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WHAT EFFECTS TO EXPECT FROM THE CONVERSION OF THE COMPETITIVENESS AND EMPLOYMENT TAX CREDIT (CICE) INTO EMPLOYER CONTRIBUTION REDUCTIONS?

The competitiveness and employment tax credit (CICE) is a corporate tax credit of 6% on salaries that are lower than 2.5 times the minimum wage (Smic). Its conversion into an additional reduction in employer contributions is a key measure in the 2019 budget. It will give rise to a temporary increase in the public deficit amounting to 0.8% of GDP in 2019, the year during which the State must finance the CICE tax credit applicable to 2018 salaries as well as the reduction in employer contributions calculated on the basis of 2019 salaries.

The measure does, however, have effects beyond the additional cost to public finances in 2019. The reduction in social contributions benefits the not-for-profit sector more than the tax credits that it is replacing. The shift also generates an increase in corporate tax (CT) and income tax (IT): a one-euro reduction in social contributions will give rise to one euro of taxable profit for profit-making companies. As this additional CT and IT is dependent on company profitability, the net effect of the shift is more beneficial to young and small companies. Lastly, converting part of the additional CT into an additional 4% reduction in Social Security contributions at the level of the minimum wage amounts to a refocussing of expenditure on low wage-intensive sectors.

Impact assessments of the CICE have produced mixed results, pointing to positive effects on the profit margins of companies, but modest effects on employment, and virtually no effects on investment. Several potentially contradictory explanations could justify these results: ineffectiveness of labour cost reduction policies; longer transmission channels than anticipated; poor targeting of the CICE. The explanation that seems to tally most with the empirical results available today is the fact that the CICE has primarily been seen as a CT reduction rather than a reduction in the cost of labour. Based on this interpretation, the conversion of the CICE could have a significant effect on employment through the effect it has on the cash flow situation of companies and on the salience of the labour cost reduction, an effect that is heightened by targeting the measure at low-wage intensive sectors. ■

- The effect of the conversion of the CICE into a reduction in employer Social Security contributions will give rise to a temporary increase in the public deficit of 0.8 percent of GDP in 2019, which mirrors the temporary gains in the public finances recorded in 2013 and 2014.
- The conversion will give rise to an increase in corporate tax revenue of 3.3 billion euro in 2019.
- The conversion will have redistributive effects that are particularly favourable to the not-for-profit sector and to young and small companies, which will benefit to the full from the reduction in contributions, while being penalised only a little by the increase in CT and IT, which will effect more profitable companies.
- The economic impact of the conversion on competitiveness and employment is not yet known, but the cash flow effect, the salience of the labour cost mechanism and the refocusing of the measure on low salaries are likely to have positive effects on employment.

The Institut des Politiques Publiques (IPP) has been developed in the context of a scientific partnership between the Paris School of Economics (PSE) and the Centre for Research in Economics and Statistics (CREST). IPP's aim is to promote quantitative analysis and evaluation of public policy using cutting-edge research methods in economics.

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Labour cost reduction policies in France: overview

France is characterised by a tax system in which Social Security contributions play a major role. France has the highest rate of Social Security contributions of all OECD countries: 17% of GDP in 2015 compared to the OECD average of 9%.

In the 1990s, the high rate of employer contributions led to a high labour cost at the level of the minimum wage compared to the international average. In the face of increased unemployment among low-skilled workers, the issue of the "minimum labor cost" has forced its way into public debate. Policies reducing employer contributions for low wages have thus been put in place and have developed progressively, now taking the form of a degressive scale with a minimum rate at the minimum wage level and limited to 1.6 times the minimum wage.

Creation of the tax credit for competitiveness and employment (CICE)

The creation of the competitiveness and employment tax credit (CICE) under the 2012 Revised Budget Act (LFR) reflects a different line of thinking. This mechanism stems from the proposal in the Gallois Report (2012) on competitiveness in France to reduce employer contributions on salaries lower than 3.5 times the minimum wage in order to foster investment and quality upgrading. This high threshold was designed to benefit companies that produce high value-added goods and services and which benefit little from general reductions in employer contributions.

The mechanism adopted, the CICE, took the form of a corporate tax credit rather than a reduction in employer contributions.
For 2013, it was set at 4% of the wage bill up to a threshold of 2.5 times the minimum wage, which is lower than the threshold recommended in the Gallois Report. The CICE rate increases to 6% for the period 2014 to 2016, then 7% in 2017, and then reverts to 6% in 2018. By its very nature, the CICE is only intended for companies that are subject to a tax on profits, and excludes de facto a number of companies in the private sector, particularly the not-for-profit sector.

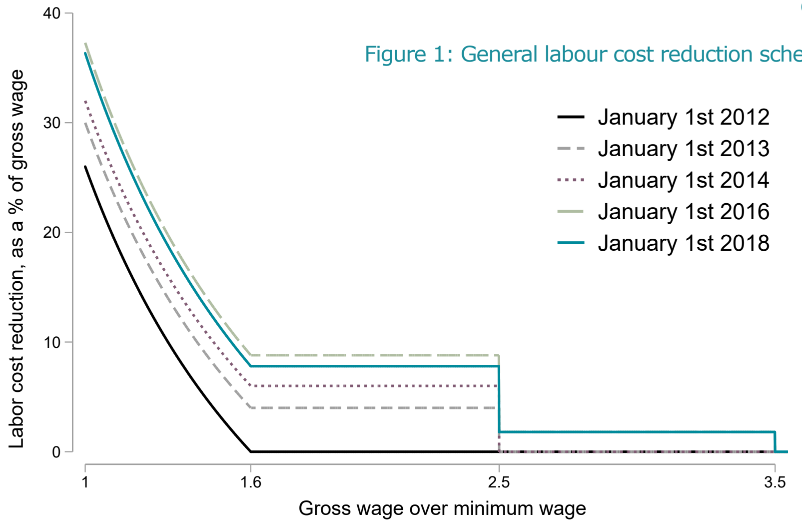
To offset this differential treatment, the government created in 2017 a payroll tax credit called CITS, which is also calculated on the basis of the wage bill for salaries below 2.5 times the minimum wage, but at a lower rate to that of the CICE, i.e., at 4%. However, the CITS is not intended for all companies that are not eligible for the CICE, but instead only for those that are eligible for a reduced payroll tax rate, i.e., primarily associations incorporated under the law of 1901, trades unions, not-for-profit foundations and some mutual funds.

Frequently amended schemes in France

In parallel with the creation of the CICE and the CITS, the "Responsibility Pact" further reduced labor costs by applying a reduced rate for "family" Social Security contributions. Since January 2015, the contribution rate has been lowered by 1.8 percentage points for salaries that are lower than 1.6 times the minimum wage, and since April 2016 for salaries that are lower than 3.5 times the minimum wage. The original version of this mechanism was geared towards achieving a "zero URSSAF contribution" for employees paid the minimum wage in order to support low-wage employment. The extension of the reduced family allowance contribution rate was intended, in the same way as the CICE, both to boost employment and to foster the competitiveness of French companies.
The rates applicable to these different labour cost reduction mechanisms have been modified on a recurrent basis. Figure 1 shows the total amount that these mechanisms represented for the period 2012 to 2018 expressed as a percentage of the gross salary. In 2012, the general reductions in employer contributions, which are also referred to as "reductions for low wages" or "Fillon reductions", constitute the sole general labour cost reduction mechanism. For an employee paid the minimum wage, companies benefit from a reduction in contributions amounting to 26% of the gross minimum wage. Since 2013, labour costs have been further reduced thanks to the CICE, the rate of which has been changed three times, and the Responsibility Pact. During the same period, the amounts of the general reductions changed, with the rate applicable to the minimum wage reaching 28.14% in 2018 for a company with over 20 employees.

> "Labour cost reduction policies between 2012 and 2018 have been characterised by a large number of schemes and constantly changing rates"

Figure 1: General labour cost reduction schemes, 2012-2018



Interpretation: This graph shows the combined effect of the general labour cost reduction mechanisms between 2012 and 2018 - general contribution reductions, CICE as of 2013 and the Responsibility Pact as of 2015 - expressed as a percentage of the gross salary for employers that are eligible for these mechanisms.

N.B.: The scale represented in the graph applies to companies with over 20 employees.

Sources: IPP tax and benefit tables, Social Security contributions (April 2018)

Economic debates on the effectiveness of the CICE

The problem of the competitiveness of French companies

The Gallois Report (2012) pointed to a decline in the French manufacturing sector, which faces competition both from companies producing higher-end goods and from those producing at lower costs. The report argues that many French companies have attempted to protect their price competitiveness by reducing their profit margins, which has caused them to reduce their investments and thus ultimately to lose out in terms of non-price competitiveness (see box 1).

Box 1: Price competitiveness and non-price competitiveness

Price competitiveness is the ability of companies to secure global market shares by selling products at lower prices than their competitors. The costs of the factors of production (labour and capital) are decisive, as are the innovations that allow for cost reductions (automation, robots, etc.).

Non-price competitiveness refers to factors other than price competitiveness that explain export trends. It can be regarded as a form of "residual" category grouping together all of the factors that explain the value of French exports for a given level of relative price and aggregated demand. These factors are diverse and can relate to quality or to differences between French products and foreign products.

The main recommendation of the Gallois Report was to boost competitiveness, reduce the costs of the factors of production affecting companies and foster investment in order to enhance non-price competitiveness.

Controversies surrounding the choice of the wage eligibility threshold for the CICE: employment or competitiveness?

Since the creation of the CICE, **the threshold of 2.5 times the minimum wage has been the subject of much debate.** As this was lower than the threshold of 3.5 times the minimum wage proposed in the Gallois Report, it was criticised for being insufficient to boost the competitiveness of companies exposed to international competition and active in industrial sectors characterised by high value-added and high wages (COE-Rexecode, 2012; Koleda, 2015). According to this point of view, the threshold of 2.5 times the minimum wage would not be sufficient to affect innovative and export-oriented companies, which are the intended target of the mechanism.

Conversely, several economists have criticised this threshold stating that it is too high and that it would limit the effects on employment while being costly to public finances (Group of economists, 2014). According to this criticism, the CICE is less effective because it is diverted from its objective of lowering the cost of the minimum wage. The labour cost reduction mechanisms applicable to low salaries were based on the premise that, for salaries close to the minimum wage, employer contributions are borne in full by the employers and increase the cost of labour.

In contrast, active workers with a salary close to 2.5 times the minimum wage experience low levels of unemployment. Thus, it is probable that an increase in the demand for qualified labour will lead to increased salaries rather than increased levels of employment. As a consequent, pursuing a job creation objective would have required targeting the bottom of the wage distribution pyramid; Cahuc (2003) recommends focusing Social Security contribution reductions on wages between 1 and 1.3 times the minimum wage.

> "The threshold of 2.5 times the minimum wage chosen for the CICE can be regarded as an attempt to strike a balance between employment and competitiveness objectives"

However, **comparing employment and competitiveness objectives is a little simplistic**, as price competitiveness is not only affected by the "direct" cost of labour within exporting companies, but also by the cost of "indirect" labour charged by service providers working for exporting companies. The value of this "indirect" labour cost as a share of exports is of the same order of magnitude as that of the "direct" cost, i.e., approximately 20% (Bas et al., 2015). The services that make up exports include many low-wage intensive tasks (cleaning, security, catering, transport, etc.). The cost of low-qualified labour is therefore a significant component of price competitiveness through the intermediate consumption channel.

Other criticisms of the creation of the CICE

One criticism of the CICE, which has been levelled against all of the labour cost reduction schemes, is that it is regarded as a "gift" to companies that increases their net profits without anything expected in return. According to this point of view, the tax expense incurred as a result of this mechanism could be used more effectively for other public policies. This criticism is based partly on the idea that job creation is barely sensitive to the cost of labour, particular as a result of Keynesian mechanisms that depend on the level of the demand for the goods and services of companies rather than the level of their production costs.

Another criticism of the CICE relates **to the choice of a tax credit applicable to corporate income tax (CT) instead of a reduction in Social Security contributions**. This choice has two major implications. Firstly, the effect of the CICE on the cash flow situation of companies is deferred by at least one year, or up to three years, depending on the tax credit imputation time lag. Imputation of the CICE (i.e., the fact of deducting the amount of the CICE from the amount of tax owed) takes place at the time of payment of corporate income tax, i.e., one year after payment of the salaries, and imputations may occur over the following two years if the amount of the corporate income tax is lower than the amount of the tax credit receivable. Thus, almost one third of the CICE receivable in respect of the salaries paid out in 2013 has been consumed after 1 April 2017!

> "The effect of the CICE on the cash flow situation of companies is deferred by between one to three years with respect to the payment of the salaries"

Secondly, the salience of the labour cost reduction is clouded by the tax credit mechanism: a reduction in employer contributions translates into a cost reduction as soon as a salary is paid, whereas the tax credit increases net profitability. These two effects - salience and cash flow effect - can lead to companies not regarding the CICE as a labour cost reduction, but instead as a corporate tax reduction.

Assessments of the CICE

Upon entry into force of the CICE, a monitoring and assessment committee was set up comprising parliamentarians, social partners, administrations and experts. *France stratégie* put out a call for research projects and several teams of researchers were selected to conduct an assessment of the effects of the CICE on the behaviour of companies - including the *Laboratoire interdisciplinaire d'évaluation des politiques publiques* (LIEPP), the research federation TEPP and the OFCE.

The results obtained by the LIEPP (2018) point to a zero effect on total employment and on employment by socio-professional category (worker/employee or managers). TEPP (2018), however, observed that CICE had a positive effect on employment in companies benefiting most from the CICE. Both the TEPP and the LIEPP teams identify a positive effect on management salaries in companies that have most benefited from the CICE. **None of the research teams observed any effects on investment, R&D expenditure or exports.**

At the end of this work, the CICE monitoring committee meeting of October 2018 concluded, based on all of the assessments, that:

1) The CICE has not had any effect on investment, research and development and exports;
2) The CICE has probably had a positive effect on profit margins, which it is difficult to identify;
3) The CICE has had a positive, but moderate effect on employment of around 100,000 jobs, the monitoring committee opting for TEPP's assessment rather that of LIEPP on this point;
4) The CICE has had a positive effect on the average salary within the companies that have benefited most from the mechanism;
5) The mechanism has not had an effect on individual salaries that are around 2.5 times the minimum wage.

One of the limits to microeconomic assessments is that they only capture relative effects among companies that benefit more or less from the CICE, but do not take account of the general equilibrium effects. These macroeconomic effects are usually analysed on the basis of theoretical models. According to the work of the OFCE, which was used by *France stratégie* in their 2018 report, the extent of these effects is very moderate (around + 20,000 jobs in the period 2013-2015).

In addition to the debate on the ability of impact assessments to precisely ascertain the aggregated effects of the CICE, it can be noted that the overall assessment shows that the effects of the CICE are well below expectations and the scale of the apparent budgetary effort. The effects on competitiveness did not give rise - in the first few years of the CICE for which it has been possible to make an assessment - to significant effects on exports, price competitiveness or investments. Even if we take the highest bracket in the TEPP assessment, the effects on employment are very modest compared to expectations: the government had estimated that the CICE would create over 396,000 jobs in 2017 (Minister of the Economy and Finances, quoted in the Senate Report on the 2012 Revised Budget Act (LFR)). Compared with the assessments of the general reductions in Social Security contributions - including the Juppé mechanism assessed by Crépon and Desplatz (2001) based on a very similar methodology - the effects on employment appear to be very slight(1).

In addition to the assessments coordinated by *France stratégie*, we can also cite the work by researchers from the IPP, who calibrated a complex model for the French labour market in order to assess under which conditions the targeting of the CICE could deliver better results for employment than the general reductions for low salaries (Breda et al., 2017). Their results suggest that no configuration of the labour market function would allow for the CICE to have significant effects on employment due to insufficient targeting of low salaries.

Four explanations can be given for these mixed results and, depending on their significance, the conversion of the CICE into a reduction in contributions announced for 2019 may have different effects:

- *Explanation 1*: The CICE has no direct effect on employment or competitiveness, except through increases in margins (and therefore profits);
- *Explanation 2*: There is a time lag in the tax credit's transmission channel; its effects will take longer to manifest themselves. This explanation is based on the fact that the profit margins of companies have been impacted by the crisis and reconstituting them is a pre-requisite to investment;
- *Explanation 3*: Focusing the CICE on salaries up to 2.5 times the minimum wage reduces its potential effect on employment;
- *Explanation 4*: The effect of the CICE has been patchy due to it being a tax credit, which has led to delayed effects on the cash flow situation of companies and a lack of salience as a labour cost reduction scheme.

Depending on which explanation is prioritised, the conversion of the CICE into employer contribution reductions will be perceived more or less as a positive reform. According to explanation 1, the conversion of the CICE will always be ineffective and the cost of the conversion to public finances makes it even more ineffective. According to explanation 2, the conversion will basically have a neutral effect. According to explanation 3, the conversion will have no effect on employment, other than refocusing the mechanism on low salaries. Lastly, according to explanation 4, the conversion is likely to be more effective than the creation of the CICE in 2013.

(1) According to the estimates of Crépon and Desplatz, 460,000 jobs were created or saved within the economy between 1994 and 1997.

Assessment of the conversion of the CICE into employer Social Security contribution reductions

Description of the reform

The major reform in the 2019 budget is the conversion of the CICE into employer social contribution reductions. This reform was written into legislation primarily through the 2018 Budget Act (LF) (Art. 42) and Social Security Budget Act (LFSS) (Art. 8); it has been supplemented by the 2019 Draft Social Security Budget (PLFSS) (Art. 8) which proposes to postpone the additional employer contribution reduction at the level of the minimum wage.

The reform as a whole comprises several separate measures:

- **Abolition of the CICE and CITS in 2019:** as of 1 January 2019, no new tax receivables will be created. However, in 2019 and in subsequent years, the CICE receivables for the year 2018 (and the previous years) must still be honoured by the State.
- **Reduction in health contributions of 6% of the gross salary up to a threshold of 2.5 times the minimum wage:** this reduction in health contributions reflects the conversion of CICE/CITS into employer contribution reductions.
- **Reduction in unemployment insurance contributions and contributions to the supplementary pension schemes at the level of the minimum wage** (and up to 1.6 times the minimum wage) to maintain employer contribution reductions already in place at this salary level at a rate of 6%.
- **A new 4% reduction in Social Security contributions at the level of the minimum wage**, which is progressively degressive up to 1.6 times the minimum wage. In the 2018 LFSS, this new reduction was scheduled for 1 January 2019; it has been postponed until 1 October under the 2019 PLFSS.

Effect of the conversion on public finances

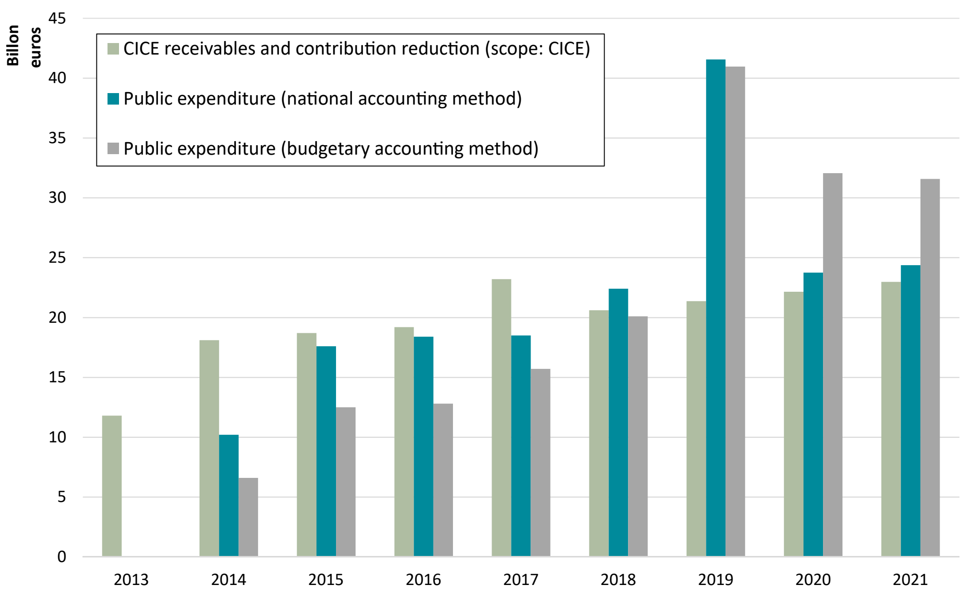
Prima facie, the conversion of a tax credit of 6% of the gross wage bill for salaries below 2.5 times the minimum wage into a social contribution reduction of 6% of the gross wage appears to be swapping like for like. In reality, as a tax credit, the CICE differs from a Social Security contribution reduction insofar as it impacts the State budget with a time lag of at least one year: in 2013, the companies eligible for the CICE received a tax credit receivable based on the salaries paid out in 2013, but this was only reflected as a tax expense in the 2014 budget. The advantage of the CICE in budgetary terms was that it cost nothing in 2013 and therefore did not exacerbate the public deficit that year.

The flip side of this advantage is that **the conversion of the CICE into employer contribution reductions leads to an almost doubling of the budgetary cost for 2019** because the CICE receivable from previous years and the tax expense due to the reduction of the equivalent social contributions for the 2019 salaries must be borne in the same year.

Figure 2 presents the changes to the budgetary cost of the CICE since 2013 and of its conversion into a reduction in employer contributions, making a distinction between the actual amount of the tax credit receivable and the effects on public expenditure according to national accounting or budgetary accounting methods. The graph is limited to companies eligible for the CICE in order to neutralise the effects of scope changes. One can clearly see how the total amounts of receivables vary according to the rate variations of 4% in 2013 and 6% in 2014 and 2016, the increase to 7% in 2017, followed by a fall in the rate to 6% in 2018.

Public expenditure under the national accounting method takes into account the whole of the tax expense of a tax credit in the year in which it is recorded, i.e., the year of payment of the corporate income tax, for example in 2014 for tax credits granted in 2013. In 2019, public expenditure defined this way will increase from 22 to 42 billion euro before falling back to 24 billion in 2020. There is therefore a temporary additional cost to public finances, which is the counterpart to the lower cost of the CICE in 2013 and 2014.

Figure 2: Changes in the budgetary cost of the CICE and of the conversion into employer contribution reductions.



N.B.: This graph shows the different values for three measurements of the tax expense represented by the CICE and of the contribution reductions replacing it (for the same scope). The CICE receivable equates to the generation of said tax, the national accounting measurement equates to the whole of the tax credit for year N+1, and the budgetary accounting measurement equates to the receipts and disbursements recorded.

Sources: 2019 Draft Budget Act (PLF); report of the CICE monitoring committee; MVC data, calculations by authors.

In budgetary accounting terms, which measure public finance disbursements and receipts, the delayed effect of the CICE is even more marked. Indeed, companies do not necessarily collect the benefits of the CICE in the corporate tax year immediately following the year in which the receivable is accrued: if the company does not make enough profits to book the tax that year, the CICE can be booked in subsequent years over a maximum of three tax years. This means that the impact of the CICE in budgetary accounting terms is much slower to manifest itself. In contrast, the effect of the conversion of the CICE into contribution reductions will be more long-term than the mere additional cost in 2019 due to the receivables accumulated, which will be paid out over the following three years.

To summarise the effects on public finances of the conversion of the CICE into Social Security contribution reductions, the reform can be interpreted as the reimbursement in 2019 by the State of the debt contracted with the companies upon establishment of the CICE. In 2013 and 2014, the "real" public deficit in France was lower due to the use of a tax credit rather than a reduction in social contributions; in 2019, the public deficit will be higher for the same reason.

> "The cost of the conversion of the CICE into social contribution reductions is the reimbursement in 2019 by the State of the debt contracted with the companies upon establishment of the CICE"

However, the analysis of the conversion of the CICE into employer contribution reductions cannot be reduced to this temporary effect on public finances. **This policy brief describes four important effects hidden behind the apparent equivalence between the tax credit and the contribution reductions:**

I) The modification to the scope of the companies covered;
II) The increased returns of the corporate income tax;
III) The effect of the new reduction contributions in Social Security contributions for low wages;
IV) The modification of the cash flow and salience effects of the labour cost reduction.

The methodology and the administrative data used for the impact assessments that are proposed in this policy brief are described in box 2 (page 9).

Extension of the scope of the CICE/CITS

The conversion of the CICE and the CITS into a reduction in employer contributions will cover not only the companies that are eligible for the CICE and the CITS, but also the establishments that are not eligible for either of the two policies, but which come under the scope of the general contribution reductions.

For the companies that are eligible for the CITS, the effect of the conversion will be an increase in the rate of the contribution reduction (the rate will increase from 4% for the CITS to 6% for the health contribution reduction). For the establishments that are not eligible for either the CICE or the CITS, the cost of labour will fall by 6% of the gross salary of employees that are paid a salary that is less than 2.5 times the minimum wage.
Based on the DADS-BRC data, we estimate that the new contribution reduction of 6% of gross salaries for salaries that are below 2.5 times the minimum wage will generate a gross cost of 22.5 billion euro for 2018 (compared with 21.6 billion euro estimated by the government - see 2018 PLFSS, Appendix 10, p. 43). The companies that did not benefit from the CICE account for expenditure of 2.3 billion euro, from which the amount of the CITS (600 million euro in 2018) must be deducted. The companies that benefited from the CICE account for expenditure of 20.2 billion euro.

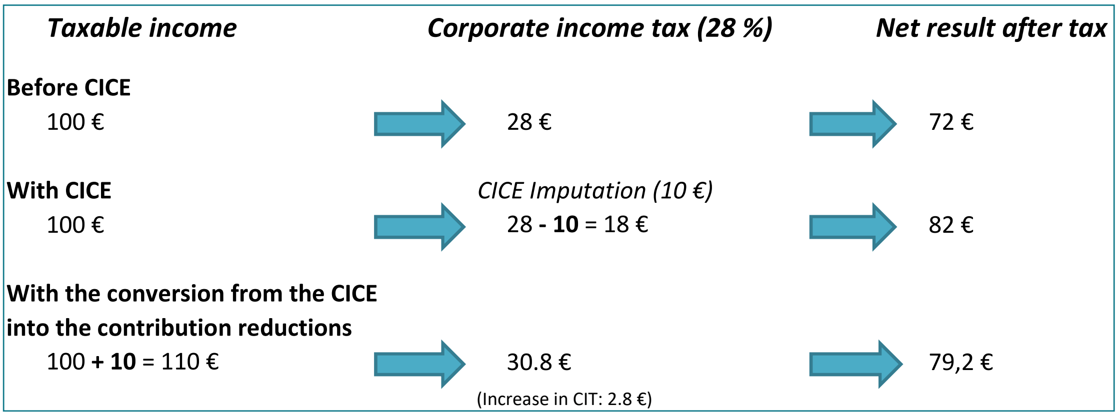
> "The not-for-profit sector will be a big winner as it will benefit from a greater reduction in its labour costs"

In total, **the effect of the scope change and the rate increase for companies that made use of the CITS generate an additional expenditure of 1.7 billion euro**, primarily for establishments in the not-for-profit sector.

Additional CT and IT: a reduction in the average CICE rate, which varies according to profitability

By the very nature of a tax credit, one euro of CICE constitutes a benefit of an equivalent amount for a company eligible for this mechanism. In contrast, a reduction in employer social contributions reduces the charges paid by companies and, therefore, increases their taxable result. Therefore, a one euro reduction in employer contributions gives rise to an increase in net profits, which is not equivalent to one euro, but to one euro minus the marginal corporate income tax rate (see diagram 1).

Diagram 1: Additional corporate income tax (CT) created by the conversion of the CICE into contribution reductions



N.B.: fictitious case of a company that pays 28% CT with a taxable result of 100 euro and whose gross wage bill under 2.5 times the minimum wage is 166 euro, giving rise to a CICE of 10 euro.

The simulations made by the IPP based on tax data (cf. box 2, page 9) imply an aggregated marginal tax rate of 19%. **Thus, for an average company, a one euro reduction in employer contributions gives rise to a net gain of 81 euro cent.** At a constant rate, the profit from a reduction in contributions is lower than the profit derived from a tax credit due to the additional CT - also referred to as the "CT return" - generated because the reductions in social contributions give rise to a potential increase in the CT to be paid by the company.

At an aggregated level, for 2019, this additional CT is estimated at around 3 billion euro, plus 276 million euro in additional IT, making **a total additional corporate income tax of around 3.3 billion euro**[(2)].

At the level of the company, this CT increase as a share of the wage bill depends on two factors: (i) the share of the wage bill eligible for the CICE and (ii) the rate of corporate income tax applied to the increase in the taxable result resulting from the conversion of the CICE. Thus, the amount of the additional CT will vary depending on the characteristics of the companies.

We can thus see in Figure 3a that the additional CT expressed as a share of the wage bill varies depending on the size of the companies. It is at its lowest for small companies and increases with the size of the company and reaches its maximum effect for medium-sized companies and then falls again for large companies. Small companies benefit more from the CICE on average, but are confronted with a lower "CT return" due to a lower effective tax rate. This lower effective tax rate can be explained by regulatory provisions (rate for SMEs of 15%, for example), as well as by the higher proportion of loss-making companies among small companies. For the biggest companies, it is the lower impact of the CICE on their wage bill that explains the lower estimated additional CT.

(2) This figure is basically comparable to the amount announced in the Draft Budget Act (PLF) if we use the estimate of 3.7 billion (PLF 2019, p. 20) or much higher if we use the estimate of 2.0 billion (PLF 2019, p. 19).

"The additional CT is lower for young and small companies, which will thus benefit fully from the conversion of the CICE"

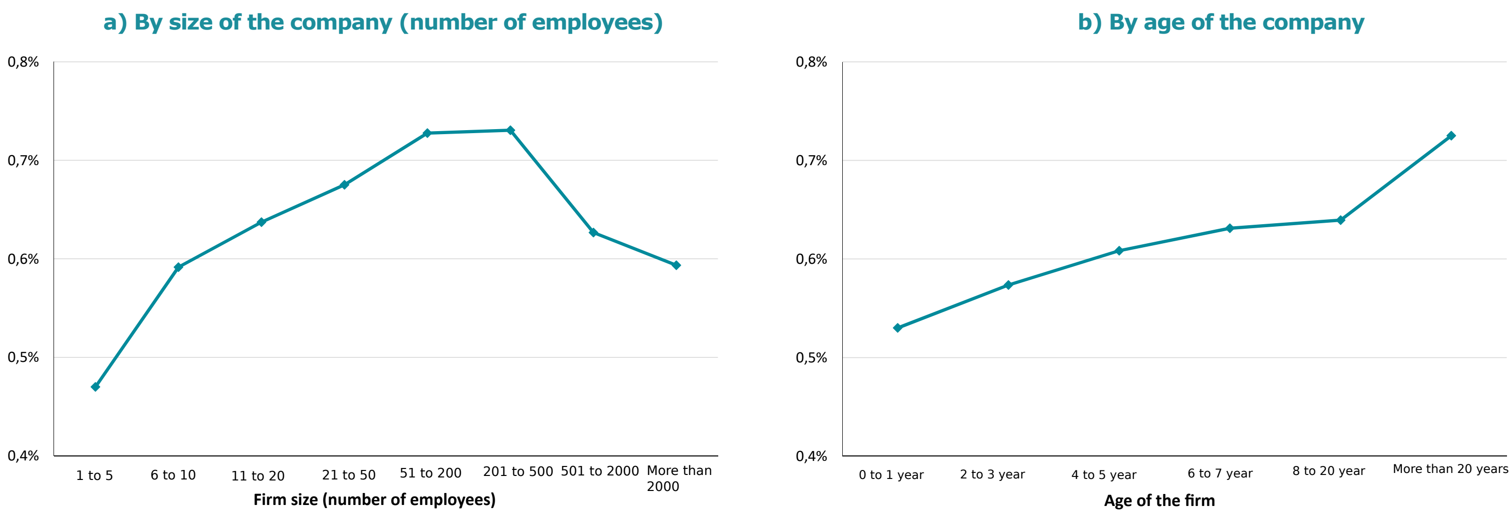
We have also noted that the effect of the conversion varies depending on the age of the companies. We can see in Figure 3b that the younger companies pay a lower additional CT than older companies. This relationship is also determined by the lower effective rate of tax paid by young companies.

New reduction at the level of the minimum wage: refocusing on low salaries

The new reduction at the level of the minimum wage scheduled for 1 October 2019 equates to a partial recycling of the CT return effect described above. This leads to a refocusing of the amounts allocated to the CICE on low salaries above 1.6 times the minimum wage.

According to our estimates, which are based on the DADS-BRC data, **the annual cost of this additional reduction would be around 3.3 billion euro for 2019 (full year)** (i.e., the same amount as the estimate in the 2018 PLFSS), and 822 million euro for 2019 with entry into force of the mechanism postponed until 1 October 2019. The budget saving for 2019 resulting from the postponement thus amounts to 2.5 billion euro. As of 2020, however, our estimates of the cost of the new reduction at the level of the minimum wage equate to the amount of the CT and IT return, i.e., 3.3 billion euro.

Figure 3: Additional corporate tax due to the conversion of the CICE (as a percentage of the wage bill)



N.B.: These graphs present the additional CT expressed as a percentage of the wage bill for several categories of companies.
Sources: BIC BRN and RSI 2015, MVC file, calculations by authors.

Total effect of the conversion of the CICE

In table 1, we map all of the effects of the conversion of the CICE based on our estimates. **We get a total budget cost for 2019 of 20 billion euro, i.e., 0.83 percentage points of GDP.** This figure is comparable to the government estimates, though the breakdown of the effects was not available on the date of publication of this policy brief.

These different aspects of the reform - abolition of the CICE and an additional reduction of 6 percentage points on all salaries below 2.5 times the minimum wage, additional reduction for low salaries and an increase in the amount of corporate tax - give rise to **total effects for companies that are fairly disparate in nature**. Without taking into account the increase in cash flow linked to the reimbursement of past CICE receivables, companies will be net losers from the reform if they benefited from the CICE and if the additional reduction on low salaries does not offset the corporate tax increase.

Figure 4 represents, **for each sector**, the total amount of the additional contribution reductions (uniform reduction of 6% and additional reduction for low wages) minus the total amount of the CICE and CITS received by the companies in the sector, and minus the additional corporate tax, all of which is expressed as a percentage of the total wage bill for the sector in 2019. We can thus see that **the companies in the not-for-profit sector are the biggest beneficiaries of the conversion of the CICE, followed closely by the low-wage sectors**, such as hotel and catering or administrative services, for which the additional reduction for low salaries, when taken into consideration for a full year, offsets the increase in corporate tax. For the construction, trade or transport sectors, the effects cancel each other out, while the sectors that have little low-paid labour (manuf

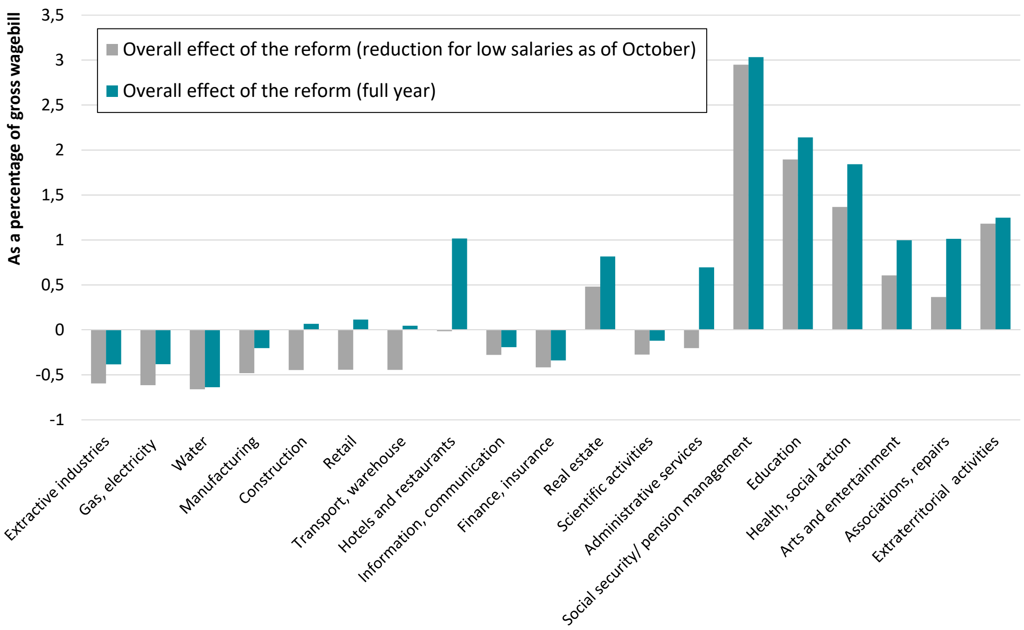
"The sectors with high levels of low-qualified labour, such as the not-for-profit sector, come out better off overall unlike the manufacturing or financial sectors"

Table 1: Estimates of the budgetary effect of the conversion of the CICE into reduced employer social contributions for 2019

Policy	In billions of euro	As a percentage of GDP
6 percentage point reduction in health contributions on salaries up to 2.5 times the minimum wage	-22.5	-0.93%
Degressive 4 percentage point reduction at the level of the minimum wage up to and including salaries that are 1.6 times the minimum wage as of 1 October 2019	-0.8	-0.03%
Corporate tax return effect	+3.0	0.12%
Income tax return effect	+0.3	0.01%
Total	-20.0	-0.83%

Sources: DADS-BRC; tax files; MVC file; calculations by authors

Figure 4: Overall effect of the reform by sector (percentage of the wage bill)



Interpretation: Taking into account application of the new reduction on low salaries as of October, the reform has a negative impact on administrative services companies; this loss is equivalent to 0.2% of the wage bill for the sector for 2019. Taking into account application for a full year, the reform constitutes a loss of around 0.7% of the wage bill.

Scope: private sector establishments eligible for Social Security contribution reductions.

N.B.: The overall effect of the reform corresponds to the combined effect of the abolition of the CICE and the CITS, the implementation of the two new employer contribution reductions and the resulting increase in corporate tax expressed as a percentage of the wage bill in each sector.

Sources: DADS 2015 and BRC 2016 data for the calculation of the reductions; BIC RN and RS 2015 and MVC file for the calculation of the corporate tax increase; ACOSS estimates for CITS tax credit.

Cash flow and salience effects

In simple terms, we can consider that a reduction in social contributions affects the behaviour of companies via two channels (Saez et al., 2018):

- **Cash flow effect channel:** The reduction in employer contributions generates greater income for companies that employ a large number of eligible workers. If the companies have limited access to tax credits, such a windfall could help companies to develop, recruit and invest more.
- **Labour cost channel:** The reduction in employer contributions reduces the overall production cost by reducing the cost of one factor of production, i.e., eligible workers. This overall cost reduction can affect recruitment decisions or companies' price policies;

The CICE differs from a reduction in Social Security contributions in respect of these two channels.

First of all, the cash flow effect is lessened due the time required to consume the tax credit. This diminishment of the cash flow effect for companies is the mirror effect of the shifting of the budgetary effect of the CICE on public expenditure: the cash flow gains for companies have been shifted in time compared to an equivalent reduction in Social Security contributions. For companies with financial constraints and which were not able to benefit immediately from the pre-financing options offered by Bpifrance, the effectiveness of the CICE may have been significantly compromised.

Conversely, the conversion of the CICE into social contribution reductions gives rise **to two cash flow effects that are beneficial to companies:** first of all, a temporary effect in 2019 with a cash flow injection due to the payment of past CICE receivables, and the actual effect of the reduction in social contributions; then, a permanent cash flow effect whereby staff recruitment or retention decisions will have immediate effects on the cash flow situation of companies.

Box 2: Data

The estimates presented in this brief are based on microsimulations using administrative data. The data used for this work were (a) data relating to receivables movements (MVC) in respect of the CICE, including the initialisation and consumption of the receivables for the beneficiaries of the CICE subject to corporate tax (DGFiP); (b) the tax files of the companies subject to the (normal and simplified) corporate tax system (DGFiP); (c) the job-level files from the annual declarations of social data (DADS) compiled by INSEE; (d) the firm-level administrative data on Social Security contributions (BRC files) compiled by ACOSS; (e) the sampled income tax file (FELIN sample, DGFiP).

Access to these data has been authorised by decision of the statistical confidentiality committee for scientific research projects on corporate taxation. Access was provided by the Secure Access Data Centre (CASD). Access to these data has been authorised by decision of the statistical confidentiality committee for scientific research projects on corporate taxation. Access was provided by the Secure Access Data Centre (CASD).

"The conversion of the CICE will have an immediate effect on the cash flow situation of companies due to the labour cost reduction, with a two-fold effect in 2019"

In addition, **the CICE probably differs from the contribution reductions in terms of the salience of the labour cost channel**. A reduction in employer contributions causes a swift reduction in the cost of labour - on a monthly or quarterly basis. Against this backdrop, it is likely that the economic decision-makers within the company have a clear perception of the change in the relative cost of labour brought about by the reduction in contributions. In contrast, a tax credit like the CICE affects the company's cash-flows when the company's profit is declared and when the tax is settled (in May of the year N+1 in respect of CT) rather than upstream when the human resource choices are made during year N. The fact that the CICE is based on the wage bill and can therefore be interpreted as a labour cost reduction is probably not "salient" or "clear" for all companies or economic decision-makers. **These "salience" effects were highlighted in recent public economics literature,** and are nowadays regarded as carrying more weight in terms of the effectiveness of public policy that was previously thought (Chetty, 2011).

A field survey of company decision-makers conducted by the LIEPP indicates that there was significant and mainly automatic use of the CICE without company executives and decision-makers necessarily perceiving the link with employment. The time and accounting lag associated with the type of tax credit is mentioned as one of the explanations for the fairly low impact of the CICE on companies' behaviour (LIEPP, 2016).

"The conversion of the CICE will make the labour cost reduction more salient"

A reading of the assessments of the CICE coordinated by France stratégie suggests that one possible interpretation of the mixed results achieved by this mechanism is that the CICE has had the effects that are traditionally associated with decreases in CT: impact on margins, low impact on employment, effects on the salaries in companies benefiting most from the mechanism, but no effect on the individual salaries covered by the CICE. What appeared to be a problematic result for the CICE monitoring committee is more coherent if the cash flow and salience effects are taken to be predominant in the decision to establish the CICE.

In light of this discussion, the conversion of the CICE into Social Security contribution reductions could be interpreted as an increase in CT that finances a reduction in employer social contributions. **The effect on employment and salaries could therefore be far greater than in the estimates based on the macroeconomic models,** which are based on the assumption that the two mechanisms are equivalent.

Other reform scenarios

The conversion of the CICE into social contribution reductions is in itself a major step, which is costly for public finances on a temporary basis. It is therefore difficult to contemplate many alternative reform scenarios if we assume that the conversion was well-founded.
One possible option would be **not to postpone entry into force of the additional reduction in social contributions until 1 October** at the level of the minimum wage and to bring it in as of 1 January 2019. This modification would generate an additional cost of 2.5 billion euro for 2019 with a potentially greater effect on the employment of low qualified employees for 2019.

A more ambitious reform would entail modifying the rates of the new general Social Security contribution reductions, replacing them with a degressive linear system up until salaries 2.5 times the minimum wage instead of maintaining the rates of the CICE (uniform reduction of 6% up to 2.5 times the minimum wage). Several economic arguments could justify such a modification: it would serve to achieve less degressivity between the minimum wage and 1.6 times the minimum wage and would put an end to the abrupt "notch" around the 2.5 times the minimum wage mark (a wage just exceeding 2.5 times the minimum wage would cause the employer to lose the full benefit of the 6% reductions). Nonetheless, based on the assessments of the CICE, no effect at these thresholds has been detected so far, thereby limiting the added value of such a conversion.

Lastly, instead of converting the CT increase into an additional reduction in social contributions for low salaries, **it is conceivable to increase the rate of the reduction up to 2.5 times the minimum wage**. The increase permitted by the 800 million euro additional tax return corresponds to an additional 0.2 percentage point general reduction for salaries between 1 and 2.5 times the minimum wage. In light of the discussion on the effects of the CICE and of the contribution reductions at the level of the minimum wage, this alternative would reduce the expected positive impact on employment.

Conclusions

The conversion of the CICE into employer contribution reductions has a major effect on public finances for 2019 due to the double burden of the CICE resulting from the past receivables and the new contribution reductions for 2019. This temporary cost is the counterpart to the gains recorded in the 2013 and 2014 budgets as a result of choosing a mechanism that takes the form of a corporate tax credit.

The reform generates five significant effects: I) an expansion of the scope of the contribution reductions to the not-for-profit sector; II) an additional CT effect, which benefits in particular young people and small companies compared to more profitable companies; III) a refocusing of the mechanism on low salaries with an additional reduction in social contributions at the level of the minimum wage; IV) immediate cash flow effects for companies; and lastly V) greater salience of the labour cost reduction mechanism. All of these effects together are likely to generate positive effects on employment that do not manifest themselves in the macroeconomic models, which are based on the assumption that the CICE and its conversion into reduced contributions are equivalent. Nonetheless, in light of the uncertainty surrounding our knowledge of such a reform, **we should adopt a cautious approach**, and future assessments will be particularly important in this respect.

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