



*Ministero dell'Economia e delle Finanze*  
*Dipartimento del Tesoro*

# Taxation in the Post-Crisis World: What Policy Changes May Be Needed?

Fiscal Forum: Fiscal Strategies After the Global Crisis

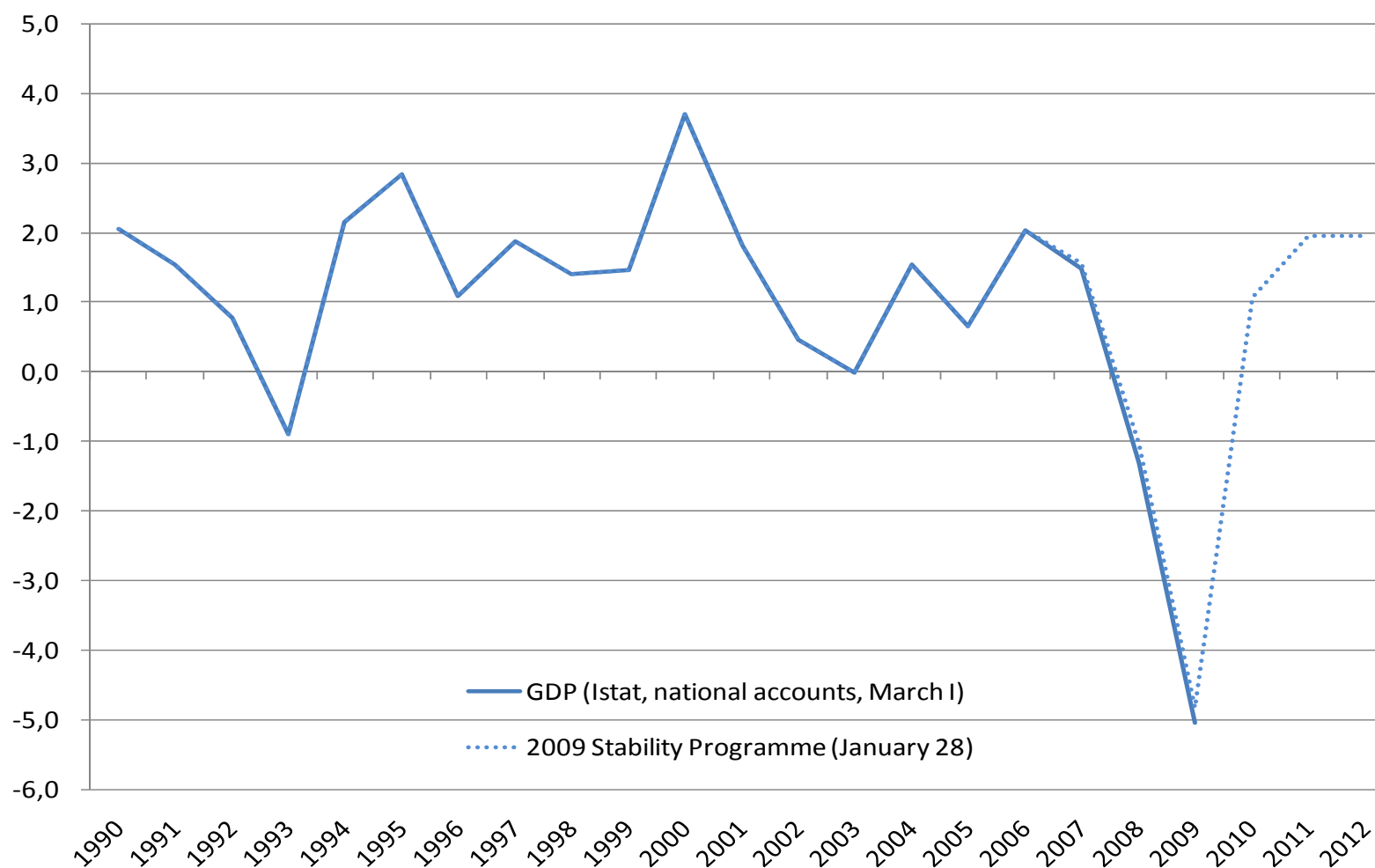
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## Deep contraction in Italy's GDP



Source: ISTAT

## Why Italy has been hit so severely by the crisis?

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- The sharp 5.0% GDP contraction in 2009 can be explained by two major components: world trade and investment.
- Italy's exports and imports decreased by 19.1% and 14.5% respectively in 2009; gross fixed investment by 12.1%. Net exports and investment contribution to GDP growth was -1.2% and -2.5% respectively.
- The 2009 performance is also affected by the negative carryover from 2008 (2008 GDP growth revised to -1.3% from -1.0%).

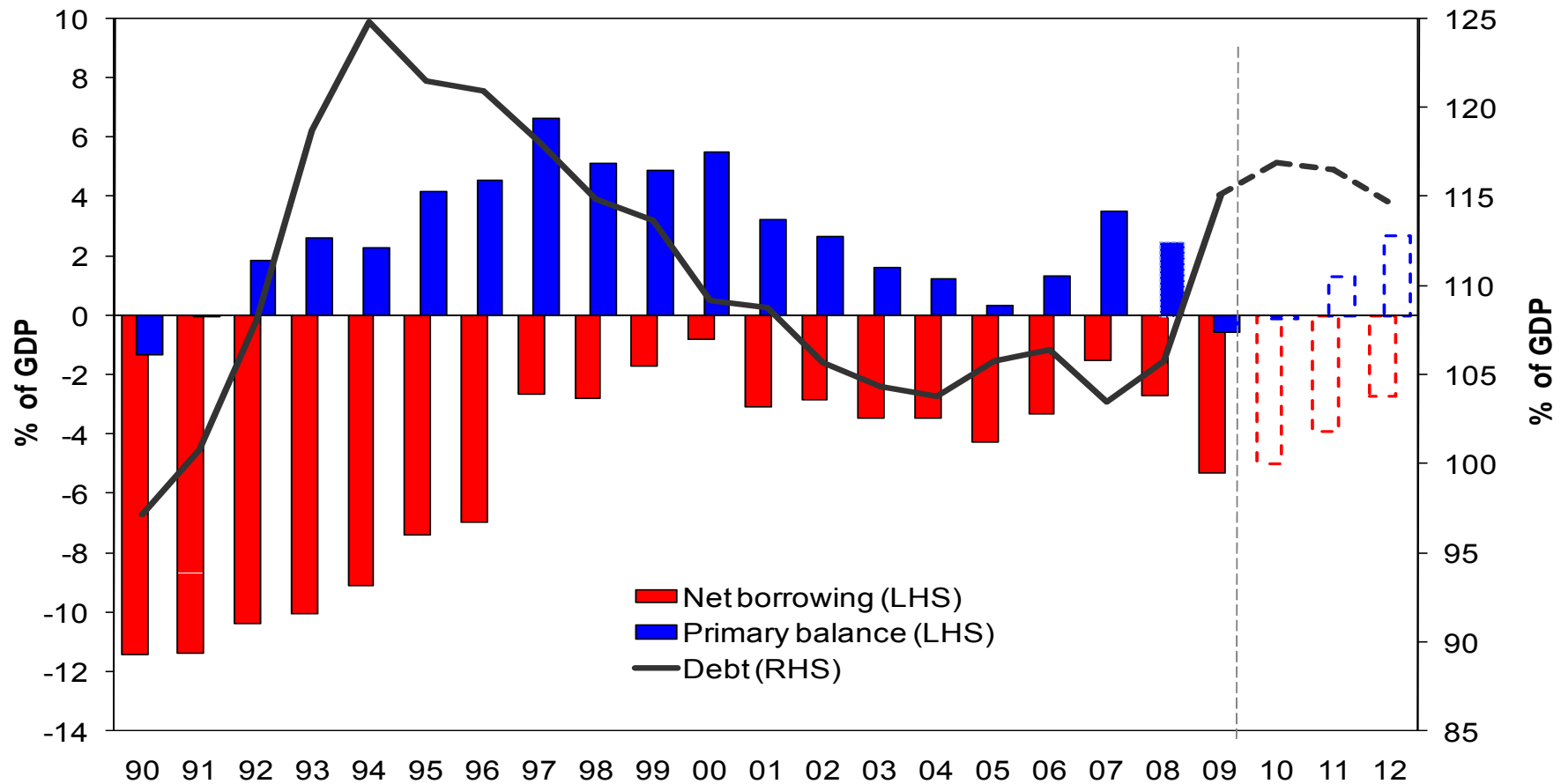
## Italy's strengths and weaknesses in the face of the crisis

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- Private sector—and especially household—debt is low.
- Housing market is less overvalued.
- Italian banks are less exposed to the factors at the root of the crisis (courtesy of good regulation, low arm's length and pro-cyclicality of leverage).

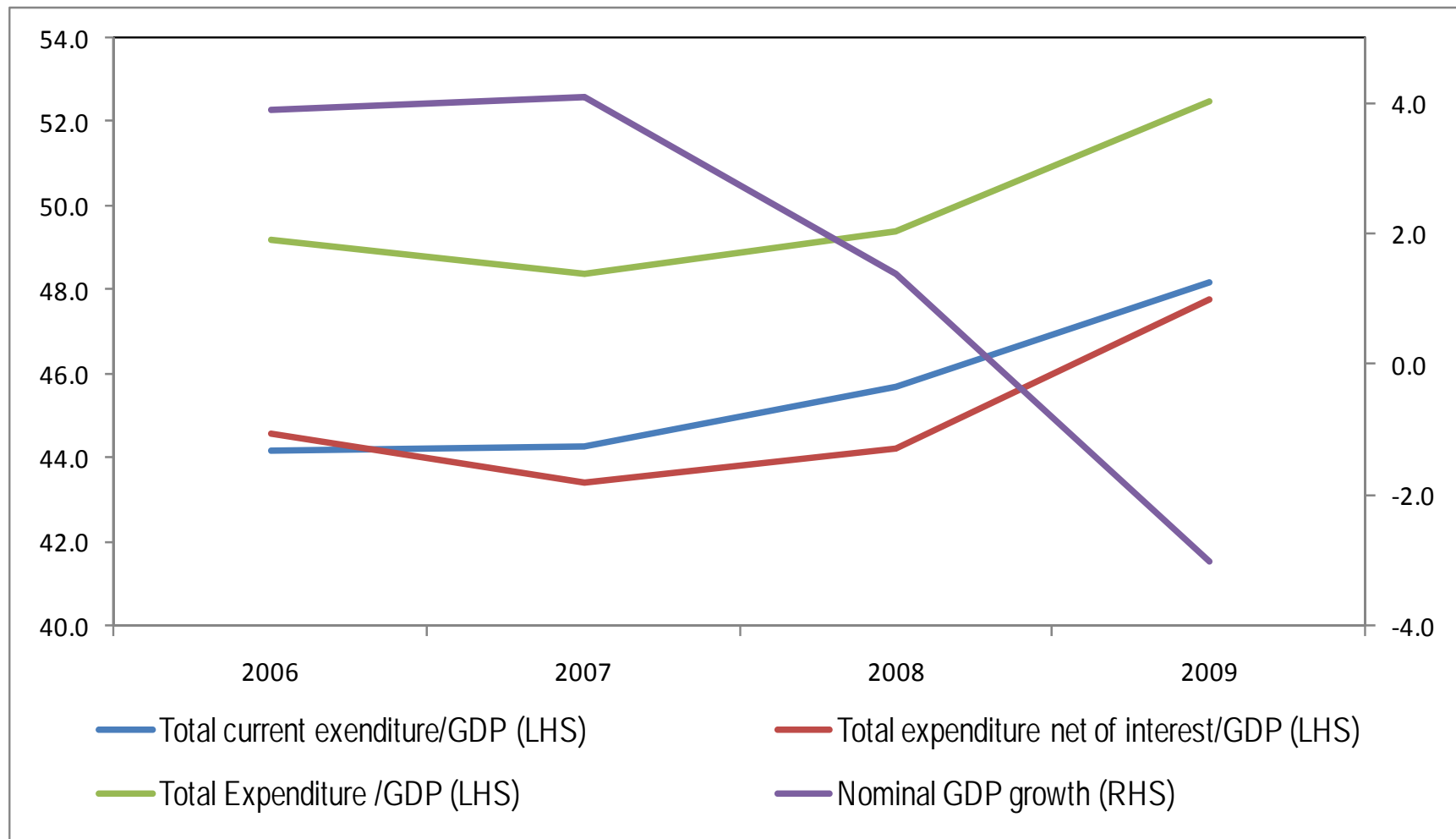
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- Italy is an export-led economy.
  - Some structural weaknesses and competitiveness problems at play.

## Fiscal exit strategy: gradual consolidation and reforms



Source: ISTAT (up to 2009), SP09 estimates afterwards.

## Expenditure-to-GDP ratios lifted by GDP contraction



## Key features of Italy's forthcoming tax reform

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- From taxation on personal income to taxation on property and consumption.
- From complexity to simplicity.
- From centre to periphery.

## From personal income to property/consumption

Italian tax system: mainly focused on personal income tax.

IRE: progressive tax on income from employment and pensions that no longer reflects the structure of the Italian economy.

*Implicit tax rate (ITR)* on labour higher in Italy than in other EU countries.

Personal income taxes are 52.9% of total revenue (35.7% IRE)

Taxes on property/consumption are 47.1% of total revenue (17.7% IRAP)

About 79% of total declared income comes from employment and pensions

Only 15% of total declared income comes from business/self-employed.

ITR on labour in Italy: 44%  
(EU average: 36,5%)

ITR on capital in Italy: 6,4%  
(EU average: 7,2%)

ITR on consumption in Italy: 17,1%  
(EU average: 20%)



## From complexity to simplicity

The complexity of IRE has increased over time in terms of tax management, structure and compliance costs.

6 classes of income, 5 tax brackets, 134 tax expenditures of which 18 taxable income deductions, 39 tax allowances, 31 tax credits, 46 exemptions and other tax benefits.

Significant tax progression with a 11pp gap between the 2nd and 3rd tax bracket.


High compliance costs for taxpayers.

Simplification of both tax structure and compliance obligations would in itself represent a major structural reform.

## From centre to periphery

### Fiscal federalism:

- Financial autonomy at local level
- Gradual shift from historical costs to the provision of essential levels of services and transfer mechanisms
- Clearer responsibilities and competences between the State and the Regions
- Accountability



In 2006, revenue from taxes linked to local activities (IRAP and ICI) accounted for about 50% of total tax revenue of regions and local authorities, with a threefold increase over the past 10 years.

Shifting from centre to periphery would enforce the benefit principle, i.e. paying taxes for public services whose efficiency can be controlled by citizens.

# High labour taxation in Italy compared to EU

## Labour taxation to stimulate labour demand

	Characteristics of indicator			Results		
	Type	Time period	Aggregation weights	Level relative to EU15	Change	
					Absolute	Relative EU15
Tax rate on low wage earners: Tax wedge on labour cost (single earner) (-)	pol	1999-2008	1/4	-3	↑	12
Implicit tax rate on employed labour (-)	pol	1999-2007	1/4	-12	↓	-2
Social security paid by employer as a % of total labour costs . Industry and services (excluding public administration) (-)	pol	1999-2007				
Undeclared work (national sources-early 2000s ) (-)	perf	2003				
Unemployment rate - 15-64 age group- Pre-primary, primary and lower secondary education - levels 0-2 (ISCED 1997) (%) (-)	perf	1999-2008		9	↑	10
Youth unemployment ratio (-)	perf	2000-2008		4	↑	-3
Long-term unemployment rate (-)	pol	1999-2008		-5	↑	16
Tax rate on average wage earners: Tax wedge on labour cost (single earner) (-)	pol	2001-2008	1/4	-3	↓	-2
Total tax wedge (including employers SSC) Married couple with 2 children, 100% and 67% of AW (OECD) (-)	pol	2001-2008	1/4	-3	↓	-3
<b>Aggregate score (based on the Narrow list)</b>				<b>-5</b>		<b>1</b>

- Implicit tax rate on labour is very high in Italy compared to EU ... although recent tax wedge cuts have been effective.
- Need for reforms in direct taxation and social contribution to make job search and employment more profitable than unemployment benefits
- Reduction in labour taxation to decrease undeclared work and spur hours worked

## Need for a credible tax exit strategy

- The financial crisis might have affected the level of structural revenue through the reduction of the level of potential output. Is this effect permanent?
- Fiscal exit strategies represent an opportunity to implement comprehensive tax reforms. However, there is no room for a reduction in the overall tax burden, at least in Italy.
- Tax system reforms should reduce tax distortions as much as possible. Moving from personal income tax to consumption/property tax should be considered.

## Need for a credible tax exit strategy (cont'd)

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- However, potential trade-offs may emerge between tax distortions and distributional effects of fiscal policy that need to be addressed.
- An example: Reducing progressivity can help reduce distortionary taxes on income but ... what are going to be the effects on automatic stabilisers (cyclical elasticities of taxes) in terms of volume and coverage?
- Tax reforms may help to address competitiveness problems and correct external imbalances.

## More focus on taxation of financial assets

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- Corporate and capital taxation may play a role in reducing volatility of asset prices.
- Need for a more effective international coordination against tax heavens.
- In recent past, the long lasting increase in asset prices have contributed to improve fiscal positions in some countries. This tax buoyancy has been considered structural, thereby convincing policymakers to adopt pro-cyclical discretionary measures.

## More focus on taxation of financial assets (cont'd)

- The reversal of asset prices showed that some tax revenue increases were only transitory, and this contributed to the sudden deterioration of the fiscal position.
- Issues related to the cyclicity of some taxation items need to be investigated further when deriving structural budgetary position and fiscal stance, especially in good times.
- The current crisis has contributed to highlight the importance of reliable and timely assessments of the fiscal stance in real time.