France

The CICE tax credit must still prove its worth

- In its fourth report, the monitoring committee on the CICE competitiveness and employment tax credit assesses its first effects in 2013-2014.
- Although CICE has clearly had a positive impact on corporate margins, the impact on employment is less certain, and non-existent for investment, R&D and exports.
- These mixed results are not surprising given the long reaction times and the fact that other economic policy measures countered the effects of CICE.
- We can expect, however, to see more positive results in the future.

The monitoring committee on the CICE competitiveness and employment tax credit released its fourth report in late September. The document was much awaited because it would provide the first ex-post assessment based on individual corporate data of the CICE tax credit's first effects in the period 2013-2014. The impact has proved to be rather limited, but let us begin by reviewing what exactly the CICE competitiveness and employment tax credit is all about.

CICE was launched in January 2013 as part of the National Pact for Growth, Competitiveness and Employment. It was the government's first key measure to reduce the cost of labour. The EUR 20 bn tax credit is calculated as a proportion of each company's gross payroll for wages up to 2.5 times the minimum wage. The CICE tax credit was initially set at 4% in 2013 and then raised to 6% in 2014. The 2017 draft budget bill calls for the tax credit to be raised to 7% as from 2018. It is also worth having in mind that INSEE treats the CICE tax credit as an operating subsidy that is allocated in the first quarter of each year, which automatically increases the gross operating profit of companies, and thus their margins[1]. This explains the stair-shaped profile of the corporate profit margins rate (see chart 1).

The CICE tax credit has several purposes. Although the end goal is to boost competitiveness, that can be done in several different ways, by supporting investment, R&D, innovation, exports, the energy transition, lower selling prices, employment, training, margins and/or cash flow, either selectively or all together. Each company is free to decide how best to use the tax credit depending on its needs. The tax credit can also be used to raise wages, but in this case, it would be transformed from a supply-side support measure into a stimulus for demand.

To evaluate the first effects of CICE, the monitoring committee commissioned three research institutes: TEPP (Labour, Employment and Public Policies), LIEPP (Interdisciplinary Assessment of Public Policies Lab) and OFCE (the French Economic Observatory). The report also integrates parallel assessments conducted by DARES,

Behind the upturn in corporate margins: the CICE effect

Corporate margins of French non-financial companies (GOP/GVA)

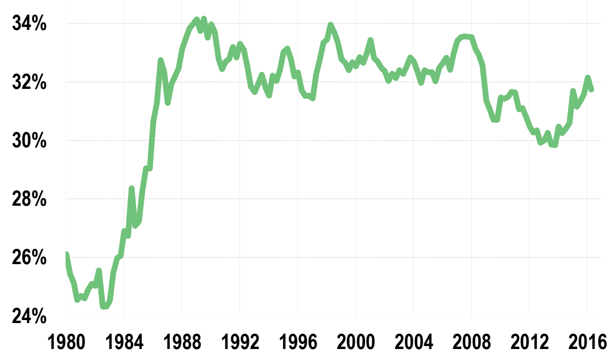

Chart 1 Source: INSEE

the French Labour Ministry's department of research, studies and statistical analysis. The assessments used a purely empirical approach (TEPP, LIEPP, Dares) or a structural approach based on the explicit modelling of the elasticity of exports to the cost of labour (OFCE)[2]. Empirical approaches used the difference in differences method, which compares the change in specific variables of interest in a testing group of companies who benefit from the economic policy measure with that of a control group of companies that do not benefit from the measure. With CICE, this task is complicated by the broad application of the tax credit, which means there is not a control group in the strict sense of the term. The distinction is made based on the intensity of benefits, depending on how much the company received from the CICE tax credit.

Meagre effects in 2013-2014

On the whole, the empirical results on the first effects of the CICE tax credit in 2013 and 2014 are not very conclusive, limited in scope, and even sometimes inconsistent. The effects are presented below in decreasing order of importance. The most positive impact can be seen in terms of corporate margins, which have improved significantly. CICE probably had an impact on corporate survival as well – i.e. by enabling some companies to avoid bankruptcy -- but this must still be confirmed by further analysis. The report also seems to show that CICE had a positive impact on employment, albeit not a very big one, and with lots of uncertainty: over the 2-year period, CICE would have helped create or save between 50,000 and 100,000 jobs. At this pace, it would be hard to meet the government's target of creating 300,000 new jobs in five years. Yet these results seem to be in line with ex-ante macroeconomic estimates (+210,000 jobs by 2020, according to research by the

[1] Gross operating profit (GOP) is equal to gross value added (GVA) minus employee compensation (gross payroll wages plus employer contributions) and other taxes on production, plus operating subsidies. The corporate profit margin rate is GOP/GVA.

[2] Depending on the variant, the study esteems that a 1% decline in unit labour costs increases manufacturing exports by between 0.5% and 0.7%. In this case, the CICE tax credit would eventually boost exports by 1.9% to 2.5%.

French Treasury department; +150,000 jobs by 2018 according to the French Economic Observatory). Regarding wages, the tax credit had little or no impact. As to investment, R&D, and exports, the assessment unequivocally concludes that there was no gain.

Several explanations

There is nothing surprising about these mixed results. First, it takes time for a measure like the CICE tax credit to bear fruit. This is particularly true for variables such as investment, R&D and exports, which have a longer response time[3]. Moreover, the measure was launched in a fairly deteriorated situation, with corporate margins at historical lows. Business leaders may have preferred to use the CICE tax credit to improve their balance sheets first before embarking on new investment projects and/or hiring.

Second, by trying to pursue several objectives at once, the CICE does not comply with the recommendations of Tinbergen's law -- one policy instrument for each economic policy objective. As a result, it is not as effective for each of its objectives. Another factor that may have reduced its effectiveness is that it was hard to appropriate the measure in the beginning, given the uncertainty surrounding whether it would last, the fact that it was not a cut in employer contributions in the strict sense of the term but a tax credit, which was not received at the same time as payment of the remuneration that gave right to the tax credit (unless pre-financed). The monitoring committee mentions the possibility that the tax credit's differed nature may have led some companies facing liquidity constraints to postpone hiring decisions.

We should also take into account the kind of companies that benefit most from CICE. They are above all small and medium-sized businesses. They tend to be active in labour-intensive sectors with little or no exposure to international competition (such as hotel and food services, administrative services and construction). For this reason, they are not really confronted, if at all, with the problems of competitiveness, and are thus less sensitive to the need to invest, innovate and export more. This point raises the question of targeting tax relief. If the goal is to boost employment, and employment alone, then it is more effective to target low wage earners. But the goal is to boost competitiveness as well. A "narrow" target can, for sure, also have positive effects (lowering the cost of labour on low wage earners can pass through to the cost of intermediate consumption for export sectors). However, a broader target would have a bigger impact on sectors with the highest exposure to international competition, also taking into account the fact they have a substantial ripple effect on job creations[4].

Lastly, other economic policy measures are also interfering with CICE, curbing or cancelling out its positive effects. There include previous or simultaneous measures that raise the cost of labour[5].

France: market share indicators (%)

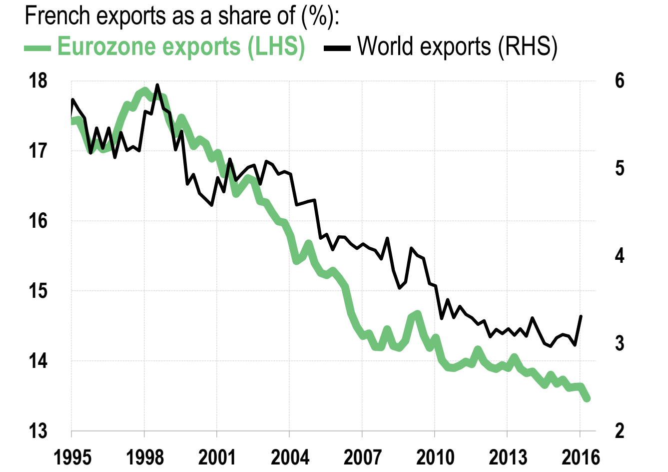

Chart 2 Sources: INSEE, Eurostat, IMF

There have also been measures dedicated to the financing of the CICE tax credit (spending savings, VAT hike and green taxes). These measures were necessary to avoid deviating too far from the government's simultaneous efforts to reduce the fiscal deficit. Nonetheless, these measures tend to drag down growth, unlike the CICE tax credit, which aims to boost growth.

More positive results in the future

We would like to conclude with a few more positive arguments. The upturn in corporate margins, which was only just starting to take shape in 2014, has since gained in strength and has been accompanied by a rebound in corporate investment. In terms of competitiveness, the CICE has at least contributed to improving the "cost" component via the induced slowdown in the growth of unit labour costs[6]. Surely, it will take longer to see improvements in the "non-cost" component of competitiveness and the expected market share gains, especially since a lot of ground has been lost (see chart 2). Yet the CICE tax credit has been rounded out with other supply-side support measures (Responsibility and Solidarity Pact since January 2015; Macron law[7]; El Khomri law[8]), all of which should have a more visible impact on growth in the future[9].

[3] To have a further look at the differentiated effects of supply-side policies in the near term and in the medium to long run, see "France: Growth will wait", Thibault Mercier, *EcoPerspectives*, 4th quarter 2016.

[4] According to research by Philippe Frocrain and Pierre-Noël Giraud for La Fabrique de l'Industrie, the creation of 100 "exposed" jobs would lead to the creation of 64 "sheltered" jobs ("Exposed and sheltered jobs in France", *Les Synthèses de La Fabrique*, n°9, September 2016).

[5] Annualised calculation of exemptions for low-wage earners (January 2011); reintegration of overtime work in the tax base for calculating Fillon exemptions (January 2012); end of the tax-exempt status of overtime work (September 2012); increase in the *forfait social*, a social welfare charge for employers (August 2012); increase in old-age pension contributions (November 2012); higher unemployment insurance premiums on short-term contracts (January 2013); annual minimum wage increases.

[6] The rate of increase in unit labour costs has been slashed in half, from the period 1999-2012 (+2% a year on average) to the 3-year period 2013-2015 (+1% a year on average). Yet the growth rate in unit labour costs still has not fallen below the Eurozone pace, which is identical.

[7] Growth, activity and equal opportunity law (enacted in August 2015).

[8] Labour, social dialogue and job security law (enacted in August 2016).