France's Reform Agenda: First Year Overview

August 28, 2018

May 14, 2018 marked the first anniversary of the election of 40-year-old Emmanuel Macron as the President of France, followed by his centrist party's (*La République En Marche* (REM) – *The Republic on the Move*) absolute majority win of seats in the French National Assembly.

To say that the pace of French reform has been fast over the past 12 months would be an understatement. In line with the key announcements made at the beginning of Macron's mandate (see **France's Reform Agenda: Overview of Key Announcements**), major labor market and tax reforms have been passed – in spite of strikes and protests – aimed at boosting investment and the attractiveness of France.

As the IMF recently pointed out, "*France has now become a reform leader in Europe*" and there is nothing to indicate that the tempo will slow down. With political rivals in disarray, Macron, despite facing a slide in his popularity, continues to benefit from a critical window of opportunity to push through a series of additional reforms, including constitutional changes (a reduction in the number of MPs, introduction of proportionality in legislative elections, etc.) as well as further economic measures. Among such reforms is the so-called *Pacte* bill, a proposed significant and wide-ranging legislation to support the business environment, which would see a dramatic shift in the French approach to State shareholdings.

One year following our short paper on the key economic measures that were being considered at the beginning of Macron' mandate, we provide our assessment of the path taken and present expected next steps.

1. Keeping the momentum of structural reforms

Despite weeks of protests, the Government has pressed ahead with the labor code reform, using direct orders ("*ordonnances*") to avoid lengthy parliamentary debates (see **Macron Reform – Labor Law Orders**). As anticipated, the reform led to decentralizing collective bargaining negotiations at the company level – thus allowing companies to negotiate with their own employees without following the rules applicable to the entire industry – and simplifying employee representative bodies by merging current structures into one social and economic committee (*comité social et économique - CSE*)[1]. Changes were also made to reduce the uncertainties of labor disputes.

A second round of labor-market reforms is expected in the coming months with respect to professional training, unemployment benefits and pensions. However, for these we expect a new approach as the Government has indicated it wants to enter a "*new phase*" with the unions through enhanced dialogue with them.

On tax reform, a first step has been taken towards the legibility and predictability of the French tax system, especially with respect to taxation of an individual's capital income, following the adoption of the Finance Law for 2018 in December 2017.

The Finance Law for 2018 provides for the implementation of a simplified flat tax on capital income earned by individuals (ie. dividends, interests, capital gains). As a general rule, capital income earned

[1] The merger of the representative bodies will become law on 1 January 2018 but companies may postpone the implementation of the CSE until termination of the current representatives' mandates/31 December 2019 at the latest.

by individuals is no longer subject to gradual income tax rates (with the maximum marginal tax rate at 45%) and social contributions (15.5%), but is instead subject to a flat tax withheld at source including personal income tax and social contributions at a combined rate of 30%.

As the flat tax does not apply to capital income from real estate investments, it is clear that the long-term objective is to encourage a shift of real estate private investments towards financial investments. This is also reflected in the long-awaited reform of the French wealth tax. Although highly contentious, the wealth tax remains but its scope has been limited to real estate properties only (with the principal residence benefitting from a discount), i.e. all other assets (especially financial assets) are now in principle excluded from the calculation of the wealth tax threshold and amount.

With respect to corporate income tax, the Finance Law for 2018 provides for a further progressive reduction of the standard rate to 25% by 2022, thus allowing France to get closer to the EU corporate tax average.

Now that the major tax measures have been passed, several commentators expect the Government to take action to improve the sustainability of public finances. Given the sensitivities surrounding spending cuts in France, this will clearly be a challenge for the Government.

2. Making Paris a Key European Financial and Digital Centre

With Brexit on everyone’s mind, the French authorities are adapting a multipronged strategy to make Paris a key European hot spot for financial affairs, from the establishment of special courts dedicated to handling international disputes with English as the working language, to the opening of new international schools.

Further targeted measures have also been announced to alleviate the tax regime and social contributions of the “*impatriates*”. As French Prime Minister Edouard Philippe summarized “*we want to offer global investors and financial institutions new opportunities and a solid and stable environment to invest, relocate, and develop their business in France and Europe*”.

So far, the results of such strategy are encouraging with, for example, Paris – which is already home to the European Securities and Markets Authority (ESMA) – having been selected to welcome the European Banking Authority (EBA) and the International Swaps and Derivatives Association turning to French law for its first civil law governed ISDA Master Agreement. More importantly, Paris became Europe’s most attractive destination for foreign investors for the first time in more than a decade according to a report released in June 2018 by Ernst & Young.

The Government is also doing a lot to put Paris in the digital frontline. In this respect, it is particularly significant that, in May 2018, Macron convened 60 top tech chief executives – including Facebook Inc.’s Mark Zuckerberg and Microsoft Corp’s Satya Nadella – for meetings in Paris ahead of the Viva Technology conference.

Among the fields that the Government has recognized as requiring priority attention are: (1) promoting start-ups in “deep tech”; and (2) passing business-friendly legislation to embrace blockchain technology and initial coin offerings (*ICOs*) (see **Publication of the French Financial Markets Authority summary of answers following the public consultation on ICOs**).

3. Upgrading business regulation to the highest standards

If the spearhead of the Government for the past year has been the stimulation of the French economy, social and environmental issues continue to play an important role in the expected reforms considering the international momentum towards a more sustainable and fairer economy (fight against corruption, green finance, social liability, etc.).

While building on the steps already taken in this regard (such as the anti-corruption "Sapin II" bill passed in 2016) and following-on from the Notat – Senard report relating to business and general interest (*entreprise et intérêt général*)[2], it is particularly important that the draft *Pacte* bill provides for a remodeling of the article of the French Civil Code defining the corporate purpose of companies, in order to reflect that managers should consider social and environmental issues in business strategies. The bill also aims to promote employee shareholding and to enhance employee representation on company boards.

The AFEP-MEDEF corporate governance code of French-listed companies has also recently been amended to include tighter non-discrimination and diversity requirements and to impose stricter clauses relating to the departure of company officers (such as supplementary pensions with performance conditions and non-competition benefits).

4. Shifting the State's approach towards strategic assets

While it has taken action to welcome and promote foreign investment in France, the Government has no intention of compromising the protection of strategic French businesses.

On the contrary, it is expected that the prior authorization regime governing foreign investments will be tightened to encompass an expansion of the strategic sectors concerned – to include semiconductors, space technology and drones, and to the extent that national security is concerned, artificial intelligence, cybersecurity, robotics and big-data storage – as well as broadening the enforcement powers granted to the French Ministry of Economy.

Likewise, the *Pacte* bill provides an amendment to facilitate the use of "*golden shares*"[3] which currently can only be issued in the case of a sale of shares by the French State.

With these changes, it is no secret that the Government is pushing for alternative means to dispose of its shareholdings in order to free up public resources in strategic businesses. It is therefore no coincidence that the *Pacte* bill also paves the way for a new wave of privatizations that could include Française des Jeux (the French State-owned gaming company) and the operator of Paris Charles de Gaulle and Orly airports, Aéroports de Paris.

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[2] Report prepared by Michelin Chairman, Jean-Dominique Senard, and Vigeo-Eiris President, Nicole Notat, released in March 2018 and which has attracted much attention.

[3] Shares giving specific rights to the French State which vary on a case-by-case basis.

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