

Focus:

An anatomy of state aid
to businesses in France



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State aid to businesses is the new form of international tax competition. Since the pandemic, certain wealthy countries have distributed state aid on an unprecedented scale: the United States has distributed \$369 billion through the Inflation Reduction Act, while the European Union's expenditure on state aid rose from €102.8 billion in 2015 to €334.54 billion in 2021. Between March 2022 and August 2023, Europe approved €733 billion in state aid, and China also provided significant support for its businesses. In Europe, France and Germany have given their own businesses the financial strength to outperform their European rivals, thereby challenging European competition policy and the single market. However, recent data suggests that in France, state aid to businesses increased well before the pandemic, taking the form of tax incentives such as tax credits or targeted tax reductions. This is one of the stylized facts I discuss in "*L'Etat droit dans le mur. Réparer l'action publique*", published by Fayard in April 2023. In this book, I wanted to document the transformations of public action in France since the Second World War in order to describe the role the government has played in the French economy and how this has changed over time. To do this, I looked at budgetary aspects: how much do the resources for public action represent and who are they based on? What are they spent on? I also looked at monetary aspects borne by the Banque de France, which, while acting independently and in coordination with the other members of the Eurozone, remains a central French public player. With this in mind, I concentrated on a few stylized facts from fiscal and budgetary issues, as these are the areas that have attracted the most attention in the public debate and which I have continued to explore since the publication of the book.

Tax incentives can be defined as "measures that provide for a more favorable tax treatment of certain activities or sectors compared to what is granted to the general industry" (Klemm, 2009). There are few theoretical arguments in their favor: they generate economic distortions between those who benefit from them and those who do not, they result in a loss of tax revenue and they come with administrative costs. The rare cases where they are justified are those where market failures result in investment costs that are too high, making investment far from optimal. Government intervention can in these cases help to boost the level of private investment, particularly in innovation (Aghion & Howitt, 2009). It is therefore relevant to

ask to what extent tax incentives have been distributed in sectors with a high capacity for innovation. Have they resulted in an increase in the level of investment in these sectors? In addition, the environmental crisis calls for a gradual greening of fiscal and tax policy (Petrie, 2021). This means integrating environmental aspects into the objectives and analysis of the budget cycle and tax policy. What is the environmental impact of state aid? This is a second major question I explored in the book.

The first difficulty in answering these questions was the lack of data. As tax incentives are not budgetary expenditure in their own right, they are not reported as such in the national accounts. Since they result in a loss of tax revenue, they are only reflected in the amounts collected by the government in the form of tax: the higher the tax incentives, the lower the amounts collected. However, the dynamics of the amounts collected are also subject to base effects, and so are not sufficient in analyzing tax incentives. Fortunately, French law has required “tax expenditure” to be reported each year in an appendix to the Finance Bill since 1979 (the administration calls the cost of tax incentives “tax expenditure”). I worked alongside Aimane Abdelsalam, a doctoral student at the University of Lille, to manually document, line by line, all the legal provisions since 1979, including the wording, the objective, the amount of the resulting tax loss and whether the beneficiaries were businesses or households (Abdelsalam & Delatte, 2023). We supplemented this base with the amounts of social security exemptions, which mirror the tax incentives for social security contributions. Given the extent of the collective nature of social spending in France and the fact that its impact is essentially borne by companies, we felt it was important to include social contribution exemptions. This information allowed us to document the amounts that the government devotes each year to helping the goods and services production sector.¹

Before revealing the amounts and the changes to them, it is useful to specify that the sum of the tax incentives does not correspond to the total tax amounts that could be collected if these incentives had not been put in place. While each tax niche reduces the amount of tax to which it is associated, the effects beyond the static equilibrium must be taken into account. For example, if the tax cuts are associated with additional investment spending, then it is likely that economic activity and the tax base will increase together and the loss of revenue will be less than the static cost. By contrast, if tax cuts are associated with lower education spending,

¹These data had already been presented in a similar way in the IRES report Abdelsalam, et al. (2022).

then aggregate productivity may fall in the long term, as may the tax base, and the loss of revenue will then be greater than the static cost. In other words, the amounts we present cannot be taken at face value when assessing the amounts that the government could recover if all the niches were abolished. Nevertheless, the amounts and the changes in them give an indication of the direction of economic policy.

Tax and social security incentives for businesses rose from 1.5% to 6% of GDP between 1979 and 2020. Up to 1995, the political priority was tax cuts, which doubled in fifteen years. The first widespread reduction in social security contributions was introduced in 1993 under the government of Edouard Balladur (although there had already been discussion of this in the 1980s, see the Lescure & Strauss-Kahn report, 1983). Under Lionel Jospin's government, tax relief measures were continued, with the goal of supporting companies introducing the 35-hour working week without any reduction in pay. Then, in 2003, the Fillon government introduced them across the board. In 2012, the Pact for Growth, Competitiveness and Employment introduced the Competitiveness and Employment Tax Credit (CICE) and extended the Research Tax Credit (CIR).² In total, the number of schemes benefiting businesses has more than doubled in forty years, and on average today a tax niche represents a loss of revenue of €160 million, but this covers a wide range of situations: some niches cost less than €1 million, while the biggest niche, the CICE, comes at a cost of up to €19 billion a year. Four schemes account for half of the total amount: the CICE, the Research Tax Credit and two tax reductions on energy products for businesses. It is interesting to note that over the same period, tax incentives for households have remained stable at around 2% of GDP, which suggests that these measures to support supply have not been financed by recovering other revenue shortfalls. All in all, tax incentives for businesses have quadrupled in forty years, with an increase in the number of programs and, above all, a concentration of resources on a few flagship programs.

As mentioned above, economic theory can be used to justify such support measures if they stimulate investment beyond the level obtained by the market (which is *sub-optimal* due to failures). In fact, several programs have been explicitly aimed at improving the competitiveness of businesses, and therefore implicitly their capacity for innovation. From research articles to study reports, a series of studies have evaluated the effects of aid on private R&D spending: for every euro of public aid received, how many

²See Carbonnier, Palier and Zemmour (2015).

euros does the company spend on R&D? Implicitly, an effective policy will have a return greater than one, which means that public support makes it possible to increase investment capacity, even if this says nothing about the optimal level of investment. The majority of studies find a return equal to one, where the amount of private R&D expenditure is equivalent to the amount of public aid received.³ This is rather disappointing, even though it is difficult to draw a definitive conclusion.

More generally, all the schemes are far from having the objective of stimulating innovation. Thus, exemptions from social security contributions are presented more as employment policies aimed at reducing the cost of labor in order to stimulate demand. Social exemptions have averaged 1.5% of GDP since 1995, and have risen steadily over the period. In fact, social exemptions account for the bulk of employment policy in France, with amounts four times greater than the budgetary missions labeled “work and employment”. However, there is a link to investment: one of the collateral effects of lower labor costs may be an increase in profit margins, which financially constrained companies decide to devote to investment and innovation. In fact, this was likely the implicit mechanism intended by the designers of the CICE, which had two objectives: employment and competitiveness.⁴ And yet the various reports evaluating the CICE rarely note any effect on investment.⁵ Sectoral data on exemptions from social security contributions and the CICE indicate that less than 5% of the amounts of these support measures is allocated to R&D-intensive sectors. The productive structure can perhaps help to explain this particularity: labor cost reduction measures are highly concentrated at the lower end of the wage scale and therefore more likely to benefit labor-intensive rather than capital-intensive sectors. In other words, it is possible that the two main objectives of tax and social incentive measures, employment and investment, are not very compatible: if tax cuts are structurally concentrated on sectors that are not highly capital-intensive (such as services), then labor-capital substitution cannot take place and the measures only risk creating low-wage traps. To find out, we will need to work with individual company data and establish a profile of companies that have benefited from tax and social security incentives. Previously,

³Out of twelve studies, six identified a yield equal to one, four a yield greater than one and two a yield less than one (see evaluation reports in the reference list).

⁴Initially, the CICE was a tax credit for businesses designed to simulate a reduction in social security contributions. It was officially switched to contribution relief in 2019. In the 2014 report by the CICE monitoring committee, an INSEE survey indicated that businesses said they would use the CICE first and foremost to invest.

⁵See the various reports by the Competitiveness and Employment Tax Credit Monitoring Committee led by France Stratégie since 2014.

evaluation studies have focused on one program at a time, which is the best way of identifying causal effects. However, it seems important to have as complete a picture as possible, given the amounts involved and the growing trends revealed by our data. One avenue in microeconomic research is to identify all the schemes individually and assess whether they have any effect on investment.

In terms of the environmental impact of public aid, the data shows that at least a quarter has been distributed to sectors that emit very high levels of carbon. This result is not surprising given that our mode of production is itself highly carbon-intensive. When the government supports a company, there is a high likelihood that it will be one with a carbon-heavy production method. However, for an effective decarbonization policy, public aid can be distributed to the most carbon-intensive companies/sectors, provided that they are also the most innovative. In fact, the best results in decarbonization lie at the intersection between high-carbon sectors that are developing technical solutions to decarbonize their production methods. The available data for the sector suggests allocation to high-carbon, low-innovation sectors. This is the opposite of what is needed. Here too, a rigorous examination requires individual data to establish a profile of companies and identify whether this aid is compatible with the transition objectives. This is essential if fiscal and budgetary policy is to be effectively “greened”. For example, in 2023, the Finance Bill will include a green budget dedicated to the transition, amounting to €40 billion. But if, at the same time, the government maintains tax incentives for carbon-intensive sectors without making any effort to innovate, then the effects of the green budget are in danger of being nullified.

In conclusion, the French model is often presented as highly protective – with high minimum wages and generous social protection – to the detriment of the business climate – high taxes and social security contributions. New data on tax and social security incentives for businesses call this narrative into question. Our data reveals that a linear and increasing policy of supply has been in place since at least 1979, when the data first became available. Since 2000, net levies on businesses (taxes less subsidies) have fallen by an average of 0.66% of GDP per year. The evaluations available do not allow us to conclude definitively that there have been positive effects on private investment and innovation. These very preliminary findings raise a number of questions. The first concerns budgetary issues. What were the budgetary implications of this policy? Has this led to less public spending? In what areas? Has there been an increase in other taxes? For whom? Has this been offset or has it contributed to the

deficit in public finances? The second question concerns political economy. What was the political motivation behind implementing this strategy and, above all, extending it on such a massive scale? Is this specific to France or part of a more global trend? These are all avenues to be explored in future research.

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