Introduction – Socio-Fiscal Incentives to Work: Taking Stock and New Research

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Abstract – Income taxation and means-tested transfers have considerably changed in France over the past fifteen years, with potentially strong implications for work incentives and inequality. In the upper half of the distribution, the rise of the CSG – in absolute terms and relatively to the progressive income tax – is increasingly leading our system towards a flat tax profile. At the bottom, high effective marginal tax rates have shifted – their distribution has changed from a U-shape to a tilde-shape – due to the expansion of in-work transfers (PPE, RSA activité, then Prime d’Activité). The upcoming reform of unemployment benefits will also change the incentives to return to work. This introduction presents three original articles that characterize these changes and their implications, and attempts to assess their contributions in the light of current policy debates and the evolution of our empirical knowledge on the issue of work incentives.

JEL classification: D31, H20, H21, H22, H23, H31, I38, J64, J65

Keywords: work incentives, tax and benefits system, unemployment insurance

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Received on 21 November 2018

Translated from the original version: “Introduction – Incitations socio-fiscales et retour en emploi : un point d’étape”
In France, tax on labour – and its impact on incentives to work – has changed significantly over the last 15 years or so. This series of three interesting articles sheds new light on the topic and provides an opportunity to set the work in a broader context while highlighting the main political issues and reviewing the scientific debate.

The first article by Michaël Sicsic analyses the incentives that target working time (intensive margin) and the choice of whether to work or not (extensive margin). The intensive margin depends on effective marginal tax rates (EMTR) while the extensive margin depends on non-marginal rates (effective participation tax rates or EPTR). This analysis takes an original approach, assessing the long-term evolution of financial incentives to work in France. It draws on the INES microsimulation model (developed by Insee and the DREES) – which reproduces the tax and benefits system in place between 1998 and 2014 –, and ERFS data (Insee’s Tax and Social Incomes Survey, pairing the Labor Force survey with tax data from the General Directorate of Public Finance). This study thus reviews the calculation of financial incentives over a long period, including early years for which we did not have access to administrative data on incomes.

First of all, the results provide a surprising snapshot of the recent tax and benefits system (Figure III). We see that, given the predominant share of national insurance contributions plus CSG (general welfare contributions) and CRDS (social debt repayment contributions), our system produces a “flat tax” of 32% for a large proportion of the gross income distribution (between the 45th and 75th percentile). Progressive income taxation only leads to a modest surtax for the upper quarter. EMTR only exceed 40% for the upper 5%.

It is more usual to observe high marginal rates in the lower end of the distribution: EMTR exceed 40% at between 0.3-1.2 times the minimum wage (Smic). Not only do these low income earners pay the same level of social contributions and CSG-CRDS (about 20%, on average) as the richest groups – plus, for some of them, a small amount of income tax – but, most importantly, they are also subjected to the regressive nature of means-tested benefits, in particular the RSA (revenu de solidarité active) income support and housing benefits (AL).

Overall, these results recall the critical need to make our tax system more progressive. One avenue worth exploring is making CSG progressive (or merging it into the income tax brackets, see Landais et al., 2011; Bargain, 2015), although, as we will see, this makes little difference for the lowest incomes.

Changes made over the past few years have had a marked effect on the lower end of the distribution. The gain made on returning to work increases – so EPTR decrease – in the lower quarter of the distribution thanks to the introduction of in-work transfers, such as the working tax credit (prime pour l’emploi, PPE) followed by the RSA reform in 2009, which includes an in-work benefit component. In contrast, mean EMTR increase considerably in the “0.3-1.2 times the minimum wage” bracket due to the benefits’ phasing out, which now come into effect at higher income levels than previously (in 1998, the phase out of the “RMI” income support only concerned very low work incomes). The EMTR curve thus shifts from a U to a tilde shape, similar to

1. The statistical department of the Ministry of Social Affairs and Health.
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that found in the United Kingdom (Bourguignon, 1998, p. 42) or in other countries that combine minimum social benefits with in-work transfers.\(^2\)

At the end of the 1990s, the incentive for introducing in-work financial support was precisely seen as a way to counter potential “inactivity traps” due to the RMI. The existence of these traps has never been conclusively demonstrated and some research actually tends to minimize their effects (Bargain & Vicard, 2014). The origin of the PPE and RSA reforms in particular lies to some extent in international – mainly Anglosphere – influence and the notion of “make work pay” (Banks et al., 2005), which may reflect a shift in social preferences to the benefit of the “deserving poor” (those at work) compared to the “idle poor” (Immervoll et al., 2007; Bargain et al., 2013). To these factors, we can add a growing awareness among public decision-makers concerning likely behavioural responses – and the consolidation of empirical results showing that labour supply elasticities are often higher at the extensive margin and among the low-skilled (Lundberg & Norell, 2018).

With this new EMTR shape, future research will have to assess the risk of a disincentive at the intensive margin: higher mean EMTR at minimum wage level may contribute to keeping people with low qualifications in low-paid jobs. Interestingly, the article demonstrates the wide disparities in situations, especially the strong variation in EMTR below 1.3 times the minimum wage (Figure II). The introduction of employment aid (especially the RSA in-work benefit component) seems to have had a beneficial effect in this respect, reducing the frequency of very high EMTR (Table 3).

Michaël Sicsic’s analysis is particularly rich because it also breaks down EMTR according to marital status and gender. However, one word of caution: EMTR do not seem to differ much for men and women, but these calculations make no assumptions about the nature of the first or second earner in the event of an increase in activity (and this issue is even more relevant regarding EPTR). We should therefore interpret this relative symmetry as the end of a gender imbalance regarding incentives to work. It is worth noting that the main economic argument in favour of an individualisation of the redistribution system is one of a strong disincentive for the second earner, regardless of gender.

Antoine Ferey’s article also looks at the issue of incentives – at the intensive and extensive margins – and, more specifically, examines the role of housing benefit (AL). He also uses ERFS data but a different microsimulation model, the IPP model (TAXIPP), and focuses on 2011 and single people without children. The author confirms the tilde shaped curve for mean EMTR and a possible gain in social optimum compared to the U-shaped curve (which is only optimal if we ignore the behavioural responses at the extensive margin, i.e. in the Mirrlees model). However, he recalls that the optimality of tilde shaped curves using Saez (2002) type models is not a definitive conclusion: these models do not take into account individual heterogeneity and the presence of very high EMTR for some.

One interesting aspect is precisely the link established by the author between a characterisation of EMTR in case studies (i.e. varying the gross income for a given family

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2. Future research could study the implicit social welfare function (Bourguignon & Spadaro, 2010), which arises from the situation in 2014 or even the present configuration with the “working bonus” (Prime d’activité) replacing the working tax credit and the RSA in-work benefit. It is likely that the abnormally low social weight on the working poor, as seen for France and other countries with generous minimum social benefits in the early 2000s (Bargain et al., 2013), has now gone up with the expansion of these make-work-pay policies, at least relatively to “the idle poor”.

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configuration, here single people, as show in Figure 2) and a more original one based on data (thus incorporating the heterogeneity of EMTR due to individual situations, at each gross income level, as shown in Figure III). With this comparison, we can clearly see that the case studies reflect in fact the upper limit of the real distribution of EMTR, while the mean EMTR vary between 46% (summit of the tilde) and 30% (higher up in the income distribution). The author also puts forward a breakdown of EMTR (and their dispersion) according to the contribution made by the various tax and benefit instruments. He shows that the summit of the tilde is drawn by the phase-out of housing benefit, which has a very strong impact on the heterogeneity of EMTR (depending on whether individuals are eligible or not for housing benefit). For the upper limit of the EMTR, at around 80%, the withdrawal rate from housing benefit (respectively other means-tested benefits) accounts for 27 (resp. 30) percentage points.

The very strong contribution that housing benefit makes to high EMTR is confirmed by similar simulations done using other tools, in particular the INES model for 2011 (Bargain, 2015, Figures 13 and 14). In qualitative terms, Antoine Ferey’s results can be extended to family configurations other than single people aged 25-55. For example, the figure below shows the budget curves and EMTR levels for single parents with one child: because of the equivalence scale of welfare benefits, high EMTR go further (up to about 1.3 times the minimum wage, compared to 1 minimum wage for single people). The budget constraint becomes almost linear in the event of abolition of housing benefits: in this scenario, the system comes close to a negative “basic income-flat tax”, and EMTR drop by about 26 points, a result in line with Antoine Ferey’s findings for single people without children. The figure also shows that the impact of housing benefit is much greater than an alternative reform

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Figure
Budget constraint and EMTR for a single-parent household with one child

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Sources: Author’s calculations based on the Ines 2011 model (Insee-DREES).

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3. The first article also shows (in Figure I(a)) that EMTR around 70-80%, for households around the minimum wage, correspond to the top decile of EMTR at these income levels.
that would make the CSG progressive with a full CSG rebate for incomes below 1.3 times the minimum wage. It should be noted that the high degressivity of housing benefits is merely the counterpart to its contribution to the disposable income of low-income households. Establishing the possible fiscal sub-optimality associated with high EMTR is only one type of characterisation of the tax and benefits system: non-Rawlsian objectives such as poverty reduction cannot but acknowledge the key role of housing benefits.

In this respect, one ambiguous aspect remains: the question of incidence. The TAXIPP model used by Antoine Ferey – like the simulations proposed in Michaël Sicsic’s article – includes different scenarios concerning the incidence of national insurance contributions and thus provides an additional level of realism. The specific problem here concerns the incidence of housing benefit. The author reminds us that a significant portion of increases in housing benefit is captured by property owners (Fack, 2006). However, it remains to be seen to what extent this effect influences the margin or the totality of the housing benefit paid, i.e. to what extent the incidence actually curbs its redistributive effect. Future microsimulation work could perhaps define a concept of disposable income net of an average (local) rental cost. In terms of policy recommendation, the problem of housing benefit incidence has led several commentators to propose the payment of housing benefit directly to low-income tenants in the form of a supplement to their RSA income support or working bonus (Bozio et al., 2015; Bargain et al., 2017): such a measure would reduce (but not necessarily completely cancel out) the incidence bias. It would also simplify the welfare benefit system and confirm the role of housing benefit in fighting poverty.

The first two articles also characterise effective tax rates on returning to work (EPTR, or effective participation tax rates). To do this, they simulate the disposable income of people in employment in the event of withdrawal from the labour market. The EPTR distribution is therefore specific to individuals in work in the selected sample. A more complete analysis could add the EPTR of inactive individuals by calculating their disposable income in employment after predicting the gross income obtained in the event of activity (for example, with a simple Heckman model applied to income rather than hourly wages). Antoine Ferey’s article offers an interesting sensitivity analysis on the type of income obtained in the event of non-employment. While labour supply models generally consider incentives over the long term (inactivity with RSA), a more realistic short-term approach requires the simulation of the unemployment benefits that the person would obtain in the event of involuntary withdrawal from the labour market; the article proposes a simple replacement rate of 60% of previous income. It then shows that housing benefits generate lower EPTR for the unemployed receiving benefits – and are therefore less of a disincentive to return to work – since unemployment benefits are included in housing benefit means testing.

Finally, Damien Euzénat’s article examines the attractiveness of a return to work in a slightly different way: he looks at measures of satisfaction with the job obtained, depending on whether it is found before or after the end of unemployment benefit entitlement. The author uses a survey conducted in 2013 by Pole emploi (the French unemployment office) and paired with the National Register of welfare recipients. Similar to generous welfare payments, high unemployment benefits are suspected of extending the duration of unemployment – informal evidence rests on the acceleration of returns to the labour market as people get closer to time when
entitlements become exhausted. There may also be a form of resignation whereby people accept default jobs before replacement incomes come to an end. The literature has never come up with a conclusive response to this question and the study puts forward an innovative approach to provide some possible answers. Alongside the objective indicators (remuneration and job stability) generally used in unemployment insurance studies, it uses subjective measures (interest in the job, feeling of being downgraded, opinion on working conditions, etc.). Until then, the literature on subjective well-being had looked at another aspect, namely the link between the drop in satisfaction during a spell of unemployment and the time taken to return to work (Clark, 2003; Gielen & van Ours, 2012). Studying how job satisfaction varies according to whether a new job was found before or after the end of unemployment benefit entitlements is thus new, and its application to French data a welcome addition to the national debate, given the imminent reform of the unemployment insurance system.

Econometric analysis shows that jobs found after or near the end of entitlement are less well paid, of shorter duration (fixed-term rather than open-ended contracts) and less highly rated than jobs found well before the end of entitlement. For the job satisfaction score, the difference is significant for a return to work after the end of the entitlement or a return up to 3 months before. The author obtains a negative effect ranging from 10% (2-3 months before the end of entitlement) to 18% (after the end of entitlement) compared to the average satisfaction rate. This estimation controls for the objective criteria (wage level in the new job and the type of employment contract): hence, the negative opinion of the jobs found around the end of entitlement is thus also applicable to non-monetary aspects (notably working conditions and unsuitability of the position in terms of experience and qualifications). One difficulty in normative terms is the question of what is most important for the individual and society. Beyond the problems of matching and the depreciation of human capital, the set of objective and subjective criteria could possibly be synthesized—in future work—in the form of monetary equivalents that respect individual preferences on how to weigh the different dimensions (cf. Schokkaert et al., 2009).

Several mechanisms can explain the results of this study, depending on our belief in the various main determinants of unemployment in France: conventional factors (reservation wage and effort) or Keynesian/frictional factors (labour demand and labour market fluidity). An extreme discourse would be: the least motivated (or most demotivated) drag their feet when it comes to returning to work and, in addition, do not make the necessary effort to find a suitable job. The opposite argument: the least employable struggle to find suitable employment and, under financial pressure, also resign themselves to accepting another type of job. The author proposes a very detailed analysis that suggests that the return to work when entitlement is exhausted is essentially motivated by financial needs. Comparing the situation just before and just after the end of entitlement helps verify the cyclical effect (labour demand). The link between the date of return to work and the reduction in consumer spending during the period of unemployment shows that those receiving benefits but whose consumption fell sharply during unemployment are actually very similar to those who have come to the end of their entitlement.

As the author acknowledges, public policy recommendations are not straightforward. From these results, it cannot be deduced that an increase in the maximum duration of compensation (unemployment benefit) – or an increase in compensation – would lead to an increase in satisfaction with the jobs found. However, it would appear
that more progressive unemployment insurance – with respect to income or skills or even the expected unemployment rate by category of individual (depending on qualification, age, etc.) – would make the system more efficient (by reducing the budgetary cost) while targeting higher replacement rates among those with less chance of returning to a satisfactory job. If we see this reasoning through, a normative touch could be added to Damien Euzénat’s analysis, taking into account the heterogeneity in living standards: to what extent does the feeling of inadequacy and de-skilling obtained in his results characterize the lowest wages, the least qualified, etc.?

The comparison between the first two articles and the last one raises a final point: the dichotomy that exists in the literature between, on the one hand, a detailed analysis of the budgetary constraints affected by tax and benefit instruments (with a long-term vision, i.e. excluding unemployment insurance, of inactivity), and on the other hand, an analysis of unemployment duration (matching models, where the time horizon is the maximum duration of compensation). The first strand of literature focuses on social benefits and the second on the parameters of unemployment insurance. But how can we ignore the fact that RSA income support takes over when unemployment benefit comes to an end, and that the RSA’s in-work benefit component also increases the gain to work compared to unemployment benefit payments? This dichotomy in the economic literature clearly illustrates the extreme specialisation of our profession – and the incremental aspect of research, recently denounced by Heckman and Moktan (2018). On the subject we are concerned with, recent literature on dynamic choices is beginning to take these different aspects on-board, but it is rarely operational for public decision analysts. Antoine Ferey’s article creates an opening in this direction insofar as it considers work incentives not only on the basis of the situation of inactive populations receiving RSA income support, but also on the basis of a situation of unemployment. These shifts in time horizons are interesting and should more systematically be included in the range of indicators available to us when assessing tax and benefit incentives to return to work.

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**BIBLIOGRAPHY**


