International Labour Review, Vol. 134, 1995, No. 2

Reduce or rationalize social security contributions to increase employment?

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Social charges (employers' contributions to social security) are often blamed for negatively affecting employment since, being based on wages, they increase labour costs. Social charges comprise all contributions made by employers to the financing of their employees' social protection. The scale of these contributions varies considerably from one country to another, according to the level of development of the social protection system and its sources of revenue, that is, the respective proportions of employers' contributions, contributions from the insured persons (employees and self-employed workers) and taxation (contributions from state and local government budgets, and taxes earmarked for the financing of certain benefits or schemes). Since these charges raise labour costs they are accused generally of impairing industry's competitiveness, encouraging automation, penalizing labour-intensive firms in comparison with highly mechanized enterprises, and creating an obstacle to recruitment, especially of low-skilled workers, who are precisely those hardest hit by unemployment.

Employers' contributions are thus at the heart of numerous discussions, controversies and proposed reforms relating to the financing of social security.[1] Two factors dominate such discussions: the level of unemployment and the chronic financial needs of the social security system. There are three broad types of objectives to be considered:

- justice, with a view to a more equitable financing of social security, such as might lead to a reduction of disparities in incomes and social conditions;

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[1] Among the many works on this topic, see in particular, in an international context: International Social Security Association (ISSA): *Methods of financing social security: Their economic and social effects*, Studies and Research No. 15 (Geneva, 1979), and *Economic and social aspects of social security financing*, Social Security Documentation, European Series No. 14 (Geneva, 1988); ILO: *Financing social security: The options. An international analysis* (Geneva, 1984); Council of Europe: *Documents relating to the Third Conference of European Ministers Responsible for Social Security*, Athens, 9-11 Oct. 1985; Commission of the European Communities: *Growth, competitiveness, employment: The challenges and ways forward into the 21st century*, White Paper (Luxembourg, 1993), Ch. 9; OECD: *Study on employment, data and explanations*, 2 vols. (Paris, 1994).

- economic efficiency, linked to the attempt to find ways of accelerating economic growth, improving the competitiveness of enterprises and more effectively combating unemployment;
- rationalization, involving a more appropriate relationship between financing sources, on the one hand, and the nature of the benefits and the eligibility conditions attached, on the other.

These are relative notions, which depend on political, economic and social choices that vary according to country, period and circumstances. Thus, a practical definition of equity largely depends on what is regarded as a desirable distribution of income and the mechanisms available to government authorities for redistributing income and reducing disparities in social conditions. The economic criterion must take into account the need to be open to international trade and for firms to be competitive in the face of increasingly intense international competition.[2] As for rationalization, it depends very much on the history and development of social security and industrial relations systems.

The presentation here takes up the following issues in turn: the incidence and nature of social security contributions; their influence on total labour costs and on the structure of employment as well as on capital-labour substitution; the consequences of alternative methods of financing social security; and the question of coherence between financing methods and the two major types of solidarity – national and occupational – upon which social security relies.

Incidence and nature of employers' social security contributions

To assess the effects that an increase or reduction in employers' contributions have on employment one must first examine the nature and incidence of these social charges, that is, consider them in relation to workers' contributions and net wages, and try to establish who bears the burden. After focusing on the difficulties of evaluating their incidence, the delicate distinction (from an economic point of view) between employers' and workers' contributions is taken up.

Establishing incidence

The question is who bears the burden of social charges and who actually benefits from an increase or decrease in contribution rates or a change in the contribution base. An increase in the rate may, for example, be borne by the

[2] When the consequences of a modification of social security contributions or taxes are considered here, it is on the assumption of *ceteris paribus* ("other things being equal"), which is to say that wage levels and structures, the costs and productivity of capital and, above all, the revenues of the social security system remain unchanged.

employers themselves. But it may also be shifted downstream if it is built into costs and prices, and thus passed on to the consumer; or it may be shifted upstream if passed on to wage earners in the form of wage cuts or smaller wage increases. If not transferable, an increase will affect company profits.

Such eventualities have numerous implications, especially as regards employment. A contribution increase shifted onto wages affects household purchasing power, consumption and savings. If shifted onto prices, it fuels inflation and may reduce the competitive capacity of firms facing strong competition. Similarly, an increase effectively borne by the employers will lead to reduced profit margins and consequently impair self-financing and, in the long term, the ability to compete and to employ. On the other hand, employers' contributions may improve income redistribution, and the social security benefits that they finance may encourage consumption and therefore industrial activity. This is likely to be an element of support to economic activity, especially in periods of recession.

Likewise, there are different interpretations of the possible effects of reductions in the contribution rate. These effects depend on how the firms pass on the reductions: by lowering prices, raising wages, or by increasing self-financing, their shareholders' dividends or their investments. They also depend on how one assesses the macroeconomic impact to be expected from the various possible types of compensation: reduction in social security benefits, increased workers' contributions or taxes, or even deficit financing.

The incidence of a measure to increase, reduce or change the employers' contributions base is difficult to evaluate because it is not uniform. It is related to many factors, such as a firm's profit goals, its degree of exposure to foreign competition, the form and intensity of competition on the markets for its products and production factors, the supply and demand elasticities of its products, trade union strategies and public policies. It follows that neither theoretical analyses nor econometric studies can provide a definitive evaluation of incidence.[3] This discourages public authorities and the social partners from attempting to use social security revenues to achieve goals of economic policy. The purpose of this protection being above all social, a consideration of its financing should focus on the search for greater coherence between the method of financing each benefit and the type of solidarity underlying it.

The distinction between employers' and workers' contributions

The principle of this distinction dates back to the earliest social insurance systems.[4] It is also mentioned in the ILO's Recommendations

[3] For a review of the literature on this topic, see Alain and Chantal Euzéby: "The incidence of employers' social contributions: The factors at stake", in *International Social Security Review* (Geneva), No. 2, 1984, pp. 139-149.

[4] See, in particular, Pierre Mouton: "Methods of financing social security in industrial countries: An international analysis", in ILO, op. cit., pp. 3-30.

No. 67 concerning Income Security and No. 69 concerning Medical Care, adopted by the International Labour Conference in 1944, as well as in the Social Security (Minimum Standards) Convention, 1952 (No. 102). However, although the distinction between employees' and employers' contributions has a legal basis, it is ambiguous from an economic perspective. Thus it could be argued that these contributions are borne entirely by the employees because if the employers paid neither their own nor the workers' social security contributions they could increase net wages without increasing their prices. However, it may be argued that the employer bears the total cost of contributions since what counts, considering production costs, is total labour costs; how the cost is divided between direct wages and social contributions is not important. The contribution paid by the employees can be considered as a burden on firms, and their removal would make it possible to reduce production costs without affecting the net wages paid to workers.

The way in which social security contributions are shared between employer and employee is of little significance in the final analysis. Both contributions, together with net wages, constitute labour costs; neither is part of the wage earner's direct income; and they are both paid to the institutions that manage the social security schemes which redistribute income to wage earners according to specific criteria. Moreover, in the national accounting system developed by the United Nations as a model for the presentation of member States' national accounts, employers' contributions are considered as part of workers' pay in the same way as the contributions legally borne by the workers. Furthermore, in Finland and Sweden, for example, where social security contributions are nominally borne almost exclusively by the employers, firms do not appear to be penalized more than firms in countries of comparable economic and social development level. The Netherlands likewise can be taken as an example to support this view: for basically economic reasons – the harmonization of the bases on which contributions and income tax were calculated – a reform introduced in 1990 transferred 10 percentage points from the employers' contribution to employees; gross wages were simultaneously increased so that net wages remained identical, and the resources of both sides remained unaffected. (But this spectacular decrease in employers' contributions can give rise to faulty interpretations; international comparisons show that Dutch employers now contribute less.)

These considerations are important from the point of view of the interpretation of international comparisons relating to methods of financing social protection in general, and to employers' contributions in particular.

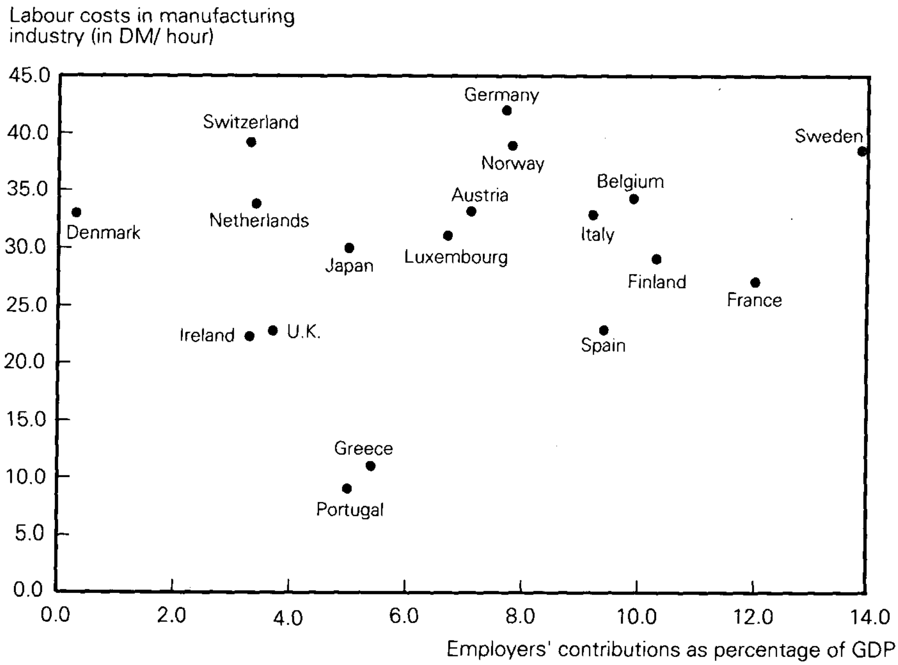
Analysis of impact

How far can one consider a cause of unemployment the fact that contributions to social security are based on gross wages and thus increase the cost of labour? It is helpful to examine the links between employers' contributions and labour costs, industrial competitiveness, replacement of workers by machinery, penalization of labour-intensive firms, and the effect of social charges on the cost of unskilled labour.

Employers' contributions and total labour costs

Labour costs are not necessarily highest in countries with the highest levels of contributions. Looking at countries that have roughly comparable levels of economic development and social protection, such as the countries of western Europe, international comparisons show that it is not in the countries where employers' social security contributions are the highest that labour costs are the greatest, or vice versa (see graph). It is also apparent that in countries where employers' contributions are particularly high, either workers' contributions are practically non-existent, as in Finland and Sweden, or wages and deductions are relatively low, as in France, Italy and Spain (see table), with the result that, overall, despite the high level of employers' contributions, firms in these countries do not necessarily have to bear heavier labour costs. The examples of France and Spain, on the one hand, and that of Denmark, at the opposite end of the scale, are particularly revealing. In the first two countries, employers' contributions are relatively high, but wages and taxes (especially personal income tax) are relatively low. In Denmark, while employers pay little in social security contributions,

Employers' contribution and labour costs in Europe, 1992



Sources: OECD and Institut der deutschen Wirtschaft.

Social security contributions and taxation in the OECD countries as a percentage of GDP at market prices, 1992

	Employers' social security contributions	Employees' social security contributions	Personal income tax	Taxes on goods and services	Other levies[1]	Total tax revenue (including social security)
Australia	–	–	11.7	8.1	8.7	28.5
Austria	7.1	6.1	9.4	13.1	7.8	43.5
Belgium	9.9	5.3	14.2	11.6	4.4	45.4
Canada	4.0	1.9	14.5	9.5	6.6	36.5
Denmark	0.3	1.2	26.4	16.0	5.4	49.3
Finland	10.3	0.6	18.9	14.8	2.4	47.0
France	12.0	5.9	6.0	11.7	8.0	43.6
Germany	7.7	6.7	11.1	10.6	3.5	39.6
Greece	5.4	5.4	4.1	18.7	6.9	40.5
Iceland	2.5	0.1	8.9	16.7	5.2	33.4
Ireland	3.3	2.0	11.7	14.7	4.9	36.6
Italy	9.2	2.6	11.5	11.4	7.7	42.4
Japan	5.0	3.7	7.4	4.1	9.2	29.4
Luxembourg	6.7	5.3	10.8	13.7	11.9	48.4
Netherlands	3.4	11.5	11.7	12.1	8.2	46.9
New Zealand	–	–	16.0	12.7	7.2	35.9
Norway	7.8	4.0	11.7	17.3	5.8	46.6
Portugal	5.0	3.1	6.7	14.2	4.0	33.0
Spain	9.4	2.0	8.5	10.2	5.7	35.8
Sweden	13.9	0.1	18.0	13.2	4.8	50.0
Switzerland	3.3	3.4	11.1	5.4	8.8	32.0
Turkey	2.5	1.9	6.4	6.9	5.4	23.1
United Kingdom	3.7	2.4	10.0	12.1	7.0	35.2
United States	4.9	3.5	10.1	5.0	5.9	29.4

[1] These include taxes on corporate income and the self-employed.
Source: OECD: *Revenue statistics of OECD Member countries 1965-1993* (Paris, 1994).

wages are high and taxes, especially the personal income tax, are considerable. Thus, labour costs must be perceived, considered, and compared as a whole.

However, this does not mean that, in a given country, a decrease in employers' contributions could not lead to a reduction in labour costs. But it does presuppose that such a reduction, if offset by an increase in the social security or tax contributions of households, is not passed on fully in the form of wage increases. Under these conditions, it could have a positive impact on competitiveness and employment. Conversely, an increase in the charges could raise the cost of labour, at the risk of impairing the capacity of firms to compete. This is why many countries are trying to stabilize, or even reduce, employers' contributions.

Competitiveness

With globalization and the intensity of international competition, it has become imperative for firms producing tradeable goods to be competitive. Economic growth and employment levels are closely correlated with the ability of industry as a whole to increase exports and withstand imports. Labour costs are an important element in competitiveness, but by no means the only one. Prices are also influenced by other production costs (raw materials and energy, interest on borrowed capital, depreciation, etc.), the productivity of the workforce, the technology used, the quality of management and the social climate. Competitiveness is also manifested through non-monetary variables, such as product quality, specialization in advanced technology and up-market products, efficiency of commercial networks and after-sales service, and prompt and more rapid delivery. Finally, falling exchange rates or the undervalued currencies of certain countries may artificially increase their competitiveness.

Replacement of workers by machines

Since they are based on wages alone, employers' contributions are sometimes regarded as "an employment tax" which engenders unemployment by encouraging firms to replace workers by machines. This claim is exaggerated for a number of reasons.

In the first place, capital/labour substitution is largely the result of technological advances and the imperatives of increasingly stiff international competition, which drive employers to modernize in order to be more productive and competitive. Secondly, it is by no means guaranteed that reductions in employers' contributions would put a stop to the substitution of capital for labour: the sensitivity of the mix of factor inputs to variations in the relative prices of capital and labour still seems very uncertain;[5] and, since machinery is produced by labour, and not the reverse, any modification in the cost of the latter is bound to be reflected in price of the machines,[6] and most of all, it is not unreasonable to consider that if the productivity gains resulting from the mechanization, computerization and "robotization" of production are indeed reflected in reduced demand for labour, this should logically lead to reductions in working hours rather than to redundancies and unemployment.

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[5] On this topic, see P. Artus: "Salaire réel et emploi"; C. Beans: "Salaires, demande et chômage: une perspective internationale", and D. Cohen and P. Michel: "Théorie et pratique du chômage en France", in *Revue économique* (Paris), No. 3, 1987; and B. Gazier: *Economie du travail et de l'emploi*, 2nd ed. (Paris, Dalloz, 1993), pp. 276-277.

[6] See in particular P. A. Samuelson: "A new theorem on nonsubstitution", in *Collected scientific papers of Paul A. Samuelson* (Cambridge, MIT Press, 1966), pp. 520-536; or M. Laure: *Science fiscale* (Paris, Presses universitaires de France, 1993), Ch. 6.

Penalization of labour-intensive enterprises

Employers' contributions place a heavier burden on firms that use large inputs of labour than on those that are highly mechanized. However, it should first be pointed out that, although the highly mechanized firms pay less in social security contributions, they have to meet the costs specifically arising from the use of machines (energy, maintenance, plant replacement). But taking the logical view of social security financing, the real question is to establish whether employers' contributions are part of normal labour costs or whether they penalize labour. By "normal" is meant that resources (contributions) and expenditures (benefits) are of the same nature, in this case, linked to wages.

In fact, much depends on the nature and conditions governing the granting of the benefits financed by such contributions. When contributions go to fund benefits that express national solidarity – that is to say, they benefit all citizens or inhabitants of a country – and are not intended to compensate for loss of earnings (for example, health care, family allowances, pensions paid regardless of means or length of service, or unemployment benefits paid to young, first-time jobseekers), they can be seen as an unjustified charge on employment which could be replaced by funding from general tax revenues. However, contributions earmarked to finance benefits which are themselves calculated on the basis of wages (contributory old-age pensions, daily allowances under health insurance schemes, unemployment benefits paid to workers who have lost their jobs) can be considered as part of normal labour costs. They follow a logic of occupational solidarity – that is between wage earners – and are a form of "deferred wages". They place a heavier burden on labour-intensive firms, just as energy, maintenance and equipment replacement costs weigh more heavily on highly mechanized (capital-intensive) firms.

Employers' contributions and unskilled labour

Unskilled or semi-skilled workers are usually those hardest hit by unemployment. The threat to their situation comes from technological progress and, in the case of workers in socially and economically advanced countries, from the workforce of countries where labour costs are very low. Moreover, potential users of unskilled labour sometimes consider its cost too high in relation to its productivity. A reduction in this cost through lower employers' contributions is often advocated, especially in the industrialized countries.[7]

To this end, removing the ceilings on employers' contributions could be contemplated, since in the countries where they still apply (Germany,

[7] See in particular Commission of the European Communities, op. cit., Ch. 9; and "Taxation, emploi et environnement: réforme fiscale pour réduire le chômage", in *Economie européenne* (Brussels), No. 56, 1994, pp. 149-190.

Greece, the Netherlands and Spain, for example), they have a disincentive effect on employment for a given total level of receipts from contributions, an effect which is all the more marked as the ceilings tend to be low in relation to the average wage. The placing of ceilings on employers' contributions in fact creates an obstacle to work-sharing as it discourages part-time work (assuming the same level of charges apply to them) and encourages employers to lengthen working hours rather than take on extra workers, especially when pay for those hours is at a level that exceeds the ceiling. The ceiling artificially increases the relative cost of unskilled labour and arguably inhibits the employment of such workers in the sectors that need them most. In fact, without the ceiling and with the same total receipts, contributions per low-wage worker would be lower, which might encourage the recruitment of unskilled labour (while discouraging the recruitment of highly skilled labour). The establishment of a progressive scale of contributions could also compound this effect. But consideration of such a measure should, in many cases, be preceded by redistributing the levy of social protection revenues between contributions and taxes – the subject of the next section.

Rationalizing the financing of social protection

Rationalization is designed to bring the search for financing methods that are more equitable and conducive to employment into line with a functional logic which takes greater account of the nature of each category of benefits and the methods of providing it.[8] To this end, the dividing line between contributions and taxes will first be drawn, then the various forms taken by these levies will be examined.

A tax or a contributions base?

The choice between taxation and contributions should logically reflect the respective importance of the two major forms of solidarity. Thus, contributions based on income from employment, especially wages, are quite justified if used to finance replacement income, i.e. benefits also calculated on the basis of those earnings, for which they are a substitute in periods of temporary or permanent inactivity (sickness, unemployment, invalidity, retirement). The persons covered are thus obliged to make an effort to provide for their future. In the case of employees, the contributions paid by them or by their employers are in effect part of their wages (an indirect or deferred wage), paid on their behalf to the social security institutions. When it is a matter of financing benefits not designed to compensate for loss of

[8] On this point and on the concept of "the financial doctrine of social security", see Guy Perrin: "Rationalization of social security", in ILO, op. cit., pp. 121-145; Jean-Jacques Dupeyroux: *Droit de la sécurité sociale*, 12th ed. (Paris, Dalloz, 1993) para. 82 ff; and Alicia H. Munnell: *The future of social security* (The Brookings Institution, Washington, DC, 1977).

earnings from employment, one is dealing with a type of social protection more in line with national solidarity and tax-based funding.

As to family allowances, in some countries they are financed by employers' contributions for essentially historical reasons arising from the fact that they were introduced (in Europe, towards the end of the nineteenth century) in the form of wage supplements paid voluntarily by certain employers to their workers when they had children. In the developing countries, where such benefits are still limited to a low proportion of households with children (generally those of employees in the modern sector) they are usually financed by contributions because they fall within the scope of an occupation-based form of solidarity. When coverage extends to virtually the whole population, such benefits come within the framework of national solidarity and have been (Iceland, the Netherlands) or should arguably be financed from taxation.

The respective weight of contributions and taxation in social security financing should therefore depend mostly on the place accorded to employment-related benefits and benefits arising from national solidarity. But this should not prevent the State from participating in the financing of unemployment and old-age benefits in order to meet the increased costs of these schemes when the employment situation deteriorates or when there is a rapid growth in the elderly population, or if a particular old-age pension scheme is confronted with a decline in the ratio of contributors to dependants (as in the case of agricultural workers' pension schemes in the developed countries).

As regards old-age pensions, this distinction between employment-related and other benefits could justify the organization of three-tiered systems as follows. The first tier concerns systems based purely on national solidarity and merely guarantees a minimum income to all persons over a certain age. This minimum can be granted without any conditions relating to means or former occupation (a universal minimum pension), or limited to persons on low incomes (a selective system). The second tier involves only earnings-related pensions and is financed by contributions from both beneficiaries and employers, and is based on those earnings (contributory pensions). The third – and optional – tier is based on individual savings and insurance policies.

Expanding the base for contributions beyond labour?

First the arguments in favour of employers' contributions based on wages alone rather than on components designed to make machines contribute are presented, then those in favour of progressive contributions.

A false solution: Social security charges on machines

There have been various proposals which would have the effect of basing contributions on the use of machines as well as labour. Underlying them is the concern to make highly mechanized enterprises contribute more and to turn technological innovation to the advantage of financing social protection, rather than to its disadvantage when contributions are based on wages alone. It is a matter of striking a better balance by reducing earnings-related social security contributions and imposing levies on the technical as well as the human capital of enterprises.

A measure to "make the machines pay" could be applied either directly, by requiring contributions based on capital investment, fixed or net assets, or indirectly, with contributions based on other aspects such as total value added or amortization. But whatever the formula chosen, a solution of this kind would certainly create more disadvantages than advantages.

From the economic point of view, it would be bound to put a brake on firms' investment and modernization efforts, at a time when they are generally considered major economic policy imperatives, being determining factors in competitiveness. Logically speaking, it is easy to say that although machines, unlike employees, pay nothing into the social security funds, they do not cost them anything either; they do not draw any benefits when they break down or become obsolete! Such a system would, moreover, amount to imposing social security charges on small enterprises (farmers, shopkeepers, artisans, the professions) which do not employ staff but have a certain technical capital and produce added value.[9]

Regressive, proportional or progressive contributions?

When a ceiling is placed on social security contributions they become regressive in that the actual deduction is proportionally lower as the wage rises above the ceiling, placing a heavier burden on low wages than on high wages. For this reason, they are often criticized both from the point of view of social justice and for their negative impact on the recruitment of unskilled workers. These considerations have led the governments of various countries to remove the ceiling (Belgium, Norway, Portugal, Sweden) or to raise it (Austria, Germany, Greece, Japan).

But one can go further and make contributions progressive, i.e. structure them in such a way that they weigh less on low wages and more on high wages. For an identical total revenue, wage earners' contributions would become more redistributive and disparities in net wages would be reduced, and employers' contributions would have less effect on the cost of unskilled labour. Such a progressive scale was introduced in the United Kingdom in 1985. Similarly, in 1993 Belgium introduced measures to reduce contributions on low wages: reductions of between 10 and 50 per cent for the lowest wages. The establishment of a "floor" (a minimum below which

[9] For a more detailed analysis, see W. Schmähl: "Technological innovation and contributory social security financing", in European Institute of Social Security: *Technological innovation and social security, EISS Yearbook 1991* (Louvain, Acco, 1992), pp. 309-341; and Alain Euzéby: "Progrès technique et cotisations sociales: faut-il faire payer les machines?", ibid., pp. 343-372.

charges are not levied), has also been suggested.[10] Such an arrangement, though applied generally and uniformly, would represent relief for employers of unskilled or part-time workers. This would, however, raise the burden on those employing highly skilled workers unless another means of financing the social benefits were adopted – taxation, for example.[11]

Which taxes?

Whether such a solution is intended to substitute fully or partially for certain contributions or to meet increased financial demands, recourse to tax-based funding raises particularly delicate problems of choice. Generally speaking, it can be said that the function of taxation is to finance public spending in the most equitable and least uneconomic manner possible. The least uneconomic taxes are those least likely to have repercussions on labour costs and to affect the self-financing capacities of enterprises. The difficulties of choosing between the various forms of tax-based funding will be considered, and the merits and demerits of a number of types of tax.

Increased tax on consumption?

This is a very attractive taxation method from the point of view of industrial competitiveness and employment, since such taxes (value-added tax, turnover tax, excise duties) hit imports while exports are exempt.[12] If certain employers' contributions were replaced by revenue from these taxes, it would have the effect of encouraging exports, while the levies imposed on goods manufactured abroad would finance a greater portion of social security costs. However, since taxes on consumption have the same effect as import duties from this point of view, an increase in such taxes could be regarded as a protectionist measure, and countries, or groups of countries, that practised it on a large scale might be exposed to trade reprisals.

A tax on consumption is often considered socially inequitable because it applies to everyone and takes no account of the consumer's capacity to contribute. It places an even heavier burden on low-wage earners, whose propensity to consume (proportion of income spent, therefore subject to these taxes) is greater than that of high-wage earners, who have a higher (marginal and average) propensity to save. Finally, increased taxation on

[10] In the case of France, see the studies of the Commissariat Général du Plan: *L'économie française en perspective* (Paris, La Découverte/La Documentation française, 1993), and *Coût du travail et emploi: une nouvelle donne,* Rapport du Groupe "Perspectives économiques", chaired by G. Maarek (Paris, La Documentation française, 1994).

[11] For other of ways of calculating social security contributions, see J. M. Dupuis: *Le financement de la protection sociale* (Presses universitaires de France, Paris, 1994); and Alain and Chantal Euzéby, op. cit.

[12] The "value-added tax" (VAT) must not be confused with a contribution that would be based on the value added with the intention of "making machines pay" through their amortization. VAT is in fact a tax designed not to affect investment or exports, which would not be the case with contributions based on added value.

consumption is likely to be reflected in higher prices and therefore to create the danger of upward wage pressure.

Increased corporation tax?

Whether it takes the form of a tax on profits, real estate or net assets, this solution involves considerable problems. First, it is likely to impair the self-financing capacity of enterprises and their ability to adapt to the demands of international competition; second, taxes on company profits are highly vulnerable to fraud and evasion (especially at international level), and such practices might be encouraged. Furthermore, the real significance of levying taxes and social security contributions on enterprises is arguable, bearing in mind that, in the last resort, it is always individuals who bear the actual burden: consumers, if the tax is passed on to sales prices; or wage earners, in that were it not for such deductions their remuneration could be higher without impairing company profits; or owners of enterprises (individuals, partners or shareholders), in that these deductions affect the profits distributed or the self-financing capacity of the enterprise.

Increased personal income tax?

Inasmuch as personal income tax is usually levied on total household earnings, taking into account family circumstances and on a progressive basis, this form of taxation is generally considered fairer than taxes on goods and services. International comparisons show that countries having most recourse to a contributions base to finance their social security are generally those with the lowest income tax (see table).[13] Taxation of household incomes is often extremely unpopular and deeply resented (especially when not deducted at source). If an increase in this tax is decided upon with the aim of reducing social security contributions – and therefore labour costs – it is important that the reduced purchasing power which it would entail is not reflected (or at least not entirely) in wage increases.

Capital gains tax?

A capital gains tax could well be envisaged as a means of reducing contributions, as this tax accounts for only a small part of fiscal systems, but it would have to be on a sufficient scale to bring in the appreciable resources required to fund social protection. The danger here would be that large increases in these taxes would have the effect of reducing savings and investment and of stifling entrepreneurial spirit.

[13] For comparisons relating to developed countries, see OECD: *Revenue statistics of OECD member countries* (Paris, annual). For commentaries on the level and structure of taxes and social security contributions in developed countries, see Alain Euzéby: *Les prélèvements obligatoires* (Paris, Presses universitaires de France, 1992).

Increased tax on income from savings?

Unearned income, in particular from savings, is generally subjected to lower taxes or deductions than earned income: no social security contributions and an often favourable tax rate. Hence the idea, often advanced, of taxing income from financial investments more heavily so that people in receipt of such unearned income contribute more to national solidarity. In most countries, this laudable aim would confront the free movement of capital: the greater the financial assets and the more heavily the income they produce is taxed in a given country, the more the owners of such assets will be tempted to relocate their investment in countries where they are more lightly taxed and where banking secrecy is greater. Increased taxation on incomes from savings would therefore presuppose broad and effective international concertation and cooperation.

Environmental taxes?

These taxes, when based on fuel carbon content, hit energy sources in proportion to the amount of carbon dioxide that they release on combustion. Many north European countries (notably Denmark, Finland, Norway, the Netherlands and Sweden) have already introduced such taxes. Though the primary objective is to combat pollution and reduce gas emissions that produce the greenhouse effect, the potential revenues from an environment tax could be used to help meet an increase in social security spending or to offset reductions in employers' contributions.[14]

Creation of a tax on exchange transactions?

The primary purpose of such a levy would be to inhibit international movements of speculative capital and their destabilizing effect on exchange rates.[15] This tax would be applied by each country to the transactions effected within its jurisdiction and could usefully contribute to solving the financial problems created by increased social security spending or by the financing of certain benefits through taxation. It should be based on the duration of the transactions, so as to produce a certain dissuasive effect on currency conversions practised for the sole purpose of gaining on the exchange. But, in order to be effective, such a tax would have to be introduced through a very broad international agreement, and therefore concluded within the framework of the International Monetary Fund.

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[14] See, in particular, Commission of the European Communities, op. cit.

[15] On the idea of such a tax see, in particular, J. Tobin: *A proposal for international monetary reform*, Cowles Foundation Paper No. 45 (New Haven, Yale University Press, 1980); R. Dornbusch: "It is time for a financial transactions tax", in *International Economy* (Washington, DC), Aug.-Sep. 1990.

Concluding remarks

Measures to reform methods of financing social security are seldom drastic or on a large scale. A cautious approach of the public authorities is justified by considerations that are both political (risk of discontent in certain social classes) and economic. Economic considerations stem from the difficulty of knowing accurately the full repercussions and the incidence of the levies imposed. In situations of high unemployment and strong international competition, employers' contributions are often made the scapegoat and considered obstacles to employment. But if measures designed to reduce these contributions are really likely to reduce labour costs and make enterprises more competitive, it must be understood that this can only be brought about at the cost of reduced purchasing power for households: increases in their taxes or contributions and/or reductions in certain social security benefits. The incentive to recruit which would result from such measures has every chance of being offset by a decline in demand and thus in the activity of enterprises. This explains the uncertainty and caution of the findings of the various econometric studies intended to evaluate the effect that different forms of reductions in employers' contributions would produce on employment.[16] Such a policy should above all be in keeping with a rationalization process aimed at a more coherent relationship between methods of social security financing on the one hand, and the nature of each type of benefit and the conditions of eligibility attached to it, on the other, i.e. at distinguishing what pertains to occupational solidarity from what pertains to national solidarity.

[16] For the countries of the European Union see, in particular, the results published by the European Commission, op. cit.