

Social VAT

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1. EDITORIAL : Social VAT and compensating measures

In France, Social VAT (or consumption tax) is proposed as an alternative way of funding social security.

Some welcome the idea; others consider it **anti-social**.

In response to this criticism of Social VAT, this month's Electronic VIVANT-Europe contains an article by Monique Durin (Braine-le-Château, Belgium) which particularly explains the distinction between rates and absolute figures, and an open analysis by David de la Croix (researcher at the Institute for Social Research at Louvain-la-Neuve University).

The aim is to indicate compensating measures which would ensure that social VAT would be fair and just – equitable taxes that would not upset the economy. They would be of five kinds:

1. VAT rates variable according to the nature of the product
2. Maintaining people's purchasing power by means of an unconditional basic income
3. Progressive income tax
4. A financial transactions tax (on the lines of the Tobin tax)
5. Inheritance tax – without harming the health of the economy.

Money “coming out of the woodwork” (Monique Duron's expression) would thus be taxed more justly and more fairly – without upsetting the economy.

2. SOCIAL VAT : FALSE DEBATE* – TRUE SOLUTION

* not to confuse rates and absolute figures

I. FALSE DEBATE

1° what is proposed is **not a tax on value added but a Social Contribution on Consumption** : SCC (collected, it's true, at the same time as Value-Added Tax and calculated on the same base), **to replace social contributions on work** – the latter being abolished (see arguments below)

2° **it is a rate, a percentage** – and what counts is the price paid by the consumer. Thus, if the base on which the calculation is made goes down the final result may be unchanged or even go down even if the rate applied goes up. E.g.-

Price net of VAT : $100 + \text{VAT } 21\% = 121$

Price net of VAT : $60 + \text{“SCC”}50\% = 90$

If production costs go down – as they will if the cost of work is reduced through the abolition of social contributions based on work – purchasing prices will also go down, even with a higher rate of tax or contribution collected.

3° in a debate one should first define the context and the objectives

Context :

- **Funding social security**, i.e. social redistribution, **is an enormous load** carried almost exclusively by workers who are properly declared : those who work pay for those who don't work; the ever-dwindling number of workers are bled individually and increasingly to pay for the ever-growing number of non-workers (from the cradle to the grave, including the unemployed, the unemployable, the sick, the retired, &c..).
- **This system is mathematically unviable, profoundly unfair for those who work, employers as well as employees, and quite absurd economically since it kills the job market, encouraging people to set up activities abroad rather than at home.**
- Considerable **levels** of unemployment caused by business shifting abroad, with psychological, social and financial consequences.
- A social redistribution system **which taxes unearned income** at 15% and earned income at 55%!

Objectives :

- To provide each citizen with the means of living decently and a sufficient guaranteed **minimum income**.
(there are three legitimate sources of income : work, the fruits of capital and benefits coming from wealth redistribution)
- To give **preference to income from work**, and to that end ...
- **To reinvigorate the job market** by reducing the cost of labour
- **To reduce the load of redistribution**, and above all ...
- **To spread this load across the whole population** instead of putting it only on the shoulders of those work.

II – TRUE SOLUTION

- Social contributions raised on the rewards of labour are collected at the very source of income, which **obliges the employer to advance or lend to the State large sums** that he can get back only when the product is sold. This leads to bankruptcies and migration of production, and kills employment.
- **It is not possible to tax unearned income at source** – it disappears in tax havens.
- There is only one solution and **that is to make everyone participate in the social redistribution process** : through consumption – when money comes out of the woodwork.
- The SCC rate can be tuned according to various criteria : necessary products – environmental impact – imports – **(3)**.

Monique DURIN
(Braine-le-Château, Belgium)

3. SOCIAL VAT – ELEMENTS OF AN ANALYSIS (a “carte blanche”)

The French government has recently tabled a proposal for introducing a social VAT so as to modify the way social benefits are financed in France. This proposal, which is fiercely criticised by the opposition, is of wider than local interest and incites reflexion.

An alternative to social contributions

Already at the beginning of the 1980s the Federal Bureau of the Plan (in Belgium) carried out a series of simulations for replacing social contributions with substantial indirect taxes (Mirabel plan). The aim was to put forward scenarios capable of containing the increase in mass unemployment emergent at that time. The results were rather encouraging.

a. The main argument was based on the perception that social contributions related solely to the work factor and led firms to adopt more and more capital-intensive technologies, whereas VAT was **neutral** with regard to this choice since it related to the entire value-added. Numerous studies made since then have shown that reductions in social contributions financed by indirect taxation were **favourable to employment**. Social VAT would therefore be a way of generalising this principle and substantially modifying the way social security was financed.

b. It was also observed, in the arguments about combating the ill effects of globalisation, that VAT applies to goods imported and not to those exported and thus heightened the competitiveness of the economy that applied it. But only up to a certain point : it should not be imagined that it could close the competitiveness gap between Europe and South and East Asia. **(1)** Yet within the euro zone when one member country increases VAT it improves its competitiveness within the zone **(2)** – which is why the European Union has set limits to policies of the sort.

c. A third argument in favour of increasing VAT comes from Germany. Chancellor Merkel and her Minister of Finance Peter Steinbrück have recently decided to lower direct taxes on companies and work and to raise VAT, arguing that to adapt to the tax competition which is taking place it is better to raise revenue from the less mobile things and activities.

d. Lastly, VAT brings the results of black work into its net, which social contributions do not do. This argument is particularly pertinent in Belgium.

A measure contrary to social redistribution?

The main criticism against social VAT is in terms of social justice. A **uniform** increase in VAT rates affects everyone. And since the less well-off spend the greater part of their income on basic consumption items they are **penalised to the hilt by VAT**. Replacing social contributions with VAT therefore amounts to transferring the resources of the poorest to the richest (at least in the short term : the savings the rich make are not affected by VAT but there comes a time when they are spent and they are taxed then).

It is true that VAT is contrary to social redistribution so long as it applies equally to all items of consumption. On the other hand, if VAT increases can be made to apply only to those items the rich buy, social VAT could turn out to be **more redistributive than social contributions** (which are proportional, and even, in some countries, subject to a ceiling).

Two questions are raised here.

a. Can VAT be fine-tuned enough **(3) (Examples of consumption tax rates)** for a policy of social redistribution? (For example, to increase it on vehicles of more than 2 litre-capacity, on restaurant menus over €20, on hotels with 3 stars or more, on screens of more than 28 inches, etc...)

b. And to what extent could people get round the measure by buying their luxury goods in another country? (The effects of a large difference between Belgian indirect taxes and those of Luxembourg are well known.) **(4) (Social VAT at the European level)**

Table 1 – Sources of government finance

	Indirect taxes (VAT...)	Direct taxes	Social contributions	Othe r
Belgium	27,0%	33,9%	32,3%	6,8%
Denmark	32,3%	53,5%	3,5%	10,7 %
France	30,3%	23,3%	36,0%	10,4 %
Germany	27,6%	24,6%	39,5%	8,3%
Sweden	29,7%	34,8%	22,9%	12,7 %

Denmark is often cited as an example for financing social security. There, solidarity is financed by a progressive income tax and by indirect taxes (VAT) – see Table 1. The anti-redistributive effects of VAT are in some way compensated for by the progressive character of the income tax. **(5) (Income tax in the Vivant model)**

In France the situation is very different, for there the tax system is very little redistributive from the beginning. Income tax, which is the most redistributive of the taxes, counts for relatively little in overall fiscal receipts ; the greater part of public finance comes from social contributions (subject to a ceiling and therefore regressive) and from VAT. The disquiet raised by the proposals for a social VAT in France seems quite justified in a country that from the outset transfers rather little of its tax income from the richest to the poorest. **(6) (Financial transactions tax)**

An inter-generational dimension

To go from a system of social security funding based on contributions to one based on VAT also poses questions **of justice between generations**. Under the present system funding comes from those between 20 and 65 years of age; under the social VAT system it would come from all consumers, irrespective of age. The social VAT thus burdens older people with funding social security. Age groups in retirement, and those approaching it, therefore have no interest in seeing the social VAT introduced. There is a means of doing away with this redistribution between the generations if desired : increase retirement pensions and finance this increase by means of public debt to be reimbursed by future generations of people who would benefit from the increased level of employment (and maybe growth) occasioned by the reduction of social contributions bearing on the work factor. **(7) (Economic situation of an elderly person in the Vivant model)**

In summary.

To replace part of the social contributions with a social VAT is a way of **promoting employment** by inciting employers to make technological choices that involve more labour input. Such a change, however, has implications for social justice, which would be adversely affected if the VAT were **not sufficiently attuned** to the types of items it would apply to. Old people also are entitled to be

anxious about such a measure ; a concomitant increase in pensions could make up for their loss of real income.

Lastly, to use an increase in VAT to reduce other types of taxation like inheritance tax **(8)** **(Taxation of capital assets in the Vivant model)** would amount to a redistribution for the benefit of the wealthy and would not seem to contribute to the efficacy of the economic system.

David DE LA CROIX

Professor at the Catholic University of Leuven

(a “carte blanche” article in LE SOIR newspaper of Belgium, 16 June 2007

4. THE VIVANT WAY OF COLLECTING CONSUMPTION TAX

By its nature, VAT is a tax that is recuperated, and thereby an occasion for fraud. VIVANT aims to limit occasions for fraud and in particular the VAT “circuses”, and proposes two methods :

1. To limit companies’ recuperation of consumption tax

The consumption tax paid on goods used only in the production or manufacture of finished goods is recuperable because the former, being inputs, are not consumed as end products.

All inputs into production processes, such as raw materials or intermediate materials (fuel, packaging, vehicle and machine maintenance, etc.) are considered intermediate products and any VAT or consumption tax paid on them can be recuperated because they contribute directly to the process of manufacture or transformation.

On the other hand, consumption tax paid on purchasing investments in finished products which do not necessarily contribute to manufacture or transformation (such as buildings, machines, computers, office furniture, heating, vehicles, telephonic and other equipment) is not recuperable.

2. To limit the number of actors in the market who actually collect consumption tax :

either by collection at the factory gate, as is suggested by Pierre Aunac, a French economist (“This is the whole point of a consumption tax conceived as a social VAT, paid directly by corporations to the social organisations, as social contributions now are.”)

or by collection at the wholesaler level

For example, the recuperation system should obviously apply to a wholesaler of heating equipment. But there is no point in applying it to those who install the heating systems. For control purposes, resources could thus be concentrated on the one wholesaler rather than spread between his 50 customers who install his goods. In practice, then, the latter would not have to claim reimbursement of consumption tax.

The same would apply to small retailers such as bookshops, florists, cafés and restaurants.

Collection of consumption tax will thus be carried **out more economically and effectively**, at a limited number of points in the distribution chain, and may be combined with fiscal, health and environmental traceability at the European level.

Jean-Paul BRASSEUR

(responsible for VIVANT-EUROPE)

EDITORIAL NOTES

(1)

Salaries are rapidly increasing in Shanghai and financial speculation is putting rents out of reach. If energy costs, and thereby freight costs, increase greatly, the cost of transporting a vehicle to

Western Europe will surpass the excess cost of assembling it there and it will be cheaper to produce it and numerous kinds of heavy or bulky goods in Europe.

(2)

It is a matter of fact that Germany, which has begun to institute a social VAT, has made its economy more competitive within the 27 European Union countries because the cost of labour has gone down.

But were all the 27 EU countries to adopt a social VAT while reducing or abolishing taxes on work competitiveness between them would not change. So what's the advantage in the longer term of a social VAT as a way of financing social security?

- It frees work from the burden of taxation and promotes initiative and entrepreneurship
- It simplifies the tax system and reduces public expenditure.

(3) **CONSUMPTION TAX RATES (%)**

FOOD :	
FOODSTUFFS	50
RESTAURANTS	20
Sub-total : 38%	
DRUGS :	
ALCOHOLIC DRINKS	70
MEDICAMENTS	50
HEALTH CARE	0
TOBACCO	70
Sub-total : 37%	
ENVIRONMENT	
FURNISHINGS	50
EQUIPMENT	50
HEATING (gas-electricity)	70
ENTERTAINING	50
WATER	70
ELECTRICITY	70
HOUSE MAINTENANCE	0
CLOTHING	50
BOOKS, MAGAZINES	50
BUILDING MATERIALS	60
DOMESTIC STAFF	0
BUILDERS' SERVICES	0
FINANCIAL SERVICES	20
Sub-total : 42%	
COMMUNICATIONS	
PURCHASE OF VEHICLES	50
FUEL FOR VEHICLES	70
VEHICLE MAINTENANCE	20
TELECOMMUNICATIONS	50
AIR TRANSPORT	50
PUBLIC TRANSPORT	0
sub-total : 56%	
GENERAL TOTAL : 42%	

In this list of items, with one exception, only goods are taxed. Services, such as those relating to health care, house maintenance and cleaning, are zero-rated. The sole exception are the financial services.

At present, tax on labour adds about 50% to the cost of goods. The mean rate of 42% Consumption Tax in the new system, calculated on the cost without this tax on labour, will not, therefore, increase the cost of living.

(4)

Against such avoidance of the consumption tax VIVANT-EUROPE proposes to apply it across the European Union.

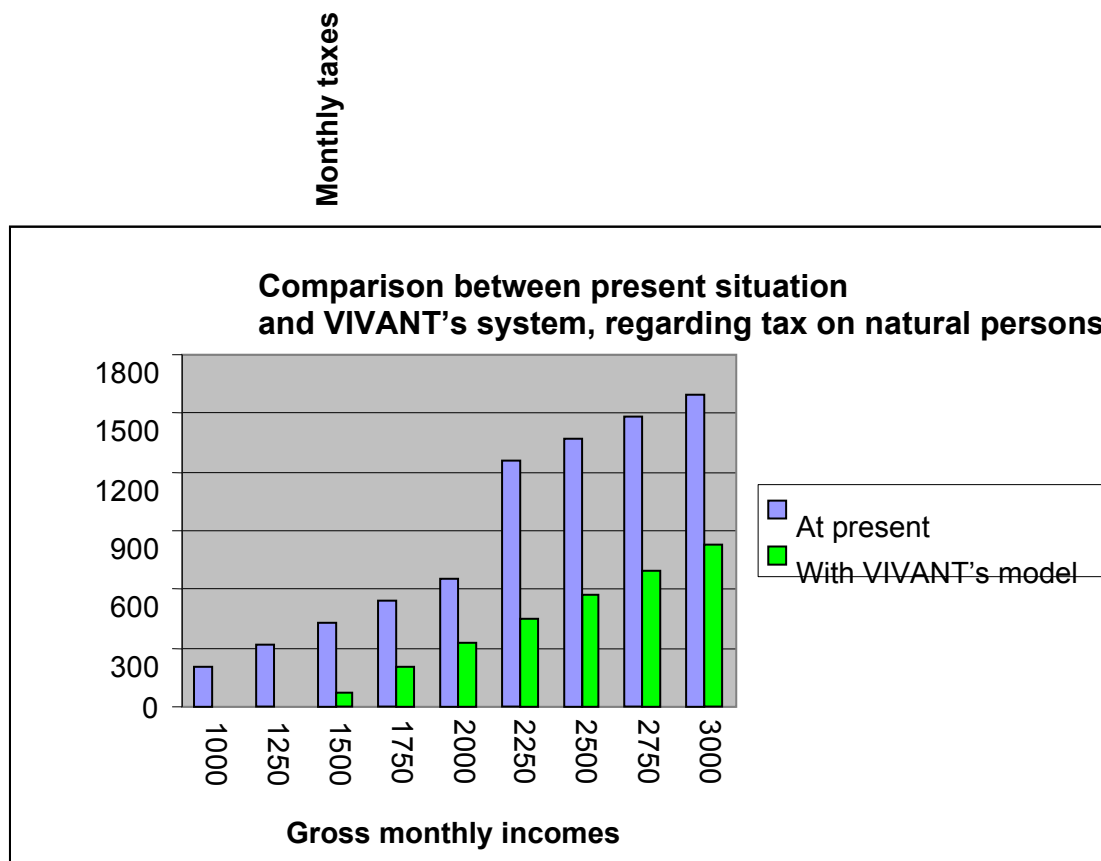
“The penalisation of European workers with regard to workers outside Europe must be stopped.

Tax on work kills employment, empties Europe of its skills and jeopardises the funding of our social security. European social security must be funded by the sale of products in Europe. (Tax on consumption without price increase)”

(5) Income tax

On the portion of income exceeding € 1,500 per month (basic income included) Vivant would apply a tax of 50%.

COMPARATIVE TABLE



Conclusion :

Taxing income in this way is both progressive in relation to income and less burdensome for the individual.

