The transformation of the CICE tax credit into a reduction in social contributions on 1st January 2019 could have a positive – though limited and short-lived – effect on employment

The effects of the CICE on employment could take different routes...

The Competitiveness and Employment Tax Credit (CICE) was introduced in 2013. It is a tax credit that most companies can benefit from, irrespective of their sector of activity, and is based on gross wages paid in the course of the year up to 2.5 times the minimum wage. The aim of the measure was to enhance companies' competitiveness – mainly via an increase in margin rate and investment – and employment, thanks to a drop in the cost of labour. For 2013, the CICE represented 4% of payroll earnings between 1 and 2.5 times the minimum wage, then 6% from 2014. The rate of the CICE was increased temporarily to 7% in 2017, then brought back to 6% in 2018.

The CICE is paid in arrears. Wages paid by companies in year N entitle them to a tax benefit which is received at the earliest during year N+1. When corporation tax (impôt sur les sociétés, IS), a tax based on company profits, is determined in April N+1 the business can then use its CICE to reduce the amount of IS due. In practice, the CICE entitlement for year N can be spread over years N+1 to N+4. If the amount of the tax credit exceeds the corporation tax owed by the company in a given year, then the CICE can be carried forward over 3 years. The balance of any unused CICE is reimbursed by the tax authorities in N+4 at the latest.

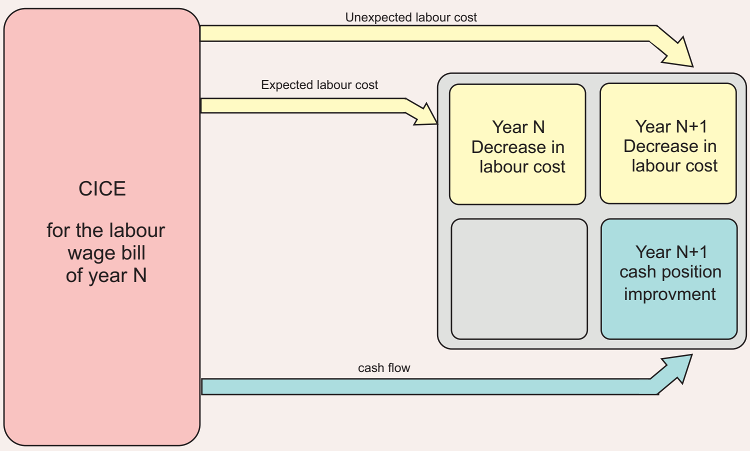
The effect of the CICE on employment can take one of two economic routes: a targeted reduction in the cost of labour or improvement in cash flow. The CICE is a hybrid measure: its assessment base is the company payroll, which makes it similar to a reduction in the cost of labour targeting the lowest wages. However, its tax and accounting mechanism identifies it as a tax credit on profits, which generally improves a company's cash flow position. Due to the complex nature of the measure, it is difficult to know how companies have interpreted the CICE.

From a theoretical point of view, these two routes do not have the same effect on employment. For a given amount, a drop in the cost of labour benefits employment growth more than a measure to improve cash flow as it distorts the capital / labour balance in favour of labour. This effect is all the greater when these two production factors are interchangeable, which is more the case for the low-paid jobs targeted by the CICE. On the other hand, a cash flow measure (equivalent to a reduction in corporation tax) has a more diffuse effect, as the company may decide to use this additional liquidity to redistribute, recruit or invest (*Figure 1*).

The CICE can take effect from year N if companies anticipate the tax benefit fully, or only from year N+1 if they are more concerned with actually receiving payment. Companies are much less able to look ahead and take advantage of the CICE from year N if they are experiencing financial difficulties (fragile cash flow situation or limited access to credit). The incentive to hire workers (or to invest, reduce prices or increase wages, etc.) may be zero in the first year. The CICE "prefinancing" mechanism, offered from 2013, was intended to remove this financial constraint, in part at least. According to the 2018 report of the CICE monitoring committee, by mid–2018, it was mainly vulnerable companies that had taken advantage of these schemes for a total of €13.8 billion of cumulated debt since 2013, or 12.4% of CICE total debt.

On 1st January 2019, the CICE will be replaced by a reduction in employers' social contributions by an equivalent amount. In 2019, employers' contributions on all wages between 1 and 2.5 times the minimum wage will be reduced by 6% (i.e. a reduction of €20.4 billion1). In addition, they will receive the CICE for wages paid in 2018 (€20.2 billion2). 2019 will therefore be a "double" year in terms of public expenditure, but its effect in terms of an employment incentive is uncertain.

1 - Routes and temporality of the effects of the CICE on employment



Source: INSEE

... but they will be difficult to measure

Several assessments have been made of the effects of the CICE on employment since it was introduced. Based on microeconomic data, the estimated and cumulated effects on employment between 2013 and 2015 appear to range between 0 and 255,000 jobs created or saved (see CICE monitoring committee report 2018). When the effects of macroeconomic closure are taken into account, some estimates suggest that over the same period the CICE could have saved or created between 110,000 and 281,000 jobs (see Ducoudré & Yol, 2018). Finally, the total effect of CICE on employment as forecast in Conjoncture in France was at first about 300,000 long-term jobs (see Conjoncture in France, December 2013), of which 215,000 were in the period 2013-2018. Clearly, the diversity of results reflects the uncertainty surrounding the effects of the measure on employment.

The dynamics of payroll employment observed between 2013 and 2017 can be reviewed and compared with the effects of the CICE estimated ex-ante. To do this, a variant of the forecasting equation used at INSEE for market payroll employment is constructed "without CICE" (Conjoncture in France, June 2018). For the period 2013-2017:

- it is assumed that value added growth is known exactly;

- public policy measures that stimulate employment growth are taken into account, with the exception of the CICE (i.e. Responsibility and Solidarity Pact and hiring bonus for SMEs), and it is assumed that their effect on employment is correctly estimated.

With these assumptions, the difference observed over the period 2013–2017 between this simulation and actual employment is examined. It covers two items that cannot be separated: on the one hand, the forecasting errors inherent in the model, and on the other hand, the effect of the CICE on employment, observed at the macroeconomic level. This difference is compared with the ex-ante effects of the CICE in the employment forecasts in Conjoncture in France since 2013.

This exercise, with its strong assumptions, does not take into account many of the factors that could affect the link between GDP growth and employment; no quantitative conclusions can therefore be drawn. However, it can at least be noted that the increase in employment in 2013 and 2014 does not seem to be the result of any significant effect of the CICE (Figure 2). This observation could therefore argue that companies did not make preparations to anticipate the effect of the CICE, at least when it was first introduced. Financing conditions for businesses were in a worse state in 2013 than today (margin rate at its lowest level for more than 20 years, stronger financial constraints), which could account for this result. For subsequent years, the change in employment appears to be relatively consistent with the forecasts for the ex-ante effects of the CICE on employment.

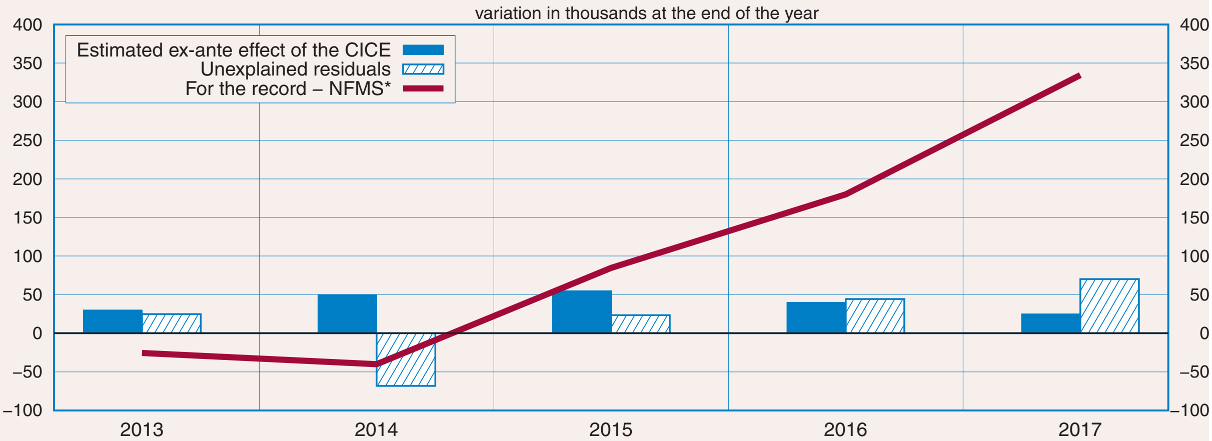
The effect of the transformation of the CICE on employment depends on how businesses view the CICE...

If the CICE is seen as a tax credit, then the switch would necessarily be favourable for employment in the long term since it would be the equivalent of replacing a tax credit by an explicit reduction in the cost of labour.

If, conversely, the CICE is already effectively perceived as a reduction in the cost of labour, then the switch will have less of an effect on employment and in particular it will have zero effect in the long term, as the reduction in social contributions will ultimately pick up where the CICE left off.

1. Source: Rapport économique, social et financier 2019
2. Source: France Stratégie (2018), "Rapport 2018 du comité de suivi du CICE".

2 - Observed residual vs estimated ex-ante effects of the CICE



Note: unexplained residuals are those that exclude the estimated effects of the Responsibility and Solidarity Pact and the hiring bonus for SMEs. The estimated ex-ante effect of the CICE corresponds to effects of the employment intensity of growth, excluding effects on employment linked with additional economic activity (measured by GDP).

*Non-farm market sectors

Source: INSEE

... but also how companies anticipate payment of the credit

In a scenario where the CICE is viewed by all companies as an unanticipated drop in the cost of labour, the switch would result in a double reduction of this cost in 2019, one linked with the CICE paid for the 2018 payroll and the other linked with the targeted reduction in employers' social contributions in 2019.

In the opposite scenario where all companies view the CICE as an anticipated drop in the cost of labour, switching would not make any particular difference compared with continuing the CICE.

Given the difficulty at this stage of leaning towards one scenario rather than another, a median assumption was selected, the equivalent of likening the CICE to a targeted reduction in the cost of labour, half of which was not anticipated (and hence contemporary) and half anticipated. This assumption falls within the continuity of figures relating to this mechanism, as incorporated into the forecasts in Conjoncture in France, and its previous comparison with the change observed in employment shows that it is probably an acceptable assumption.

The effect of the transformation can be estimated using the Mésange model[3]

Using a gap analysis scenario where the CICE remains in place on a permanent basis, and according to this median assumption, the switch would have the same effect on employment as a one-off unanticipated drop in the cost of labour in 2019 of around €10 billion and targeting wages below 2.5 times the minimum wage[4]. This would then have a favourable effect on employment in 2019, reaching a peak in 2020 given its dissemination effects, then eventually disappearing. The effect on activity would follow the same dynamic.

More specifically, the effect on employment would be around 50,000 jobs on average for 2019–2021. This effect would be due on the one hand to additional economic activity, and on the other to the employment intensity of growth, resulting in around 30,000 jobs on average for 2019-2021 (*Table*). However, this estimate must be considered with caution, given the assumption made about the way companies view the CICE. In addition, the effect that was measured was focusing strictly on the switch from the CICE and includes no additional measures. ■

Effect on employment of the transformation of the CICE into a reduction in social contributions

Gap analysis scenario for maintaining the old-format CICE	2019	2020	2021
Employment (thousands)	+40	+70	+40
including employment intensity of growth	+30	+40	+30

How to read the table: excluding the effect on employment linked with additional economic activity (measured by GDP), the transformation of the CICE into a reduction in charges would lead to approximately 30,000 additional jobs in 2019 compared with a situation where it continued to exist in its former tax credit format, and 40,000 jobs if the effect on employment were linked to the additional economic activity. In 2020, this gap would increase to +40,000 jobs (or +70,000 if the effect linked with additional GDP were included) before returning to an average of +30,000 jobs in 2021 (or +40,000).
Source : modèle Mésange, INSEE.

3. Macroeconometric model of the French economy co-developed by INSEE and the Directorate-General of the Treasury. A particular feature of the latest version, published in May 2017, is a breakdown of the labour market into skilled and unskilled workers, adapted from the assessment of policies targeting a reduction in the cost of labour. See Bardaji et al. (2017).
4. If the CICE were continued, it would in fact be a targeted decrease in the cost of labour of around €20 billion from 2019, the result for each year of anticipated and unanticipated effects by companies. However, transforming the CICE results in an equivalent and targeted reduction in employers' social contributions, also from 2019, combined with the unanticipated effect of the CICE paid for salaries in 2018 (targeted drop in the cost of labour of €10 billion)

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