The free movement of Europe's citizens in question

By [Gérard Cornilleau]

The British election has reignited the debate on the free movement of EU citizens within the Community. The fact that in less than 10 years the number of people originating from Central and Eastern Europe (mainly Bulgaria and Romania) has increased tenfold in the UK, rising, according to Eurostat, from 76,000 in 2004 to 800,000 in 2013, is undeniably behind this new unease around intra-European migration.

Further fuelling this debate over permanent migration is the issue of the free movement of seconded workers who travel to take up jobs in a country other than their country of residence with no justification other than the possibility of reducing labour costs by avoiding paying social security contributions in the host country.

EU legislation on the movement of citizens within the Community is ambiguous. On the one hand, workers have an absolute right to free movement, but this right is limited for the inactive population because in principle it should not lead to social expenditures by the destination States. European populations must thus remain socially connected to their State of origin. In theory, "social benefits tourism" is impossible, and not only are the Member States in no way compelled to take in hand intra-EU migrants, they are even entitled to expel them if their stay lasts more than 3 months and does not exceed 5 years. This was the holding of the European Court of Justice in a ruling on 11 November 2014, in the Dano case, named after a Romanian national living in Germany who was denied social assistance for herself and her son. The European Court held that she could not herself meet her own needs or those of her family and she was not looking for work. In these circumstances she did not have a right to residence in Germany or to the benefits of social assistance. The European Court recalled that European legislation on the freedom of movement was aimed at preventing EU citizens from other Member States from becoming an “unreasonable” burden on the social assistance system of the host Member State.

The available data on migration between European countries are relatively disparate and often incomplete. What is known is that there is little migration of inactive people who may be motivated by the pursuit of non-contributory social benefits. The same is essentially true for the migration of active workers. Europe remains in effect partitioned into linguistic blocs that limit the permanent movement of people between countries. Compared to the geographic mobility seen in the United States, the European Union is characterized by a low level of internal migration. While the statistics are not definitive, current assessments indicate that in the 2000s internal mobility was about 10 times lower in Europe than in the US: between 0.01 and 0.25% of the population of EU countries immigrated annually in the major European countries, in contrast to 1 to 1.7% in the US[1]. Since then, population movements have, it seems, increased a little in Europe while slowing in the US, but there has not been the kind of turnaround that would call into question the diagnosis that there is structurally less mobility in Europe.

As for the migration of inactive people, which is provoking fear of an increase in “benefit tourism” motivated by the search for generous non-contributory social assistance, the available data show that the potential for this is extremely low. A recent report for the Commission[2] estimates the population of non-active intra-European migrants at between 0.7% and 1% of the overall population in the major countries. Consequently, the share of social benefits paid to the corresponding population is extremely low. As a significant proportion of inactive migrants consist of students and retirees who have a sufficient income, the issue of benefit tourism therefore seems merely anecdotal.

While it is strict for the economically non-active, European legislation, which is very oriented towards free trade, promotes social competition between the Member States through a right to the secondment of workers from one country to another that is clearly too lax. This legislation was initially designed to promote the non-permanent mobility of corporate executives who wished to continue to benefit from the social security cover of their country of origin in the event of a long-term mission. But since the opening to Eastern Europe, some business sectors have made increasingly massive use of the possibility of hiring workers from other countries and paying low social contributions in the countries of origin, with no justification due to labour shortages or greater productive efficiency. In France, 10% of the workforce in the meat industry is now on secondment from other European countries. One hundred thousand construction workers, out of a workforce of 1.8 million workers, are in the same situation. Their labour cost is 20 to 30% lower than for nationals. In addition, due to the difficulty of checking on the payment of social contributions in their country of origin, many of these workers are in an irregular status. The Commission has of course proposed technical measures to more thoroughly verify the activity of the businesses seconding the workers as well as the payment of their contributions, but in all likelihood this will not be adequate to stem the strong growth of a movement that has its source directly in social competition.

What all these issues have in common is the demand for solidarity between European states, especially in deeds. Migratory movements, whatever their nature, tend to balance divergent developments in the labour market and the distribution of the population around the territory of the EU. There is no reason in principle to oppose greater mobility. On the contrary, given the current imbalances between European countries, increased mobility should be encouraged – without, of course, abandoning the macroeconomic, monetary and fiscal policies that represent the most effective tool for combatting economic divergences.

But an accommodative policy on mobility implies a distribution of immediate costs that cannot be accomplished without at least a minimum of convergence in the systems both for providing support to those who are worst off and for sharing a certain amount of resources. Clarifying the rules on social competition is also essential.

To avoid having mobility motivated solely by the search for lower labour costs, the principle of equal treatment of workers within a given country needs to be applied strictly. This implies that in the case of secondments, the social contributions should be levied at the rate of the country in which the employee is actually working. The amount of the contributions collected by the social security and tax authorities of the host country could be returned to the country of origin. There are two possible scenarios: if the contributions received exceed those that would have been paid without the secondment, there is no problem in financing the benefits paid to the seconded employees. In the opposite case (employees of large corporations in the richest countries seconded to poorer countries), an additional assessment could be imposed by the country of secondment. The principle of equal treatment of local and seconded workers is compatible both with a lack of direct social competition and with maintaining the rights of employees.

Lowering the barriers to the free movement of all EU citizens would on the other hand be greatly facilitated by the implementation of a plan to bring about a convergence in minimum compensations, whether we are talking about wages or social welfare. The establishment of a European minimum wage and a European minimum income would eventually eliminate social competition and do away with concerns that migration might be motivated solely by the search for non-contributory benefits. Furthermore, helping living standards catch up over the longer term would certainly be a way to strengthen confidence in the European Union project.

In the shorter term, solidarity between States must go hand in hand with loosening constraints on migration. This implies that States likely to take in citizens who are eligible for non-contributory social benefits should receive financial assistance from the Commission. This assistance could involve setting up a new European social budget that would cover the financing of a certain number of social minima. The EU budget could be increased by an additional 0.25 percentage point of GDP. Consideration should be given to whether a project like this for the partial Europeanization of social policy would benefit from such an increase in the EU budget. But other possible transfer mechanisms that would ensure financial solidarity between States for any non-contributory benefits paid to migrants could also be considered.

If we are to avoid States retrenching within their own borders and, ultimately, the long-term weakening of the European project, which was *a contrario* based on a desire for openness, it is undoubtedly time to revise a few principles and to establish a proactive programme for social convergence and for pooling the immediate costs that may result from mobility.

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[1] See Mouhoud E.M and Oudinet J. (2006), "Migrations et marché du travail dans l'espace europée" [Migration and the labour market in the European space], *Économie internationale,* no. 105. Also see Xavier Chojnicki (2014), "Les migrations intra-européennes sont d'ampleur limitées et se concentrent sur les grands pays" |Intra-European migration is limited in scale and concentrated in the big

countries], *Blog du CEPII*, Post from 4 September 2014. For a fuller analysis, see Ettore Recchi, *Mobile Europe, The Theory and Practice of Free Movements in the EU*, Palgrave Macmillan, London, 2015.

[2] See "Fact finding analysis on the impact on Member States' social security systems of the entitlements of non-active intra-EU migrants to special non-contributory cash benefits and healthcare granted on the basis of residence", DG Employment, Social Affairs and Inclusion *via* DG Justice Framework Contract, Final report submitted by ICF GHK in association with Milieu Ltd, 14 October 2013.

How to reform the reduction on payroll taxes?

By Mathieu Bunel, Céline Emond, Yannick L'Horty

More than 20 billion euros are spent every year by the State to compensate the general exemptions from social security contributions, making this the leading employment policy plank in France, both in terms of the total budget and the numbers concerned – more than one employee out of two benefits from the reduction in contributions. In these times of fiscal pressure and the inexorable upward trend in unemployment, questions are being raised about the sustainability of such a scheme, whose scale, which was unified by the 2003 Fillon reform, consists of a reduction that shrinks as the wage rises, up to the level of 1.6 times the minimum wage (SMIC). At the level of the SMIC, the reduction comes to 26 points (28 points for firms with fewer than 20 employees).

In an article published in the *Revue de l'OFCE* (Varia, no. 126, 2012), we evaluate the impact of a complete removal of the general exemptions as well as of a number of partial reforms of the thresholds for exemption from social security contributions, using the latest data suited to the analysis. In our estimate, the simple elimination of all general exemptions would lead to the destruction of about 500,000 jobs. We also explore the effects of reorganising the exemption thresholds, by screening a number of possibilities that would affect the various parameters that define the exemption arrangements. In every case, a reduction in the amount of exemptions would have a negative impact on employment, but the extent of the job losses would vary from simple to double depending on the terms of the reform. To ensure the least negative effect would require that the reductions in the exemptions spare the sectors that are most labour-intensive, which means better treatment for the exemption schedules that are most targeted at low wages. Since the goal is to improve the unemployment figures, it is important to concentrate the exemptions on lower wages, and thus to give a boost to the sectors that are richest in terms of labour.

However, concentrating exemptions too much in the vicinity of the minimum wage would increase the cost to employers of granting wage rises, which would be favourable neither to purchasing power nor to the quality of the jobs that condition future employment. While a new balance can always be sought in order to meet the urgent budget situation, to be sustainable it must be good for today's jobs without neglecting those of the future.

2013: what impact will the (national) fiscal measures have on growth?

By Mathieu Plane

This text supplements the October 2012 forecasts for the French economy

After having detailed the multiplier effects expected for the different fiscal policy instruments, the average domestic fiscal multiplier associated with the austerity measures being implemented in France in 2013 will be 0.9. This policy will cut GDP by 1.7% in one year alone. After a cumulative fiscal effort of 66 billion euros in 2011 and 2012, the structural saving expected for 2013 represents about 36 billion euros (1.8 GDP points) if we include both the measures in the 2013 budget bill (*Projet de loi de finances* – PLF) and the various measures adopted previously (Table). The fiscal shock resulting from the PLF for 2013 comes to 28 billion euros, of which 20 billion is solely on tax and social security contributions (*prélèvements obligatoires* – PO). Of the remaining 8 billion, an increase of nearly 5 billion euros in tax and social security contributions is from the second supplementary budget (*Loi de finances rectificative* – LFR) for the summer of 2012, the rest being mainly due to the first LFR for 2012 and to the hike in contributions resulting from the revision of the pension reform in summer 2012.

In total, the fiscal effort in 2013 can be broken down between tax and social contributions of about 28 billion euros (1.4 GDP points) and structural savings on primary public expenditure of 8 billion (0.4 GDP point). The burden of higher taxes and social contributions breaks down to nearly 16 billion euros for households and more than 12 billion for business. This breakdown does not take into account the competitiveness measures announced on 6 November by the Prime Minister. The tax credits for competitiveness and employment (CICE) will not have any fiscal impact in 2013, with the exception of the possible establishment in 2013 of an advance on their future tax credits for some companies short of cash.

Based on the variants in the fiscal multiplier, made with e-mod.fr according to the economy's position in the cycle, for the main taxes and social security contributions as well as for the key components of public expenditure [1] and based on the different evaluations we were able to carry out, particularly in the context of the assessment of the Five-year economic programme, we applied a specific fiscal multiplier to each measure for 2013 (Table). The short-term multipliers take into account only the direct effects of the measures on domestic activity, regardless of the fiscal policies of our trading partners, which amplify the impact of national policy. It is also assumed that monetary policy remains unchanged. The long-term multiplier values differ from the short-term ones, being generally lower unless a long-term negative output gap is maintained.

Of the 16 billion euro increase in tax and social security contributions on households in 2013, the discretionary increase in personal income tax (IR) will be 6.4 billion, including 3.2 billion from the 2013 Budget Act (*Loi de finances*) – against 4 billion in the PLF, as the proposal to tax capital gains on securities at the income tax scale will be largely amended, and the yield from the measure could decrease by about 0.8 billion, with the shortfall being able to be offset by the extension of the exceptional 5% contribution from the IS tax on large corporations), and with the rest coming from the supplemental LFR for 2012 (including 1.7 billion solely from the de-indexation of the personal income tax schedule). While the increase in personal income tax from the 2013 PLF is targeted at high earners, the amount this will contribute (3.2 billion) represents only 11% of the increase in tax and social security contributions (20% if we limit ourselves to households) in 2013, and less than 9% of the total fiscal effort. According to our calculations, the average fiscal multiplier associated with the different measures that increase personal income tax will be 0.7 in 2013.

The increase in taxes and social contributions from households will come mainly from the increase in payroll taxes and social security contributions (8.7 billion euros) set out in the Social Security budget act (PLF) for 2013 (2.9 billion) and the measures in the supplemental LFR for 2013 (5.3 billion, which includes changes to the tax exemption on overtime, a limitation on tax breaks and employee savings, a higher CSG wealth tax on income from capital, etc.) and pension reform, with an increase in the contribution rate (0.5 billion). The average fiscal multiplier related to these measures is 0.9. Finally, the reform of inheritance tax will raise a further 1.1 billion in tax and social contributions. On the other hand, the revenue from the ISF wealth tax will be 1.3 billion lower than in 2012. Indeed, the yield from the one-off wealth tax contribution set up under the supplemental LFR for 2012 will be greater than from the one set up under the new reform in 2013. The fiscal multiplier for these two measures is 0.3.

In total, according to our calculations, the increase in levies on households in 2013 will on average have a multiplier of 0.8 and will amputate growth by 0.6 GDP point.

For business, the measures adopted mainly involve an increase in the corporate income tax as provided in the budget bill (PLF) for 2013 (8 billion euros, of which 4 billion is related to the reform of the deductibility of financial expenses). The average multiplier for the increase in the corporate income tax (IS) is estimated at 0.7 in 2013. 2.3 billion euros will come from a rise in social security contributions and payroll taxes with a fiscal multiplier of unity. Finally, other measures such as the sectoral measures on the taxation of insurance or the exceptional contribution of the oil industry will increase the tax burden on business by 1.9 billion in 2013, with an average fiscal multiplier estimated at 0.5.

In our assessment, the increase in taxes and social contributions from companies will on average have a multiplier of 0.8 and will reduce GDP by 0.5 GDP point in 2013.

In addition, the short-term fiscal multiplier associated with public expenditure in a low phase of the cycle is, in our model, 1.3, so it is higher than that associated with tax and social contributions. This result is consistent with the most recent empirical literature (for details, see the box, "Fiscal multipliers: size matters!" The estimated loss of activity resulting from tightening up on public expenditure will come to 0.5 GDP point in 2013.

In total, the average domestic fiscal multiplier associated with the austerity policy being implemented in France in 2013 will be 0.9, and this policy will reduce GDP by 1.7%. This result is in the lower range of the latest work of the IMF; using recent data on 28 countries, it has estimated the actual multipliers at between 0.9 and 1.7 since the beginning of the Great Recession.

Main measures affecting the structural public deficit in 2013

	Measures (in bn)	*Fiscal multiplier estimated in the short term*	Impact on GDP (%)
Households	**15.7**	*0.8*	**-0.6**
Income tax	**6.4**	***0.7***	**-0.2**
PLF 2013 (taxation of capital income at IR tax rate, new brackets, etc.)*	3.2	*0.6*	-0.1
LFR II 2012 (reversal of tax exemption of overtime)	0.5	*0.4*	0.0
LFR I 2012 (de-indexation of IR brackets, suppression tax breaks and Scellier scheme, etc.)	2.7	*0.8*	-0.1
ISF wealth tax	**-1.3**	***0.3***	**0.0**
PPLF 2013 (reform of ISF wealth tax)	1.0	*0.3*	0.0
LFR II 2012 (repercussions from one-off 2012 contribution)	-2.3	*0.3*	0.0
Inheritance tax	**1.1**	***0.3***	**0.0**
LFR II 2012 (reversal of breaks on inheritance tax)	1.1	*0.3*	0.0
Social contributions and payroll tax	**8.7**	***0,9***	**-0.4**
Social security PLF 2013 (reform of self-employed payroll tax, higher tax on beer and tobacco, etc.)	2.9	*1.0*	-0.1
LFR II 2012 (reversal of overtime exemption, limitation of tax breaks and employee savings, higher CSG wealth tax, capital income, etc.)	5.3	*0.8*	-0.2
Pension reform (higher contributions)	0.5	*1.0*	0.0
Other	**0.8**	***0.6***	**0.0**
PLF 2013 (higher tax on vacant housing, tougher "automobile malus", etc.)	0.9	*0.6*	0.0
LFR II 2012 (lower VAT on books)	-0.1	*1.0*	0.0
Business**	**12.2**	*0.8*	**-0.5**
Corporate income tax	**8**	***0.7***	**-0.3**
PLF 2013 (limits on financial expenses deductibility, reform of the "cinquième acompte", etc.)	8	*0.7*	-0.3
Payroll tax and social contributions	**2.3**	***1.0***	**-0.1**
Social security PLF 2013 (higher CNRACL contribution rate, reform on wage tax, etc.)	1.8	*1.0*	-0.1
Pension reform	0.5	*1.0*	0.0
Other	**1.9**	***0.5***	**-0.1**
PLF 2013 (sectoral measures on taxation of business insurance) (sectoral measures on taxation of business insurance)	1.3	*0.8*	-0.1
LFR II 2012 (one-off contribution of oil industry, taxation of financial transactions, etc.)	0.6	*0.2*	0.0
Total Business and Household Taxes and Contributions	**27.9**	*0,8*	**-1,1**
Structural saving on primary public expenditure	**8.0**	*1.3*	**-0.5**
Total fiscal impulse	**35.9**	*0.9*	**-1.7**

* This amount incorporates the downward revision of the yield initially foreseen in the PLF 2013 of the measure taxing capital gains at the personal income tax rate, which is to be offset by the extension of the exceptional 5% corporate income tax contribution for large corporations.

** This breakdown does not measure the final fiscal impact that is to be borne by households if the increase in business taxes is passed on in prices.

Sources : PLF 2013, Social security PLF 2013, LFR I and II 2012, OFCE calculations.

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[1] For more on this, see Creel, Heyer, Plane, 2011, "Petit précis de politique budgétaire par tous les temps", *Revue de l'OFCE*, no. 116, January 2011.

Replacing the “Prime pour l’emploi” benefit by a reduction in employee social security contributions on low wages

By Guillaume Allègre

Nicolas Sarkozy has announced plans to replace the “prime pour l’emploi” benefit (“PPE”) by lowering the social security contributions of workers earning between 1 and 1.3 times the minimum wage (“SMIC”). The reduction on contributions would amount to 4 billion euros and would benefit 7 million low-wage workers. The gain announced (just under 1,000 euros per year) would necessarily be regressive. The elimination of the PPE (2.8 billion euros according to the 2012 Budget Bill, p. 76) would be supplemented by higher taxes on financial income.

This proposal is very similar to the original proposal of the Jospin government in 2000 that provided for a reduction on the CSG social contribution for workers earning less than 1.4 times the SMIC. That reform, which was passed by Parliament, was blocked by the Conseil constitutionnel because the decline in the CSG provided to low-income earners depended on wages alone, and not on individual family circumstances. As the CSG is considered a tax, the high court held that progressivity required taking into account taxpayers’ ability to pay, and therefore their family responsibilities. To deal with this ruling, the Jospin government created a new instrument, the PPE benefit, which closely resembled the CSG reduction, but which was calculated, to a very small extent, on the family situation (high income ceiling at the household level, with a small increase for children). But unlike the CSG reduction, the impact of the PPE does not show up on the pay-slip: the benefit is calculated from income tax returns and reduces the tax payable by the household, with households who do not pay tax receiving a cheque from the Treasury. This means that there is a one-year lag in the receipt of the benefit. The PPE was approved by the Jospin government and then increased under the Villepin and Raffarin governments, and by 2008 amounted to 4.5 billion euros (2010 Budget Bill, p. 53). At that point a full-time employee on the minimum wage received 1,040 euros per year. The PPE was then frozen by the Fillon government. This freeze, together with the fact that the RSA benefit was deductible from the PPE benefit, led to a 1.7 billion euro reduction in the value of the PPE between 2008 and 2012, from 4.4 billion euros to 2.8 billion. By 2012, a full-time employee on the minimum wage now received only 825 euros a year. Moreover, the lack of a boost in the minimum wage has greatly reduced the number of households eligible for the full rate (as well as the number of employees eligible for the full-rate reduction on employer contributions). This effect comes on top of the impact of rising unemployment, which is reducing the number of eligible employees. A 4-billion euro scheme, for which the maximum gain would be just under 1,000 euros, would amount to a little less than the PPE did in 2008. If we add in the cost of the RSA income supplement (1.6 billion in 2012), and if we take into account the previous RMI and API-related incentive schemes (600 million), we conclude that these various support mechanisms for low-income employees would total 5.6 billion euros in 2012, against 5.1 billion in 2008, an increase that barely exceeds inflation: the new policies that have been proposed since 2008 have been funded mainly by shuffling instruments targeted at the same population.

The replacement of the PPE by a reduction in social contributions would represent progress in administrative terms, since the government would cease to levy contributions and then repay a smaller tax credit to the same people 6 to 12 months later. The benefit of lowering contributions would be immediate and strongly linked to employment. This would also clarify the fact that low-paid employees are contributors to and not beneficiaries of social assistance. The proposed merger of the CSG tax and income tax (with the PPE as one element) has precisely the same goal. This reform nevertheless raises several questions. What would happen if the Constitutional Council were approached? And, employees working part-time currently benefit from an increase in the PPE; will this be renewed?

“Social VAT”: Is it anti-social?

by Jacques Le Cacheux

The prospect of a “social” value added tax, which was raised anew by the President of France on December 31 during his New Year speech, is once again provoking controversy. While the French employers association, the MEDEF, has included this measure in a series of proposed tax changes designed to restore France’s competitiveness, the Left is mostly opposed. It views the “social VAT” as an oxymoron, an antisocial measure that is designed to cut the purchasing power of consumers and hits the poorest among them disproportionately and unfairly. But what exactly are we talking about? And from the viewpoint of taxes on consumption, what is the situation in France relative to its main European partners?

The proposal to establish a social VAT represents, in fact, a combination of two measures: raising the VAT rate and allocating the additional revenue obtained to finance social welfare, while lowering – in principle by the same amount – social contributions. The way that these two operations are conducted can differ greatly: the rise in VAT could involve the standard rate (currently 19.6%), the reduced rate (currently 5.5%, but recently increased to 7% for a range of products and services), the creation of an intermediate rate, a switch to the standard rate of certain products or services currently at the reduced rate, etc., while the reduction in social contributions could cover employer contributions or employee contributions, be uniform or targeted on low wages, etc. Many policy choices are available, with distributional impacts that are not identical.

France now has one of the lowest rates of implicit taxation on consumption in the European Union (Eurostat). Its standard VAT rate was reduced to 19.6% in 2000 after having been raised to 20.6% in 1995 to help ensure compliance with the Maastricht criteria, as the recession of 1993 had pushed the budget deficit significantly higher. This rate is now slightly lower than the rate applied by most of our partners, particularly as the deterioration of public finances has recently prompted several European countries to raise their standard rate of VAT. The reduced rate, at 5.5%, was, until the increase decided in December 2011 on certain products and services, the lowest in the EU.

What can we expect from a social VAT? Let’s consider in turn the effects on competitiveness and then on purchasing power, while distinguishing the two aspects of the operation. A VAT hike has a positive impact on the competitiveness of French business, because it increases the price of imports without burdening exports, which are subject to the VAT of the destination country. In this respect, a VAT increase is equivalent to a devaluation. In so far as most of France's trade is conducted with our European partners within the European single market, this could be deemed a non-cooperative policy. Fine, but if all our partners were to use this type of "internal euro zone devaluation" – recall that in 2007 Germany increased its standard VAT rate from 16% to 19% – and we didn't, this would actually amount to a real appreciation of the "French euro". It would undoubtedly be better to aim for improved fiscal coordination in Europe, and to work for more uniform rates. But current circumstances are hardly favourable for that, and the threat of a VAT increase may be one way to encourage our main partner to show more cooperation on this issue.

Allocating the revenue raised to reduce social contributions will, in turn, have an additional positive impact on competitiveness only if it leads to a real reduction in the cost of labour to firms located in France. This would be the case if the reduction targeted employer contributions, but not if it were on employee contributions.

Can we expect a positive effect on employment? Yes, at a minimum thanks to the impact on competitiveness, but this would be small, unless we were to imagine a massive increase in VAT rates. The effect of lowering labour charges is less clear, because the employers' social contributions are already zero or low on low wages, which, according to the available studies, is precisely the category of employees for which demand is sensitive to cost.

Isn't the decline in the purchasing power of French households likely to reduce domestic consumption and cancel out these potential gains? In part perhaps, but it's far from certain. Indeed, the rise in VAT is unlikely to be fully and immediately reflected in selling prices: in the case of Germany in 2007, the price increase was relatively small and spread over time –meaning that the margins of producers and distributors absorbed part of the increase, thus reducing the positive impact on business somewhat. In France, empirical work on the increase in 1995 shows that it too was not fully and immediately reflected in prices; and, although one cannot expect symmetrical results, it's worth recalling that the cut in VAT in the restaurant business was not passed on much in prices.

Would the rise in VAT be "antisocial" because it winds up hitting the poorest households disproportionately? No! Don't forget that the minimum income, the minimum wage (SMIC) and pensions are indexed to the consumer price index. So unless these indexes were somehow frozen – which the government has just done for some benefits – the purchasing power of low-income households would not be affected, and only employees earning above the minimum wage, together with earnings on savings, would suffer a decline in purchasing power, if consumer prices were to reflect the rise in VAT. It should also be noted that, if there is a positive impact on employment, some unemployed workers would find jobs and total payroll would increase, meaning that the depressive impact on consumption often cited by opponents of this measure would only be minor, or even non-existent.

In short, "social VAT" should be neither put on a pedestal nor dragged through the dirt. As with any tax reform, we should certainly not expect a panacea against unemployment, or even a massive shift in our external accounts, even though it should help to improve our external price-competitiveness. But rebalancing our tax burden to focus more on consumption and less on the cost of labour is a worthy goal. In the context of globalization, taxing consumption is a good way to provide resources for the public purse, and VAT, a French innovation that has been adopted by almost every country, is a convenient way of doing this and of applying, without explicitly saying so, a form of protectionism through the de-taxation of exports. VAT is not, on the other hand, a good instrument for redistribution, since the use of a reduced rate on consumer products ultimately benefits the better-off as much or more than it does the poor. Most of our European partners have understood this, as they either do not have a reduced rate (as in Denmark) or have one that is substantially higher than ours (often 10% or 12%). It would be desirable to make the French tax system fairer, but this requires the use of instruments that have the greatest and best-targeted potential for redistribution: direct taxes – income tax, CSG-type wealth taxes, property tax – or social transfers, or even certain government expenditures (education, health). What is missing in the proposed "social VAT" is making it part of a comprehensive fiscal reform that restores consistency and justice to the system of taxes and social contributions as a whole.

Should tax breaks on overtime be reversed?

By Eric Heyer

Among the savings plans announced on 24 August 2011 by French Prime Minister François Fillon figures a change to the system of tax reductions on overtime hours and their exemption from social contributions,[1] a scheme that has been in force in France since 1 October 2007. This provides an opportunity to take another look at some of the main conclusions of the work carried out by the OFCE (French version) on this subject.

1 – An article to be published soon in the *Oxford Review of Economic Policy*[2] explains how the impact of this scheme will differ depending on the position of the economy in the cycle

at the time the measure is applied.

- In a favourable economic climate, an increase in working hours prompted by lower labour costs and the elimination of payroll taxes would seem appropriate. The measure is of course not funded (the public deficit deteriorates), and financing it through higher levies would radically change its nature, even though this would not call into question its positive impact on employment and unemployment.
- However, this measure is poorly suited to the kind of economic downturn that the French economy is going through today. In a situation of mass unemployment, an increase of 1% in working hours has a negative impact on employment (-58,000 jobs at 5 years and -87,000 at 10 years). The unemployment rate would increase slightly (0.2 point at 5 years, 0.3 point at 10 years). The measure would have a small impact on growth (0.2 point at 5 years and 0.3 point at 10 years) and is not funded: the deficit would deteriorate by 0.5 point at 5 years (0.4 point at 10 years).

2 – This corroborates the results of a recent study published in *Economie et Statistique*[3]. The authors examined data on 35 sectors of the French economy and estimated that a 1% increase in overtime would destroy about 6,500 jobs in the commercial sector (*i.e.*, 0.04% of commercial jobs), three-quarters of which would be temporary jobs.

Thus, in a context of a severe economic crisis, it seems that an incentive to work longer hours would hurt employment, especially temporary employment.

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[1] The government decided to reintegrate overtime hours into the general schedule of tax reductions while maintaining specific advantages on taxes and social welfare charges.

Concretely, this measure will not change anything for employees: net remuneration will not be reduced, and income tax will not be increased. As for employers, they will continue to benefit from exemptions on charges for declared overtime hours, but will see smaller breaks on charges on low wages. This will take effect next January 1st and, according to the government, will generate 600 million euros in revenue from additional social contributions.

[2] Heyer É. (2011), "The effectiveness of economic policy and position in the cycle: The case of tax reductions on overtime in France", *Oxford Review of Economic Policy*, forthcoming.

[3] Cochard M., G. Cornilleau and É. Heyer (2011): "Les marchés du travail dans la crise", *Economie et Statistiques*, no. 438-440, June.