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A Strategy for Public Spending

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French public expenditure has followed an upward trend for more than thirty years. In 2015, it stood at 57% of GDP, compared with an average of 48.5% for OECD countries; just two Scandinavian countries –Denmark and Finland– spend as much. Public employment as a whole does not seem to lie behind that additional expenditure. The level of public expenditure is higher in France for most missions, but particularly so for economic affairs and social protection.

The "right" level of public expenditure is very largely dictated by constraints from compulsory levies, balancing the budget, and debt. With public debt that is close to 100% of GDP, any increase of one percentage point in the interest rate would, in the long run, cost the equivalent of the budget for higher education and research. Therefore, the aim of reducing public expenditure in France is, above all, to provide the French Government with room for manœuvre that enables it to invest in the country's future.

Of course, in the short term, a reduction in public expenditure can have a negative impact on activity, because a cut in public expenditure is not automatically balanced out by a rise in private expenditure. However, the effect varies significantly according to the type of expenditure that is targeted, and the way in which the programme is announced and managed. This *Note du CAE* shows that an ambitious cut in public expenditure is compatible with renewed growth if that cut is selective, structural, and supported by a temporary programme of investment.

Foreign experiences have shown the usefulness of implementing a swift review of public policies by means of cost/benefit analyses, in order to redefine the scope of expenditure or the instruments of public action, expenditure generally not being the sole lever of action. No sector of intervention should escape that review, even those that are deemed priority sectors.

To succeed, the transformation of public policies must be placed at the top of the political agenda. The Prime Minister must make a commitment, communicate widely, and bring together ministers and directors of administrations to define a consistent overall programme, with a timescale. Specific governance must be put in place to make local authorities and agencies part of the approach, with appropriate incentives.

Redefining public intervention brings about far-reaching changes in beneficiaries and in the public administration. Hence, it is essential to plan temporary indemnity arrangements for the "losers" and to develop policies on support, mobility, and re-training for public officials, so that they can be deployed to the posts that need to be filled. The programme must be seen as an investment that has a sufficient budget.

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Turning around our public finances is not just a European commitment; above all, the aim is to provide the French Government with room for manœuvre that enables it to invest in the country's future, make effective public interventions, limit tax pressure so as not to discourage talent and innovation whilst preserving social protection, and, finally, help the most vulnerable to deal with ongoing structural changes.

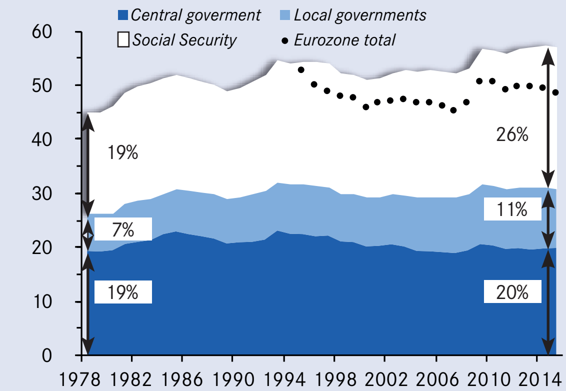
The aim of this *Note* is to set out the conditions for a virtuous fall in public expenditure in France. Without calling into question the objectives of public policies, the idea is to identify cheaper levers of action in order to attain those objectives, and to draw inspiration from foreign experiences for transforming public action.

The finding: French specificities and points of consensus

An upward trend in expenditure that is driven by Social Security and local authorities

French public expenditure as a percentage of GDP has shown an upward trend for more than thirty years (Graph 1). Public revenue has also grown, although it has remained less than expenditure; we need to go back to 1974 to find a balanced budget. That growth in expenditure is mainly driven by the expenditure of Social Security and of local authorities, whereas there is a slight fall in the expenditure of central administrations. State expenditure has been rationalised since the *"Loi organique relative aux lois des finances"* (LOLF, Organic Law governing Finance Laws) that was passed in 2001, the *"Révision générale des politiques publiques"* (RGPP, General Review of Public Policies) that was started in 2007, then the *"Modernisation de l'action publique"* (MAP, Modernisation of Public Action) from 2012, as well as the programming, as part of the Responsibility Pact, of a plan to reduce expenditure by 50 billion euros over the period 2015-2017.

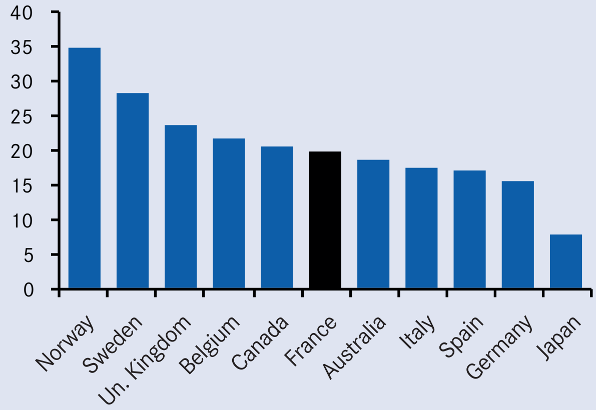
1. Development of public expenditure[a] in France,
1978-2014, as a % of GDP



Note: [a] Expenditure by subsector of government, net of transfers between administrations (the amount of expenditure per subsector is equal to the total expenditure of the general goverment).

Sources: INSEE, National accounts, 2010 basis (France), Eurostat (Eurozone) and authors.

2. Share of public employment in total employment,
2013, as a %



Source: OECD, data 2013 (except for Germany, data 2009).

If we aggregate all the levels of administration, government expenditure reached 57% of GDP in 2015, which places France at the head of OECD countries. Only two Scandinavian countries –Denmark and Finland– spend as much.

At first sight, public employment as a whole does not seem to be the source of that extra public expenditure in France. The proportion of public employment within overall employment is not systematically higher than in other OECD countries[1] (Graph 2); it is certainly higher than in Germany, but much lower than in the Scandinavian countries and the United Kingdom.[2] As a proportion of GDP, the public payroll has grown very little over the last 35 years. By including civil servants' retirement pensions, it accounted for 12.9% of GDP in 2015, a rise of just 0.4 point since 1980.[3] Setting aside pensions, the rise was just 0.1 GDP point over the same period.

For its part, public investment has fallen by 0.8 GDP point since 1980, and accounted for just 3.5% of GDP in 2015 –a figure that is nonetheless higher by 0.8 GDP point than the eurozone average. During the recent crisis, European countries devoted a significant share of their budget efforts to investment, which is more malleable than the remuneration of public officials. In France, the phenomenon is mainly observed in local authorities, which concentrate two thirds of public investment (except for R&D), whereas remuneration has increased continuously

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[1] Due to a lack of data, not all OECD countries could be covered.

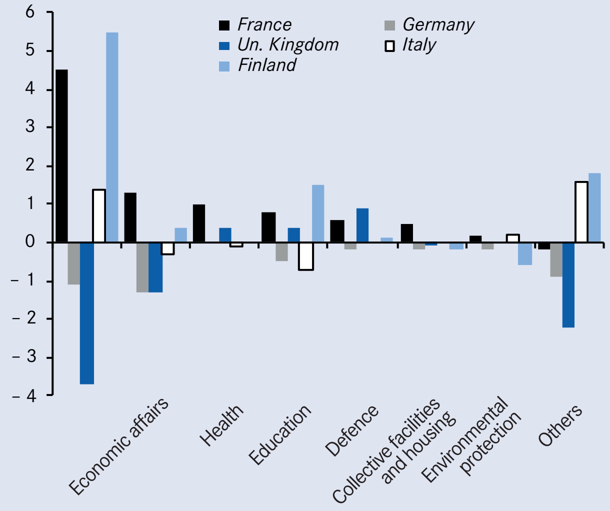
[2] In the United Kingdom, the health system is based on a public healthcare network, from general medicine to hospital, which makes the comparison a fragile one (physicians are counted as public employees).

[3] According to data from the OECD (2015): *Government at a Glance*, OECD Publishing, Paris.

since the 1980s, an increase that largely exceeds the expected impact of the transfer of competences from the State to local authorities.[4] The weight of local administrations in France is also observed in public procurement; they account for nearly 60% of the total amount of public procurement, as opposed to just 53% on average in OECD countries.[5] And yet, public procurement represents an expenditure item that is comparable to public employment in France.

Economic theory gives no clear indications on the "right" level of public expenditure, which is rather dictated by constraints in terms of public levies, balancing the budget, and indebtedness. In that regard, the very strong increase in public debt over the last 35 years (up by 75 GDP points, half of that since the 2008 crisis) is a strong constraint for the coming years. The interest cost fell from 2.6 GDP points in 2007 to 2 points in 2015, due to the exceptionally low level of interest rates. With debt that is currently close to 100% of GDP, an interest-rate rise of one point would lead over time to an increase of 1 GDP point in the interest cost,[6] which is the equivalent of the budget for higher education and research.

3. Public expenditure: deviations from the eurozone average in 2015, in % of GDP



Source: Eurostat.

France spends more than other OECD countries in almost all areas, particularly in social transfers

If France is in an "average" position within the OECD as regards its public employment, how can we explain the clearly higher levels of public expenditure, which stand at 57% of GDP as opposed to an average of 48.5% in OECD countries? The comparison of expenditure by high-level function suffers from the differences in nomenclature between countries; nonetheless, it provides some items in response (Graph 3). We can see a higher level of expenditure in France for most missions, especially economic affairs and, even more, social protection.[7]

Two thirds of the extra public expenditure in France comes from the social sphere; social protection and health account for 5.5 GDP points more in France than the average in the eurozone. Above all, it is a case of retirement expenditure, but housing subsidies as well as family allowances and health also contribute to extra social expenditure in France. The higher level than elsewhere of retirement-related public expenditure results from the choice of near-total socialisation, with basic schemes and compulsory additional schemes operating on a pay-as-you-go basis.[8] It is also a result of the relative generosity of the system with regard to relative life expectancies of people aged over 60. However, the various pension reforms implemented since the start of the 1990s should contribute to lessening that expenditure in percent GDP in the future. In the case of public expenditure on health, the gaps between countries are once again explained by the degree of risk socialisation, as well as by the effectiveness of the organisation of health care (see Box 3). Finally, in the matter of housing,[9] rental and purchase are heavily subsidized, with an effectiveness that is greatly challenged (see below).

Away from social expenditure, public expenditure in France is 3 GDP points higher than the average in the eurozone. In that regard, the "Economic Affairs" function stands out; the item covers subsidies to businesses, and it is higher in France because of tax credits (*Crédit impôt recherche*, CIR, Research Tax Credit) and *Crédit d'impôt compétitivité emploi*, CICE, Tax Credit for Encouraging Competitiveness and Jobs), which are henceforth counted as expenditure.

The high-level of public expenditure on teaching in France is explained by the very low participation of private expendi-

[4] Beynet P. and H. Naerhuysen (2007): "Les facteurs d'évolution de la dépense publique en France : une rétrospective", *Note TrésorEco*, no 26, December. During the last decentralisation phase (between 2002 and 2013), communes saw their staff expenditure increase whilst competences were being transferred towards the *départements* and the regions. See Cour des Comptes (2016): *Les finances publiques locales*, Rapport sur la situation financière et la gestion des collectivités territoriales et de leurs établissements publics, October.

[5] OECD (2015): *op.cit*. Some countries have higher proportions, but most often they are federal States. It should be noted that France is characterised by a number of contracting authorities (public purchasers) that is significantly higher than in all the other countries. In a *Note du CAE* that deals with public procurement, the authors proposed a series of measures to boost efficiency, *cf*. Saussier S. and J. Tirole (2015): "Strengthening the Efficiency of Public Procurement", *Note du CAE*, no 22, April.

[6] The rise being gradual in line with debt roll-over. See the Analysis and Forecasting Department of the OFCE (*Observatoire Français des Conjonctures Économiques*, French Economics Observatory), 2017.

[7] The Court of Audits draws up a similar finding in its recent report. See *Cour des Comptes* (2017): *La situation et les perspectives des finances publiques*, June.

[8] It is most often the case that the other countries have chosen a mixed system with a public basic scheme supplemented by a significant private capitalisation regime that is compulsory or optional.

[9] Housing subsidies paid to households are classified under the "social protection" function. The expenditure of the "accommodation and collective facilities" function covers the construction of housing (especially social housing), collective facilities being made available, water supplies, and public lighting.

ture in that area. Total expenditure per pupil and student is not higher than in other European countries; it is lower than in Austria, the United Kingdom, Sweden, Belgium, Denmark, and the Netherlands.[10] However, that does not give discharge from carrying out a deeper examination of the whole of that mission, of which the results can be deemed disappointing given the sums invested and the challenges to be taken up.[11] We may question the allocation of means between the various levels of education (France stands apart from the other countries due to a lower level of investment in primary education), the types of teaching, and the level of financial participation by families (for higher education).

In sum, the high level of public expenditure in France is explained in part by social choices: a significant degree of pooling social risks, and a great majority of finance for education coming from public funds. However, those choices are not enough to explain the extra expenditure, which leads us to wonder about its effectiveness with regard to the objectives assigned and to the existence of alternative levers for attaining the same objectives.

Public expenditure and growth

According to Keynesian theory, a reduction in public expenditure has, in principle, a negative impact on activity in the short term, because the fall in public expenditure is not immediately balanced out by a rise in private expenditure; on the contrary, private expenditure can itself be negatively affected by a knock-on effect.[12]

However, the many research studies on the impact of a fall in public expenditure in the short term lead to mixed results (*cf.* Box 1). A recurring problem is the fact that the budget adjustment does not generally take place on a random basis; it is triggered by a worsening in public finances, a variation in activity, or any other economic phenomenon (banking crisis, variation in the oil price, development of monetary policy, etc.). Moreover, fiscal policy is often rolled out over several years, which makes its exact dating a delicate matter, with the same being true of the distinction between the effect of fiscal policy itself and the effect of the other shocks suffered by the economy during the period.

Studies based on macro-econometric models[13] generally conclude that fiscal multipliers lie between 0 and 1.5: all things being otherwise equal, a deficit reduction of 1 percent of GDP reduces GDP in the short term by 0 to 1.5%, depending on the instrument selected.[14] According to those models, a rise in taxes (or a fall in transfers) has less of a negative effect in the short term than a cut in expenditure, because, in the former case, households partially compensate for their fall in available income by dipping into their savings.[15] The models also conclude that the multipliers are higher in the low phase of the activity cycle, if the interest rate is close to zero (so it cannot go any lower) or if the budget adjustment takes place in several countries at once. The recessive effect of the adjustment is at a maximum after two years, but it disappears after five years, except in exceptional cases (cut in public investment, budget adjustment launched during a recession and some taxes rises).[16]

A second group of studies has used budget documents to identify the decision taken on a basis that is truly independent of the economic situation. That second, so-called “narrative”, approach highlights a strong negative impact of fiscal adjustments made using tax rises, but a weak or even non-significant effect (no impact on average) from adjustments made by lowering expenditure. According to that literature, the effect of a cut in expenditure does not seem to depend on the position of the economy in the cycle or on constraints linked to monetary policy. In reality, the key variable seems to be the budget adjustment’s ability to modify the expectations of households and businesses, thus to trigger even more consumption and investment on the part of the private sector.[17] That positive effect through an improvement in confidence appears to be more easily reached if the adjustment involves a structural reduction in expenditure (deemed more sustainable and with no negative effect on potential growth) than if it involves a rise in taxes or cut in expenditure across the board (which are deemed more easily reversible).

[10] OECD (2016): *Regard sur l’éducation*, Les indicateurs de l’OCDE.

[11] *Cf*. France Stratégie (2014): *Quelle France dans dix ans? Les chantiers de la décennie*. See also the successive PISA surveys, which reveal a strengthening of the correlation between academic success and social origin. The challenges are summarised in Anne-Braun J., K. Lemoine, E. Saillard and P. Taillepied (2016): “Formation initiale et continue: quels enjeux pour une économie fondée sur la connaissance?”, *Trésor-Eco*, no 165.

[12] See, for instance, Diop M. and A. Diaw (2015): “Politique budgétaire et stabilité macroéconomique en Union économique et monétaire”, *Revue de l’OFCE*, vol. 137, no 1, pp. 181-209.

[13] Neo-Keynesian models or dynamics of stochastic genral equilibrium models.

[14] Coenen *et al.* (2010) have reviewed the models used by five leading institutions: the International Monetary Fund, the European Central Bank, the European Commission, the USA Federal Reserve Bank, and the Bank of Canada. On average, the multiplier is close to 1 for a fall in investment or consumption. It is of the order of 0.7 for a fall in meantasted transfers, between 0 and 0.5 for other transfers, and of the order of 0.2 for a rise in taxes. Coenen G. *et al.* (2010): “Effects of Fiscal Stimulus in Structural Models”, *IMF Working Paper*, no 10/73.

[15] According to Mineshima *et al.* (2014), the average multiplier, across 41 studies, is 0.75 for expenditure and 0.25 for taxes. *Cf.* Mineshima A., M. Poplawski-Ribeiro and A. Weber (2014): “Fiscal Multipliers” in *Post-Crisis Fiscal Policy*, Cottarelli, Gerson and Senhadji (eds), Cambridge MIT Press.

[16] See Batini N., L. Eyraud, L. Forni and A. Weber (2014): “Fiscal Multipliers: Size, Determinants, and Use in Macroeconomic Projections”, *IMF Technical Note*.

[17] See Alesina A. and S. Ardagna (2010): “Large Changes in Fiscal Policy: Taxes versus Spending”, *Tax Policy and the Economy*, no 24, pp. 35-68; Alesina A., C. Favero and F. Giavazzi (2015): “The Output Effect of Fiscal Consolidation Plans”, *Journal of International Economics*, vol. 96, no S19-S42; Alesina A., O. Barbiero, C. Favero, F. Giavazzi and M. Paradisi (2015): “Austerity in 2009-13”, *Economic Policy*, July, pp. 383-437; Alesina A., O. Barbiero, C. Favero, F. Giavazzi and M. Paradisi (2017): “The Effects of Fiscal Consolidations: Theory and Evidence”, *NBER Working Paper*, no 23385, May.

1. Measuring the fiscal multiplier

The fiscal multiplier is the effect of a variation in public expenditure (or taxes) or the level of GDP in the short and medium term. Estimating budget multipliers is a delicate process due to inverse causality: fiscal authorities react to macro-economic conditions. Moreover, strong GDP growth mechanically raises tax revenues and reduces some expenditure, especially social transfers. Finally, historic episodes of reducing public expenditure are often spread over several years, and have sometimes been supported by expansionary monetary policies or structural reforms that also affect the growth rate.

Economic research tries to circumvent those difficulties through two broad methodologies, based on macro-econometric models (*ex ante* estimations) or on past episodes (*ex post* estimations). The two methods are complementary. The first is well adapted to anticipate the impact of a variation in the margin (e.g. 1% of GDP) of public expenditure, and it has the advantage of relying on a model of the economy concerned (in our case, France). However, it rests on parameters estimated under conditions that do not eliminate the problem of inverse causality. The second method enables to study private wide-ranging budget reforms that are likely to modify private expectations. Nonetheless, the estimate is made based on the experience of varied countries that are not always comparable with the French economy.

In 2017, the OFCE made an estimate of the first type with the help of the *e-mod.fr* model. According to that model, a fall in public expenditure of 1% of GDP, together with an equivalent fall in compulsory levies (thus, with no variation in the budget balance *ex ante*), leads to a 0.6% fall in French GDP in the first year, and a fall of almost 1% in the 2nd and 3rd years. The recessive effect is greater if the fall in expenditure covers employment or public investments, and it is more moderate if the choice is made to reduce social benefits or civil servants' salaries (Table).[a] Tax multipliers are generally weaker, except for social-security contributions, especially those paid by employers (multipliers comparable with those of investment).

The works of Alberto Alesina, Francesco Giavazzi, and their colleagues propose an *ex post* estimate based on a sample of over 170 stabilisation plans in sixteen OECD countries (including France) over the last 35 years, the authors take a "narrative" approach based on the budget programmes themselves (and not just on the figures supplied *ex post* by the national accounts department), in order to correct the estimate biases presented above. They find that in order to reduce the public deficit, it is less costly (in terms of GDP) to reduce public expenditure than to raise taxes. A budget adjustment made by reducing expenditure can even have no effect on GDP if the reduction in expenditure is credible and triggers a rise in investments.

Multipliers according to the position in the cycle[a] and the type of expenditure or levy

	Output gap: – 2%		Output gap: 0%		Output gap: + 2%	
	1st year	5th year	1st year	5th year	1st year	5th year
Expenditure multipliers[b]						
– Investment	1.2	0.4	1.1	0.1	1.0	– 0.1
– Public employment	1.6	0.3	1.5	– 0.1	1.3	– 0.3
– Social transfers	1.0	0.7	0.9	0.5	0.9	0.3
Levy multipliers[c]						
– Employers' social-security	1.2	1.0	1.1	0.6	1.0	0.4
– Employees' social-security	0.8	0.5	0.8	0.4	0.8	0.2
– CSG (General Social Contribution)	0.8	0.6	0.8	0.4	0.8	0.2
– VAT (Value-Added Tax)	0.6	0.9	0.6	0.6	0.6	0.4

Reading: A rise in public investment of 1 GDP point raises activity by 1.2% in the first year if GDP is initially 2% above its potential level, by 1.1% if it is initially at its potential level, and by 1% if GDP is initially 2% below its potential level. After five years, the effect on GDP is nil, except in the final case, where it remains reduced by 0.4%.

Notes: [a] Output gap as a % of potential production at the time of the budget shock; [b] Impact of a rise in expenditure of 1% of GDP on GDP, in %; [c] Impact of a fall in levies of 1% of GDP on GDP, in %.

[a] For the methodology, see Creel J., É. Heyer and M. Plane (2011): "Petit précis de politique budgétaire par tous les temps : les multiplicateurs budgétaires au cours du cycle", *Revue de l'OFCE*, no 116, January.

What lessons are there for France today? Although it is difficult to accurately anticipate the impact on GDP of a programme of reduced public spending, existing research suggests that:

– The recovery phase of activity is favourable to carrying out an adjustment.[18] However, the fall in expenditure must be gradual (in order not to snuff out recovery) as well as

[18] However, France is in a less favourable position than Canada, Sweden, or the United Kingdom when those countries sharply reduced their public expenditure in the 1990s. Each one also experienced a crisis during the previous years and suffered from high rates of unemployment, but the three countries were able to take advantage of a more favourable world situation.

credible (to modify the expectations of the private sector). Those two constraints call for a reduction in "structural" expenditure (modification to the scope of intervention or the mode of intervention, digitisation of some services, etc.), which are at once more gradual and more sustainable than cutting all expenditures proportionaly;
– Setting up a public-investment programme during the activity-reduction phase is probably an effective means of countering the possibly recessive effects in the short term of a fall in current expenditure;
– A reduction in transfers can have a limited effect on activity in the short term if it leaves the most modest households unaffected;
– A simultaneous fall in taxes is likely to attenuate the possibly contractionary effect of the expenditure-reduction programme, although the proportion is difficult to anticipate.

A strategy for France

Political economy of spending cuts

An initial approach to reducing public expenditure involves a slight but uniform reduction in all expenditure. That approach gambles on efficiency gains in the entire public sphere, and it is often considered more acceptable politically, because it is seen as less unfair. It is also less likely to mobilise lobbies. In France, that approach has been taken for the central government since the LOLF was implemented, with a certain amount of success as regards the State's budget (*cf*. above). Nonetheless, we can expect efficiency reserves to be run down as expenditure falls. There is also the risk that adjustments cover the maintenance of facilities, which will do no more than postpone expenditure.

Overall, OECD countries that have succeeded in implementing significant expenditure reductions have not followed that path; instead, they have made strong choices between various items of expenditure. Lorach and Sode (2015) show that countries that reduce their public expenditure the most are generally selective, with large cuts made to some items –most countries have reduced social transfers by targeting them more strongly– whereas other items rise.[19] However, France stands apart due to the non-selective nature of its expenditure reductions. One strategy for France could be to reset the perimeter of public expenditure, and, in some sectors, remove the State, not from regulation but from direct intervention. For example, housing policy could be based to a greater degree on regulating supply (building permits, construction standards and regulating leases) and less on subsidising demand (see below).

That type of choice concentrates the possible loss on a small number of individuals. In our example, those individuals would be landlords who see a fall in rents and in the selling prices of their assets, as well as, on a transitional basis, tenants and first-time buyers who would lose grants without seeing an immediate fall in prices. To limit opposition to reform, foreign experience and theoretical literature alike suggest not proceeding in a sequential manner, but, in a single stroke, make an announcement of a set of reforms, so as to assess overall redistributive effects and compensate for them if necessary. That can be compatible with a gradual implementation of reforms. However, it is important to announce a costed objective set to a realistic timeline, and to communicate widely regarding that target in order to co-ordinate all stakeholders (political leaders, administrations, the private sector and the voluntary sector) around that target.

Programmes to reduce public expenditure are rarely implemented without there being losers. Thus, it is important to plan for losers to be compensated, if only on a partial and transitional basis. However, that means being able to identify losers, which leads on to the importance of designing the entire adjustment plan at a single stroke and of having reliable simulation tools.

Governments that reduce expenditure do not seem to suffer systematically at subsequent elections. On the contrary, when the budget adjustment has favoured a reduction in expenditure (rather than a rise in taxes), electors tend to reward the outgoing government (Box 2).

Need for selectivity

Until the present, French strategy on reducing public expenditure has prioritised horizontal approaches, enacting rules for the non-replacement of people who retire and the dissemination of methods of "new public management".[20] However, the result is not up to the challenges, whether in terms of controlling expenditure –that strategy has certainly reduced the State's expenditure, but not the expenditure of all public administrations– or in terms of general performance. The LOLF has certainly promoted projects and annual performance reports (produced by the administrations) that aim at improving the management and quality of services, but it has not promoted the assessment of the socio-economic effectiveness of public policies with regard to their objectives and to the means mobilised. And yet, that assessment approach

[19] Lorach N. and A. Sode (2015): "Quelle sélectivité dans la réduction des dépenses publiques?", *La Note d'Analyse de France Stratégie*, no 28, avril. The indicator is the sum of the absolute values of the gaps between the development of various items and the development of total public expenditure between two years. The absolute values are weighted by the share of the item at the start of the period. A weak indicator shows that the various items develop in a uniform manner.

[20] Reducing public expenditure whilst spending better and without reducing the perimeter of the Government has been at the heart of the "LOLF", implemented in 2001, then the "RGPP" of 2007, the pivotal part of which was the non-renewal of one out of every two civil servants. In 2012, the latter was replaced by the "MAP", which restated the emphasis on modernisation and performance as levers to reduce public expenditure. In other words, the political economy that suggests reducing all expenditure, a reform that affects everyone, being seen as fairer, has largely prevailed.

2. Foreign experiences

In the past, many countries carried out ambitious programmes to reduce public expenditure, often after a period of crisis.

Lorach *et al*. (2014)[a] analyse 17 episodes of public-expenditure reductions of at least 3% of GDP over 3 years in OECD countries between 1990 and 2007. Spending cuts especially covered social transfers (especially in Finland, Ireland, and Denmark), and, to a lesser degree, the remuneration of public officials (Canada and Finland). Five of those experiences were also analysed by Aghion *et al*. (2014),[b] with the same finding on targeting social-transfer expenditure: health and social protection, in the case of Canada; family and unemployment benefits, health, education, housing, and community services, in the case of Sweden. In addition, Canada reduced its defence spending and Sweden reduced its local-authority spending. Sweden reduced the number of public jobs from 400,000 to 250,000 between 1993 and 2000. Those budget adjustments were also a success in political terms, since four of the five cases led to the government be re-elected. According to existing empirical studies, it seems more dangerous from an electoral point of view to increase compulsory levies than to reduce expenditure.[c]

In terms of method, it appears that the programmes that have managed to substantially and sustainably reduce public expenditure involved a strategic spending review, in order to target reductions on some policies, whilst, going the other way, other policies were boosted.[d] Canada's experience is particularly interesting.[e] Learning lessons from failed attempts at reducing all expenditure proportionately in the 1980s, the government elected in 1993 placed a spending review at the top of its priorities, with several important principles:

- Application that was as wide as possible ("nothing off the table") to encourage acceptability;
- A principle of responsibility: each Ministry put forward an adjustment without prior intervention by the Ministry of Finance, as part of strongly associating and involving Ministers and directors of administrations;
- A lack of pre-established targets for each Ministry, in order not to curb the review process;
- Overall decision-making at a single stroke, after a spending review for all Ministries.

Great care was taken over the governance of the spending-review programme and the decision-making process, by placing political leaders and directors of administrations in tandem to steer the process in each Ministry. Arbitrations were carried out by three committees: a committee of directors mobilised intensively to examine the adjustments proposed by Ministries –a peer review–, an *ad hoc* committee of Ministers to give opinions on the proposals and build political consensus, and, finally, the Cabinet, to carry out finally arbitrations. A small team of senior officials was put together to facilitate general coordination.

Since 2008, several European countries have carried out budget-adjustment programmes. Once again, those programmes were swiftly implemented after elections, by governments that, with the exception of Greece, had campaigned on the matter.[f] For the period from 2009-2011, adjustments made in Europe covered mainly public employment, social-security spending, and the item headed "economic affairs".[g] Spending cuts were spread widely in some countries (Sweden, Germany, and Poland. In other countries (e.g. Slovakia and Bulgaria), the spending structure was modified. The Netherlands (in the 1980s) and the United Kingdom (since 2010) have put in place spending reviews that show some similarities with the Canadian model. The quality of governance and the close association between political leaders and directors of administrations emerge as essential elements.[h] Conversely, the failure of various attempts made in Italy in the 2010s must be linked to the weak political capital of Prime Ministers, who themselves did not make it their main priority.[i]

[a] Lorach N., C. Mareuge and C. Merckling (2014): "Réduction des dépenses publiques : les leçons de l'expérience", *La Note d'Analyse de France Stratégie*, July.

[b] Aghion P., G. Cette and É. Cohen (2014): Changer de modèle, Odile Jacob.

[c] See, for instance, Alesina A., R. Perotti and J. Tavares (1998): "The Political Economy of Fiscal Adjustment", *Brookings Papers on Economic Activity*, Spring or Brender A. and A. Drazen (2008): "How to Budget Deficits and Economic Growth Affect Reelection Prospects? Evidence from a Large Panel of Countries", *American Economic Review*, vol. 98, no 5, December.

[d] Henriksson J. (2017): *Ten Lessons About Budget Consolidation*, Bruegel Essay and Lecture Series.

[e] Bourgon J. (2009): "The Government of Canada's Experience Eliminating the Deficit, 1994-1999: A Canadian Case Study", *Centre for International Governance and Innovation*.

[f] Giavazzi F. and A. Alesina (2017): *Is Austerity Governments'Kiss of Death?*, Mimeo.

[g] Lorach N. and A. Sode (2015): "Quelle sélectivité dans la réduction des dépenses publiques ?", *La Note d'Analyse de France Stratégie*, o 28, April.

[h] Vandierendonck C. (2014): "Public Spending Reviews: Design, Conduct, Implementation", *European Commission Economics Papers*, no 525.

[i] Lorenzani D. and V.E. Reitano (2015) : "Italy's Spending Maze Runner: An Analysis of the Structure and Evolution of Public Expenditure in Italy", *European Commission Discussion Paper*, no 23.

is essential to justify and improve public policies. For a given policy, when France spends more than comparable countries for results that are no better, it is legitimate to re-examine the instruments of public policies. Several areas are covered in this *Note* to illustrate the point. Moreover, the proportional cut strategy has also had the consequence of a fall of attractiveness of the public sector, as is shown by recruitment difficulties in education.

In parallel, the "new public management" has sought efficiency in public expenditure by insisting on performance and on individual empowerment rather than on procedures. France has lagged behind other countries in implementing those new management methods, and in France, those methods have been limited to carrying out audits and adjustments in managing human resources, such as the introduction of bonuses and of annual assessment interviews. In many ways, public management has to deal with the same difficulties as other organisations, especially businesses: an accurate definition of objectives and drawing up a vision of the transformations to be carried out; the need for "leadership"; a link between "profession"–based approaches and the overall approach; anticipating resistance by focusing on mobilising teams rather than trying to impose a plan; placing project leaders in positions of responsibility.[21] However, public management also has to deal with specific difficulties.[22] Moreover, with performance constraints that are less pressing than in the private sector, the instruments for organising possible transitions and reclassifications are not yet in place.[23] In addition, strategies remain overly fragmented between the macroeconomic framework, "sectoral" policies, and their governance, marked by divisions between the Budget, the *Secrétariat général à la modernisation de l'action publique* (SGMAP, Secretariat-General for Government Modernisation), and the Civil Service. They express poorly the roles of the policy and of the framework, and they soon appear to lack credibility in light of having insufficiently defined the objectives, or of having taken on too many constraints on a *a priori* basis in the field of public action or its terms (for example, never challenging the delimitation of the public sector).

Above all, applying the principles of new public management has taken the form of financial incentives alone, forgetting the importance of incentives that are intrinsic in delivering public services. Those difficulties have been abundantly analysed in the literature,[24] and have led the other countries to move to a new approach to public governance, one that is more inclusive of citizens in co-production with officials and more careful of the specific motivation of Civil Service officials, for example by placing more emphasis on their mobility and on their empowerment as a lever of motivation rather than on simple financial incentives that, moreover, have been reduced. The OECD henceforth proposes an approach to public governance that is more pragmatic than the one promoted in the 1980s.[25] This gives way to new perspectives to improve the horizontal approach to State modernisation. The report entitled *Quelle action publique dans dix ans?*[26] placed particular emphasis on the generalisation of performance and management contracts, management training, adapting the supply, and innovation within the public sphere.

However, that cannot be enough, and France must re-examine its public-expenditure priorities, as has been done by most other European countries. That requires a systematic reassessment of public policies (perimeters and instruments), and the adoption of arrangements for managing reforms, including compensating some losers who would otherwise block the process. The traditional view tends to equate public action with public expenditure, and it must be set aside.

The perimeter of public expenditure and action

One way of thinking of reducing expenditure is to consider redefining the instruments of public action for a given objective. For example, the policy on higher education aims at excellence whilst facilitating university access to all. Registration fees that are sometimes higher at graduate level, together with a system of exemptions based on parental resources (e.g. as at the University of Turin) or a system of grants, would enable that dual objective to be attained more cheaply.

Such selectivity is possible in matters of budget expenditure, without calling into question the ambition of policies or solidarity.

As regards ambition, environmental policies are an emblematic case. In theory, they should not take up a significant portion of the budget, since it is a matter of correcting a problem of externality; the solution to that is to set up an incentivising price signal, using eco-taxation or quota markets under an overall cap (see the Swedish experience).[27] The budget impact can even be favourable: tax income in the short term, reduction of curative expenditure in the long term. However, it should be noted that the double dividend is never total, because it is generally necessary to combine that dividend with support measures to manage transitions or to ensure their acceptability (purchasing power, competitiveness).

However, other examples can be quoted, such as housing for agriculture (Box 3). In both cases, the budget contributions mobilised are significant (at national level for housing, and

[21] *Cf*. France Stratégie (2015): *Quelle action publique dans dix ans? Cinq objectifs, cinq leviers*, Report D. Bureau and M-C. Naves (coord.).

[22] Tirole J. (1994): "The Internal Organization of Government", *Oxford Economic Papers*, vol. 46.

[23] On the other hand, the German railway reform, for example, was enabled by the setting up of a particular structure (BEV = *Bundeseisenbahnvermögen*, Federal Railway Assets), uncoupling the human-resources policy of the new Deutsche Bahn (DB, German Railway) from traditional procedures administered in that area, new employees being covered by private contracts and existing employees being made available to the DB on the basis of a range of terms and conditions that enabled them to retain some statutory benefits.

[24] For a presentation of the main critical arguments, see, in particular, Dunleavy P., H. Margetts, S. Bastow and J. Tinkler (2006): "New Public Management Is Dead-Long Live Digital-Era Governance", *Journal of Public Administration Research and Theory*, vol. 16, no 3, pp. 467-494 and for a discussion of those arguments, de Vries J. (2010): "Is New Public Management Really Dead?", *OECD Journal on Budgeting*, vol. 2010/1.

[25] See, for example, the principles of Open Government and the works on leadership and strategic human-resource management in OECD publications.

[26] France Stratégie (2015) *op. cit*.

[27] *Cf*. Bureau D. (2013): "Fiscalité et compétitivité: la démonstration suédoise", *Références Économiques pour le Dévoloppement (CEDD)*, no 26.

at European level of agriculture). Designed on a distributive basis, the latter are poor performers in that regard, with subsidies increasing rents as well as the price of land. They also seem very inefficient at economic and environmental level. Thus, the subject is not one of budget; there is a need to deal with the public policies themselves, transform the terms of subsidies to ensure distributive efficiency, or, going the other way, tip them towards a price signal, depending on the case. And, finally, design a gradual reform with support measures so as not to come up against the question of equity (the induced devaluation of some assets).

In commercial sectors (housing, energy, transport, agriculture, etc.), public-expenditure reduction must go hand-in-hand with putting in place the right financial incentives for public and private stakeholders. Reform can also rely on independent authorities (to establish conditions of access, pricing for essential infrastructures, public-service requirements imposed on operators, and their remuneration), as well as the quality of sectoral regulations (especially health and environmental safety), so that they do not form obstacles to the entry of new stakeholders or of innovation.[28]

To the contrary, in areas of State sovereignty (security, justice, etc.), budget expenditure has few alternatives. In that case, far greater importance is taken on by the development of policies and of information systems to measure the effectiveness of the action and develop competition by comparison.[29]

Between those two extremes lie health, education, vocational training (Box 3), public insurance, and social policies. In those sectors, pricing is crucial to provide the right incentives, limit moral hazard (*cf*. hospital pricing, risk pricing in the “Catnat” scheme (CatNat = *Catastophes Naturelles*, Natural Catastrophes), etc.), and enable facilities to be financed under proper conditions.

On a cross-cutting basis, the *Notes du CAE* on digital administration[30] and on public procuments[31] underline the potential for innovation linked to digital technology for reducing expenditure without lessening the quality of the service provided (or even by increasing that quality).[32] Digital technology enables old public services to be provided at lower cost because of time and efficiency gains, and it also enables the State’s contours to be redefined. Public action is challenged in some sectors where the private sector is no longer lacking, but it is renewed by means of a platform Government that makes citizens take part in implementing public policies, developing towards structures that are often less bureaucratic, smaller, and less costly. Those transformations imply being able to carry out an in-depth reorganisation of administrations, thus being able to manage staff mobility, staff training, and the recruitment of “talents”, especially in the data sciences and IT.

More generally, even if public employment is not a good lever for reducing public expenditure, it is necessarily affected by a redefinition of the scope of public action. Thus, any reduction in public expenditure must not only take account of winners and losers in reforms amongst citizens, but also take the full measure of the impact of that change in scope on officials and administrations: training, new recruitment, incentives through involvement in decision-making and assessment processes, as well as career mobility and a potential overhaul of administrative bodies.

Implementation pitfalls

By making the budget approach one based on management and not one based on means, the LOLF has taken a step forward, especially in terms of providing information to Parliament. However, it has not enabled a drastic boost in selectivity: the budget discussion has remained focused on means; the parliamentary discussion on the regulatory law, which should have widened the assessment of results to public action, did not take off.

Fundamentally, the LOLF has neglected the problems of incentive that confront every centralised planning process.[33] Maintaining an essentially annual budget process offers a partial explanation for the inertia of public choices. In the usual framework of budget negotiation, managers most often expect that they will have no difficulty in obtaining budgets to finance future priorities, so they concentrate their energy on defending other credits. In the absence of a credible contractual framework that would encourage managers to reveal their reserves of productivity, the latter expect that the efforts made today will lead the Minister of the Budget or their supervisory authority to ask them for even more tomorrow, whereas those who conceal their efficiency reserves lead a quiet life, and that blocks any productivity dynamic.[34]

[28] *Cf*. Conseil Économique pour le Développement Durable (CEDD) (2016): *Comment concilier développement économique et environnement?*, Rapport pour le ministre de l’Écologie.

[29] *Cf*. Bureau D. and M. Mougeot (2017): “Performance, incitations et gestion publique”, *Rapport du CAE*, no 66, La Documentation française.

[30] Algan Y., M. Bacache-Beauvallet and A. Perrot (2016): “Digital Administration”, *Note du CAE*, no 34, September.

[31] Saussier et Tirole (2015) *op. cit*.

[32] The Court of Audits, in its June 2017 report on the situation and outlook for public finances, also suggests levers for action to improve the efficiency of public expenditure.

[33] Those problems have been studied in particular by Tirole J. (1994): “The Internal Organization of Government”, *Oxford Economic Papers*, vol. 46 and Laffont J-J. (1999): “Étapes vers un État moderne” in *État et gestion publique*, Rapport du CAE, no 24, La Documentation française.

[34] That is the so-called “ratchet” effect, which undermines the effectiveness of planned systems if it is not understood that information being transmitted by departments to reallocate budgets is conditional upon the ability of the “centre” to commit itself not to make opportunistic use of the information that it thus receives on their effectiveness.

3. Some avenues for reviewing public spending: recommendations by the CAE

Housing[a]

Public spending on housing was of the order of 41 billion euros in 2014 –i.e. 2% of GDP. That spending includes 16 billion in housing subsidies, which have a well-documented inflationary effect, with the benefits being captured by constructors and lessors. The *Notes du CAE* on the subject recommend, on the one hand, incorporating housing benefits into an overall redistributive policy, which would reduce the risk of capture by owners-lessors, and, on the other hand, acting on regulating the supply to free up land and construction (for example, generalise the transfer of responsibility of the *plan local d'urbanisme* (PLU, Local Town-Planning Scheme) at the level of the *intercommunalité* (public establishment for intermunicipal co-operation); simplify regulations).

Moreover, the management of social housing could be improved. In order to better meet the needs of the most vulnerable households and to attenuate social segregation (which gives rise to additional costs), the authors of the *Notes* call for grants to be spread around territories and social-housing offices based on transparent tension indicators. In areas with a lack of so-called "highly social" housing, they suggest reserving public grants for projects that contribute to reducing spatial segregation measured across the conurbation.

Agriculture[b]

Each year, French agriculture receives public support that exceeds 10 billion euros. To that are added tax and social-security exemptions and deductions. In 2013, all those benefits represented, for an average holding, 84% of agricultural income. However, French agriculture produces unsatisfactory results: commercial performance is worsening, employment is falling sharply, and ecosystems are experiencing strong degradation.

For the authors of the *Note*, those poor performances are due to several factors: a predominance of small structures, sluggish technical progress, uneven level of training amongst farmers, a lack of co-ordination between sectors, etc. In addition, public policies lack clear focus, and their various tools sometimes pursue contradictory objectives. The *Note* recommends replacing undifferentiated benefits and environmental cross-compliance with amenity remuneration that could be differentiated on a geographical basis. In addition, it recommends prioritising criteria that are directly linked to externalities in targeting subsidies, without *a priori* penalising the enlargement of structures if it does not give rise to negative externalities.

The *Note* also proposes taking action at community level, by reducing incentives to specialise in a small number of crops and by gradually reducing aid per hectare (which make land more expensive) and replace them with budgets that target public goods or social objectives. In that regard, it is important to move towards results-based payments that are contractual and non-transferable, and to cap individual payments that do not remunerate the production of a public good.

Health[c]

Public spending on health accounted for over 8.7% of GDP in 2014 in France, according to the OECD. To that total, it is important to add 2.4% of GDP for private spending, covered either by additional insurance or by patients themselves.

The diversity of the French health-insurance system (Social Security and complementary bodies) impedes control of health spending (due to a lack of co-ordination between Social Security and complementary bodies), and involves high management costs (of the order of 13.4 billion euros, including 7.2 billion in 2015 for the bodies that come under Social Security). By encouraging people to take out generous collective contracts, the system feeds fee over-runs and the rise in medical fees. Those collective contracts pool the risks between individuals that are at low risk (employees), whereas the unemployed and the elderly must pay higher premiums to obtain additional insurance.

The *Note du CAE* suggests putting an end to that insurance diversity by focusing basic cover on a basket of solidary healthcare, and by refocusing optional insurance on covering healthcare outside that basket. The institution financing the solidary healthcare basket could then enter into contracts with healthcare professionals in order to better control expenditure as well as access to healthcare. In the short term, defining a standard contract offered by every insurer (and eliminating the distortions linked to Social Security exemptions) would lead to creating competition in the additional-insurance sector. It would also be necessary to provide additional-insurance providers with the means of contractualisation by giving them access to the necessary information.

Other levers exist to contain healthcare spending whilst reducing inequality of access to healthcare. For outpatient care, one of those levers would be to replace patient fees and contributions with an annual deductible and a co-payment, based on patient income and not covered by insurance, in order to make policyholders liable for "small" healthcare needs whilst giving them better cover for more costly healthcare needs.

[a] Trannoy A. and É. Wasmer (2013): "How Should Property Prices be Moderated?", *Note du CAE*, no 2, February and Trannoy A. and É. Wasmer (2013): "Rental Housing Policy", *Note du CAE*, no 10, October.

[b] Bureau J-C., L. Fontagné and S. Jean (2015): "Time to Decide on French Agriculture", *Note du CAE*, no 27, December.

[c] Askenazy P., B. Dormont, P-Y.Geoffard and V. Paris (2013): "Towards a More Efficient Health System", *Note du CAE*, no 8, July and Dormont B., P-Y. Geoffard and J. Tirole (2014): "Rebuilding the Health Insurance System", *Note du CAE*, no 12, April.

Vocational training[d]

Unlike the case in Germany, Austria, and Switzerland, apprenticeships do not play a key role in France for the insertion into employment of young people with few or no qualifications. Apprentice numbers have almost doubled over 20 years, but that increase has mainly benefited those with the highest qualifications, whereas the proportion of unqualified apprentices fell from 60% to 35% from 1992 to 2010.

In France, the governance of vocational training is very complex and costly. Substantial efficiency gains could be made, especially by centralising the collection of financing. In addition, vocational training develops too slowly on the basis of need, and there is still no direct link between the quality of training and its long-term prospects. A decentralised certification system would enable training provision to be more closely tied to the best-performing providers and schools, whilst leaving a place for local initiative, whether it comes from employers, local authorities, the Ministry of National Education, or voluntary networks.

Finally, it would be necessary to end the "out-of-quota" system that allows businesses to use part of the apprenticeship levy for other purposes, and adapt Government grants to regions based on qualifications. It is desirable to concentrate public resources on apprenticeship and pre-apprenticeship for the professional insertion of young people with few qualifications, because that is where those resources make a difference. Part of the task was completed with the 2014 Sapin Act (the "out-of-quota" share fell from 31% to 23%), but the reform must be continued until its elimination; the financing of higher-education establishments must go through other channels, as part of an overall reform of financing those establishments.

[d] Cahuc P., M.Ferracci, J. Tirole and É. Wasmer (2014): "Apprenticeships for Employment", *Note du CAE*, no 19, December.

To create an expenditure-reduction dynamic, three conditions are necessary in terms of process:

- At the start of the process, a clear indication of the objectives of the reform, allowing the smallest possible margin for objectives to be redefined on an *ex post* basis;
- The Prime Minister to be directly involved and totally committed;
- The reform concept is meticulous and detailed, with particular attention being paid to its design.

Foreign experiences (Canada, Australia, the United Kingdom the Netherlands, Ireland etc.) also highlight the usefulness of strategic reviews of public expenditure (see Box 2). France has carried out such reviews, but with little success, with the reviews of the 2016 vintage, in particular, not having led to any new savings. The reasons for the failure refer back once again to shortcomings in governance: reviews that are too close to standard budget exercises are insufficiently prospective, and they exacerbate the worries of officials or public opinion; the link between their assessment process and the decision-making moment must be designed to avoid wait-and-see behaviour (in that regard, it may be counter-productive to want to reveal results too early); finally, the exercise must involve Parliament, which has final responsibility for allocating means, and provide proper articulation of the roles of the Ministry of Finance and the other Ministries.

The work must be put back on the drawing board by doing better than in the past to incorporate the economic approach and the governance of reviews of missions, which is crucial to ensure success.[35] In that regard, it is important to see the review of missions as an exhaustive exercise that must not be interrupted until all policies have been covered, to involve civil servants early on in the process in order to limit tactical behaviour between the political world and the administration, and to enable Ministries to better finance their new priorities, so that they can be bought fully into the strategic approach to prioritisation.

Recommendations

The foregoing analysis suggests that an ambitious reduction in expenditure is compatible with a return to growth, on condition that it is selective and structural (as opposed to a planing strategy). A structural reduction in expenditure is at once more credible than a plane (which can easily be challenged) and more gradual (it must necessarily go together with a transition phase). Supported by a temporary investment programme, of which the effect on growth in the short term is potentially significant, such a strategy may seem one that can succeed without snuffing out economic recovery. It presumes that the case will be approached from the angle of public policies and not directly in terms of expenditure, that there will be communication on the need for a structural approach and on the timeline of the transformation, breaking with the planing policy, and drawing inspiration from foreign policies to put in place adequate governance.

Recommendation 1. Put in place a swift review of all public policies by relying on cost/benefit analyses; draw out options for cost reduction or for redefining perimeters of intervention.

[35] *Cf.* Lorach *et al.* (2014), *op. cit.*

The approach could rely on the digital revolution, which offers an exceptional opportunity to redefine the perimeter of intervention as well as boost the efficiency of public services. Successes that have already been obtained in the area of "digital government" (especially in the field of taxes or job agencies) are encouragement to go further by expanding the approach to all public administrations.

In line with that approach, it does not seem wise to think in terms of public employment but more widely, in terms of sector (taking all expenditure into account across a single sector) and of transforming policies, as we have illustrated above in the case of housing, agriculture, health, and vocational training. Foreign experiences suggest that the commitment of the government at the highest level, the direct involvement of the Prime Minister, and associating all the Ministries (Ministers and directors of administration) are keys to the success of an ambitious transformation programme.

Recommendation 2. Place public-policy transformation at the top of the political agenda, with a strong commitment from the Prime Minister and strong communication. Associate all the Ministers and directors of administrations to define a consistent overall programme.

In that spirit, even sectors deemed priorities (like education, the police, and defence) must be associated with the approach, since efficiency gains are not incompatible with boosting means (as we have seen in the case of higher education). Specific governance needs to be put in place to associate local authorities and agencies with the approach, with appropriate incentives, e.g. access to means for implementing new priorities.

To facilitate the appropriation of arbitrations over time, it would be useful to present annually to Parliament a document that sets out all public expenditure by objective and by function. That report would present the efforts at reducing expenditure, the macro-economic and socio-economic assessments of variations in expenditure, and multiyear budget strategies.[36]

Recommendation 3. Ensure the macro-economic management of the budget adjustment, especially by modulating the public-investment programme on the basis of growth development.

Empirical works conclude in general that public investment has a particularly marked impact on GDP in the short term. A significant share of public investment is made at local level, so an incentive arrangement must be put in place to ensure good overall co-ordination.

Recommendation 4. Plan temporary arrangements to compensate "losers", and develop policies to support mobility and training for public officials to be deployed to posts that need to be filled.

Redefining public intervention will call less for a fall in total public employment than for a transformation of existing jobs. The administrative transformation must be thought of as an investment, with a dedicated budget to support the change for beneficiaries of policies and for the staff of administrations.

[36] See Bozio A. and B. Dormont (2016): "Governance of Social Protection: Transparency and Effectiveness", *Note du CAE*, no 28, January.

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