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Should VAT or the CSG be substituted for social security contributions?

The debate over social VAT (a VAT increase financing a cut in social security contributions) has resurfaced in France. The debate needs clarifying, however, and several points warrant analysis, in particular:

- is it preferable to raise VAT or the CSG (*contribution sociale généralisée*, a broad-based levy on all household income) to finance a cut in social security contributions?
- is it preferable to reduce employers' social security contributions or employees' social security contributions?

To answer these questions, the objective of this tax shift must be specified. Is the objective:

- to improve firms' competitiveness or profitability? If so, raising VAT and raising the CSG are equivalent. There is a risk, however, that firms will not lower their prices in response to the cut in employers' social security contributions;
- to narrow the gap between net and gross wages? If so, employees' social security contributions should be cut, and an increase in the CSG is preferable to an increase in VAT, since the CSG is levied on all income and not only on income that is consumed.

Patrick Artus
Senior Economic Advisor
patrick.artus-ext@ossiam.com
@PatrickArtus
Patrick Artus

Isabelle Gravet
Research Assistant
isabelle.gravet-ext@ossiam.com

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First possible measure: raising the standard rate of VAT and cutting employers' social security contributions

The VAT increase under consideration would apply to **the standard rate** (currently 20%), and not to the reduced rate (5.5%) or the intermediate rate (10%), which apply to food and basic necessities.

A 1 percentage point increase in the standard rate of VAT yields €7.5 billion for central government; a 1 percentage point cut in the rate of employers' social security contributions costs €10.8 billion. **Budget neutrality** therefore implies that **a 1 percentage point cut in employers' social security contributions must be offset by a 1.44 percentage point increase in the standard rate of VAT**.

Contrary to a widely held view, **the distributional effects of an increase in VAT** across consumers at different income levels **are small**[1].

What are the effects of substituting VAT for employers' social security contributions?

- **a reduction in labour costs**, leading either to a fall in the prices of domestic output or to an increase in firms' profits;
- a VAT increase applying to all goods consumed, including imports, **hence a rise in import prices**.

If the reduction in labour costs is passed through to firms' selling prices, the result is:

- no effect on the prices of goods and services produced in France (the VAT increase being offset by the reduction in labour costs);
- an improvement in competitiveness (higher import prices and lower export prices, since exports are not subject to VAT).

If firms do not pass the reduction in labour costs through to their prices, the result is:

- an increase in profitability;
- an increase in the VAT-inclusive prices of goods and services produced in France;
- no improvement in competitiveness.

Second possible measure: raising the standard rate of VAT and cutting employees' social security contributions

Offsetting a 1 percentage point cut in the social security contribution rate again requires a 1.44 percentage point increase in the standard rate of VAT. The objective of this measure is to **narrow the gap between net and gross wages by reducing the tax wedge** (the difference between the labour cost borne by the employer and the net wage received by the employee, after social security contributions and direct taxes). **The tax wedge** stands at 47.2% in France, against an OECD average of 35.1% (**Charts 1 and 2**).

[1] Trésor-Éco No. 371, "Analyse de la composition des recettes de TVA" [Analysis of the composition of VAT receipts], September 2025

Chart 1
Tax wedge* (as % of labour costs)

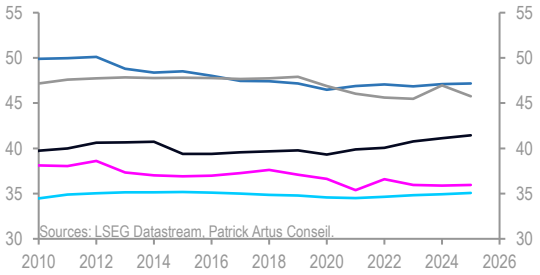
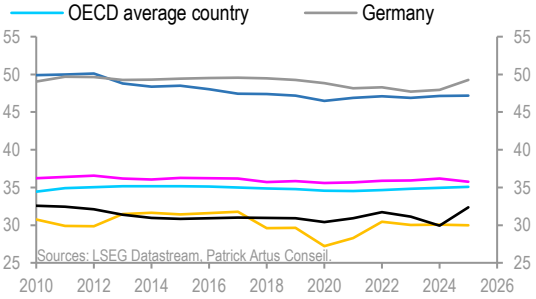


Chart 2
Tax wedge* (as % of labour costs)



* Tax wedge calculated for a single worker without children at the average wage.

This measure:

- raises the prices of goods and services, whether produced in France or imported;
- **increases employees' purchasing power**, since VAT taxes not only their consumption but also that of retirees and recipients of capital income (the VAT base is broader than the social security contribution base).

Wages in 2025 amounted to €1,150 billion, pensions to €426 billion and capital income to €135 billion. However, **the tax base is consumption, that is, income less saving**. It is frequently argued that retirees' saving rate is high; the most recent data[2] nonetheless show that in 2022 the net saving rate of households whose reference person is aged 65 or over averaged 8%, against 11% for households as a whole. That study also shows that the net saving rate by income bracket ranges from −29% for the bottom income quintile (the 20% of households with the lowest incomes) to 0% for the second quintile, 6% for the third, 10% for the fourth and 27% for the fifth. Overall, retirees have a saving rate no higher than that of the economically active population, and the most affluent households, in which capital income is concentrated, have a very high saving rate. **The lower yield of this measure** — an increase in VAT combined with a cut in employees' social security contributions — **therefore stems from the low propensity to consume of recipients of capital income**.

Third possible measure: raising the CSG and cutting employers' social security contributions

The CSG is levied on earned income (wages, bonuses, allowances and benefits in kind), on replacement income (retirement pensions, unemployment benefits, daily sickness benefits) and on capital income (rental income, dividends, interest and capital gains on securities).

CSG and CRDS receipts amount to €166 billion, of which nearly €158 billion for the CSG alone: €111 billion on earned income, €28 billion on replacement income and €18 billion on capital income (the CRDS, *contribution pour le remboursement de la dette sociale*, is a separate and much smaller levy resting on essentially the same bases). A 1 percentage point increase in the CSG yields €17 billion, while a 1 percentage point cut in employers' social security contributions costs €10.8 billion: **the CSG must therefore be raised by 0.63 percentage point to offset a 1 percentage point cut in the social security contribution rate**.

What are the effects of this tax shift?

- **a reduction in production costs in France**, resulting either in lower prices or in higher profits;
- **a reduction in the disposable income of employees, retirees and recipients of capital income**.

If firms pass the cost reduction through to their prices, the result is:

- an improvement in competitiveness (lower producer prices for goods and services);
- stable demand and purchasing power, as the fall in prices offsets the loss of income.

[2] André M., Buresi G., "Consommation et épargne par catégories de ménages en 2022" [Consumption and saving by household category in 2022], Insee Focus No. 338, November 2024. Distributional national accounts, 2020 base. The net saving rate is calculated excluding the adjustment for the change in pension entitlements (D.8).

A higher saving rate among recipients of capital income may nonetheless be assumed. Their purchasing power would be reduced, since they benefit less than other consumers from the fall in the prices of goods and services.

Fourth possible measure: raising the CSG and cutting employees' social security contributions

Offsetting a 1 percentage point cut in social security contributions again requires a 0.63 percentage point increase in the CSG rate. This measure has the following consequences:

- prices and competitiveness remain unchanged;
- income is transferred to employees at the expense of retirees and recipients of capital income.

Summary: which measure should be preferred?

If the objective is firms' competitiveness, their social security contributions should be cut. **In that case, an increase in the CSG and an increase in VAT have equivalent effects on competitiveness**, since both lower the price of domestically produced goods and services relative to imported foreign output, and lower the price of exports relative to foreign prices. One risk nonetheless remains: that firms use the cut in employers' social security contributions to widen their margins rather than to reduce their prices. In that event, profitability rises but purchasing power falls.

If the objective is to support real wages, employees' social security contributions should be cut. If VAT is raised in compensation, and if the saving rate of recipients of capital income is very high, the transfer of income in favour of employees is smaller than if the CSG is raised (VAT taxes income that is consumed, the CSG all income). **An increase in the CSG should therefore be preferred** to finance a cut in employees' social security contributions.

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