

Unclassified

ECO/WKP(2007)31



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

01-Aug-2007

English - Or. English

ECONOMICS DEPARTMENT

ECO/WKP(2007)31
Unclassified

MEETING THE CHALLENGES OF DECENTRALISATION IN FRANCE

ECONOMICS DEPARTMENT WORKING PAPERS No. 571

By
Stéphanie Jamet

All Economics Department Working Papers are available through OECD's Internet Web site at
http://www.oecd.org/eco/working_papers

JT03230695

Document complet disponible sur OLIS dans son format d'origine
Complete document available on OLIS in its original format

English - Or. English

ABSTRACT

Meeting the challenges of decentralisation in France

Despite France's previously well-deserved reputation as a highly centralised state, a significant number of responsibilities have been devolved to regional and local government over the past two decades. The process has not been easy. The extremely large number of very small municipalities makes economies of scale in the implementation of policies hard to realise, and measures to overcome this have been at best only partially successful. Competence is often shared between levels of government, obscuring accountability, and the central government has often retained an arguably unnecessary degree of prerogatives. Reorganising the system to avoid overlapping responsibilities and improving transparency and accountability in local government finance provide some difficult challenges.

This Working Paper relates to the 2007 OECD *Economic Survey of France* (www.oecd.org/eco/survey/france), and is also available in French under the title "Faire face aux défis de la décentralisation en France".

JEL classification: H71, H72, H77

Keywords: France, fiscal federalism, decentralisation, public expenditure efficiency

Copyright © OECD, 2007. All rights reserved.

**Application for permission to reproduce or translate all, or part of, this material should be made to:
Head of Publications Service, OECD, 2 rue André-Pascal, 75775 PARIS CEDEX 16, France.**

Table of contents

| | |
|---|----|
| Meeting the challenges of decentralisation in France | 5 |
| The growing importance of local public finances | 5 |
| The main characteristics of the system of sub-national governments | 7 |
| A “multi-layered” system with shared responsibilities | 9 |
| Local government resources | 10 |
| Inequalities between municipalities are substantial | 13 |
| The special case of the RMI | 14 |
| Limiting pressures on government spending | 16 |
| Improving inter-governmental co-operation | 16 |
| Ensuring that the system’s organisation does not hamper its effectiveness | 17 |
| Developing an information system to stimulate competition and allow sub-national government spending to be evaluated | 19 |
| Making sub-national governments accountable with resources while at the same time limiting pressures on compulsory levies | 19 |
| A system with little transparency that does not give sub-national governments financial autonomy ... | 20 |
| Towards ensuring effectiveness through accountability | 22 |
| Conclusion and summary of recommendations | 23 |
| Bibliography | 25 |
| Glossary | 26 |
| | |
| Boxes | |
| 1. Co-operation between municipalities | 9 |
| 2. Financial transfers from the State to sub-national governments | 12 |
| 3. Decentralisation and government employment | 17 |
| 4. Business tax | 20 |
| 5. Summary of recommendations to meet the challenges of decentralisation | 24 |
| | |
| Tables | |
| 1. Sub-national government – Who does what? | 11 |
| 2. Breakdown of the variance in resources by region and <i>département</i> | 14 |
| | |
| Figures | |
| 1. Central and sub-national governments spending and revenue trends | 6 |
| 2. Government deficit and debt | 7 |
| 3. Decentralisation ratios in the OECD countries | 8 |
| 4. Per-capita GDP disparities between regions | 13 |
| 5. Impact of transfers of responsibilities on expenditure by sub-national governments | 16 |
| 6. Resources of sub-national governments | 20 |

MEETING THE CHALLENGES OF DECENTRALISATION IN FRANCE

By Stéphanie Jamet¹

Over the past twenty-five years, France has moved forward in a decentralisation process intended to shift new powers and responsibilities to local officials and sub-national levels of government. Ultimately, this new division of powers, by bringing policymakers and citizens closer together, should make it possible to offer high-quality policies tailored to the diversity of local circumstances. But while decentralisation promises to deliver positive outcomes in policy effectiveness, there can be no guarantees, and the transition towards a State with less centralised powers is a difficult exercise. A number of problems have emerged in France that are linked to the system's complexity, the sharing of responsibilities and insufficient empowerment of sub-national governments. Since decentralisation remains in a transitional phase, it is important that solutions to these problems be found rapidly so the system can evolve towards a more effective organisation of power-sharing.

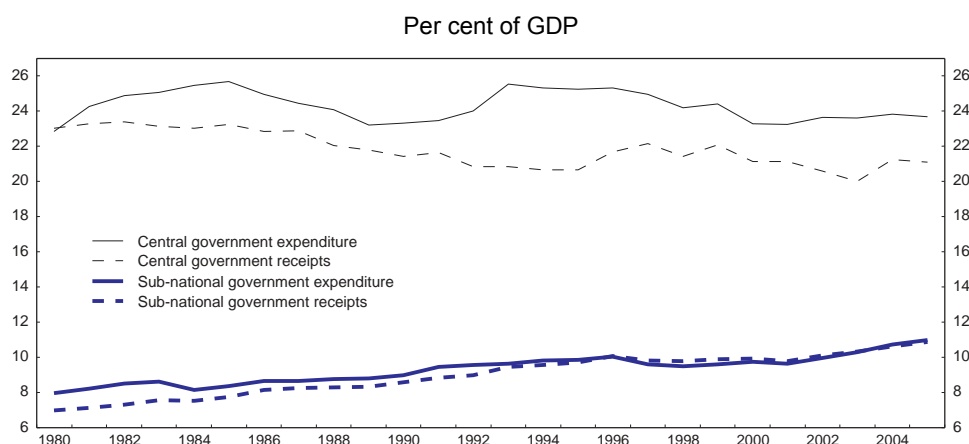
While the French budget situation has improved somewhat in recent years, since 1980 the debt burden has tripled as a proportion of GDP, whereas France, like other OECD countries, has been forced to contend with new budgetary pressures. Decentralisation is not unrelated to these trends, even if it is not the primary cause. As a result, the future sustainability of public finances hinges to some extent on the success of decentralisation, and more specifically on the balance to be struck in all of the relationships between the State and sub-national levels of government.

The growing importance of local public finances

While France remains a centralised country, the importance of local public finances has expanded continuously over the past 25 years, and today's spending by sub-national governments has reached 11% of GDP, or 20% of aggregate public expenditure (Figure 1). The growing importance of local government spending has not been accompanied by a deterioration of the finances of those governments (Figure 2). Their budgets have been practically balanced since the early 1990s, and their debt burden is low in relation to GDP and has declined over that period.

The soundness of local public finances is the result of a budget rule that compels sub-national governments to fund all of their operating expenses out of their own revenues (taxes, transfers and operating income). Only to finance capital investment may they incur debt, and this limits the widening of their deficits. Many other OECD countries also impose fiscal obligations to limit the indebtedness of

1. This paper was originally produced for the OECD *Economic Survey of France*, published in June 2007 under the responsibility of the Economic and Development Review Committee. Stéphanie Jamet is an economist in the OECD Economics Department. The author is thankful to Paul O'Brien, Peter Jarrett and Claire Charbit for their helpful comments on previous drafts and to Céline Letrémy for her help on this work. The author also thanks Andrew Dean and Val Koromzay for useful comments as well as Raoul Doquin St. Preux and Mee-Lan Frank for excellent technical assistance.

Figure 1. Central and sub-national governments spending and revenue trends¹

1. Social security expenditure and receipts are not included.

Source: OECD, National Accounts.

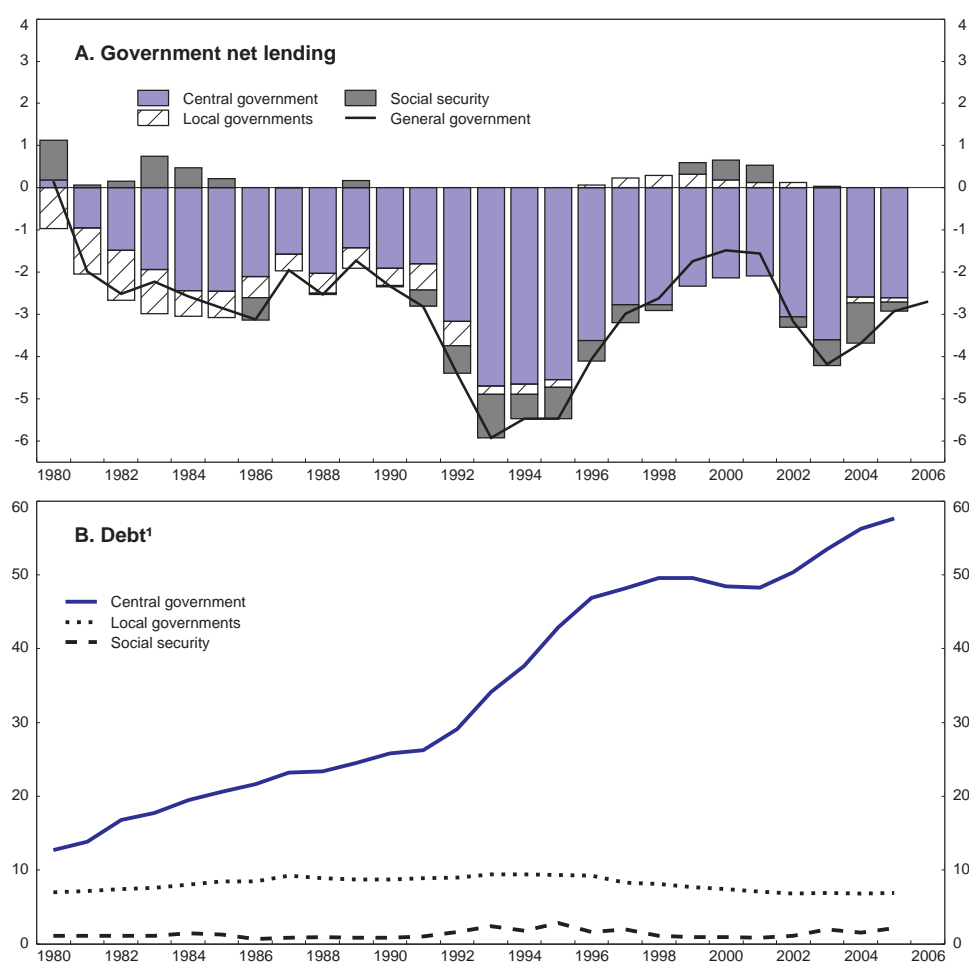
sub-national governments, thus prompting them to balance their budgets. A comparison with the fiscal rules of the other OECD countries shows that the rules in France are effective in ensuring the sustainability of sub-national government indebtedness, but that they impose no constraints on the growth of the public sector as a whole (Sutherland *et al.*, 2005). This finding is consistent with comparative spending and revenue trends for the central and sub-national governments. The rise in spending by sub-national governments was only partially offset by the drop in State expenditure, and, in all, since 1980 the total of this expenditure has risen by four percentage points of GDP. Aggregate taxes and social charges imposed by all levels of government rose by two points of GDP over the same period.

France, like other OECD countries, will have to cope with strains resulting from spending triggered by population ageing (OECD, 2007), and sub-national governments will not be spared by those pressures. As yet unfunded retirement benefits for employees of those governments are very substantial (Pébèreau, 2005). Local and regional authorities will have to address the population's growing needs for long-term care, especially insofar as they bear responsibility for administering the "personalised autonomy" benefit (*aide personnalisée d'autonomie* – APA) for people over 60 who lose the ability to care for themselves. Demographic trends can be expected to allow unemployment to recede, which would consequently limit expenditure on the minimum subsistence income (RMI), which is financed by the *départements*. Yet, the magnitude of this effect is uncertain, insofar as it hinges on enactment of structural policies in the labour market and is probably insufficient to offset the other strains on public finances.

To deal with these pressures, the central government has adopted a cost-control strategy² and reforms regarding social security were undertaken, such as the pension (OECD, 2007) and the health insurance (OECD, 2005a) reforms, although substantial efforts are still needed. At the same time, the central government aims to reduce the rates of aggregate taxation and social security contributions, which are among the highest of any OECD country, and which hamper the French economy's resilience. The challenge now is to continue these reforms and encourage sub-national governments to adopt the same

2. Implementation of the framework law for national budgets (loi organique relative aux lois de finances – LOLF), whose purpose is to assign a mission and a performance indicator to each expenditure, the launch of a great many audits and procurement policy reforms.

Figure 2. **Government deficit and debt**
Per cent of GDP



1. Maastricht definition.

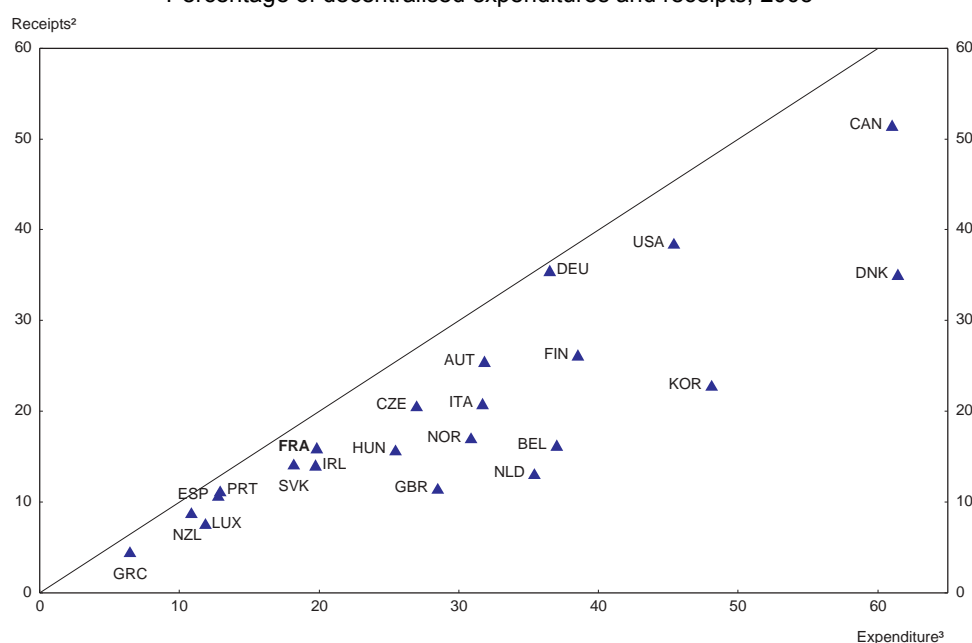
Source: INSEE, Comptes nationaux; OECD, National accounts.

objectives. However, the organisation of the system of sub-national governments and the way decentralisation has been carried out so far pose a number of problems, both for the control and effectiveness of government spending and for the burden of tax and social contributions.

The main characteristics of the system of sub-national governments

Decentralisation was carried out in two main stages. The first took place in the early 1980s and actually implemented decentralisation, including a transfer to local elected officials of the executive powers previously wielded by the prefects – the central government's representatives at the local level. Regions became an official level of government, and the first clusters of powers, such as partial administration of secondary schools, were devolved. The second stage, begun in 2003 and still in progress, aims to deepen decentralisation. One of its objectives is to clarify the division of powers by creating the possibility of designating a given sub-national government as lead manager (*chef de file*) for a particular area of responsibility. Regions are supposed to have the lead in fields concerning economic measures for

Figure 3. **Decentralisation ratios in the OECD countries**
 Percentage of decentralised expenditures and receipts, 2005¹



1. 2003 for Canada and New Zealand; 2004 for Korea.
2. Including tax sharing agreements and excluding transfers received from other government levels.
3. Excluding transfers received from other government levels.

Source: Statistics Canada; US Bureau of Economic Analysis; Statistics Norway; OECD, National Accounts.

enterprises and employment, whereas departments are generally to have the lead in health and social areas. Sub-national governments were also given the right to experiment with policies in certain domains. Power transfers have continued, including the shifting of administration of the RMI and – for the first time – transfers of personnel, such as elementary-school technical staff.

Despite these two waves of decentralisation, France remains a relatively centralised country (Figure 3). The State has retained full responsibility in relatively few areas, such as defence, foreign policy and pensions, but in many other areas it shares powers with the lower levels, often holding on to a major role for itself. Responsibility is still almost totally central with regard to labour market and health policies, even if certain employment policy contracts, occupational training and selected health care mechanisms have been decentralised. Responsibilities for education are heavily shared, with management of elementary and secondary schools, as well as the technical staff of those schools, lying with sub-national governments but teaching staff and curriculum controlled centrally (OECD, 2007). The same holds true for the RMI and APA, with the amounts of the allowances set centrally but their administration assigned to the *départements*. However, some experimentation is taking place as regards the RMI (see below), in order to see whether measures giving more power to local authorities would be more efficient than general rules fixed by the State for the whole country.

One of the particularities of the French system is that the State is represented at each level of elected sub-national government (regions, *départements* and municipalities³). Departmental and regional prefects⁴ have been maintained, but their roles have evolved. They are still the representatives of the State

3. In a *commune*, the mayor is both the representative of the State and the (elected) head of the municipality.
4. The regional prefect is the prefect of the *département* in which the regional capital is located.

and are responsible for implementing central government policies at the local level. They head the prefectural services, which are organised to mirror the various areas of central government policy. The State is generally present locally through the Ministries' "deconcentrated" services; for each Ministry, regional or departmental directorates implement and monitor ministerial policies. What may therefore be called "dual representation", with both deconcentrated services and services of the lower levels of government, is peculiar to France, even though there are equivalents of French prefectures in other unitary countries with histories of centralisation (OECD, 2006).

A "multi-layered" system with shared responsibilities

The French system of sub-national governments is complex and often described as multi-layered (Box 1). As in many OECD countries, there are three main levels written into the Constitution: regions, *départements* and municipalities, which are administered by councils elected by direct universal suffrage⁵. Adding to this structure are other levels, whose roles vary depending on the area involved, but which stem essentially from the desire of various governments to remedy the division or fragmentation of the municipalities (of which there are 36 500, including 15 000 with populations of under 300). Instead of the municipality-merging policies enacted in other countries, such as Denmark and Japan, France has chosen the path of co-operation. This has developed on a number of occasions and taken a variety of different forms, but in each instance specific powers have been handed over to groups of municipalities, with each

Box 1. Co-operation between municipalities

There are various types of groups of municipalities:

- Associations (*syndicats*) of municipalities, which in most cases predated communities;
- Communities of municipalities, associating municipalities in rural areas;
- Metropolitan communities (*communautés d'agglomération*), uniting municipalities to form a metropolitan area with a population of over 50 000;
- Urban communities, uniting municipalities to form an ensemble of over 500 000 people.

Associations of municipalities were set up to administer certain public services (water, sanitation, transport, electricity, etc.) At the same time, "intercommunality" groupings of municipalities began spouting up in the 1970s and started becoming more numerous in the late 1990s as a result of legislation passed in 1992 and 1999. Municipalities join forces in public intercommunal co-operation establishments (*établissements publics de coopération intercommunale* – EPCIs) to deliver certain services – either technical services, as in the case of associations of municipalities, or broader undertakings such as economic development or town planning. Intercommunality has been encouraged by higher State subsidies for municipalities that join forces, transfer powers to communities and accept the principle of a single business tax (*taxe professionnelle*) (see below).

EPCIs differ from territorial entities in a number of respects. The persons administering them are not elected directly but are delegated by municipal councils. Their powers are limited. Lastly, to create an EPCI requires central-government approval (*via* prefects).

EPCIs have their own tax revenue. This can be either additional, consisting of an extra share of local taxes, or unique, when business tax (the chief local tax) is earmarked for the community. The 1999 legislation gave municipalities belonging to the same community ten years to harmonise their business tax rates.

5. There are 36 500 municipalities, 100 *départements* and 26 regions. Municipalities are the oldest and smallest administrative subdivision. The *départements* were created at the time of the French Revolution and the regions have been instituted in the wake of the first wave of decentralisation, in 1986.

holding on to other broad responsibilities. The main form of co-operation is known as *intercommunalité*, which the central government began to encourage greatly in the 1990s, and which has subsequently spread massively. This involves municipalities that join forces via public intercommunal co-operation establishments (*établissements publics de coopération intercommunale* – EPCIs) to deliver certain services. In 2006, 86.5% of the population was covered by a *community*. Adding to these communities are other forms of co-operation which in some cases predated them, and which may overlap, but which have not been dismantled. There exist, for instance, many associations of municipalities (*syndicats de communes*) empowered to handle specified technical issues, but also “countries” (*pays*) in the sub-national sense, which are groups of municipalities clustered around a given economic, social or cultural activity. In all, France’s very clear territorial division into three levels of government – regions, *départements* and municipalities – is supplemented by a multitude of overlapping groupings of municipalities.

The Constitution gives sub-national governments financial autonomy with regard to revenue and expenditure. They are free to use their revenue as they please, and there is no hierarchy of authority between these territorial entities. Adding to this principle is the general authority clause for sub-national governments, which are theoretically free to govern any areas of “relevant local concern”. Accordingly, they must not infringe the powers of the central government, nor those of other entities. In practice, insofar as there are no precise definitions of each entity’s domain of authority, the distribution of powers is complex, and in many cases different levels of government get involved in the same areas (Table 1). To cope with the multiplicity of players and shared responsibilities, the State has developed a policy of contractual relations with the other levels of government (OECD, 2006). The policies of the various territorial entities within any given region are often co-ordinated under a “regional scheme” and lead managers have been designated in certain fields, though not systematically. Responsibilities are very often still shared.

The books of sub-national governments and EPCIs are audited by regional accounting boards and the prefects. Audits look at the legality of budgets and compliance with the budget rules governing local-government debt, but not at expenditure before the fact. The financial interests of sub-national governments are upheld and aligned with those of the State within the *Local Finance Committee*, made up of representatives of Parliament, local authorities, and the central government. This committee has decision-making power over the apportionment of the State’s main transfers to the lower levels (see below), and it must be consulted on concerning local-government financial issues.

Local government resources

The resources of sub-national governments consist primarily of tax revenue (50% of total resources) and *grants* from the State (35%⁶). Under a constitutional principle, when a power is devolved, the central government must also transfer the resources previously spent exercising that power, either by increasing the tax revenue of the governments in question (this has generally been done by transferring a portion of State tax revenues) or through grants.

There are a great many local taxes. The primary direct local taxes, known as the “four oldies”, are: business tax, paid by companies on the value of their fixed assets, equipment and value added (see Box 4 below); residency tax, paid by households (and by businesses in respect of premises for private use) on the estimated rental value of their dwelling; and separate property taxes on developed and undeveloped land, which are paid by owners on their property’s rental value.

6. When tax compensation from the State to offset exemptions are included.

Table 1. Sub-national government – Who does what?

| Levels of government | Regions | Départements | Communities | Municipalities | State interventions |
|--|---------|--------------|-------------|----------------|---------------------|
| Economic Development | | | | | |
| "Coordination" | x | | | | |
| Support to business | | x | x | x | x |
| Infrastructure | | | | | |
| Road maintenance | | x | x | x | |
| Highway management and cleanliness | | x | | | |
| Fishing ports | x | x | x | x | |
| Airports | | x | x | x | |
| Infrastructure and transport planning | x | | | | |
| Education | | | | | |
| Teaching | | | | | x |
| Child care | | | x | x | |
| Primary school buildings and equipment | | | x | x | |
| Lower secondary school buildings and equipment and technical staff | | x | | | |
| Upper school buildings and equipment and technical staff | x | | | | |
| Universities | | | | | x |
| Employment and integration | | | | | |
| Adult training | x | | | | |
| Administration of the RMI and the RMA benefits | | x | | | |
| Housing | | | | | |
| Construction of social housing | | x | x | x | |
| Departmental plans to house disadvantaged people | | x | | | |
| Old people's homes | | | x | x | |
| Solidarity fund for housing | | x | | | |
| Support for people in difficulty | | | | | |
| Coordination of support for people in extreme difficulty | | x | | | |
| Fund for assisting youths in difficulty | | x | | | |
| Personalised autonomy benefit | | x | | | |
| Health | | | | | |
| Financing medical equipment | x | | x | x | |
| Training of social and para-medical workers | x | | | | |
| Other medical-social measures | x | x | x | x | |
| Environment | | | | | |
| Sewage treatment | | x | x | x | |
| Waste | | | x | x | |
| Combating noise | | | x | x | |
| Combating air pollution | | | x | x | |
| Water | | | x | x | |
| Departmental planning | | x | | | |
| Culture and tourism | | | | | |
| Tourist offices | | x | x | x | |
| Historic monuments | x | x | x | x | x |

Source: OECD based on the following websites: <http://www.assemblee-nationale.fr/index.asp>, www.interieur.gouv.fr, <http://www.senat.fr/themes/td1recents.html>

The powers of sub-national authorities over the four main local taxes encompass rates and bases. Sub-national governments and EPCIs vote to set the rates of the four direct local taxes (with each level voting to set its own rate for each tax). To avoid excessive disparities between tax rates, and so that the tax

burden is shared between households and businesses, there are rules governing tax rates⁷. With respect to tax bases, sub-national governments may decide to exempt certain categories of taxpayers from property tax or business tax. They may also alter certain allowances in respect of residency tax. In all, and by international standards, sub-national government power over these taxes is high, and it is used extensively (Blöchliger and King, 2006).

Sub-national authorities also collect a number of indirect taxes. The two main ones that are partially transferred to sub-national governments are real estate transaction taxes (*droits de mutation à titre onéreux*), and the excise tax on petroleum products (*taxe intérieure sur les produits pétroliers* – TIPP). Unlike the four direct local taxes, sub-national governments have little or no power over these taxes. As a result, there is no reason for the corresponding revenue trends to mirror the expenditure that they finance. Within aggregate tax resources, the relative importance of these indirect taxes has grown because of their dynamic performance. The transaction taxes in particular, which chiefly benefit *départements*, have risen sharply with the buoyant real estate market. These accounted for 40% of aggregate revenue from the four main departmental taxes in 2005, versus only 30% in 2001.

Sub-national governments also receive packages of transfers from the State, which have evolved far more dynamically than prices. Such transfers are paid for three main reasons: to finance public services; to offset revenue losses resulting from State-ordered exemptions from local taxes; and to reduce wealth and expenditure disparities between localities (Box 2).

Box 2. Financial transfers from the State to sub-national governments

Financial transfers from the State to sub-national governments are paid for different purposes, and the grants take a variety of forms. The system is made complex by the fact that the various grants do not correspond to the different purposes. The three leading purposes are:

- To finance functions assigned to the sub-national governments. Whenever the State delegates a function, it provides the sub-national governments with the resources previously earmarked for that purpose, either through tax revenue or through grants. Thereafter, grants are adjusted according to a formula that has turned out to be more favourable than inflation.
- Tax compensation to offset exemptions. When the State decides to exempt certain taxpayers from a given local tax (or to lessen the amount of the tax), it compensates the sub-national governments for the lost revenue. There have been many such exemptions with regard to residency tax and business tax.
- Equalisation. The State uses transfers to reduce some of the difference in purchasing power (ratios of expenditures to revenue) between sub-national governments. Each year, the State decides the amount of an equalisation “envelope” to be apportioned among sub-national governments on the basis of indicators of their respective resources and expenditures.

Under the initial system, the various grants corresponded to the various purposes, but over time, as it became increasingly difficult to offset transfers of responsibilities or longstanding exemptions exactly, individual grants were consolidated into larger ones. The current system that has resulted from these changes is intermediate. It consists essentially of an overall operating grant (*dotation globale de fonctionnement* – DGF), but other grants still exist. The DGF accounts for over 60% of State funding and includes transfers in respect of all three purposes. Sub-national governments may use it as they choose. One part of the grant consists of a set amount proportional to amounts paid the previous year, which depends on population and also includes an offset for the elimination in 1999 of the wage-related portion of the business tax. The other part seeks to promote equalisation; it depends on the shortfall of the tax potential and tax revenue from households. It includes the “urban solidarity grant”, the “rural solidarity grant” and the “national equalisation grant”. The DGF is paid to municipalities, EPCIs, *départements* and regions. Since 1996, the DGF has been indexed to the sum of inflation and 50% of volume GDP growth. Apart from this grant, there are other grants that finance particular expenditures. The decentralisation grant, for example, finances transfers of responsibility not included in the DGF.

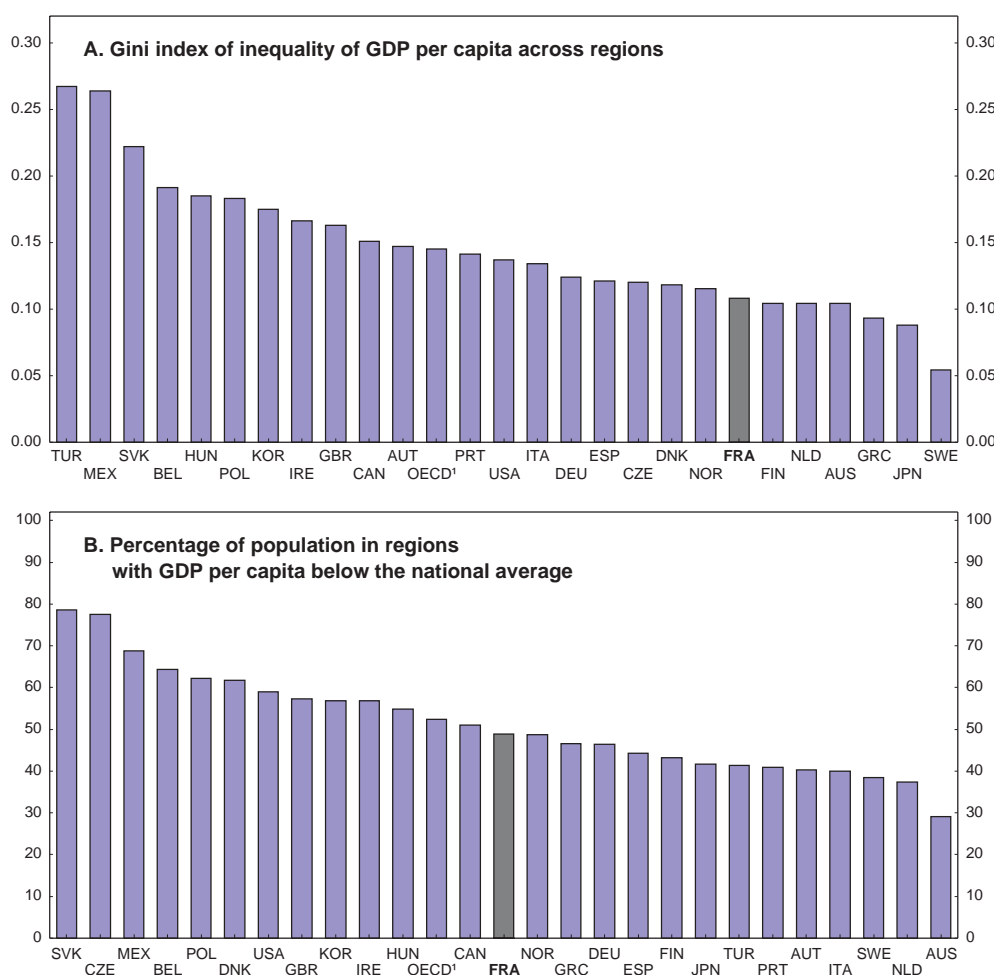
7. First, the rates of the four taxes can not be higher than the previous year’s average rates. Second, a rule requires co-ordination between changes in the rates of the four taxes, although many exceptions to this rule have been introduced.

Inequalities between municipalities are substantial

Inequalities between regions, as measured by per capita GDP, are lower than the average of OECD countries (OECD, 2005b). But the percentage of the population living in the poorest regions is close to the average in OECD countries, with 49% of the population living in regions where GDP per capita is below the national average (Figure 4).

Wealth inequalities tend to increase as the level of territorial subdivision narrows, and they are especially great between municipalities. Inequalities between regions or between *départements* account for only a minor proportion of total resource inequalities: 78% of resource inequalities between municipalities stem from unequal resources within regions, and 60% within *départements* (Table 2). The main source of resource inequality is business tax (see below), and unequal expenditure is attributable in part to the geographical concentration of poverty (OECD, 2007). In all, the ratio of expenditure to revenue, which is called purchasing power, varies sharply among sub-national governments.

Figure 4. Per-capita GDP disparities between regions
2003



1. Average of 26 countries.

Source: OECD regional database.

Table 2. Breakdown of the variance of municipal resources by region and *département*

| | | Variance within | Variance between | Total Variance |
|--|-----------------------|-----------------|------------------|----------------|
| Tax capacity per resident ¹ | – Regions | 83% | 17% | 100% |
| | – <i>Départements</i> | 69% | 31% | 100% |
| Resources per resident ² | – Regions | 78% | 22% | 100% |
| | – <i>Départements</i> | 60% | 40% | 100% |

Note: Total variance of municipal resources disaggregated into a variance *between* regions and *départements*, and a variance within regions and *départements*.

1. As determined by the four principal municipal taxes.

2. Tax capacity plus transfers from the State.

Source: OECD calculations based on detailed data on the State operating transfer provided by the French Urban Communities Association.

The State strives to narrow wealth gaps between sub-national governments by means of equalisation mechanisms. As in many other OECD countries, the equalisation policy that France has put in place seeks to diminish inequalities of both resources and expenditure, but unlike the situation in some other countries, the French system does not seek to eliminate inequalities altogether. The equalisation system is complex; there are a number of different transfers having equalisation as their specific objective (such as the DGF's equalisation component). Other transfers not initially intended to promote equalisation may in fact have equalising effects. In all, 40% of the purchasing power inequalities of the municipalities were corrected in 2001, the corresponding proportions being 51% for *départements* and 54% for regions (Gilbert and Guengant, 2004). These rates for correcting inequalities vary sharply among municipalities. The resources earmarked for equalisation have increased over time. Nevertheless, they amounted to a scant 0.3% of GDP in 2006, which seems low in comparison with other countries' outlays, even if such figures are difficult to compare (Blöchliger *et al.*, 2007). The extent of the correction of inequalities, while it has increased over time, would also appear relatively slight as compared with the results of other European countries, whose equalisation systems manage to reverse an average of two-thirds of inequalities.

The special case of the RMI

This organisation of sub-national governments poses a number of problems, which may be illustrated by what happened when the RMI was decentralised. When it was created in 1988, the RMI mechanism was shared between the central government, which administered the allowance, and the *départements*, which were supposed to handle back-to-work aspects, and yet no extra resources were allocated for that purpose. In actual fact, however, very little was done in the way of back-to-work measures, insofar as the *départements* lacked the incentives (and the special resources) to develop them in order to reduce the number of people on benefit, since the State paid the bulk of benefits. To remedy this problem, administration of the RMI allowance (and of the RMA – the special contract to help RMI recipients get back to work) was decentralised to the *départements* in 2003, although the central government retained the power to set the amount of the allowance.

As it does whenever it delegates responsibilities, the State pledged to hand over funding “euro for euro”, and to transfer to the *départements* the amount it had allocated for this purpose in 2003. This was done by granting the *départements* a fraction of the domestic duty on petroleum products (TIPP), which is a State-imposed levy, the rate of which *départements* have no means of adjusting. The plan was for future variances between RMI-related outlays and TIPP revenue, which were expected to remain slight, to be borne by the *départements*. But by 2004, financing problems began to emerge. The TIPP base expanded only slightly, whereas RMI outlays rose sharply because of poor labour-market conditions and a reform of unemployment benefits that shifted many jobless on to the RMI. In addition, along with decentralisation of the RMI came spending growth above and beyond the cost of the allowance itself, probably because of insufficient staff provided by the central government and the high cost of National Agency for

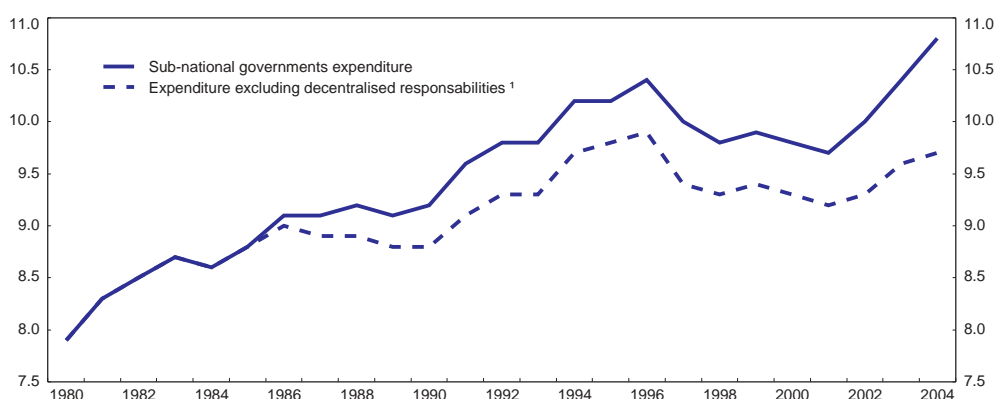
Employment (ANPE) services invoiced to the *départements* (Mercier, 2007). In all, compensation from the State covered only 92% of RMI expenditure in 2004 and 85% in 2005. The central government decided to close that gap with an exceptional grant in 2004. For 2005 through 2007, a “departmental mobilisation fund for labour-market integration” (*fonds de mobilisation départementale pour l’insertion* – FMDI) has been set up and will be able to meet some of the shortfall between revenue and expenditure, but it will be tailored to the special needs of disadvantaged *départements* and their efforts to promote labour-market integration.

While all of the decisions that followed the initial choice to decentralise labour-market integration aspects of the RMI were taken for consistent reasons, such as to bolster *départements’* incentives to get involved in labour-market integration and enable them to finance such responsibilities, they have also led to a situation that poses a number of problems and threatens to impair policy effectiveness:

- The autonomy of *départements*: they must finance the RMI for which the amount and the beneficiaries are defined by the State. This lack of autonomy may have prompted some of them to cut spending on labour-market integration in order to finance the allowance, which they are obliged to pay, thus causing a loss of spending efficiency. Insofar as the RMI is partially financed by a State-imposed levy, taxpayers do not see their contribution to its funding and are therefore not motivated to demand results from the policy.
- Shared responsibilities: the *départements* finance the allowance and must establish the integration contract that is incumbent on all recipients of the allowance; the State sets the amount of the allowance. Moreover, the Family Allowance Fund (*Caisse d’allocations familiales* – CAF) keeps the rolls of RMI recipients up to date and disburses the allowance; the *départements* contract out integration measures to the ANPE, which is a State-run agency; and the regions handle adult training. Under this system, there is no clear head of integration policy, no specifically proclaimed objective and no evaluation of the system as a whole. It is difficult to implement a purely local labour market integration scheme. Each player may therefore pass the buck to another, which creates scant incentive for a truly effective mechanism. While the State tries to limit its participation so as to spur sub-national governments to enact more effective policies to scale back the number of recipients, as long as the central government sets the amount of the allowance and therefore influences expenditures, it is difficult for it to stop playing its current role as financier of last resort.
- Overall coherency: decentralisation of the RMI raises problems of social-policy asymmetry insofar as other social minima remain wholly State-financed (OECD, 2007). Moreover, employment policy still remains essentially a central-government prerogative, and employment plays an important role in individual integration. It would seem more effective for employment and integration policies to be administered at the same level of government.

The potential solutions to these problems provide a fairly good illustration of the directions that a reform of the system as a whole would take, and of the problems that would arise. Several solutions are possible. One would be to give the *départements* more power and autonomy by having them administer all social benefits, along with major responsibilities in the realm of employment policy, as well as tax revenues to fund the expenditure, and over which they would have real decision-making powers. Partial trials of this option are being conducted in certain *départements* (under the 2007 Budget Act) that have been empowered to make use of the earned income tax credit (*prime pour l’emploi* – PPE) as they see fit, as well as integration policies to institute new incentives to help people get back to work. Yet the RMI remains, as in many other OECD countries, fixed at a national level in order to guarantee a certain amount

Figure 5. Impact of transfers of responsibilities on expenditure by sub-national governments
Per cent of GDP



1. Excluding expenditure linked to the transfers of responsibilities.

Source: Ministry of Finance, Direction générale du Trésor et de la Politique économique.

of income for all. Responsibilities would thus still be shared. Another solution would be to restore the State's authority over the RMI and to make employment and integration policies a package under central-government control.

Limiting pressures on government spending

The experience of other OECD countries shows that it is not uncommon for decentralisation to be accompanied by an initial increase in aggregate government spending, either because of rigidities that prevent State expenditure from decreasing by as much as sub-national government expenditure increases, or on account of issues involving how the system is organised. Ultimately, however, decentralisation ought to be able to lead to greater efficiency in government spending.

Spending by sub-national governments grows mechanically with transfers of responsibilities from the State. And yet a Ministry of Finance study shows that such transfers of responsibilities account for only half of the growth in their spending, as a percentage of GDP, since 1985 (Figure 5). A number of factors may explain these upward pressures, which have been amply documented in recent research (Bonrepaux and Mariton, 2005; Richard, 2006).

Improving inter-governmental co-operation

Decentralisation can take two opposite forms: a transfer of all responsibilities connected with a given function, or delegation of the management of a service for which the State continues to make specifications and thus retains most responsibilities. Between these two extremes lies a continuum of configurations in which responsibilities are shared, but each of these should be the result of an optimal trade-off between the need to make sub-national governments accountable and a desire to deliver services of identical quality nationwide. In practice, apart from transfers of major functions, decentralisation has taken the form of numerous one-off transfers – in many cases of public services, the management of which is delegated with no real consideration for trade-offs. Nevertheless, delegation of a service for which the State continues to set specifications may well entail higher costs, because neither sub-national governments nor the State has an incentive to take the best decisions in terms of cost-benefit analysis, insofar as responsibilities are shared. More generally, for all sub-national government expenditures, the State retains

Box 3. Decentralisation and government employment

There are three types of “civil service” in France: State, territorial and hospital, which are heavily compartmentalised. Given the impossibility of lay-offs, adjustments in the employment volume of the first two civil services are possible through: *i*) decentralisation of staff, *i.e.* transfers from the State civil service to the territorial civil service; *ii*) *secondment*, whereby civil servants are sent to work for another civil service while officially remaining part of their initial unit; *iii*) adjustment of the number of job openings to be filled through competitive examinations; and *iv*) non-replacement of State civil servants who retire. Prior to 2003, there was no decentralisation of staff, so short-term adjustments were possible only through secondments. Secondments were arranged for low- or moderately-skilled civil servants (categories B and C), but they were rare for the most highly skilled (category A), because insofar as State service is deemed the most prestigious, there is no incentive for managers to transfer, even temporarily, to the territorial civil service. Non-replacements of retiring State civil servants were very rare. In all, public employment rose sharply in the sub-national governments (by 43% in 20 years), whereas it did not begin to slow significantly at the State level until 2005.

an important power via the definition of public service standards in which the lower levels of government have little say (Richard, 2006). So that decentralisation may ultimately deliver a benefit in terms of efficient government spending, responsibilities between the State and the lower levels of government should be defined more clearly, and the division should be stabilised. Co-ordination between the State and the lower-level authorities should also be improved, especially by allowing those authorities a role in setting standards of relevance to them.

Successful decentralisation in the realm of expenditure depends to a great extent on proper re-allocation of resources, and human resources in particular, from the State to sub-national governments. Yet from this standpoint, decentralisation has been a failure. There has been practically no such re-allocation in 25 years of decentralisation (Box 3). The ranks of central-government employees have continued to increase, while sub-national government payrolls have expanded massively (Pébereau, 2005; Richard, 2006). This rise in State employees at a time when State prerogatives were declining was absorbed by a bolstering of the State’s *deconcentrated services* (see above), which has made the system of sub-national governments more cumbersome. Nevertheless, since 2004 some transfers of State employees to sub-national government have occurred to accompany transfer of competences, and the government is trying to re-orient the State administration towards the implementation of national policies. In the future, it is essential that the State take greater advantage of the large number of retiring civil servants to trim the central-government payroll and expand staff transfers from one civil service to another, as was the case with National Education technical staff.

In addition to these rigidities concerning the volume of employment, salaries in the three branches of civil service are indexed to the same civil service “point” value that is negotiated with the trade unions by the Ministry for the Civil Service. These pay trends are not always suited to the resources of sub-national governments nor to regional prices and may therefore on occasion have put pressure on their spending. These governments should thus play a greater role in pay negotiations.

Ensuring that the system’s organisation does not hamper its effectiveness

The system as it has emerged, with multiple layers of administration, is especially conducive to generating a number of additional costs. These costs are of two types. Because of the system’s complexity, expenses can exceed the lowest cost at which a given service of given quality could be delivered. This “technical” production cost overrun stems in particular from the duplication of administrative services. Apart from the extra technical cost, the system in which the same service can be offered at more than one level, thus offering households and businesses multiple channels through which to benefit from the service, can therefore trigger a mechanism of one-upmanship between levels of government that leads to an

overproduction of services. The most striking example of this is aid to businesses, where it is commonplace for a company that sets up in a commune to receive assistance from each level of government (OECD, 2006). This overproduction of local public goods and services can potentially reduce production of private goods and services and thus induce a change in consumption patterns, which would constitute an opportunity cost. Such costs, and more generally the cost-benefit analysis of decentralisation, are difficult to measure. Some evaluation methods exist, but they have never been implemented in France (Gilbert *et al.*, 1998) while other countries, such as Spain and Italy, have tried to assess the cost of inefficiencies of the decentralisation system.

The overlapping of functions between multiple levels of government also leads to a situation in which responsibilities are not defined clearly, expenditure is not determined by the results obtained, and policy evaluation becomes more difficult as a result. The contracts that the State uses to co-ordinate the players are necessary and central to successfully implement decentralisation but, as they are currently working, they are themselves a source of administrative red tape and systemic inertia and therefore do not fully solve the problem of the lack of ultimate authority (André, 2005; OECD, 2006). To avoid such problems, the system should be geared towards greater specialisation and a more coherent allocation of responsibilities and, therefore, towards the phasing out of the general authority clause. An intermediate solution would be to define lead managers for each function that would be given responsibility for co-ordinating actions, checking that resources are allotted properly and reporting to citizens on the policies carried out. The proposal made in several reports to attribute neighbourhood services to municipalities, social welfare to *départements* and land-use planning and economic development to regions is one possible division of responsibilities. Whatever formula is chosen, it should be dictated by policy coherence, especially with regard to the battle against unemployment; thus, for example, occupational training should not be administered separately from the RMI.

Intercommunality seems to have been another source of additional costs. When it was first introduced, intercommunality led to an increase in aggregate local expenditures, which is not surprising insofar as the municipalities that joined forces received additional *intercommunality grants*. Subsequently, municipal spending should have slowed, but this has not been a sustained trend. Since 2000, the consolidated expenditure of municipalities and communities has been outpacing the long-term spending trend of municipalities alone, largely due to an expansion of the services they provide (Richard, 2006).

Municipalities have been encouraged to group together to receive the intercommunality grant, but to keep intercommunality from remaining an empty shell, and in order that there be a genuine transfer of resources and expenditures from municipalities to communities, a number of mechanisms were instituted. The intercommunality grant depends on a fiscal integration coefficient, which measures the share of fiscal resources that are directly used by communities and not redistributed to municipalities (otherwise, this would mean that expenditure has not been really transferred to communities) It is the prefect's responsibility to monitor the amounts redistributed to municipalities. In addition, transfers of functions from municipalities to communities have to comply with certain rules designed to ensure that related expenditure does not remain with the commune, which would result in additional costs (OECD, 2006).

Now that municipalities have been encouraged to group together and transfer functions to the community level, they should be encouraged to achieve economies of scale. One possibility would be to put a time limit on the intercommunality grant. If this solution does not seem feasible, the government might wish to make the intercommunality grant conditional on achieving economies of scale and to bolster controls on doing so⁸. But implementation of this might entail a certain amount of red tape and would pose problems that would be difficult to overcome, insofar as economies of scale are hard to identify and to measure. In the longer term, the State might consider implementation a single grant, consolidated between

8. As suggested by the Richard report (2006).

communes and the intercommunal groupings so that the latter would share out the funds according to functions actually carried out. But this solution could weaken citizens' control over decision-making because those running the groupings are not currently directly elected, and it would run up against difficulties in deciding how to share out the funds among the communes.

The advisability of having technical functions administered by associations of municipalities rather than by communities should be explored, and if that would result in inefficiencies, then the associations should be incorporated into the communities. Other forms of co-operation should be gradually eliminated unless they are fully justified.

Developing an information system to stimulate competition and allow sub-national government spending to be evaluated

The current system's efficiency problems stem in part from the shortage of available information about sub-national governments' choices regarding expenditures, revenue and the quality of services rendered. This lack of information has several consequences. Citizens are unable to make proper judgements about either the effectiveness of the policies carried out or the choices that are made, and as a result they exert no real pressure on policy decisions. This lack of pressure does not encourage elected officials or local managers to be accountable, and so information is not developed. Neither office-holders nor citizens can compare the effectiveness of their government's expenditure as compared to others.

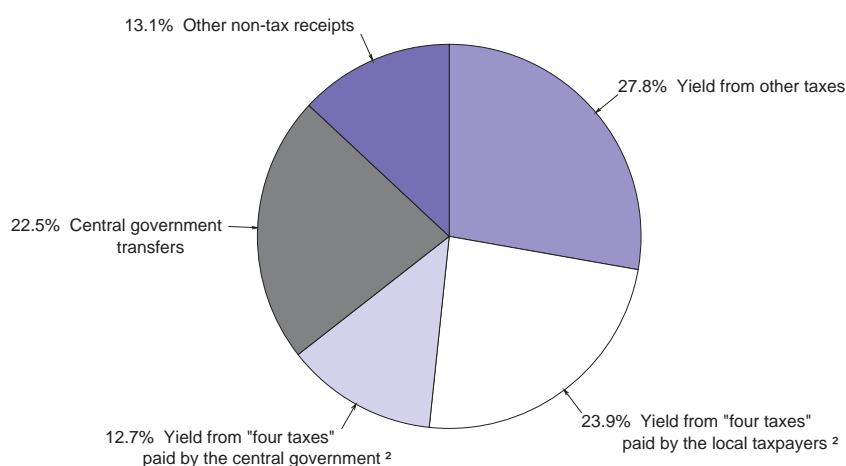
It is therefore important to develop an information system on all sub-national government expenditure and how it is financed, which citizens could access easily. The figures should be comparable between governments, and they should be consolidated, especially between municipalities and communities. The central administration is working to create an information system to collect and organise available data – no longer in response to statistical needs as is the case today, but to further the objective of facilitating comparisons between local administrations so as to give them incentives to provide the quality of services that people want in a transparent manner and at minimum cost. Here, France could learn from what has been done in other countries, such as Norway, which has developed such a very comprehensive information system.

Another objective of the information system could be to encourage sub-national governments to set spending priorities, to develop measures of the efficiency of services rendered, (thus to formulate budgets using rules similar to the framework law for national budgets), and to move towards an agreement between the State and sub-national governments on a standard for their spending trends, if this seems desirable. Some governments, especially those of significant size, have already adopted this type of model for their budgets. Such experiences ought to be developed, within the Local Finance Committee, for example, disseminating the experiences of pilot governments and helping others to implement the methods.

Making sub-national governments accountable with resources while at the same time limiting pressures on compulsory levies

Changes in the structure of the revenue of sub-national governments have reduced their fiscal autonomy. Tax revenue as a percentage of total resources has declined continuously, whereas transfers from the State have risen, reaching nearly 35% in 2003 (Figure 6). Since sub-national governments are not answerable to citizens for how they use State transfers, the increase in the share of these transfers in their gives those governments no strong incentive to spend money most efficiently. The cost of that inefficiency is borne partially by the State (as a major contributor to local finances), and ultimately by citizens of France.

Figure 6. **Resources of sub-national governments¹**
Regions, *départements* and municipalities, 2003



1. Operational receipts only.
2. Professional tax, housing tax, built and non-built real estate taxes.

Source: Ministère de l'Intérieur et de l'Aménagement du Territoire; DGCL, "Les collectivités locales en chiffres 2006".

A system with little transparency that does not give sub-national governments financial autonomy

This trend stems in particular from the State's increasing control over local taxes. As explained above, the State may decide to grant reductions or full exemption from local taxes, in which case it provides compensation for the lost revenue. This option has been used extensively, especially for business tax (Box 4) and also for the property tax. In all, the proportion of aggregate revenue from the four main local direct taxes that is financed by the State has increased steadily, to nearly 35% in 2003.⁹

Box 4. Business tax

This tax is payable annually by unsalaried individuals or legal entities engaged in a business. The tax is assessed in the commune in which the firm has premises or land. It is collected by municipalities and EPCIs, *départements* and regions. Business tax has three bases which are combined in a complex manner: the rental value of assets subject to property tax (fixed assets); the rental value of equipment and moveable assets; and a fraction of turnover. Historically, a fraction of salaries was also part of the base, but this was abolished so as not to discourage businesses' demand for labour (OECD, 2005a).

Business tax is made complex because of its component mechanisms:

- An equalisation contribution to reduce rate differences between sub-national governments, which is paid by establishments located in municipalities in which the tax rate is below average.

9. It is impossible to know the percentage for subsequent years, insofar as this compensation has been incorporated into the DGF.

Box 4. Business tax (cont'd)

- A minimum contribution payable by all taxpayers, including those whose tax base is zero or very low, which is based on the property tax.
- A minimum contribution based on value added. Above a certain threshold of turnover (EUR 7.6 billion, excluding tax), businesses must pay at least 1.5% of their value added in business tax.
- Numerous deductions from the base and many exemptions, which in many cases are decided by the State to assist certain businesses. One quarter of businesses are exempt.
- A ceiling in relation to value added, which has been changed several times. From 2007, the amount paid by a business may not exceed 3.5% of its value added (1.5% for agricultural firms). Prior to 2007, the ceiling had been between 3.5% and 4%, depending on the firm's turnover.

This capping of the amount of business tax on the basis of value added has led to a situation in which 52% of business tax revenue was based on value added in 2003. The proportion of business tax financed by the State increased from 25% in 1998 to 39% in 2003. Business tax has thus drifted very far away from the tax as it was conceived originally. At the same time, it poses a number of problems, which were explained at length by the Fouquet Commission in 2004 as part of its mission to review the tax and propose reforms. Since salaries were removed from its base, the business tax has hit hardest at capital, and thus at highly capital-intensive firms, creating inequalities between sectors. In addition, business tax has proven to be a handicap for companies exposed to international competition.

To address these problems, the Fouquet Commission was asked to propose measures to make business tax more neutral economically, but not to reduce it. The Commission proposed replacing it by two separate taxes: one based on value added, with a rate set locally between a nationwide floor and ceiling (from 1.2% to 3.2%); the other based on the rental value of the firm's property, also with a rate set locally. Such a system would have imposed less of a surtax on capital-intensive industry. Sub-national governments would have been empowered to set the tax rates within a given range. Lastly, exemptions would have been re-examined in the light of a constitutional principle of equal taxation for all.

The Government did not take up these proposals, essentially because they would have resulted in substantial shifting of the tax burden between sectors of the economy, part of which the State wanted to offset, which would have been very costly. In the end, the tax was changed as follows:

- Implementation of a true ceiling since this is now fixed as a function of each year's tax rather than as a function of the rate in 1995.
- The value added ceiling was reduced to 3.5%.
- The tax credit for new investment was made permanent.
- Sub-national governments were asked to share in financing the value added-based ceiling. The State still bears the cost of the differential between theoretical revenue using the 2005 rate¹ and the 3.5% value added ceiling, but local government now bears the whole burden of foregone revenue due to rate increases in excess of the 2005 rate applied to companies at the ceiling.

1. Or, if either is lower, the 2004 rate or the rate of the tax year.

Because the State has come to bear the cost of an increasing share of sub-national government tax revenue, a distinction has been created among three notions that ought to coincide – “voted revenue”, “paid revenue” and “received revenue” (Valletoux, 2006). The distinction between “voted” and “paid revenue” introduces a lack of transparency for the taxpayer and incentives for the authorities to raise rates, insofar as the increases are not borne directly by voters. The distinction between “paid” and “received revenue” has enabled sub-national governments to take in resources in excess of what taxpayers pay in local tax. Yet

these resources do place an indirect burden on national taxpayers since State transfers must ultimately be financed, and thus State taxes have paid part of the bill. In the end, taxpayers may be under the illusion that the levy rate is not increasing, whereas the pressures are in fact shifted to central government taxes. The lack of transparency prevents them from knowing the real cost of the policies implemented within their borders and thus from judging their effectiveness. For their part, sub-national governments have only scant incentives to provide the best policies, given the taxes imposed on their residents.

In addition, the multiple exemptions awarded by the State lead to a situation in which taxpayers are not all taxed on the same basis. Because business tax is capped in relation to value added, half of all firms pay this tax on the basis of their value added alone. Likewise, because of income-related reductions, half of all households pay property tax solely as a function of their income. Households and businesses that benefit from such reductions are unaffected by small rate changes. Moreover, households with identical income and businesses with identical value added are subject to taxes having different bases, depending on their geographic location.

Alongside the State's increasing control over local taxes, the bases for residency and property taxes have become archaic insofar as registered rental values are still those of 1970. These bases were re-valued in 1990, but the new bases have never been used. A national coefficient has been applied to the 1970 base each year, with the result that in many cases bases have become both undervalued and disconnected from their current market values.

In all, revenue from the "four taxes" as a proportion of aggregate sub-national government tax revenue has decreased, from 70% in the mid 1990s to only 57% in 2003. Yet these taxes, over which local authorities wield considerable power, are the ones that provide financial autonomy. Another explanation for this trend is the fact that the latest functions to be transferred and financed by tax revenue were funded via the transfer of a portion of a State tax, such as the TIPP or property transfer tax, rather than by prompting the sub-national governments to finance them with local taxes. While some of these taxes, such as transfer tax, may constitute substantial resources for sub-national governments, those governments have only very limited say over the revenue they yield (essentially with respect to the base and little regarding the rates). As a result, they do not deliver the same financial autonomy as local taxes.

Lastly, some of the functions transferred have been financed by transfers from the State rather than tax resources. Equalisation grants have become more widespread, even if they remain limited (see above). For these reasons, the share of State transfers in the aggregate resources of sub-national governments has also increased.

The financial autonomy of the sub-national governments can be measured through the ratio of own resources to total resources. Own resources include the revenue from taxes for which sub-national governments are empowered by law to set the base or the rate, and other non-tax local resources over which they wield control. The financial autonomy ratio has dropped in recent years, to 61% in 2003 for municipalities and EPCIs, 63% for *départements* and 41% for regions. This ratio does not incorporate the loss of local autonomy triggered by the increase in State tax revenue for sub-national governments, to the detriment of local taxes.

Towards ensuring effectiveness through accountability

Sub-national governments need the financial resources to perform the functions that are devolved to them and to meet the obligations arising from decisions taken by the State. They ought to be able to fund the services and policies for which they bear major responsibility through local taxes, since this is the type of funding that enhances accountability and encourages them to report to their citizens (Blöchliger and King, 2006). But this principle runs counter to the State's increasing control over local taxation and the

dysfunctions of local taxes. The aim of this paper is not to propose comprehensive reform of local taxation, because that would require consideration of all of the levies imposed on businesses and households (see OECD, 2005a for proposals on this issue). Nevertheless, certain principles towards which local taxation should strive will be stated.

As long as problems related to intercommunality remain unsolved, the broad outline of the areas in which sub-national governments exercise responsibility has not been stabilised, and expenditure by those governments is not subject to binding budget rules, the danger is that creation of a new tax would lead to greater pressures on spending and the overall tax burden. Efforts should therefore focus on reforming sub-national government resources as they exist today.

Because of the resultant impairment of the accountability of sub-national governments through their resources, the State should reduce its role in funding local taxes. Broadly speaking, there are a great many tax exemptions in France, but they are not always justified (Conseil des impôts, 2003; OECD, 2005a). In the particular case of exemptions from local taxes, the State should give more consideration to how its decisions affect the resultant incentive structure for sub-national governments, rather than looking at the problem solely from the standpoint of compensating lost revenue. Exemptions decided by the State should relate exclusively to taxes levied by the State.

The bases for local taxes should be clarified, both to avoid problems of inequalities among taxpayers and to enable sub-national governments fully to assess the impact on taxpayers of any rate changes they decide to make. A solution should be found for situations in which a second tax base has in fact come into existence, in particular for property tax and business tax. Two solutions are possible: to abolish existing reductions and revise the initial local bases (*i.e.* rental value for property tax and fixed asset value for business tax), or to shift these taxes towards their new *de facto* bases – income for property tax and value added for business tax. While these bases are more mobile than the initial ones and thus theoretically less relevant for local taxes, their values are simpler to ascertain. In connection with comprehensive reform of taxation, other options could be considered.

As with all State expenditures, clear objectives should be set for financial transfers from the State to sub-national governments, and their results should be evaluated. The two main objectives ought to be financing of public services and equalisation. Public services over which the State retains primary responsibility could be funded by grants, but with mechanisms to encourage sub-national authorities to administer the services efficiently. Regarding equalisation, the current system is particularly complex and thus difficult to evaluate, whereas a tax such as business tax gives rise to substantial inequalities in resources from one locality to another. In particular, State transfers to offset the multiple exemptions benefit the areas where the taxpayers concerned reside, especially if these are high-tax jurisdictions. This would likely have an impact on wealth inequality, though no evaluations have been made.

In connection with objectives to keep public spending in check, State grants to sub-national governments should be made subject to a more stringent standard of evaluation. Commitments to this effect need to be pursued.

Conclusion and summary of recommendations

France has undertaken a process of decentralisation that has brought policies closer to citizens, but that has not fully achieved the expected gains in efficiency because of the system's complexity and inertia, as well as the low level of accountability of sub-national governments. Recommendations to meet the challenges of decentralisation and ensure that it is consistent with control over public spending and overall taxation are summarised in Box 5. Nevertheless, implementation of these reforms is made difficult *inter alia* by multiple office-holdings – a particularity of France in which politicians tend to combine local

offices with seats in Parliament. A number of reports have shown this practice to be an obstacle to proper implementation of decentralisation, especially insofar as it leads to conflicts of interest, *e.g.* with regard to equalisation issues (Roman, 1998). Multiple office-holding has already declined somewhat, and solutions for institutional renewal, which transcend the scope of this paper, have been proposed. Nevertheless, this element of the problem ought to be considered if decentralisation is to be completely successful.

Box 5. Summary of recommendations to meet the challenges of decentralisation

Keep pressures on public spending under control

Clarify, and gradually stabilise, the sharing of responsibilities between the State and sub-national governments. Avoid transferring administration of a function without transferring all of the related responsibilities. Give sub-national governments a greater say in decisions that concern them, and especially decisions that specify standards of public service. Ensure that the system for setting national civil-service pay does not trigger inappropriate trends for the employees of sub-national governments.

Impose strong limits on upward pressures on public employment by not replacing a portion of retiring State employees, and by continuing the process of staff decentralisation. Assess the role of deconcentrated State services and scale them back when justified, especially if there are duplications of effort with the services of sub-national governments.

Limit overlapping functions between sub-national governments by gearing the system towards greater specialisation and a more coherent allocation of responsibilities. Enact the proposal to rescind the general authority clause for regions and *départements*. If this proposal is not implemented, try out the notion of “lead manager” when more than one sub-national government intervenes in a given area.

Ensure that intercommunality leads to economies of scale and efficiency gains by doing away with the associated grant. Evaluate the relevance of associations of municipalities and other co-operation structures redundant with intercommunality, and gradually eliminate them when they are a source of inefficiencies.

Make sub-national governments accountable while limiting upward pressures on overall taxation

Establish a correspondence between types of responsibilities of sub-national governments and types of financing such that all parties involved are more motivated to achieve efficiencies. Ensure that sub-national governments can use local tax revenues to finance functions over which they have full responsibility. Use grants to finance services over which the State retains substantial decision-making powers, while at the same time instituting mechanisms to promote management efficiency. Transfers of State tax would be one way to finance such expenditure.

Limit and gradually eliminate local tax reductions accorded by the State. When tax relief is contemplated, consider its impact from the standpoint of incentives to sub-national governments and not just compensation for lost revenue.

Set clear objectives for State transfers to sub-national governments and evaluate the results thereof. Implement plans to limit the progression of such transfers. Make equalisation a more central objective of the transfers. Fully evaluate the results of equalisation and review the system if they are not satisfactory. Consider simplifying the system.

Review local taxes to rectify the drift away from their original bases, preferably as part of a general review of principles and practices for all of the levies imposed on households and businesses.

Develop an information system so as to spur competition and ease evaluation of local government expenditure efficiency

Develop an easily accessible information network on spending by sub-national governments, focusing on how that spending is financed and the quality of services rendered. Introduce a system of comparable data on the accounts of sub-national governments and the consolidated accounts of municipalities and communities.

Encourage sub-national governments to emulate the principles of the framework law for national budgets to approach their spending in terms of missions with attached objectives and performance indicators. Develop *ex ante* control over expenditure. Try to reach agreement between the State and sub-national governments on a standard for spending trends.

Bibliography

- André, P. (2005), “L’avenir des contrats de ville”, *Rapport d’information du Sénat* No. 402.
- Blöchliger, H. and C. Charbit (2007), “Fiscal Equalisation in OECD Countries”, OECD Fiscal Federalism Network, *Working Papers*, forthcoming.
- Blöchliger, H. and D. King (2006), “Fiscal Autonomy of Sub-Central Governments”, OECD Fiscal Federalism Network, *Working Papers*, No. 2.
- Bonrepaux, A. and H. Mariton (2005), *Rapport au nom de la commission d’enquête sur l’évolution de la fiscalité locale*, Assemblée Nationale, No. 2436.
- Conseil des impôts (2003), “La fiscalité dérogatoire: pour un examen des dépenses fiscales”, *Rapport au président de la République* No. 21.
- Cour des comptes (2005), *L’intercommunalité en France: Rapport au Président de la République suivi des réponses des administrations et des organismes intéressés*, La documentation française, Paris.
- Fouquet, O. (2004), *Commission de réforme de la taxe professionnelle, rapport au premier ministre*.
- Gilbert, G. and A. Guengant (2004), “Évaluation de la performance péréquatrice des concours financiers de l’État aux communes”, *Économie et Statistique*, No. 373.
- Gilbert, G., A. Guengant and C. Kissin (1998), *La multiplicité des collectivités territoriales est-elle un facteur de surcoûts financiers?*, Rapport à la délégation à l’aménagement du territoire et à l’action régionale.
- Mercier, M. (2007), “Financement du RMI: sortir de l’impasse par une plus grande responsabilité sur les dépenses”, *Rapport d’information du Sénat* No. 206, Paris.
- OECD (2005a), *OECD Economic Surveys: France*, Paris.
- OECD (2005b), *Regions at a Glance*, Paris.
- OECD (2006), *OECD Territorial Reviews: France*, Paris.
- OECD (2007), *OECD Economic Surveys: France*, Paris.
- Pébereau, M. (2005), *Des finances publiques au service de notre avenir* ; La documentation française, Paris.
- Richard, P. (2006), *Solidarité et performance, les enjeux de la maîtrise des dépenses publiques locales*, Rapport au ministre délégué au Budget et à la Réforme de l’État et au ministre délégué aux Collectivités territoriales, Paris.
- Roman, B. (1998), *Rapport de l’Assemblée Nationale sur le projet de loi organique limitant le cumul des mandats électoraux et fonctions électives*, Paris.
- Sutherland, D., R. Price and I. Joumard (2005), “Fiscal Rules for Sub-Central Governments”, OECD Economic Studies No. 41, 2005/2.
- Valletoux, P. (2006), “Fiscalité et finances publiques locales: à la recherche d’une nouvelle donne”, *Rapport du conseil économique et social* No. 24.

Glossary

| | | |
|---------|---|---|
| AAH | Allocation aux adultes handicapés | Adult disability allowance |
| ANPE | Agence nationale pour l'emploi | National Employment Agency |
| APA | Allocation personnalisée d'autonomie | Personal Autonomy Allowance |
| API | Allocation de parenté isolée | Single parent allowance |
| ASS | Allocation de solidarité spécifique | Specific solidarity allowance |
| ASSEDIC | Association pour l'emploi dans l'industrie et le commerce | Association for Employment in Industry and Commerce: Organization managing unemployment contributions and payments |
| CAF | Caisse d'allocations familiales | Social Security Office |
| CERC | Conseil de l'emploi, des revenus et de la cohésion sociale | Council for Employment, Income and Social Cohesion |
| CEREQ | Centre d'études et de recherches sur les qualifications | Centre for Study and Research on Occupational Skills |
| DGF | Dotation globale de fonctionnement | Global operating grant |
| EPCI | Établissements publics de coopération intercommunale | Public Institutions for Inter-communal Co-operation |
| FMDI | Fonds de mobilisation départementale pour l'insertion | Departmental fund for employment |
| INSEE | Institut national de la statistique et des études économiques | National Institute for Statistics and Economic Studies |
| LOLF | Loi organique relative aux lois de finances | Constitutional Bylaw on Budget Acts |
| PPE | Prime pour l'emploi | Employment Allowance – earned-income tax credit |
| RMA | Revenu minimum d'activité | Minimum employment income |
| RMI | Revenu minimum d'insertion | Social/occupational integration minimum income – minimum benefit paid to those with no other source of income |

| | | |
|------|---|---------------------------|
| TIPP | Taxe intérieure sur les produits pétroliers | Tax on Petroleum Products |
| ZEP | Zone d'éducation prioritaire | Education Priority Zone |
| ZUS | Zone urbaine sensible | Sensitive Urban Area |

WORKING PAPERS

The full series of Economics Department Working Papers can be consulted at www.oecd.org/eco/Working_Papers/

570. *Enhancing incentives to improve performance in the education system in France*
(July 2007) Paul O'Brien
Renforcer les incitations à une meilleure performance du système éducatif en France
(juillet 2007) Paul O'Brien
569. *Combating poverty and social exclusion in France*
(July 2007) Stéphanie Jamet
Lutter contre la pauvreté et l'exclusion sociale en France
(juillet 2007) Stéphanie Jamet
568. *The competition law and policy indicator*
(July 2007) Jens Hoj
567. *Structural policies and economic resilience to shocks*
(July 2007) Romain Duval, Jørgen Elmeskov and Lukas Vogel
566. *Family policy in Hungary: how to improve the reconciliation between work and family?*
(July 2007) Philip Hemmings
565. *Encouraging sub-national government efficiency in Hungary*
(July 2007) Alessandro Goglio
564. *Integration of immigrants in OECD countries: do policies matter?*
(July 2007) Orsetta Causa and Sébastien Jean
563. *The unemployment impact of immigration in OECD countries*
(July 2007) Sébastien Jean and Miguel Jiménez
562. *Migration in OECD countries: labour market impact and integration issues*
(July 2007) Sébastien Jean, Orsetta Causa, Miguel Jimenez and Isabelle Wanner
561. *The internationalisation of production, international outsourcing and employment in the OECD*
(June 2007) Margit Molnar, Nigel Pain and Daria Taglioni
560. *Why has Swedish inflation been persistently low?*
(June 2007) Felix Hüefner
559. *The Swedish housing market – better allocation via less regulation*
(June 2007) Felix Hüefner and Jens Lundsgaard
558. *Linkages between performance and institutions in the primary and secondary education sector*
(June 2007) Douglas Sutherland and Robert Price
557. *Toward a more efficient taxation system in New Zealand*
(June 2007) Annabelle Mourougane
556. *Income inequality, poverty and social spending in Japan*
(June 2007) Randall Jones
555. *Improving the efficiency of health care spending: selected evidence on hospital performance*
(May 2007) Espen Erlandsen

554. *Cross-country analysis of efficiency in OECD health care sectors: options for research*
(May 2007) Unto Häkkinen and Isabelle Joumard
553. *What promotes fiscal consolidation: OECD country experience*
(May 2007) Stéphanie Guichard, Mike Kennedy, Eckhard Wurzel and Christophe André
552. *Globalisation and the macroeconomic policy environment*
(April 2007) Karine Hervé, Isabell Koske, Nigel Pain, Franck Sédillot
551. *Why has core inflation remained so muted in the face of the oil shock?*
(April 2007) Paul van den Noord and Christophe André
550. *Housing markets and adjustments in monetary union*
(April 2007) Peter Hoeller and David Rae
549. *Financial markets in Iceland*
(March 2007) Peter Tulip
548. *The political economy of delaying fiscal consolidation*
(March 2007) Boris Cournède
547. *The impact on growth of higher efficiency of public spending on schools*
(March 2007) Frédéric Gonand
546. *Performance indicators for public spending efficiency in primary and secondary education*
(February 2007) Douglas Sutherland, Robert Price, Isabelle Joumard and Chantal Nicq
545. *Monetary policy and macroeconomic stability in Latin America: the cases of Brazil, Chile, Colombia and Mexico*
(February 2007) Luiz de Mello and Diego Moccoero
544. *The Brazilian "tax war": the case of value-added tax competition among the states*
(February 2007) Luiz de Mello
543. *Public spending efficiency: institutional indicators in primary and secondary education*
(January 2007) Frédéric Gonand, Isabelle Joumard and Robert Price
542. *Enhancing turkey's growth prospects by improving formal sector business conditions*
(January 2007) Rauf Gönenç, Willi Leibfritz, Gökhan Yilmaz
541. *Fiscal relations across levels of government in Australia*
(January 2007) Vassiliki Koutsogeorgopoulou
540. *Russian manufacturing and the threat of 'Dutch Disease': A comparison of competitiveness developments in Russia and Ukrainian industry*
(January 2007) Rudiger Ahrend, Donato de Rosa and William Tompson
539. *Stimulating innovation in Russia: The role of institutions and policies*
(January 2007) Christian Gianella and William Tompson
538. *Healthcare reform in Russia: problems and prospects*
(January 2007) William Tompson
537. *A golden rule for Russia? How a rule-based fiscal policy can allow a smooth adjustment to the new terms of trade*
(January 2007) Christian Gianella