), *International Migration Outlook 2014*, OECD Publishing, Paris..

OECD (2014b), *OECD Reviews of Innovation Policy: France 2014*, OECD Publishing, Paris.

OECD (2015a), *Débats sur les politiques migratoires No 6. L'école est-elle (encore) un des principaux vecteurs d'intégration en France ?*

OECD (2015b), *Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies*, OECD Publishing, Paris.

OECD (2016a), Economic Outlook No 100, November 2016.

OECD (2016b), *Low-Performing Students: Why They Fall Behind and How to Help Them Succeed*, Country note France.

OECD (2016c), *Les impôts sur les salaires 2016*, May 2016.

Pipame, Pôle interministériel de Prospective et d'Anticipation des Mutations économiques (2015), *Enjeux et perspectives de la consommation collaborative*, June 2015. Available at: http://www.entreprises.gouv.fr/files/files/directions_services/etudes-et-statistiques/prospective/Numerique/2015-07-Consommation-collaborative-Rapport-final.pdf

Pisani-Ferry, J. et al. (2016), *Quinze ans de politiques d'innovation en France*, Rapport de la Commission nationale d'évaluation des politiques d'innovation, January 2016.

Price Waterhouse Coopers for the European Commission (2016), *Assessing the size and presence of the collaborative economy in Europe*, 2016.

Ratto M., Roeger W., and in 't Veld J. (2009), *QUEST III: An Estimated Open-Economy DSGE Model of the Euro Area with Fiscal and Monetary Policy*, Economic Modelling, 26 (2009), pp. 222-233.

Senate (2016), *Information report on the annual assessment of the laws' enforcement*, 31 May 2016, Report n° 650. Available at: https://www.senat.fr/notice-rapport/2015/r15-650-notice.html

Sutherland H. and Figari F. (2013), *EUROMOD: the European Union tax-benefit microsimulation model*, International Journal of Microsimulation, 6(1) pp. 4-26I.

Taly, M. (2016), *Les coulisses de la politique fiscale*, PUF.

Unédic (2016), *Situation financière de l'Assurance chômage : prévision 2016-2017*, February 2016.

Vandenbussche H. (2014), *Quality in Exports*, European Economy Economic Papers 528, September 2014.

Varga J. and in 't Veld J. (2014), *The potential growth impact of structural reforms in the EU. A benchmarking exercise*, European Economy Economic Papers 541.

Villard N. (2015), *La France, ce pays qui crée des start-up à la chaîne !*, Capital, 9 June 2015, Available at:

World Bank Group and PwC (2016), *Paying taxes 2017: The Global Picture*, November.

World Bank (2017), *Doing Business*. Available at: http://www.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB17-Report.pdf

ZEW (2016), *The Effects of Tax Reforms to Address the Debt-Equity Bias on the Cost of Capital and on Effective Tax Rates*, Taxation paper No. 65, 2016.