Flash Economics

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France: how can we make ‘work pay’?

It is often said that in France ‘work no longer pays’.

Yet the minimum wage is substantially higher than replacement incomes (RSA, unemployment benefit): work pays more than inactivity.

There are three reasons for saying that ‘work no longer pays’: there is a huge gap between the cost of labour for the employer and the net salary received by the employee (the tax wedge is very high in France); for employees at the lower end of the income scale, compulsory expenditure (transport, housing, food, insurance, etc..) accounts for a very large proportion of income; and finally, the purchasing power of wages has been falling since 2019 as a result of the decline in labour productivity.

How can take-home pay be increased? We can:

- Tax-finance social protection revenues (as in Denmark);
- Reduce employees' social security contributions and increase a tax with a broader base than salaries (CSG or VAT);
- Make pensioners pay a larger share of social protection expenditure or slow the growth of pensions;
- Increase the minimum wage (but the effect on unskilled employment would be negative);
- Lower taxes on low-wage earners, financed by increased taxation of high incomes or wealth.

The most promising avenues seem to be broadening the tax base that finances social protection and increasing the contribution of pensioners.

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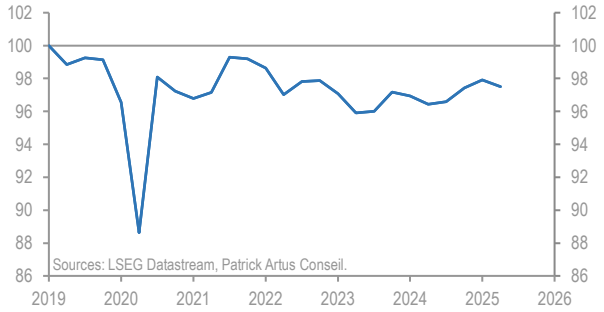
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Why do people say that work no longer pays in France?

The 'work no longer pays' argument can be defended because of:

- **The high level of the tax wedge** in France (the difference between the cost of labour for the company and the net salary received by the employee); the tax wedge is 47.9% in France and 34.9% on average in OECD countries ; a high tax wedge is associated with a low net salary;
- **The decline in real wages** since 2019 (**Chart 1**);

Chart 1
France: Real compensation per employee deflated by HICP (2019.Q1 = 100)



- **The high level of compulsory expenditure for a person with a low income ;** for the 1st income quintile, the 20% of people with the lowest income. When we add transport, housing, food, energy, insurance and telecommunications consumption, we see that these expenses absorb 71% of income.

However, even low-skilled work pays more than inactivity.

The SMIC (minimum wage) is currently 1,426 euros per month net, while the RSA is 647 euros per month for a single person and 1,164 euros per month for a single adult with two children. Unemployment benefit represents an average of 71% of earned income.

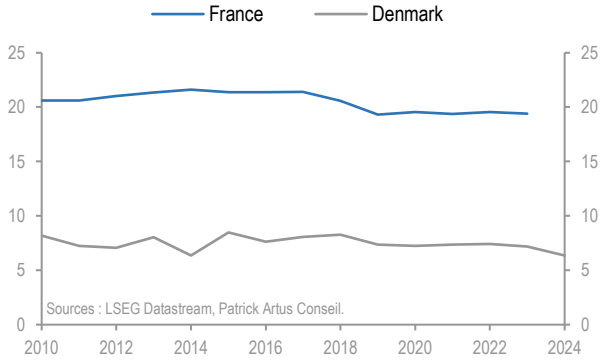
How can take-home pay be increased?

There are several ways of increasing the take-home pay received by employees.

1. Taxing social protection revenues

Base the financing of social protection on taxes (income tax in particular) and not on social security contributions; Denmark is an example of this solution (**Chart 2**).

Chart 2
Net social contributions (as % of nominal GDP)



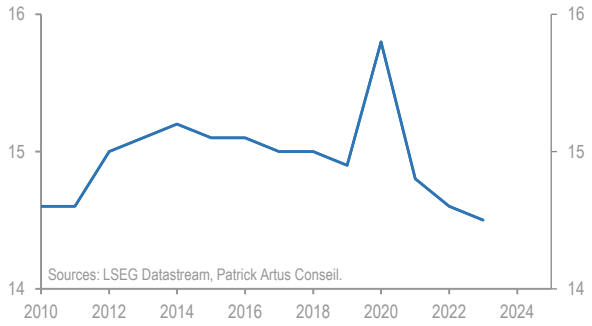
2. In the same vein, reduce employees' social security contributions and increase tax with a broader base than salaries (CSG or VAT)

This would make it possible to finance social protection on income other than salaries (capital income, imports in the case of VAT). Many countries use a higher VAT rate than France (20%): 22% in Italy, 23% in Portugal and Ireland, 25% in Spain, Belgium, Sweden and Denmark, 25.5% in Finland.

3. Making pensioners pay a larger share of social protection expenditure

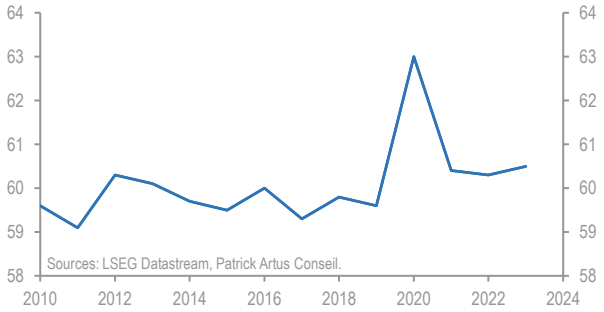
An increase in social contributions or the CSG paid by pensioners, or a gradual reduction in the burden of pensions (**Chart 3**), would reduce the tax wedge.

Chart 3
France: Public pension expenditure
(as % of nominal GDP)



4. Increase the minimum wage (Chart 4), which would spread to low wages.

Chart 4
France : Monthly minimum wage
(as % of the median gross monthly earnings)



5. Reduce taxes (social security contributions, CSG) on low salaries and finance this reduction by increasing taxation on high incomes and wealth.

Raising taxes on high incomes or wealth would only reduce the tax wedge by a very small amount. Such taxation could hardly raise more than Euros 20 billion, which would only reduce the tax wedge by 1 percentage point if it reduced taxes on employees (**Chart 5/6**).

Chart 5
France: Compensation of employees in enterprises (wages and social contributions)

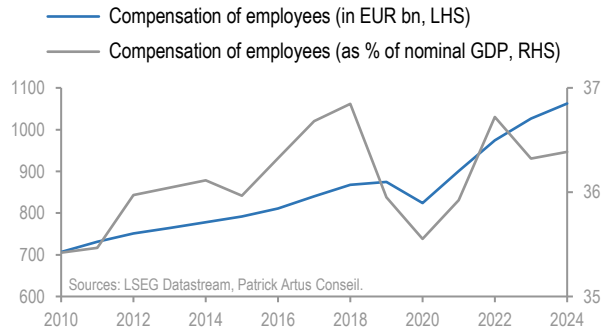
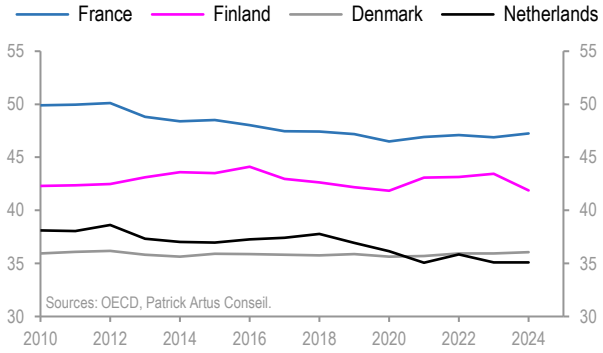


Chart 6
Average tax wedge(as % of labour costs)



Summary: What is the most effective way forward?

There is a broad consensus that the tax wedge is too high in France, and that it should be possible to increase the net salaries received by employees, particularly low-income earners. Raising the minimum wage would have a negative effect on unskilled employment; raising taxes on high incomes or wealth would only reduce the tax wedge by a very small amount.

The most effective avenues seem to be:

- **Substituting a broad-based tax for social security contributions,** which would have the favourable effect of increasing net real wages and being redistributive;
- **Making pensioners pay a larger share of social protection expenditure, or reducing the generosity of the pension system,** which will in any case be necessary because of the continuing decline in the ratio of the number of contributors to the number of pensioners (from 1.7 today to 1.3 or 1.4 in 40 years' time), and which would be justified by the high level of healthcare spending by pensioners (healthcare spending for a person aged between 75 and 84 is €6,448 a year, compared with €1,807 for a person aged between 17 and 59).

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