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Reform of indirect taxation and VA-based employer contribution New Caledonia on its way to social VAT?

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Abstract:

Considering the case of the economic policy of New Caledonia (a French small Pacific territory), this paper analyses the consequences of collecting social contributions through a consumption tax (social VAT).
It is then shown that a social VAT (added to a standard VAT) would bring some strong advantages (superior to what a VAT would do), and would largely ease wage increase, by apportioning this increase on a large base, and so avoiding inflationist pressures.

Key Words: New Caledonia, Island states, Taxation, Employment, Finance, VAT, social VAT

JEL classification: H3, E62, R10, R51

Résumé :

A partir de l'étude de la politique économique de la Nouvelle-Calédonie, cet article analyse les conséquences d'une fiscalisation des charges sociales, via une taxe sur la consommation (mécanisme de TVA sociale).
Il est montré qu'une TVA sociale apporterait des avantages importants (et nettement à ce qui résulterait d'une TVA simple), et faciliterait les revalorisations salariales en basant les charges sociales sur une assiette large contrecarrant ainsi les pressions inflationnistes.

Mots clés : Nouvelle-Calédonie, PEI, fiscalité, emploi, TVA, TVA sociale

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Reform of indirect taxation and VA-based employer contribution
- New Caledonia on its way to social VAT? -

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Summary
Considering the case of the economic policy of New Caledonia (a French small Pacific territory), this paper analyses the consequences of collecting social contributions through a consumption tax (social VAT).
It is then shown that a social VAT (added to a standard VAT) would bring some strong advantages (superior to what a VAT would do), and would largely ease wage increase, by apportioning this increase on a large base, and so avoiding inflationist pressures.

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The government of New Caledonia which was elected in May 2009 has taken the decision to establish a large social policy, which goes from increasing basic income to the regulation of the prices of essential products, to the regulation of bank charges and a whole set of aids for underprivileged parts of the population or the middle class (revaluation of the amount and extension of housing support, basic old-age pension).

The other aspect of this new economic policy is competitiveness. This competitive policy hangs together with the increase of the purchasing power since it entails lower costs when, conversely, wage increase lies heavy on the firms' costs.

In order to solve this contradiction, the government's president has announced that he's studying the possibility of a VA-based employer contribution, meaning a transfer of the tax basis from wages to added value. Besides, the government is planning an efficient tax reform that could consist either in VAT or a renovated and simplified customs taxation. Whatever the reform, a VA-based employer contribution is an innovative measure which corresponds to a social VAT (without going necessarily along with a usual VAT, which can be named 'fiscal' VAT).

What is at stake in these various reforms is avoiding a social stalemate such as Guadeloupe (a French overseas department) had to undergo in 2009, what with the unions thinking wage increase was vital and with the employers considering it as unsustainable for the firms (Lagadec 2009).

This paper presents the concept of a social VAT and shows how bringing it in in the situation of New Caledonia (along with traditional VAT or not) could allow to gain manoeuvring space for an actual boost of the purchasing power without undermining the firms' competitiveness.

1. Economic overview of New Caledonia

1.1. Key Figures

With French Polynesia and Wallis-and-Futuna, New Caledonia is one of the three French Pacific territories. It enjoys from a unique constitutional arrangement. This is laid out in the 'Accord de Nouméa', which was signed in 1998 and sets out a process for France to hand over responsibilities for non-regalian sectors (i.e those that do not involve defence, foreign policy, justice, public order, money), with the possibility of referendum on independence during the 2014 – 2018 period.
New Caledonia has one of the largest economies in the Pacific Islands region, with a relatively high GDP per capita (comparable to New Zealand), but there are significant disparities in income distribution (both geographically and ethnically). Although New Caledonia has significant nickel resources, which account for 90% of its export earnings, and is still heavily reliant on financial transfers from France which account for approximately 25% of GDP.

Table 1: Main economic indicators of New Caledonia (2009)

	New Caledonia
Population	245 580
HDI	0.878
Gini Index (2004)	50
Per capita GDP (euros)	24 900
Adjusted annual growth rate	1.8% [2]
Inflation	3.4%
Rate of Unemployment (2004)	16.3%
Exports / imports cover rate	36% [3]
Transfers from state (billions of euros)	1.14
Minimum guaranteed wage (euros / month)	1 042.5

Source : Lagadec and Ris (2010)

New Caledonia is unique in being a South Pacific economy predominately based on mining[4], and has some quite sophisticated domestic industries and services to support the mining sector. Despite the substantial fall in world nickel prices in 2008-09, with several large mining infrastructure projects, the nickel industry will become even more important to New Caledonia's economy, significantly increasing its contribution to GDP, and generating further employment opportunities in the longer term. However, price volatility due to the nickel industry's cyclical nature makes it obvious that there is a need to reduce economic uncertainty through economic diversification.
Caledonia's growth over the last ten years has gone along with a relative decrease of the importance of the public sector in Caledonia's economy (Sudrie 2009). Besides, the important growth of fiscal revenue has allowed to diminish the dependence of public finances on metropolitan transfers and has permitted to finance public spending without increasing public debt (which remains low). Nevertheless public finances bear some structural weakness: revenue is partly linked to the evolution of the nickel price whereas the recent increase of public spending is mostly structural (CEROM 2008).

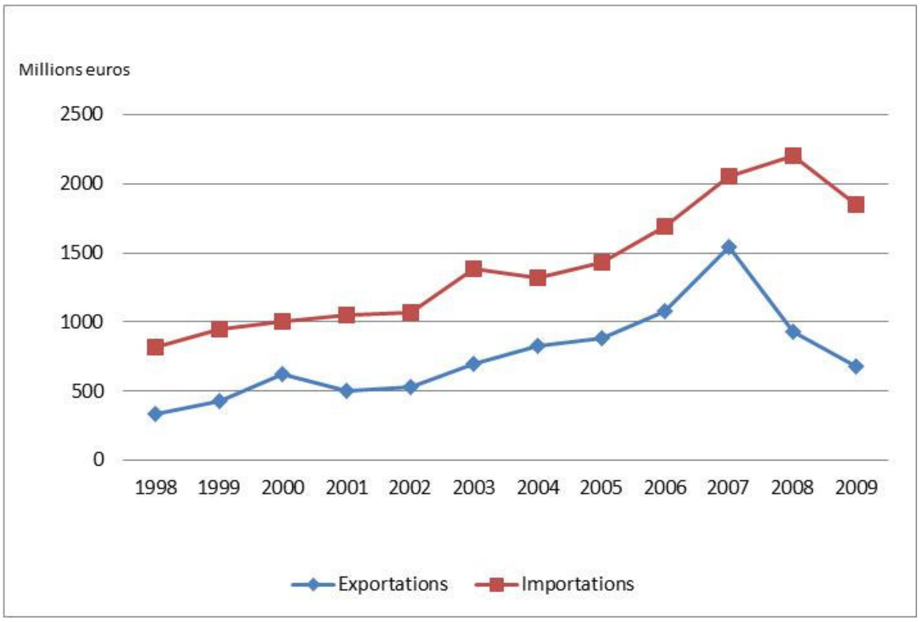
1.2. The main indicators of foreign trade

New Caledonia's openness is relatively limited. The trade openness ratio[5] actually increased between 1998 (18 %) and 2006 (25 %) but it remains small compared to the rate prevailing in the other Small Island States (SIS). Indeed according to CEROM (2008) only 13 % of the SIS have rates as low as New Caledonia's. In any other case the rate varies from 50 to 80%. Thus New Caledonia, despite its small domestic market, is really highly introverted (CEROM 2008: 20-21).
New Caledonia's opening up rate being so low is notably due to the market protection policy that has been implemented. Indeed, New Caledonia applies a number of trade barriers to protect local industry and employment. A preferential tariff regime for the entry of EU-origin products remains.

[2] 6.2% in 2007.
[3] 75% in 2007.
[4] New Caledonia has a long-established nickel industry (more than 25% of the world's known nickel resources).
[5] Exports plus imports as a proportion of GDP.

New Caledonia consistently runs a trade deficit. With the exception of nickel, the propensity to export is limited; the production facilities are hardly looking abroad. New Caledonian exports are modest because of the Territory's overwhelming reliance on mineral exports, and because local production costs are high.
The first chart shows the export/import evolution of New Caledonia over the last ten years.

Chart 1. Evolution of New Caledonia's foreign trade since 1998



Source: ISEE[6].

Improving the exports on imports ratio since 2004 has been mechanically linked to an increase of the international nickel price (reaching a peak in 2007); in the same way, the brutal decrease of the exports on imports ratio in 2008 followed a drop of prices from mid-2007.

1.3. Social inequalities

The Caledonian society presents high inequalities of monetary revenue. The 20 % of the wealthiest households (approximately 15 000 tax households) receive 55 % of all the revenue declared to the tax administration, against 40 % in Metropolitan France, 41 % in Australia and 43 % in New-Zealand (CEROM 2008: 45).
In 2006, the Gini index calculated for New Caledonia was 50. France has a 33 Gini index, for Australia and New Zealand the Gini index is 35[7].

This significant disparity in wealth distribution is made more painful for some by the high cost of living owing to small market size and heavy market protection (favouring local and European goods).

[6] New Caledonia Institute of Statistics and Economic Studies.
[7] The most equalitarian countries have an approximate 25 ratio (Japan, Norway). The least equalitarian countries (Brazil, South Africa, Haiti or Botswana) have an approximate 60 index.

In 2006, in the private sector, two third of employment are paid under 200.000 Pacific francs (1 680 euros). The part of salaried workers from the private sector who are paid the minimum wage or less is 37% in New Caledonia (sources CAFAT[8]) against 14 % in Metropolitan France.
The minimum wage in New Caledonia (132.000 Pacific francs (1.109 euros) in January 2010) equals 70 % of the metropolitan minimum guaranteed salary (SMIC), while the salaried agricultural workers are paid the agricultural minimum guaranteed salary which corresponds legally to 85 % of the minimum guaranteed salary (SMG), with prices in New Caledonia being considerably higher than in European countries (CEROM 2008: 59).

Moreover, the high inflation rate in recent years was even stronger for the poorest households because increase in food prices was much higher than for the other goods.
Accordingly, the strong inflationary pressure encouraged public authorities to establish a freeze on prices and sales margins for imported goods, local products and some services. A limited number of products and services are still regulated in New Caledonia; this is the case for essential or basic necessity products in particular.

Inequalities in New Caledonia correspond acutely to a problem of purchasing power for the lowest salaries. This justifies the recent policy of wage increase.

The government of New Caledonia has a variety of mechanisms at its disposal to regulate the economy. Economic legislation is one of the instruments in the same way as taxation, while monetary policy is the responsibility of the State[9].
In this context, reforms to encourage redistribution and the increase of purchasing power appear as a prerequisite for stronger and sustained growth.

1.4. An outline of New Caledonia's tax system

Relative parts of direct and indirect taxation

Caledonia's budget is first and foremost a budget of income redistribution between the ‘collectivities’ among which the three provinces come first. This ‘re-balancing’ was planned by the ‘Accord de Nouméa’ and the 1999 organic law which confirmed New Caledonia's institutional specificity.
In 2007 New Caledonia received revenue of 152 billion CFP francs, 141 billion of which coming from taxation.
We can make out two main categories: the one pertaining to the base of redistribution to collectivities (territory, provinces, municipalities) among which direct and indirect taxes. And the ones directly allocated by New Caledonia to some establishments and various bodies (notably the CAFAT, which manages the social security).
From 2002 to 2007, the tax revenue increased from 74 billion francs to 141 billion (89% increase). After 2007, the tax revenue has plateaued (economic crisis, sharp fall of the international nickel price and so of the nickel revenue).

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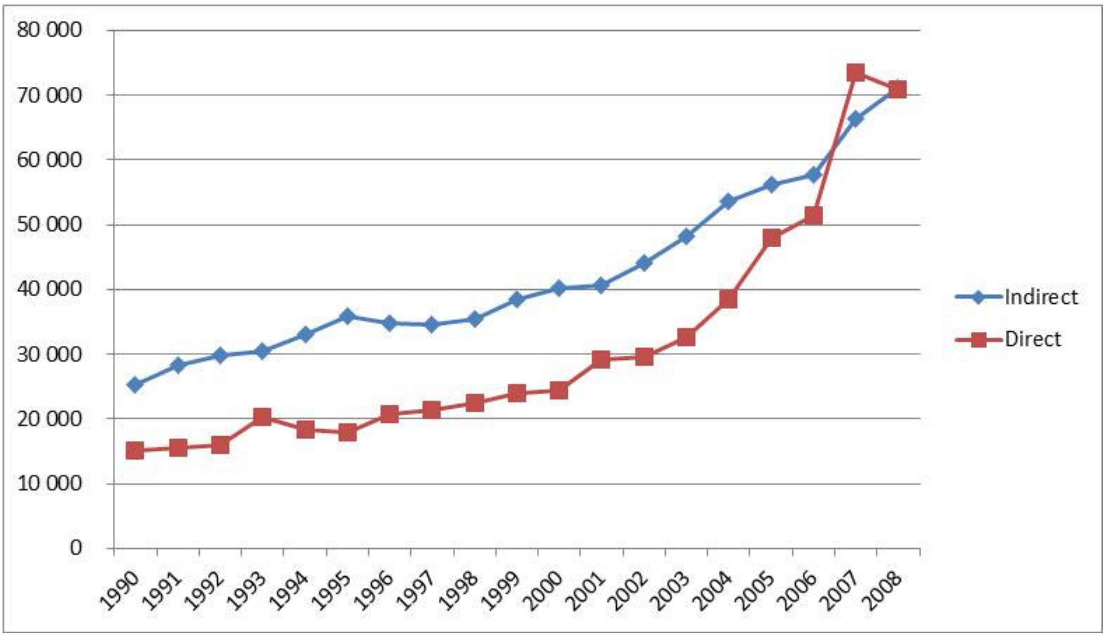
[8] CAFAT is the New Caledonia public health insurance and family benefit fund (www.cafat.nc).
[9] The three French Pacific territories share a common currency, the French Pacific franc, whose current parity of 119.2 CFP to the euro has been fixed by the French government.

The general import tax (main customs tax in New Caledonia), which up to 2006 was New Caledonia's main resource went down to third in 2007 due to the exceptional yield of the tax on firms (high rise of the nickel price).
Five taxes only shared between them nearly 60 % of the total product and customs revenue represented 21% of the whole revenue (which was a minimum reached in 2007):

- IS 35 (tax on the mining and metallurgical firms): 18 %.
- IS (tax on firms): 13 %.
- TGI (import general tax): 11 %.
- IR (income tax): 9 %.
- TSS (solidarity tax on services): 8 %.

Consequently from 2006 on there was a significant inversion of the yields of direct and indirect taxation which the CTC shed light on (CCT 2008: p.9). Direct taxation, traditionally lesser, caught up with indirect taxation in 2006, and then overtook it (see Chart 2). The crossing of curves is good in terms of social justice as redistribution by tax lies mainly on direct taxation (income taxation being progressive).

Chart 2. Revenue from direct and indirect taxes since 2002 (billions of Pacific Francs)



Source: ISEE.

New Caledonia tax and customs competence

New Caledonia's tax autonomy, which pre-existed since 1900, was confirmed by article 9 of the law n° 88-1028 dated from 9th November 1988 bearing statutory provisions in preparation for New Caledonia's self-determination. It read: 'the Territory is competent in the following matters: 1° duties and taxes levied in the Territory'. It was re-affirmed by article 22 of the organic law n° 99-209 from 19th March 1999 relative to New Caledonia which stated that 'New Caledonia is competent in the following matters: 1° duties and taxes levied for the benefit of New Caledonia…'.
New Caledonia's tax autonomy allows for taxation which differs from Metropolitan France's. For the same reasons a reform of Caledonian taxation may well lead to solutions unprecedented in Metropolitan France (see Laroque and Salanié (2002: 25–48) for a description of various policy experiments that took place in France).

The increasing importance of a reform stems from the current system being the fruit of a 'historic sedimentation' according to CTC's phrase (CTC 2008: 6): taxes add up with time whereas the exemptions by product develop. The exemptions largely turn Caledonian customs taxation into a complex system with little efficiency.

2. Shifting the taxation of the employer contributions to a new basis

The value added tax (VAT) is now found in more than 130 countries (raising around 20 percent of the world's tax revenue), and has been the centerpiece of tax reform in many developing countries. Most countries that have adopted a VAT seem to have gained a more effective tax instrument in doing so (Keen and Lockwood 2010: 138–151).
While Value Added Tax (VAT) and Goods and Services Tax (GST) have been a part of tax landscape in Europe for the past 50 years, they have only become a regular occurrence in the Asia-Pacific region in the past 10 to 20 years.
Concerning Social Value Added Tax (SVAT), references in English are rare. Indeed, only very few countries have established a SVAT mechanism.

2.1. The principles of contribution transfer

Taxing employer contributions consists in transferring the amount of employer contributions included in the firms' cost price to what will remain a social contribution, but will be registered like VAT, i.e. not in the cost price. The price, inclusive of tax, of the products manufactured locally will remain unchanged and in both cases the firms will pass it on to their buyers in the selling price.

Thus we are dealing here with a new mode of calculation of social contributions ('normal' VAT being called 'fiscal' VAT). Fiscal VAT and social VAT remain undifferentiated at the collection level (and will be called, allowing for the most global expression, 'social VAT'). It's where tax affectation occurs that the distinction would appear, as one part (the 'social' one) would contribute to the welfare system (for a discussion on taxes paid by employers and employees, see Picard and Toulemonde (2001: 461–470).

The calculation and collection of the social VAT (SVAT) are similar to the VAT's: they would apply to all the goods sold on the given territory and wouldn't apply to exports. The export prices would be 'non SVAT' and the prices on the domestic market would be SVAT inclusive. Here lies the interest of the social contributions transfer mechanism which would entail two gains:

- Decreasing export prices by suppressing contributions (hence an increase in competitiveness).
- Increasing import products prices by adding SVAT to VAT (protection of the domestic market).

Establishing such a mechanism would decrease the firms' costs (wage increase being balanced by social contributions deducted from cost prices).

A similar mechanism has been devised by the government of New Caledonia which was elected in May 2009. This concern is doubly innovative as:

- New Caledonia has not made the choice of using VAT and relies, for an important part of its fiscal revenue, on customs duty[10], which is also the case of many SIS in the Pacific (Cook Islands, Fiji Islands[11], Papua New Guinea, Samoa, Tonga, Vanuatu, cf. Appendix 1).
- Few countries have chosen social VAT. Danemark is one of the few countries that have established a SVAT mechanism. Indeed in 1987 this country achieved a tax reform that entailed the suppression, between 1987 and 1989, of the social contributions made by the employers. The deficit for public finances was balanced by a 22 to 25 % increase of VAT. In France the 1994 Perben Act established such a mechanism in La Reunion, Guadeloupe and Martinique. More recently Germany introduced SVAT in July, 1, 2007 (see Besson 2007, for a presentation of the introduction of SVAT in Denmark and Germany).

2. 2. Gains expected from a social VAT mechanism

Globally speaking, the advantages can be divided into three categories:

- Fighting firms delocation:
    - by decreasing labour cost to boost employment; the expected corollary to the lower labour cost being notably the decrease of moonlighting (Memon, 2010),
    - by suppressing any tax-related distortion in the production cost between goods, be they manufactured in the given country or not. This means that SVAT would apply to domestic products as well as imported goods and would be non-discriminatory whatever the country of origin of the products. *A contrario*, employer contributions may be seen as a discriminatory tax hitting domestic production and exempting foreign production. Thus domestic goods are disadvantaged at export and the imports in competition with them on the domestic market are given an advantage. In this way the traditional simple VAT system can be seen as an ‘inverted customs duty’.
- Reducing public deficit :
    - by applying SVAT to the civil servants' pensions that as a consequence would not be financed by the state any more,
    - by making foreign producers take part in the social protection of the given country by taxing imported goods (a firm producing and selling in a country, employing ten salaried workers, must pay ten social contributions whereas one that imports the very same goods with two salaried workers has to pay two only).
- Promoting external trade surplus:
    - by decreasing the price of export products (sold non inclusive of VAT and SVAT),
    - by increasing the price of imported goods.

The last two advantages (public deficit and trade surplus) seem to be the most important in the case of New Caledonia.

[10] Customs duty represent, depending on the year, between 20 and 25 % of the fiscal revenue of New Caledonia (Source: Institute of Statistics and Economic Studies of New Caledonia).

[11] Narayan and Prasad (2003:5-26) examine issues arising from a 25% increase in the VAT in Fiji in 2003.

For a thorough synthetic approach of the advantages of SVAT, it can be said that such a device would allow improving competitiveness without reducing global demand which fuels growth and employment. The increase of competitiveness also permits to boost the purchasing power. The reason being that, as long as the employer contributions have been removed from the production costs, increasing salaries (revaluation of the basic wages in each branch) would be less penalizing for the firms. Thus SVAT allows for new margins for a resolute policy to upgrade the purchasing power.

The quantitative and dynamic consequences of a social VAT reform are analyzed by Fève, Matheron and Sahuc (2009) using two general equilibrium models. They show that the fiscal reform turns out to generate a small, positive long–run effect on aggregate variables and yields a modest welfare gain.
Furthermore, implementing SVAT would considerably simplify the current tax system in New Caledonia. As outlined by Bird (2004), one of the most important lessons emerging from experience in various countries is that an essential precondition for the reform of tax administration is to simplify the tax system to ensure that it can be applied effectively (Grandcolas (2005) shows some complementary conditions of success of VAT implementation in the Pacific).

2. 3. The economic inconveniences expected from a SVAT mechanism

Fiscal equity.
The system of social contribution is progressive whereas VAT is regressive, the latter can be seen as an inequitable tax[12]. The question of equity becomes vital when one focuses on the core of the system (substituting SVAT for contributions), since the increase of VAT rates would apply to individuals who are not directly concerned by the decrease in contributions. Gibson (1998) shows how Papua New Guinea's VAT impacts on consumer welfare and which items should be exempt from the VAT on the ground of distributional equity and poverty alleviation.
It must be noted that the principles of equity must be balanced with those of efficiency (problematic of optimal taxation); and, in this case, the lack of equity is not a major problem. On this issue, see Mankiw, Weinzierl and Yagan (2009), who show clearly that from a theoretical point of view optimal taxation would entail recommending regressive taxation of high wages (the efficiency of stimulating savings outweighing a highly inequitable modality).

Inflation.
There would be a real inflation risk due to SVAT if the tax was substituted for employer contributions (not employee contributions) and only if the firms didn't translate the lower employer contributions in their selling prices (increased margin; windfall effect). Then, in this configuration, consumers might have to 'bear' the tax in the form of an inflation shock.

[12] Atkinson and Stiglitz (1976) showed that direct taxes dominate indirect taxes.

3. SVAT as a tool to boost up wages. Illustration with the case of New Caledonia

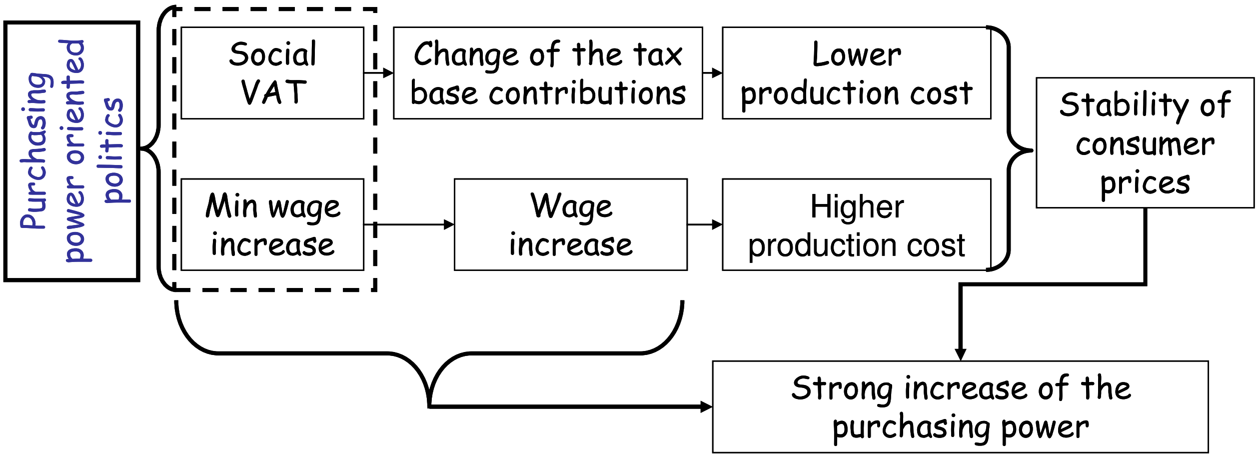
3.1. Gaining manoeuvring space through changing the tax base of social contribution

New Caledonia, like many SIS, is faced with the problem of a high cost of living (UN 2009: 112), that is to say a degraded purchasing power (*a fortiori* in the context of the global economic crisis and its current and future impacts). To counter the decrease of the purchasing power, the immediate solution may appear to be increasing salaries, but such a measure would meet with important difficulties:

- In the private sector (where average wages are lower than the civil servants') there could be no direct action except on the amount of the minimum salary.
- Increasing the minimum wage might entail narrowing the wage scale (society would undergo a levelling down of salaries).
- Increasing minimum wages would entail difficulties for firms.

Conversely, with an increase of wages accompanying the establishment of a SVAT, it would be possible to improve the purchasing power without weighing on the firms' contributions (Chart 3).

Chart 3. SVAT with wage increase



As long as the wage increase did not exceed the amount of the contributions 'saved' in this fashion, the firms' global contributions would not increase as a consequence of the reform.

Beside the direct advantages of an increase of the purchasing power and a stability of the contributions, such a policy would have a number of indirect advantages:

- Financing social contributions would apply on a very wide base and would be less painful.
- Firms would benefit from a classic VAT (with more flexibility and more cash flow for the enterprises, which should contribute to boosting the economy).
- In a reform where fiscal VAT would substitute for customs duty, the protection of firms in competition with imports would be better than with a simple VAT: VAT and social VAT apply to importations. As SVAT has a higher rate than VAT by definition, the protection would grow as much.

3.2. Illustration

The simulations linked to a passage to SVAT appear to be a difficult task, as Malinvaud (1998: 40) shows: 'Let's suppose an undifferentiated diminution of the employer contributions rate is established simultaneously with a compensatory increase of the VAT rate. This decision should immediately trigger a whole set of reactions, either simultaneous or chain reactions. They will concern prices without VAT and with VAT included, costs, transfers, anticipations. Keeping precise track of this set of reactions would imply a deep knowledge of the forms of competition, of how wages decisions are made, of the inflexibility of prices and salaries, of how transfer revisions are regulated. All the more so as situations vary from one good to the next, one transfer to the other and as the context where these multiple reactions will occur will itself be influenced by the these reactions, notably if there are favourable effects in terms of employment. As we don't possess this deep knowledge required for a precise follow-up beyond a few terms, we must rely on our judgement and schematize by paying attention to relative prices and costs as much as to effects of volume.'

To make it easier to understand the mechanism envisaged we will simply illustrate it here with two examples, in the case of products manufactured in New Caledonia and in the case of imported goods (with one VAT and with one SVAT). To this effect the table below indicates the rate of the various employee and employer contributions in New Caledonia.

Table 2. Various contributions on 1st January 2006

Risk	**Employer**	**Salaried worker**	**Total**	**Monthly base (*)**
Illness	11,30 %	3,85 %	15,15 %	0 à 399 100
Old age pension	9,10 %	3,90 %	13,00 %	0 à 306 500
Family benefits	6,14 %	–	6,14 %	0 à 306 500
Unemployment	1,52 %	0,34 %	1,86 %	0 à 306 500
Industrial injury	0,72 to 6,48%	–	0,72 to 6,48%	0 à 306 500
Housing social fund	2 %	–	2 %	0 à 258 800
Vocational training	0,25 %	–	0,25 %	0 à 306 .500
Total of social contributions	**30,31 %**	**8,09 %**	**38,40 %**	
In-house training	0,70 %	–	0,70 %	Whole salary
Exceptional contribution for solidarity	–	0,75 %	0,75 %	On the part of salary over 306 500

Note: (*) Pacific franc (one euro = 119.2 Pacific francs)

Source : Centre of European and international networks of social welfare (Centre des Liaisons Européennes et Internationales de Sécurité Sociale'; www.cleiss.fr).

Let's consider the case of an input-importing industry (raw materials) with a customs taxation of 20 %[13] (the industry enjoys exonerations on input importation). We suppose that the imports (raw materials or goods) cost 30, the depreciation 15 for the industry and 10 for the import–distribution, the salaries without employer contributions cost 40 for the industry and 20 for import-distribution[14]. The amount of customs duty reach respectively 6 and 7.5 whereas employer contributions reach respectively 12,7 and 6,3[15].
We consider an 8% profit margin and rates of VAT and SVAT which maintain the same level of revenue. This means in effect an 8% fiscal VAT rate[16] and a 14 % social VAT rate[17]. The first rate is inferior to the customs rate since the base is larger and the second rate is inferior to the employer contributions rate as the base is also larger (all the more so for import where the part of salaries in the cost is lesser).

This example details:
- The current situation.
- The situation of a VAT substituting for customs duty (at the very least with constant revenue).
- The situation of a VAT substituting for customs duty and a SVAT substituting for employer contribution.
- The situation of a VAT substituting for customs duty and a SVAT accompanied by a 10% wage increase.

Table 3 illustrates the effects of a social VAT accompanied by wage boosting in the case of the industry and of the import (the wage share in the cost price differs widely as well as the effects of taxation change).

The example shows that the selling price to the Caledonian consumer would be left globally unchanged[18], with VAT and SVAT correctly calibrated, the economy as a whole enjoying the advantages of SVAT (or simply VAT): flexibility of the firms' treasury, price transparency, end of the "inverted customs duty" (SVAT), better competitiveness, a boosted economy.
As for imported goods, the price will be increased by the VAT or SVAT, that is to say, in the second case by 22%[19]. Yet the situations of the industry and of imports differentiate in a dual way. Should there be a shift to VAT, the price of the industrial goods would increase whereas the price of the import goods would decrease. This time the difference is linked to the employer contributions for import (wages) having a lower base, which outweighs the previous base.

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[13] This is approximately the average customs duty in New Caledonia; source: Department of Economic Affairs of New Caledonia (Direction des Affaires Economiques).
[14] The relative values of wages and depreciation in relation to raw materials (local industry) or of products (import) have been determined after consulting the former president of the Federation of Industries of New Caledonia as well as the former president of the tradespeople's Union of New Caledonia.
[15] 40 × 30.3 % and 20 × 30.3 % (percentage of employer contribution for New Caledonia; see table n° 2).
[16] This rate would compensate the customs revenue. Besides it is in conformity with the rate planned in the 2007 aborted reform (CTC 2008: 54). See Table 3.
[17] This would compensate the amount of employer contribution. See Table 3.
[18] The impact of on prices would depend, for each sector, on the part of salaries in the production cost. The higher this part, the more the selling cost inclusive of tax would mechanically decrease due to the SVAT substituting for employer contributions. The part of salaries depending on the sectors, the prices would decrease in certain sectors and increase in others. It's at the level of the global economy that the effect on prices would be neutral, for a SVAT rate calibrated to this effect (which would necessitate enhanced economic simulations).
[19] Though the example in Table 2 offers illustration rather than a prospective view, it's likely that this 22 % is closer to the example that would prevail should the SVAT support all the social security expenses. Indeed in 2006, the government of New Caledonia was planning to replace 36 billion Pacific francs of fiscal revenue by a VAT rate of about 8 %. Social contributions amount to approximately 65 billion Pacific francs (industrial injury, unemployment, family benefits,

Table 3. Example of a SVAT with wage increase in New Caledonia

	Current		VAT		SVAT		SVAT + 10% W	
	Industry	Import	Industry	Import	Industry	Import	Industry	Import
Raw materials, inputs, without tax	30,0		30,0		30,0		30,0	
Products		30,0		30,0		30,0		30,0
Customs duty	6,0	7,5	0,0	0,0	0,0	0,0	0,0	0,0
Equipment depreciation	15,0	10,0	15,0	10,0	15,0	10,0	15,0	10,0
Wages without employer contribution	40,0	20,0	40,0	20,0	40,0	20,0	44,0	22,0
Employer contribution to the social security	12,7	6,3	12,7	6,7	0,0	0,0	0,0	0,0
Profit before tax	8,3	5,9	7,8	5,3	6,8	4,8	7,1	5,0
Selling price without tax	112,0	79,7	105,5	72,0	91,8	64,8	96,1	67,0
Selling price without any VAT	n.a.	n.a.	105,5	72,0	91,8	64,8	96,1	67,0
VAT collected	0,0	0,0	8,4	5,8	7,3	5,2	7,7	5,4
SVAT collected	0,0	0,0	0,0	0,0	12,9	9,1	13,5	9,4
Selling price inclusive of tax	**112,0**	**79,7**	**113,9**	**77,8**	**112,0**	**79,1**	**117,3**	**81,7**
Variation of the tax revenue			2,4	-1,7	1,5	0,4	2,5	0,9
Variation of the price inclusive of tax (%)			1,8%	-2,5%	0,0%	-0,9%	4,7%	2,4%
Variation of real salary (%)							5,3%	7,6%

If one compares columns 2 and 3 (current ones) to 8 and 9, gross salary would increase by 10 % and the prices inclusive of tax by 4.7 % in the case of industry and by 3.3 % in the case of import. Thus the industry would be penalized in comparison with import-distribution because of lesser customs duty on inputs when a VAT wouldn't *a priori* offer the same flexibility. Yet, conversely, SVAT would offer compensations in terms of market protection (the VAT rates would apply to the imports in competition with the local production). If some goods required further transitory protection, some specific protectionism might intervene.

Depending on whether one makes calculation in relation to the prices of industrial goods locally transformed or in relation to the import prices, the actual gross salary would increase by 5.3 or 6.7 %. Thus a positive effect on the purchasing power is made possible without penalizing the firms which, on the contrary, would benefit from the increase of demand thus created.
That would notably pinpoint the irrelevance of the argument that the New Caledonia current economic policy, including wage increase, would increase prices.

Should the taxation of employee contributions be added to the SVAT mechanism, the effect on the purchasing power would be reinforced further.

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illness). This adds up to about 100 billion Pacific francs, which would correspond to a 28 % ÷ 36 × 100 = 22.2 % global VAT (fiscal VAT plus social VAT).
Source : http://www.cafat.nc/net/Cafat.nsf/Caf-chiffres/Caf-chiffres-020.

Conclusion

While the VAT system has spread to most countries it can be noted that an important proportion of SIS have not made the choice of this fiscal tool.

In New Caledonia, a reform of indirect taxation launched in 2004 aborted a few years later[20]. Tradespeople and entrepreneurs (*i.e.* the people supposedly in charge of collecting the tax) were strongly reluctant to the introduction of VAT, notably because with its large base VAT would imply less protection for the market (tariffs). Other aspects may explain why VAT has not been a privileged tool of fiscal revenue in the context of some small island countries:

- The risk that substituting VAT for customs duty could entail an inflation shock (due notably to fixing margins not in a percentage but in absolute value in economies with little competitiveness) – VAT being later applied to this margin, contrary to what happens with customs duty.
- The traditional argument that the VAT is economically neutral is hardly relevant in an economy whose sectors include very few processing stages.

In a way it is by going beyond VAT that New Caledonia and other SIS could have a major interest in this tool. By including the financing of social contributions in this tax (social contributions would consequently be transferred from labour to the value added that is to say to the consumption because of the principle of the deductibility of the VAT system), both an improvement of export competitiveness and an increased protection for import could be reached (in comparison with shifting to simple VAT).

Furthermore the transfer of contributions would permit a wage increase without lessening the firms' competitiveness; this would create opportunities to boost the purchasing power (consequently to increase the global demand for firms working in the domestic market).

There would be no need for this reform to be brutal. A VAT could be established (or not) while maintaining employer contributions; then, the transfer of these contributions to a SVAT could be done gradually: by decreasing step by step the employer contributions and increasing VAT rates at the same time.

Having a progressive agenda would comply with Grandcolas's recommendations to ensure the success of fiscal reform: 'in administrative terms, establishing VAT in the Pacific island countries is possible should some conditions be met. First a strong and explicit motivation at the head of the state is needed; next preparing a detailed plan of implementation with realistic dates for the major steps is required' (Grancolas 2004: p. 22).

In the case of New Caledonia the executive's motivation to carry out a fiscal reform and wage increase seems real (Gomès 2009). What remains is to determine the best architecture to join the different objectives without deteriorating the economy's competitiveness.

[20] See CTC (2008: p. 53).

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Appendix 1: Public revenue in the Pacific countries

	Population	HDI	Total revenue & grants / GDP (%)	Average Tariff rate (%)	VAT	VAT rate (%)	Customs revenues / total revenue & grants (%)	VAT revenues / total revenues & grants (%)
Australia	20 743 000	0,962	36.0	5.3	Yes	10,0	2,10	15,95
Cook Islands	18 900	..	34.2	7	Yes	12.5	11.2	31.9
Fed. states of Micronesia	111 000	0,569	59.1	4.21	No	n.a.	6.4	n.a.
Fiji	839 000	0,762	24,1	15.6	Yes	12.5	16.4	31.4
Kiribati	95 000	0,515	90.9	17.22	No	n.a.	13.6	n.a.
New Caledonia	250 000	0,878	39,89 (*)	18.83	No	n.a.	14,82 (*)	n.a.
New Zeland	4 180 000	0,943	36.0	3.2	Yes	12.5	3,2	29,5
Niue	2 200	..	90		No	n.a.	21.4	n.a.
Palau	20 000	0,861	27.6	3.02	No	n.a.	6.7	n.a.
Papua New Guinea	6 330 000	0,53	36.1	32.1 (**)	Yes	10,0	5.5	8.3
Rep. of Marshall Islands	59 000	0,563	65.2	9	No	n.a.	7.6	n.a.
Samoa	187 000	0,785	32.5	7	Yes	12,5 - 15	9.4	23.1
Solomon Islands	500 000	0,602	65.9	78.6 (**)	No	n.a.	25	n.a.
Tonga	100 000	0,819	35.7	17.6	Yes	15,0	27.5	36.2
Tuvalu	11 000	0,583	126	15	No	n.a.	21,8	n.a.
Vanuatu	226 000	0,674	30.1	25.13	Yes	12,5	23	27.5

Notes : (*) Grants include civil servants' wages paid by France, which feed the tax basis and so create a kind of double account. (**) Simple average MFN applied: 4.9% for Papua New Guinea, 9.9% for Solomon Islands.

Sources : Authors' computations using data from CEROM (2008), PNUD (2009), doingbusiness.org, French Ministry of Foreign Affairs, Australian Government, New Zealand Government, Kaufmann (2009), WTO (2009).

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Présentation du LARJE (EA 3329)

Les axes de recherche

La recherche développée par le LARJE est axée sur les ressources naturelles, la biodiversité et l'environnement d'une part, le droit et l'environnement économique et social insulaire d'autre part. Ces thèmes se déclinent dans une optique de développement durable, liée à l'émancipation progressive du Pays dans le statut issu de l'accord de Nouméa. Ils entendent favoriser une recherche non seulement fondamentale, mais aussi appliquée sur les aspects économiques et juridiques de l'évolution des populations et des politiques locales liées aux activités humaines et industrielles en Nouvelle-Calédonie, particulièrement le nickel. Dans cette optique, les membres de l'équipe continueront à favoriser les ouvertures sur l'étranger par des collaborations avec les institutions régionales (CPS, PROE notamment) et les universités de la zone (USP à Port-Vila et Suva, AUF et Universités australiennes).
Le LARJE (équipe d'accueil n° 3329) a été évalué et renouvelé pour 4 ans par le MESR (décision du 29/11/2007).

Les membres de l'équipe

- ✓ Guy Agniel, Professeur des universités en droit public
- ✓ Elisabeth Alma, Maître de conférences HDR en sciences de gestion (en délégation)
- ✓ Didier Babel, PRAG d'économie-gestion
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- ✓ Mathias Chauchat, Professeur des universités en droit public (directeur de l'équipe)
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