

Long-term competitiveness based on an environmental tax

By [Jacques Le Cacheux](#)

“Shock” or “Pact”? The debate over the loss of France’s competitiveness has recently focused on how fast a switchover from employer payroll taxes to another type of financing is being implemented, implying that the principle of doing this has already been established. As France faces a combination of a deteriorating situation in employment and the trade balance, plus growing evidence that its companies are becoming less competitive compared to those of most of our partners [1] and that business margins are alarmingly low for the future, the need to reduce labour costs seems to be clear. But how and how fast are subject to debate. Should there be a rise in the CSG tax, VAT, or other charges, at the risk of reducing the purchasing power of households in an economic context that is already worse than bleak?

The economic situation has to be managed at the euro zone level

The value of switching a portion of charges on employers – a figure of 30 billion is often bandied about – over to another levy is often disputed by invoking the risks that such a strategy would pose to what is already sluggish growth: undermining consumption would further curtail business opportunities, hurting activity and thus employment and margins.

But France is in this depressed situation only because the European Union is committed to a forced march of fiscal adjustment that everyone – or almost everyone – now recognizes is counterproductive and doomed to failure: as the heartbreaking situation in Spain illustrates, the quest to

reduce the budget deficit when the economy is in recession is futile, and “virtuous” efforts – repeatedly slashing public spending and increasing taxes – merely weaken the economy further and increase unemployment, since the fiscal multipliers are very high, as Keynes demonstrated over 70 years ago!

Fiscal support for economic activity is the only way out. But the experience of the early years of the first Socialist government is alive in all our memories: the failure was as great as were the illusions, and the “turn to austerity” made the government unpopular. An approach that failed in the context of the early 1980s, with a less open economy, an autonomous monetary policy and the possibility of adjusting the currency’s exchange rate, is all the less appropriate in the context of deeper integration and the single currency. Trying to maintain the purchasing power of French households while the rest of the euro zone is in recession and French companies are less competitive could only widen the deficit without boosting growth or employment.

We must therefore continue the fight in Europe: to slow down the pace of deficit reduction; to implement a more accommodative monetary policy in the euro zone, which would have the double advantage of reducing the cost of debt, public and private, thereby making them more sustainable, and of exerting downward pressure on the exchange rate of the euro, boosting external competitiveness at a time when the US and Japanese central banks are seeking to reduce the value of their own currencies, which would automatically push the euro up; and to jointly engage in a coordinated European policy to support growth, by funding research and investing in trans-European transport and electricity and in education and training.

The national productive capacity must be supported and stimulated

The lack of competitiveness of French industry is not reducible to a problem of labour costs. And it is well known that a downward spiral of wage moderation and social dumping, which we can already see is wreaking havoc in Europe, can only lead the euro zone into a deflationary spiral, comparable to what these same countries vainly attempted in the 1930s in their "every man for himself" effort to escape the Great Depression.

Reducing social spending cannot therefore be an answer, while rising unemployment and the precarious situation of an increasing number of households, workers and retirees are pushing up the needs on all sides. Lowering wages, as some countries have done (Greece and Ireland in particular), either directly or through an increase in working hours without an increase in pay, is not a solution, as wage deflation will further depress demand and thereby feed yet another round of social dumping in Europe.

Improving cost competitiveness by reducing the charges on wages may be part of the solution. But this option does not necessarily send the right signals to businesses and will not necessarily lead to a decrease in their selling prices or an increase in hiring: windfall gains are inevitable, and the greatest affluence is likely to go to shareholders as much as to customers and employees. Reductions in social security contributions could be targeted for certain levels of pay, but they cannot be sectoral or conditional or else they would violate European rules on competition.

It is also necessary to encourage and assist French companies in modernizing their supply capacity. The new Public Investment Bank [*Banque publique d'investissement* – BPI] can help by funding promising projects. But we can also make use of the taxation of corporate profits, including through incentives for investment and research that allow tax credits and depreciation rules: this is a way of more directly using incentives for businesses and conditioning public support on

conduct that is likely to improve their competitiveness.

Environmental taxation: a lever for long-term competitiveness

Which charges should now bear the cost of these measures to boost business? Discussions on the respective advantages and disadvantages of VAT and the CSG tax abound. Suffice it to recall here that the VAT has been created to anticipate the reduction in tariff protection, which it replaces very effectively without discriminating on the domestic market between domestic products and imports but while exempting exports: an increase in VAT therefore differs little from a devaluation, with very similar pros and cons, especially with regard to its non-cooperative character within the euro zone. But also recall (see our post of July 2012) that consumption is now relatively less taxed in France than a few years ago, and less than in many of our European partners.

The recourse to a genuine environmental tax would, with regard to the other options for financing these concessions, have the great advantage of promoting sectors that are less polluting and less dependent on fossil fuels – while at the same time diminishing our problems with trade balances, which are partly due to our energy imports – and putting in place the right price and cost incentives for both businesses and consumers. In particular, taking a serious approach to the energy transition demands the introduction of an ambitious carbon tax that is better designed than the one that was censored by the *Conseil constitutionnel* in 2009. Its creation and its step-by-step implementation need to be accompanied by reforming both the direct levies on household income and the main means-tested benefits so that compensation is kept under good control (cf. article in the [work “Réforme fiscale”, April 2012](#)).

A “competitiveness shock” therefore, but also a “sustainable competitiveness pact”, which encourages French companies to take the right paths by making good choices for the future.

[1] See in particular the [post of 20 July 2012](#).