The economic damage inflicted by production taxes

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Production taxes in France have been a contentious issue that was closely linked to employment and wage growth. France currently sets one of the highest production taxes in the EU which can also be an example of the government's over-taxation strategy. As a result of the pandemic, the French government proposed a production tax cut to encourage employment and ease burden on the French manufacturing sector. The projected cut would be a 15% reduction of total net taxes (after subsidies are deducted). this is seen as positive economic moves that were much anticipated from the French, the issue is not settled yet as bringing French taxation in line with the European level involves reducing production taxes by at least €45 billion (considered in terms of GDP, with production subsidies deducted).

French production taxes have been harming French society for years. Data and econometric models show that it is counterproductive to employment and wage growth, hurting companies and consumers alike. The fact that French production taxes are double the EU average and seven times as high as in Germany strongly indicates the absurd levels in France. In order to diminish this difference, France has announced a €10-billion cut in production taxes. However, in order to converge production taxes with the EU average, economists advise an additional cut of €35-billion. Such a cut would result in €156 billion in additional turnover, €12 billion in net surpluses for companies, €42 billion in additional pay and the creation of 750,000 jobs. On top of this, public finance will also benefit from this. Lowering production taxes would result in a growth in social security contributions, personal income tax and VAT, as well as decreases in unemployment-related expenditures. The figures speak for themselves; reducing current levels of production tax would overall benefit French businesses and consumers without destabilizing public finances.

In what ways do the current levels of production tax harm businesses?

Current levels of production taxes are damaging businesses on many levels and to varying degrees. Through distortions and indirect effects, it seriously impedes the full performance of companies and businesses. This is particularly true for those with a low margin, whose survival is especially threatened.

Production taxes are distorting in two ways. Given that they are levied upstream in the production process, producers must pay the taxes before sales or profits are made. This, in turn, is distorting given that sales vary depending on the sectors and productivity of different business units. The fact that they are levied upstream means that businesspeople are biased regarding their choice of organising production, ultimately leading to lower quality and productivity. In addition to the individual negative effect on the company itself, the consequences are multiplied through what is called the "cascade effect". This term reflects the fact that a production tax affects all the companies along the chain, due to the distorted decisions made by producers. This bias results in an inaccurate representation of companies' financial position. One such effect is a reduction in competitiveness. This, in turn, has hindered unemployment reduction, which remains high despite periods of economic recovery.

Among all sectors, industry is especially vulnerable due to its exposure to international competition. High production taxes disincentivizes shareholders to invest in France, where they could opt to invest in less severe tax systems. The result has been the closure of industrial sites who could not run at a profit and instead generated losses, having no option other than shutting down. Consumers as well are often forced to change their behaviours based on them which may affect both product elasticity and demand.

Benefits of cutting production taxes

An econometric analysis taking a direct overall approach to companies was conducted to investigate the effects of lower production taxes. The variable chosen was corporate turnover, a sensible selection given that companies are directly impacted by production taxes and thus their "cascade effect" should be examined on the total revenues of companies. (Bentata & Marques 2021) The empirical results indicate that production taxes have a substantial negative impact on growth on companies' turnover. In more concrete terms, €1 in production taxes destroys €3 in turnover.

A decrease in production taxes boosts companies' operating surpluses and earnings, thereby increasing the size of the tax base, leading to higher corporate tax receipts. The logic is that companies would increase production, creating additional demand for

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labour, capital and intermediate consumption. The multiplier effect would see a greater demand due to the increase in turnover, producing yet a further increase. This would then lead to more hiring and greater consumption.

Cutting production taxes also creates indirect impacts. Among these, is a rise in employee compensation due to higher demand for labour or wages, leading to an additional increase in production. There would also be lower public spending due to lower unemployment, as well as increases in income tax, VAT and corporate tax revenues. 56% of the jobs would also be created in areas outside the Ile de France region, where most production is concentrated. Human health and industry sector, characterized by their low-margin activities, would be those who would stand to gain the most from a cut from production tax. By eliminating the cascade effects, these sectors would have more scope to improve their productive activities, such as investing, hiring, lowering prices and/or raising wages.

The belief that lowering production taxes will be detrimental to public finances because it would imply an increase in public deficit or in other types of taxation is ill-founded. The increase in economic activity means that after two years, the initial cost of the production tax reduction will be offset due to higher revenues, thereby incurring no cost to the public finances. The study predicts that eliminating the tax could reduce the trade deficit by increasing exports and reducing imports. Furthermore, economists predict that doing so would generate significant gains and savings, namely growth in social security contributions, personal income tax and VAT together with decreases in unemployment-related expenditures. Downstream taxes would capture additional wealth resulting from the envisioned upstream revenue-reducing measure.

Even though supported by econometric analyses and a vast array of data, the driving force preventing a reduction in production taxes has been motivated by political interests. The reluctance of local authorities, who receive the majority of the gains from tax, would see their revenues significantly decline after a tax cut, thereby avoiding this policy decision at all costs. As a possible solution, the study suggests sharing traditional downstream taxation. In doing so, it offers an opportunity for local authorities to create a powerful link with wealth creation in their territories.

A positive approach for households, consumers, employees and savers

The massive reduction in production taxes will be good news for households who ultimately bear the economic cost of this taxation. Depending on elasticities of supply, taxation will lead to a fairly significant change in supply and/or demand, will decrease the quantities exchanged and will reduce the utility of the players, resulting in a dead loss for society. The ability to shift the tax burden onto consumers depends on price elasticity. Producers or distributors of an especially sought-after good such as petrol will be able to shift the economic burden of a tax increase onto their customers. In contrast, a producer of a good in less demand will be less able to shift the tax increase onto customers. In extreme cases, he will be forced to absorb the entire amount of the tax and to reduce his margins, at least in the short term. When companies are unable to pass the tax onto their customers, they tend to take aim at their employees or shareholders. They will tend to be less generous when it comes to raising wages or offering dividends to their shareholders.

In cases where firms are unable to re-allocate the burden onto consumers, the burden would likely be shifted onto employees and shareholders. Employees may face wage-cuts or reduction in benefits which would bring up questions on meritocracy as well as standard of living. Shareholders may be prevented dividends and larger amounts of investments would be asked from investors leading to stock fluctuations. Consumers may find goods more expensive but will have more liquidity to spend. Hence, this would provide a situation where consumers can choose how they spend rather than be taxed prematurely.

Conclusion

The report has made the case for the lowering of production taxes in France. While it has been standard practice to tax firms on their factors of production, this upstream tax creates significant distortions. Despite the visible revenue it generates, it nevertheless creates indirect costs that do not outweigh its benefits. Among these costs are suppressed economic activity, leading to less wealth creation and overall tax revenues reduction while increasing unemployment-related expenditures. Lowering production taxes is often averted on the basis that it poses a risk to public finances. Contrary to popular belief, however, doing so would not create a deficit due to the wealth created from “downstream” taxes. One other major challenge that lowering production taxes poses is finding a way of favouring tax bases over tax rates - favouring, thus, value-enhancing taxes instead of damaging ones. The report also highlights the importance of establishing a win-win revenue sharing of the gains from taxation between local and national authorities (i.e. the sharing of traditional “downstream” taxation).

References

Bentata P., Marques N., *Production Taxes hold back wages, jobs and growth* (2021) Institut Economic Molinari. Available at: https://www.institutmolinari.org/wpcontent/uploads/sites/17/2021/11/etude_impots_de_production_novembre2021_en.pdf