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TAX SYSTEM AND REFORMS IN EUROPE: FRANCE

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TAX SYSTEMS AND TAX REFORMS IN EUROPE: FRANCE

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Abstract
This paper aims at discussing the main features of France's tax system, its recent reforms and those underway. It is part of a wider research on European taxation, carried on at this Department, under the direction of L. Bernardi and P. Profeta, and the supervision of V. Tanzi. Firstly, one considers, also with reference to the European average, the trends of the total tax revenue (direct and indirect taxes) and the total fiscal revenue, this last showing the fundamental role played by the social security contributions in the French fiscal structure. Then, one surveys some quantitative and institutional features of the main national and local taxes, according to the most recent Financial Laws and one discuss the evolution of the implicit tax rates from 1970 to 1997 dwelling also upon the tax wedge on labour. The high value of this last indicator is a real obstacle to the French development and helps to explain the fiscal reforms' direction in the 1990s. France started to cut social security contributions for unskilled workers in 1993, but the tax burden on labour still remains too heavy. Therefore, apart from reducing the complexity of VAT system, lowering the PIT rates and achieving environmental targets, the underway and future interventions will have to focus once again on the improvement of the labour market performance.

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1. Introduction, contents and main conclusions

This chapter aims to discuss the case of France analysing the most significant features of its tax system and its more recent changes and reforms.

Inside Europe one can distinguish four models of tax system (Bernardi, 2000): the Dual Income Taxation-DIT model, that is the system of Nordic countries, the British, now also Netherlander model where one observes a reduced level of expenditure, overall tax pressure and social contributions for PAYG pensions, the Mediterranean model with a low total fiscal pressure and rough welfare and finally the Rhine one. France is the second European country, behind Germany, showing a very high overall fiscal burden according to this last model that is characterized by a different mix of direct, indirect taxes and contributions to finance a still entirely public and rich welfare.

Paragraph two shows the development of the taxation system from the beginning of the 1970s to the end of the 1990s. The fiscal burden is gradually increased in the long run: the most important changes concern direct taxes, mainly the PIT, whose revenue as percentage of GDP has more than doubled and social security contributions. The level of tax on income and profits is also significant: thus, it can be predicted that the French tax system is characterized by a relevant tax-wedge on labour. All this creates now problems and shows the need of reforms since the tax-wedge on labour is a concrete obstacle to the French development.

As concerns the main taxes, France is similar to other European Countries. However there are some peculiar elements. The PIT tax base is very narrow in France, the calculation of fiscal liability takes place following the *family quotient* method, that was introduced in 1945, and the level of tax progressivity is the highest compared to the eleven other OECD Countries, showing that PIT acts as a further burden on the highest income levels. The classes of income are six, the minimum rate, according to the Finance Law of 2001, is 7.50 percent whereas the maximum is 52.75 percent.

With reference to Corporation tax, France adopts the imputation system and the principle of territoriality. In 2000 the net revenue from this tax was 37.30 billions € whereas for 2001 it should rise to 42.57 billions €.

Among direct taxes, France also has the I.S.F. (impôt de solidarité sur la fortune), a property tax, whereas VAT dominates within indirect taxes.

The State or the Regions are the beneficiaries of the employers' contribution to the development of further vocational training, but the most important local taxes are the "foncier bati" tax, the "foncier non bati" tax, the "taxe d'habitation" and the "taxe professionnelle".

In paragraph four will examine fiscal burden in France either through analysis of the distribution of taxation by economic functions or through implicit tax rates. The high burden on labour predicted in section two is to be underlined : in fact, in the last thirty years taxes on labour have increased by over 9 percentage points of GDP, whereas the French trend of the implicit tax rate on employed labour has been very similar to the European one. Thus, in 2000 the tax wedge on labour in France occupied the fifth place in the OECD list.

The taxes on consumption, instead decreased slightly and amongst those on capital, taxes on real estate & capital play the most important role. Finally, from the comparison between the effective marginal and average tax rates and the statutory rate, one can understand the wide tax discrimination in favour of debt financing that obviously discourages the firm's capitalisation.

The last paragraph is devoted to fiscal reforms. The cuts in social security contribution at the lower end of the wage scale started in 1993 wholly base themselves upon the observation of the figures concerning the fiscal burden on labour. Another significant step forward in this direction was taken in 2001 with the introduction of the "employment bonus", a tax credit that will benefit some 8-10 million low-income households. At the moment then, the effects of the shift from labour to consumption or corporate income taxes is being studied with the aim to bring taxation to bear more on scarce resources, such as the environment, than on abundant ones, such as labour supply.

Tax reforms should aim to simplify and modernise the VAT system, whereas for the PIT a further reduction of the top marginal rate to reach 52.5 per cent in 2003 should be considered.

When one talks about the changes of the corporate income tax, the need to strengthen the special regime for small enterprises and newly created companies and the neutrality of funding is highlighted. On the one hand, favoured tax treatment will be able to compensate for the difficulty in raising finance and for the disproportionate costs stemming from administrative complexities. On the other hand one will try to wipe out the wide discrimination in favour of the debt financing noted above.

Finally, the reinforcement of the relationship with the taxpayers and the improvement of the efficiency of the tax collection could be two measures not only to free-up resources for beneficial uses, such as fighting tax evasion, but also to increase the fiscal revenues of Local Government.

All in all, after years of economic stagnation and unemployment, from 1997 France started its rapid growth: the efforts made to increase the domestic demand and the disposable income, to create jobs and reduce the labour costs, to consolidate the budget situation and bring down inflation and, finally to improve business investments have been repaid.

However, other substantial improvements can and must be realised, also with reference to the structure of taxation in order to continue to grow on a sustainable basis and thus to overcome the slowdown largely caused by world uncertainty, increasingly palpable after September 11th. In particular, in order to continue to reduce taxes it will be necessary to increase the efforts to control public expenditure, to prevent inflationary effects and to continue fiscal consolidation.

2. The structure of the system and its development from the '70s

2.1 The current structure of taxation and of social security contributions

The tax system of France follows, in general terms, the systems of taxation adopted by European and other industrialized Countries. Fiscal rules are assembled in a General Code (Code Général des Impôts – CGI) consisting of two books: the first concerns the calculation of the basis of assessment and settlement of the different taxes and the second the terms of collection. Another fundamental text is the Fiscal Procedures Book (Livre des procédures fiscales) that regulates the control and checks activity of the Financial Administration. The financial law passed yearly contains the possible changes of various tax structures.

As regards the macroeconomic situation in 2001, the net borrowing of General Government in France (Statistical Annex of European Economy, 2002) reached the level of 1.4 percent of GDP whereas in 1993 it was about 6 percent. Naturally this significant reduction was due to the 1992 Maastricht Treaty, requiring this value to be reduced to 3 percent, and to subsequent rules of the Stability and Growth Pact, that created a framework in which many EU Countries have implemented fiscal consolidation efforts. The primary surplus represented 1.8 percent of GDP whereas the debt amounted to 57.6 of GDP, respecting also in this case the Maastricht roof of 60 percent. The total revenues of Government in 2001 can be divided into three headings: taxes (27.7 percent of GDP), social contributions (18.1 percent) and other revenues not of fiscal type (3.7 percent). The level of total expenditures is 52.6 percent of GDP and the primary expenditure amounts to 49.4 percent of GDP, with one of its main items, that is social monetary transfers reaching 18.1 percent of the French gross domestic product.

The French structure of taxation in 1999[1] is depicted in Tab.1 (see par.2.2 for the analysis of its development).

The total fiscal revenue corresponds to 47 percent of GDP: the total tax revenue amounts to 29.5 percent of GDP, whereas the remaining part (17.5 percent of GDP) is represented by social security contributions. In France, like in others OECD Countries, social security contributions are the largest single source of general Government revenue. The dominant role of such contributions stems directly from the so-called Bismarckiam model which remains the foundation of the social security system in much of Europe today. The model sees Government-provided social security as a special form of insurance, with both benefits and contributions tied to the wages of workers. Among the chargeable persons, employers play the most important role: their share of the social contributions is 70 per cent of the total one.

Direct taxes reach 13.9 percent of GDP, almost 30 percent of the total fiscal pressure and they are dominated by the personal income tax, corporation tax being only 2.6 percentage points of GDP.

As concerns indirect taxes, a fast growing revenue source is general consumption tax, especially the value-added tax (VAT). In fact, the substantially increased importance of VAT has served to counteract the diminishing share of specific consumption taxes, such as excises and custom duties. In 1999 French VAT is 0.6 percentage points higher than the European average, whereas the excise duties only total 3 percent of GDP.

We can underline also that the share of central Government on total tax revenues is higher than the underestimated (because of their various sharing to national taxes) share of local authorities (Regions, Municipalities) even if the latter has increased over the past 17 years. In 1999 it is 4.7 percent of GDP, a little more than a fifth of the Central Government's one.

Within this French fiscal outline, the most important taxes are Personal Income Tax, Corporation Tax, taxes on financial activities, I.S.F. (impôt de solidarité sur la fortune), VAT, excise duties, employers' contribution to the development of further vocational training and the "taxe professionnelle".

We will come back to these subjects in the following sections.

2.2 Developments of the system from 1970 to 2000

According to available data and estimates (Tab.1), in France the share of taxes and social contributions in the GDP increased slightly by 2.2 percentage points to 47 between 1995 and 1999. In 1999 the total fiscal revenue was 5.3 percentage points higher than in 1980 and 12 percentage points higher than in 1970. The relatively high tax to GDP ratio that we observe today is to a large extent due to the tax increase in the 1970s, in the 1980s, and, though smaller, in the 1990s: however, recent developments suggest that this trend may be ending.

The share of indirect taxes as a percentage of GDP increased by a bit more than half a point between 1970 (15 percent) and 1999 (15.6 percent), staying under the threshold of 15 percent only at the beginning of the 1990s. The main changes in indirect taxation occurred in the 1970s when the falling of general sales or turnover taxes was only partly balanced by VAT. In particular, the share of VAT in GDP decreased significantly from 1970 (8.9 percent) to 1993 (7.3 percent), reaching 7.9 percent in 1999. Revenues from excise duties remained almost stable at around 3 percent of GDP, whereas other indirect taxes in France still play an important role at the end of 1990s with growth of their tax burden at 0.4 percentage points from 1993 to 1997.

[1] It is the last datum available.

The share of direct taxes as a percentage of GDP was around 13.9 percent in 1999: there was a big rise of 2 percentage points between 1975 (7.4 percent) and 1985 (9.4 percent) whereas in the following ten years the increase was more moderate (nearly 0.8 percent). Therefore, the evolution of direct taxes was not smooth. It was affected either by the corporate income tax trend, that stood at about 2.6 percent of GDP in 1999, approximately one percentage point more than in 1993, or by the personal income taxation trend: its revenues, always as a percentage of GDP, are more than doubled compared with 1970. The growth of income tax revenues was a reflection of strong economic growth during the period. Such growth increased the revenues from most taxes, but had a particularly strong influence on income tax revenue. In the case of personal income taxes, this is because of their progressive rate structure; in the case of corporate income tax, because corporate profits tend to increase more in proportion to output. Direct taxes other than those on personal or corporate income still play a minor role: in 1999 they represented 1 percent of French GDP.

As tax – to- GDP ratio has risen, the largest part of the increase has taken the form of higher social security contributions: the expanding share of these contributions seems to be directly linked to the upward pressure on aggregate benefit spending resulting from higher unemployment, ageing populations and rising Government expenditure on health care programmes, that is to the expansion of social insurance systems substantially financed by such contributions. In 1970 they were 12.7 percent of GDP whereas 25 years later their share increased by 6.7 percentage points to 19.4 percent (Tab.1). At the end of the 1990s, social contributions represent 17.5 percent of GDP. However their percentage of total taxation is almost the same as in 1970: as a matter of fact, the most important increase concerns the 1980s and the beginning of the 1990s. Later, there was a weak but continuous reduction reaching 17.5 percent in 1999.

Employers pay more than twice that paid by employees, whereas the share concerning the self employed is the smallest.

2.3 A comparative view with the European average

The tax burden in the European area, defined as the ratio of Government fiscal receipts to gross domestic product (GDP) is very high by international standards: in 1999, it was 43.1 percent of GDP. France is generally in line with the European average, this was especially true in the 1970s. In the 1980s and 1990s on the contrary the difference becomes more marked: in 1985, for instance, it was 4.6 percentage points. Ten years later instead total fiscal revenues in France amounted to

TAB. 1 *Structure and development of fiscal revenues in France and European average as % of GDP, 1970-2000*

	1970		*1975*		*1980*		*1985*		*1990*		*1995*		*1999*	
	France	*Europe*	*France*	*Europe*	*France*	*Europe*	*France*	*Europe*	*France*	*Europe*	*France*	*Europe*	*France*	*Europe*
Direct Taxes, of which	*7.3*	*8.9*	*7.4*	*11.9*	*8.6*	*12.7*	*9.4*	*13.1*	*9.4*	*13.2*	*10.2*	*13.3*	*13.9*	*14.5*
Personal income	4.4	5.5	4.6	8.9	5.5	9.3	6.2	9,0	5.8	8.9	7.3	9.6	10.4	9.9
Corporation income	2.2	2.2	1.9	1.9	2.1	2.2	2.0	2.8	2.4	2.9	1.9	2.4	2.6	2.8
Indirect taxes, of which	*15.0*	*13.0*	*14.5*	*12.2*	*15.3*	*13.2*	*15.8*	*13.0*	*15.1*	*13.0*	*15.2*	*15.1*	*15.6*	*14.6*
VAT	8.9	5.1	8.5	5.7	8.6	6.6	8.6	6.1	8.0	6.6	7.6	6.9	7.9	7.3
Excise duties	2.9	3.5	2.6	3.5	2.8	3.2	3.0	3.2	2.8	3.1	3.1	3.4	3.0	3.5
TOTAL TAX REVENUE	22.3	21.9	21.9	24.1	23.9	25.9	25.2	26.1	24.5	26.2	25.4	26.9	29.5	29.1
Social contributions	*12.7*	*11.7*	*15.0*	*12.8*	*17.8*	*13.4*	*19.3*	*13.8*	*19.3*	*13.7*	*19.4*	*15.0*	*17.5*	*14.0*
Employers	9.3	7.2	10.8	7.7	11.9	7.8	12.5	7.9	11.9	7.8	12.0	8.0	12.3	7.8
Employees	2.4	3.5	3.2	3.8	4.6	4.3	5.2	4.5	5.8	4.5	5.9	5.1	4.2	4.5
Self Employed	1.0	1.0	1.0	1.3	1.3	1.3	1.5	1.5	1.6	1.4	1.5	1.8	1.1	1.7
TOTAL FISCAL REVENUE	35.0	33.6	36.9	36.9	41.7	39.3	44.5	39.9	43.8	39.9	44.8	41.9	47.0	43.1
Administrative level														
Central Government	20.4	19.7	18.9	21.1	20.3	22.3	20.5	22.1	19.5	22.2	20.1	22.5	21.8	23.7
Local Government	2.1	2.2	2.8	2.8	3.0	2.9	3.9	3.1	4.1	3.8	4.4	4.0	4.7	4.3

Sources: 1970-1995, Eurostat, 2000; 1999, Eurostat New Cronos Databank 2002(data equalized with Eurostat, 2000).

Notes: Minor items are omitted.

44.8 percent of GDP, whereas in Europe they were around 42 per cent. On the other hand, in 1999 French fiscal burden exceeds the European average by 4 percentage points (Tab.1).

Differences in the tax burden across Member States are especially due to the weight of the public sector in the economy. There is a close relation between tax receipts and Government expenditure as percentage of GDP. The long run increase in the overall tax burden is closely related to the growing share of the public sector: taxes are upped to finance increasing levels of spending. The overall tax burden has risen substantially during the past three decades and, at the same time, the tax structures in Member States have undergone major changes particularly because of increased international tax competition that has been one of the driving forces behind the convergence of the effective tax rates of the tax systems within the EU.

The most striking feature of these past developments has been the increasing tax burden on labour in order to finance welfare spending, such as pensions, health care and other social benefits. For just this reason, France recently followed the example of the United States, the United Kingdom, New Zealand and Canada: such schemes aim to increase participation to work, in particular for people eligible for unemployment compensation or welfare benefits. This is considered to be effective in encouraging labour supply, especially if combined with a minimum wage, at a reasonable level, that must be fixed in order to minimise its effects on labour market flexibility.

As concerns direct taxes, France has always been under the European average: from 1995 in France they exceed 10 percent of GDP, whereas at European level they are around 13 percent of GDP (Tab.1).

At last, we consider indirect taxes: their evolution, as opposed to that of direct taxes, shows that their share as percentage of GDP has been, from 1970s higher than the European average by about 2 percentage points.

3. Some quantitative and institutional features of main taxes

3.1 The Personal Income Tax-PIT (Impôt sur le revenu)

This tax is paid by the individual. In the case of partnerships which have not opted to pay corporation tax, the tax is payable by each partner.

The basis of assessment is the total net income, determined according to the formula applicable to each type of income (including income from foreign sources in cases where taxpayers are resident in France), less any legally deductible expenses (e.g. maintenance payments, cost of accommodating an elderly person and aggregate underpayments from previous years). In other words, the taxable income is a global income. It includes the totality of net incomes belonging to the following categories: salaries, wages, pensions, private income, life annuity, revenues of movable capital, plus values, land revenues, revenues and plus values of non-salaried professions.

The exemptions (Tab.2) concern persons whose net income does not exceed the minimun guaranteed of 5,994.55 € or the fixed value of 7,250 €: this threshold rises to 7,920 € for people over the age of 65; interest on certain Government loans; certain pensions, benefits and allowances and capital gains. The personal income tax is, however, payable on capital gains realised by individuals when they transfer assets or rights of any kind for a valuable consideration, although

TAB.2 *Some measures for the calculation of the PIT*

Measures	*Year 2000*	*Year 2001*
Exemptions		
Minimum guaranteed	up to 38,650 F	up to 5,994.55 €
Low income (people under the age of 65)	up to 46,800 F	up to 7,250 €
Low income (people over the age of 65)	up to 51,100 F	up to 7,920 €
Deductions		
Deduction of 10% of the declared wage or salary	from 2,350 F to 78,950 F	from 364 € to 12,229 €
Abatement of 10% granted for pensions	from 2,080 F to 20,400 F	from 323 € to 3,160 €
Abatement of 20%	up to 722,000 F	up to 111,900 €
Abatement of 1,590 € for elderly or disabled people		up to 9,790 €
Abatement of 795 € for elderly or disabled people		from 9,790 € to 15,820 €

Source: MINEFI 2002

there are numerous exemptions from this requirement. In addition, net capital gains realised from the transfer of securities for valuable consideration are also taxable.

There are then specific deductions (Tab.2) for all expenses involved in earning or maintaining income. In the case of employees, occupational expenses are fixed, as a general rule, at 10 percent of the declared wage or salary, with a minimum of 364 € and a maximum of 12,229 € applying to expenses incurred in the 2001 tax year. An allowance of 10 percent is granted for pensions and free life annuities; this allowance may not exceed 3,160 € for total pensions received by a household. In the case of salaries, wages, pensions and free life annuities, a personal allowance of 20 percent is granted up to a legally declared income level, after the specific deductions, of 111,900 €. This treatment concerns also, in certain cases, craftspeople, tradesmen, merchants, industrialists and farmers who have joined registered management centres and persons who have joined registered associations open to members of the professions and to holders of public office. Individuals aged 65 or over and disabled persons qualify for a tax allowance of 1,590 € if their total net income is

TAB.3 *Personal Income Tax 2001*

Income classes	*Rate*
Up to 4,121 €	0
4,121 € - 8,104 €	7.50%
8,104 € - 14,264 €	21%
14,264 € - 23,096 €	31%
23,096 € - 37,579 €	41%
37,579 € - 46,343 €	46.75%
over 46,343 €	52.75%

Source : MINEFI 2002

less than 9,790 €. A reduced allowance of 795 € is granted to individuals aged 65 or over or disabled persons whose total net income is between 9,790 € and 15,820 €.

To mitigate the tax burden of the families, the use of the *family quotient* has been introduced (Law 31 December 1945) in the calculation of fiscal liability: family incomes are aggregated, but the aggregate income is divided by a number of points, awarded on the basis of the taxpayer's family situation (the family quotient). The progressive rate is applied to this resulting income; at last, this partial tax is multiplied by the number of points to determine the recoverable tax . However, the advantage derived from the use of this method is subject to an upper limit.

The Financial Law for 2002 (art. 2, CGI, art. 197-I-2°) has brought the roof resulting from the application of family quotient from 12,440 F to 2,017 €. For single, divorced or separated taxpayers, the roof of the tax allowance joined to the first dependant child goes from 21,930 F to 3,490 € in 2001. Moreover, the roof of 6,220 F granted to singles that have brought up one or more children, the last aged more than 26, is fixed at 964 € for 2001, whereas tax reduction for beneficiaries is 570 €.

There is also a tax reduction, concerning expenses for children (mainly nursery-school), of 25 per cent of the sum paid in 2001 up to 2,300 € per child. On the other hand, 61 €, 153 € and 183 € are the tax reductions as a child goes on to a different level of school.

The rates and the income classes for 2001 are indicated in Tab.3: the Finance Law of this year has reduced the first four rates by 0.75 per cent and the last two by 0.5 per cent.

3.2 Corporation Tax-CT (Impôt sur les sociétés)

The profits of businesses operating in France are the basis of assessment (principle of territoriality). According to a strict definition (art. 38, 2° sub, CGI), these profits comprise the difference between the value of net assets at the end of the financial year and their value at the beginning of the same financial year, plus payments to shareholders less additional injections of capital (Monaco, 1999). In practice, a company's profit is determined on the basis of its annual accounts, with adjustments in the form of statistical deductions and additions to take account of specific fiscal rules.

The bodies exempted from payment, subject to certain conditions, include Regions, Departments, Municipalities, farmers' associations and cooperatives, housing associations, investment companies and societies whose aim is to make goods available to their members.

The standard rate is one third, but a reduced rate of 19 percent applies to long-term capital gains, except for certain capital gains of a financial nature. A rate of 24 percent or 10 percent applies to income from real estate or farming and to certain types of income from movable property accruing to public institutions engaged in administrative activity, to civic associations and to non-profit organisations. According to the last finance laws, the different effective rates of the corporation tax for 2002 are indicated in Tab.4.

For companies with a turnover lower than 7,630,000 € and which capital is owned for at least 75 percent by individuals or by similar firms, the rate for the first 38,120 € is reduced to 25 percent for 2001 and to 15 percent for 2002.

Dividends that parent companies receive from their French or foreign branches are subtracted from total net profit after a deduction of 5 per cent of total dividends, tax credit included. A longstanding issue is that double taxation of distributed profits, first at the corporate level and subsequently at the shareholders' level, can produce a high combined tax rate on equity. Therefore, France but also other Countries, adopted a system that grants a tax credit to dividend recipients corresponding to the corporate tax on distributed profits. This is known as the imputation system as opposed to the so-called classical system without such credits.

New companies and those that are installed in sectors needing development can benefit from these temporary exemptions if they satisfy particular requirements. Moreover, in addition to special regimes and allowances, France grants simplified tax filing to small business. These measures are designed to offset the disadvantages of new or small enterprises in financing their investment projects, but also to reach equity objectives.

TAB. 4 *Corporation Tax 2002*

PME[2] exempted from social contribution	
Up to 38,120 €	15.45%
over 38,120 €	34 1/3%
long-term plus values	19.57%
Other than PME (turnover exceeds 7,630,000 €)	
profits	34 1/3% - 35.43%
long-term plus values	19.57% - 20.20%

Source: MINEFI 2002

Expenses and charges are deducible on certain conditions:

- They must be refer to normal management of the company;
- They must be justified and related to the company's aim;
- They must determine a reduction of the company's net profit;
- Their deduction must not be hampered by a particular provision of law.

At the same time, long run plus-values are deducted from profit and taxed separately at the reduced rate of 19 percent.

The tax credit attaching to companies' distributed earnings under the imputation system may be offset in full against tax liability but it is not refundable in principle.

Losses may be carried forward for a period of five years, except for depreciation postponed during a loss-making period, which may be carried forward with no time limit. Optionally, and under certain conditions, losses may be carried back three years.

All companies also have to pay an annual flat rate according to their turnover, but only if this exceeds 76,000 €. Furthermore Financial Law of 4 August 1995 has committed corporate bodies to a contribution of 10 per cent of corporate income. The rate of this contribution was reduced to 6 per cent for 2001 and 3 per cent for 2002 (Financial Law for 2001).

Special features are:

- consolidated group liability: subject to certain conditions, when a parent company holds at least 95 percent of the dividends and voting rights of subsidiary companies, the parent may assume sole liability for the corporation tax payable by those subsidiaries;

- consolidated-profits regime: the taxable profits of parent companies are computed by adding to the parent company's profits the profits, calculated in accordance with French tax rules, of all the companies in France and abroad in which the parent directly or indirectly holds at least 50 percent of voting rights;

[2] PME : petites et moyennes entreprises. This social contribution is calculated whit reference to the fiscal liability reduced by an annual abatement that can't exceed 762,245 €. The rate is 3.3 percent.

- worldwide-profits regime: the taxable profits of French companies are consolidated with the profits and losses, calculated in accordance with French rules, of all their direct operations abroad.

3.3 Taxation of income from financial capital

As concerns the taxation of financial activities France applies an imputation system: dividends are taxed according to the personal income tax of the shareholders and corporate and withholding taxes paid on dividends are fully or partly creditable. This imputation system does not give any relief to residents who are shareholders in companies established in other Countries, with respect to corporate income tax already paid in those Countries, while it does for resident companies. However, owing to bilateral tax treaties with certain Countries, France grants refundable tax credits to non-residents. The transfer of shares, bonds and some non-quoted stocks is taxable if the total amount earned in 2001 exceeded the threshold of 7,623 €. Therefore only over this threshold plus values are completely taxable: they are subjected to PIT and the rate is 16 percent plus 10 percent as a social withdrawal[3]. The same treatment is valid for financial profits even if in this case there isn't the above mentioned threshold: so they are always taxable.

The taxation of interest income from Government bonds in France only concerns residents and the rate is 15 percent. The withholding tax is final if the taxpayer so decides. Otherwise, interest income is included into the taxable income and taxed at the individual's marginal rate.

Certain National Savings Products are tax exempt and other short-term products are withheld from 15 percent up to 50 percent when unnamed.

3.4 ISF (Impôt de Solidarité sur la Fortune)

As concerns property taxation, we consider the institutional structure of the ISF. It must be paid by individuals of all nations, with fiscal residence in France or abroad owning, on the First of January 2002, a taxable property valued at over 720,000 €.

The tax is payable on movable goods and real estate, rights and values composing the property, not exempted and belonging to family. The rates and the property classes are indicated in Tab.5. Total burden is reduced by 150 € for dependants.

Finally in the framework of direct taxes we can mention the land tax and the taxes on dwellings.

[3] This 10 percent is calculated as follows: 7.5 percent to CSG (Contribution sociale généralisée), 0.5 percent to CRDS (Contribution pour le remboursement de la dette sociale) and 2 percent to social withdrawal.

TAB. 5 *I.S.F. 2002*

Net patrimony value	*Rates*
Up to 720,000 €	0%
720,000 € - 1,160,000 €	0.55%
1,160,000 € - 2,300,000 €	0.75%
2,300,000 € - 3,600,000 €	1%
3,600,000 € - 6,900,000 €	1.30%
6,900,000 € - 15,000,000 €	1.65%
over 15,000,000 €	1.80%

Source: MINEFI 2002

3.5 Value added Tax –VAT (TVA)

VAT (Taxe sur la valeur ajoutée-TVA) dominates among indirect taxes. The Beneficiary is the State, but a levy of 0.7 percent, whose revenue is assigned to the special budget for agricultural welfare benefits, is included in each of the VAT rates.

The tax must be paid, in general terms, on the supply of movable goods, the provision of services and equivalent operations effected by taxable persons as part of the economic activity of an industrial, commercial, creative, professional, agricultural or civic nature; on the acquisitions of movable tangible property effected by taxable persons or non-taxable legal persons from taxable persons established in other Member States of the European Union (with certain exceptions) and equivalent transactions; on the importation of goods; on the operations explicitly ordained by law, such as those carried out by cooperatives, those connected with real estate, self-supply and purchases of certain products from persons not liable to VAT; on the operations which are outside the scope of VAT legislation or are exempt from VAT, but for which the law provides the possibility of opting for VAT, for example certain local authority services.

VAT is collected in connection with the supply of goods or the provision of a service (tax chargeable on receipt of payment), transfer of ownership, importation, purchase or intra-Community acquisition (tax chargeable on the fifteenth day of the following month or on the date of the invoice, depending on the nature of the taxable transaction).

The basis of assessment is represented by prices or fees for goods and services, including all applicable charges and taxes other than VAT.

The main exemptions are the following:

- exports and equivalent transactions;
- certain banking and financial operations;
- activities subject to local entertainments tax: sporting events, gaming clubs and casinos;

- certain activities carried out by non-profit organisations in which their management has no vested interest;
- certain operations carried out by Government bodies or local authorities;
- certain real-estate operations;
- medical and paramedical activities;
- certain imports;
- educational activities.

With some exceptions, VAT paid on the purchase of goods or services for business use is deductible from VAT due in respect of sales. Taxpayers can obtain a quarterly or yearly refund of any overpaid VAT.

The three different rates are (from the First of April 2000):
- standard rate of 19.6 percent;
- reduced rate of 5.5 percent particularly for agricultural products, most foodstuffs, books and theatre and cinema tickets;
- minimum rate of 2.1 percent particularly for medicinal products and newspapers.

There are also other rates concerning specific operations in Corsica and in DOM-TOM (Domaines d’outre mer-Territoires d’outre mer).

3.6 Excise Duties

The excise duty on mineral-oil and allied products is another example of an important indirect tax payable by the importers, manufacturers and distributors of mineral-oil products who release these products for consumption. It is levied on mineral-oil and allied products which are used as heating or motor fuels at the point when they are released for consumption. Annual rates as fixed by the Finance Act 1999 (Article 26) are indicated in Tab.6. Article 26V of the Finance Act 1999 introduced a refund of part of the excise duty on diesel for road haulage vehicles weighing 12 tonnes and over; the refund is granted on the first 40.000 litres per vehicle/year.

Tobacco duty is collected when tobacco products are supplied for consumption. The basis of assessment is the retail price and the standard rates (as percentage of the retail price) referred to different product groups are indicated in Tab.7.

TAB.6 *Excise duty on mineral-oil and allied products (1999)*

Product designation	*1999 rate (in €)*	*Taxable unit*
Leaded petrol		
High-octane leaded petrol	63.36	100 litres
Unleaded petrol		
High-octane unleaded petrol	53.15	100 litres
Diesel	37.83	100 litres
LPG and methane		
as motor fuels	10.02	100 kg net
as heating fuels		
Heavy fuel oil for heating	2.31	100 kg net
Liquid paraffin		
kerosene motor fuel	37.83	100 litres
paraffin oil for heating	7.85	100 litres

Source: art.26 Finance Act 1999

TAB.7 *Tobacco duty*

Product group	*Standard rate (%)*
Cigarettes	58.30
Cigars	28.86
Finely-cut tobacco for rolling cigarettes	51.00
Other smoking tobacco	46.74
Snuff	40.20
Chewing tobacco	27.47

Source: Directory of taxes, EU Commission 2001

As concerns the manufactured (Continental France and Corsica) tobaccos, the rate is 0.74 percent of the selling price excluding tax. The beneficiary of this duty is the special budget for agricultural welfare benefits-BAPSA.

Finally, spirits duty is payable on intermediate products and spirits and is levied either per hectolitre of the finished product or on the basis of the pure alcohol content per hectolitre. There is no export duty, whereas, as regards imports the tariff applies to all taxable liquids, regardless of their origin. The beneficiary is the old-age solidarity fund (Fonds de solidarité vieillesse). Part of the revenue from the duty levied pursuant to Article 403 of the General Tax Code is also allocated to the compulsory health-insurance schemes.

3.7 Employers' contribution to the development of further vocational training

The beneficiaries are State-registered joint collection bodies and national or regional Government training centres; the State or the Regions; the State (general budget) for the amounts paid into the public treasury (total contributions due minus expenditure allocated to training measures). The tax must be paid by all employers, the exemptions concern the State, the local authorities and their public administrative establishments. Employers must devote a minimum percentage of their annual wage bill to the funding of training measures.

The rates, up to 1999, are:

- 1.5 percent of the annual wage bill for employers with an annual average of at least 10 employees (2 percent for businesses engaged in temporary work). These rates include a payment of 0.3 or 0.4 percent, depending on whether or not the employer is liable for apprenticeship tax, for sandwich-course training as well as a levy of 0.2 percent (0.3 percent for businesses engaged in temporary work) for individual educational leave;
- 0.15 percent for employers with an annual average of fewer than 10 employees, plus a levy of 0.1 percent, which applies only to employers who are liable for apprenticeship tax.

In addition, all employers are liable for a specific contribution of 1 percent of wages and salaries paid to employees on fixed-term contracts.

The basis of assessment is the gross pay, i.e. prior to deduction of national insurance contributions.

3.8 Taxe professionnelle

This tax must be paid by individuals and corporate bodies that usually practise in France a professional non-salaried activity. It's an important local tax.

The basis of assessment is formed by two elements: firstly the locative value of immobilizations used to practise the activity, secondly either 18 percent of the wages of the executives with an abatement of 152,449.01 € (1,000,000 F) for 2001 (914,694.10 € for 2002) or 1/10 of the revenues for activities with less than 5 wage-earnings. In 2003 the wage component will be abolished.

According to the art. 1647 E of the CGI, the companies with a turnover that exceeds 7,622,450.86 € (50 millions F) must paid a "cotisation minimale", concerning the annual added value, which rate is 1.2 percent for 2000 and 1.5 percent from 2001. There is also (CGI, art. 1648 D) a "cotisation nationale de péréquation" to guarantee fiscal uniformity among Commons.

Finally one can observe two kinds of exemptions: permanent and temporary. The first concern the agricultural (CGI, art. 63), artisan (CGI, art. 1452-1455) and some industrial, commercial, non-commercial and social activities. The second instead can be either geographically limited or applied to the whole territory.

Among local taxes one can also consider the "foncier bati" tax, the "foncier non bati" tax and the "taxe d'habitation", that is real estate taxes (par.4.3).

4. The fiscal burden

4.1 The distribution of taxation charge

The distribution of taxation by Economic Functions (Tab.8) points out on which economic activity or on which production factor a tax is levied and provides an indicator of the discriminative effects of the tax system. It can also show the need to shift the French tax burden: for instance, it could be moved away from labour to real capital and environmental taxes.

One can distinguish the following categories: consumption, labour employed, labour self-employed, capital. Environmental taxes, split into taxes on energy, transport, pollution and the use of natural resources, are shown as an "of which" category since they are usually also consumption or capital taxes.

From 1985 to 1995 in France, the taxation of consumption, measured as a percentage of GDP, decreased by one percentage point especially because of the fall of revenues from VAT. In the second half of the 1990s instead, there was an increase up to 11.8 per cent of GDP in 1997.

The burden on labour is very high: during the years considered it increases by 9.3 percentage points up to 25.7 percent of GDP. However the most significant rise happens between 1975 and 1985, when the taxes on labour represent more than 24 percent of GDP.

The share of taxes and contributions belonging to the category *employed* is the most significant: as a matter of fact it always represents 90 percent of taxes on labour even if in 1990s the category *self-employed* exceeded the threshold of 2 percent of GDP. On the other hand in the long run the difference between employers and employees, within employed labour has become less and less significant: only 1.4 percentage points in 1997 against 4.5 in 1975.

From 1970 to 1997 the taxation on capital as a percentage of GDP also increased, if one doesn't consider the slight fall in 1992. Despite its name, the category *capital* comprises not only taxes which are directly linked to capital but also taxes which are levied on operating a business, therefore it is even subdivided.

TAB.8 *Structure according to the economic function as percentage of GDP*

	1970	*1975*	*1980*	*1985*	*1990*	*1995*	*1997*
Consumption	*12.8*	*11.7*	*12.1*	*12.3*	*11.6*	*11.4*	*11.8*
Labour	*16.4*	*18.9*	*22.6*	*24.3*	*24.0*	*25.3*	*25.7*
employed	15.0	17.5	20.8	22.2	21.9	23.2	23.5
self-employed	1.4	1.4	1.8	2.1	2.1	2.1	2.2
Capital, of which	*5.8*	*6.4*	*7.0*	*7.8*	*8.2*	*8.1*	*8.9*
real estate & capital	2.1	2.6	2.7	3.1	3.1	3.5	3.9
monetary capital	0.4	0.6	0.7	0.8	0.5	0.2	0.2
Environment	*2.1*	*1.8*	*2.2*	*2.4*	*2.4*	*2.6*	*2.6*
Energy	1.8	1.4	1.8	2.0	1.9	2.0	2.0
Transport	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Pollution	0.1	0.1	0.2	0.2	0.2	0.3	0.3
TOTAL	*35.1*	*36.9*	*41.7*	*44.5*	*43.8*	*44.8*	*46.4*

Source: Eurostat, 2000. 1997 is the last data available

In Tab.8 we report only the typical kinds of capital: taxes on real estate and taxes on real capital that are all taxes on the ownership, the income from or the transaction in real estate/real capital and taxes on monetary capital that are instead taxes on interests, bank transactions etc.

The largest part of capital taxation stems as a matter of fact from the taxation of real estate & capital: in 1997 it represents 3.9 percent of GDP. The second biggest capital taxes are those on non-allocable incomes. Since 1975 their ratio to GDP has increased from 2.2 percent to 2.6 percent. On the other hand the tax burdens on monetary capital, wealth and business seem firm, at least in the 1990s.

Finally, between 1980 and 1997, revenues from environmental taxes have increased by 0.4 percentage point up to 2.6 percent. This corresponds to an increase from 5.3 percent to 5.6 percent of total taxation The growth is almost exclusively the result of higher energy tax revenues which reached the threshold of 2 percent of GDP. The taxation of transport remained constant at around 0.3 percent when measured as a percentage of GDP and the same argument is valid also for taxes on pollution or on the use of natural resources.

A very useful indicator to study the distribution of the fiscal burden in a Country is also the implicit tax rate. The implicit tax rate is calculated by dividing the revenues from taxes on a special activity or good by an appropriate corresponding aggregate tax base from national account statistics.

The definitions of implicit tax rate to which we will refer are those provided by Eurostat. However, the calculation procedure of these tax rates is somewhat controversial and different definitions may provide different values.

The trends of the implicit tax rates in France from 1970 to 1997 relating to labour, consumption and other factors, are shown by Fig.1.

At 44.9 percent in 1997, the implicit tax rate on labour is over 14 percentage points higher than at the beginning of the 1970s. However the evolution of this indicator, that was sustained by Income tax and social contributions, is quite stable. From 1973 to 1984 it increased steadily by 0.9 percentage points per year on average, and since then its growth was more moderate: an average of 0.3 percentage points a year.

The implicit tax rate on productive factors other than employed labour has again increased and is more than ten percentage points above the Union's average. This very irregular evolution is mainly the result of a temporary growth in the corporate tax rate.

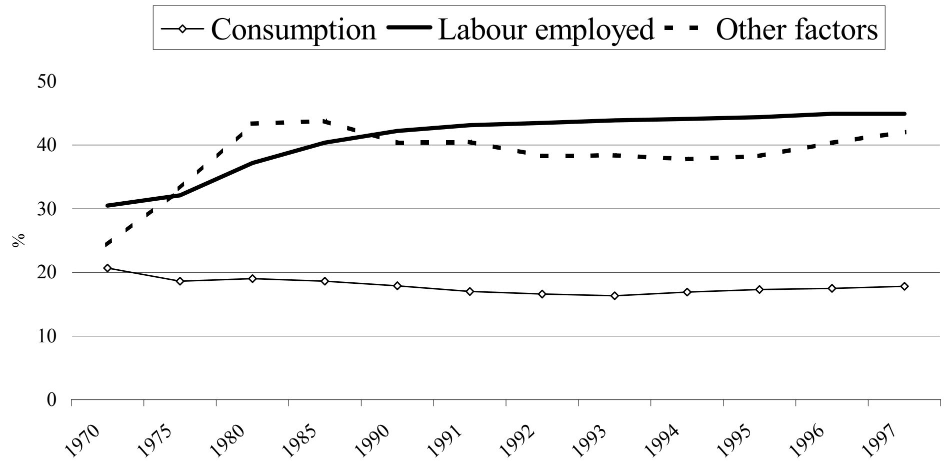
The most stable is the implicit tax rate on consumption: perhaps, the choice of leaving consumption taxation, whose role in France has diminished over recent years, under the threshold of 18 percent as from the 1990s was due to the supposed regressivity of these taxes and to anti-inflationary goals.

We turn now to analyse the equity issue, focusing on the redistributive effects of the PIT in France. Our focus on PIT, and the consequent exclusion of all other taxes is obviously somewhat restrictive especially if one considers that in France social security contributions and indirect taxes are very important in the structure of taxation. However, following this line of argument does not lead to any firm conclusion. Moreover, policy makers appear to accept that income redistribution is a proper policy goal of the PIT, whereas the same cannot be said for many other taxes.

Usually, the impact of a tax on the distribution of income is measured taking the difference between the pre-tax and post-tax Gini coefficients. This measure of redistributive effect depends mainly on two factors: the average tax rate and the progressivity of the tax, calculated with the progressivity index proposed by Kakwany.

Among the OECD Countries, according to Wagstaff et al. (1999), France shows the lowest difference between Gini coefficients on gross and net incomes (RE=0.0154), the lowest average tax rate and the highest level of tax progressivity. All this means that in France PIT acts as a further burden on the highest income levels. Therefore income redistribution is an important objective of the French tax system and it is mainly reflected in the highly progressive tax schedule of the personal income tax. However for low-income working families with children, the French tax system compares poorly with other EU Countries, such as Germany and the UK, where there are positive transfers for the most needy, perhaps because the PIT tax base is very narrow in France (Joumard, 2001).

FIG. 1 *Implicit Rates 1970-1997*



Source: Eurostat

4.2 Tax wedges on labour and corporate taxation

The tax wedge on labour measures the distortion in the decision of using an additional labour unit. Thus it reveals if the taxation brings differences between marginal labour productivity and net wage.

The French marginal tax wedge on labour is perfectly aligned with the average of the EU area Countries, approximately 53 percent (Joumard, 2001).

In 2000 the French average tax wedge on labour, after the reduction of 5 percentage points compared to the beginning of the 1990s, is instead around 48 percent, a little higher than the EU average that reached 44-45 percent. The shares of personal income tax and employees social security contributions appear very similar, whereas employer's social security contributions count for almost 30 percent by themselves.

Finally the difference with the OECD average is more significant : about 15 percentage points for average tax wedge and 12 percentage points for marginal tax wedge on labour. The high level of the wedge, not only in France but also in the whole of Europe is one of the main problems faced by European fiscal systems: in fact it depresses employment and growth, either from the side of supply, or from the side of labour demand (Petretto, 2002).

We can consider then the distortion on the location and on the choices of investment caused by the taxation system, focusing on the relationship between the effective marginal tax rate, the effective average tax rate (at a probability rate of 20 percent) and the statutory rate (Giannini and Maggiulli, 2001). The first is usually lower than the second because of the benefits of tax allowances from the tax base, i.e. for depreciation and interest payments. On the other hand, the statutory rate only gives some information, which can be useful at a first glance, but to have a more precise assessment of the tax burden charged on corporations one must refer to the effective rates.

These rates may be "backward looking" or "forward looking". The first are useful mainly to compare the distribution of the tax burden among different firms or over time, or with respect to other taxation basis or to changes in tax code (Giannini e Maggiulli, 2001). Joumard (2001) reports an estimate according to which in the middle of the 1990s the backward effective rate of corporate taxation in France was near 3 points under the "all-in" statutory rate.

According to the Devereux and Griffith methodology (Giannini and Maggiulli, 2001), as concerns "forward looking" rates we can refer either to effective marginal tax rate (EMTR), when the real before tax return is the minimum rate required to undertake the investment or to the effective average tax rate (EATR) when the investment project generates economic rents.

On one hand when the source of finance is equity, there was not much difference between the French effective marginal (about 45 percent) and average tax rate (about 42 percent) in 1999: moreover the first tax rate was very high compared to other European Countries and slightly greater than the statutory rate (40 percent), a situation that considerably differs, for instance, from the Italian one.

On the other hand, when investment is financed using debt, the effective marginal tax rate is negative (about –10 percent) because of the interaction between interest payments deducibility and tax allowances. The effective average tax rate is instead positive: it reaches 30 percent and the jump is fairly consistent.

The results show that the potential distortion introduced by the French tax system in the allocation of capital is high and that there is a wide tax discrimination in favour of debt financing.

4.3 Taxation by levels of government and fiscal federalism

The share of total tax revenues (excluding social security contributions) that goes to Central Government is clearly over 50 percent. However, from 1975 to 1999 it fell respectively from 86.3 to 74 percent of total tax revenues (Tab.1).

On the other hand, there has been some rise in the attribution of tax revenues to local Government such as the growth of 0.4 point from 1985 to 1999 as percentage of total tax revenue. In 1999, the local share of fiscal revenues was 4.7 as percentage of GDP, twice as much compared to 1970.

Communes played the most important role in the process of increasing local tax receipts between 1985 and 1999, whereas Regions gave only a marginal contribution, although they sharply increased their taxes over the period, perhaps because of their relatively small budgets.

The increase of tax bases explains instead between 80 and 90 percent of the total increase in local tax receipts up to 1986, whereas the rise in tax rates only the remaining 20 percent.

These figures give an idea of the degree of fiscal decentralisation. However, the differences in the share of taxes going to local Government are not the only indicator of local political influence.

Even if France is still quoted as an extreme example of unitary Country in the European context and the capacity of local entities is quite uneven, the map of local jurisdictions is highly fragmented and the fiscal powers of the lower tiers of Government remain substantial (Guy, 1991). The tax sovereignty is exclusively in the hands of Parliament, but Communes, Departments and Regions all benefit from an important taxing power compared with other European Countries. The elected assemblies at these lower tiers of Government vote on tax rates directly, even if their autonomy in the determination of tax bases is rather limited.

In such a context, intergovernmental fiscal relations in France are often complex and inter jurisdiction differences in fiscal capacities are sometimes marked. Consequently, the need for fiscal equalisation is extremely high and justifies the existence of a wide, efficient system of subsidies for local Governments.

Among real estate taxes, the most important at local level are the "foncier bati" tax, the "foncier non bati" tax and finally the "taxe d'habitation" (Liberati, 2000) . The first and the second are very similar even if the "foncier bati" tax concerns rented built estate whereas the "foncier non bati" tax any other kind of rented estate (mines, ponds, etc.). In both cases, the basis of assessment is the opportunely calculated ratable value, but there is an abatement of 30 percent and 20 percent respectively.

The "taxe d'habitation" calculated with reference to the locative ratable value and intended to finance the Communes budgets, is a more "personal" tax: in fact there are basis of assessment abatements linked to family situation of the taxpayer. The rate can noticeably change, for instance in 2001 for Communes it was 10.38 percent whereas for Departments it was 5.86 percent. At last, if the locative value exceeds 30,000 F there is also a withdrawal on behalf of the State. In this case the rates can vary from 0.2 percent to 1.7 percent.

4.4 A comparative view with the European average

In this paragraph we compare the indicators of fiscal burden that we have seen for France with the same figures corresponding to the European average, whose calculation is often characterized by a wide dispersion of national data.

The most general indicators of the incidence of the fiscal burden are certainly the implicit rates. The French trends of implicit tax rates on consumption and labour employed are similar to the European ones, even though in general their levels are higher in France than in Europe. The third kind of implicit tax rate, that is on other factors, appears instead very different from the European average: in 1997 it was 42.1 percent of GDP in France and only 31 percent at the EU level.

From the point of view of efficiency, taxes on labour create a tax wedge in France, which in 2000 occupies fifth place in OECD list (Joumard, 2001). Social contributions paid by the employers play the most important role in the tax wedge determination with the consequence of augmenting labour costs and reducing labour demand. Furthermore, if the system contains some elements of family taxation, high marginal tax wedges on labour may discourage a potential second earner from taking on a job. For most EU Countries, high tax wedges on labour largely reflect the important role played by wage-based contributions in financing the transfer system, as well as its broad coverage and public nature. High tax wedges on labour help also to explain the low degree of labour resource utilisation since taxes on labour may in turn partly shifted forward into labour costs (Daveri and Tabellini, 2000).

As regards the taxation of the corporations, we have already noticed that marginal effective rate is positive and higher than the average of the other Countries, considering the case of equity finance, whereas in the case of debt financing it is slightly negative. Effective average tax rate reaches instead the levels of 42 percent and 33.1 percent (equity finance) and 30 percent and 22.3 percent (debt finance) in France and in the EU respectively.

There isn't a firm conclusion concerning the comparison of the redistributive impact of PIT between France and the European average. We can only put forward some indications about the share of direct taxes in France that is lower than the European average by 0.6 percentage points in 1999. On the contrary, indirect taxes as a percentage of GDP are more important in France and so are social contributions, mainly thanks to the high shares paid by employers.

At last, the available data does not allow us to compare the apportionment of taxes by levels of Government between France and other EU Countries very well: they only allow us to observe that in France something less than 75 per cent of total tax revenues (excluding social contributions) goes to Central Government and more than 15 per cent to Local authorities, a situation very similar to the

European average one. The most significant differences are represented by the low revenues of Central Government in Germany and the high receipts of Local authorities in Nordic Countries.

5. Tax reforms in the '90s and those currently planned

5.1 A quick glance at the budget and the general economic environment

After a poor performance during 1990-96, the French economy benefited from rapidly growing activity, low inflation and a rich job market, entering the new millennium with favourable prospects. In fact, the French economy ended 2000 with a strong growth, escaping the production slowdown observed in other OECD Countries. Household spending rebounded under the impulse of robust job creation, lower taxes and strong consumers confidence, whereas companies were expanding their capacities, invigorating business fixed investments, after years of underachievement in the 1990s and improving export performance together with the competitiveness of French products abroad (OECD Economic survey, France, 2000 and 2001). In this favourable landscape, activities related to information and communication technologies also have been particularly strong and the unemployment rate declined, reaching less than 9 percent, its lowest level in ten years: one million jobs have been created in the past two years in the business sector and there have been pro-employment public measures, such as cuts in social security contributions that accompanied the weekly working time reduction to 35 hours (Economic Outlook, France, 2001).

Thus, France benefited from the recovery of world trade that is from a positive international environment and in spite of tensions on productive capacities surfacing in 2001, was able to subdue price increases thanks to several factors. First, import as a share of GDP has risen sharply, especially for manufactured products, bridging the gap between demand and output. Second, indirect tax cuts, greater market competition and administrative measures have reduced consumer price increases. Third, wage moderation has continued to prevail in an environment of greater labour market flexibility.

These measures have increased the real disposable income and have supported private consumption. Moreover, companies' net earnings have been at a historical high creating a favourable environment for continuing expansion of the capital stock.

However, progress still needs to be made in boosting the economy. As a matter of fact, France entered a phase of marked cyclical slowdown at the beginning of 2001. GDP growth eased, business expectations deteriorated, unemployment rose, exports fell back and an increasing inflation curbed the household purchasing power. Moreover, the terrorist attacks on September 11th in the

United States have made matters worse and consequently the world slowdown and uncertainty will probably continue in 2002. The impact of this negative situation on public finances is already perceptible. Tax receipts are lower than forecast and the budget deficit will be higher than the projections in the 2002-2004 programme of public finance. According to the general strategy of public finance adopted from 1997, the level of debt should pass from 57.6 in 2000 to 57.3/57.1 points of GDP in 2003, whereas the GDP growth should settle in a fork from 1.4 to 1.6 percent in 2002 and from 2.8 to 3.2 in 2003. Thus, the next stability programme should incorporate a tightening of public expenditure and fiscal policy should continue to target bringing the structural deficit into balance over the next years.

5.2 Tax reforms in the '90s

From mid-1990s to stimulate the demand of labour, France started to cut social security contributions for the low-paid and/or low-qualified workers: a system of graduated rebates of social charges on low wages was instituted in 1993. Thus, the reduction in non-wage labour costs covered about one fourth of wage earners and amounted to about 18 percent for workers at the minimum wage in 1998. The labour cost reduction induced by this system of cuts has three main effects on employment. The substitution effect and the income effect are known, whereas the so-called assessment effect is peculiar to targeted tax cuts. Their interaction can justify the trend break in the employment share of unskilled workers in '90s, but also the brake on individual wages increases and can determine an interference with another instrument of structural policy, the minimum wage (L'Horty, 2000). If social security contributions are cut, the labour cost of unskilled workers decreases when minimum wage increases. As a matter of fact, minimum wage and targeted social contributions cuts are two interdependent instruments of structural policy. This interdependence can be positively seen if the targeted social contributions cuts permit to avoid the unfavourable consequences of the minimum wage increase on the labour cost and the employment, however without interfering with the minimum wage objective, that is the reduction of the wage differences.

Moreover, from 1999 to make work more attractive for targeted groups of the population, people who qualify for the basic income support are granted a temporary exemption for the tax on rented flats (taxe d'habitation) once they find a job.

With reference to the VAT system, we can consider its evolution up to 1993, that determined the removal of the border controls within the EU and that left to the Countries their freedom to use different tax rates, even if an increasing harmonization started in 1991 when the member States agreed that the standard rate was at least 15 percent. In fact, in 1993 France applied the standard rate of 18.6 percent and two reduced rates of 2.1 and 5.5 percent respectively, keeping in line with the European average. At the moment, the VI European Directive regulates the French VAT system and the standard rate, after being raised to 20.6 per cent, was set at 19.6 per cent, as from the First of April 2000.

During the 1990s, there have been significant changes in the corporate tax rates. In 1990 the tax rate for distributed profits was 42 percent whereas the tax rate for re-invested profits was 37 percent. This last was reduced by 3 percentage points in 1991 and it has been extended also to distributed profits in 1992: thus passing from two different tax rates to one. In 1993 this tax rate was once again lowered, reaching the current level of 33 1/3 per cent.

On the other hand the highest PIT tax rate has been moved from 54 percent to 53.25 percent. In fact, in an environment of increased tax competition, and given the major tax reforms undertaken elsewhere in the European Union, failure to reduce taxes could result in losses of human and financial capital.

Finally, some taxes that were costly to collect and had a low yield, like the road tax, have been abolished; other taxes, for instance the television licence fee or quasi-fiscal taxes, might also be done away with.

5.3 Tax reforms under way and planned in the light of OECD and UE suggestions

According to two recent OECD studies (Joumard, 2001 and Tax Policy Studies, 2001) future tax reforms must above all improve labour market performance, that is reduce the tax burden on labour.

As we have already noticed, since the mid-1990s, France started to cut social security contributions, but the tax burden on labour still remains high. Thus the digressive reduction of employers social contributions at the lower end of the wage scale will continue in association with the reduction of the working week, whereas employers and employees unemployment insurance contributions will gradually be reduced from 6.18 in 2000 to 5.4 in 2003. In 2001 social partners have agreed on a new programme to help job-seekers return to employment and the authorities have decided that an employment bonus (prime pour l'emploi), delivered through the tax system must be introduced to "make work pay" for low-income families. It is expected to reduce the tax wedge and benefit up to 10 million people, mainly full time workers. Moreover, since 1999 the French Government is gradually removing the wage component from the base of the *taxe professionnelle* and extending the tax base to fund contributions for health and family from labour to capital income.

To avoid that the reduction in the tax burden on labour was only paid for by cuts in primary expenditure, the possibility of shifting this burden more onto consumption or capital has been considered. On this subject, econometric simulations based on the European Commission's Quest II model (Leibfritz, Thornton and Bibbee) show that the shifting from labour to consumption tax could increase the employment level by 0.73 with very little reduction in wages (-0.02): as a matter of fact, consumption taxes are quite indifferent towards saving and investment decisions, they don't distinguish between imports and locally-produced goods and they guarantee a symmetrical treatment of labour, transfer and capital income, thus creating fewer disincentives to work. On the other hand, the shifting from labour to corporate income tax could be still better for the employment level despite the significant fall in wages (-2.10) and in GDP (-0.67). A reduction in labour tax rate equivalent to 1 percentage point of GDP and financed by a reduction in Government transfer payments, would determine instead a rise of 2.01 in employment, of 0.03 in the level of wages and lastly of 2.29 in GDP.

When one talks about PIT, the suggestions are the following: the broadening of the bases by limiting special allowances, the introduction of a suitable tax treatment for the self-employed and the increase of the neutrality of capital income taxation. In France, between 2001 and 2003 the most important interventions concerned the personal income tax focus on tax cuts for low income, introduction of a refundable tax credit for low-paid workers and reduction of CSG (contribution sociale généralisée) and CRDS (contribution pour le remboursement de la dette sociale) for workers earning up to 1.3 times the minimum wage. France has also recently raised the general personal income tax allowances, thus exempting the income of most low-qualified workers from taxation. At last, the Financial Law of 2001 lowered the first four PIT tax rates by 0.75 per cent and the last two by 0.5 per cent. However, tax rates on personal income will be trimmed once again and the top marginal rate should be lowered to reach 52.5 percent in 2003.

Another important aim of tax reforms should be the reduction of the VAT rates and the simplification of this important indirect tax. Reducing the complexity and increasing the modernisation of the VAT system would in turn cut compliance costs and thus improve the fiscal situation of small businesses and their propensity to exportation. Technology is changing the nature of consumption taxes and these challenges call for renewed and enhanced coordination in VAT and other indirect taxes (Tanzi, 1995) . For the period 2000-2002, for instance, France planned to apply a general cut in the VAT rate (1 percentage point: from 20.6 to 19.6) and reduced VAT rates on labour-intensive services with the objective of stimulating demand for these services, raising the employment level and bringing part of the informal economy to the surface.

A fiscal reform proposal concerns the neutrality of the tax system towards savings vehicles in order to increase economic efficiency and reduce administrative costs. On this subject, France and other EU Governments have started an exchange of information, the only way to avoid distortions in the taxation of the income from the invested savings.

Also the increase on the taxation of property at local level, that implies a bringing up to date of land registers and a correct evaluation of land and building could contribute, as alternative to the net wealth taxation, to improving the neutrality of the tax system and to rebalancing the tax burden on labour. Devolving the expenditure and taxing power (fiscal devolution), optimising the benefits (local Governments are better able to meet local needs and preferences for many public services) and minimising the disadvantages could help to achieve other important targets.

The recommendations concerning corporate income tax are four: first, the neutrality of funding, that is the reduction of the bias towards debt financing of corporations; second, the broadening of the base, third the strengthening of the existent special corporate tax regimes for small enterprises, newly-created and information technology companies and finally the introduction of strict anti-fragmentation rules. The incentives and the progressive rates structure may give rise to abuse with larger companies splitting up into smaller units for tax purposes. As concerns corporate and capital taxes, there is room for the creation and the extension of an environmental-related tax financing the reduction of the working week and for a cut of taxes on dwellings. At last, from 2001 to 2002 the French corporate tax rates have been reduced (Tab.3): from 26.5 percent to 15.45 percent, from 35 1/3 percent to 34 1/3 percent and finally from 20.14 percent to 19.57 percent as concerns PME exempted from social contribution. On the other hand as regards "Other than PME", from 36.43 percent to 35.43 percent and from 20.77 percent to 20.20 percent.

The fiscal reform must aim also at achieving environmental targets in a coordinated way. In fact, co-ordination efforts have not been very successful in the past and tax breaks for polluting activities exposed to international competition continue to exist. However there is much room for taxes on different kinds of energy to reflect the environmental externalities caused by their use and for exemptions in particular sectors to be cancelled. These interventions, together with the planned progressive rise in the environmental taxes, should improve the efficiency and simplify the achievement of these environmental targets. France has been trying for some years to make its growth environmentally sustainable: however environmental taxes and charges have been used more with a view to financing expenditure on pollution control than providing adequate microeconomic incentives, thus showing the difficulty of framing a coherent environmental strategy.

Finally, one must improve the tax administration reducing compliance costs and overlaps among levels of Government, reinforcing the relationship with the taxpayers and raising the efficiency of the tax collection: all these interventions would free-up resources for more beneficial uses such as combating tax evasion.

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