The Great Tax Reform, a French Myth

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The French Prime Minister announced on 19 November 2013, that he suspended the implementation of the eco-tax and that he will conduct a great tax reform. This great reform is often mentioned in the French public debate, but its contents and its objectives are not clearly settled. The reform can be unanimously approved as everyone gives it a different content.

Taxation has three objectives: public and social expenditures financing, income redistribution, and economic incentives. For some people (for instance, OECD, 2013), the reform must reduce these ambitions, taxation should become more neutral; for others, it should, on the contrary reinforce them.

Some advocate a sharp reduction of taxes, that would boost the French economy by making French firms more competitive, by encouraging people to work more, households to save, firms to invest and to increase employment. But this requires further public spending cuts, while the Government is already committed to lower it by 70 billion euros (-6.3%) until 2017.

Some propose to transfer the social welfare financing from firms to households. For instance, the Medef, the French employers' organisation, requires a 116 billion euros cut in company taxation. This would require a new and sharp increase in the households' tax burden, with the risk of a large fall in consumption. Should France engage in this direction, which means revive tax competition in Europe?

Some advocate to reduce taxes on labour and capital income to increase the taxation of consumption, which would be less harmful to activity, but others denounce the unfairness of indirect taxes affecting proportionally more the poorest people who do not save.

Others propose to distribute more fairly the tax burden between labour and capital incomes, to increase the redistributivness of the French taxation. But the France is already one of the most redistributive countries, which strongly taxes the richest people and the capital incomes.

Some propose to suppress all tax expenditures, to expand tax bases and to reduce tax rates. But they forget about the incentive role of taxation. Many tax devices, even complex, are legitimate for fairness reasons (as the *quotient familial*), for employment incentives (such as social security contributions rebates on low wages, the *Prime pour l'emploi*, allowances for child care expenses) or for justifiable targets (such as tax credit for donations). Some household incomes remained untaxed, but it is difficult to tax imputed rents and unrealized financial gains.

To make the taxation more ecologically-friendly is certainly an ardent obligation but is there a double dividend (ecology and job) or does the ecological gain have a cost in jobs, in purchasing power, in competitiveness? Can we increase our environmental taxation without a European (or even global) agreement, unlikely today? How to reconcile the ecological target and the tax revenue one? Ecological taxation is necessarily complicated if we want to avoid to hit (too much) farmers, industrial sectors, poorest people, peripheral regions, etc. This is what we have learned from the failures of the carbon tax (in 2009) or the eco-tax (in 2013).

Certainly, it is necessary to combat tax evasion and tax optimisation by larger multinational firms, but this requires a European tax harmonisation, which is not without danger, if it obliges France to align domestic tax rates with the lowest tax rates in the MS (on Income Tax

or on CIT). As for many European issues, two projects should be opposed: a liberal one decreasing public revenues, a social democratic project, based on the maintenance and development of the European social model, but where is the democratic field where these two projects can be confronted?

A ‘miracle’ project thus emerged: the merging of our income tax with the CSG (*Contribution sociale généralisée*[1]). But, here too, the objective of the merger is not well specified. Is it expected to make our system simpler or more redistributive? More or less family-friendly?

The evocation of a great tax reform could be a fallacy, masking the inability to tackle the current problems of the French economy: the difficulty to insert in the new international division of production; the growth of inequalities in status and in primary incomes induced by globalisation and the financialisation of the economy; the inability of developed countries, and especially of the euro area MS, to find a new dynamic of growth after the financial crisis.

The main issue is probably not so much the tax structure, but the economic policy error made at the euro area level, to add fiscal austerity to the depressive shock induced by the financial crisis and, in the French case, to increase taxation by 3 percentage points of GDP since 2010 (i.e. 60 billion euros) to reduce the public deficit induced by the recession, without waiting for growth recovery.

The French tax system collects 46% of GDP; primary public spending represents approximately 50% of potential GDP. This high level of public and social expenditure constitutes a choice of society that can be maintained; the French tax system is already strongly redistributive. France is one of the few developed countries where income inequalities did not strongly increase in recent times. Certainly, some reforms are needed to improve further its redistributiveness, to make it more transparent and more socially acceptable. However, it is at the level of primary income distribution that inequalities must be reduced. There is no tax reform miracle: the current system, product of a long process of economic and social compromise, is difficult to improve.

So, we should not have too much illusion about economic and social gains to expect from a tax reform. Five axes seem however essential:

-to reaffirm the principle that all households’ incomes must be subject to tax; to strictly enforce the principle: “everyone must contribute to public expenditure according to his contributory capacities”. These capacities should be evaluated on a family basis.

-to reaffirm the principle that all labour income must pay social security contributions, all capital income must pay social security contribution;

- to split tax expenditures in three categories: those determining the contributory capacity of households (which must be maintained and no longer be considered as tax expenditures); economic or social subsidies (which must be transformed into explicit subsidies); the other expenditures should be deleted.

- to rise environmental taxation and taxation on financial activities, to maintain capital taxation, to reduce labour taxation.

– to combat companies and richer people tax optimization. This should be done through European tax harmonization. But France should take the lead on this rather than take part to dangerous tax competition.

[1] A proportional tax on all households’ incomes to finance the non-contributive social benefits.

A social choice, a high level of public expenditure

In 2013, the share of public expenditure in GDP was 57% in France, ranking France third among the OECD countries, after Finland and Denmark (table 1). This figure is temporarily inflated by the depression that hits France: primary public spending (excluding interest payments) accounted for 50% of potential GDP. This level corresponds to a French (and even European) choice of a mixed society, a compromise between socialism and capitalism, where a significant part of households' needs are covered in a socialized manner, either by benefits in kind (education, health, childcare), either by benefits in cash, which are universal (family allowances), assistance (old age minimum income, RSA (*Revenu de Solidarité Active* a minimal income) or social insurance (pensions, unemployment). In France, no political party, no important social movement proposes to change this model. For instance, under Sarkozy's Presidency the RSA was introduced which even extends social protection.

For 17 years, the weight of primary expenditure increased very slightly in France (+ 1.1 percentage point of potential GDP against +0.5 percentage point in the euro area); primary public spending in volume increased by 1.9% per year, on average, but GDP grew by only 1.5% per year. This contrasts with the decreases recorded in Austria, Sweden and Germany (table 1). But several European countries have experienced large increases (Belgium, Ireland and the United Kingdom); it is also the case for the United States and Japan. Two trends come in conflict in developed countries: the growth of social needs (education, health, pensions) induces a rise in public expenditure; the liberal ideology leads to the reduction of State intervention and to the privatization of some of its functions. But private solutions are often more expensive, raise inequalities and undermine social cohesion. Thus, in the eurozone, despite the pressures from the Commission, the share of public spending has slightly increased over these past 17 years.

An analysis of public expenditures by function (table 2) shows that it is the size of expenditures directly benefiting households which explains the level of public expenditures in France compared with its partners. France does not made a choice between solidarity benefits, insurance benefits and universal benefits: it provides the three of them. France has a public health system; France gives both universal family allowances and specific benefits to poorer families, helps both working women with young children care and women who give up their job to care after their young children; unemployment benefits are relatively generous. Finally, France pays a generous old-age minimum income and a generous minimum income. The supplementary pension system is public. Public expenditures on education in France are 1 percentage point of GDP higher than in the euro area, due to a higher proportion of young people in the population and to the low level of private education expenditure.

So, any substantial decrease in public expenditure would lead to the privatisation, in one form or another, of expenditures directly benefiting households. Either public spending is fully privatised at the expense of the poorer, or public spending is allocated only to the poorer, the other part of the population having to turn to private institutions (for health insurances, education, pension); in this case, the losers are the middle-class, which should contribute to the funding of the poorest, while paying for their own expenses.

Table 1. Public expenditure in GDP

	Public expenditure, in % of GDP	Primary expenditure, in % of potential GDP	Public expenditure, in % of GDP	Primary expenditure, in % of potential GDP	Public expenditure, in % of GDP	Primary expenditure, in % of potential GDP	Change 2013/1996
	2013	2013	2007	2007	1996	1996	
Finland	58.5	56.9	47.4	51.1	60.2	56.7	+0.2
Denmark	*57.2*	*55.0*	*50.8*	*52.9*	*58.9*	*56.0*	*-1.0*
France	57.0	53.3	52.6	51.9	54.5	50.5	+2.8
Belgium	54.7	52.7	48.2	45.7	52.4	43.6	+9.1
Sweden	51.8	51.7	50.9	52.4	62.9	58.3	-6.6
Greece	58.5	48.5	47.5	38.0	43.8	32.9	+15.6
Austria	51.3	47.8	48.6	48.6	55.9	51.9	-4.1
Neths.	49.7	46.4	45.2	45.7	49.4	44.4	+2.0
Euro area	**49.8**	**45.7**	**46.0**	**44.9**	**50.5**	**45.0**	**+0.7**
Italy	50.6	43.3	47.6	44.3	52.2	41.4	+1.9
UK	*49.8*	*43.3*	*43.4*	*43.6*	*41.4*	*38.2*	*+5.1*
Germany	44.6	42.7	43.5	41.9	49.0	45.6	-2.9
Japan	*43.1*	*42.3*	*35.8*	*36.9*	*36.3*	*35.6*	*+6.7*
Ireland	42.9	42.2	36.7	32.7	39.2	33.9	+8.4
Portugal	48.7	41.9	44.4	42.3	42.4	38.2	+3.7
Spain	44.8	39.8	39.2	39.6	43.2	37.9	+1.9
USA	*41.9*	*35.5*	*37.1*	*35.3*	*36.6*	*32.0*	*+3.5*

Source: OECD. *Economic Outlook*. November 2013. Expenditure relating to potential GDP figures depend very much of the evaluation of the output gap, which is particularly delicate for the years 2007-2013. We used here the OECD figures. According to our own evaluation, the ratios for France would be 49.3% in 1996. 50.1% in 2007 and 2013: the rise would be only 0.8 points.

Table 2. Expenditure par function in GDP in 2012

Percent of GDP

	France	Germany	Italy	Euro area	UK	Sweden	USA
General services	3.5	3.6	3.7	3.2	2.8	6.2	2.0
Interest payments	2.4	2.5	5.4	2.7	3.0	1.0	3.8
Defence	1.9	1.1	1.4	1.3	2.4	1.4	4.2
Public order	1.8	1.6	1.9	1.8	2.4	1.4	2.2
Economic affairs	3.7	3.4	3.4	4.3	2.8	4.4	2.2
Environment	1.1	0.6	0.9	0.8	0.9	0.3	0.0
Housing, collective amenities	1.9	0.5	0.7	0.8	0.8	0.7	0.7
Culture	1.4	0.8	0.7	1.1	1.0	1.1	0.3
Health	8.3	7.0	7.3	7.4	8.0	7.1	8.7
Education	6.1	4.3	4.2	5.0	6.1	6.8	6.3
Social protection	24.4	19.4	21.0	20.6	18.0	21.4	8.1
Total	56.6	44.7	50.6	50.1	48.1	52.0	40.0

Source: OECD database.

Many French economists and politicians, liberal think-thank (Institut Montaigne, 2012), and international institutions consider that France should undertake a competitiveness strategy, through a sharp cut of social benefits allowing for a decrease in employers' social contributions. But there is no miracle: this strategy would reduce incomes for households who, for example, would have to pay private insurances for their health expenses. Such a reform would result in a more expensive (as shown by the example of the United States) and more unequal (each family would pay according to its risks and not to its income) system.
In my opinion, it would be better to distinguish the two objectives: on the one hand, it is necessary to manage social protection according to its own objectives; on the other hand, competitiveness must be sought either through R&D, innovation and quality research, or, in last resort, by a decline in wages (and dividends) paid by firms. There is no reason to look in priority for competitiveness gains via social spending cuts.
The current Government is committed to reduce by 70 billion euros the amount of public expenditure (i.e. 3.3% of GDP; 6.3% of their amount) while the previous Government already had aimed to reduce government functioning expenses. This commitment requires dramatic cuts in public services and social expenditure, dangerous for social cohesion, economically and socially unwelcome in times of mass unemployment.

Overall, France maintained a high level of social protection, which allows inequalities in income and poverty rates to be lower than in Anglo-Saxon, or Mediterranean countries. Poverty rates decreased in France, as opposed to Nordic countries and Germany (table 3).

Table 3. Rates of poverty in Europe **in %**

	1997	2007	2012	Evolution
Germany	12	15.2	15.6	+3.6
Austria	13	12	12.1	-0.9
Belgium	14	15.2	14.6	+0.6
France	15	13.1	13.5	-1.5
Netherlands	10	10.2	10.3	+0.3
Spain	20	19.7	20.7	+0.7
Greece	21	20.3	20.1	-0.9
Italy	19	19.9	18.2	-0.8
Portugal	22	18.1	17.9	-4.1
Denmark	10	11.7	13.3	+3.3
Finland	8	13	13.1	+5.1
Sweden	8	10.5	12.9	+4.9
Ireland	19	17.2	16.1	-2.9
United Kingdom	18	18.6	17.1	-0.9

Source: *Eurostat.*

At the same time, France did not escape the general trend of increases in very high wages and incomes. The share of 1% highest wages in the total gross payroll increased from 5.5 % in 1996-1998 to 6.9% in 2008 and remained at 6.6% in 2010[2]. The share in households' incomes

[2] Selon *Emploi et salaires*, INSEE Références, 2013.

of the 0.1% richest rose from 1.72% to 2.03; the share of the 1% richest rose from 6.48% to 7.07[3].

The ratio of the income of the deciles D10/D1 was, in 2012, 17.5 before redistribution, 5.7 after (table 4). The French system is strongly redistributive, mainly due to social benefits. The redistributive role of taxation is less clear, particularly for higher incomes.

Table 4. Primary and available incomes in 2012

	Incomes before redistribution	Social benefit rates	Tax rates	Incomes after redistribution
D1	16.1	145.0	- 4.0	42.2
Q1	28.3	59.6	- 4.6	47.8
Q2	60.5	8.1	-6.5	67.3
Q3	87.3	3.4	-9.6	85.6
Q4	111.6	1.7	-12.2	108.6
Q5	215.6	1.1	-19.3	190.7
D10	281.5	0.5	-22.0	240.5
Total	100	5.6	-13.7	100

Source: INSEE, (2013*): France, Portrait social.*

A heavy and original taxation system

In 2013, France ranked third among OECD countries with the highest compulsory contribution rates (table 5), at the same level as Northern Europe countries and Italy.

The French tax system has four characteristics as compared with EU partners, and in particular with Germany (tables 6a and 6b):

- France has two income taxes (the progressive so-called income tax and the proportional CSG), but their cumulated weight is relatively low. Conversely, the local tax is relatively heavy.
- Employers’ social contributions are high; employees’ contributions are relatively low.
- Local business taxes are relatively heavy.
- Capital taxation is relatively high, while consumption taxation is rather low (table 7).

Of course, there is no reason why French taxation should be brought in line with taxation in our EU partners (especially Germany). It is normal to have high social contributions in a country where social insurance benefits are high. The high level of employers’ contributions is partly offset by the level of net wages. However, these figures would suggest that France should increase the weight of its income tax and its VAT, and should reduce employers’ social contributions, in other words implement a tax competition strategy; that France should reduce capital taxation, which means reducing the redistribution induced by its system. It is a social and political choice that France should make: to remain original (which is dangerous in an open economy) or to align with other countries.

[3] *Les revenus et le patrimoine des ménages*, INSEE Références, 2013.

Table 5. Compulsory contribution rates

	1990	2007	2011	2013 (p)
Denmark	46.5	48.7	48.1	48.0
Belgium	42.0	43.9	44.0	46.4
France	42.0	43.5	44.2	46.0
Italy	37.8	43.5	42.9	45.4
Finland	43.5	43.0	43.4	44.7
Sweden	52.2	48.3	44.5	44.5
Austria	39.7	42.3	42.1	43.1
Euro area	**38.6**	**39.6**	**39.1**	**40.4**
Netherlands	42.9	37.5	38.7	39.7
Germany	34.8	36.2	37.1	37.4
UK	35.5	36.1	35.5	35.8
Portugal	27.7	36.4	31.3	32.2
Greece	26.2	32.0	31.2	32.2
Spain	32.5	37.2	31.6	31.8
Ireland	33.1	30.8	28.2	28.6
Japan	*29.1*	*28.3*	*27.6*	*27.8*
USA	*27.3*	*28.3*	*25.1*	*26.2*

Source: OECD, database.

Table 6a. Structure of taxation, in % of GDP in 2007

	DE	AT	BE	SP	FI	FR	EL	IE	IT
Personal income	9.0	9.4	12.2	7.4	13.0	7.5	4.9	8.8	11,1
Corporate income	2.2	2.4	3.6	4.6	3.9	3.0	2.6	3.4	3,8
Employers' social contributions and wage tax	6.3	9.3	8.3	8.9	8.7	12.2	5.1	3.3	8,9
Employees (and other people) social contributions	6.9	7.6	5.3	3.2	3.2	5.1	6.6	1.6	4,1
Taxes on capital	0.9	0.6	2.3	3.0	1.1	3.5	1.4	2.5	2,1
Taxes on goods and services	10.6	11.7	11.0	9.5	12.9	10.7	11.4	11.1	11,0
Others	0.0	0.3	0.0	0.2	0.0	1.5*	0.0	0.0	2,6**
Total	**36.0**	**41.8**	**43.6**	**37.2**	**43.0**	**43.7**	**31.8**	**31.0**	**43,4**

	NL	PT	DK	SE	UK	EA15	JP	US
Personal income	7.7	5.5	25.3	14.6	10.8	9.7	5.5	10.6
Corporate income	3.2	3.7	3.6	3.8	3.4	3.2	4.8	3.1
Employers' social contributions and wage tax	4.5	4.8	0.2	12.3	3.7	7.3	4.7	3.3
Employees (and other people) social contributions	8.3	6.9	1.0	3.0	2.9	4.9	5.6	3.3
Taxes on capital	1.2	1.4	1.9	1.2	4.5	2.4	2.5	3.1
Taxes on goods and services	11.2	13.7	16.3	12.9	10.5	10.9	5.1	4.7
Others	0.2	0.1	0.2	0.2	0.1	0.6	0.0	0.0
Total	**38.7**	**32.5**	**48.9**	**47.4**	**36.0**	**39.4**	**28.3**	**27.9**

* Business local taxes; ** IRAP. Source: OECD, *Public Revenue Statistics*, 2013.

Table 6 b. Structure of taxation, in % of GDP in 2011

	Germany	France
Total	36.9	44.1
Personal income	9.1	7.5 (2.5 +5.0)
Corporate income	1.7	2.5
Employees' social contributions	6.3	4.0
Employers' social contributions	6.7	11.4
Others social contributions	1.2	1.3
Wages taxes	-	1.3
VAT and other indirect taxes	10.8	10.9
Local business tax*	-	1.2
Taxes on capital	0.9	3.7
Households' local tax		*1.1*
Households' property tax	*0.2*	*0.8*
Company property tax	*0.3*	*0.6*
Wealth tax	-	*0.2*
Inheritance/donation	*0.2*	*0.4*
Transactions	*0.2*	*0.6*

Source: OECD, *Public Revenue Statistics*, 2013.

Table 7. Implicit tax rates in 2011 in %

	Labour	Consumption	Capital
EA17	37.7	19.4	28.9
Germany	37.1	20.1	22.0
Belgium	42.8	21.0	30.7
Spain	33.3	14.0	26.3 (2009)
France	38.6	19.9	44.4
Ireland	28.0	22.1	n.a.
Italy	42.3	17.4	33.6
Netherlands	37.5	26.3	12.9
Sweden	39.4	27.3	27.0
UK	26.0	19.5	34.9

Source: Eurostat, *Taxation trends in the European Union*, 2013.

Recent reforms

The recent history of French taxation is marked by three episodes.

1) The taxation rate decreased by 1.6 percentage points from 1999 to 2002. This is the effect of Lionel Jospin's *cagnotte (jackpot)*. The strong growth in 1997-2000 reduced the public deficit, prompting the Government to reduce taxes. The measures taken by the Jospin Government represent approximately 35 billion euros, or 2.3% of GDP, split between households (12 billion), companies (12.5 billion) and indirect taxes (10.5 billion). Some measures (VAT and CIT rates cuts) represented a return to normal after the 1995-1997 tax

increases taken to meet the Maastricht criteria. Other measures fit into an employment policy based on lowering employers' contributions and removing the inactivity trap (introduction of the PPE, *prime pour l'emploi*, employment premium). Some were purely political, without economic justification (income tax cuts, car tax abolition). From a macroeconomic point of view, this policy was strongly criticized by the European Commission, which considers that it was pro-cyclical and responsible for the high French public deficits in 2003-2004.

2) Measures taken in 2007, by Nicolas Sarkozy, at the beginning of his presidency, in particular the TEPA law (law for labour, employment and purchasing power) reduced tax revenues by 16 billion euros in a full year: tax-exemption of overtime compensations and of mortgage interest payments, reduction of the ISF (high wealth tax) and of inheritance rights, decrease of local business taxes, extension of the *Crédit Impôt Recherche* (tax credit for R&D expenses). In the following years, the government decreased also the VAT rate on hotels and catering (by 2.4 billion) and reduced once more local taxation of companies (by 4.5 billion).

3) However, since 2011, the France has accepted the European constraint to reduce its public deficit. From 2011 to 2013, tax increases reached 60 billion euros (3% of GDP). Nicolas Sarkozy removed the exemption for mortgage interest payments, increased social contributions on extra-wage remunerations and on capital incomes, introduced a contribution on high incomes, hardened CIT and income tax legislations, removed price-indexation of income tax brackets; i.e. a total of 30 billion euros increase in taxes. The fiscal assessment of Sarkozy's Presidency illustrates the difficulties of a liberal reform of French taxation. His proclaimed objective, a dramatic reduction in the compulsory tax rate (by 4 points), was not reached: the rate was 43.4% in 2007; it ended at 45.0% in 2012.

Table 8. Compulsory taxes rate evolution

1999	44.9
2000	44.2
2001	43.8
2002	43.3
2003	43.1
2004	43.3
2005	43.8
2006	44.1
2007	43.4
2008	43.2
2009	42.1
2010	42.5
2011	43.7
2012	45.0
2013	45.9
2014	45.9
2015	45.6
2016	45.4
2017	45.3

François Hollande removed the tax-exemption on overtime wages, increased inheritance taxation and the ISF, increased capital income taxation, maintained the non-indexation of income tax brackets, lowered the ceiling of the family tax reduction (the *quotient familial*),

increased social contributions on pensions, extra-wages compensations, self-employed revenues, hardened the CIT legislation (taxation of 20% of interest paid by firms to CIT, increase in capital gains taxation). In 2014, households' taxation increases by 12 billion euros (increase in VAT rates, increases in transfer tax, additional lowering of the ceiling of family tax reduction, taxation of complementary health employers' contributions, etc.).

This strong increase in taxation was not intended to finance a similar increase in public spending. The financial crisis reduced French GDP by approximately 8%, which means a 4 percentage points of GDP cut in tax revenues; both the Fillon Government and the Ayrault Government agreed to try to reduce this deficit by adding a fiscal shock to the financial crisis one. This strong increase, without counterparts in terms of expenditure, detrimental to activity, fuelled a beginning of fiscal revolt (the taxation *ras-le-bol*). Two million households see their incomes becoming imposable to the Personal Income tax. But, it also allowed to delete several injustifiable tax expenditures, to tax more capital income and the richest.

Another episode opens in 2014. Under the effect of a strong campaign by employers complaining about the French excessive taxation that affects firms' competitiveness and ability to invest, the Government introduced the CICE (competitiveness and employment tax credit) and announced a responsibility Pact (a new cut in employers' social contributions), a strong decline in the CIT, the abolition of the C3S[4], all in all for 40 billion euros. Facing the households' fiscal discontent, the Government announced also a solidarity Pact some tax cuts for households as a reduction of employee's social contribution for low wages and a reduction of income tax for low incomes (for 5 billion euros).

However, from 2013 to 2017, the Government is committed to reduce the public deficit by 50 billion public and the firm taxation by 40 billion. This would be funded by an increase of 5 billion of taxation of households and by a decrease of 50 billion of public expenditure. 35 billion are lacking: will the government have to renounce to reduce the public deficit, increase taxation or increasing the reduction of public spending?

The reform of the Social Security financing

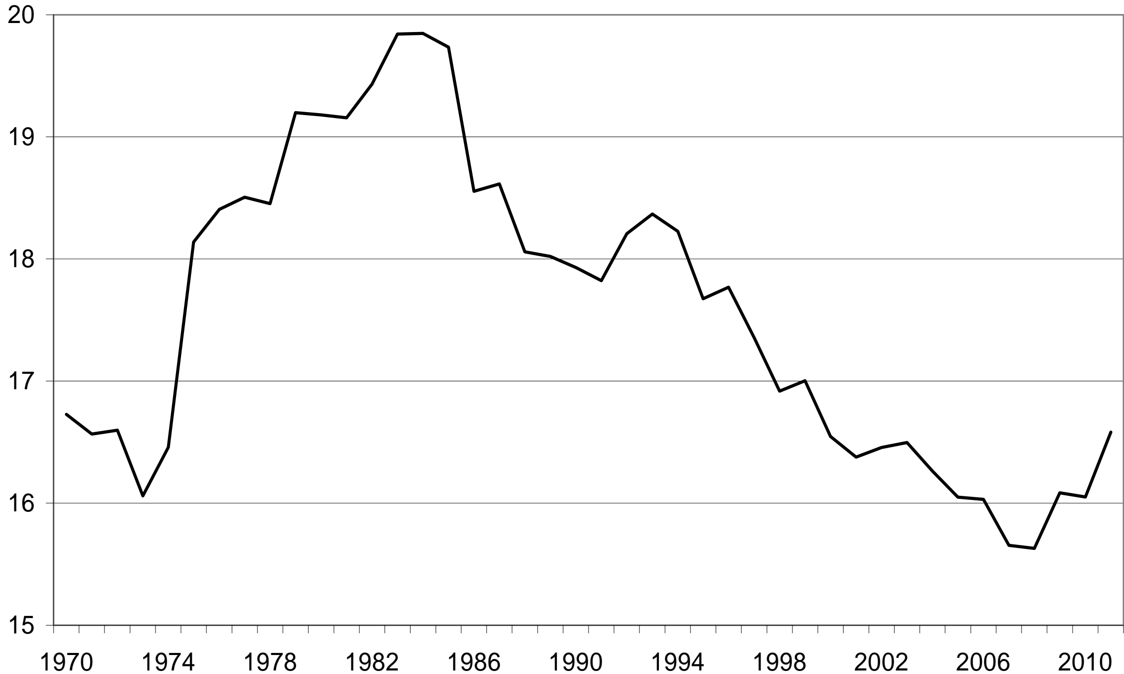
The reform of the social security financing is often presented as essential, both to improve the competitiveness of the French economy and to reduce the tax burden on labour.

There are three arguments for the reform of social protection financing. The first is that financing must obey an economic logic: social insurance benefits (unemployment, retirement) should be financed by contributions paid on wages while universal benefits (family benefits, health insurance) and assistance ones (non-contributive benefits, minimum incomes) should be funded by general taxation. The second is that the financing of universal benefits must avoid harming employment; it should therefore weigh either at the level of enterprises on all production factors: labour and capital, or at the level of households, on all their incomes. The third, more circumstantial argument, is that French companies suffer from a deterioration of their competitiveness, that France cannot devalue, so, reducing labour costs via a sharp reduction of employers contributions would be welcome. But another resource should be given to the social protection system.

[4] *Contribution Sociale de Solidarité des Sociétés*, a tax on gross sales of larger firms to finance non-employees pensions.

France is the OECD country with the highest social security contributions. This is explained by the importance of the French social protection system. The French worker does not have to pay to a private insurance company for his retirement and his health. He receives relatively generous family and unemployment benefits. His net wage may be lower (which compensates for the additional wage costs induced by social security contributions). Since 1984, because of exemptions, the share of employers' social contributions in value added has decreased quite significantly, from 19.8% in 1984 to 15.8% in 2007 (see chart 1) so that one can hardly blame them for being responsible of the recent loss of competitiveness of the French economy.

Chart 1. Employers' social contributions share of in companies' value added (in percentage points)



At the median wage level, social contributions rates are 44% for employers and 21.7% for employees. France has the particularity to collect social security contributions without ceiling and to reduce payroll taxes for low-wage earners. Wages below 1.6 times the SMIC (the *minimum wage*) are benefiting from reductions in employers' contributions: 26 points at the SMIC level. Low-wage earners receive the RSA (*revenu de solidarité active*) or the PPE (*prime pour l'emploi*). This system is highly progressive and difficult to reform without reducing its redistributive character.

The reform should clearly distinguish the contributions that open related wage-earning rights (pensions, unemployment benefits, and sickness replacement benefits). These contributions must remain proportional to wages if we want to keep wage-related benefits. It is not possible to finance by a general tax higher benefits for those who received higher wages. These contributions represent 38.5 points. They should not be included in the compulsory tax rate which should be lowered by 15.5 points, from 46 to about 30.5 points. Any future increase in these benefits should be financed by the rise of employees' contributions so that the social choice – salaries contribution/pensions level/retirement – would be transparent and would not weigh on competitiveness. Universal or solidarity benefits (health, family) should be funded by taxes. Any future increases in health benefits must be financed by a tax on all households'

income. There also, this will not affect firms' competitiveness. However, firms benefit strongly from the existence of health and family benefits (for instance, of child care benefits), so it is not illegitimate that they contribute.

Currently, employees' social contributions exclusively finance social insurance benefits. It would be inappropriate to reduce them and to finance insurance benefits by general taxation. The project of a reduction of employees' contributions for low wages (announced by Francois Hollande on March 31, 2014) has no economic logic (as unemployment and unions regimes are in deficit and would complicate any more the wage bill.

The underlying problem is therefore: what to do with current employers' social contributions for health and family (17.45 points). Five projects are on the table. The first two (CSVA or ecological taxation) would not improve firms' competitiveness, but could boost employment by a substitution effect. The third (increase of the CSG offset by an increase in gross wages) could be a social clarification, without economic impact. The last two (CSG rise without compensation, VAT rise) suppose a decrease in households incomes to improve competitiveness or profitability of French companies.

Exonerations of employers' social contributions.

As a comprehensive reform has not been undertaken, the solution adopted since 1993 has been the extension of social security contributions' exemptions. In 2013, 54 devices are in place for a total cost of 28 billion euros (table 9). It is now the major tool of the French employment policy. These exemptions are based on the theory that labour costs explain the level of unemployment, particularly at the minimum wage level; so it is necessary to reduce the weight of social protection or to make it financed by other factors than labour. In the opposite direction, they undermine the financing of social protection for which own resources decrease; they tend to socially devalue labour (see Friot, 1999).

Table 9 Exemptions from social security contributions in 2013 (billion euros)

	Compensated	Non-compensated
Low wages	20 700	
Overtime	550	
Specific workers	1 200	1 700
Geographical areas	1 500	
Jobs at home	150	1 700
Specific sectors	700	
Total	24 800	3 400

Source: PLFSS (2014).

Firms benefit from a reduction of their social security contribution, by 26 percentage points (on 44 points) for workers paid at the SMIC (minimum wage), which decreases linearly up to 1.6 times the SMIC. This reduces by 18.6% the cost of the minimum wage. In addition, workers at minimum wage received the PPE, 7.7% of the net SMIC, to widen the gap between the minimum wage and the RSA (the minimum income). The *ex ante* cost of these reductions in social security contributions was about 20.7 billion euro in 2013. Their impact remains controversial (see Sterdyniak, 2007); the French labour ministry estimates it about 800,000 additional jobs (26 000 euros by job, which is high as the cost for a firm of a worker paid at

the SMIC level, without social contribution reduction is 24 540 euro). The *ex-post* cost would be lower, 10 billion euro, since these jobs induce 11 billion public revenues in social contributions and in lower unemployment benefits. According to Heyer and Plane (2013), the impact would be 500,000 additional jobs (110,000 created by capital-labour substitution, 230,000 by basis effect, 80 by demand effect and 80 by competitiveness effect). The effect is reduced to 330,000 (250,000) jobs if the measure is financed *ex post* by increases in taxes (in public expenditure).

Targeting social contributions on low wages has three justifications. The first one is that the minimum wage is too high in France and is responsible for the unskilled workers' high unemployment while graduate workers are close to full employment. But, in a mass unemployment situation, companies have the choice and may prefer to hire over-qualified employees, who, themselves, are resigned to apply for jobs below their qualifications. Despite the relatively high level SMIC, the gap between graduates and unskilled people unemployment rates is not higher in France than in other countries (table 10); the gap did not diminish in France more than in other countries (table 11). The second one is a pure basis effect: it is less costly to reduce labour cost for low wages than for higher wages. The third on is that labour demand elasticity to labour costs would be higher for low than for higher wages. Thus, the study by Heyer and Plane (2013) make the assumption that this elasticity ranges from 0.9 at the minimum wage to 0.2 for higher wages. According to Brunel and *al*. (2013) this elasticity is 0.75 at the SMIC level and 0.25 above 1.6 SMIC. As the elasticity is below 1, this policy appears more costly public jobs creation (see, Sterdyniak, 2013). In a recent work, Cahuc and Carcillo (2014) find an elasticity of 2 at the SMIC level, but they generalise a very specific episode, when during the 2008-09 crisis, a temporary social contribution cut allowed small firms to reduce workers layoffs.

Table 10. Unemployment rate by level of education (2011)

	Primary	Tertiary	Gap
Spain	26.4	11.6	14.8
Germany	13.9	2.4	11.5
United States	16.2	4.9	11.3
Belgium	12.1	3.4	8.7
France	12.9	4.9	8.0
OECD	12.6	4.8	7.8
Finland	11.3	4.0	7.3
United Kingdom	11.0	3.9	7.1
Sweden	10.8	3.8	7.0
Austria	7.1	2.3	4.8
Italy	9.4	5.2	4.2
Denmark	8.9	5.0	3.9
Netherlands	5.4	2.8	2.6

Source: OECD (2013): *Employment Outlook*.

This strategy has three drawbacks: it benefits most to services sector than to industry (where wages are higher); it encourages firms to create a specific category of jobs at the minimum wage, without any prospect of promotion, often by using outsourcing for some tasks; it

encourages firms with lower wages at the expense of those who make efforts to promote their employees.

A single worker paid at the SMIC costs 1 602 euros by month to his firm (for a 35 hour working week); he has to contribute for 467 euros to unemployment and retirement schemes, representing deferred wages; he receives a net transfer of 83 euros (employment premium + housing benefit - generalised social contribution (CSG) – income tax- health and family contribution); his net income is 1 212 euros. So, he does not support any tax burden and receives a health insurance for free. His standard of living is totally disconnected from his labour costs.

Table 11. Difference between the employment rate of higher-graduates and non-graduates

	1994	2011	Evolution
Germany	34.4	31.4	-3.0
United States	34.0	28.9	-5.1
Belgium	34.0	36.5	+ 2.5
Austria	32.8	30.3	-2.5
Italy	32.7	28.2	-4.5
Netherlands	30.6	25.3	-5.3
United Kingdom	30.3	27.3	-3.0
France	29.4	28.1	-1.3
Spain	28.5	26.8	-1.7
Denmark	28.4	23.2	-5.2
Finland	28.3	28.8	+ 0.5
Sweden	20.5	23.5	+ 3.0

Source: OECD (1996, 2013): *Employment Outlook.*

But these exemptions weaken the social security financing. Employers' social contributions, *PPE* and *RSA-activité* create a category of low-paid employees, for which wage increases are very costly for the employer and unprofitable for the employee. A 10% increase in the wage of a worker paid at the minimum wage (for 136 euros) cost 226 euros to the firm and brings in 25 euros to the employee. Companies are encouraged to create specific unskilled jobs, without carrier prospects, trapped in a low-wage situation. These jobs do not match the increasing qualification of young people. In the future, France will have to change its employment strategy. Conversely, the persistence of a large mass of unskilled workers and the social denial to lower the standard of living of the working poor, do not allow now to take the risk to remove or to reduce these schemes.

Some economists or politicians have proposed to remove social contributions for firms with more than 20 employees or to condition them to wage negotiations or to the reduction of the share of short-term labour contracts or to men/women wages equality or to ecological targets. The risk is to build a labyrinthine system that would in fact eliminate such exemptions, which would encourage firms to dramatically reduce low-wage jobs.

The existing contributions reduction at the minimum wage level (26 points) is larger than health and family employers' contributions (17.45 points), so it complicates and paralyzes a great reform. It would be difficult to reform employers' contributions without increasing the relative cost of unskilled labour (see below).

In 2014, during the debate on the CICE and on the Responsibility Pact (see below), two views were opposed: the *industrialist* economists argued for a global decrease in employers' contributions; the labour economists for the pursuit of low wages targeting. Finally, the CICE reduces contributions on wages below 2.5 times the SMIC (for 20 billion euros); the Responsibility Pact reduces low wages contributions by 5 billion and social contributions on wages below 3.5 SMIC for another 5 billion. The French contribution system is more and more complicated. The simplest measure would have been the abolition of employers' contributions for family benefits, but firms with lower wages were losing.

Social contributions on value added

The reduction in employers' social contributions could be offset by an increase in taxes on profits. This reform renounces to competitiveness gains, but expects employment effects by capital/labour substitution. The removal of all employers contributions, family and health (17.45 points or 98 billion euros, net of low wages social contribution exemptions) would require the creation of a Social Contribution on value added[5] of 8.3%: EUR 29 billion would weigh on capital rather than on labour (table 12).

Table 12. Changes in the social contributions basis (€ billion, figures for 2011)

	Before reform	After reform
Gross wages	678	678
Employers' social contributions	244	156
CSAV on wages		69
EBITDA	352	352
CSAV on EBITDA		29
VA (factor prices)	1,274	1,274

This measure would not affect company profitability in the short term, the increased taxation of capital would be offset by lower taxation of labour; the total firms' burden would be unaffected. In the medium term, companies should react by using more labour and less capital (including the overall cost would be higher but profit rate unchanged after-tax). The overall cost, calculated by adding labour and capital costs, would not change. *A priori*, prices should not increase.

On the other hand, the reform would have five consequences:

-The relative cost of work relatively to capital would be reduced which would encourage firms to use less machines and more labour.

-The absolute cost of work would be reduced, which would labour-intensive activities.

-Households would be encouraged to turn to products with a high labour content at the expense of the products with strong content capital.

-A transfer would be made highly from capital-intensive firms towards companies using work-intensive ones. The social protection financing would be shared more fairly between branches, while it currently weighs heavily on branches with high payroll / added value ratio.

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[5]-It should be a "real value added ", without investment or capital depreciation deductibility.

-At the macroeconomic level, the increase in consumption (induced by the increase in employment) would offset the decline in investment (induced by the reduction of capital requirement).

Theoretically, the debates of 1987-1988 as those of 2006-2007 showed that the measure made sense when considering that France is permanently in a Keynesian unemployment situation. In a model where the long-term unemployment rate is equal to an equilibrium rate, this measure cannot, by definition, create jobs and translates into less capital and less production.

Let us suppose that the elasticity of substitution between capital and labour is σ; w, the real wage rate, π the rate of profit (after tax), *t* the rate of contributions employers, θ the rate of the tax EBITDA, *n*, the employment, *k* the capital.

The production constraint is written: $y = \alpha n + (1-\alpha)k$

The choice of the production technique gives: $k = n + \sigma(w + t - \pi - \theta)$

The constraint of exhaustion of the product is: $y = \alpha(w + t + n) + (1-\alpha)(\pi + \theta + k)$

The stability of the resources of the social security constraint is: $0 = \alpha t + (1-\alpha)\theta$

We drop the employers' social contributions while taxing in compensation the profit; the rate of profit, determined by the world capital market, remaining fixed.

In a classical situation, the employment is an increasing function of the real wage: $n = n_{\circ} + lw$.

But the measure does not increase real wages. Employment does not vary. *Ex-post*, capital decreases by $k = \alpha\sigma t/(1-\alpha)$, the production by $y = -\sigma t$.

In a Keynesian situation, the real wage is fixed, production is determined by demand, employment increases of $n = -\sigma t$; the capital decreases by $k = \alpha\sigma t/(1-\alpha)$. Production is fixed, but labour/capital substitution increases employment.

The reform decreased by 11.2% the labour/capital relative cost. If the capital-labour substitution elasticity is unitary, the reform should raise employment by 3.15% (600,000 jobs). Since the elasticity of substitution was supposed to be 0.45, simulations performed with OFCE's quarterly model of the French economy (see Timbeau et *al.*, 2007) resulted in a lower number of jobs created (227,000 for 17.45 points).

According to some economists, this transfer would undermine the capacity of firms to innovate. However, modernization by substituting capital for labour is harmful in a mass unemployment situation. Firms can be innovative in using extremely skilled workers rather than capital.

The measure would be detrimental to high profit firms and will encourage low or zero profit ones. This can be considered dangerous for economic dynamism. In the opposite direction, some companies may have high profits because they benefit from rents; others may be in trouble because they use many workers and are challenged by low-wage countries production: it is normal to help them.

A transition question however remains: the reform may hurt existing firms to encourage new ones, which do not already exist. The problem is mitigated if favoured companies exist and the reform aims to prevent their disappearance.

The measure would provide a competitiveness advantage for labour-intensive sectors and a disadvantage for capital intensive sectors. The risk is that the first effect plays little (due to differences in labour costs between France and emerging countries) and that the latter plays much (due to competition with other European countries).

Studies conducted in 2007 showed that the transfer would be neutral for innovative companies (those that benefit from the research tax credit). It would hurt the energy sector, financial activities, real estate and agri-food sector. The winners sectors would be: services to firms, equipment goods construction, automotive. Large companies would be losing; small companies would win. The winners represent 69% of companies, 50% of value added, 54% of exports.

In 2007, an argument against this reform was that it would require the introduction of a new tax with a new basis, value added, which would have a cost in terms of additional declaration for firms. But since then, the creation of CVAE (*Contribution sur la valeur ajoutée des entreprises*) to partly replace the local business tax strongly makes the proposal more credible: it only requires to increase the tax rate from 1.5% to 9.8%, from 12 to 110 billion. The 2007 debate had rejected this measure as being too risky; also judging that slowing down capital/labour substitution was not going in the right direction.

Ecological taxation

The need to save energy and to reduce greenhouse gas emissions makes it necessary to introduce environmental taxes. In a mass unemployment situation, one can think that any increase in environmental taxation must be offset by a decrease in employers' social contributions. Globally taxes paid by firms do not increase, so *a priori* their prices; firms' competitiveness is not affected; but they are encouraged to use more labour and pollute less. This is the 'double dividend logic': environmental taxes would have the double virtue of reducing the use of polluting products and of allowing, thanks to collected revenues, to reduce the labour cost. In 2011, in France, environmental taxation accounted for only 1.8% of GDP compared to 2.3% for the euro area (but 4% for the Denmark and the Netherlands).

The combination of an environmental tax and of employers' social contributions cuts can lead, with a cost zero cost for public finances, to a reduction of pollution and to a decline in unemployment. This is all the more likely that the country initially has a strong unemployment level. On the other hand, environmental tax revenues are important when demand for taxed goods is not very price-elastic. There is a contradiction between the ecological objective (taxation can be so well-targeted and heavy than its *ex-post* revenue is low) and the revenue objective: the tax must be profitable to allow a strong reduction of employers' social contributions. The risk in terms of social security resources is to lose a relatively well-ensured basis against a basis dedicated to decrease. This would be the case for example if we replaced employers' contributions by a deterrent tax on diesel. For ecological taxation, two strategies are possible:

1. The rise of the eco-tax may be offset by a grant for production (or consumption) of each type of product (the *bonus-malus* principle); green products will be subsidized and polluting products taxed. It can also be offset by a subsidy to each producer (or consumer) based on its past consumption of polluting products. This strategy has the advantage of not directly harming polluting sectors; but it is difficult to implement: it assumes a fine knowledge of the production process. How to treat new firms? How to integrate permanently the technical progress? If companies are encouraged to modify their production techniques, households are not discouraged from consume the products whose production is a source of pollution. Households can choose cleaner cars (as opposed to abandon using cars).

2. The tax can be offset by a reduction in social security contributions. This hits directly polluting firms whose average production cost increases; the increase in their price diverts

households to use polluting products. This strategy does not request microeconomic analysis to be implemented; it will promote labour-intensive sectors, with low energy utilisation, but industrial sectors will be especially hit.

This reform would significantly change the cost structure of firms, which would require costly restructuring: some activities would not be profitable anymore and should therefore be stopped; others would become profitable, but would require new investments. It is not certain to generate considerable financial resources.

In France, the failure of the climate-energy tax in 2009 may induce a pessimistic feeling: to make the tax acceptable, part of its revenues must be used to help poorest households, victims of higher fuel and heating prices, and to subsidize energy saving in collective transportation or in construction. So, prices will likely increase and competitiveness will deteriorate. We should create a price index excluding energy taxation and ask households (excluding the poorest) to accept a fall in their income to finance energy saving and support to the poorest.

In all cases, such a reform should be coordinated at the European, or even worldwide level to prevent that polluting sectors go away to produce in poor or emerging countries or in developed countries less concerned with ecological objectives. But poor and emerging countries are prepared to accept a worldwide agreement only if it is asymmetrical: a portion of the tax revenues in the developed countries should be used to help poor countries to make the necessary efforts (adoption of cleaner production technologies). So the transferred revenues cannot be used to reduce social contributions.

Some have proposed to offset a Carbon tax by taxing products imported from countries which do not apply the tax. For example, if European countries impose to their firms a 100 euro fee per emitted tonne of CO_2, they will apply the same tax to imported products, subtracted eventually from the already paid tax. This would be justified before the WTO by the argument of the ecological urgency and by the principle of the similar treatment of national and foreign producer. But, this project seems unrealistic: the amount of emitted CO_2 would be impossible to calculate, product-by-product. The issue of competitiveness on external markets is not solved (unless we accept to reimburse the Carbon tax for export). Finally, will the WTO accept this project? Why not apply the same problematic to social contributions, by protecting our social system by taxing products from countries that do not have enough social protection?

The most promising strategy for our competitiveness would be an environmental tax, which revenues would be used to reduce social employers' social contributions and which would allow us to tax imports from countries that do not tax. It would thus be a triple dividend. But will the WTO be dupe?

Here again, the measure is effective in a Keynesian unemployment situation. With the same model, we assume that the elasticity of substitution between labour and energy is σ ; the real wage rate is w, the price of the energy is π , *t* is the rate of contributions employers, θ the rate of the tax on energy, *n*, employment, *e* energy consumption.

The production constraint is: $y = \alpha n + (1-\alpha)e$

The choice of the production technique gives: $e = n + \sigma(w + t - \pi - \theta)$

The constraint of exhaustion of the product is: $y = \alpha(w + t + n) + (1-\alpha)(\pi + \theta + e)$

The stability of social security resources constraint is: $0 = \alpha t + (1-\alpha)\theta$

We drop the contributions employers by increasing compensation tax on energy, the objective being to obtain a decrease η of energy consumption.

In a Keynesian situation, the real wage is fixed, output is demand-determined, and the energy tax must be $\theta = \eta / a$: employment increases by $n = \alpha\eta/(1-\alpha)$. We have a substitution labour/energy at constant production.

In a classical situation, employment is an increasing function of the real wage: $n = n_\circ + lw$. But the measure does not increase real wages. Employment does not vary. *Ex-post*, the production decreased by $y = -(1-\alpha)\eta$ for a fee $\theta = \eta / \alpha\sigma$. The ecological target is obtained, but not the employment one.

An increase in the CSG

The more coherent reform would be to consider that family and health benefits only concern households and should be financed by them. This funding allows for the transparency of social choice: family benefits would appear as a transfer between households, expenditure on health as a choice of households, which does not affect firms. The rise of the CSG, the *Contribution sociale généralisée*, a uniform rat tax on all households' income, would provide a resource well defined to social security.

We forget some traditional arguments: firms need a healthy workforce (which justifies that they contribute to health expenditure), which renews itself (which justifies that they contribute to family expenses), which is available (which justifies that they contribute to the costs of child care).

This reform could be conducted by four modes:

1) With fixed gross wages, it would cause a huge transfer from households to companies. Companies would gain (households would lose) 17.45% of gross payroll, 5.5% of GDP. It is the reform advocated by the Montaigne Institute (2012), on a softer level, which corresponds to the competitiveness shock.

2) Employees could benefit from a compensatory 17.45% increase in their gross wage. The CSG rate could increase from 8% to 22.3% on wages (+ 14.3 points).

3) Alternatively, after the wage increase, the CSG could be raised by 10.5 percentage points on all incomes. Wage earners would thus gain 4.8% of their incomes; retirees would lose 11.3% (their CSG rate would increase from 7.1 to 17.6%); the capital-income earners would lose 12.4% (Their CSG rate would increase from 15.5% to 26%).

4) We could introduce compensatory measures for pensioners or for income earners, and thus achieve neutrality.

In the second case, the measure would be neutral; it would be a simple accounting operation, with no competitiveness effect. Contrary to Piketty's argument, it would not impact the cost of wage increases or of new hires. However, low wages firms would lose in the operation: they would bear an increase of 17.45% of the SMIC, but will not benefit of the health and family social contributions suppression, as their exemptions from contributions (26 points today) are superior to these contributions. Compensatory measures should be introduced for them.

In the third case, the measure would be neutral for the firms; it would allow gains for employees at the expense of pensioners and capital-income earners. This poses two problems: is it legitimate to strongly degrade the relative situation of pensioners (which will already

deteriorate due to the impact of pension reforms)? As we will see, the taxation of capital income is already as heavy as the taxation of labour income, so that the rise of the CSG would request compensatory measures (a decrease of the current specific Social Contribution of capital income). This could then lead to the fourth case: a totally neutral measure.

Social VAT

To finance social protection by a so-called social VAT has been proposed by many entrepreneurs and politicians. This was decided by Nicolas Sarkozy at the end of his presidency, removed by François Holland upon his arrival to Presidency, and then implemented in 2014. But contrary what its supporters think, the social VAT is not a miracle reform which would make pay social protection by machines or by foreign producers. It could have a positive impact on employment if it would result in a reduction of employees and retired people real income.

In a closed economy. Should Social VAT encourage firms to use more labour? Let us suppose that some points of employers' social contributions are replaced by VAT points. In the best case, firms will reflect fully the contributions in their production prices, so consumer prices will remain stable. However, VAT and employers' social contributions have *roughly* the same base (payroll), as the VAT does not weigh on investment, so on capital (see Sterdyniak and Villa, 1984 and 1998). Therefore, VAT, as employers' social contributions, only weighs on labour. The measure has no impact on the relative cost capital/labour: labour costs are reduced but the price of capital goods, which incorporates no VAT, is also reduced. The measure does not encourage firms to use more work and less capital. It does not change the relative situation of capital-intensive or labour-intensive branches: the labour-intensive branches support both heavy social contributions and heavy VAT, as they benefit little from the deductibility of VAT on investment. Capital-intensive enterprises bear little employers' social contributions (as they have few employees) and VAT (since they benefit from the refund of the VAT on their investment). Not only globally, but also for each sectors, the decline in employers contributions is offset by the increase in VAT. There is no sectorial effect. As the relative prices of goods do not change, consumers have no reason to change their structures of expenditure.

To see it more precisely, note p, consumer, q price prices production, w the wage, π the rate of profit, δ the rate of depreciation of capital, t the rate of contributions employers and θ the VAT rate. Suppose that the company produce 1 unit of goods with 1 unit of work and k unit of capital. Its production price is: $p=(1+t)w+k(\pi+\delta)p$.The consumer price is: $q=(1+\theta)(1+t)w+k(\pi+\delta)q$

A reform that reduces the rate of employers' social contributions and increases VAT rate leaving fixed the product $(1+\theta)(1+t)$ has no effect on the relative cost capital/labour, or on the prices of the various branches (characterized by different k). It is therefore an illusion if its purpose is to promote labour-intensive sectors or encourage companies to use more labour.

The equivalence between VAT and contributions social employers is however true only at first order, this for several reasons:

- VAT focuses on the firm results; the social contributions on its initial expenditure. With the reform, public finances shares more gains and losses with the firms. The volatility of profits is reduced, which can be conducive to investment. But in this case, the ideal would be not to increase VAT, but taxing the EBITDA or better the profit (table 13), with the drawback to

increase the volatility of public finances revenues. In reverse, if entrepreneurs like risk, they prefer to be taxed on the factors of production than on profits.

- Social contributions focus on added value less profits; the VAT on added value less investment. The measure favours dynamic companies which invest at the expense of those that pay dividends, which may be favourable to growth.

- The measure causes a decrease in the capital price relatively at the price of consumption. This decline hits the owners of the capital in place. The rate of profit does not diminish, the profitability of the new capital is unaffected, but reduces the purchasing power of consumer goods for the dividends paid on the capital in place. The measure is thus a punctual tax on installed capital.

Table 13. The choice of the basis of firm's taxation

Plate	Economic effect	Volatility of the resource	Impact on firms
Payroll	reduces employment		Increases the risk
AV	reduces employment		
EBITDA	reduces	strong	Reduces the risk
Profit	Reduces investment	Very strong	Greatly reduces the risk

This reasoning shows nevertheless that it is questionable to consider that the VAT is paid by the consumer while employers' social contributions social are supported by firms or by workers.

In an open economy. To replace employers' social security contributions points by points of VAT provides competitiveness gains: the price of imported goods on the domestic market increases ; the price of domestic products sold on the domestic market remains theoretically fixed; the price of exports, exempt from VAT, decreases: it is a disguised devaluation. As devaluation, the measure has an inflationary impact. Suppose that one increases VAT rate by 5 percentage points while lowering payroll taxes by 6 percentage points. The aftermath of the reform, import prices rise by about 5%; the export prices are theoretically falling 5%. The consumer price increase of 1.25% (as imports represent 25% of the domestic market). The national economy has got competitiveness gains of 5%, but with a loss of 1.25% of the purchasing power of French residents. Two strategies are possible:

- To let indexation mechanisms plays, which involve automatically the increase of the minimum wages and pensions, and less automatically of wages. These increases will be reflected in the price, and then again in wages, until domestic prices have increased by 5%; competiveness gain was therefore only temporary. The inflationary risk is stronger if firms slowly reflected the decline of the labour costs while distributors immediately impact the strong increase in VA; the sharp rise in inflation in the first year, can challenge the current weakness of wage increase[6]. For 5 points of VAT, higher inflation would be in the order of 1.5 to 2% the first year.

[6] However, due to the existence of the euro, the rise in inflation in France would be that weakly reflected in interest rates, which would have the advantage of easing the burden of borrowers.

- To let prices increase and to block wages and social benefits. The competitiveness gains may be permanent. But it must be clearly announced that social VAT will lower the purchasing power of wages and pensions, which is hardly *social*. Social VAT is only a way to practice an internal devaluation.

Social VAT is therefore not a miracle tool that would provide gains of competitiveness without loss of purchasing power for wage earners and pensioners. Social VAT does not work at the expense of the capital income. For a given real income of workers and pensioners, VAT and contributions social employers have approximately the same macroeconomic impact. Social VAT certainly have some advantages: reduction of the volatility of the profit of the companies, increasing business dynamics and taxation, once for all, on accumulated capital. However, this is not a way to change the burden of financing social protection; it would continue to weigh on labour income.

The only tax reform that would provide gains of competitiveness without decrease of workers income would be to create specific duty on imports and use its revenue to reduce VAT (see Sterdyniak and Villa, 1998), but this is forbidden by the rules of the EU and of the WTO.

A competitiveness shock?

There were a debate in France: should we compensate the employers' social contribution reduction by an increase of the VAT or the CSG? According to Box 1, the two measures are approximately equivalent. The great issue is the reaction of enterprises between to maintain their prices to restore their margins, which will induce in a sharp drop in French households real income or to lower their prices to gain competitiveness. In the first case, the question is: will the revival of investment offset the decrease in consumption? In the second, will external trade gains offset the decrease in consumption? In the second case, the policy is uncooperative. Its impact is nil if all Euro area MS practice similar policies. Finally, in both cases, the relative cost of labour decline, which could have positive long-term effects.

The VAT increase is accompanied by prices increase. Theoretically, social benefits and minimum wage are indexed. They would therefore no suffer for any purchasing power loss. But the social security deficit will be increased. Employees would require wage increases to offset the rise of prices. These indexations would gradually reduce the competitiveness or margins gains. The measure therefore implies an agreement between social partners to blocking minimum wage, social benefits and wages. On the contrary, the victims of the rise of the CSG could not benefit from any indexation mechanisms and must accept the fall in their purchasing power. The CSG has, in addition, the advantage of being a resource assigned to social security, more guaranteed that VAT points.

Box 1. The equivalence between VAT and CSG

Let us suppose that GDP is 100 exports and imports 25. Wages (including social contributions) are 80; profits, 20. Firms' investment is 20 of which half is imported. Consumption is 80 (including 15 of imported products). In the short term, the wages and pensions are fixed.

(1) Employers' contributions are reduced by 5, CSG increased by 5. Firms maintain their prices and thus increase their profits. *Ex-post*, there is no gain competitiveness in the short term. Wages are worth 75 which mean a loss of 6.25% in purchasing power. The profits are worth 25. The relative wage cost decreases by 6.25%. With standard assumptions: propensity to consume wages: 0.8; to

invest profits: 0.4; multiplier: 1; elasticity of capital/labour substitution: 0.3. The GDP fell by 2% but employment is stable.

(2) Employers' contributions are reduced by 5, VAT increased by 5. French companies keep fixed their prices of production. *Ex-post*, there is no gain competitiveness. The consumer price increase of 6.25%. The purchasing power of wages declined from 80 to 75. The relative wage cost is reduced by 6.25% since prices are fixed. The macroeconomic impact is the same as in case 1.

(3) Employers' contributions are reduced by 5, CSG increased by 5. Companies fully reflected lower costs in their prices. The producer prices drop 5%; the consumer prices fell by 4%. The purchasing power of wages drops by 1%. The gains in competitiveness are 5%. The relative wage cost decreases by 3.75%.With export elasticity to relative prices at 1, 0.5 import elasticity at 0.5, GDP increases by1.25% and employment by 2.35%.

(4) Employers' contributions are reduced by 5, VAT increased by 5. Companies fully reflected lower costs in their prices. The producer prices drop by 5%; the consumer price increases by 1%. The purchasing power of wages decreases by 1%. The competitiveness gains are 5%. The relative wage cost decreases by 3.75%. The macroeconomic impact is the same as in case 3.

Should France undertake a competitiveness shock?

The philosophy of the shock is that households accept a brutal decline in their purchasing power to improve firms' profitability or competitiveness. French taxation would go in the direction of the standard European model. The reform raises five issues:

1. The Government should say clearly to the households that they must accept a reduction of their real income.

2. What commitments would take firms in terms of investment and employment in France in exchange of a measure that would greatly increase their profits? How to avoid that they increase their dividends or their investments abroad?

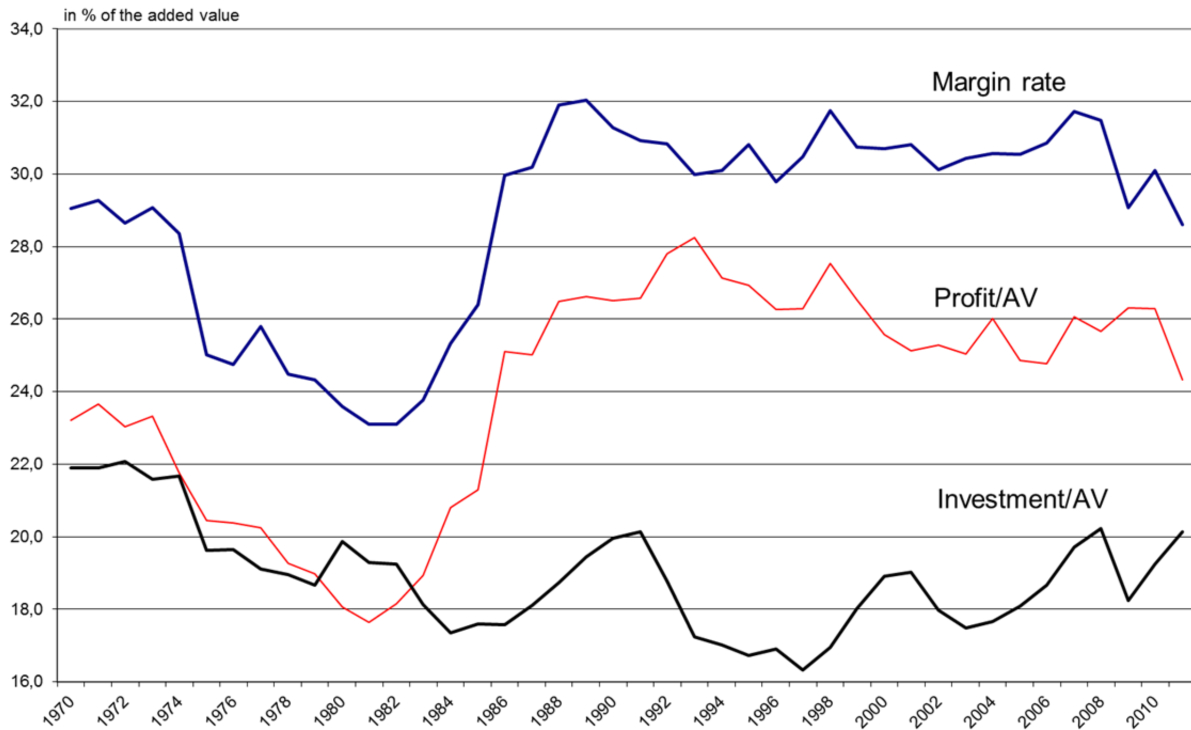
3. Should France engage a German-type strategy: to increase firms' competitiveness at the expense of households' real income knowing that this strategy is disastrous at the level of the euro area? Of course, this reform replaces the impossible devaluation in the euro area. But it undermines the European partners of France (which react by acting similarly) and does not guarantee competitiveness gains against countries outside the euro zone, which depend of the euro exchange rate. Successive internal devaluations do not replace a reform of the organisation of the economic policy of the euro area.

In Europe, the France is in an intermediate situation between the Northern countries that have made strong gains of competitiveness at the expense of the purchasing power of their populations and the Southern countries, which have experienced excessive wage increases. In 2000, the share of wages in added value was 66.8% in Germany, 66.9% in France, 65.5% in the Eurozone. In 2007, it had dropped to 61.2% in Germany (-5.6 points), 62.8% in the Eurozone (-2.7 points), 65.7% in France (-1.2 points). Should European workers fight by accepting the reduction of their share in the added value? In base 100 in 2000, the level of real wages in 2011 was 97.9 in Germany and 111.2 in France (an increase of 1% per year). Who is wrong?

4. The share of EBITDA in the societies added value was 29.6% in 1973. It fell to 23.1% in 1982, and then is straightened out to 30.2% in 1987 (Chart 2). It was at 30.8% in 2006, i.e. a satisfactory level. The decline since 2007 is explained by the fall of activity and by workforce retention. It was not caused by the increase of taxation or by excessive increases in wages. A measure that would reduce consumption (and therefore GDP) may induce in a further decline

of the share of the profits, which can only recover by a "growth shock". Similarly, the share of the profits (cash flow + net dividends + net interest payments) is returned to a satisfactory level. The problem is that in 1973, investment expenditure was of the order of the profits, while it is lower by 3-4 points now. Can we increase the profits share of without guarantee on investment?

Chart 2. Margin rate, profits rate and investment rate for French societies.



5. To use internal devaluation assumes that the France suffers essentially for a lack of price competitiveness. However, de-industrialization has other deeper causes. Firms prefer to grow in emerging countries ; scientific studies are neglected ; young people refuse industrial careers too risky and too poorly paid ; the France did not succeed, neither to protect its traditional industries, neither develop in innovative sectors ; its financial sector prefers the joys of speculation to the financing of production and innovation, etc. This would not be solved by devaluation. The France needs an industrial revival, which may be impulse by the poles of competitiveness, the research tax credit, the Ministry of Productive revival and which must be funded by the BPI, whose ability to act must be enlarged and intervention criteria specified.

Despite these doubts, the Government has decided in 2012 that firms will benefit for the CICE (*Credit d'Impôt pour la Compétitivité et l'Emploi*), a tax credit calculated as 6% of their gross salary, limited to remunerations below 2.5 times the minimum wage. This tax credit has a cost of 20 billion, which should be financed for 10 billion by further reductions of public spending, for 6.5 billion by the increase in VAT, for 3.5 billion by an increase of environmental taxation. In January 2014, the normal VAT rate increases for 19.6 to 20%; the intermediate rate for 7 to 10%. As, in the same time, firms benefit for the CICE, these

increases had no impact on inflation rate. The choice of a tax credit rather than a social contribution reduction makes the measure complicated and less visible for firms.

In 2014, the government decided that a Responsibility Pact will add 10 billion of employers' social contribution reduction. Some economists mobilized to obtain that these reductions are concentrated on the industrial sector (or, at least, benefit to all workers) to improve the industry competitiveness, to support upgrading firms' strategy, to help enterprises productive and innovative firms (who pay higher wages). But labour economists insist to pursue the targeting on low-wages. Finally, a complicate compromise was decided: 5 billion euros to reduce employers' family social contributions by 1.8 points on wages until to 3.5 SMIC, 5 billion to reduce employers' social security contributions on low-wage. In total, the measures taken would represent a decrease of 3.9% of wage costs; about 22% of the measure would benefit the industry. France adopts therefore the internal devaluation strategy.

According to estimates carried out by the OFCE, these measures will have virtually no effect on GDP (the effect on domestic demand offsetting the competitiveness effect); employment would increase by approximately 260 000 (a decrease of 0.9 point the unemployment rate), by substitution effect. It leads however to a system extremely complicated, where social security contributions would be progressive for the remuneration less than 1 to 1.6 times the SMIC, proportional then with a credit tax for compensation below 2.5 times the minimum wage and a reduction for compensation below 3.5 times the minimum wages. This is explained by the influence of the thesis: "we need to compensate for the high level of the minimum wage".

The CICE, then the responsibility Pact, do not engage a coherent reform of the financing of social protection since the Government intends to finance mainly the drop in the employers' social contributions by a decreased in public and social expenditures. But will it be possible to reduce them by 70 billion without calling into question the French social model?

Taxes on business

It is not easy to accurately calculate the weight of taxes on businesses because it is difficult to distinguish between taxation on firms, salaries and consumers. For a firm that must choose an establishment, all taxes matter, including the tax on the income of its management, but also public expenditure and social protection which the firm and its employees enjoy. Must indirect taxation be included in taxes on businesses? Not in principle, because it is passed on to consumers, but the impact may be only partial. Do we need to integrate the employers' social contributions? No, in principle because they weigh on wages in the long term, but the long term may be distant.

According to a somewhat arbitrary definition (CIT + tax on wages + property taxes + taxes on capital + local taxes), the weight of taxes on business was, in 2011, between 4 to 5 points of GDP, Sweden (7.5%), France (6.4%), and the Italy (6.1%) being above, Germany (2.2%) and Spain (2.5%) well below (table 14).

Table 14. Business tax in % of the GDP in 2011

	CIT	Taxes on wages	Other taxes	Total	Employers' social contribution
Germany	1.7	0	0.5	2.2	6.7
Austria	2.2	2.9	0.6	5.7	6.8
Belgium	2.9	0	1.1	4.0	8.7
Denmark	2.8	0.3	0.6	3.7	0.1
Spain	1.8	0	0.7	2.5	8.5
Finland	2.7	0	0.4	3.1	9.0
France	2.5	1.4	2.5	6.4	11.4
Ireland	2.5	0.2	0.8	3.5	3.4
Italy	2.7	0	3.4	6.1	9.2
Netherlands	2.1	0	1.3	3.3	5.1
RU	3.1	0	2.1	5.2	3.9
Sweden	3.2	4.4	0.9	7.5	7.5
Japan	3.4	0	2.3	5.7	5.4
United States	2.3	0	2.2	4.5	3.1

Table 15. Evolution of the nominal rate of the CIT

	1990	2010	2013
Austria	30	25	25
Germany	40.5 DB / 54.5NDP	30.2	30.2
Belgium	41	34 *.	34 *.
Denmark	40	25	25
Spain	35	30	30
Finland	44.5	26	24.5
France	42 DB/37 NDP	34.4	33.3/34.4/38.0/40.2
Greece	46/40 industry	40	26
Ireland	43/10 industry	12.5	12.5
Italy	46.4	31.4	27.5
Portugal	40.2	35.2	31.5
Netherlands	35	26.5	25.0
United Kingdom	34	28	23
Sweden	53	26.3	22
Hungary	50	19	19
Poland		19	19
Czech Republic		19.6	19
Japan		39.54	37.0
United States	38.65	39.2	39.1

* with a system of notional interest. DB: dividends; NDP: undistributed profits. Source: OECD, tax database.

If the Corporate Income Tax represents a small share of tax revenues, it is particularly felt by firms. Since twenty years, taking into account the globalisation and the Single Market, firms may arbitrate for their financial or productive locations, which has intensified the tax competition. Almost all EU MS dramatically reduced their CIT rate (table 15). However, the comparison is made difficult by the existence of a local business tax that may be based on the benefit (Germany), on the added value (Italy, France) and by significant differences in the assessment of the tax base (in particular depreciation rules). The France has a normal rate of 33.3% (and a reduced rate of 15% for very small firms. In addition, large companies have to pay a social contribution (an increase of 3.3%) and a temporary contribution (an increase of 10.7%). Finally, dividends are subject to a 3% contribution. These high rates do not bring higher revenue from the CIT (table 14).

At the European level, the current situation is unsatisfactory. Countries have different rules for calculation of tax bases. Transfers between parent-enterprises and subsidiaries are managed by a patchwork of bilateral agreements. Large firms practice tax optimization by choosing carefully the location of their headquarters, of their subsidiaries and of their financial operations. They used transfers prices, the inter-enterprises credits and royalties to locate their profits in low CIT-rates. The need to avoid a costly competition tax, the single market, the increase in the number of trans-European firms companies make it increasingly necessary to the organise the CIT at European level. But this faces the tax autonomy of the Member States. Ireland and the CEECs refuse any increase in their tax rate.

Since 2000, the Commission proposes to reform the corporate tax on a multinational basis. It suggests that the groups can choose to be taxed on a comprehensive tax base determined by a European rule. The profit of the group would be shared among the various States in which it operates, according to a non-manipulable allocation key (added-value, payroll, etc.); each State will impose at its national rate its share of the group profit. This would remove the profit transfers practices. However, it is difficult to give to some firms a choice between two systems of taxation business. It is difficult that the subsidiaries of a multinational company do tax declaration to the tax authorities of the parent. How would be ensured the consistency of its tax returns in the host country? Finally, this system is scarcely compatible with the strong disparity in national tax rates.

So, Europe should try to undertake the painful road to a negotiated convergence, which should have four phases:

- a strong homogenization of tax bases;
- a clear recognition of the principle of taxation at the source, so an agreement to the fight against unjustified transfers of profits to countries with low rates;
- the setting of a floor rate, which would depend on the level of development reached by the MS, for instance 20% for the new entrants, to 30% for the old. The minimum rate would be gradually increased with the economic convergence. MS which consider that they provide specific business benefits would be allowed to tax a higher rate, at their own risk;
- The MS in transition economies should be allowed to subsidize their firms, with a payroll basis, thereby avoiding the risk of transfers of profits in these countries. Subsidies to companies would also be allowed easier than now for aid to the poorest regions, for the sectors in difficulty, the aid for innovation and research, for the employment of certain categories of workers. Thus, countries could seek to attract companies that create jobs, innovate and businesses looking for tax optimization.

Many delicate issues remain: how to take account local taxation? Which, between MS and the Commission, would have the initiative of the temporary (for economic reasons) or structurally (to encourage R & D) tax relief measures?

At the same time European countries should be frontally addressing tax and regulatory heavens and first establish a comprehensible list of them; OECD countries should prohibit their banks, their financial institutions and their firms to locate their operations and to subsidiaries in these heavens. They should renegotiate tax treaties to limit them to countries that have minimum tax rates of on companies and households.

The French rate is now relatively high, even if it is offset by more favourable depreciation rules. VAT and social security contributions affect the labour costs; EBITDA taxation, the capital cost; the tax on corporations, the not borrowed capital costs. In a situation of mass unemployment, the objective must be to reduce taxation of labour rather than of capital. Also, one can justify that the France has chosen so far to focus its effort on the reduction of social contributions rather than on corporate income tax.

In this context, the reform of the local business tax is debatable. The "*taxe professionnelle*" was initially based on the payroll, the productive capital and the property. The removal of the labour base in 2003 turned it into a capital tax. The reform of 2010 decreased the taxation by 5 billion, but this reduction focuses on the capital base, thereby promoting the capital/labour substitution and capital-intensive firms. In reverse, the reform has the advantage of encouraging industry. It creates a Contribution on enterprises added-value (CVAE) that can increases in the future to replace employers social contributions social, to weigh more on capital and less on labour.

To discourage the distribution of dividends, the France introduced in 2013 an additional taxation on distributed profits (at the rate of 3%). In fact, this is debatable since distributed profits are taxed at the level of the shareholder by the Social contributions and the income tax while non-distributed profits escape of the taxation at the owner level and will be taxed, at best, when the shares will be sold, but can actually escape (see below).

Interest charges are deductible from the CIT, which does not hit the borrowed capital. This is consistent with the vision of the IS as a 'tax on shareholders', but this helps indebted companies to reduce the amount of their CIT. This encourages fictitious sub-capitalisation and allows risky financial packages as the LBO. In 2012, the France decided to introduce 25% of the net financial charges of the Firms in their CIT basis for the firms where these are higher than 3 million euros.

In 2013, the Government had proposed to introduce a new tax based on the EBITDA, which would increase, to replace a lot of small taxes. The advantage is the new tax would hit interest charges and transfers of royalties, to fight against fiscal optimisation. It also would also tax the capital depreciation, which can be considered as a drawback (by weighing on the industry or by discouraging investment) or as a quality (by discourage the capital/labour substitution). Before the opposition of the firms, the Government has abandoned this project.

Since 2011, entrepreneurs' organisation claim for a drastic reduction of their taxes. In early 2014, the French government organized des "*Assises de la taxation des entreprises*", firms have claimed a massive decline of the CIT rate (their objective was a rate of 25%), without expansion of the base. They requested the abolition of the C3S, of all taxes based on the payroll (transport tax, wage tax, apprenticeship tax, housing tax) and of many small taxes (who finances public operators, professional organisations or who have ecological or

behavioural objectives). But it is legitimate that firms contribute to the costs of transport of their employees; the payroll tax replaces VAT for the sectors which are not submitted to it; behavioural taxation is often justified. After the *Assises*, the Government announced the progressive abolition of the C3S (from 2015 to 2017), which will cost 5.8 billion, the removal of the surcharge of CIT in 2016 (for 2.3 billion) and the target to reduce the CIT rate from33.3% to 28% in 2020, all that representing 10 billion of reduction of the business taxation of enterprises by 2017.

In the recent past, the French strategy was to maintain a high level of CIT rate but to introduce fiscal expenditures to encourage companies to invest and to employ in France. France had followed developed a generous Research Tax Credit and the Tax Credit for competitiveness and employment. The tax system was heavy, with many behavioural taxes. Now, the new strategy seems to be decrease the CIT nominal rate to fully participate to the European tax competition.

Taxes on households

In the broad sense, direct taxation of households represented 15.3% of GDP in 2011. It includes the CSG (5% of GDP), the non-contributive employers' social contributions (5%), the income tax (2.3%), the residential tax (1.1%), the taxes on property (0.7%), the taxes on succession and donation (0.4%), the wealth tax (ISF, 0.2%), the tax on transfer (0.2%).

Tax on income and wealth tax (ISF) are the only progressive taxes, the only ones who take in account all household incomes and characteristics. In France, their weight is low: it is normal that they are, in themselves, strongly progressive. The French particularity is the coexistence of a tax on income, very concentrated but with a small weight, of a proportional CSG (*Contribution social generalisé*), and of progressive employers social contributions, without any ceiling and with exemption on low wages. In addition, the poorest families are helped by the PPE (the *Prime pour l'emploi*), the RSA (*Revenu de Solidarité Active*) and housing allowances. By taking in account all its components, the French is strongly redistributive (table 4 and table 16), so that it will be difficult to improve it, but this redistributivness is obtained in a complicated way.

Table 16. Taxation and redistribution, family two children, in euros per month, 2013

	SMIC	4 SMIC	10 SMIC
Gross wages (1)	1430	5720	14 302
Employers contributions health-family (2)	297	1189	2 975
Contributive employers contributions (3)	330	1318	3318
Contributive employees contributions (4)	197	789	1836
Low-wage exemption (5)	-372		
CSG (6)	112	450	1 124
RSA/housing benefit/family benefit (7)	371/280/169	129	129
Income tax (8)	0	235	1 846
VAT (9)	327	656	1 284
Tax-benefits * (10)	-476	2401	7100
Net tax rates **(11)	-41,1%	39.2%	46.0%

Source: author calculations by the author. * (10) = (2) + (6) + (8) + (9)-(5)-(7); ** (11) = (10) / ((1) + (2)-(4)-(5)

The tax treatment of families

The French system of taxation and benefit is based on family. The Society recognizes the right of persons to marry (or to be engaged in a PACS, a solidarity civil pact), to found a family, to pool their resources. It evaluates the living standard of a family by dividing its overall resources by a number of tax part (the family quotient, which approximates the number of consumption units, such as estimated by OECD or by INSEE). This system ensures the family horizontal equity: two families of different composition, but with the same living standard support the same tax rate. Similarly, the RSA provides approximately the same living standard to the poorest families, regardless of their composition.

So, the French taxation system included the conjugal quotient (QC), which is part of the family quotient (QF). Some economist (such as LPS, 2011) accuse the QC to treat the wage of the women as an extra income; Nothing in the legislation supports this point of view, especially as the quotient conjugal benefits to couples of the same sex united by a PACS. They claim that the QC subsidized couples of unequal income, but the QC as the QF are based on the view of that the family members are equally pooling all their resources. We think that this view is closer to the reality that the view that each parent keeps for him his own salary while children live only with social benefits, a practice who could justify the individualization of the income tax. Our solidarity view is also normative: a parent must ensure to its children the same standard of living as its own; this based child maintenance (after a divorce). A single person who has an income of 5,000 euros per month has not the standard as a married person with the same income, with three young children, whose spouse is not working temporarily: nothing can justify that their tax should be the same. To refuse the QF principle would also not allow social policy to assess the living standard of families for the RSA, for housing allowances, etc...

Questioning the family quotient would violate the principle who wants that: "each citizen contributes to public expenditure according to his contributory capacities", unless it was enacted that married persons are not pooling their resources and that parents have no duty of care towards their children. The children would be expected to live from family benefits: this would require a substantial increase in family benefit, at 35% of the median income (580 euro per child), or, at least, 350 euros (35% of the poverty threshold) (Sterdyniak, 2011), when the current family benefit per child is 0 (for a family with one child), 35 euros (two children), 100 (three children).

The QC system does not prevent the France to have a relatively high rate of women activity (table 17). To reduce the marginal rate of taxation of women would need to overtax mono-actives families who are generally poorer. To deny to the active spouse to take in account the charge of its inactive spouse inactive in its tax income would require giving to the inactive spouse a right to the RSA, regardless of his spouse's income. But, in this case, the marginal tax rate of an inactive spouse, who take a job, would be 38% (the rate of withdrawal of the RSA), the same level than the current maximum rates of the income tax, 36.9% (90% * 41%) or 40,5 (90*45%). If the joint taxation of spouses increases the rate of marginal tax of certain married women whose salary is much lower than their husband' salary, the QF plays in the opposite direction. An individualized system, which would not take account the children, with an inactive spouse tax credit, will not lead necessarily *ex post* to lower marginal tax rates (see the opposite view in OECD, 2013). An individualized taxation system will be necessarily less satisfactory from the redistributive perspective that a family-based system as families with

children, mono-actives families, families where the income of the spouses are unequal, would be overtaxed.

Table 17. Participation rate of persons 25-55 years in 2008 in %

	Men	Women	Gap	Gap in full-time equivalent	Fertility rate
Finland	91.2	85.9	5.3	8.1	1.75
Sweden	93.1	87.5	5.6	10.4	1.75
Denmark	93.4	86.3	7.1	11.4	1.75
France	94.5	83.2	11.3	18.2	2.0
Austria	93.0	81.7	11.3	20.9	1.4
United States	90.5	75.8	14.7	19.7	2.1
Germany	92.9	80.5	12.4	21.1	1.4
United Kingdom	91.7	78.3	13.4	23.5	1.65
Belgium	92.2	78.7	13.5	24.0	1.65
Spain	92.6	74.7	27.9	24.0	1.3
Ireland	91.6	71.9	19.7	28.8	1.85
Netherlands	93.8	81.6	12.2	29.0	1.65
Italy	91.0	65.2	25.8	32.9	1.3
Japan	96.3	70.4	24.9	32.9	1.2

Source: OECD, Active Population Statistics (2010)

The QF ensured a rather satisfactory tax treatment to families with children. The first and the second child accounts for a half tax part. In fact, the QF has a ceiling. In the past, the maximum tax reduction for a child was 2400 euro, which corresponded approximately to the exemption of 35% of the median income ((580-30) * 12 * 41) = 2700 euro) and therefore was not too high. The Ayrault government decreases the ceiling down to 1500 euros, without any specific justification. On the other hand, the additional half part from the third child (and beyond) is tax expenditure, a tax benefit to large families that could be called into question (see below).

The concept of income

Two taxpayers with the same income should pay the same tax. Some economists claim that labour income, costly in time and effort should be less taxed (but should we then overtax the pensioners and the unemployed?). Others claims that capital income should not be taxed, since it come from the savings of income that has already be taxed (or from capital which have paid succession right), but it is the new revenues of the current period which are taxed. Also, we advocate a basic principle: everyone must contribute to public expenditure according to his contributory capacities, so according to his global income. We will compare the taxation of capital and labour income using an economic definition of revenue and taxes (which does not include contributive social contributions, but which include non-contributive employees and employers social contribution). We compare the maximum tax rate, those who apply to the highest incomes.

Let us first consider the wages imposition. With regard to the income tax, the nominal tax rate is now 41% above 71,000 euros per tax share, 45% beyond 150,000 euros, 48% above 250,000 euros, from 49% above 1 million. However, we must add the CSG-CRDS and the non-contributive social contributions. On the other hand, the contributive contributions are

deferred wages and should not be included in the tax rate. Thus, the marginal tax rate of 45% corresponds to an economic rate of 60%. These rates are high compared to others countries, some of which have a higher income tax maximum rate but have a ceiling on social security contributions (table 18). Only, Belgium and Sweden have a higher maximum tax rate. At the level of the minimum wage, using the same conventions, taking into account the exemptions for employers' social security contributions, the *Prime pour l'emploi* and housing allowance, the rate of taxation of a single person is negative by 6.8%.

In 2013, the French government has introduced a tax of 50% at the firm level, on the part of wage which exceeds 1 million euro. This was justified by the will to fight against the increases of wage inequality in enterprises, to fight against exorbitant salaries for some managers and financial traders. However, this tax is established only for two years.

Table 18. Maximum tax rate of labour income

	Income tax	Social contributions (heath-family)		Total
		employers	employees	
Germany	47.5	0	0	47.5
Austria	50	0	0	50
Belgium	50 + 3.4	18.4	3.55	66.1
Spain	27, 13 + 15, 87	0	0	43
France	45 + 8 (75)	20.8	0	60 (77.2)
Italy	43 + 1, 9	0	0	44.9
Netherlands	52			52
United Kingdom	50	0	0	50
Sweden	25 + 31, 56	14.2	0	62
United States	35 + 6, 85			41.85
Japan	40 + 10	0.13		50.2

Source: Calculation of the author from: OECD: *Taxing wages* (2011)

The left-wing government introduced, in 2013, a radical reform: the submission of the capital income to the income tax schedule, when they were taxed before at a specific levy in discharge. This can be justified by equity reasons (to show that all incomes are similarly taxed), but leads to economic tax rates extremely high for the capital incomes, at least when they are taxed.

Interest incomes are taxed at 24% up to 2 000 euros; at the income tax schedule after. They pay the CSG and Social Contribution (in total 15.5%). However, an interest rate of 4%, with 2% inflation, corresponds to an actual income of 2%. The 24% levy corresponds to an economic rate of 79%; the income tax taxation at 45% leads to an economic taxation of 116.4%. This rate is high, but depends on the rate of inflation.

Dividends come from companies' profits, which, in principle, were already taxed by the CIT, at the rate of 34.43% (plus now a 3% tax). This is why they benefit from a reduction of 40% in the income tax. Taking into account CSG, Social Contribution and CIT, the resulting economic rate is 63.2%.

Capital gains taxed, are theoretically the capitalisation of non-distributed profits, which are taxed by the CIT; they are now subject to the income tax with an allowance which depends on

the detention length: 50% after 2 years, 65% after 8 years. If we make the assumption that annual capital gains are 10% of the capital (8%, representing an actual profitability and 2% inflation), economic tax rate was 87.1% (for a detention of one year), 67.7% after 5 years and 61.0% after 8 years. After a revolt of the *pigeons*, young entrepreneurs, capital gains on small forms owners have an allowance of 85 % after 8 years of detention, the taxation of their gains was 53.5%, which is lower than the taxation of dividends, but is not shockingly low. Shareholders are encouraged to keep their shares and to be paid by capital gains rather than dividends.

Non-taxed capital gains escape taxation at the household level, but they have paid, in theory, paid, the CIT; their economic tax rate is 34.43%.

Our calculations may be challenged: the effective rate of the CIT would not be 34.3%, due to tax avoidance of enterprises. In fact, in 2006, the last year before the crisis, CIT on non-financial corporations earned 42 billion, for paid 68 billion net dividends, 139 billion non-distributed profits, less 132 billion of fixed capital consumption, representing an apparent tax rate of 35.9%.

Rental property incomes support a property tax (representing on average 10% of the rent), the CSG, the Social Contribution and the Income Tax. The rate of 45% IR is therefore an economic rate of 62.4%.

Real estate gains are now subject to a taxation of 34.5%, after an allowance (2% per year from 5 to 17 years; 4% from17 to 24 years and 8% thereafter, so that taxation is zero at the end of 30 years). Let us consider a person who buys a housing for 100, which resells it after 10 years; let us suppose that the increase in the price of housing is 8% per annum for general inflation of 2%. Its economic gain is 79. The taxable gain is 94 (since the inflation of the first 5 years is not taken into account) and the tax is 32.4, which means an economic rate of 41%.

Implicit rents (those that the owner derives from housing he inhabits) are not subject to tax on income or to social contribution. Because of the property tax, economic tax rate is 10%. Capital gains on a principal residence are not taxable.

Table 19. Economic tax rates

	Economic tax rates 2013
Wages	60.0
Interests	79.0 * / 116. 4 **
Property tax revenues	62.4
Implicit rent	10.0
Real estate gains	0/41
Dividends	63.2
Capital gains taxed	87.1/60
Untaxed capital gains	34.43

* Taxation to the 24% levy ; ** Taxation to income tax

In fact, the economic rates are considerably higher than nominal rates (table 19). Interests, rent income, dividends and capital gains, when taxed, are taxed at high rates.

We have to make a political choice between two principles: the same economic taxation rate for all income (which paradoxically would require a specific taxation for capital income) and a higher taxation of capital income since they are mostly received by the richest, are not the fruits of the effort, this is paradoxically obtained by applying the same schedule as for the labour income, while by forgetting CIT and inflation depreciation.

One can hardly consider reforms that would still increase the rate of taxation of capital income. With respect to interest income, it could decide to tax only the real interest income, by allowing the deduction of capital depreciation induced by inflation; in this case, social security contribution at 15.5% should be maintained (in symmetry with non-contributive social contributions on labour income). Taxation rate would then 58.2%.

Capital gains do not necessarily correspond to non-distributed profits. It is difficult to tax unrealised gains, which can be cancelled by a stock market crash. The best system would be one where companies distribute a tax credit to their shareholders, who would represents the e actually paid CIT and where the shareholders would be imposed to the income tax and the social contribution on the total: 'dividends + capital gains adjusted for inflation', with measures to guarantee to all capital gain was taxed (see below). In this case, taxation rate would also of 58.2%.

The problem lies mainly in the devices that allow escaping taxation. A principle should be stated: it is financial institutions to convince investors in the interest of the product they offer, the State did not fiscally inciting to any form of investment. So PEA (share saving contracts) and life insurance contracts be subject to ordinary taxation.

We should remove the possibility that using rich families to escape capital gains taxation by the donation to children. Thus, a wealthy shareholder can accommodate his titles in an *ad hoc* financial vehicle which receives its dividends, use the titles as surety for loans from his bank who provide the money he needs to live, and thus does not declare income; then he bequeath the share of the financial vehicle to his children, who pay no taxes on capital gains. So, it would it be legitimate to pay tax on the unrealized capital gains in case of transfer by gift and inheritance.

The other black hole of taxation remains implicit rent (and the non-taxation of the capital gains on the main residence). It is not fair that two families of the same income should pay the same tax if one has inherited an apartment and the other must pay rent: their living standards are very different. It would be desirable to gradually introduce a taxation of implicit rents. In return, mortgage interest payments could become deductible from the taxable income, which would encourage young people in phase of acquisition at the expense of detained wealth.

To delete all tax expenditures?

The French system comprises many tax expenditures devices, 34 billion euros for the income tax, 60% of its amount. They adversely affect the tax progressivity; many have no actual economic and social justification; they have been put in place to satisfy a pressure group. Their total removal seems to be an obvious reform.

However, certain taxes reductions are necessary to take account the contributive capacity of households. This is the case of the quotient familial, which does that take into account the size of the household to assess its living standard. Similarly, it is legitimate to allow the deduction of alimony, the donations to the charity organisation, the cost children care, the specific charges of dependent persons.

Others tax expenditures are justified for social reasons. They could not be removed without putting in place of the replacement devices: this is the case for the additional tax parts for large families or for invalids. It would not be justifiable to tax family benefits which are already far from ensuring parity of the livings standards between families and individuals without children (see Sterdyniak, 2011). We should strongly increase family benefit before to tax them.

Others correspond to tax logic. This is the case for the reduction of 40% on dividends, for the reduction of 10% for professional expenses of employees (which is excessive but avoids have to deal with numerous requests for taxation to the real costs, which compensates the possibilities of non-employees to declare a part of their personal expenditure as professional fees). Some tax expenditures should be converted into grants: tax reduction for historical monuments maintenance, for energy savings works, the aid to overseas territories. Some refundable tax credits (like the *Prime pour l'emploi)* are already in fact subsidies.

The current Government has already removed the non-taxation of overtime wages. The total of tax reductions of a household for all voluntary schemes is capped to 10 000 euros. The capping of tax reduction is however a less effective policy than a precise watch, tax expenditure by tax expenditure, if they should be retained or replaced.

The gain possible by the abolition of no justified tax expenditures would be about 8 billion euros: 2.5 billion by the reduction of pensioners' advantage, 1 billion by the reduction of the advantages of individual employers, 3 billion by the taxation of exempted capital income (PEA, life insurance, distribution of profit to employees), 1 billion of removal of the exemption of rental or productive investment. But the beneficiaries of its measures will try to protect their privileges.

In its programme, somewhat inspired by Landais, Piketty and Saez (2011), François Holland announced the creation of a new income tax, more simple; that would unify the CSG and the income tax. But the characteristics of this NIT remain to be defined (see, in particular, Allegre, Cornilleau and Sterdyniak (2007), Sterdyniak (2012)). Such a reform would oblige to rethink the French system and open the field of the democratic debate. Should we remove or increase the family character of the French tax system? Do we reduce or increase its redistributivness?

The word *simple* can worry: a progressive tax that takes into account the characteristics of the household can be simple? The French system exempts the poorest and already taxes much more the very rich than that other developed countries. It is an illusion to believe that the reform could make it even more progressive.

According to its partisans, this fusion would that all French would feel *imposed*, but this means that the poorest households (the unemployed, pensioners, employees below the SMIC) who currently do not pay income tax or CSG or who receive an RSA a higher than the CSG they would suffer from the reform.

This reform should suddenly remove all tax expenditures, but the difficulties would appear quickly: many tax expenditures should be maintained or replaced by grants.

One of the objectives of the reform is to tax capital income as labour income. But this is not so simple once acknowledged that it must take into account the non-contributory social contributions paid by employers, the social security contribution paid by capital incomes, the CIT already paid, the distinction between real and nominal interest. Soon, it would appear that the capital incomes are often already taxed more than labour incomes.

Due to historical reason, pensioners are less taxed than employees; they do not pay the non-contributive social contribution that the employers pay on the payroll; they benefit for a lower CSG rate. Should the tax reform remove these advantages (as proposed by OECD, 2013) when it is already expected that, in the future, the ratio pension/wage will decrease due to the recent pension reforms?

Progressive cleaning of the current system by the disappearance of the unfair tax expenditures is for us a path more assured that the myth of the great reform. On the other hand, it seems not necessary to go to a withholding tax paid directly by companies: tax may remain citizen, paid by the taxpayers, who could see the effective weight.

The France has a high level of local taxes. These are more archaic and less progressive than national taxes. They are also most unequal because the rich pay little in rich municipalities and the poor pay much in the poor ones. Both in terms of economic efficiency and social justice, France should reverse recent developments leading to reduce the burden of income tax (with precise base and schedule), and to increase local taxes. Decentralization tends to increase local spending, which could aggravate local disparities. France should reduce the residential tax, create a supplement to the income tax, which the product would be redistributed to local communities on the basis of their needs (population, numbers of children, numbers of people in difficulty).

Do we need an ISF?

The ISF (solidarity tax on the wealthy) is justified by five arguments. Holders of an important heritage benefit particularly from the social organization; it is just that they specifically pay for its cost. Wealth distribution is more unequal than income distribution: between the 1st and the 9th decile, the ratio is 4.6 for income, of 217 for wealth; so, the wealth taxation is more redistributive than income one. In France, the ISF does not tax professional property; therefore, it encourages entrepreneurs and their families to invest in their company and to remain involved. The ISF may oblige certain owners of real estate, not occupied or under-occupied, to put them on the market. Fiscally, the ISF may oblige some holders of financial portfolios to sell securities, so to realize capital gains, which would be taxed.

Since the 2012 reform, ISF rate ranges from 0.5% to 1.5%. The ISF is still heavy earners of interest, dividends, property income, taxed capital gains, but not for the owners of their residence, or for the beneficiaries of non-taxed capital gains non-taxed (table 20). 2012 reform introduced a cap for all of taxes paid by an ISF taxpayer at 75% of its income. But the assessment of taxes remain questionable (neither CIT nor non-contributive social contributions are taken into account) as well as the assessment of income (interests are not adjusted for inflation, implicit rents and unrealised capital gains are not taken into account). Income taken into account should include capitalized interest and unrealised capital gains, but the Constitutional Council denied this inclusion, adopted by the Parliament. Tax evasion is still possible for the richest. However, firms' owners can no longer deduct their professional debt of their professional wealth.

Table 20. Marginal tax rates in 2013

	Without ISF	ISF - 0.50%	ISF-1%	ISF- 1.5%
Interests	116.4	141.4	166.4	191.4
Rents *.	62.4	70.7	79.1	87.5
Imputed rents*	10.0	18.4	26.6	34.8
Dividends **.	63.2	69.4	75.6	81.8
Capital gains taxed **.	60.0	66.2	72.4	78.6
Capital gains not taxed **.	34.4	40.7	46.9	53.1

* 6% profitability; * 8% profitability.

Table 21. Imposition of the households' wealth in % of the GDP in 2011

	Wealth tax	Inheritance and gift rights
Germany	0	0.16
Austria	0	0.01
Belgium	0	0.67
Denmark	0	0.22
Spain	0	0.21
Finland	0	0.21
France	0.22	0.43
Greece	0.23	0.06
Ireland	0	0.14
Italy	0	0.03
Luxembourg	0.60	0.10
Netherlands	0.0	0.26
Portugal	0	0
Sweden	0	0
United Kingdom	0	0.19
Switzerland	0.95	0.15
Japan	0	0.31
United States	0	0.09

Source: OECD (2013), *Public revenue statistics*.

In regards to the rich, tax competition concerns also on wealth taxation and succession rights. In Europe, only Luxembourg, Switzerland, France and Greece maintain a wealth tax (table 21). The weight of the rights of succession is very low except in Belgium and in France. Does France need to align? No. The France should advocate in Europe for a tax on large fortunes that would be all the more welcome that all countries have problems of public finances problems. We must however distinguish two cases: if it is a financial wealth, the exile costs in France a loss of the tax on profits and has little economic consequences; if it is a professional property, it can mean the closure of the firm and the loss of productive capital. So, France exempts property professional from the ISF and from a part of succession rights if the heirs

continue to manage the firms. Certainly, these devices may be considered to be contrary to equity, but it is a lesser evil and it is not bad to sometimes encourage productive capital.

Despite the crisis, despite the difficulties of public finances, despite the worsening of inequalities in income and wealth, there was not any coordination in Europe to increase the tax burden on the richest. So, the risk is so great that persists and widens the tax competition among countries to attract the wealthy.

To protect its right to tax, France should take retaliatory measures against its nationals establishing abroad for tax reasons. In 2011, the Government had reintroduced an *exit tax*, a tax on unrealised capital gains of those leaving the France. The France however may clash with the censorship of the EUCJ, which can invoke the freedom of establishment principle. A possible measure is a world taxation of all French citizens, following the American model. To retain their right to vote, French people installed abroad should make a tax statement to the France and pay a tax equal to the difference between those due in France and those abroad paid. To make this manageable tax, it would apply only above a certain level of income/wealth and in countries with low rates of taxation on income or wealth.

How to help the poor...

The France helps the poorest households by a complicated system including the RSA (le *Revenu de solidarité active*, family-based minimum income), the PPE (la *Prime pour l'emploi*, an individualized benefit to encourage people to work), housing allowances (family-based) and means-tested family benefits (School allowance, Family complement for large families). Since 2000, the governments are persuaded that it is the too small gap between the non-qualified workers wages level and assistance income who explain the high level of unemployment rate of non-qualified workers ; they try to increases this gap by premium to low-wages workers (the PPE, the RSA-Activity).

Despite the efforts of Martin Hirsch, his promoter, the RSA does not include the PPE and housing allowances. The RSA is composed of a basic allocation: RSA-base, (a differential minimum income, which depends on the family composition), which is reduced by 38 euros for 100 euros of income from activity. So, a low-wage worker may ask for the RSA-Activity. The RSA is an allowance paid monthly on the basis of a quarterly income statement; the RSA base is theoretically dependent on an effort to insert. The PPE is paid automatically on the basis of the declaration for the income tax on income, with a delay of one year. The RSA is entered on the PPE, so that a household which does not ask for the RSA receives automatically the PPE.

The system aims to provide a minimum income to the poorest while preserving their incentive to work. So, the RSA (499 euros per month for a single person) is significantly less than the minimum income for retirees (792 euros). As shown in tables 22 and 23, the RSA provides an income of about 40% of median income (i.e. below poverty threshold, 60% of the median income). A single person escapes poverty if it wage is above 0.5 SMIC; a couple with two children must have wage below 1.5 minimum wage. In total, the rate of marginal gain is of the order of 50% for a single person (table 24). For a couple, the rate is very low between 1 and 1.5 SMIC, which may discourage the employment of the wife of a minimum-wage earner (table 25). Before the RSA activity, this is the first job that was discouraged.

Table 22. The case of a single in euros par month (2013)

	RSA	1/2SMIC	SMIC	1.5 SMIC
Wage	0	548	1 097	1,646
RSA	415	207	-	-
PPE	–	-	80	–
Housing benefit	301	246	49	0
Income tax				-102
Total	716	1 001	1 226	1 544
% median income	42.5	59.4	72.7	91.6

The rent is estimated at 400 euros.

Table 23. The case of a family (2 children) in euros par month (2013)

	RSA	One active spouse			Two active spouse	
		1/2SMIC	SMIC	1.5 SMIC	1, 5 * SMIC	2 * SMIC
Wage	0	548	1 097	1,646	1,646	2 194
RSA	856	522	312	103	–	–
PPE	–	–	–	–	126	166
Family benefit	48	127 +48	127 + 48	127 + 48	127 + 48	127 + 48
Housing benefit	473	473	369	209	211	54
Total	1 377	1718	1 953	2 133	2 158	2,589
% median income	38.9	48.5	55.2	60.3	61.0	73.2
PPE*			93	13		
Total			1 734	2 043		

The rent is estimated at EUR 500 euros. The children were 7 and 10 years. * if they do not ask for RSA.

Table 24. The gain from employment. Single

	Euros (in % of net wage)
RSA to 0,5 SMIC	285 (52%)
0.5 to SMIC	225 (41%)
RSA to SMIC	510 (46.5%)
SMIC to 1.5 SMIC	318 (58%)

Table 25. The gain from employment. Couple two children

		Without RSA
First active		
RSA to 0,5 SMIC	341 (62%)	0
0.5 SMIC to SMIC	235 (43%)	16 (2%)
RSA to SMIC	576 (52.5%)	357 (32.5%)
SMIC to 1.5 RSA	180 (33%)	309 (56%)
Second active. First active at the SMIC		
Inactive to 0,5 SMIC	205 (37%)	424 (77%)
Inactive to 1 SMIC	636 (62%)	855 (78%)

The current system has six drawbacks:

- The non-take-up rate of the RSA-activity remains important (68%). Low-wage workers refuse to be subject to ongoing monitoring to reach a relatively small benefit. Due to the effect of stigma faced by the RSA, they do not want to be confused with the base RSA recipients. By contrast, the PPE is given automatically, without monitoring, but with a delay of one year.
- The RSA provides an allowance of about €110 per child for families with 1 or 2 children at the level of the minimum wage, allowance that fills a hole in the French system, which was not enough generous for poor working families. But this allowance is not paid to the families of unemployed workers. We should pay these 110 euros in the form of a family complement to all poor families with 1 or 2 children (those with 3 children and beyond having already a family complement and more generous family benefits).
- The RSA, as all family benefits, is indexed on the price, not on wage or median income. Its holders are at risk to see their situation deteriorate gradually.
- An equivalent device to Scandinavian countries disability allowances, paid on medical, economic and social criteria ensuring to people who have to chance to recover a job (temporarily or permanently) a more satisfactory income equivalent to the retirees minimum income pension is missing in France.
-The RSA is not paid to young people less than 25 years while many of them have difficulties of insertion.
- The system is not more generous for the family with children than for the people without children, while one might wish that they enjoy a more favourable allocation, for three reasons: people, without job but with children fulfil a social role, that of parents ; their children are not responsible for the lack of resources of their parents and have the right to a standard of living standard higher than that society gives to people without children who are partly responsible for their situation; the allowance must allow parents to raise their children in satisfactory conditions.

In 2013, a parliamentary report (Sirugue, 2013) had proposed a reform consisting to create an Activity Premium (*Prime d'Activité*, PA) that would replace the RSA-activity and the PPE. But, as the RSA base would persist, very low-wage families should seek two allowances: RSA base and the PA. The system would be complicated for them. The Sirugue report proposes to extend the right to the PA to young people below 25, which is justified, but it offers a constant cost reform, without even proposing to recover the savings currently made by the non-take up. So, the extension of the right to people less than 25 years would be funded by existing recipients of the RSA and the PPE. The scale of the PA was arbitrary, with a slope and a peak at 0.7 SMIC, which have no justification. The marginal tax rates remain low in some places; high in others. There are no strong improvements over the existing system. Overall, the situation of families was not improved. The risk was that the PA suffers the same rate of non-take up as the RSA and that many families lose the PPE without wanting to ask for the PA.

We should simplify the system by introducing a family complement of the order of 100 euros per child from poor families, employed or unemployed, with 1 or 2 children, by replacing the PPE by an increase of the SMIC offset by a decrease of employer social contributions; the RSA should be maintained, but its role would be reduced and the non-take up would have less

consequence for families with children. Finally, we should create an insertion allowance, at the amount of the RSA, for young people looking for a job, which should allow them to begin to accumulate retirement rights.

In 2014, the Government wishing to take an action for poor families in return for the responsibility Pact decided to introduce a reduction in social contributions of low wages workers (up to 1.3 times the SMIC). This would be a fourth allocation for low-wage families, a new complication of payroll. The resources of social protection would be weakened. It has no justification as employees' contributions finances contributory benefits. The government announced also an income tax reduction for the poorest taxable households (which would benefit to 3 million households at a cost of 1 billion), which would have the form of an *ex-post* reduction of taxes calculated according to the current tax scale. This reduction would limit the rise in the income tax resulting from measures decided during the last four years (freezing of the scale, taxation of family supplements for pensioners, imposition of overtime, imposition of employers'contributions for complementary health insurance, removal of the additional half part of widows). There too, this is a band-aid, which does not go in the direction of a consistent reform.

After the crisis

The crisis resulted in a sharp deterioration of public finances in virtually all the EU MS. In 2012, the public deficit represented 3.7% of GDP in the euro area, public debt rose from 66.5 % of GDP in 2007 to 93% in 2012. However, the situation of the euro MS was better than the situation of the United States (deficit: 9.3%), of the United Kingdom (deficit: 6.3%) and of Japan (deficit: 8.3%). The structural primary balance of the area is balanced in 2012 (even retaining the Commission's calculation).

European countries face a double dilemma. First they need to choose a macroeconomic strategy. According to a Keynesian perspective, they must maintain large public deficits as long as the unemployment rate does not go down significantly. The euro area has lost 8.5 points of GDP due to the financial crisis; to recover to the crisis would be enough to bring public deficits to a sustainable level. The objective must not be a balanced budget, but the real "public finances golden rule", a balance budget net of investment expenditure, which authorises, in France, a structural deficit of 2.4% of GDP.

Instead, the strategy advocated by the IMF, the OECD and the European Commission is to quickly reduce public deficits. The risk is then to engage in a long period of stagnation; the fiscal restriction reduces on demand; tax revenues decrease; public deficits and debt ratios hardly improve. Given the threat of financial markets, European countries have chosen the second strategy, which has kept Europe in depression. .

The second choice is between spending cuts and tax increases. International institutions warned against increases in taxes (especially direct taxes) that would affect firms' competitiveness and profitability, their capacity to invest and to create jobs, the willingness of households to work and to save. They advocate reductions in public and social expenditure which they deny the economic and social usefulness. Only, the VAT, which weighs on consumption, could be increased. To promote employment, the country should continue to lower taxes affecting firms. Thus, this strategy requires the continuation of tax competition. The risk is that it has a strong depressive impact, since it reduces spending which have a strong impact on demand, and it involves the MSE, against the will of peoples.

The alternative strategy would aim to preserve the *European social model,* and therefore a high level of public and social expenditure by relying on its comparative advantages (education and health free for all, public infrastructure, social benefits) to remain competitive. In this context, MS should tax financial transactions, should increase the taxation of financial income, capital gains, high income whose swelling is one of the causes of the crisis, should tax highest heritage, and should create a confiscatory tax rate on exorbitant income tax rate. Taxation should encourage firms and banks to productive behaviour. It should promote investment rather than financial activities and dividends distribution. It should encourage energy savings rather than job cuts. It should promote the reduction of wages inequalities by taxing, at the firm level, the distributions of too high compensations. This tax strategy should therefore be European, but who will promote it in Europe? At the European level, this requires a strategy of tax harmonisation, guaranteeing to each country the possibility of taxing its firms and its residents, banning unfair competition, establishing minimum tax rate for firms, high income and wealth, prohibiting banks and firms to have subsidiaries in tax havens, organizing the rise of ecological taxation. The ecological constraints will force in the coming years to change our ways of producing and consuming. People will have to renounce to the conspicuous consumption model where new needs are constantly imposed by large companies' propagandas. A choice must be made between two strategies: to focus the restriction on the poorest if ecological constraints translate into increases in price without compensation; to move to a more sober and less unequal society. Thus, Europe should take a turn resolved to become environmentally friendly, solidarity and social turning in which the tax strategy should register.

What strategy for fiscal reform in France?

In 2014, four strategies are possible:

– A strategy focused on the increase in taxes for the richest and multinational firms. It was the French strategy from mid-2012 to mid-2014. In this context, the government had to restore the ISF, to increase the rights of succession, to tax capital income as labour income, to increase the upper marginal rate of the income tax, to create a confiscatory rate for exorbitant incomes. This strategy also requested to the strong measures against tax exile and tax tourism, since the France was already one of the countries which tax the most the richest. France should also fight against tax evasion devices (which is difficult for an isolated country alone).

– A strategy focused on the reduction of taxes on firms in order to improve the competitiveness and the attractiveness of France. Firms, less taxed, would invest more in France and would create jobs, offsetting the initial reduction of taxes revenue. Initially, the taxes paid by salaries and households should be increased; French people must accept a certain decline of their income to let the French Firms be more competitive. But this strategy would induce an initial negative demand shock; its social acceptance requires that firms make firm commitments in terms of job creation, what they cannot do. It is, moreover, an uncooperative strategy at European level. This is the strategy chosen by Valls Government.

– A rationalization strategy to remove all fiscal expenditures, which would reduce tax interventionism, which is satisfactory in some cases (taxation of capital income), less in others. Its gains are probably overestimated.

– An ecological strategy raising environmental taxation. But its impact on firms' competitiveness is likely to be heavy if this strategy is not a piece of a European strategy.

Tax reform is not a so easy task.

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