ECO FLASH

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France's attractiveness: 2018 was a good year

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- **In 2018, France remained an attractive place to invest, despite a tense social climate and an economic environment marked by the slowdown in European economy, Brexit and trade tensions between the United States and China.**
- **According to the EY barometer, France outperformed Germany and ranked right behind the UK in terms of the number of foreign investment projects. The industry, digital and services to corporate clients sectors attracted the greatest number of projects.**
- **France's attractiveness highlights the resistance of its industrial network, the strength of its entrepreneurial ecosystem and the dynamism of its research. Recent reforms are also having a favourable impact. However, there is still room for progress in terms of taxation and labour costs.**

FDI projects in the big European countries
Number of projects

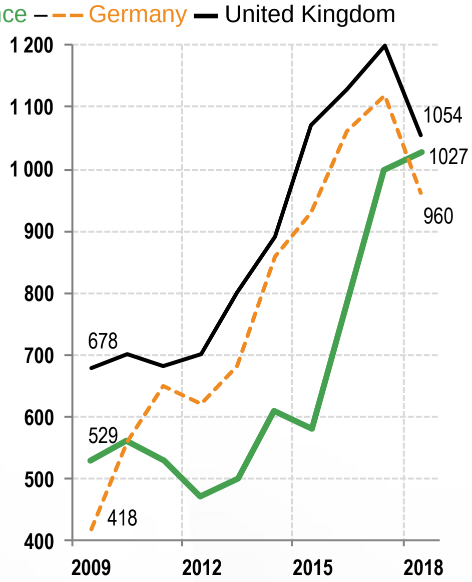

Chart 1 Source: EY, BNP Paribas

According to INSEE, the economic attractiveness of a country is "its capacity to attract specific external resources. Economic attractiveness is shaped by two complementary factors: traditional "productive" considerations and "residential" factors. Together they can be used to map out a region's attractiveness."

Attractiveness: definition and measurement

More specifically, economic attractiveness can be defined as a country's capacity to attract new economic activities and mobile production factors over a given period of time. This notion is used to justify investment decisions and to attract new business to a country or region. Attractiveness policies aim to attract foreign investment to boost the level of economic activity. These policies are justified by theories of regional attractiveness such as those developed by the new economic geography or industrial economic theories.

New economic geography theories take into account the non-price factors of an economy attractiveness and competitiveness. Companies are supposed to base their location choices on region externalities linked to the clustering or dispersion of economic activities. Companies operating in the same sector can be encouraged to concentrate geographically in order to benefit from economies of scale and infrastructure externalities (transport, proximity and accessibility of suppliers and markets, etc.). To the contrary, they can be encouraged to disperse when their concentration results in negative externalities, such as pollution or local competition that drives up input prices. Public authorities can act on these externalities, for example by defining a ceiling

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price for inputs or by developing infrastructures-which are key factors in a company's location choice.

Industrial economic theories round out those provided by the new geographic economy by emphasising the specific resources of a given region, whether institutional, industrial or technological. Through the location of technology hubs, clusters and industrial zones in a given area, companies are able to benefit from technological externalities and human capital interactions. The development of research and training programmes for the local population are also key factors to enhance attractiveness.

A prerequisite for the implementation of policies aiming at attracting new foreign economic projects is the measurement of attractiveness. Foreign direct investment (FDI) inflow is one the best gauge. The number of jobs created by foreign projects in the country is an additional key indicator.

In this article, we focus on the opinion surveys developed by consulting firms such as EY, Bain & Company and Kantar. We also have a look at the AmCham France survey (the US Chamber of Commerce in France). These surveys report the investors' opinions on a given country. In 2019, the Kantar survey questioned 500 investors on France's attractiveness, while EY queried 210 business leaders. Business France's annual report on international investment in France also provides comprehensive information on the subject. It maps out FDI characteristics in France (originating country, sectors, number of jobs created, etc.) and reviews France's attractiveness in the light of the international environment in which the investments were generated.

Two other composite indicators round out these survey results. Each year the World Bank publishes its Doing Business index, which ranks 190 countries according to the quality of their business climate. It puts a score to each country based on the ease of doing business on their territory. Each year, the World Economic Forum also releases its Global Competitiveness Index. In a single index, it combines macro and micro-economic aspects of competitiveness for 140 countries. It links the results of 98 indicators covering institutions, infrastructures, macroeconomic stability and innovation capacity.. This index ranks countries based on their degree of competitiveness.

Overview

In 2019, France scored 77,29 out of 100 in the "Doing Business" index, improving slightly compared to 2018 (+0.99), a sign of resilience in a global and European environment increasingly uncertain from an economic and political perspective. The World Economic Forum's Global Competitiveness Index confirms this point as France ranks 15th among the more competitive countries in 2019, up two ranks compared to 2018.

According to survey results, France is still an attractive destination. In AmCham's 2018 survey, 55% of the US investors who were interviewed considered France as a "good" destination for investment, up from 48% in 2017. The EY 2018 survey results are also interesting and instructive. France rose to second place in the ranking of the most attractive European countries, right behind the UK and slightly ahead of Germany (see chart 1). With 1027 investment projects in 2018, France outperformed Germany (973 projects) and closed in on the UK (1054 projects). However, the number of jobs created by these investment projects is still very low at an average of only 43 jobs per project.

Top 10 countries of FDI projects in France

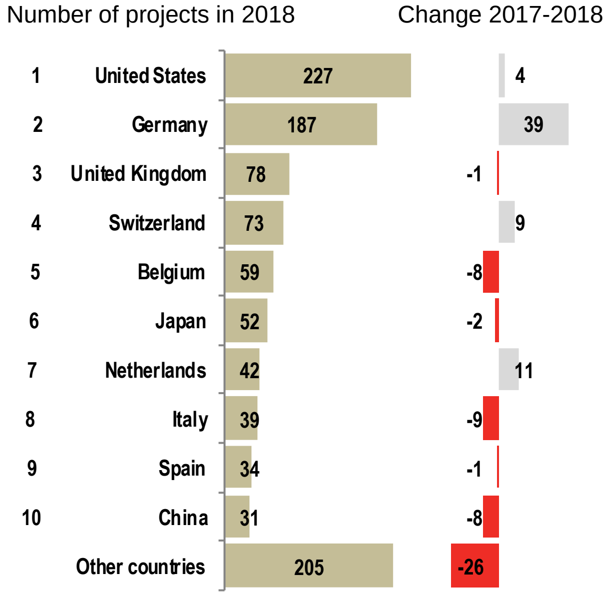

Chart 2 Source: EY, BNP Paribas

Another positive result of the EY survey: in 2018, France became the number one European destination for Research & Development (R&D) investment projects with 144 projects, outperforming both Germany and the UK (with 64 and 74 R&D projects, respectively). France remains the European leader for FDI projects in industrial sectors. Digital activities attracted the most FDI in 2018 (171 projects), followed by services to corporate clients (121 projects).

All in all, the five most attractive sectors in France account for 50% of FDI projects, making France the European country with the most diversified distribution of FDI. Moreover, Paris ranks second among global cities in terms of investment projects, just behind London. However, France still lags behind the UK and Germany when it comes to strategic sectors such as digital activities and head offices. Although digital activities received the most FDI in 2018, France is still outpaced by its UK and German competitors, who reported 288 and 218 investment projects respectively in this sector. As to head offices, according to the EY barometer, the number of HQ projects declined by 24%, in line with the European trend (-23%).

The EY barometer also reports that the number of FDI projects declined by 4% in Europe in 2018, after increasing continuously during the previous six years. This has been the first decline since 2012. Another striking result: this negative signal for Europe's attractiveness does not carry over to France, which has maintained its attractiveness, thanks notably to industry. A third of investment projects involve production sites or extensions of existing sites. This is particularly noteworthy considering that industry is one of the sectors hit hardest by the decline in FDI projects in Europe.

The historic decline in FDI in Europe occurs in the midst of a complex geopolitical environment. Investors are especially worried about the absence of a Brexit deal defining the conditions under which the UK leaves the European Union. In the EY barometer, 38% of investors considered Brexit to be the main threat to Europe's attractiveness. As the geographic gateway to the Old World, France benefits from this situation.

The Ile-de-France region reported the biggest increase in FDI from the UK, followed by Madrid and Frankfort. The UK ranks third as the source of FDI inflows into France.

At a time when US fiscal reforms are encouraging US and foreign companies to repatriate their profits to the US, it has not prevented US companies from turning towards France: the US is the biggest investor in France just ahead of Germany. It accounted for 18% of investment projects in 2018, compared to 13% for Germany (see chart 2).

Strengths and weaknesses

France's main attractiveness factors are the strength of its industrial network, its entrepreneurial ecosystem and dynamic research. The reforms undertaken in recent years have also had a positive impact. In contrast, there is still room for progress in terms of administrative red tape, taxation and labour costs.

In 2018, France maintained its position as the first destination for industrial activities in Europe, just ahead of Turkey and Germany. It has been the leader for more than ten years now. According to Business France, this dynamic should gain momentum in the years ahead since the government is determined to revitalise France's industrial fabric to benefit from the Industrial Revolution 4.0. According to the Business France survey, more than 84% of investors praised the quality of employees, the upmarket shift in products and the digitalisation of industrial processes.

Although France managed to pull through the European economic slowdown with its attractiveness unscathed in 2018, the government has reason to fear in 2019 a backlash from the tense social climate. The second "Choose France" summit initiated by President Macron was designed notably to reassure the business leaders of the 120 participating multinationals. Of the business leaders surveyed by EY, 31% thought that reforming the social dialogue would have a positive impact on France's attractiveness. 47% deplored the cumbersome administrative procedures for companies and more than a third complained of heavy taxation and the high cost of labour.

Numerous reforms have been launched in recent years to ease these constraints and create a more business friendly environment. Initiated by François Hollande and amplified by Emmanuel Macron, these reforms fit within the general framework of supply-side policies. They include the transformation of the CICE tax credit for competitiveness and employment into reduced employers' contributions in order to lower the cost of labour; the transformation of the ISF wealth tax into a real-estate wealth tax and a flat-rate withholding tax (PFU) to reduce capital taxation; and the PACTE law to streamline administrative red tape for businessmen. Other initiatives such as "the Industrial Territories project" and the 2025 Productivity pact are currently being elaborated in order to lower entrance barriers.

France also promotes a favourable environment for innovation. This is illustrated by its performance as the most attractive destination in Europe for R&D projects, as well as by the effervescence of French Tech. The dynamic momentum of research and innovation is bolstered by a solid network of incubators as well as by a panoply of tax incentives, including the Research Tax Credit and the Innovation Tax Credit (see box). These incentives, coupled with the number of students in advanced research and engineering, encourage the tech giants to strengthen their presence in France. For 84% of the business leaders surveyed by Business France, innovation was the competitive advantage that made the biggest difference for France. The majority of respondents also praised France's cluster network, the potential for partnerships with university research teams and easy access to financing.

Research tax credit

The Research Tax Credit (CIR) is a fiscal mechanism created in 1983 that aims to reduce the cost of R&D spending for companies. Since its creation, the CIR has been modified several times. In 2008, the calculation method was overhauled: tax deductions are no longer based on the increase in R&D spending but on total volume, creating a bigger incentive for companies whose expenditures increase little or none at all from one year to the next. The eligibility criteria, in contrast, have never been changed. Any company can benefit from the tax credit, regardless of their sector or size, as long as they pay corporate tax (IS) and report R&D spending. The tax credit covers three types of R&D spending: for fundamental, applied and experimental research. For eligible companies, the tax credit is applied on a prorata basis for the number of hours worked on behalf of research. The tax credit rate reaches 30% for all R&D spending up to EUR 100 million, and 5% above this threshold. The amount of the tax credit can be deducted from the corporate tax or for companies without a tax liability, into a Treasury credit. Since 2013, there has also been an Innovation tax credit for SMEs. The tax credit rate reaches 20% and covers R&D spending for the design and realisation of prototypes and for pilot installations for new products.

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