THE GREAT TAX REFORM, A FRENCH MYTH

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The need for a great tax reform is often debated in France, although the content and objectives of such a reform are never clearly specified. There is no unanimity on how the tax reform should be designed, some advocating that the reform should aim at cutting taxation (which implies further public spending cuts) while according to some others the tax system become more progressive. The French tax-to-GDP ratio is 46%, and primary public expenditure amount to 50% of potential GDP. This high level of public spending reflects a choice of society, which should be maintained. The French tax system is already very progressive, similar taxation applies to capital and labour incomes. France is one the very few countries where inequalities have not risen in the recent past.

The paper addresses, for each category of tax, the reforms which could be introduced, and discusses whether they would be appropriate. In particular, the paper shows that replacing employers' social contributions by VAT would be useless. It is desirable but difficult to raise environmental taxation; French taxation should remain family-based, merging the income tax with the CSG is not desirable. Tax expenditures should be reconsidered, especially as concerns companies' and households' tax optimization schemes. Merging PPE and RSA is not obvious. A competitiveness shock (i.e. strong cuts in employers' social contributions and corporate taxation financed by a rise in CSG) should be implemented only in a European context.

Keywords: tax reform, French tax system.

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1. Introduction

French tax revenues increased by 60 billion euros (i.e. 3% of GDP) between 2010 and 2014. France ranks second in the world behind Denmark in terms of tax-to-GDP ratio. There seems to be a broad consensus according to which the French taxation system is not only heavy, but also unfair, complex and opaque. In the 2012 presidential election campaign, François Hollande had promised a great tax reform and has since then been widely criticized for not having undertaken it. Following protests related to the eco-tax introduction, and more generally, the rise in tax discontent, Jean-Marc Ayrault, Prime Minister, announced on 19 November 2013, that he would launch a great tax reform. In 2014, tax and social security contributions cuts were announced. But they were not part of a great tax reform, since they have no specified counterparts in terms of public spending cuts. The need for a great tax reform is often mentioned in economic debates in France, but the contents and objectives of such a reform are never clearly specified. There is a consensus on the need for a tax reform, but not on how it should be designed.

Taxation has three objectives: financing public and social expenditures, income redistribution, and economic incentives. According to some (see for instance, OECD, 2013), the tax system should have limited ambitions in these three areas; for some others, these ambitions should be strengthened.

Some are in favour of substantial tax cuts, expected to support the French economy by increasing domestic competitiveness, by giving firms incentives to invest and to create jobs, by giving people incentives to work more and to save more. But the implementation of tax cuts implies additional public spending cuts, although the Government is already committed to cut taxes by 50 billion euros before 2017.

Some propose to transfer the financing of social welfare from firms to households. Hence, the Medef (the French employers' organisation) requests company taxation to be cut by 137 billion euros. Should France step in tax competition in Europe through company taxation cuts, partly offset by higher households' tax burden and by public and social expenditure cuts?

Some advocate tax cuts on labour and capital incomes and tax increases on consumption, deemed less harmful to output, but others denounce the unfairness of indirect taxes, which hit more in proportion poorest people who consume almost entirely their incomes.

Others propose to share the tax burden more fairly between labour and capital incomes, to make French taxation more redistributive, to tax more heavily high incomes and wealth. But France is already one of the most redistributive countries, where richest people and capital incomes are more heavily taxed than elsewhere.

Some propose to abolish all tax expenditures, to widen tax bases and to cut tax rates. But they forget about the incentive role of taxation. Many tax schemes, even when they are complex, are justified for fairness reasons (such as the *quotient familial*), for jobs (such as social security contributions rebates on low wages, tax deductibility of child care expenditure, financial support to working poor (such as the *Prime pour l'emploi, PPE)*, or incentives (such as tax relief for donations to charity, trade unions' membership, tax credit for maintaining historical buildings). It may be noted that some incomes are not taxed, such as some capital incomes (life insurance, *Plan d'épargne en actions, PEA*), unrealized financial gains (but it is difficult to tax non accrued gains), imputed rents (for owner occupied housing, but who would dare to tax these rents?). What is needed is a long and patient process to dismantle tax expenditures rather than a great reform.

French taxation should become more environmentally-friendly, but is there really a double dividend (environment and jobs) or do ecological gains induce costs in terms of jobs, purchasing power, or competitiveness? Can French environmental taxation be increased in the absence of a European (if not world-level) agreement which looks very unlikely today? How to reconcile environmental and tax revenues objectives? Ecological taxation is necessarily complex if ones tries to avoid to (too much) hit farmers, industrial sectors, poorest people, peripheral regions, etc. This is what the failures of the carbon tax (in 2009) or eco-tax (in 2013) have shown.

Tax evasion implemented by large companies and richest people should be combatted, but this requires taxation harmonisation at the EU level, and is not without danger, if this obliges France to

bring its tax rates in line with EU average tax rates (as concerns wealth tax, corporate income taxation and income taxation). As for all EU issues, one should oppose a tax harmonisation liberal project according to which tax revenues should be cut, and a project where the European social model should be preserved and developed. But where could these two projects be democratically debated?

A 'miraculous' project re-emerged in France: merging the income tax with the CSG (*Contribution sociale généralisée,* see Landais, Piketty and Saez, 2011). But, here also, neither the objectives nor the means of the project were clearly specified. Is the project expected to make our system simpler or more redistributive, to be fairer to families or to support women's autonomy?

There is a risk that the idea of a great tax reform is a fallacy, hiding the inability to tackle the real problems of the French economy: the difficulty to insert in the new international division of labour; the rise in inequalities in status and in primary incomes induced by globalisation and the financialisation of the economy; the inability of developed countries, especially in the euro area, to find a new growth path since the financial crisis.

The structure of the taxation system is probably not the main problem to address, but rather the economic policy mistake made at the euro area level, to add fiscal austerity on top of the depressive shock induced by the financial crisis and, in France, to increase taxation by 3 percentage points of GDP since 2010 in order to cut the public deficit entirely induced by the recession.

The French tax-to-GDP ratio is 46%; primary public spending amount to around 50% of potential GDP. This high level of public and social expenditure is a choice of society which should be maintained. The French tax system is already highly redistributive. France is one of the few developed countries where income inequalities did not rise strongly in the recent past. Certainly, some reforms are needed to make the tax system even more redistributive, to make it more transparent and more socially acceptable. However, inequalities should be reduced first and foremost at the level of primary incomes. There is no miraculous tax reform: the current system results from a long process of economic and social compromise and will be difficult to improve.

2. A social choice: a high level of public spending

In 2013, French public spending amounted to 57% of GDP, placing France third among OECD countries, after Finland and Denmark. The economic depression led this ratio to rise temporarily: primary public spending (excluding interest payments) account for 50% of potential GDP.[2]

This level corresponds to a French (and even European) choice of a mixed economy, a compromise between socialism and capitalism, where a significant share of households' needs are covered in a socialized way, either by benefits in kind (education, health, childcare), either by benefits in cash, such as universal benefits (family benefits), assistance benefits (old age minimum income, RSA, *Revenu de Solidarité Active*) or social insurance benefits (pensions, unemployment). There are no proposals from any political party or social movement to dismantle this model. Thus, the various pension reforms have not chosen to switch from a pay as you go to a pension funds system. Thus, under Sarkozy's Presidency, the RSA was introduced which extends further social protection.

Over the last 17 years, the weight of primary public expenditure increased in France (+2.8 percentage point of potential GDP against +0.7 percentage point in the euro area); primary public spending in volume increased by 1.9% per year, on average, but GDP grew by 1.5% only per year. This contrasts with the strong falls observed in Austria, Sweden and Germany (Table 1). But primary public spending rose substantially in several EU countries (Belgium, Ireland and the United Kingdom); this is also true for the United States and Japan. Two opposite trends took place in developed countries: rising social needs (education, health, pensions) induce a rise in public expenditure, whereas the liberal ideology pushes for less State intervention and for privatizing some of its functions. But private solutions are often more expensive, raise inequalities and undermine social cohesion. Thus, in the euro area as a whole, the share of public spending has increased slightly over the last 17 years despite the pressures from the Commission.

2. The GDP level corresponding to normal cyclical conditions, if we assume that such a level may be estimated.

Table 1. Public expenditure to GDP ratios

	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		2007		1996		2013/1996
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	39.6	47.5	38.0	43.8	32.9	**+6.7**
Austria	51.3	47.8	48.6	48.6	55.9	51.9	*-4.1*
Netherlands	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*
Japon	*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***

Note: Public expenditure to potential GDP ratios depend substantially on the output gap, which is particularly difficult to estimate for 2007 and 2013. In this table, we use the OECD figures. According to our own estimates, the French ratios would be 49.3% in 1996, 50.1% in 2007 and 2013, i.e. would have risen by 0.8 percentage point only.
Source: OECD, *Economic Outlook*, November 2013.

France is one of the countries with the highest public spending to GDP ratio. Apart from regalian functions (armed forces, police and justice), the State provides free services to households (education, health); finances collective equipment, research, culture, substantial; allocates substantial transfers (family policy, minimum income) and organises a substantial collective insurance (pensions, unemployment). The ageing of populations generates an increase in health and pension expenditure, the technical changes generate a need for higher education and research spending, the rise in exclusion makes it necessary to increase solidarity benefits; the population wishes more collective equipment, more safety measures. Innovative companies like sectors in difficulty should be supported. Large military spending like large international aid

expenditures are necessary to play an important role at the international level. For all these reasons, there is a rising trend in public spending.

The high level of French public spending is especially clear in the area of social protection, which is 4% of GDP higher in France than in the euro area average (Table 2). France has made no choice between solidarity benefits, insurance benefits and universal benefits: it provides the three of them. The French health system is almost entirely public, there are universal family allowances, young child-care allowances to help working women who take a job, and allowances to help women who give up their job to care after their young children; unemployment benefits are relatively generous (accounting for housing benefits). There are also a RSA (*Revenu de solidarité active* – minimum income) and housing benefits. Last, there is relatively generous pensioner minimum income (accounting for housing benefits). The supplementary pensions system is public. Public expenditures dedicated to education are 1 percentage point of GDP higher in France than in the euro area, due to a larger proportion of young people in the population and to the low level of private education expenditure (Table 2).

Table 2. Public expenditure per function in GDP in 2012

Percent of GDP

	France	Germany	Italie	Euro aera	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*
Functioning	*9.6*	*8.8*	*12.4*	*9.0*	*10.6*	*10.0*	*12.2*
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.

So, any substantial cut in the public expenditure ratio implies privatising, in one way or another, 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 rest of the population having to turn to private institutions. There is a risk that the society becomes a three-speed society, with free but low quality health or education for the poor; and higher-quality benefits for the richer who can afford to pay for them.

Besides, public spending is not a GDP component. A large number of public expenditure consist in transfers to companies and to households, which finance private consumption spending, themselves satisfied by private companies.

Many economists, politicians, liberal think-tanks (Institut Montaigne, 2012), and international institutions (OECD, 2013) consider that France should implement a competitiveness strategy, through sharp cuts in social benefits allowing to cut employers' social contributions. But such a strategy would weigh on households' incomes, households having to pay for private health insurances for instance. Such a reform would result in a more expensive (as shown by the US example) and unfair system (each family would pay according to its risks and not to its incomes). It would be preferable to consider each objective separately: on the one hand, social protection should be managed according to its own objectives; on the other hand, competitiveness should be improved either through R&D, innovation or, as a last resort, through lower wages (and dividends) paid by firms. There is no reason *a priori* why competitiveness gains should be obtained mainly *via* lower social spending.

The current Government is committed to cut public expenditure by 50 billion euros (i.e. by 4.5%). This implies substantial cuts in public services and social expenditure, which is harmful for social cohesion, is economically and socially undesirable in times of weak demand and mass unemployment.

So far, the social protection level has remained high in France. As a result, income inequalities and poverty rates are lower in France than in Anglo-Saxon and Mediterranean countries, and they are not rising contrary to Nordic countries and Germany (Table 3).

Table 3. Rates of poverty in Europe

	1997	2007	2013	Change 1997/2013
Germany	12	15.2	16.1	+4.1
Austria	13	12.0	14.4	+1.4
Belgium	14	15.2	15.1	+1.1
France	15	13.1	13.7	-1.3
Netherlands	10	10.2	10.4	+0.4
Spain	20	19.7	20.4	+0.4
Greece	21	20.3	23.1	+2.1
Italy	19	19.9	19.1	+0.1
Portugal	22	18.1	18.7	-3.3
Denmark	10	11.7	12.3	+2.3
Finland	8	13.0	11.7	+3.7
Sweden	8	10.5	14.8	+6.8
Ireland	19	17.2	16.1	-2.9
United Kingdom	18	18.6	15.9	-2.1

Source: Eurostat. Poverty rate at 60% of median income.

However, higher wages and incomes rose in France. The share of the 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[3]. From 2004 to 2010, the number of households' paying the ISF (wealth tax) rose by 69%. In households' incomes, the share 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%[4].

In 2013, the D10/D1 income ratio was 20.1 before redistribution and 5.9 after (Table 4). The French system is strongly redistributive, mainly because of social benefits. The redistributive role of taxation is less clear, particularly for higher incomes.

3. According to *Emploi et salaires*, INSEE Références, 2013.
4. According to *Les revenus et le patrimoine des ménages*, INSEE Références, 2013.

Table 4. Primary and disposable incomes in 2013

	Incomes before redistribution	Social benefit ratio	Tax ratio	Incomes after redistribution
D1	14.4	168.4	-4.3	41.6
Q1	26.6	61.1	-4.9	46.8
Q2	59.6	8.1	-6.9	66.1
Q3	82.8	3.4	-10.1	84.7
Q4	111.4	1.7	-12.7	108.7
Q5	219.6	0.6	-20.2	193.5
D10	289.8	0.5	-22.9	246.6
Total	100	5.7	-14.4	100

Source: INSEE, *France, Portrait social*, 2014.

3. A heavy and original taxation system

In 2013, France ranked second among OECD countries in terms of compulsory tax rates (table 5), at the same level as Northern European countries.

Table 5. Total tax revenues as a % of GDP

	1990	2007	2013 (p)
Denmark	45.8	47.7	48.6
France	41.0	42.4	45.0
Belgium	41.2	42.4	44.6
Finland	42.9	41.5	44.0
Sweden	49.5	44.9	42.8
Italy	36.4	41.7	42.6
Austria	39.4	40.5	42.5
Euro area	**36.5**	**38.3**	**39.3**
Netherlands	40.4	36.3	37.3
Germany	34.8	34.9	36.7
Greece	25.0	30.9	33.5
Portugal	26.5	31.3	33.4
United Kingdom	34.2	34.1	32.9
Spain	31.6	36.4	32.6
USA	*25.6*	*26.9*	*30.1*
Ireland	32.4	30.4	28.3
Japon	*28.5*	*28.5*	*27.8*

Source: OECD, Revenue Statistics, 2014.

The French tax system has four characteristics as compared with EU partners (Tables 6 to 8):

— There are two income taxes in France (a progressive tax (IR) and a flat tax (CSG)) having in total a relatively low weight. Conversely, the household's 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 6. Structure of taxation, in % of GDP in 2007

	DE	AT	BE	ES	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	SW	UK	EU15	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**

* Mainly business local taxes.
** Mainly IRAP.
Source: OECD, *Revenue Statistics*, 2014.

Indeed, there is no reason why French taxation should be brought in line with EU partners' taxation. Social contributions should be high 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 could suggest that France should reduce public spending, increase the weight of its income tax and of its VAT, cut employers' social contributions and capital taxation. But this would mean implementing a tax competition strategy, harmful at the EU level. France needs to make a social and political choice: remain original (which is dangerous for an open economy) or come in line with other countries.

Table 7. Structure of taxation in Germany and France, in 2012

In % of GDP

	Allemagne	France
Total	36.5	44.0
Personal income	9.3	8.0 (2.9+5.1)*
Corporate income	1.8	2.5
Employees' social contributions	6.2	4.0
Employers' social contributions	6.5	11.3
Others social contributions	1.2	1.3
Wage taxes	—	1.4
VAT and other indirect taxes	10.4	10.8
Local business tax	—	1.1
Taxes on capital, of which :	0.9	3.8
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*	*0.5*
Transactions	*0.3*	*0.6*

*CSG-CRDS+IR
Source: OECD, *Revenue Statistics*, 2014.

Table 8. Implicit tax rates in 2012

	Labour	Consumption	Capital
EA17	*38.5*	*19.3*	*30.7*
Germany	37.8	19.8	22.2
Belgium	42.8	21.1	35.5
Spain	33.5	14.0	25.3
France	39.5	19.8	46.9
Ireland	28.7	21.9	13.0
Italy	42.8	17.7	37.0
NLD	38.5	24.5	13.7
Netherlands	38.6	26.5	30.6
UK	25.2	19.0	35.7

Source: Eurostat, *Taxation trends in the European Union*, 2014.

4. The recent reforms

The recent history of French taxation can be split into four episodes.

1) The tax-to-GDP ratio decreased by 1.6 percentage points from 1999 to 2002. This is the so-called '*jackpot*' effect of Lionel Jospin: strong GDP growth in 1997-2000 reduced the public deficit, prompting the government to cut taxes. The measures introduced by the Jospin Government amount to roughly 35 billion euros, i.e. 2.3% of GDP, split between households (12 billion), companies (12.5 billion) and indirect taxes (10.5 billion). Some of these measures (VAT and CIT rates cuts) were a return to normal after the 1995-1997 tax increases measures introduced to meet the Maastricht criteria. Other measures are part of an employment policy based on lowering employers' social contributions and removing the inactivity trap (introduction of the PPE, *prime pour l'emploi*, an employment premium, cut in residency tax). Some had purely electoral purposes and hardly any economic justification (income tax cuts, car tax ('*vignette automobile*') abolition). From a macroeconomic viewpoint, this policy was strongly criticized by the European Commission, which considers it was responsible for the high level of French public deficits in 2003-2004. According to the Commission this is an illustration of a pro-cyclical policy.

2) Measures introduced in 2007 by Nicolas Sarkozy, at the beginning of his presidency, in particular the TEPA law (law for labour, employment and purchasing power) induced tax cuts of around 16 billion euros in full-year basis: tax-exemption of over-time pay, of mortgage interest payments, cuts in ISF (high wealth tax) and inheritance taxes, cuts in local business taxes, widening of the *Crédit Impôt Recherche* (tax credit for R&D expenses). In the following years, the government also cut the VAT rate on hotels and restaurants (2.4 billion euros) and reformed companies' local taxation (4.5 billion euros).

3) However, starting from 2011, France accepted the European constraint of reducing public deficits. From 2011 to 2013, tax increases reached 60 billion euros (3% of GDP). The Fillon government removed the tax exemption on mortgage interest payments, rose the '*forfait social*' and capital income taxation, introduced a contribution on high incomes, toughened CIT and income tax legislations, froze income tax brackets (formerly price-indexed); all

in all raising tax revenues by 30 billion. The five-year Sarkozy's Presidency shows that it is difficult to implement a liberal reform of French taxation. The announced objective of cutting massively the tax-to-GDP ratio (by 4 percentage points) was not met: the ratio rose from 42.1% in 2007 to 43.7% in 2012.

From 2012, François Hollande removed the tax-exemption on overtime pay, 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*), rose the *forfait social,* the social contributions on pensions and self-employed contributions, toughened CIT legislation (25% of interest payments subject to CIT, increase in capital gains taxation). In addition, in 2014, households' taxation was increased by 12 billion euros (increase in VAT rates and in inheritance taxation, additional lowering of the ceiling of family tax reduction, taxation of complementary health employers' contributions, etc.).

The financial crisis cut French GDP by 8%; i.e. 4 percentage points in terms of tax revenues. The Fillon and Ayrault governments both agreed to comply with financial markets and EU Commission's diktats and to add an austerity tax shock to the financial crisis shock. The strong rise in taxation, without counterparts in terms of expenditure had a negative impact on output and fed a feeling of tax revolt (the so called *'ras-le-bol fiscal'*). Conversely it allowed abolishing several unjustifiable tax expenditures and to increase taxation on capital incomes and on the wealthiest.

4) Another episode started in 2014. Under strong lobbying from employers complaining about excessive taxation harmful to firms' competitiveness and investment, the government introduced the CICE (competitiveness and employment tax credit) and announced a responsibility Pact, CIT cuts, and the abolition of the C3S[5], totalling 40 billion euros. In face of growing tax discontent, the government also announced households' tax cuts, such as cuts in employees' social contributions on low wages (which was later

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

rejected by the *Conseil Constitutionnel*) and income tax cuts for low and middle incomes (amounting to 5 billion euros).

Table 9. Tax-to-GDP ratios

In %

	Tax-to-GDP ratios
1999	43.6
2000	42.8
2001	42.5
2002	41.9
2003	41.8
2004	41.9
2005	42.5
2006	42.8
2007	42.1
2008	41.9
2009	41.0
2010	41.3
2011	42.6
2012	43.7
2013	44.7
2014	44.7
2015	44.6
2016	44.5
2017	44.4

Source: INSEE until 2013, and *Projet de loi de programmation des finances publiques 2014-2019*, from 2014.

The Government committed to cut the public deficit by 50 billion euros and company taxation by 40 billion between 2013 and 2017. This would be financed by public expenditure cuts amounting to 50 billion euros. 40 billion are thus lacking: the French government seems to have abandoned the objective of rapid public deficit reduction.

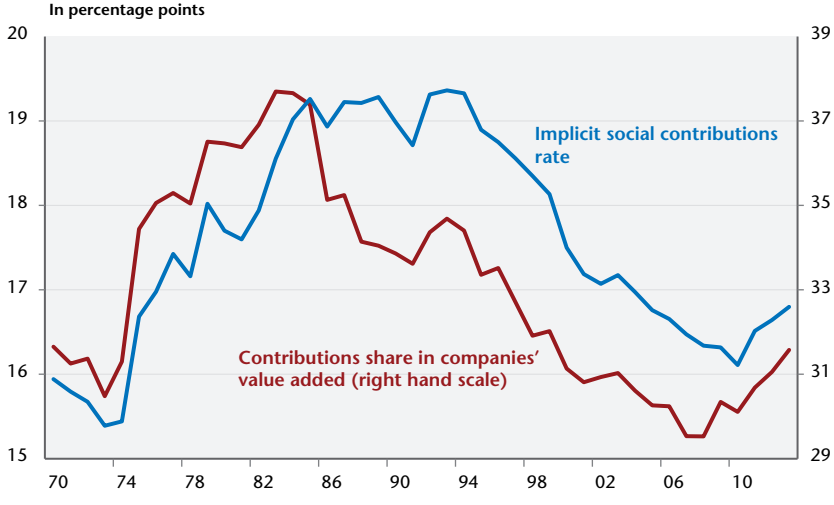
5. The reform of the Social Security financing

There are three arguments in favour of reforming social protection financing. The first argument is that financing should follow an economic and social rationale, according to which social insur-

ance benefits (unemployment, retirement) should be financed by contributions on wages while universal and assistance benefits (health, family and minimum income) should be funded by general taxation. The second argument is that universal benefits financing should not be harmful to employment; and should therefore weigh either at the level of companies on all production factors: labour, capital and energy, or at the level of households, on all their incomes. The third, and more circumstantial argument, is that French companies need a price-competitiveness shock and since currency devaluation is impossible, labour costs need to be cut via lower employers' contributions. But in counterpart other resources should be allocated to social protection.

France is the country with the highest social security contributions in the world. This is due to the size of the social protection system: the French worker does not have to pay a private insurance for his retirement and health. Family and unemployment benefits are relatively generous. Net wages may be lower (which offsets the additional wage costs induced by social security contributions). Since 1984, employers' social contributions have fallen quite substantially as a share of value added, from 19.8% in 1984 to 15.8% in 2007 (Figure 1), thanks to tax exemptions. Hence employers' social contributions can hardly be blamed for being responsible of the recent competitiveness losses of the French economy.

Figure 1. Employers' social contributions share in companies' value added



Source: INSEE.

At the median wage level, social contributions rates stand at 44% for employers and 21.7% for employees (including the CSG). A French specificity is to collect social security contributions without ceiling and to cut payroll taxes on low wages (with social security entitlements being unaffected). Thus, wages at below 1.6 times the SMIC (the *minimum wage*) benefit from employers' contributions rebates, amounting to 28 percentage points at the SMIC level. Besides, low-wage earners are entitled to 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 characteristics.

The reform should clearly distinguish social insurance benefits (pensions, unemployment, and sickness replacement benefits), entitled on the basis of work-related contributions. These contributions should remain proportional to wages if benefits are to remain linked to wages. General taxation cannot entitle higher benefits to higher-wage earners. These real contributions amount to 38.5 percentage points. They should not be part of the compulsory tax rate. The latter should be lowered by 15.5 percentage points, from 44.5 to about 29 points. Any future increase in these benefits should be financed by higher employees' contributions so that the employees' social choice – contributions/pensions level/retirement age – is transparent and does not weigh on competitiveness. Currently, employees' social contributions finance only social insurance benefits. The plan of lowering employees' contributions on low wages (announced by Francois Hollande on 31 March 2014) had no economic rationale and would have complicated the wage bill further. Fortunately, the Constitutional Council rejected the plan, saying that these regimes should continue to be contributive: benefits entitlement relies on contributions paid.

On the contrary, universal (health, family) or solidarity benefits should be financed by taxation. Currently, they are financed by employers' social contributions (without ceiling), by the CSG and by social levies on households' capital incomes. In the past, it was considered that companies were benefiting from the existence of health and family (especially child-care expenditure) benefits, which were ensuring the availability of a healthy labour force, and hence it was not illegitimate that companies contribute to universal social protection financing. Firms' competitiveness and

wage costs issues lead to put this argument aside. Any future increases in terms of health expenditure should be financed by taxation on households' incomes, such as the CSG. Here also, this will have no impact on firms' competitiveness.

Therefore, the underlying problem is: what shall be done with current health and family employers' social contributions (i.e. 17.45 percentage points)? Five projects are on the table. The first two (CSVA or ecological taxation) would not improve firms' competitiveness, but could increase employment via substitution effects. The third (increase in the CSG offset by an increase in gross wages) would bring a social clarification, without economic impact. The last two (CSG rise not offset, VAT rise) imply lower households' incomes to increase French companies' competitiveness or profitability.

5.1. Employers' social contributions exemptions.

In the absence of a comprehensive reform, the solution adopted since 1993 has been to extend social security contributions' exemptions schemes. In 2014, there were 71 exemption schemes, amounting to 28 billion euros (table 10). It has become the major instrument of the French employment policy. These exemptions are based on the theory according to unemployment is high because of labour costs, especially at the minimum wage level. Conversely, these exemptions undermine the social protection financing, which sees its own resources declining; these exemptions tend to devalue the social role of work (see Friot, 1999).

Table 10. Exemptions from social security contributions in 2014

Billion euros

	Offset	Non-Offset
Low wages	20,700	
Overtime	510	
Specific workers	1,140	1,740
Geographical areas	1,410	
Households' workers	180	1,770
Other sectors	630	150
Total	24,570	3,660

Source: PLFSS (2015).

Companies benefit from social security contributions cuts on low wages, amounting to 28 percentage points (over 44) for workers paid at the SMIC (minimum wage) level and decreasing linearly up to 1.6 times the SMIC. This lowers the minimum wage cost by 18.6%. In addition, minimum-wage earners are entitled to the PPE (7.7% of the net SMIC) in order to widen the gap between the minimum wage and the RSA (the minimum income). These social security contributions rebates had *ex ante* a cost of around 20.7 billion euros in 2013. Their impact is controversial (see Sterdyniak, 2007); according to the French ministry for Labour, the impact is 800,000 additional jobs (26 000 euros by job, which is high when the employers' total wage cost for a worker paid at the SMIC level is 24 540 euro without social contributions rebates. The *ex-post* cost would be significantly lower, 10 billion euro, since these jobs generate 12 billion euros in terms of social contributions and lower unemployment benefits. According to Heyer and Plane (2013), the impact would be 500 000 additional jobs (110 000 via capital-labour substitution, 230 000 via a basis effect, 80 000 by higher demand effect and 80 000 by a competitiveness effect). The effect comes down to 330 000 (250 000) if the measure is financed *ex post* by higher taxes (by lower public expenditure).

Three justifications may be given for targeting low-wages social contributions. The first one is that the minimum wage is too high in France and deemed responsible for unskilled workers' high unemployment while graduate workers are close to full employment. But one may argue that in a mass unemployment situation, companies have a choice and may prefer to hire over-skilled employees, themselves resigned to apply for a job below their skills. It is true that unemployment rates are higher and employment rates are lower for unskilled than for skilled people. But the gap between unemployment rates is not larger in France than elsewhere (Table 11), despite the SMIC, and the gap between employment rates did not shrink despite the policy of lowering social contributions at low-wage levels (Table 12). The second justification is a pure basis effect: it is less costly to cut labour costs for low than for higher wages. But social contributions cuts on low wages are an incentive to create poor quality jobs.

Table 11. Unemployment rates by level of education (2012)

	Primary	Tertiary	Gap
Spain	31.2	14.0	17.2
Germany	12.8	2.4	10.4
United States	14.3	4.6	9.7
Belgium	12.1	3.4	8.7
France	13.8	5.1	8.7
OECD	13.4	5.0	8.4
Sweden	12.3	4.0	8.3
Finland	11.6	3.9	7.7
United Kingdom	10.5	3.6	6.9
Italy	12.2	6.4	5.8
Austria	7.7	2.1	5.6
Denmark	9.6	4.7	4.9
Netherlands	6.6	3.0	3.6

Source: OECD (2014): *Employment Outlook.*

Table 12. Higher-graduates and non-graduates employment rates

	1994	2012	Change
Germany	34.4	30.4	-4.0
United States	34.0	27.2	-6.8
Belgium	34.0	37.0	+ 3.0
Austria	32.8	31.4	-1.4
Italy	32.7	27.8	-4.9
Netherlands	30.6	25.4	-5.2
United Kingdom	30.3	27.3	-3.0
France	29.4	28.9	-0.5
Spain	28.5	28.0	-0.5
Denmark	28.4	25.0	-3.4
Finland	28.3	29.2	+ 0.9
Sweden	20.5	24.7	+ 4.2

Source: OECD (2014): *Employment Outlook.*

The third justification is that labour demand elasticity to labour costs would be higher for low than for higher wages. Thus, Heyer and Plane (2013) assume that this elasticity ranges from 0.9 at the minimum wage level to 0.2 for higher wages. According to Brunel *et al.* (2013) this elasticity is 0.75 at the SMIC level and 0.25 above 1.6 SMIC. As long as the elasticity is lower than 1, this policy

appears more costly than public jobs creation (see, Sterdyniak, 2012b). But these estimates have no recent empirical basis on French data. 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 the number of layoffs.

This strategy has three drawbacks: it benefits more to services than to industrial sectors (where there are fewer low wage jobs); it is an incentive for firms to create a specific category of jobs at the minimum wage level, without any career prospect, often through outsourcing; it supports low-wage companies at the expense of the companies making efforts to promote their employees.

A single worker paid at the SMIC costs 1 671 euros by month to his firm (for a 35 hour working week); he pays 540 euros in terms of contributions to unemployment and retirement schemes, representing deferred wages; he receives a net transfer of 140 euros (PPE + housing benefit - generalised social contribution (CSG) – income tax – health and family contributions); his disposable income is 1 271 euros. He does not support any tax burden and is entitled to health insurance for free. The standard of living of minimum wage-earners is totally disconnected from their labour costs.

But these exemptions weaken the social security financing. Employers' social contributions, and RSA generate low-paid jobs, for which wage increases are very costly for the employer and very limited for the employee. Hence, a 100 euros rise in the wage of a worker paid at the minimum wage, raises the employer's costs by 165 euros and raises employee's wage-earnings by 40 euros. Companies are encouraged to create specific unskilled jobs, without career prospects, trapped in a low-wage situation. Cutting contributions on low wages does not encourage skilled job creation, although there is a certain level of unemployment rate for skilled people too. One day, France will have to change its employment strategy. Conversely, the persistence of a large number of unskilled workers and the social denial to lower the standard of living of the working poor, do not really allow to dare to remove or to reduce these schemes.

Contributions cuts at the minimum wage level (28 percentage points) are currently larger than health and family employers'

contributions (17.45 percentage points), which makes it difficult and even prevents the implementation of a great reform. It would be difficult to reform employers' contributions without increasing unskilled jobs' relative labour costs.

5.2. The social contribution on value added

Employers' social contributions rebates could be offset by increasing companies' profits taxation. In so doing, one would abandon the objective of gaining competitiveness and target capital/labour substitution. Abolishing all employers' family and health contributions (17.45 percentage points or 98 billion euros, net of exemptions on low wages social contributions) would require the introduction of a Social Contribution on value added (SCVA[6]) of 8.3%: 32 billion euros would weigh on capital rather than on labour (Table 13).

Table 13. Changing the social contributions basis

In billion euros, figures for 2013

	Before reform	After reform
Gross wages	612	612
Employers' social contributions	196	100
SCVA on wages		64
Gross operating surplus	352	352
SCVA over gross operating surplus		32
Added value (factor prices)	1,160	1,160

Source: Authors' estimates.

Such a measure would not affect company profitability in the short term. Higher capital taxation would be offset by lower labour taxation; the overall firms' burden would be unaffected. In the medium term, companies would respond in using more labour (at unchanged real wages, but lower total cost) and less capital (the overall cost would be higher but the after-tax profit rate would be unchanged). *A priori*, prices would not rise.

6. Let us recall that it is a "real value added ", without investment or capital depreciation deductibility.

But such a reform would have five consequences:

— The relative labour/capital cost would diminish, which would be an incentive for companies to use less machines and more labour.

— The labour cost would be reduced in absolute terms, which would support service industries.

— Households would be encouraged to buy products with a high labour content, which would see their relative price decrease at the expense of capital-intensive products.

— A transfer would be made from highly capital-intensive firms to labour intensive companies. Social protection financing would be shared more fairly between branches, while it currently weighs heavily on branches with high payroll to value added ratio.

— At the macroeconomic level, the increase in consumption (induced by job creation) would offset the decline in investment (induced by lower capital needs).

From a theoretical perspective, the debates in 1987-1988 as in 2006-2007 showed that this measure made sense only if one considers that France is durably 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 note σ the elasticity of substitution between capital and labour, w the real wage rate, π the rate of (after tax) profit, t the employers' contributions rate, θ the tax rate on gross operating surplus, n, employment, k the capital.

The production constraint is:

$$y = \alpha \,.\, n + (1 - \alpha) \,.\, k$$

The choice of production technique gives:

$$k = n + \sigma \,.\, (w + t - \pi - \theta)$$

The product exhaustion constraint is:

$$y = \alpha \,.\, (w + t + n) + (1 - \alpha) \,.\, (\pi + \theta + k)$$

The social security resources stability constraint is:

$$0 = \alpha \,.\, t + (1 - \alpha) \,.\, \theta$$

Let us assume that employers' social contributions are cut; this being offset *via* higher profit taxation, the rate of profit, determined by the world capital market, remaining fixed.

In a classical situation, employment rises with real wages: $l : n = n_0 + l \,.\, w$. But the measure does not increase real wages. Employment does not change. *Ex post*, capital decreases by $k = \alpha \,.\, \sigma \,.\, t/(1 - \alpha)$; output by $y = -\sigma \,.\, t$.

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

The reform decreases the labour/capital relative cost by 11.2%. If the elasticity of substitution between capital and labour is unitary, then the reform should raise employment by 3.15% (600,000 jobs). Since the elasticity of substitution is slow, the production technique changing only once new capital is introduced, then the full effect would be obtained only after several years. The simulations run with OFCE's quarterly model of the French economy (see Timbeau *et al.*, 2007) led to less job creation (227,000 for 17.45 points), since the elasticity of substitution was assumed to be 0.45.

According to some economists (see Malinvaud, 1998, Groupe de travail, 2006), this transfer would undermine the capacity of firms to innovate and modernise. However, modernisation by substituting capital to labour is harmful in a mass unemployment situation. Firms can be innovative in hiring highly skilled workers rather than in using capital intensively.

The measure would be detrimental to firms making high profits and would encourage companies making low or no profits. This may be considered dangerous for economic activity. On the contrary, some companies may earn high profits because they benefit from rents; others may be in trouble because they are high many workers and face low-wage countries competition, in which case it would be justified to support them.

However a transition issue remains: the reform may be detrimental to existing firms and techniques, and encourage the emergence of new companies or techniques. This is less of a problem if the companies supported already exist and if the point is to keep them alive.

The measure would provide a competitiveness advantage for France in labour-intensive sectors and a disadvantage in capital

intensive sectors. The risk is that the first effect is small (due to differences in labour costs between France and emerging countries) and that the latter effect is large (due to competition with other European countries).

Studies implemented in 2006 (see Groupe de travail, 2006) showed that the employers' social contributions/CSVA transfer would be neutral for innovative companies (which benefit from the research tax credit). It would hurt the energy sector (+1.3% of the wage bill), financial activities (+0.9%), real estate activities (+0.5%) and agriculture and food industries (+0.2%). The winning sectors would be: services to firms (-0.3%), equipment goods (-0.25%), construction (-0.25%), automotive industry (-0.2%). Large companies would be losing; small companies would win. The winners would cover 69% of companies, 50% of value added, 54% of exports.

In 2006, an argument against this reform was that it would require the introduction of a new tax, with a new basis – the value added –, which would entail costs in terms of additional statements for companies and control from public administration (COE, CAS, 2006). But the introduction of the CVAE (*Contribution sur la valeur ajoutée des entreprises*) to replace partly the local business tax makes the proposal much more credible: requiring only to increase the CVAE from 1.5% to 9.8%, i.e. from 12 to 110 billion. The 2007 debate had rejected this measure as being too risky, judging also that slowing down capital/labour substitution was not going in the right direction.

5.3. Environmental 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 may think that any rise in environmental taxation should be offset by lower employers' social contributions. On the whole, companies' tax burden would not rise and so *a priori* prices would be unchanged; firms' competitiveness would not be affected; but companies would be encouraged to use more labour and pollute less. This is the 'double dividend logic': environmental taxes would have the double advantage of giving incentives to reduce the use of polluting products and of allowing, thanks to collected revenues, to reduce labour costs. In 2013, envi-

ronmental taxation amounted only to 1.8% of GDP in France, as compared to 2.3% in the euro area (but 3.8% in Slovenia and 3.6% in the Netherlands), and 3.9% in Denmark.

Combining environmental taxation and employers' social contributions cuts may lead to less pollution and lower unemployment without any cost for public finances. This is all the more likely to happen in a country with under-employment. But environmental tax revenues will be all the more substantial that demand for taxed goods has low price-elasticity. There is a contradiction between the ecological objective (a high and targeted taxation may be so effective that it generates *ex-post* low revenues) and the revenue objective: tax revenues must be significant to allow substantial cuts in employers' social contributions. In terms of social security resources, the risk is to lose a relatively well-ensured basis against a basis intended to erode. This would be the case for example if employers' contributions were replaced by a deterrent tax on diesel.

Two strategies may be considered as concerns ecological taxation:

1. The rise of the eco-tax may be offset by a production (or consumption) subsidy for each type of product (the *bonus-malus* principle); green products are subsidized while polluting products are more heavily taxed. It can also be offset via subsidies to each producer (or consumer), according to their past consumption of polluting goods. Such a strategy has the advantage of not directly harming polluting sectors, but is difficult to implement: it requires a fine knowledge of the production processes. How to deal with new firms? How to embed ongoing technical progress? Taxation gives companies an incentive to change their production techniques, but it gives no incentive to households for not consuming goods resulting from a polluting production process. Households may choose greener cars (instead of stopping using cars).

2. Environmental taxation may be offset at the aggregate company level by social security contributions cuts. This hits directly polluting firms in raising their average production costs; companies' price increases lead households to consume less polluting products. This strategy can be implemented without any prior microeconomic analysis; it will support labour-intensive sectors, using little energy, but industrial sectors will be particularly hit.

A tax reform altering significantly the cost structure of firms implies costly restructuring: some activities are no more profitable and should therefore be stopped; some others become profitable, but require new investments. Whether it will generate substantial financial resources or not is uncertain.

In France, the failure of the climate-energy tax in 2009 may lead to be pessimistic: the acceptance of such a tax reform requires that part of its revenues are used to help poorer households, hit bit higher fuel and heating prices, and to subsidize energy savings (collective transportation, construction sector). On the whole, prices are likely to rise and competitiveness to deteriorate. A price index excluding energy taxation should be introduced and households (at the exception of the poorest) should accept lower incomes to finance energy savings and support to the poorest.

In any case, such a reform should be coordinated at the European and even at the world level, to prevent polluting sectors from relocating production in poor or emerging countries, while other countries could decide not to introduce environmental tax measures in order to maintain their domestic industries. But poor and emerging countries will accept a worldwide agreement only if it is asymmetrical: part of the tax revenues raised in developed countries should be used to help poorer countries to make the necessary efforts (adopting less polluting production techniques). The eco-tax revenues cannot be used to cut employers' social contributions.

Some have proposed to offset the eco-tax by taxing products imported from countries not applying the eco-tax. For example, if European countries raise a 100 euro fee on European companies per emitted tonne of CO_2, they will apply the same tax on imported products, after deduction of already paid taxes. This would be justified before the WTO, on the ground of ecological need and on the principle of domestic and foreign producer similar treatment. However this project seems unrealistic: the amount of emitted CO_2 would be impossible to calculate, product-by-product. Moreover, the issue of competitiveness on external markets would remain (unless the eco-tax is repaid for exports). Last, can the WTO agree with such a project? Why not apply the same problematic to social contributions: protecting our social system in taxing products from countries with too low social protection?

The most promising strategy for our competitiveness would be to introduce an environmental tax, the revenues of which would be used to cut employers' social contributions and allowing us to tax imports from countries with no environmental taxation. There would thus be a triple dividend. But will the WTO agree?

Here again, the measure is effective only in a Keynesian unemployment situation. Let us consider the same model as above. σ is the elasticity of substitution between labour and energy, w is the real wage, π the price of energy, t: the employers' contributions rate; θ the tax rate 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 product exhaustion is:

$$y = \alpha \,.\, (w + t + n) + (1 - \alpha) \,.\, (\pi + \theta + e)$$

The stability of social security resources constraint is:

$$0 = \alpha \,.\, t + (1 - \alpha) \,.\, \theta$$

Let us assume employers' contributions cuts offset by higher energy taxation, the objective being to decrease energy consumption by η.

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

In a classical situation, employment is a rising function of the real wage: $n = n_0 + l \,.\, w$. But the tax measure does not allow to increase real wages. Employment does not change. *Ex post*, production decreases by $y = -(1 - \alpha) \,.\, \eta$ with $\theta = \eta/(\alpha\sigma)$. The ecological effect is obtained, but not the employment one.

5.4. Increasing 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 transparent social choices: family benefits would appear as a transfer between households, health

expenditure as a households' choice not involving firms. The rise in the CSG would provide a well designed resource to Social security.

The traditional arguments would be left apart: firms need a healthy workforce (which justifies that companies contribute to health expenditure), renewing itself (which justifies that companies contribute to family expenses), and is available (which justifies that companies contribute to child care costs).

This reform could be implemented through four modalities:

1) With fixed gross wages, the reform would imply a huge transfer from households to companies. Companies would gain (households would lose) 17.45% of gross payroll, i.e. 5.5% of GDP (assuming that exemptions on low wages are abolished). This is the reform advocated by the Institut Montaigne (2012). This reform 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): in this case, the reform would be entirely neutral.
3) Alternatively, after the wage increase, the CSG could be raised by 10.5 percentage points on all incomes. In purchasing power, employees would thus gain 4.8%; pensioners would lose 11.3% (their CSG rate would increase from 7.1% to 17.6%); rentiers (capital income earners) would lose 12.4% (their CSG – social security contributions on incomes would increase from 15.5% to 26%).
4) Offsetting measures could be introduced for pensioners or rentiers so that neutrality is reached.

In the second case, the measure would be neutral; it would be a simple accounting operation. There would be no competitiveness shock. Contrary to Piketty's argument[7], it would have no impact on the cost of wage increases or of job creation. However, low-wage companies would lose: they would bear a 17.45% rise in the SMIC;

7. « La baisse de coût du travail pour un salaire brut donné, s'appliquera aux nouvelles embauches et aux augmentations de salaire, mais ne doit pas se faire sur le dos de ceux qui ont déjà un emploi », Libération, 24 septembre 2012.

they would pay at best no health and family benefits, while exemptions from contributions (28 percentage points today) are higher than health and family contributions (17.45%). Offsetting measures would be required for such companies.

In the third case, the measure would be neutral for firms; it would give purchasing power gains to employees at the expense of pensioners and capital income earners. This raises two issues: is it fair to deteriorate substantially the relative situation of pensioners (already projected to deteriorate under the impact of pension reforms)? As we will see later in the paper, capital income taxation is already as heavy as labour income taxation, and so the rise in the CSG would require compensatory measures (abolishing social security contributions on incomes or introducing a rebate to account for inflation or corporate taxation already paid). This could then lead to the fourth case: an entirely neutral measure.

5.5. Social VAT

Many industrial business leaders and parliamentarians have put forward social VAT. But contrary to what its proponents say, social VAT would not be a 'miracle' reform allowing for social protection to be financed by machines or by foreign producers. It could have a positive impact on jobs only if it led to lower employees and pensioners' purchasing power.

Let us consider first a closed economy. Would social VAT encourage firms to use more labour? Let us assume that several percentage points of employers' social contributions are replaced by VAT percentage points. At best, firms will translate fully contributions cuts in production prices and consumer prices will remain stable, despite higher VAT. However, VAT and employers' social contributions have *roughly* the same base (payroll), since the VAT does not weigh on investment and hence on capital (see Sterdyniak and Villa, 1984 and 1998). Therefore, VAT, like employers' social contributions, weighs only on labour. VAT has no impact on the relative capital/labour cost: labour costs are lowered but capital goods prices, which bear no VAT, are reduced similarly. The measure does not encourage firms to use more labour and less capital. It does not alter the relative situation of capital-intensive and labour-intensive industries: labour-intensive industries support both heavy social contributions and heavy VAT, as they benefit hardly from VAT

deductibility on investment. Capital-intensive companies bear little employers' social contributions (as they have few employees) and VAT (since they benefit from VAT refund on their investment). The cut in employers' contributions is offset by higher VAT not only at the aggregate but also at each sector levels. There is no sector effect to be expected. Relative prices of goods do not change and hence there is no reason why consumers would change the structure of their expenditure.

In order to see this more precisely, let us note p consumer prices, q production prices, w the wage, π the rate of profit, δ the depreciation rate of capital, t the employers' contributions rate and θ the VAT rate. Let us assume that the company produces 1 unit of goods using 1 unit of labour and k units of capital. Its production price is: $p = (1 + t)w + k(\pi + \delta)q$.

The consumer price is: $q = (1 + \theta)(1 + t)w + k(\pi + \delta)q$

A reform reducing the employers' social contributions rate and increasing the VAT rate leaving the $(1 + \theta)(1 + t)$ ratio unchanged has no effect on the capital/labour relative cost, or on the prices of the various sectors (characterized by different k). The social VAT can therefore not promote labour-intensive sectors or encourage companies to use more labour.

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

— VAT weighs only on companies' sales; social contributions on initial expenditure. The reform leads company taxation to be more in line with the business cycle. Profit volatility is reduced, which may have a positive impact on investment. But in this case, the best reform is not to increase VAT, but to tax the gross operating surplus (EBITDA), or even better profits (Table 14), although this would with increase tax revenues volatility. But if entrepreneurs like to take risks, they prefer taxation on production factors than on profits.

— Social contributions weigh on value added less profits; the VAT on value added less investment. The measure favours dynamic companies investing at the expense of companies paying dividends, which is positive for growth.

— The measure decreases the investment price relative to the consumption price. This decrease hits the owners of the

existing capital. The rate of profit does not diminish, new capital profitability is unaffected, but the purchasing power in consumer goods for dividends paid on the capital in place is reduced. The measure is thus a punctual tax on already installed capital.

Table 14. The choice of companies' taxation base

Basis	Economic effect	Volatility of the resource	Impact on firms
Payroll	Detrimental to employment		Increases the risk
AV	Detrimental to employment		
EBITDA	Detrimental to investment	High	Reduces the risk
Profit	Detrimental to investment	Very hign	Reduces highly the risk

This "quasi-equivalence" also shows that it is arguable to consider that VAT is paid by the consumer while employers' social contributions are paid by firms or by workers.

Let us consider now an open economy. Replacing employers' social security contributions points by VAT points provides competitiveness gains: the price of imported goods increases due to the rise in VAT; the price of domestic products sold on the domestic market remains fixed in principle; the price of exports, exempt from VAT, decreases: it is a disguised devaluation. Like devaluation, the measure has an inflationary impact. Let us assume that VAT is increased by 5 percentage points while social contributions are cut by 6 percentage points. The day after the reform, import prices rise by around 5%; export prices should in theory fall by 5% (if companies translate entirely social contributions' cuts in their selling prices). Consumer prices increase by 1.25%, with imports amounting to 25% of the domestic market. The domestic economy benefits from competitiveness gains of 5%, but thanks to a 1.25% loss of French residents' purchasing power. Two strategies may then be considered:

— Let indexation mechanisms play, which involves a rise in the minimum wage, wages, and pensions. These increases will have an impact on prices, and then again on wages, until domestic prices have increased by 5%; the competiveness gain will therefore be only temporary. The inflationary risk is all the more stronger that firms transmit slowly the fall in

labour costs while retailers immediately transmit the strong rise in VAT and that the sharp rise in inflation in the first year, may challenge the current weakness of wage increases[8].

— Let prices increase and freeze wages and social benefits. Competitiveness gains may then be permanent. But it should be clearly announced that social VAT will lower workers' and pensioners' purchasing power, which cannot be said to be *social*. Social VAT is a way to implement internal devaluation.

The competitiveness of the French economy will be improved only insofar as higher prices for imported consumer goods have no impact on wages. Using social VAT thus implies that wage earners' and pensioners' purchasing power is reduced.

Social VAT is therefore not a miracle tool which would provide competitiveness gains without entailing losses in wage earners' and pensioners' purchasing power. Social VAT does not allow to shift the employers' social contributions burden from domestic employees to foreign producers. Each country has to finance its social protection. Social VAT is not more favourable to labour than to capital. For a given purchasing power, VAT and employers' social contributions have approximately the same macroeconomic impact. Social VAT has a few advantages: reducing company profit volatility, support to dynamic companies, and a once for all taxation on dividends and interest payments. However, social VAT cannot modify the social protection financing burden, which would continue to weigh on labour. Social VAT cannot boost employment without lowering purchasing power. As compared to the CSG, the VAT has a drawback (or advantage) or not saying explicitly which economic agent will pay for the reform: this will result from the indexation mechanisms

The only tax reform allowing to provide competitiveness gains without lowering workers' incomes would be the introduction of specific duty on imports, using its revenues to lower VAT (see Sterdyniak and Villa, 1998), but this is forbidden by the EU and WTO rules.

8. However, due to the existence of the euro, the rise in inflation in France would hardly be reflected in interest rates, which would have the advantage of easing the debt burden on borrowers.

6. A competitiveness shock?

Let us assume that an agreement is reached on the need to raise competitiveness: should employers' social contributions cuts be offset by higher VAT or CSG?

According to the Box, both measures are roughly similar. The main issue is to know whether companies will choose to keep their prices unchanged to restore their margins, which will induce in a large drop in French households' real incomes or will they cut their prices to increase their competitiveness. In the first case, the question is: will the rebound in investment offset the decrease in consumption? In the second case, the question is: will external trade gains offset the decrease in consumption? In the second case, the policy is uncooperative. Its impact is nil if it is implemented by all countries. Last, in both cases, the relative labour cost falls, which could have positive long-term effects.

The VAT rise leads to some increases in prices. In theory, social benefits and the minimum wage are price-indexed. They would therefore suffer no loss in purchasing power. But the social security deficit will increase and the situation of companies hiring low-wage workers will not be improved. Also, employees would request wage increases to offset the rise in prices. The indexation mechanisms would gradually reduce the initial gains in competitiveness or margins. The measure therefore requests social partners' agreement to freeze the minimum wage, social benefits and wages. On the contrary, the victims of the rise in CSG would not benefit from any indexation mechanism and would have to accept lower purchasing power. In addition, the CSG has the advantage of being a resource assigned to social security, more ensured *ex ante* than VAT percentage points.

Box. On the quivalence between VAT and CSG

Let us consider a country where GDP is 100, exports and imports 25. Wages (including social contributions) are 80; profits, 20. Company investment is 20, of which half is imported. Consumption is 80 (of which15 is imported products). In the short term wages and pensions are fixed.

(1) Employers' contributions are cut by 5, CSG increased by 5. Firms maintain their prices and thus increase their profits. *Ex post*, there is no

competitiveness gain in the short term. Net wages amount to 75, i.e. a 6.25% loss in purchasing power. Profits amount to 25. The relative wage cost decreases by 6.25%. Under standard assumptions, propensity to consume wages is 0.8; to invest profits: 0.4; multiplier: 1; capital/labour elasticity of substitution: 0.3. GDP falls by 2% but employment is stable.

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

(3) Employers' contributions are cut by 5, CSG increased by 5. Companies fully transmit lower costs in their prices. The producer prices drops by 5%; consumer prices fall by 4%. The purchasing power of wages drops by 1% only. Competitiveness gains are 5%. The relative wage cost decreases by 3.75%. Under standard assumptions of export-price elasticity at 1, import-price elasticity at 0.5, GDP increases by1.25% and employment by 2.35%.

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

6.1. Should a competitiveness shock be implemented?

The "competitiveness shock" philosophy is that households should accept a strong fall in their purchasing power to improve firms' profitability or competitiveness. French taxation would converge towards the standard European model. The reform raises six issues:

1. Should the Government say clearly to households that they need to accept their real incomes to fall?

2. What would be firms' commitments in terms of investment and jobs in France in exchange of a measure increasing massively their profits? How to avoid that companies increase dividends payments or investments abroad?

3. Should France take steps towards a German strategy: increasing firms' competitiveness at the expense of households' real incomes knowing that this strategy is disastrous at the euro area level? Of course, this kind of reform replaces the impossible

devaluation in the euro area. But it is detrimental to European partner countries (which would respond with the same kind of measures) and does not guarantee competitiveness gains vis-à-vis non euro area countries, which depend mainly on euro exchange rate developments. Successive internal devaluations cannot replace a reform of the euro area economic policy framework.

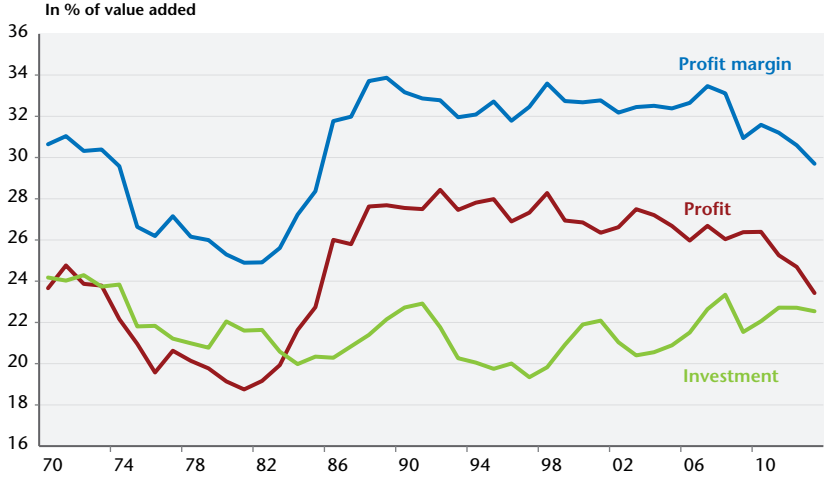
4. In Europe, France is in an intermediate situation between Northern countries which made strong competitiveness gains at the expense of their populations' purchasing power, and Southern countries, which experienced excessive wage increases. In 2000, the wage share in value added was 66.8% in Germany, 66.9% in France, 65.5% in the euro area. In 2007, it was down to 61.2% in Germany (-5.6 points), 62.8% in the euro area (-2.7 points), 65.7% in France (-1.2 points). Should European workers fight against each other by accepting a lower wage share in value added? On a 2000=100 basis, real wages had fallen to 97.9 in Germany in 2011, and risen to 111.2 in France (i.e. a 1% rise per year). Which country is wrong?

5. The share of profits in companies' value added was 29.6% in 1973. It fell down to 23.1% in 1982 before rising to 30.2% in 1987 (Figure 2). It stood at 30.8% in 2006, i.e. at a satisfactory level. Since 2007, it has been falling again due to the output fall and labour hoarding, which should be in principle a temporary phenomenon. The ratio did not fall because of higher taxation or excessive wage growth. The profit share in GDP can only recover under a "economic growth shock". Similarly, the share of profits (defined as cash flow + net dividends paid + net interest payments) in value added has returned to a satisfactory level. The problem in that investment spending was of the same size as profits in 1973, and is now 3-4 percentage points lower in terms of value added. Should the profit share be increased without any guarantee on investment?

6. Internal devaluation can be effective if the French economy suffers mainly from a lack of price competitiveness. But de-industrialization has probably other deeper roots. Firms prefer to operate and expand in emerging countries; scientific courses are not the first choice for students; young people do not wish to start industrial careers where pay is low and career prospects uncertain; France succeeds neither to protect its traditional industries, nor to develop in innovative sectors; the financial sector prefers speculation to

financing production and innovation, etc. This would not be solved by devaluation. France needs an industrial revival, which was already impulsed by competitiveness poles, the research tax credit, the Ministry of Industry, and which should be funded by the BPI (public investment bank), whose ability to act should be enlarged and field of competence specified.

Figure 2. Profit margin, rate of profit, and investment ratio of French companies



Source: INSEE.

Despite these doubts, in 2012 the Government decided that from 2014 French firms would be entitled to a CICE (*Credit d'Impôt pour la Compétitivité et l'Emploi*), a tax credit amounting to 6% of their gross wage bill, applying to wages below 2.5 times the minimum wage. This tax credit amounts to 20 billion euros and should be financed by additional public spending cuts (10 billion), higher VAT (6.5 billion) and higher environmental taxation (3.5 billion). In January 2014, the normal VAT rate increased from 19.6% to 20%; the intermediate rate from 7 to 10%. As, in the same time, firms benefited from the CICE, these increases had no impact on the inflation rate. Choosing a tax credit rather than social contribution cuts makes the measure complicated and less visible for firms.

In 2014, the government decided that a Responsibility Pact would increase employers' social contribution cuts by 10 billion

euros. Some economists argued that these cuts should be targeted on industrial sectors (or, at least, should apply to all workers) in order to improve industrial competitiveness, to support upgrading firms' strategy, to support innovative firms (who pay higher wages). But labour economists insisted on pursuing a low-wage targeting strategy. Finally, a complicated compromise was made: 5 billion euros to cut employers' family social contributions by 1.8 percentage points on wages until to 3.5 SMIC, 5 billion to reduce employers' social security contributions on low-wages. On the whole, the measures implemented would cut wage costs by 3.9%; around 22% of the measures would benefit the industry. France therefore starts to follow an internal devaluation strategy.

According to Ducoudré and Heyer (2014), these measures will have virtually no impact on GDP (the effect on domestic demand offsetting the competitiveness effect); employment would rise approximately 260 000 (i.e. the unemployment rate would fall by 0.8 percentage point) via a substitution effect. This leads however to a highly complex system, where social security contributions are progressive for wages between 1 and 1.6 times the SMIC, and flat from that level with a tax credit for wages below 2.5 times the SMIC and a rebate for wages below 3.5 times the SMIC. This reflects the influence of the idea according to which: "the high level of the minimum wage needs to be offset".

The CICE and the responsibility Pact are not part of a coherent reform of social protection financing, since the French government says it intends to finance employers' social contributions cuts by lower public and social expenditures.

7. Company taxation

The company tax burden cannot be easily measured, because it is uneasy to say which part of taxation bears respectively on companies, workers and consumers. In a company's location decision process, all taxes play a role, including management incomes taxation, and also public expenditure and social protection which the firm and employees benefit from. Should indirect taxation (such as excise duties for instance) be incorporated in company taxation? In principle, the answer is no, because these taxes are passed on to consumers, but possibly only partly. Should

employers' social contributions be included? In principle, no, because they weigh on wages in the long term, but the long term may be a very far horizon.

According to a rather arbitrary definition (CIT + taxes on production), the company taxation burden ranged in the EU in 2013 within 5 to 7 percent of GDP, being clearly higher in France (9.4%), and Sweden (11.3%), and clearly lower in the Netherlands (3.6%) and Germany (4.4%, see Table 15).

Table 15. Non-financial company taxation in 2013

In % of value added

	Income taxes	Taxes on production	Total	Social contributions
Germany	3.8	0.6	4.4	10.2
Austria	3.6	4.0	7.6	9.5
Belgium	4.4	1.5	5.9	16.5
Denmark	4.0	1.9	5.8	3.1
Spain	3.2	1.4	5.6	11.5
Finland	4.4	0.2	4.6	11.0
France	3.8	5.6	9.4	16.3
Italie	4.8	3.5	8.3	15.4
Netherlands	2.6	1.0	3.6	12.4
UK	3.8	2.9	6.7	9.9
Sweden	4.0	7.3	11.3	13.9
United States	4.2	2.4	6.6	10.3

Source: OCDE (2015), National accounts.

Even if the corporate income tax represents a small share of tax revenues, companies are highly sensitive to it. Over the last twenty years, globalisation and the European Single Market have facilitated the possibility for firms to choose where to locate their financial or productive activities, which strengthened tax competition. Almost all EU countries drastically cut their CIT rate (Table 16). In 2012, the UK launched a new tax competition wave in cutting its CIT rate to 24%. However, the comparison is made difficult by the existence of a local business tax which may be based on benefits (Germany), on value added (Italy, France) and even more by substantial differences in the tax base assessment (in particular in depreciation rules). In France there is a normal rate of

33.3% (and a reduced rate of 15% for very small firms), on top of which large companies have to pay a social contribution (a 3.3% increase) and a temporary contribution (a 10.7% increase). Finally, dividends are subject to a 3% contribution. These high rates do not bring higher CIT revenues.

Table 16. Changes in nominal rates of CIT

	1990	2010	2013
Austria	30	25	25
Germany	40.5 DB / 54.5 NDP	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	19.6	19
Poland		19	19
Czech Republic		19	19
Japan	50	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.

The existing system is far for being satisfactory at the EU level. Countries have different rules for tax bases calculations. Transfers between headquarters and subsidiaries are managed by a patchwork of bilateral agreements. Large firms use tax optimisation, by choosing carefully the location of their headquarters, of their subsidiaries and of their financial operations. They use transfer prices, inter-enterprise credits and royalties to locate their profits in low CIT-rates countries. The need to avoid a costly tax competition, the single market, the rising number of companies operating in several EU-countries make it increasingly necessary to organise

CIT at the European level. But tax federalism comes into conflict with MS autonomy in terms of taxation. Hence, Ireland and CEECs refuse any rise in their tax rates.

Since 2000, the Commission has proposed to reform the multinational companies' corporate tax base. The Commission suggests that a multinational group may choose to be taxed on a comprehensive tax base set by a European rule. The profits of the group would be split among the different member states where the company operates, according to an allocation key (value-added, payroll, etc.). The share of profits made in each MS would be taxed at the domestic tax rate. This would allow to abolish profit shifting practices. However, it seems difficult to give companies a choice between two corporate taxation systems. One can hardly imagine how multinational companies' subsidiaries could fill in tax assessments only to the tax authorities of their parent company. How would the consistence of tax assessments in the host country be ensured? Finally, this system is hardly compatible with the strong disparity in national tax rates.

Hence we do not see how Europe can avoid a painful road towards a negotiated convergence on corporate taxation, which should be done through four steps:

— Strong homogenization of tax bases;
— Recognition of the source principle of taxation, hence agreement to combat unjustified profit shifting in low tax countries;
— Setting of a floor rate which would vary according to the MS development level, such as 20% for the new MS, to 30% for the older MS. The minimum rate would be gradually increased in line with economic convergence. MS who consider that they provide specific advantages to their companies would be entitled to set a higher tax rate, at their own risk;
— MS in transition should be allowed to subsidize their firms, on a payroll basis, which would prevent the risk of profit shifting in these countries. Subsidies to companies should also be more easily allowed to help the poorest regions, the sectors in difficulty, innovation and research, jobs for some categories of workers. Thus, countries could try to attract job-creating and innovating companies instead of companies looking for tax optimization.

Some difficult issues remain: how to account for local taxation? Who, between MS and the Commission, would decide upon temporary (for economic reasons) or structurally (to encourage R&D) tax relief measures?

EU countries should also combat tax and regulatory heavens. First, a comprehensive list of the latter should be done. Second, OECD countries should prohibit their banks, financial institutions and firms to locate any operation and to have any subsidiaries in these heavens. Tax agreements should be made to restrict them to countries having minimum tax rates on companies and on households.

In order to discourage dividend payments, France introduced in 2013 an additional taxation on distributed profits (at a 3% rate). This is in fact arguable, since paid dividends are taxed at the shareholders' level via social contributions and the income tax, while non distributed profits escape taxation, and will be taxed, at best, when they are sold, although they may actually escape (see below).

Interest payments are deductible from the CIT, which does not hit borrowed capital. This is consistent with the view according to which the CIT is a "tax on shareholders". This helps indebted companies to reduce their CIT payments. This encourages fictitious under-capitalisation and allows risky financial packages such as LBOs. In 2012, France decided to re-introduce 25% of net financial company payments in the CIT base, for firms where they are higher than 3 million euros. In 2013, the Government planned to introduce a new tax based on the EBITDA, with a view to raise it overtime, replacing a number of small taxes. This new tax had the advantage of bearing on interest payments and royalties transfers, therefore of combating tax optimisation. It also bears on capital depreciation, which can be seen as a drawback (by weighing on the industry and discouraging investment) or as an advantage (by discouraging capital/labour substitution). The Government abandoned this project in front of companies' opposition.

The French tax rate is high, even if it is partly offset by more favourable depreciation rules. VAT and social security contributions hit labour, EBITDA taxation hit capital; corporate taxation hits non-borrowed capital. In a mass unemployment situation, the objective should be to cut labour rather than capital taxation.

Hence, it is justified that France chose so far to focus on social contributions rather than on corporate income tax cuts.

From that perspective, the reform of local business taxation is debatable. The "*taxe professionnelle*" was initially based on the payroll, productive capital and land property. The "labour" base was abolished in 2003 and turned into a capital tax. The 2010 reform cut taxation by 5 billion, but this applied mainly to the 'capital' base, thereby promoting capital/labour substitution and capital-intensive firms. Conversely, the reform has the advantage of encouraging industry. A contribution based on companies' value added (CVAE) was introduced, and will possibly be increased in the future to replace employers' social contributions, which will allow weighing less on capital and more on labour.

In early 2014, the French government organised the "*Assises de la fiscalité des entreprises*". Firms requested a massive CIT rate cut (targeting a rate of 25%). They requested the abolition of the C3S (a tax weighing on companies' turnover and financing non-employees pensions), of all taxes based on the payroll (transportation tax, wage tax, apprenticeship tax, housing tax) and of many small taxes (financing public operators, professional organisations or organisations with ecological or behavioural objectives). But it is fair that firms contribute to their employees' transportation costs; the payroll tax replaces VAT for the sectors which are not subject 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 abolition of the CIT surcharge in 2016 (a 2.3 billion cost) and the objective of cutting the CIT rate from 33.3% to 28% in 2020. On the whole, this will cut company taxation by 10 billion before 2017.

In the recent past, the French strategy was to maintain a high CIT rate but to maintain also, and even extend, tax expenditure measures to encourage companies to invest and to create jobs in France. Thus, France had introduced a generous Research Tax Credit, followed by the Tax Credit for competitiveness and employment. France had chosen tax incentives, rather than neutral taxation. The strategy which seems to prevail now is to cut the CIT nominal rate so as to take an active role in European tax competition.

8. Households' taxation

Broadly speaking, households' direct taxation amounted to 14.85% of GDP in 2012. This includes the CSG-CRDS (5.1% of GDP), non-contributory employers' social contributions (4,4%), the income tax (2.9%), the residency tax (0.8%), property taxes (0.75%), taxes on inheritance and donation (0.45%), the wealth tax (ISF, 0.25%), the tax on transactions (0.2%).

The income tax and the wealth tax (ISF) are the only progressive taxes, the only taxes accounting for households' total incomes and characteristics. In France, their weight is low: by nature, they should be strongly progressive. The French specificity is the coexistence of an income tax, very targeted but with a small weight, of a proportional CSG (*Contribution sociale generalisée*), and employers' social contributions without any ceiling and progressive (because of low-wage exemptions). In addition, the poorer families are entitled to the PPE (*Prime pour l'emploi*), the RSA (*Revenu de Solidarité Active*) and housing benefitfs. On the whole, the French system is highly redistributive (Table 4 and Table 17), which makes it difficult to improve, but this redistributiveness is obtained in a complicated way.

Table 17. Taxation and redistribution, family two children, in 2013

In euros per month

	SMIC	4 SMIC	10 SMIC
Total employer labour cost	1 685	8 227	20 595
Contributive employers contributions (3)	330	1 318	3 318
Employers contributions health-family (2)	*297*	*1 189*	*2 975*
Low-wage contribution exemption (5)	*372*		
Gross wages (1)	1 430	5720	14 302
Contributive employees contributions (4)	197	789	1836
CSG (6)	*112*	*450*	*1 124*
RSA/housing benefit/family benefit (7)	*371/280/129/60*	*129*	*129*
Income tax (8)	*0*	*235*	*1 846*
Disposable income	1961	4375	9625
Saving rate	0%	10%	20%
Added value tax (9)	*327*	*656*	*1 284*
Tax-benefits * (10)	-476	2401	7100
Net tax rates ** (11)	-41,1%	39,2%	46,0%

* (10) =(2)+(6)+(8)+(9)-(5)-(7)
** (11)=(10)/((1)+(2)-(4)-(5))
Source: Author's calculations.

8.1. Tax treatment of families

The French taxation and benefit system is family-based. The French Society recognizes the right of individuals to be married (or to sign a PACS, a solidarity civil pact), to found a family and pool resources. The living standard of a family is assessed by dividing its overall resources by a number of tax shares (the family quotient approximates the number of consumption units, as estimated by OECD or INSEE). The family quotient system ensures family horizontal equity: two families of different composition, but with the same living standard are subject to the same tax rate. Similarly, the RSA provides approximately the same living standard to the poorest families, regardless of their composition.

Thus, the French taxation system includes a conjugal quotient (QC), as a compulsory element of the family quotient (QF). Some (such as Landais *et al.*, 2011) blame the QC for treating women wages as an extra income. But this cannot be related to legislation, especially as the couples of the same sex, who are PACSed, are also entitled to the QC. Landais *et al.* (2011) claim that the QC subsidise couples of unequal incomes, but the QC like the QF consider that family members pool their resources. In our view, this approach is closer to reality, than the approach according to which each parent would keep their own wages for themselves, letting children live only on social benefits, the only case who could justify income tax individualization. Our approach on family solidarity is also normative: parents should ensure their children have the same standard of living than themselves; this is the basis of child maintenance (after a divorce). A single earner with 5,000 euros per month does not have the same living standard as a married person with the same earnings, three young children, and a spouse who does not work: there is no reason why taxation should be the same in the two cases.

Questioning the family quotient would violate the principle according to which: "each citizen contributes to public expenditure according to his contributory capacities", unless it was enacted that married persons do not pool their resources and that parents have no duty to care for their children. Children would be expected to live on family benefits: this would require a substantial increase in family benefits, reaching 580 euros per child (and at least 350 euros) at 35% of the median income (at the poverty threshold) (Sterdyniak, 2011).

The QC does not prevent France to have a high female participation rate (Table 18). The marginal tax rate of women could be cut only through increasing single-earner families' taxation, but the latter are generally poorest. Denying the working spouse the right to account a share for its inactive spouse in its taxed income, required that the inactive spouse is entitled to the RSA, regardless of their spouse's income. But in this case the marginal tax rate of an inactive spouse, who takes a job, would be 38% (the withdrawal rate of the RSA), the same level than the current maximum income tax rates, 36.9% (90% * 41%) or 40.5 (90 * 45%). If joint taxation of spouses increases the marginal tax rate of married women who earn less than their husband, the QF has an opposite effect. An individualized tax system, not accounting for children and with a tax credit for inactive spouses, will not necessarily lead *ex post* to lower marginal tax rates (for the opposite view, see OECD, 2013). An individualized tax system will be necessarily less satisfactory from a redistributive perspective than a family-based system as families with children, single-earner families, families with unequal spouses earnings, would be over-taxed.

Table 18. Participation, 25-55 year-olds, in 2008

In %

	Men	Women	Gap	Gap, in full-time equivalent	Fertility rate
Finlande	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
Japon	96.3	70.4	24.9	32.9	1.2

Source: OECD, *Labour Force Statistics (2010).*

The QF ensured a satisfactory tax treatment to families with children. A ceiling of 2400 euros for the first two children was amounting approximately to the exemption at 35% of the median income ((580-30) * 12 * 41) = 2700 euro) and was therefore not too high. The Ayrault government decreased the ceiling down to 1500 euros, without any specific justification. But the additional half-share starting from the third child is a tax expenditure, a support to large families which could be questioned (see below).

Refusing the QF principle would not allow social policy to assess the living standard of families for the RSA, for housing allowances, and other means-tested benefits. According to Landais *et al.* (2011), individualisation corresponds historically the Republican ideal according to which there is no intrusion of the political sphere in the individual sphere.[9] But this view forgets about the point that getting married (or PACSed) is an individual right, guaranteed by the *Declaration des droits de l'homme*. This view brings us back to the early 20th century, with the right parties fighting against progressive taxation, judged to be an awful intrusion in individual private lives. This does not explain how solidarity benefits can be calculated without political intrusion in the individual sphere.

8.2. The concept of income

Two taxpayers earning the same incomes should pay the same tax. Some economists claim that labour income, costly in time and effort should be less taxed (but should pensioners and the unemployed be then over-taxed?). Others claims that capital incomes should be less taxed, since they come from income savings already taxed (or from capital already subject to inheritance taxation), but the point is to tax the new incomes of the current period. So we advocate a basic principle: everyone should contribute to public expenditure according to their contributory capacities, i.e. according to their total incomes. We will compare capital and labour incomes taxation using an economic definition of incomes and taxes (excluding contributive social contributions). We will compare here only the maximum tax rates, those applying on highest incomes.

9. « L'individualisation correspond historiquement à l'idéal républicain de non-intrusion du politique dans la shpère individuelle ».

Let us first consider wage earnings taxation. With regard highest wages, the nominal tax rate is now 41% above 71,000 euros per tax share, 45% beyond 150,000 euros, and temporally 48% above 250,000 euros, 49% above 1 million. However, the CSG-CRDS and the non-contributive social contributions must be added to calculate an economic tax rate. On the other hand, contributive social 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 61.4%. These rates are high in comparison with neighbour countries, some of which have a higher maximum income tax rate but have a ceiling on social security contributions (Table 19). Only Belgium and Sweden have a higher maximum tax rate than France. At the SMIC level, using the same conventions, and accounting for employers' social security contributions exemptions, the *Prime pour l'emploi* and housing benefits, the tax rate of a single person is negative by 6.8%.

Table 19. Maximum labour income tax rates in 2013

	Income tax	Social contributions (heath-family)		Total
		Employers	Employees	
Germany	47.5	0	0	47.5
Austria	50	0	0	50
Belgium	50 + 3.7	18.4	3.55	63
Spain	30.5 + 21.5	0	0	52
France	45 + 8	22.8	0	61.4
Italy	43 + 2.6	0	0	45.6
Netherlands	52	0	0	52
United Kingdom	45	0	0	45
Sweden	25 + 31.7	16.8	0	62.9
United States	35 + 6.85	0	0	41.85
Japon	40 +10	0.15	0	50.15

Source: Author's calculations based on OECD: *Taxing wages* (2014).

In 2014, the French government had also introduced a tax rate of 50%, on the share of wages exceeding 1 million euro (i.e an economic tax rate of 72.5%). This was justified by the need to combat the rise in wage inequalities in companies, to fight again exorbitant wages for some managers, sportsmen/women and financial traders. However, this tax rate was set only for two years.

Old-age pensions may seem to be the less taxed category of incomes (Table 20), since they are not subject to employers' family and health contributions, and no social levies. In the past, pensioners paid no social contributions. It was considered useless to raise contributions on benefits. It was simpler to set directly pensions benefits at a satisfactory level. The introduction of the CSG and its subsequent increases, allowed to shift part of the contributions paid by the economically active to pensions and wealth incomes. The process was entirely done for supplementary pensions, but not entirely for the pensions general system (there remains a gap of 0.9%). This gap will probably be filled one day to finance old-age care expenditure. Conversely, pensioners have to pay a supplementary health insurance of around 1200 euros per year (i.e. 6% of the pensioners average income), while the cost is around 480 euros for an employee (2.4% of the average income), often covered to a large extent by the employer. The risk is for retirees that the shift continues from family/health contributions and CSG, as the MEDEF wishes, with some employees' trade unions apparently willing to accept. But pensioners will not benefit from purchasing power gains in retirement, and undergoing reforms already tend to lower the relative level of pensions. Should this be pursued?

Table 20. Economic tax rates for a 45% nominal tax rate

	Economic tax rates, 2014
Wages	61.4
Pensions	51.1
Interest received	116.4
Property tax revenues	62.4
Implicit rent	10.0
Real estate gains	5/40.3
Dividends	62.0
Capital gains taxed	66.8/60.6
Capital gains untaxed	34.43

Source: Author's calculations.

In 2013, the left-wing government introduced a major reform: taxing capital income gains at the income tax schedule, there was already a specific levy deducted at source on some of these gains. The purpose may be to show that all incomes are taxed similarly,

but this leads to high tax rates on capital incomes, at least when the latter are taxed.

Interest incomes gains are taxed at 24% up to 2 000 euros; at the income tax schedule from that level. But an interest rate of 4%, with a 2% inflation imply a real 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 are part of companies' profits, which have already been taxed at the CIT, at the rate of 34.43% (and currently also at a 3% tax rate). This is why dividends benefit from a 40% rebate in the income tax. Taking into account the CSG, Social security contributions and CIT, the economic rate is 62%, for an income tax rate of 45%.

Taxed capital gains are theoretically the counterpart of non-distributed profits having been taxed at the CIT. They are now subject to the income tax with an allowance depending on the detention length: 50% after 2 years, 65% after 8 years. Let us assume that capital gains are 10% of the capital (8% representing actual profitability and 2% inflation), then the economic tax rate is 66.8% after 5 years and 60.6% after 8 years.

Non-taxed capital gains escape taxation at the households' level. But in theory they have been taxed at the CIT; their economic tax rate is 34.43%.

Our calculations may be questioned: the CIT effective rate would not be 34.3%, accounting for companies' tax avoidance possibilities. In fact, in 2006, the year before the crisis, CIT on non-financial corporations collected 42 billion euros, for 68 billion of net dividend payments, 139 billion of non-distributed profits and 132 billion of fixed capital consumption, i.e. an effective tax rate of 35.9% (the rate is increased due to companies making losses).

Rental property incomes are subject to a property tax (amounting on average to 10% of the rent), the CSG-CRDS, social contributions and the income tax. The income tax rate of 45% therefore translates into an economic rate of 62.4%.

Real estate gains are now subject to a taxation at the income tax of 19%, after an allowance (6% per year from 5 to 21 years; 4% in

year 22, so that taxation is zero at the end of 22 years) and a 15.5% taxation to the CSG/CRDS/Social contributions after a rebate (1.65% per year from 5 to 21 years; 1.6% the year 22, 9% per year after so that taxation is zero at the end of 30 years). Here also, the reasons for such a complicated system cannot be easily explained. Let us consider a person who buys a house at 100, and sells it 10 years later; let us assume that meanwhile housing prices rose by 8% per annum and annual inflation by 2%. The economic gain is 79. The taxable gain is 81 for the income tax and 106 for the CSG; the paid tax is 31.9, i.e. an economic tax rate of 40.3%.

Implicit rents (the rents the owner would earn from renting his home) are not subject to income tax or social contributions. Because of the property tax, the economic tax rate is 10%.

Capital gains on the main residence are not taxable. In fact, households often sell their main residence to buy a new one, and so it is difficult to tax the capital gains needed for the new acquisition. Households pay transfer taxes at a 5% rate on the amount of their acquisition.

All in all, the economic rates are considerably higher than nominal rates (table 20). Interest payments, property rent incomes, dividends and capital gains are taxed at high rates.

It is difficult to consider reforms which would increase further capital incomes tax rates. As concerns interest incomes, one could decide to tax only real interest incomes, by allowing to deduct capital depreciation induced by inflation; in this case, social security contributions should be maintained at 15.5% (as a counterpart of health and family social contributions on labour income). The economic taxation rate, corresponding to the nominal 45% rate, would thus be 58.2%.

Capital gains are not necessarily equal to non-distributed profits. It is difficult to tax unrealised gains, which may vanish in the event of a stock market crash. The best system would be for companies to distribute a "*avoir fiscal*" (tax credit) to their shareholders, amounting to the actually paid CIT. Shareholders would then be imposed at the income tax and social contributions, on the basis of: "dividends + accrued capital gains adjusted for inflation", possibly with measures being introduced to ensure that all capital gains are taxed (see below). The economic taxation rate would also be 58.2%.

The main difficulty comes from in the tax avoidance schemes. A principle should be stated: financial institutions should be responsible of convince savers about the advantages of the products they sell; but the State should not give tax incentives to any financial product. So PEA (equity assets contracts) and life insurance contracts should be subject to ordinary taxation. Today, a wealthy shareholder can place his assets in an *ad hoc* company which receives its dividends, uses companies' equity assets as a guarantee to obtain loans from his bank, which provides the money he needs to live. Thus the wealthy shareholder does not declare incomes and when may bequeath the shares of this company to his children, who will pay no taxes on capital gains. So it would it be fair to tax unrealized capital gains for transfers by donation or inheritance.

Implicit rents, and non-taxation of capital gains on the main residence, are the other black hole of taxation. It is not really fair that two families earning the same incomes pay the same tax, although one inherited an apartment and the other one must pay a rent: their contributory capacities are very different. It would be desirable to introduce gradually a taxation of implicit rents[10]. In counterpart, mortgage interest payments could become deductible from the taxable income, which would support young people who are building patrimonial assets at the expense of people already having patrimonial assets. As concerns housing gains; inflation should not be deductible except on the main residence and gains on the main residence should be subject to taxation (at the exception of gains reinvested in buying the main residence).

8.3. Abolishing all tax expenditures?

The French system includes many tax expenditures schemes, amounting to 34 billion euros as concerns income taxation, i.e. near 60% of income taxation revenues. They are detrimental to tax progressivity; many have no economic and social justification; some have been introduced to satisfy pressure groups (such as tax cuts on journalists' incomes, tax exemptions in PEA). Abolishing these schemes seems to be an obvious reform to be done.

10. Implicit rents amount to ca. 150 billion euro in 2010. A 15.5% tax rate would raise 15 billion euros (accounting for some unavoidable undervaluation).

However, some of these schemes allow to account for households' contributory capacity. This is the case for the *quotient familial*, which only account for the households' size to assess their living standard. Similarly, it is legitimate to allow the deduction of alimony, donations to charity organisations, child-care expenditure, care expenditure dependent persons specific charges.

Some other tax expenditures are justified for social reasons. They could not be removed without introducing replacement schemes: this is the case for additional tax shares for large families or for invalids. It would not be justifiable to tax family benefits which are already far from ensuring parity of livings standards between families and individuals without children (see Sterdyniak, 2011).

Others follow a taxation rationale. This is the case for the 40% rebate on dividends, for the 10% rebate on wage earnings for employees' professional expenses (which is excessive but avoids to have to tackle numerous requests for taxation to real costs, which offsets the possibilities of self-employed to shift part of their personal expenses in professional expenses), et consequently of the capped rebate for pensioners' incomes.

Some tax expenditures should be replaced by subsidies: tax rebates for historical monuments maintenance, for energy savings works, aid to overseas territories. Some refundable tax credits (like the *Prime pour l'emploi)* are in fact already subsidies.

The current government has already abolished the taw exemption for overtime work. The total amount of tax reductions a household may benefit from tax exemptions schemes is capped to 10 000 euros. It is however less effective to cap tax reductions than to look at each tax expenditure and decide whether they should be maintained or removed.

At most, abolishing unjustified tax expenditures would raise around 8 billion euros: 2.5 billion on pensioners, 1 billion on individual employers, 3 billion on financial savings (PEA, life insurance, employee participation in company profits), 1 billion on rental or productive investment. But the beneficiaries of its measures will oppose such moves.

In its electoral programme, somewhat inspired by Landais, Piketty and Saez (2011), François Hollande mentioned the introduction a more simple income taxation, unifying the CSG

and the income tax. But the characteristics of this new income taxation remain to be defined (see Allègre, Cornilleau and Sterdyniak, 2007, and Sterdyniak, 2012). Such a reform would oblige to rethink the French system and open the field of all possibilities in the democratic debate. Should the family characteristic of French taxation be removed or extended? Should redistributiveness be reduced or increased?

The search for '*simplification'* may be worrying: can a progressive taxation system account for households' composition? In France, the tax system exempts the poorest and already taxes the richest much more heavily than in other developed countries. It is an illusion to believe that the reform could make it even more progressive.

According to its proponents, a simple and unified system would lead all French citizens to feel *imposed*, but does this mean that poorest households (the unemployed, pensioners, wage-earners below the SMIC) who currently do not pay income tax would suffer from the reform?

This reform would allow removing all tax expenditures at once, but difficulties would quickly appear: many tax expenditures would have to be maintained or replaced by grants.

One of the objectives of the reform is to tax capital incomes like labour incomes. But this is not so easy, once it is acknowledged that several elements need to be taken into account: non-contributory social contributions paid by employers, social security levies paid on capital incomes, CIT already paid, distinction between real and nominal interest rates. It would very rapidly appear that capital incomes are often already more heavily taxed than labour incomes.

In our view, it would be safer to improve gradually the existing tax system by abolishing unfair tax expenditures than to pursue the myth of implementing a great reform. Besides, we do not find it necessary to shift towards a withholding tax paid directly by companies: taxation may keep a "citizen" characteristic, be paid by taxpayers, who see the effective tax burden.

Local taxation is high in France. Local taxes are archaic and less progressive than national taxes. They are also more unequal because the rich pay little in rich municipalities and the poor pay a lot in poor municipalities. Both in terms of economic efficiency and social fairness, France should reverse recent developments

which lead to reduce the income tax burden and increase local taxes. Decentralization tends to increase local spending, which could widen local disparities. It would be desirable to reduce the residential tax, create a supplement to the income tax, the revenues of which would be redistributed to local communities according to their needs (population, numbers of children, number of people in difficulty).

8.4. Is there a need for an ISF?

The ISF (*'Impôt de solidarité sur la fortune'*, wealth tax) is justified for five reasons. First, the wealthiest benefit particularly from the social organization; it is only fair that they contribute more than others to its costs. Wealth distribution is more unequal than income distribution: between the 1st and the 9th deciles, the ratio is 4.2 for income, 205 for wealth.[11] Thus, wealth taxation is more redistributive than income taxation. The French ISF does not tax professional property; therefore, it encourages entrepreneurs and their families to invest in their company and to remain committed to it. The ISF may oblige some owners of non – or under-occupied real estates, to sell or rent them. Finally, the ISF may oblige some financial portfolios holders to sell securities, hence to realize capital gains.

Since the 2012 reform, the ISF rates range from 0.5% to 1.5%. The ISF remains heavy for interest, dividends, property income, and taxed capital gains earners, but not for the owners of their residence, or for the beneficiaries of non-taxed capital gains (Table 21).

The 2012 reform introduced a cap for all taxes paid by an ISF taxpayer at 75% of its income. But the tax assessment remains questionable (neither CIT nor health and family social contributions are taken into account) as well as the assessment of incomes (interests are not adjusted for inflation, implicit rents and unrealised capital gains are not taken into account). However, firms' owners can no longer deduct their professional debt from their professional wealth. The incomes taken into account should have included capitalized interests and a share of unrealised capital gains, but the Constitutional Council denied this inclusion. Tax evasion remains possible for the richest.

11. 2010 figures, according to *INSEE Première*, n° 1380, novembre 2011.

Table 21. Marginal tax rates in 2013

In %

	Sans ISF	ISF à 0.50%	ISF à 1%	ISF à 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 **	62.0	68.2	74.4	80.6
Capital gains taxed **	60.4	66.6	72.8	79.0
Capital gains not taxed **	34.4	40.7	46.9	53.1

* 6% profitability.
** 8% profitability.
Source: Author's calculation.

As concerns the richer, tax competition bears also on wealth and inheritance taxation. In Europe, only Luxembourg, Switzerland, France and Greece have kept a wealth tax. The weight of inheritance taxation is very low except in Belgium and in France. Should France come in line with other countries? No, but the risk of tax evasion makes it more difficult to tax the richest. Two cases should however be distinguished: as concerns financial wealth, tax evasion reduced tax revenues in France but has minor economic consequences; as concerns professional property, this may imply a firm's closing down and the loss of productive capital. So professional property is exempted in France from the ISF and from a part of inheritance rights when heirs continue to manage the firm. These schemes may be considered to be contrary to equity, but this is better than nothing and this is not bad to encourage sometimes productive capital.

France should take retaliatory measures against its citizens leaving abroad for tax reasons. In 2011, the Government had reintroduced an *exit tax*, a tax on unrealised capital gains for people leaving France. However, France could be censured by the EU Court of Justice, in the name of the freedom of establishment principle. A measure could be to tax all French citizens at the world level, following the US model. To retain their right to vote, French citizens living abroad should make a tax statement in France and pay a tax equal to the difference between taxes due to be paid in France and those paid abroad. It would be manageable to do so, if it would apply only from a certain level of income/wealth and in countries with low taxation rates on income or wealth.

8.5. As concerns the poor...

France helps poorest households via a complicated system involving the RSA (*Revenu de solidarité active*, a 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 poor families). Since 2000, governments, encouraged by many economists (see for instance Laroque and Salanié, 2000), are convinced that the gap is too small between unskilled workers' wages and assistance incomes, which would explain the high unemployment rate level of unskilled workers. They try to increase this gap by subsidising low-wage work (the PPE, the RSA-Activity, as an incentive to create jobs.

Despite Martin Hirsch's efforts, the RSA does not include the PPE and housing allowances. The RSA has a basic element: the RSA-basis (*RSA socle*). This basic element depends on the family composition and is reduced by 38 (resp. 100) euros for 100 euros of labour (resp. other) incomes. Thus a family with a low-wage worker is entitled to the RSA-Activity. The RSA allowance is paid monthly on the basis of a quarterly income statement; the RSA-basis depends in principle on the efforts made to find a job. The PPE is paid automatically on the basis of the income tax assessment, with a one-year delay. The RSA is deductible from the PPE, so that a household not claiming for the RSA receives automatically the PPE.

The system aims to ensure a minimum income to the poorest while preserving their work incentive. So the RSA-basis (499 euros per month for a single person) is significantly below the pensioners' minimum income (792 euros). As can be seen from Tables 22 and 23, the RSA provides an income of about 40% of the median income (i.e. below the poverty threshold at 60% of the median income). A single person will be lifted out of poverty for wage earnings at 0.5 SMIC; a couple with two children needs to earn 1.5 minimum wage. In total, the marginal gain rate is in the order of 50% for a single person (Table 24). The rate is very low for a couple, between 1 and 1.5 SMIC, which may be a disincentive for the spouse of a minimum-wage earner to take a job (Table 25). Before the RSA-activity was introduced, the first job was discouraged.

Table 22. The case of a single

In euros par month (2013)

	RSA	0.5 SMIC	SMIC	1.5 SMIC
Wages	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.
Source: Authors' calculations.

Table 23. The case of a family with 2 children

In euros par month (2013)

	RSA	Single wage-earner			Two wage-earners	
		0.5 SMIC	SMIC	1.5 SMIC	1.5*SMIC	2*SMIC
Wages	0	548	1,097	1,646	1,646	2,194
RSA	856	522	312	103	–	–
PPE	–	–	–	–	126	166
Family benefits	48	127 + 48	127 + 48	127 + 48	127 + 48	127 + 48
Housing benefits *	473	473	369	209	211	54
Total	1,377	1,718	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 500 euros. Children are 7 and 10 year-old. ** If they do not claim for RSA.
Source: Author's calculations.

Table 24. The gain from employment. Single

	In euros (% of net wages)
RSA to 0.5 SMIC	285 (52%)
0.5 SMIC to SMIC	225 (41%)
RSA to SMIC	510 (46.5%)
SMIC to 1.5 SMIC	318 (58%)

Source: Author's calculations.

Table 25. The gain from employment. Couple two children

En euros

	Avec recours au RSA	Sans recours au RSA
First active		
RSA to 0.5 SMIC	341 (62%)	
0.5 SMIC to SMIC	235 (43%)	16 (2%)
RSA to SMIC	576 (52.5%)	357 (32.5%)
SMIC to 1.5 SMIC	180 (33%)	309 (56%)
Second active. First active at the SMIC		
Inactif to 0.5 SMIC	205 (37%)	424 (77%)
Inactif to 1 SMIC	636 (62%)	855 (78%)

Source: Author's calculations.

The current system has six drawbacks:

— The non-take-up rate of the RSA-activity remains high (68%). Low-wage workers refuse to be subject to a social monitoring in order to get a relatively small benefit. Due to the stigmatisation effect, RSA recipients do not wish to be confused with RSA-base recipients. The PPE is paid automatically, without monitoring, but with a delay of one year.

— The RSA provides an allowance of around 110 euros per child for families with 1 or 2 children at the SMIC level. This allowance fills a hole in the French system. However, unemployed workers' families are not entitled to it. 110 euros should be paid in the form of a family complement to all poor families with 1 or 2 children (those with 3 children and more benefiting already from a family supplement and from more generous family benefits).

— The RSA, like all family benefits is indexed on prices only. RSA recipients may see their relative situation deteriorate over time.

— A scheme similar to disability allowances in Scandinavian countries, allocated on medical, economic and social criteria ensuring people who have no chance to get a job (temporarily or permanently) a more satisfactory income, similar to the retirees minimum income, is missing in France.

— Young (below 25) people are not entitled to the RSA, although many of them have difficulties of getting into the labour market.

— The system is not more generous for families with children on the RSA, while we may wish a more generous benefit for these families, for three reasons: RSA recipients with children fulfil a social role, as parents, which the RSA recipients without children do not fulfil. RSA-recipients' children are not responsible for the lack of resources of their parents and have the right to a higher living standard than the one ensured by the Society to RSA recipients without children, who are partly responsible for their situation. The allowance should allow parents to raise their children in satisfactory conditions.

In 2013, a parliamentary report (Sirugue, 2013) had proposed the introduction of an Activity Premium (*Prime d'Activité*, PA) which would replace the RSA-activity and the PPE. But as the RSA-base would remain, very low-wage families would have to claim for two allowances: the RSA-base and the PA. The system would have been complicated for them. The Sirugue report proposes to extend the right to the PA to below 25 young people, which is justified, but propose a reform at constant costs, without even proposing to recover the savings currently made by the current non-take up of the RSA. So, extending entitlement to below 25-year olds would be paid by existing RSA and PPE recipients. The PA's scale 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 families' situation 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.

In 2014, the government announced the PPE and the RSA will be merged, without specifying how the new scheme would be designed. In our view, the system should be simplified by replacing the PPE by an increase in the SMIC, if needed offset by a job subsidies; a family supplement of around 100 euros per child in poor families, employed or unemployed, with 1 or 2 children; the RSA should be maintained, but its role would be reduced and the non-take up would have less consequences for families with children. Finally, an insertion allowance should be introduced, of the amount of the RSA, for young people looking for a job, which should allow them to begin to accumulate retirement rights.

9. After the crisis

The crisis led to a sharp deterioration of public finances in almost all EU MS. In 2013, the public deficit reached 2.9% of GDP in the euro area, while public debt had risen from 66.5% of GDP in 2007 to 93% in 2013. However, the deficit in euro MS was smaller than in the United States (9.3% of GDP), the United Kingdom (6.3% of GDP) or Japan (8.3%) of GDP. There is a structural primary surplus of 1.5 percent of GDP in the euro area (even using the Commission's estimates).

European countries face a double dilemma. First, they need to choose a macroeconomic strategy. From a Keynesian perspective, large public deficits should be maintained as long as the unemployment rate does not fall significantly. The euro area lost 8.5 percent of GDP due to the financial crisis; recovering this GDP loss would be enough to bring public deficits to a sustainable level. The objective should not be a balanced budget, but the real "public finances golden rule", i.e. a balances budget net of investment expenditure, which allows 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 reduce public deficits very rapidly. The risk is for the euro area economy to remain in stagnation for a long period of time; fiscal austerity weighs on demand; tax revenues decrease; public deficits and debt ratios hardly improve. In view of the threat of financial markets and ratings agencies, European countries have chosen the second strategy and this has kept Europe in depression.

The second point is to choose between spending cuts and tax increases. International institutions warn against tax increases (especially direct taxes) which would be detrimental to firms' competitiveness and would be a disincentive for households to work, save, and invest. International institutions advocate drastic cuts in public and social expenditure, denying any economic and social usefulness in these expenditures. Only VAT, which weighs on consumption, could be increased. Countries should continue to cut company taxation, so as to promote employment. Thus, this strategy implies the continuation of tax competition. The risk is that it has a strong depressive impact, since it cuts spending which have a strong impact on demand and that it undermines the *European social model*.

The alternative strategy would aim to preserve the *European social model,* therefore a high level of public and social expenditure, relying on its comparative advantages (free and high quality education and health for all, public infrastructure, social benefits) to keep the European economies competitive. In this context, MS should tax financial transactions, should increase taxation of financial incomes, capital gains, high incomes and wealth (the rise of which is one of the causes of the crisis), and should introduce a confiscatory tax rate on exorbitant incomes. Taxation should encourage firms and banks to have a behaviour favourable to production. It should support investment rather than financial activities and dividends distribution. It should encourage energy savings rather than job destruction. At the EU level, this strategy requires tax harmonisation, letting each country the possibility to tax domestic firms and residents, banning unfair competition, setting minimum tax rates for firms, high incomes and wealth, prohibiting banks and firms to have subsidiaries in tax havens, organizing the rise in ecological taxation. Production and consumption modes will need to be deeply modified in the coming years under the ecological constraints. The consumption model where new needs are constantly generated by large companies' strategies will have to be changed. Ecological constraints should not translate into higher prices without any counterpart, so that the efforts do not weigh on the poorest; Europe should move to a sober and less unequal society. This strategy should be implemented at the EU level, but who may promote this strategy in Europe?

10. What strategy for a tax reform in France?

In 2015, four strategies can be considered

A strategy focusing on increasing taxation for the richest and multinational firms. This was the French strategy from mid-2012 to mid-2014. This strategy required strong measures against tax evasion, since France was already one of the countries with the highest taxation on the richest. This strategy would have also required to combat all schemes allowing tax evasion (which is difficult to do for an isolated country).

A strategy focusing on company tax cuts in order to improve the competitiveness and attractiveness of the French economy.

Less heavily taxed companies would invest more in France and create jobs, which would offset the initial fall in tax revenues. Initially, taxes paid by employees and households would need to be increased; French households would have to accept a certain fall in their living standards in order to let French Firms become more competitive. This strategy raises two issues: the negative impact on demand it would have in the short-term and its social acceptance. Moreover, this is a non-cooperative strategy at the European level. This is the strategy chosen by the Valls Government.

A rationalization strategy, targeting the abolition of tax and social expenditures, which would require to abandon tax interventionism, and is satisfactory in some cases (savings taxation), less in some others. The gains of such a strategy are probably overestimated.

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

Hence, the economic and social gains which may be expected from a tax reform should not be overestimated. In our view, five axes should however be considered in priority:

— to reaffirm the principle according to which all households' incomes must be subject to income taxation; taxation should to strictly enforce the principle according to which: "everyone should contribute to public expenditure according to their contributory capacities". These capacities should be assessed on a family basis.

— to reaffirm the principle according to which all labour incomes must pay social security contributions, all capital incomes should pay social security levies;

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

— to increase progressively environmental taxation and taxation on financial activities, to maintain capital taxation, to reduce labour taxation.

— to combat tax optimization and tax tourism implemented by companies and the wealthiest. This requires tax harmonisation at the world or EU levels, but in this area, France should take the lead and make proposals, and if necessary, make decisions alone.

Implementing a tax reform is far from being easy.

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