

# The myth of fiscal reform

By [Henri Sterdyniak](#)

On 19 November, the French Prime Minister announced that he was suspending the implementation of the “ecotax” and working on a major tax reform. This has been raised frequently in public debate, without the reform’s content and objectives being spelled out. Conflicting proposals are in fact being presented.

Some advocate a sharp reduction in taxes, which could boost the French economy by encouraging employees to work harder, households to save more, and businesses to invest and hire, which would make France more competitive. But public spending would have to be reduced further, even though the government has already committed to a 70 billion reduction by 2017. What spending should be cut in particular? Social benefits would have to be drastically reduced, which is not compatible with the maintenance of the French social model. Some want to shift the burden of social protection from businesses to households. The MEDEF for instance is calling for reducing taxes on business by 100 billion. This would require another sharp hike in taxes on households, leading to a collapse in consumption. Should France move in that direction, should it renew tax competition in Europe by lowering household income?

Others are proposing distributing the tax burden more equitably between income from labour and income from capital and strengthening the redistributive character of taxation. But France is already one of the world’s most redistributive countries, with high taxes on big earners, large estates and capital income. All these are already heavily taxed, following increases made by the Fillon and then Ayrault governments.

Some propose chasing down tax and social niches, expanding the tax brackets and reducing rates. But doesn’t this forget the

incentive role of taxation? Many programmes, even complex ones, are legitimate for reasons of equity (such as the family quotient) or as employment incentives (such as exemption from social charges on low wages or for child care) or assistance to the working poor (e.g. the PPE in-work tax allowance) or as other incentives (such as the exemption of charitable donations or union dues). Some income is of course not taxed, such as certain capital income (life insurance or PEA plans) or unrealized capital gains (but it is difficult to tax gains that are merely potential) or implicit rents (such as enjoyed by those in owner-occupied apartments), but who would dare to touch these? The point is more a patient dismantling of niches, which has been underway for several years, rather than a major reform.

Making our taxation more ecological is certainly a pressing obligation. But is there really a double dividend in jobs and in ecology? Doesn't the environmental gain have a cost in jobs, purchasing power and competitiveness? Can we increase environmental taxation in France without a worldwide agreement, which looks unlikely today? Environmental taxation is necessarily complicated if we want to avoid hitting (too hard) farmers, industry, poor people, marginal regions, disadvantaged suburbs, etc. This is the lesson of the failure of the carbon tax (in 2009) and France's ecotax (in 2013).

We must of course fight against tax evasion by the wealthy and by large corporations, but this mainly involves tax harmonization at the European level, which is not without risk if it means that France must align with the lowest bidder on taxing wealth (ISF), the corporations (IS) or income (IR).

A large-scale tax reform, one that does not alter the tax burden, inevitably means winners and losers. Who the losers will be should be made clear: retirees, homeowners, savers?

A miracle project has shot to the surface: the merger of income tax and the CSG wealth tax. But neither the terms nor

the objectives of this merger have been specified. It is running first of all into opposition on principle from the trade unions, who take a dim view of any merger of a State tax with the CSG tax, whose proceeds are allocated directly to social protection. A reform would lead towards putting the State in charge of sickness and family benefits (especially if at the same time a portion of employer contributions were taxed), with the risk that social benefits become adjustment variables with respect to the public finances.

The CSG tax currently hits employees harder than those on replacement income. A merger of CSG and income tax without specific compensation could thus be very costly for pensioners and the unemployed, and in particular for poor people who currently pay neither the CSG tax nor income tax. Conversely, capital income currently incurs a total taxation – the CSG, the Contribution to the Reimbursement of the Social Debt (CRDS) and the main social charges – of 15.5%, which is significantly higher than the 8% paid by employees. This can of course be considered as offsetting the fact that, by definition, they are not hit by employer contributions. But, as we shall see, comparing levies on different forms of income is not so easy.

A merger like this could provide an opportunity for a complete re-think of the various programmes that have gradually led to narrowing the income tax base, and in particular certain tax loopholes. But some of these tax expenditures are essential, so it would be necessary to replace them with explicit subsidies or keep them in the merged tax. The merger would not in itself solve the problem of income that is currently exempt, whether this is implicit rent or certain capital gains.

Some want to merge all the programmes helping poor people (RSA income supplement, PPE tax benefit, housing allowance) through a negative tax administered by the tax authorities, thereby ignoring the need for the kind of detailed, personalized,

real-time follow-up that France's Family Allowance Fund (CAF) is able to provide.

The lawmakers will have to decide the question of whether the merged tax should be calculated individually or jointly per family. This is an important issue: should the State recognize the right of individuals to pool their incomes and share this with their children? But should we really be launching this debate today? Is calling into question the family nature of our tax system all that urgent right now? Individual treatment would mean transferring the most significant charges, in particular at the expense of single-earner families or middle-class families. With an unchanged burden, this would imply a sharp rise in the tax burden on households. A uniform reduction in rates would be highly anti-redistributive, to the detriment of families in particular and in favour of single people without children. Individualization should necessarily be accompanied by a strong increase in benefits for children (especially large families). This would lead to a more redistributive system in favour of poor families, but better-off families would lose out, which raises difficult questions about horizontal equity.

There is also the question of what kind of levy is used. We cannot move to a simple system of withholding at source without greatly reducing the progressive, family character of the French system. A company does not need to know the income of their employee's spouse or their other income. A reform would make it possible to withhold a first tranche of income tax (of 20% of income for example), while factoring in allowances (an individual deduction, possibly a deduction for a spouse with no income, a deduction for children). The balance would then be collected (or refunded) the following year according to the tax roll. The system would hardly be simplified. Contrary to what we are told by Thomas Piketty, a CSG-income tax merger is not the touchstone of tax reform.

Should we be concerned that the evocation of a tax reform is

simply a sham, masking a refusal to address the real problems of the French economy: the difficulty of fitting into the new international division of labour; the growth of inequality in primary income due to globalization and the financialization of the economy; and the failure of the developed countries, especially the euro zone, to find new sources of growth after the financial crisis?

The problem is probably not so much the structure of taxation as it is the error in economic policy made — at the level of the euro zone of adding fiscal austerity to the depressive shock caused by the financial crisis and, at the level of France, of raising taxes by 3 GDP points since 2010 (60 billion euros) to fill a public deficit attributable solely to the recession.

The French tax system takes in 46% of GDP; primary public expenditure represents 50%. At the same time, France is one of the few developed countries where income inequalities have not increased greatly in recent years. Our high level of public and social spending is a societal choice that must be maintained; the French tax system is already highly redistributive. Some reforms are of course necessary to further improve its redistributive character, to make it more transparent and socially acceptable. Nevertheless, what matters most is precisely the level of the formation of primary income. There is no miracle reform: the current system, the product of a long process of economic and social compromise, is difficult to improve.

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# Croatia in the European Union: an entry without fanfare

By [Céline Antonin](#) and [Sandrine Levasseur](#)

On 1 July 2013, ten years after filing its application to join the European Union, Croatia will officially become the 28th member state of the EU and the second member country from former Yugoslavia. Given the country's size (0.33% of the GDP of the EU-28) and the political consensus on its membership, Croatia's accession should pass relatively unnoticed. However, there are challenges posed by its entry. Indeed, at a time when the European Union is going through the worst crisis in its history, legitimate questions can be raised about whether Croatia is joining prematurely, particularly as it is experiencing its fifth successive year of recession. The latest [OFCE Note \(no. 27, 26 June 2013\)](#) reviews two of the country's main weaknesses: first, a lack of competitiveness, and second, a level of corruption that is still far too high to guarantee steady and sustainable growth.

With 4.3 million inhabitants, Croatia initially experienced a period of strong economic growth up to 2008, based on the strength of its tourist industry and on consumption that was largely underpinned by lending from foreign capital. The crisis revealed, yet again, the limitations of this development model and highlighted the country's structural weaknesses: a high level of dependence on foreign capital, the vulnerability of a system of (quasi) fixed exchange rates, an unfavourable environment for investment and wide-scale tax evasion.

Even though negotiations thankfully addressed some of these problems, others are still unresolved. For instance, with

respect to the economy, the domestic market is still not open enough to competition, with the result that the country suffers from a lack of competitiveness. At the legal level, the progress made in the fight against corruption, tax evasion and the underground economy has been woefully inadequate, depriving the country of the foundations for robust growth. Following on the heels of Romania and Bulgaria, the entry of Croatia may unfortunately endorse the idea that curbing corruption is not a prerequisite for joining the EU. In view of the repeated institutional crises that have hit the European Union since 2009 and widespread Euroscepticism, it is now urgent for the EU to make its priority deepening rather than widening.