Ministero dell'Economia e delle Finanze

Dipartimento delle Finanze

ECFIN Workshop
'The role of tax policy in times of fiscal consolidation'

Consolidation on the revenue side – country experiences

Undersecretary of State

Vieri Ceriani

Ministry of Economy and Finance

Brussels – 18 October 2012

Overview of presentation

- The international crisis and Italy’s economy
- Revenue trends and tax composition in Italy and other EU countries
- “Salva Italia” decree: a strategy for fiscal consolidation, balanced growth and social fairness
- The “delega fiscale” and the strategic orientation of tax reform

The international crisis and Italy’s economy

The international crisis and Italy's economy

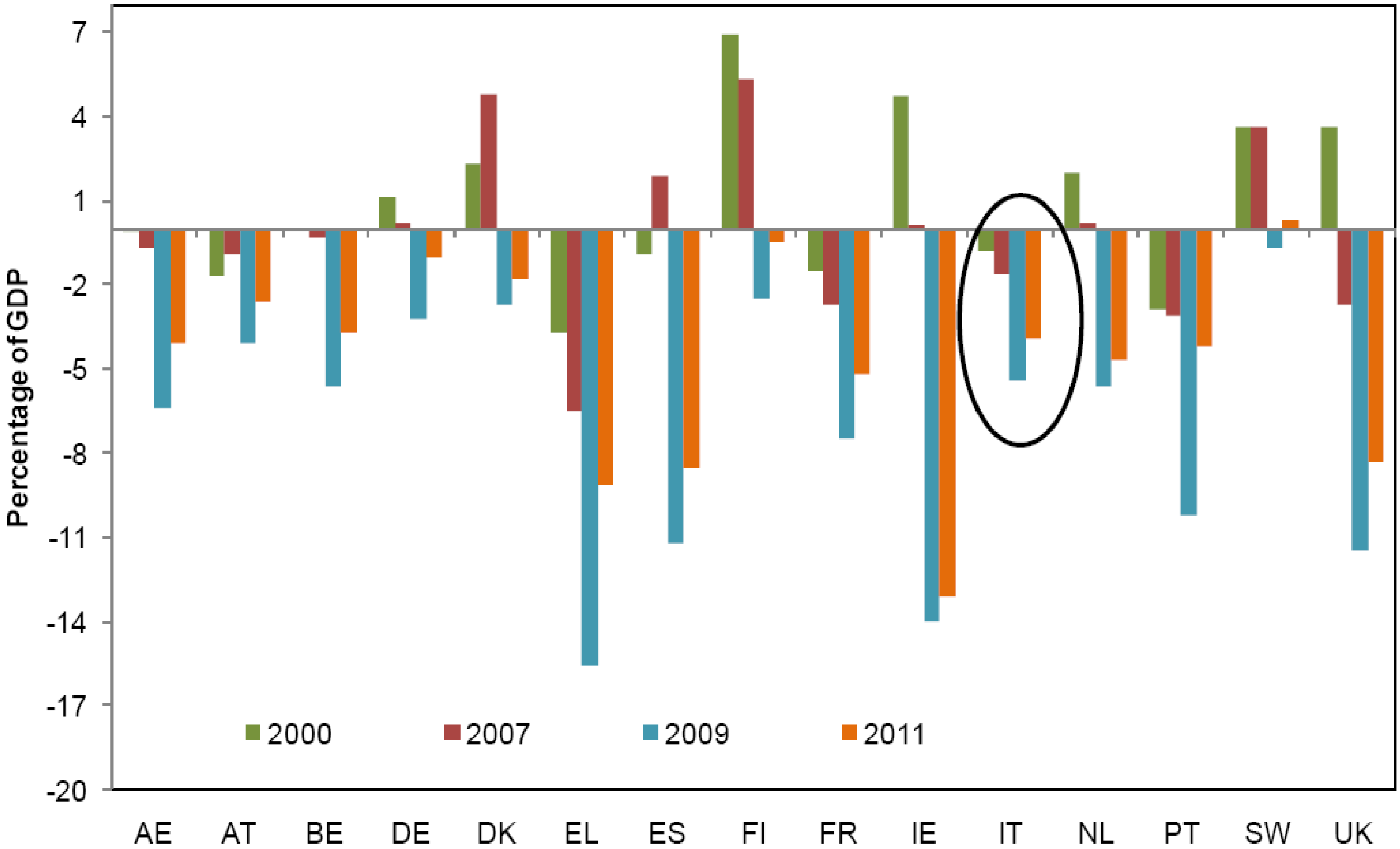
- No major macroeconomic imbalances apart from high public debt: no major bubbles in the housing market, low household debt, fundamentally sound banking system, no major external imbalances
- No increase in discretionary spending during the crisis: very prudent fiscal policy; automatic stabilisers allowed to work
- Policy measures promptly enacted to continue fiscal consolidation and enhance potential growth
- However, the European sovereign debt and banking crisis is major threat to Italy's economic growth and fiscal sustainability.

The international crisis and Italy's economy: the macroeconomic scenario

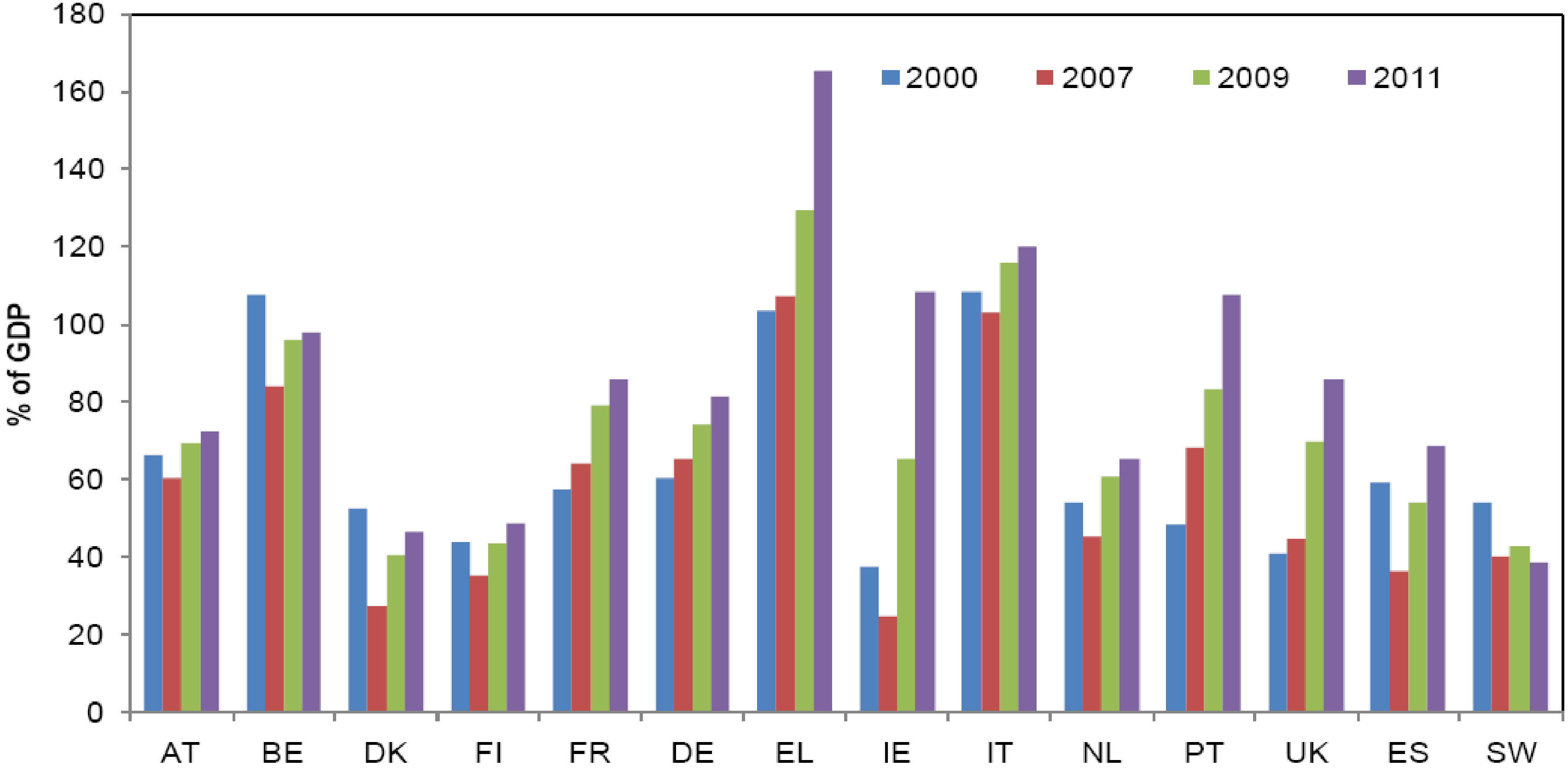
(% change yoy)	2011	2012	2013	2014	2015
Real GDP	**0.4**	**-2.4**	**-0.2**	**1.1**	**1.3**
Domestic demand net of inventories	*-0.4*	*-3.6*	*-0.6*	*0.7*	*1.0*
Inventories	*-0.5*	*-0.9*	*0.1*	*0.1*	*0.0*
Net export	*1.4*	*2.3*	*0.2*	*0.2*	*0.2*
Nominal GDP	**1.7**	**-1.0**	**1.2**	**3.0**	**3.2**
GDP deflator	**1.3**	**1.4**	**1.4**	**1.9**	**1.9**
Labour cost	**1.4**	**1.1**	**0.9**	**1.2**	**1.2**
Productivity (on GDP)	**0.3**	**-1.2**	**0.1**	**0.6**	**0.7**
Unit labour cost (on GDP)	**1.0**	**2.3**	**0.8**	**0.5**	**0.5**
Employment (FTE)	**0.1**	**-1.2**	**-0.3**	**0.4**	**0.6**
Unemployment rate	**8.4**	**10.8**	**11.4**	**11.3**	**10.9**
Current account balance	**-3.3**	**-1.4**	**-1.3**	**-1.1**	**-1.0**

Source: September 2012 Update of Economic and Financial Document.

The deterioration in Italy's public deficits during the crisis has been modest



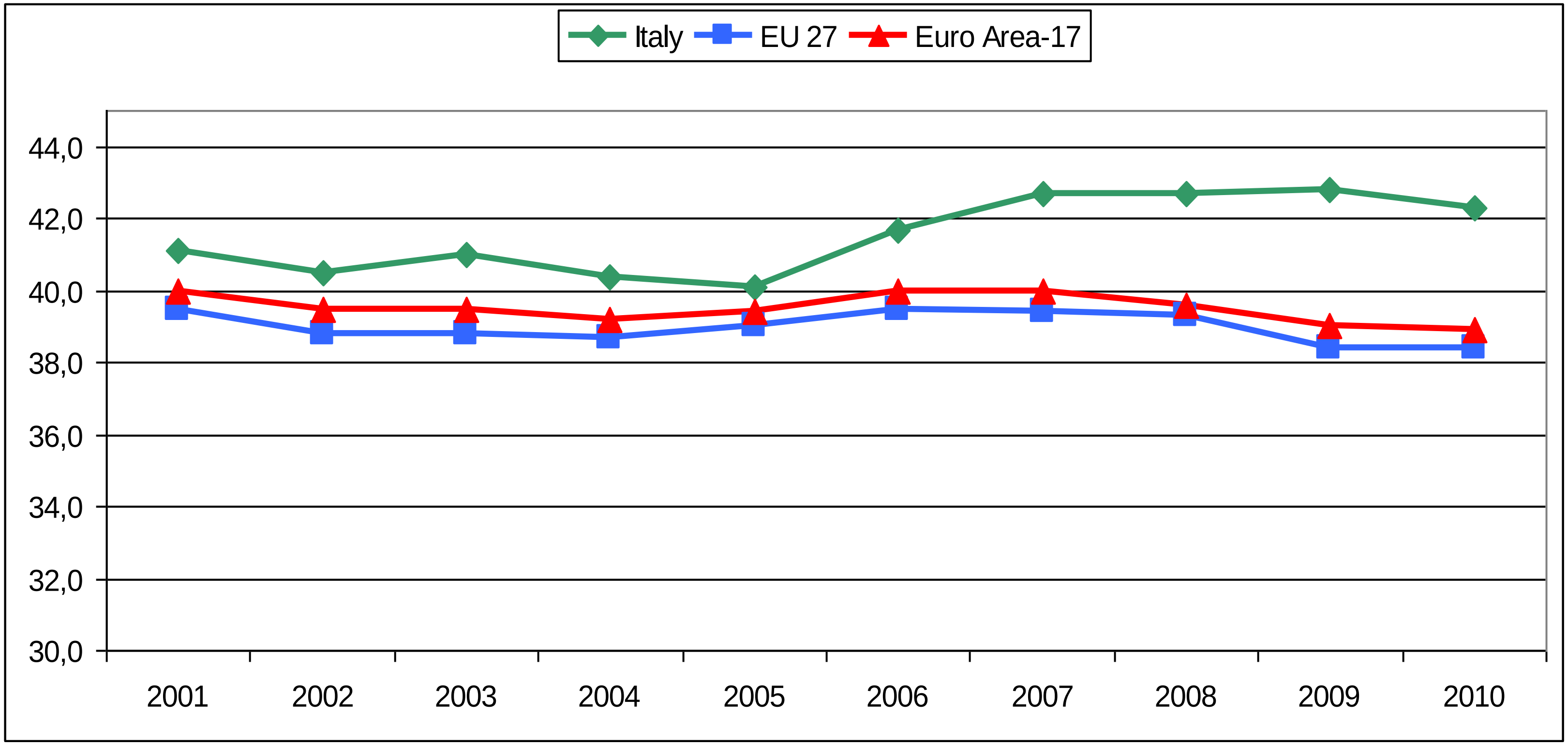
Debt to GDP increased mainly due to the denominator…



Source: Eurostat

Revenue trends and tax composition in Italy and in the EU

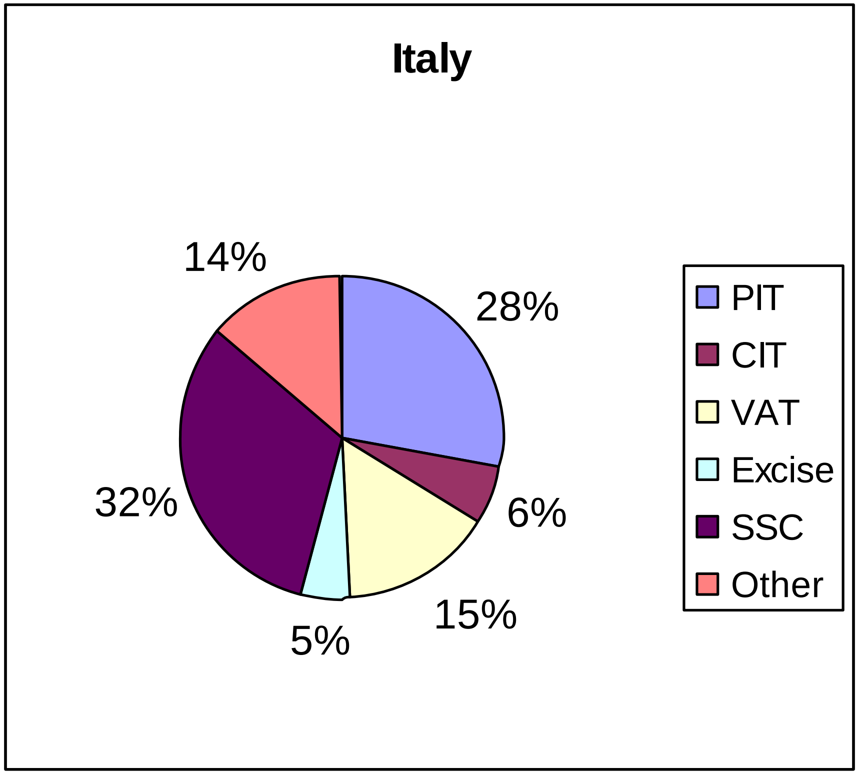
Tax to GDP ratio differs in Italy and in EU area

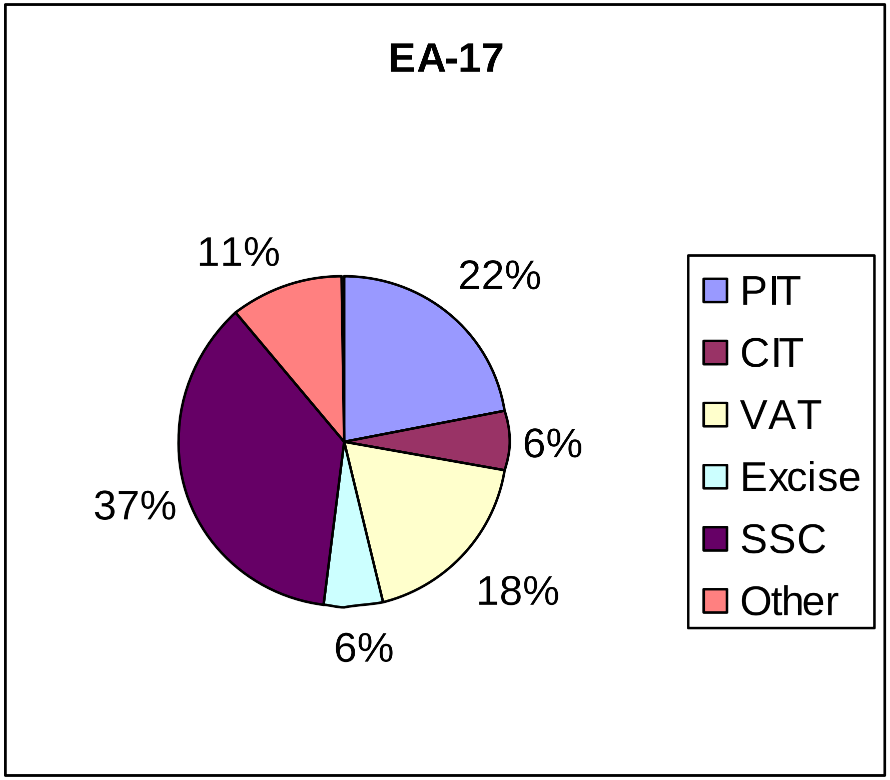


Source: European Commission, Taxation Trends in the EU, edition 2012

In 2010 tax to GDP ratio in Italy is 42.3% (EU27: 38.4%; EA17: 38.9%) and remained relatively stable over the recession period 2008-2009

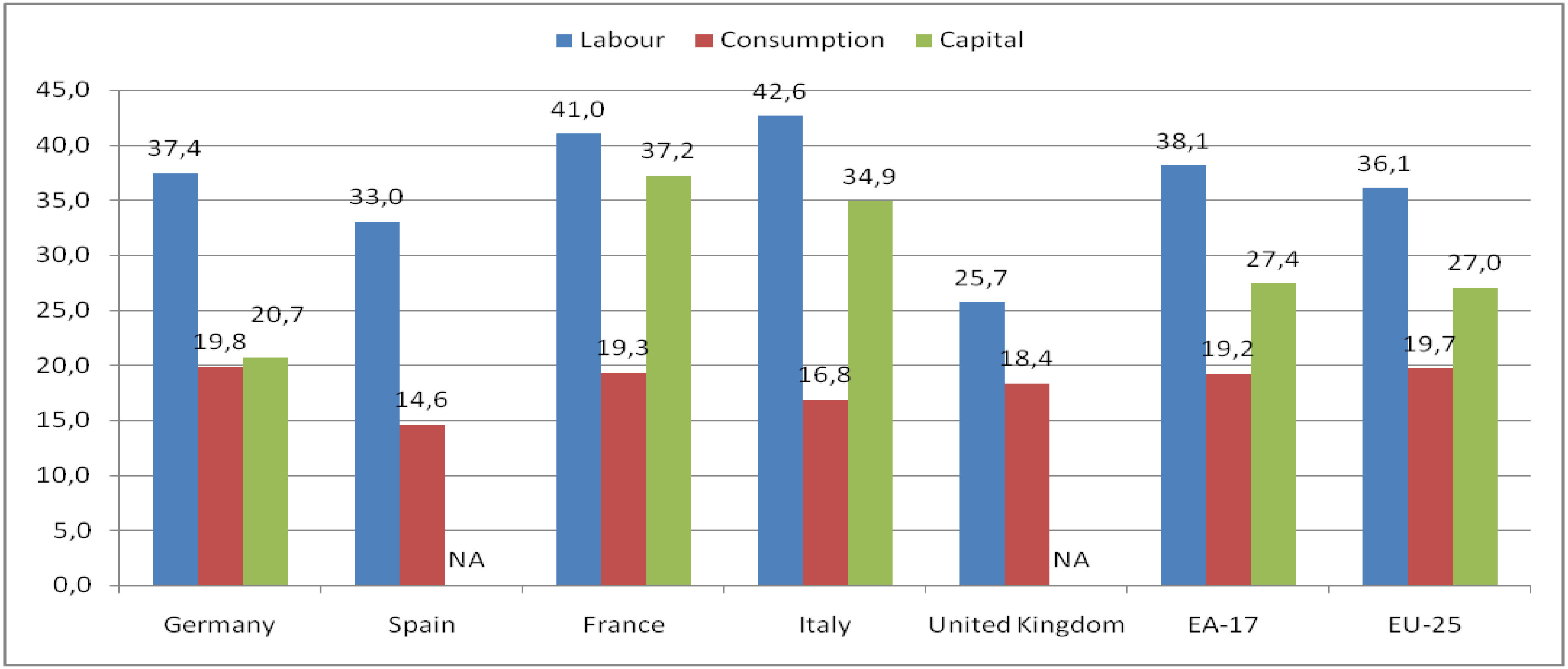
…the tax mix differs from the Euro Area average…





Source: European Commission, Taxation Trends in the EU, Edition 2012 (year 2010)

In Italy implicit tax rate on consumption is significantly lower than on labour and capital in 2010…

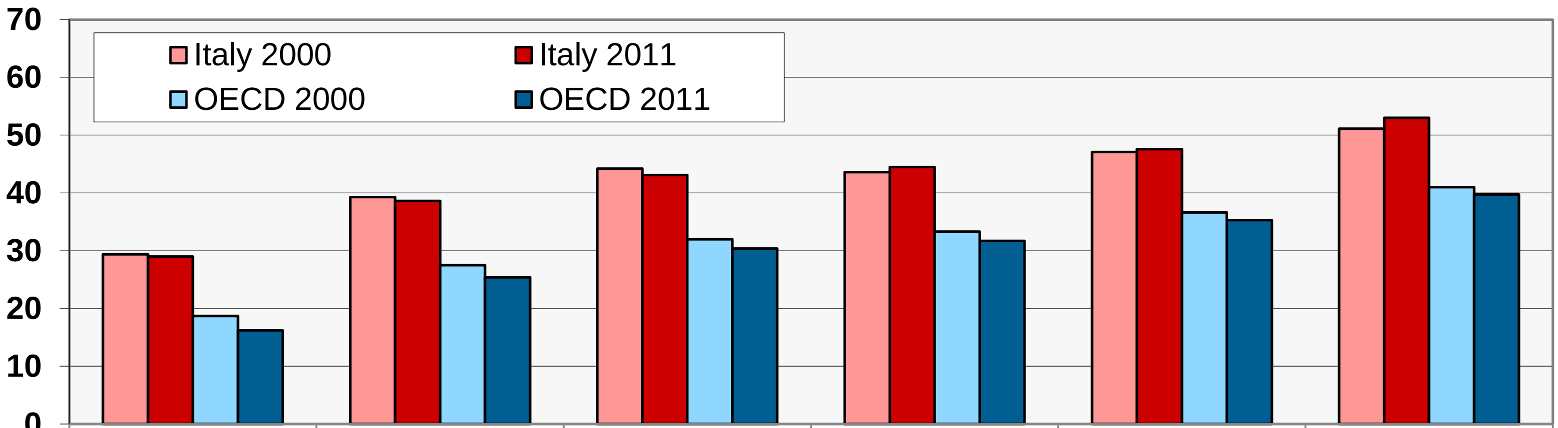


Source: European Commission, Taxation Trends 2012 edition

In 2010, Italy had the highest level of implicit tax rate for labour (42.6%) in the EU and the second for capital (34.9%).
The ITR on consumption (16.8%) is well below the EA17 and EU25 average (respectively 19.2% and 19,7%): potential for shifting the burden from direct taxation to indirect taxation.

Tax wedge on labour in Italy slightly decreased only for lone parents and married couples between 2000-2011...

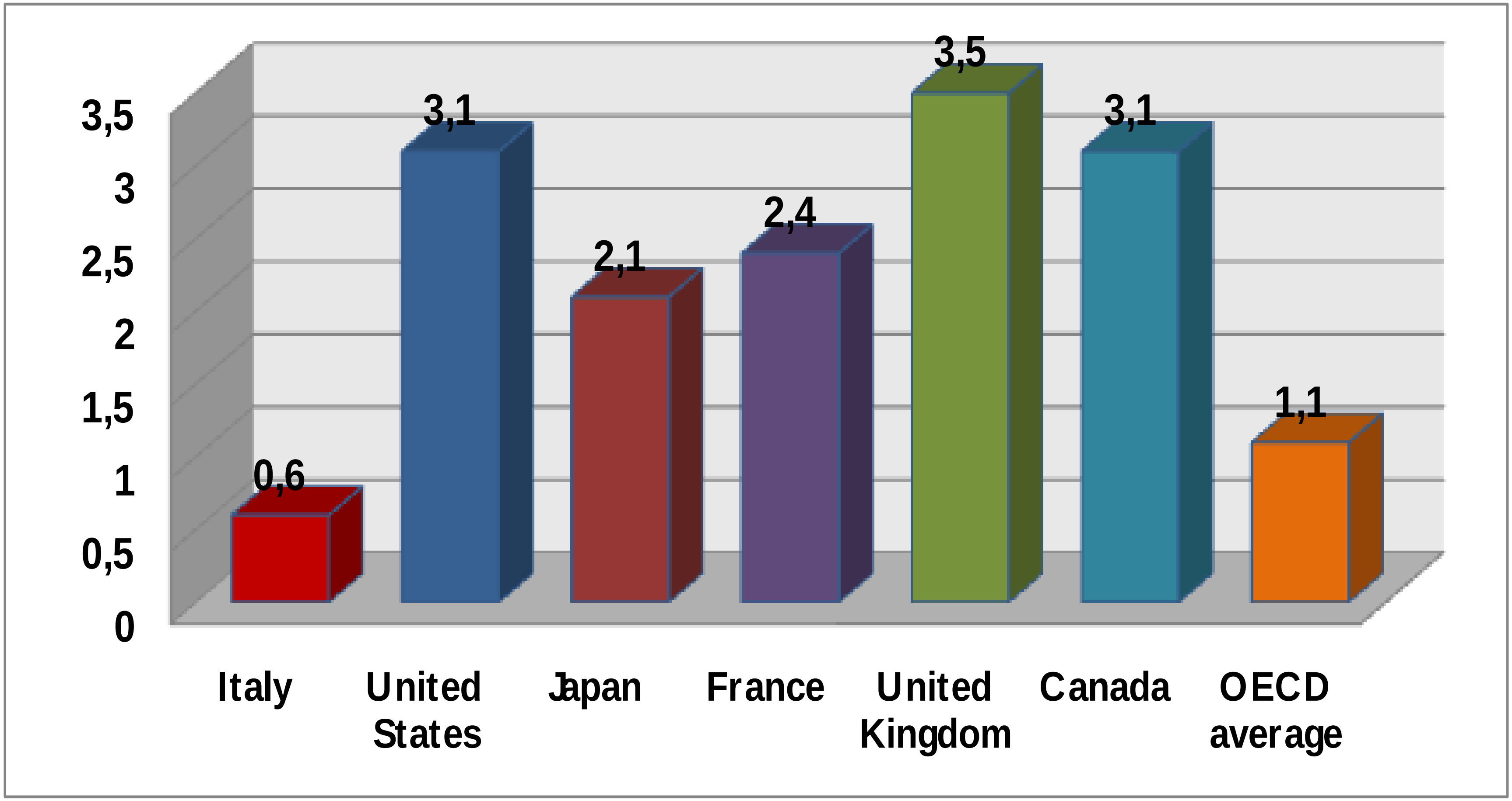
Average Tax Wedge by wage levels and household types (% of total labour costs)



	Lone parent 2 children 67% of average wage	One-earner couple 2 children average wage	Two-earner couple 2 children 100% + 67% average wage	Single 67% of average wage	Single average wage	Single 167% of average wage
Italy 2000	29,4	39,3	44,2	43,6	47,1	51,1
Italy 2011	29,0	38,6	43,1	44,5	47,6	53,0
OECD 2000	18,7	27,5	32,0	33,3	36,6	41,0
OECD 2011	16,2	25,4	30,4	31,7	35,3	39,7

Source: OECD, Taxing Wages, 2011 edition

…property tax to GDP in Italy was much lower than in OECD countries



Source: OECD, Revenue statistics, 2011. Property tax excludes tax on trasfers of property and other non-recurrent taxes

Rethinking the tax mix in Italy: key issues

- PIT and Social Security Contribution revenues account for 60% of the total revenues (59% in EU17 average). PIT reforms (2003, 2005, 2007) slightly alleviated tax pressure on low-wage earners
- Revenue from SSC is below the EU average, reflecting an high degree of labor market informality and weak enforcement
- The share of taxes on goods and services in total tax revenue is lower in Italy than in the rest of the EU (15% versus 18%)
- The revenue productivity of the VAT (i.e. actual VAT revenue as a percentage of theoretical revenue at the standard rate) remains relatively low (around 40%, compared to the 50% of the EU average in 2007-2009). This is due to a range of exemptions and coverage of reduced rates broader than average, as well as to weaknesses in the tax administration.
- The share of excise taxes is slightly lower (about 5%) than the EU Area average (6%).
- Before IMU the share of recurrent property taxes to GDP was only 0.6 per cent (OECD average: 1.1%; France: 2.4%; UK: 3.5%), mainly reflecting the exemption of owner-occupied dwellings and the outdated cadastral system.

2011: One year of Reforms
From the summer decrees to the “Salva Italia”

One year of reforms…the summer 2011 decrees

- In 2011 Italy's economy was weakened by the slowdown of the global economic cycle and by growing tensions in the sovereign debt market for the Euro area
- Fiscal consolidation, growth and equity are the three pillars on which the Government's strategy is based
- These objectives coincide fully with those behind the renewed governance of Europe
- In 2011, the action of rebalancing of the public accounts was pursued with determination, with a view of achieving a balanced budget
- Two Decrees enacted a major fiscal consolidation plan in the course of the summer 2011:
  1. D.L. 98/2011 (July)
  2. D.L. 138/2011 (August)

One year of reforms: from the summer 2011 decrees…

D.L. 98/2011 (July 2011)

- Impact on net deficit in 2011: 0,13% of GDP
  - Increase in net revenues 0,12 % of GDP
  - Decrease in net expenditures 0,01 % of GDP

D.L. 138/2011 (August 2011)

- Impact on net deficit in 2011: 0,05 % of GDP
  - Increase in net revenues 0,05 % of GDP
  - Decrease in net expenditures

Source: "Documento Economia e Finanza 2012 – Section I

Revenue-increasing measures initially make the greater contribution to the net correction, though gradually diminishing over the years, when measures to contain the trend of expenditure are fully on stream

…to the "Salva Italia" decree
Fiscal consolidation and…

- On December 22, 2011, the Parliament approved a supplementary budget for 2012-2014, the so called "Salva Italia" decree.
- The additional adjustment measures were needed to meet the target to balancing Italy's budget by 2013
- Fiscal consolidation measures involved both:
    1. increased tax revenue
    2. expenditure cuts
- D.L. 201/2011 (December 2011)

	2012	2013	2014
Impact on net deficit (% of GDP)	1.27	1.37	1.41
Increase in net revenues	1.38	1.86	1.91
Decrease in net expenditures	0.14	0.48	0.68
Decrease in tax expenditures	-0.25	- 0.97	-1.18

…growth-enhancing reforms strengthen each other…

- On the tax side, measures included in the "Salva Italia" decree reflected a strategy for promoting growth, competitiveness and the capitalisation of companies.
- Tax revenue generated mainly from taxes on property and consumption (less detrimental to growth) and partly used to reduce the burden of taxation on labour and capital.

- Measures aimed at reducing the tax burden on labour and capital include:
  1. ACE (Aid to Economic Growth)
  2. Increase of the lump-sum deduction for the Regional Tax on Productive Activity (IRAP) for employees under 35 and women employed under permanent contracts
  3. Deducibility from direct taxes of the IRAP for the part levied on labour costs

…being aimed at the equitable sharing of the burden of taxation…

'SALVA ITALIA' DECREE : TAXING WEALTH ON A REAL BASIS

- Taxing wealth raises revenue in a manner consistent with **efficiency** and **equity** objectives.

- The 'Salva Italia' decree introduced a set of measures in order to tax wealth on a real basis:
  1. taxation of real properties situated in Italy by removing the anomaly of the exemption of the owner occupied dwelling with a revaluation of the taxable base (IMU)
  2. taxation of financial assets
  3. taxation of specific luxury assets: (vehicles, vessels and private aircraft)

… being aimed at the equitable sharing of the burden of taxation

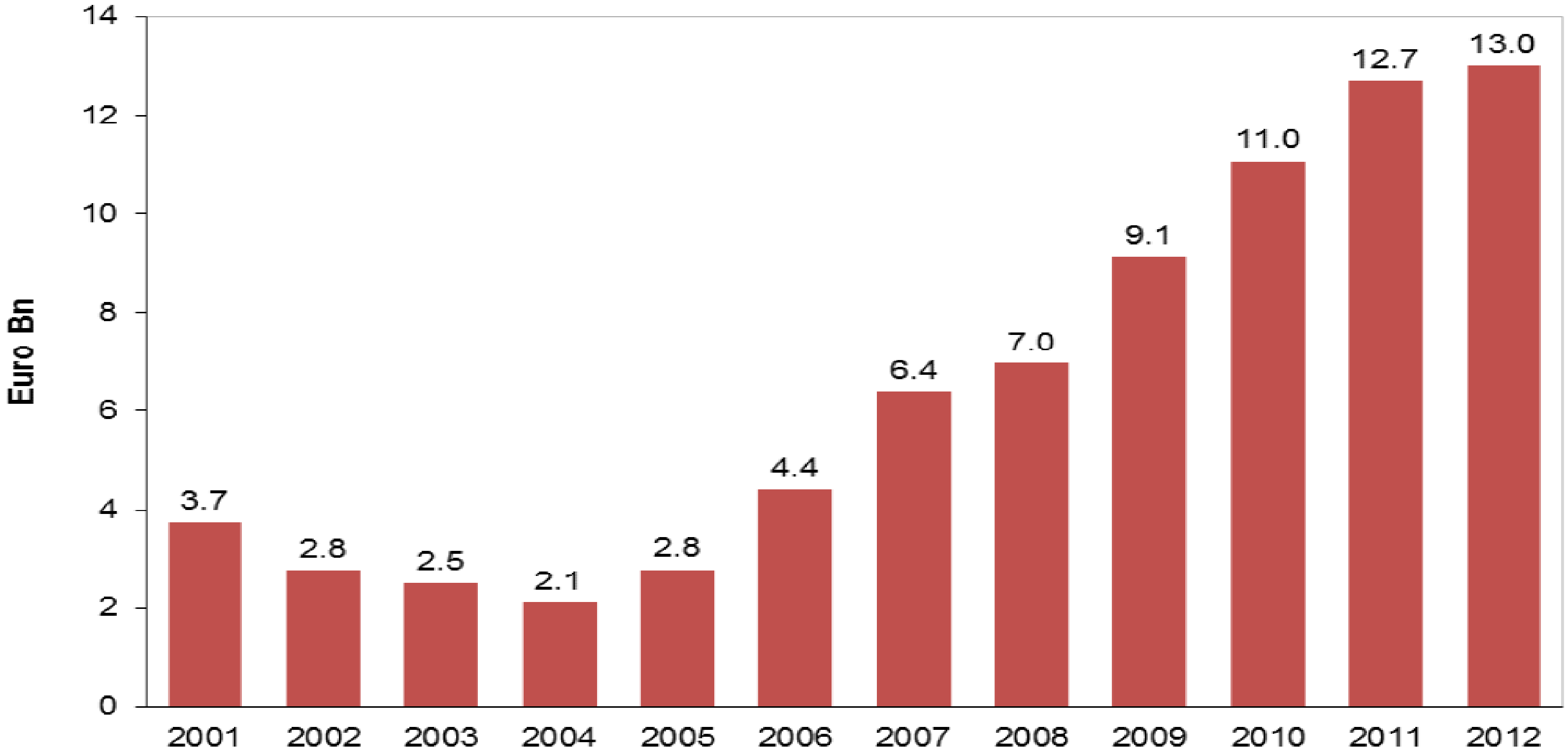
'SALVA ITALIA' DECREE : FOSTERING TAX COMPLIANCE AND IMPROVING TAX COLLECTION

1. Supplying the Inland Revenue with all information on financial transactions
2. Rewarding scheme for transparent taxpayers
3. Limiting and combating the use of cash
4. Lying to the Inland Revenue during a control becomes a crime

Fiscal package 2012-2014 - Main tax measures and budgetary impact (as a % of GDP)

	2012	2013	2014
Increase of taxes on consumption			
Excises duties (DL 201/2011)	0,38	0,36	0,35
Excises duties and lottery (DL. 98 e 138/2011)	0,26	0,25	0,25
VAT 20% to 21% tax rate increase (DL 138/2011)	0,27	0,27	0,26
VAT 10% rate (increase to 11% as of 01/07/2013)	0,00	0,07	0,14
VAT 21% rate (increase to 22% as of 01/07/2013)	0,00	0,13	0,26
Total	***0,91***	***1,08***	***1,26***
Increase of taxes on wealth			
Tax on real estate with a revaluation of tax base (DL 201/2011)	0,68	0,69	0,70
Taxation of specific luxury assets (DL 201/2011)	0,02	0,02	0,02
Stamp duty on financial assets (DL 138/2011 and DL 201/2011)	0,17	0,17	0,16
Tax on real and financial assets held abroad and on shielded capitals (DL 201/2011)	0,10	0,13	0,04
Total	***0,98***	***1,02***	***0,92***
Reduction on IRAP tax wedge and on corporate tax			
ACE	-0,06	-0,09	-0,18
Deducibility of the Regional Tax on Productive Activity (IRAP)	-0,10	-0,23	-0,19
from direct taxes for the part that is levied on labour costs	-0,09	-0,12	-0,13
for employees under 35 and women	-0,01	-0,11	-0,06
Total	***-0,16***	***-0,32***	***-0,37***

A growing profile for recovery of evaded taxes…



Source: Ministry of Economy and Finance - Revenue Agency.

The 2011 tax measures: …a notable fiscal effort mainly relying on the revenue side …

- Italy made further progress towards fiscal consolidation with the fiscal packages 2012-2014

- The quality of the measures included in the tax package is growth-friendly and broadly in line with the policy recommendations formulated in the Annual Growth Survey:
  - Tax wedge on labor has been reduced (almost by 0.8 pp)
  - ACE on new equity capital has been established
    - Both ACE and full deductibility of IRAP put Italy at the top of EMTR ranking in OECD countries (EMTR= -10%) in 2012, Devereux et al, 2012)
  - Taxes on wealth and consumption have been increased
  - Measures to increase compliance have been introduced
  - Horizontal and vertical equity has been increased

The ‘delega fiscale’ and the strategic orientation of tax reform

The ‘delega fiscale’ and the strategic orientation of tax reform

The Delega Fiscale sets out a framework that to guide subsequent structural tax reform, rather than delivering reform in itself or altering the overall level of taxation. To this extent it:

- provides significant improvements in several areas of tax design and administration

- builds on strengths of the current system that have been reinforced by recent measures, including:
  1. Revision of the property tax
  2. Introduction of the ACE

Three sets of measures relate to core elements of tax design…

- Bringing cadastral values closer to market values
- Establishing greater certainty and transparency for taxpayers and tax authorities
- Unifying the treatment of retained earnings across different types of business by addressing distortions of business decisions on organizational form and investment levels

Bringing cadastral closer to market values

- Cadastral values more than 20 years out of date.
- Realignment of cadastral prices with market prices is essential for greater fairness in property taxation, and for a more effective use as a central element of the local public finances.

- Realignment will:
  1. Improve fairness
  2. Increase effectiveness of this (relatively growth-friendly) tax as a source of local finance
  3. Provide revenue that might be used in part to reduce distorting transaction taxes

Improving Taxpayer Relations

- The central goal of protecting taxpayers' rights while safeguarding revenue from abuse will be substantially furthered by:
  1. A General Anti-Abuse Rule to promote certainty clarifying when tax schemes will be regarded as abusive;
  2. 'An enhanced relationship' to encourage companies to better manage risky tax positions
  3. Reduced use of criminal proceedings to strengthen taxpayers' confidence
  4. Ensuring criminal procedures do not apply when fraud is not an issue..

Unifying Treatment Over Forms of Business

- The IRI would offer unincorporated businesses the same treatment for retained earnings as corporations, to reduce distortions from the differential treatment of retained earnings in different forms of business.

- The IRI aims to eliminate the non-neutrality between:

1. **incorporated and unincorporated businesses (choice of organizational form)**
2. **investment and financing decisions**

Other provisions also offer significant gain…

- Further developing ‘tax gap’ analysis
  1. Key for designing interventions, using an eclectic range of methods needed
  2. Can be integrated with ‘policy gap’ analysis

- Regular reporting of tax expenditures
  1. Building on very extensive work already done
  2. A first step in aim (set out in DF) of eliminating/reducing those serving no purpose warranted by their cost
- VAT grouping
  1. Eases a real distortion
  2. Revenue cost to be assessed, along (in medium term) with broader VAT treatment financial sector

- Review of transactions taxes
  1. These are high in Italy, and can be very distorting

The IMF assessment…

…The delega fiscale provides a framework for significant improvement in both the design and the implementation of the Italian tax system

…The measures envisaged are potentially conducive to the growth objective stressed in the title of the delega fiscale…

(Report on the Delega Fiscale and the strategic orientation of tax reform- IMF Fiscal Affairs Department, September 2012)

http://www.tesoro.it/primo-piano/