

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.

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