Tax systems and tax reforms in Europe: Italy

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TAX SYSTEMS AND TAX REFORMS IN EUROPE: ITALY

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Abstract
This paper aims at discussing the main features of Italy's tax system, its recent reforms and those underway. It is part of a wider research on European taxation, carried on at this Department, under the direction of L. Bernardi and P. Profeta, and the supervision of V. Tanzi. The present Italian tax system (second section) was built by a general reform of the first '70s, suitable for an industrialised country. The overall pressure and the basic structure became with the time closer and closer to European average. This progress however was for a long time carried on without any rationality and leaving many defects in the structure and features of the main taxes (section three). Then the distribution of fiscal burden (section four) is heavily concentrated on labour, is higher than European average on corporations and this discourages a recovery from a long stagnation of Italian economy, that now is deteriorating to a true decline. Contrary to almost all European countries, long time due reforms begun only at the end of the '90s. First the "Visco"'s reform of 1997 and after the quite different "Tremonti"'s reform which is now underway. The opinion of the Author is that both these reforms may have their pros and cons but both fail the aim to strongly enhancing growth. This requires far more radical interventions, very larger than the marginal reforms adopted or underway in other European countries and suggested by International Organisation. Such a reform other ways may prove to be not at all easy, particularly on political ground.

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1. Introduction, contents and main conclusions*

Out of all European member states the economic history of Italy over the last few decades has certainly been the most affected by the complex ups and downs of the fiscal system. This does not go unnoticed by eminent national (Pedone, vv. yy.) and international observers (Tanzi, 1996). In 1971 the tax system was completely reformed to make it suitable to the new economic environment of developed industrial country. Initial stages of the reform were not at all easy. The lack of expected revenues gave rise to ensuing long saga of Italian budget deficit and debt. But during the '90s 4 points of increase in fiscal pressure were crucial to fulfil Maastricht requirements.

Tax avoidance and exemptions in Italy are near a record among developed countries: this reflects the widespread structure of the economy and also the persistent high level of inefficiency (and corruption) of tax Administration. Thus the need to raise revenues to pay for a growing public expenditure has been covered for a long time by the very inefficient rule of "reducing the basis and increasing the rates (or the number of taxes)". Only at the end of the '90s did the long due reforms begin to take place, on the initiative of two Ministers of Finance, Mr. Visco and Mr. Tremonti, as much eminent as known for being at loggerheads.

After this introduction, section two reconstructs the development of the system from the time of the fundamental reform of the early '70s up to the late '90s. Overall fiscal pressure has increased by almost 15 points and the extra space has been assumed by the great personal and general consumption taxes. Compared with European average, the Italian tax system manifests a strict closeness. It shows then a departure from the most consolidate models (Nordic, Rhine, Anglo-Saxon and Mediterranean). It looks like a mix of Rhine and Mediterranean models further characterised by many signals of a diffused presence of taxes with restricted basis and high rates.

The main taxes are about the same in Italy as in other European countries. In the third section we review their most specific features. The tax basis of income tax is mostly restricted to labour income and formal progressivity is high. The tax unit is the individual, the allowances for dependent parents and single earner households are low. Corporation tax is slow in catching up with the international progress of reducing and converging "all-in" rates. The field of capital income taxes has been played only recently and generally taxation

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is carried out by final withholdings (or similar sources taxation). VAT has a low productivity, while excise duties on energy products are particularly high. The main local taxes are a business tax for the Regions and a property tax for the Municipalities, both introduced during the ‘90s, as part of the process of decentralisation, but the revenues cover only a part of local expenditures.

The analysis of the distribution of fiscal burden (section 4) emphasises the high share suffered by labour, a charge on consumption lower than European average, the weak participation of other factors to total taxation, and the absence of environmental taxes. From the beginnings of the ‘70s to the late ‘90s the overall fiscal pressure has increased almost only as an effect of the progressive growth of burden on labour (increasing by nearly thirty points over this the period). The tax wedge on labour became one of the highest, in the EU and OECD. The high statutory rates of corporate taxation have also raised the wedge on corporate capital, although alleviated by a widespread avoidance and elusion, and by generous tax relieves.

The reform of the ‘70s created a highly centralised revenue system, increasingly criticised from the ‘80s. Now the Regions are almost self-sufficient, but the level of their effective fiscal autonomy is not high. This is also true for the Municipalities A dramatic devolution of State’s functions to the Regions is now planned but it’s difficult to imagine other sources of financing than not autonomous apportionment of great national taxes.

In the final section we describe the more recent reforms and the current debate. The long stagnation of Italian economy growth from the beginnings of ‘90s and the risk of a decline of country’s economy required to give the priority to interventions enhancing growth, by detaxing production factors and creating some impulses from the side of demand. This has been done or is planned only very partially. Obviously equity should not have losses, remembering the Pigouvian relationship between welfare and the “national dividend”.

In 1997 the “Visco” reform started with reference to the Nordic Dual Income Tax system. The “all-in” statutory rate of corporation was reduced by more than ten points even if it still remains well above the European average. An allowance for “ordinary” income from internal sources was introduced, in order to make the choice of financing more neutral and progressively reduce the effective average rate. The attainment of greater neutrality was strengthened by the new wide basis Regional tax on business which substituted previous taxes on firms with a more restricted basis. In the whole the wedge on capital has been reduced but not at all that on labour. The redistribution of the burden may have penalised the small firms, very important for the Italian economy. Changes were also brought in the domain of capital incomes from different sources up to some years ago confusedly taxed (particularly rents) or not taxed at all (capital gains). The different sources were well defined and unified in an homogenous taxation at two final withholding rates. The reform had to be continued, by extending the Dual Income Tax approach and progressively reducing the burden and perhaps also the progressivity of income tax. Many innovations of "Visco" reform were undoubtedly welcome, particularly as to the reduction of corporation tax "all-in" rate and the new regimes of taxation of capital income. Other interventions on firms taxation and Regional financing were more controversial.

Mr. Tremonti, the Minister of Finance of the new Government entered on charge in spring 2001, proposed his own bill of reform for the fiscal system in December, which is at present (July, 2002) at the approval of the Parliament. Many changes introduced by Mr. Visco have already been or should be repealed. The structure of the reform is not very far from those adopted recently by many European countries, but its figures are quite more radical. Income tax should change drastically in its structure, with the result of attributing significant advantages to the low-middle and the highest incomes. The loss of revenue (and the demand impulse) is estimated at about 20 Billion of Euro, above 1.5 per cent of GDP. The taxation of capital incomes should be further simplified and with few exceptions realised with a final withholdings at the low rate of 12.5 per cent. Finally corporate taxation should be thoroughly amended in many respects. Mr. Visco's allowance for internal capital has been frozen, while the Regional business tax should be progressively repealed. Statutory "all in rate" should decrease, but to a level which is still not competitive in the European context. The recent German reform should be imitated to change to participation and dividends exemption and abolish of imputation system. A wide opportunity should be given to opt for a consolidate balance, even with foreign controlled companies. In the whole the proposal has been well accepted for some relevant aspects but it has also raised considerable debate: the most controversial points are the tax cut for the rich, the low level of capital income rate and the conversely high rate for corporations.

The attempts to improve Italian tax system set up by Mr. Visco and Mr. Tremonti may be evaluated in various ways, also according to one's political preferences. But one has to ask himself if reforms of this kind (like those recently adopted in other European countries) are enough to contribute significantly to the priority target of enhancing growth. Given the recent conclusions drawn by a diversified but converging literature (supply and demand of labour; endogenous growth models; more standard demand side econometric estimations;

statistical inferences; empirical evidence) a larger and far more radical intervention seems needed. It should be able to cope with the present main tax constraints on economic development, i.e. the wedges on labour and corporate capital. The following lack of revenue might in principle be covered by expenditure costs cuts not “rolling back” the welfare state, a reasonable departure from balanced budget European target, and increasing taxes on environment externalities, on immovable properties, on consumption and without throwing down those on capital rents and gains. This is only a first sketch, which requires to be far more elaborated as to its economic effect and is not easy at all, particularly on political grounds, but at least it seems more relevant to be discussed than other minor issues which have been endless debated during recent years. In fact it is broadly in line with recent OECD suggestions concerning tax reforms in European Union countries, but it is far more radical than what is implicit in these suggestions and further from the marginal kind of the reforms in this direction which have been already adopted or are under way in almost all European countries.

2. The structure of the system and its development from the ‘70s

2.1 The current structure of taxation and social security contributions

In Italy in 2001 the General Government net borrowing was 1.7 per cent of GNP and it is planned to reach a not easy 1.1 per cent in 2002. A large primary surplus is still needed (5-6 per cent of GDP) to compensate the burden of interests, due to the great amount of public debt (currently 109 per cent of GDP). Primary expenditure is made up by the high values of collective consumption (43.9 per cent) and monetary transfers (41.4 per cent, almost all pensions) while capital (7.6 per cent) and other minor expenditures have a low level. Remember that in Italy the welfare system (education, health, pensions and other social transfers) are almost all in the hands of public sector.

In Italy the total 1999 (the last data comparable with Europe) Government revenues may be divided into three headings (Banca d’Italia, 2002; Ministero dell’economia, 2002): taxes (30.1 per cent of GNP), social contributions (12.8 per cent), other non-fiscal revenues (3.3 per cent). The basic structure of the taxation system remains that which was introduced with the overall tax reform of 1971-74. The previously existing system was completely inappropriate to the new status of industrialised country which Italy gained after the sustained development of the ‘50s and the ‘60s. It was still schedular, indirect taxes were prevailing, the relationships among different levels of government were confused, the Administration was inefficient and largely corrupted. The goals of the reform (Cosciani, 1964), in accordance with prevailing ideas at that time, (Keynesian economics and redistributive aptitudes) were:

i) To give more room to direct taxation, by introducing a Comprehensive Income Tax, with a large basis and a highly progressive and personalised nature (=Imposta sul Reddito delle Persone Fisiche-IRPEF), a personal tax on corporation profits and non business bodies (Imposta sul Reddito delle Persone Giuridiche-IRPEG);

ii) Rationalising indirect taxes, by replacing the existing turnover tax with a Valued Added Tax (=Imposta sul Valore Aggiunto-IVA), in accordance to EEC rules, and further eliminating customs and toll duties plus a large number of small taxes on goods and services and on operating a business;

iii) To centralise tax revenues at the level of Central Government, in order to reduce administrative costs and to have at hand more powerful tools for fiscal and redistributive policies.

The impact of the 1971-74 reform (see below point 2.2 for subsequent developments) can still be seen by looking at the present status of the system, as it is depicted in Tab. 1. Up until 1999 the total fiscal pressure is near 43 per cent. The total burden is made up of something less than two thirds by taxes and for the remaining part by social contributions. The effects of the ‘70s reform are clearly demonstrated by the fact that now direct and indirect taxes come to about the same amount. Despite the fact that in Italy a large number of taxes survive, a great amount of revenue is yielded from a relatively small number of headings, a feature that Italy shares with almost all European countries: personal income tax, corporate tax, value added tax, main excise duties sum up to 23.2 points of GDP, near 80 per cent of all taxes. Furthermore direct taxes are dominated by income tax (66.6 per cent) and indirect taxes by VAT (55.2 per cent).

Italy’s social contributions have always been near the European average, but with a larger share for the component due by employers. The pensions system pushes up contributions, it is almost entirely public, Payg, with high substitution rates and dependence ratios (due to low age of pensioning). Note that from 1998 contributions don’t include payments for health care, although in Italy the National Health Service supplies a dominant share of medical treatments. The Service is financed mainly from a regional tax on business activities (par. 3.6) and from regional sharing of the revenues of VAT (par. 4.3).

The share of Central Government on total tax revenues (i.e. excluding social contributions) is largely higher than the share of Local authorities (Regions, Counties-Provinces, Municipalities). We will see in the next section that something has changed on this point during the last years. For the moment we should note that the figures reported in Tab.1 underestimate the fiscal revenues of Local government, due to their various sharing to national taxes (income tax, VAT, taxation of energy).

2.2 Developments of the system from 1970 to 2000

The start up of the ‘70s reform was not at all easy. The number of tax-returns increased dramatically, from 3.5 up to 30 million for PIT and up 5 million for VAT (the last is about the sum of returns of both Germany and France, due to the wide dispersion of Italian productive structure in many small units). The new taxes were too sophisticated for the average culture of tax-payers and Administration officers, also because a heavy system of accounting was imposed also upon small business to fight avoidance. Thus we can see in Tab. 1 that in the early ‘70s the level of total taxes was very low in Italy, just at the moment when welfare expenditures were growing at a strong rate. The resulting tax gap unbalanced the budget: the subsequent long story of high Italian public deficit and debt here begun.

The change arrived at the middle-to-late ‘70s. A general withholding at the source was introduced for all dependent workers and the self-employed were required to self assess their income and pay tax yearly. For lower incomes presumptive coefficients of assessment were introduced together with quick checks, while accounting requirements were reduced. Fiscal drag pushed up the revenue of income tax: from 1974 to the middle of the ’80sthe inflation rate was around 15 per cent. At the beginnings of the ‘80s the working of main taxes was finally at work, but the recovery of revenues up to European average arrived only a decade after. The way in which this result was obtained were however not at all the best. Tax policy was not made by enlarging the basis of the main taxes and strengthening assessment from the Administration, in both cases acting to reduce avoidance and exemptions. Instead new taxes were introduced and the rates of those already existing were raised: the fiscal drag was

TAB. 1 *Structure and development of fiscal revenues in Italy and European average as % of GDP, 1970-2000*

	1970		*1975*		*1980*		*1985*		*1990*		*1995*		*1999*	
	Italy	*Europe*	*Italy*	*Europe*	*Italy*	*Europe*	*Italy*	*Europe*	*Italy*	*Europe*	*Italy*	*Europe*	*Italy*	*Europe*
Direct Taxes, of which	*5.3*	*8.9*	*6.1*	*11.9*	*9.8*	*12.7*	*13.2*	*13.1*	*14.6*	*13.2*	*15.6*	*13.3*	*15.0*	*14.5*
Personal income	0.1	5.5	3.0	8.9	6.1	9.3	8.2	9,0	8.6	8.9	9.3	9.6	10.2	9.9
Corporation income	3.0	2.2	2.1	1.9	2.4	2.2	3.1	2.8	3.7	2.9	3.6	2.4	2.6	2.8
Indirect taxes, of which	*10.5*	*13.0*	*8.2*	*12.2*	*9.3*	*13.2*	*9.6*	*13*	*11.4*	*13*	*12.5*	*15.1*	*15.1*	*14.6*
VAT	0.0	5.1	3.6	5.7	4.8	6.6	5.2	6.1	5.8	6.6	5.7	6.9	5.6	7.3
Excise duties	4.9	3.5	3.7	3.5	2.9	3.2	2.8	3.2	4.0	3.1	3.9	3.4	3.1	3.5
TOTAL TAX REVENUES	15.8	21.9	14.3	24.1	19.1	25.9	22.8	26.1	26,0	26.2	28.1	26.9	30.1	29.1
Social contributions	*10.0*	*11.7*	*11.7*	*12.8*	*11.5*	*13.4*	*12*	*13.8*	*12.9*	*13.7*	*13.1*	*15.0*	*12.8*	*14.0*
Employers	7.9	7.2	9.7	7.7	8.6	7.8	9.2	7.9	9.2	7.8	8.6	8.0	9.0	7.8
Employees	1.7	3.5	1.6	3.8	2.1	4.3	2.3	4.5	2.5	4.5	2.8	5.1	2.4	4.5
Self Employed	0.4	1.0	0.4	1.3	0.8	1.3	2.2	1.5	1.2	1.4	1.7	1.8	1.4	1.7
TOTAL FISCAL REVENUES	25.8	33.6	26.0	36.9	30.6	39.3	34.8	39.9	38.9	39.9	41.2	41.9	42.9	43.1
Administrative level														
Central Government	13.7	19.7	13.4	21.1	17.9	22.3	21.2	22.1	23.7	22.2	24.6	22.5	23.9	22.9
Local Government	2.2	2.2	0.8	2.8	0.8	2.9	3.2	3.1	1.8	3.8	2.9	4.0	6.2	4.0

Sources: 1970-1995, Eurostat, 2000; 1999, Ministero dell'economia (2002) for Italy and Eurostat New Cronos Databank 2002(data equalised with Eurostat, 2000).
Notes: Minor items are omitted.

only partially compensated[1]. The worst part of this irrational tax policy, motivated mainly on political grounds, was a long series of temporary surcharges, of amnesties and anticipations of payments (see Gerelli,1986; Pedone, 1989; Galeotti and Marrelli, 1992.). During the ‘90s (Bernardi, 2000) tax policy was instead an important factor in fulfilment of Monetary Union requirements: the incidence of total taxes increased by about 4 points from 1990 to 1997.

The distribution of taxes among different levels of Government shows that the share of Local authorities which had decreased after the ‘70s reform, recovered slightly in the ‘80s, to realize a sharp increase at the end of the ‘90s, due to the introduction of the mentioned regional tax on business (par. 3.6) and of the Municipalities’ tax on immovable property (par. 3.7).

2.3 A comparative view with the European average

When comparing fiscal systems of different countries one must be very careful, also if these countries are alike in economic and basic fiscal structure and have similar institutions. The need to proceed with caution, particularly with reference to European countries originates basically from the fact that inside Europe historically four models of tax system emerged (Bernardi, 2000). First, the system of Nordic countries that is now changing toward the so called “Dual Income Taxation-DIT” system, then the British model, which at present is extending also to the Netherlands, the Rhine model at the very centre of Europe and finally the Mediterranean model.

As a consequence, levels and composition of taxes may vary considerably among European countries. The average overall pressure is estimated at 43.1 per cent in 1999, but this value is the mean of a range which spans from the 34.3 per cent of Portugal to the 52.2 per cent of Sweden. Indirect taxes are by far the most uniform, due to the harmonisation which has been induced over the last years by the European Commission. The average rate of indirect taxes is around 15 per cent, but starting with 9.9 per cent in Spain and rising to 29.6 per cent in Denmark. As for social contributions, the average of 11.4 per recent is made up, amongst others, of Ireland’s 2.7 percent and 16.6 percent for France. These differences come basically by the relative shares of public and private supplies of health, education and pensions. Institutional arrangements may be also relevant as the taxation or non-taxation of pensions, or of other social benefits, or including the reimbursement, or not, of VAT in the yield and so on.

With all these factors in mind, the case of Italy looks quite particular. For almost all the items, aggregate or specific, Italy is always very near to the European average and consequently not close to none of the typical European model of taxation. One might asks himself if this closeness to

[1] The rate of CT increased from 25 per cent to 36 per cent, the standard rate of VAT from 12 to 20 per cent. The exemption of interests on public bonds was eliminated in 1986 and the rates on capital incomes were augmented.

European average is only an historical causality, or rather the consequence of the middle position occupied by Italian economy among that of the different groups of countries which belong to the various tax models that we have just seen and particularly between the Rhine and Mediterranean models. Taking further into account the Italian large extension of the informal economy (Tanzi,1996; Bovi, 2002) we have a signal that the closeness to the European average may also means that the main taxes have high rates and restricted basis.

3. Some quantitative and institutional features of main taxes

3.1 The Personal Income Tax-PIT (IRPEF)

IRPEF was introduced in 1974, substituting a large number of previous taxes on income, generally real, both at national and local level. The beneficiary is the State but some additional rates may be imposed by Regions (0.9-1.4 percent) and Municipalities (up to-0.5 per cent). The basis is the total net income but the high degree of avoidance and exemptions strongly reduce the coverage of the tax, as one can see in Tab. 2, bearing in mind that this kind of estimations is inevitably subjected to a high degree of uncertainty. The just mentioned data on the extension of informal economy in Italy seem however to confirm what emerges from our (and from other similar, Bordignon and Zanardi, 1997) estimates. Agricultural and buildings rents are partially under-valuated, both for some persistence of assessments according to the cadastral system (agriculture) and the exemption of the income from the house of residence. Dependent labour and pension incomes are nearly all

TAB. 2 *The basis of the Income Tax in Italy, 1999 - Absolute values in Billions Euro*

	Absolute Values	*Per cent of the Total*	*Estimated per cent Avoidance*	*Estimated per cent Exemptions*
INCOMES				
Agriculture	2.0	0.4	2.1	85.4
Buildings	19.0	4.2	33.3	36.7
Dependent Labour and Pensions	344.0	74.0	8.5	12.9
Self Employed and unincorporated firms	93.0	20.0	59.5	
Capital	3.5	0.8	0.0	94.2
Others	3.0	0.6		
TOTAL	*465.0*	100.0	22.8	22.9

Source: Figures on basis, our projections from Ministero delle finanze (1997). Estimation of avoidance and exemptions, our evaluation, see Bernardi (1996). The figures concerning buildings are not completely updated to mo st recently changes of tax code.

assessed and cover 74.0 per cent of the basis. Tax avoidance is very high for self-employed and unincorporated firms. Capital rents are only dividends with a generally full tax credit, due to the imputation system in force. All interests are subject to a proportional withholding tax and capital gains were in fact exempt until very recently.

In Tab. 3 we can look at the structure of the tax. It is progressive across five income brackets with increasing marginal rates. The mean declared income (about 15,000 Euro) pays a gross average rate of about 23 per cent, however, mitigated by allowances in favour of both employed and self-employed persons. The taxing unit is the individual, but allowances are given for the dependent spouse and children. Many estimations show that the correction of the household rate of taxation according to the number of incomes and of dependants is in fact quite poor.

Due to the allowances, the level of exemption is about 6,000 Euro for the single labour worker and 3,000 Euro for the self-employed. In the case of a household with a non working spouse and two children the level of exemption is around 9,000 Euro. Notice that in Italy the poverty line is estimated at around 6,000 Euro for the single, the double for the four component household. Social contributions are deductible from the basis, while tax expenditures can be subtracted directly from the gross tax, to a percentage near to the value of first rate. The main items are health expenses, life and accident insurance payments, charitable contributions, interests on house mortgage loans.

TAB. 3 *Structure and parameters of the income tax in Italy - IRPEF 2002 - Values in Euro*

Brackets	*Marginal Rates*	*Mean Rates*	*Allowance Dependent Worker*	*Allowance Self Employment*	*Allowance spouse*	*Allowance two sons*
UP TO 10,329	18.0	18.0	1,146	413	546	1,032
10,330 – 15,494	24.0	20.0	542	103	546	1,032
15,495 – 30,987	32.0	26.0	439	52	496	1,032
30,988 – 69,722	39.0	33.2	77		440	639
OVER 69,722	45.0	45.0	52		422	570

Notes: 1) Marginal rates don't include the surcharges of Regions (0.9-1.4 per cent) and Municipalities (up to 0.5 per ent).

2) Mean rates and allowances are calculated about at the middle of any bracket.

3.2 Corporation Tax-CT (IRPEG)

Corporation tax was also introduced by the '70s reform. It applies also to non commercial bodies, but its coverage in Italy is lower than in other countries, due the prevailing share of small unincorporated firms. It doesn't differ too much from the standard corporation tax adopted in other developed countries, then the basis is given by net profits, assessed in the ways shown in Tab. 4. The basis is restricted by many factors: capital gains in some cases are taxed at a rate lower than the standard one: in fact biggest corporations usually realise them in countries (as The Netherlands) were they are exempt. Stocks can be evaluated up to LIFO. Capital losses are fully deductible. The same in fact is true for interests payments. The acceleration of depreciation can reach a factor of two for the first three years. It should be added that there exists also a relevant level of avoidance that we estimated in about 25 per cent (Bernardi, Bernasconi, 1996). A large amount of specific tax relieves, incentives and allowances further characterise the Italian CT, as in other countries. The incentives more relevant are subject to the approval from the EU. We should at least mention the "Legge Visco" which for the years 1999-2000 (after extended to 2001) has givene an allowance to investments financed with internal resources. A powerful tax credit also has been adopted for firms which make investments during the yeas 2001-06 in the South or other disadvantaged Regions of the country. Finally, in 2001 the "Legge Tremonti" was passed, which allows 50 per cent of the investments made in 2001-2002 to be deduced from the profits for the part which exceeds the average of 1996-2000.

TAB. 4 *The basis of Corporation Tax in Italy - IRPEG - 2002*

PROFITS		*LOSSES*	
ITEMS	*ASSESSMENT*	*ITEMS*	*ASSESSMENT*
Revenues	Sale of goods, services, corporation shares, bonds	Costs	Labour and goods & services
Capital gains	At realizing	Capital losses	At realizing
		Interests paid	According to taxable incomes
Dividends and interests perceived	Nominal value	Depreciation	Constant instalments and acceleration
Stocks	Up to LIFO	Current losses	Up to five years

The basic rate of CT in Italy is now at the level of 36 per cent to which it should be added the regional tax on business which hits the net value added of enterprises at a normal rate of 4.25 per cent. This "all-in" rate is high with respect to present European average (Giannini, 1999), also as we see below it was reduced by the "Visco reform" of 1997 from the level of more than 53 points it reached at the middle of the '90s (par. 4.2 and 5.2). The same reform to alleviate further fiscal burden and to increase incentive for corporate capitalisation introduced a preferential taxation for financing with internal sources: the so called "ordinary revenue" of new capital is taxed at 19 per cent. From time to time the share of assets and profits subjected to the lower rate had to be increased and thus the effective average rate should fall beneath the statutory rate. This regime has however be frozen by Ministry Tremonti in 2001.

The taxation of dividends may follow two separate paths. First the imputation system, with a tax credit corresponding to the tax already paid by the corporation. Otherwise one may choose to pay a withholding at 12.5 per cent, but without the tax credit. The second system is heavier for taxpayers who have an income up to about 70,000 Euro, but it is easier to administrate. In both cases the taxation of dividends stay at much higher level than respect to interests, a distortion which has not been corrected also by the more recent reforms.

3.3 Taxation of income from financial capital

This field of taxation gives raise to relevant questions regarding efficiency and equity and poses further difficulties of assessment in an increasingly integrated world (Tanzi, 1995). We saw that the '70s reform in fact included only dividends in the basis of the personal income tax. Interests perceived by the individual were instead subject to withholdings at a various but generally moderate rates. Capital gains were in fact exempted[2]. These regimes were confused and distorted, with many opportunities of arbitrage and elusion (Giannini, Guerra, 2000; Alworth and other, 2001).

After the "Visco" reform, the returns originated from financial assets are divided into two components: the traditional "capital incomes" (dividends, interests and so on) and the reviewed category of "other incomes" (capital gains from the sale of shares, bonds, currencies, precious

TAB. 5 Ta*xation of financial returns in Italy by types and rates*

Rate of 12.5%	*Rate of 27%*
CAPITAL INCOMES	*CAPITAL INCOMES*
Any kind of public bonds	Bank and Post Office deposits
Private long term bonds	Bank and private short term bonds
Dividends without tax credit	Derivative and atypical bonds
"OTHER INCOMES"	*"OTHER INCOMES"*
All incomes except capital gains "qualified"	Capital gains "qualified"'

Notes: 1) Short term bonds are those which have a duration under 18 months; long term are those longer.
2) Qualified capital gains are given by more than 5% of total capital for securities traded in regular markets and 25% otherwise.

[2] Interests and capital gains were instead included in the taxable basis of corporate and unincorporated firms.

metals, and receipts from "innovative" financial activities). The present outline of taxation of financial returns in Italy is depicted in Tab. 5. Notice that the number of rates has been reduced to only two. Both capital incomes and "other incomes" are subject to these rates in a co-ordinated way.

To avoid "lock-in" effects, elusive activities and differences in the burden imposed on the two type of incomes, all capital gains should be taxed at accruals. Non residents are exempted provided that they don't live in countries classified as tax havens whereas residents who invest outside may choose between a withholding from the intermediary or a self assessment.

Finally the new regime has strengthened the favour treatment of savings devoted to funded pensions, that in Italy however have still a very small room. The model is the EET and avoids double taxation. Then it exempts contributions to pension funds from taxation, within the limits of 12 per cent of the income of the saver. Interests gained during the time of accumulation are taxed at 11 per cent. If the pension is paid as a rent, it is taxed under the normal PIT as to the component originated from contributions. This coming from the interests cumulated during the working life is exempt, whereas the last part corresponding to the interests of the years of pension are taxed at 12.5 per cent. The same regime applies if the pension is paid as a lump sum of capital, to which in this case applies the average rate of PIT during the five years before drawing the pension to the component due to contributions.

3.4 Value Added Tax-VAT (IVA)

Also the Valued Added Tax (Imposta sul Valore Aggiunto-IVA) was introduced by the '70s reform and follows EU standards. Thus the tax is payable to the State (but 38.55 per cent is now devolved to the Regions). As usual in EU, the basis is the total business value added minus investments expenses. Thus the basis corresponds to final consumption[3]. The due tax is calculated by the method tax-to-tax. Data and parameters of VAT are shown in Tab. 6 below.

VAT is the second source of taxation in Italy, after the income tax, and its basis is made up mainly of internal sales, after the abolishment of customs inside the European union. Refunds are somewhat high and their reimbursements were paid with a long delay, before that the "Visco"s reform allowed their compensation with other fiscal liabilities. After the EU process of harmonisation, there remain three statutory rates: at 4 per cent for basic food products and

[3] Note the difference with regional business tax (par 3.6) whose basis is made up by a different definition of value added, i.e. the sum of labour costs, interests paid and profits, net from depreciation.

TAB. 6 *Data and parameters on Value Tax in Italy - IVA - Recent years*

REVENUES 2000		*RATES*		*EXCLUSION*	
GROSS	*91 Bin €*	4 per cent	Basic foods, necessities	Exemptions	Financial transactions; Public Transport; Postal services; Health; Education; Welfare
Internal sales	79 Bin €		drugs, books & newspapers		
Imports	12 Bin €	10 per cent	Other foods; water; energy, sport and entertainments		
UE and other corrections	6,5 Bin €			Not taxable	Exports, some intra UE sales
Tax refunds	13,5 Bin €			Allowances	Agriculture and small units
NET REVENUES	*71 Bin €*	20 per cent	Standard Rate	Total exemptions	12.6 per cent
Per cent of GDP	6.1			Total Avoidance	38.2 per cent
Per cent of total taxes	20.6	9.6 per cent	Effective rate	- industry	14.6 per cent
		50.4 per cent	Productivity	- services	55.2 per cent

Sources: Revenues 2000, Ministero dell'economia (2002); Rates, Tax Code; Productivity, OECD; Exemptions, not taxable and allowances: Tax Code; Avoidance: Bernardi, Bernasconi (1996).

essentialities (and for books and newspapers), 10 per cent for other food products, water, gas and electricity, sport and entertainment. The standard rate is at 20 per cent for all other goods and services. The weighted rate is about 16.0 per cent, the effective rate is 9.5 per cent, about 40 per cent below. This value is very low for the European standards , whose mean is about 15-20 per cent.

The low productivity of VAT in Italy is a consequence of a high level of both exemptions and avoidance (the last estimated to be very high, not in industry, about 15 per cent, but in the vast domain of services, more than 50 per cent): the point is relevant because from IVA avoidance necessarily depends that of its components made up by personal incomes. The exemptions benefit financial transactions, public services and health, education and welfare A favour regime is finally granted to agriculture.

3.5 Excise duties on energy and other minor taxes

In Italy the total yield of excise duties on energy has been more than 3 points of GNP during 2000, the highest value in Europe. The tax hits particularly oil products especially petrol and diesel oil. VAT is charged and then the prices to consumers are very high both for households and for firms.

The other area of specific indirect taxes is made up first of taxes on starting a business, the highest is the tax on registration of legal acts (0.6 per cent of GDP) Others taxes are imposed on insurance, mortgages, stamp duties, motor vehicles. Instead succession and gift tax was completely abolished during 2001: it was anyway largely avoided and eluded. Italians like to play an so the State taxes any kind of game, gambling, lotteries, entertainments and the resultant yield is not irrelevant (0.8 per cent of GDP).

Finally at regional and local level a lot of smaller taxes are applied, for example on authorisation of business activity or occupation of public areas, use of public water and the disposal of solid wastes.

3.6 Regional Tax on Business-IRAP

The model pursued by Governments of the ‘90s to give the greater fiscal autonomy required by Regional and Local authorities consisted in creating an important local resource, integrating it by sharing to national taxes (PIT, VAT, petrol tax) and finally reducing State transfers to specific targets, as investments and, above all, to equalise the local resources of Regions with very different levels of wealth[4].

Thus in 1998 a new regional tax was adopted, the Imposta sulle Attività Produttive-IRAP which provides about half of the financing of Regions. It gives a relevant yield (2.6 per cent of GDP) and it is largely (but not mandatory) devoted to financing the health system, the main function of Regions. We saw that the aim of the new tax were not only to strengthen fiscal federalism, but also to comply with the overall strategy of the "Visco Reform" to innovate enterprises taxation (Giannini, Guerra, 2000).

The tax is imposed on all engaged in commercial business (companies, firms, private services, agricultural producers) and on Public Administrations. IRAP is charged on the value of net value added resulting from the business pursued within the Region. The basic rate is at 4.25 per cent, but it may be changed up to a percentage point by Regions and different treatments are provided for the various sectors of activity.

3.7 Municipalities Tax on Immovable Properties-ICI

According to the same strategy adopted for Regions, a proper tax was also introduced in 1993 for Municipalities, which hits upon immovable properties, the Imposta Comunale sugli Immobili-ICI. The revenue is not very high, slightly less than 1 per cent of GDP, a value well below that of taxes on property in countries like the U. K. (3.3 per cent of GDP). There is the suspicion of widespread avoidance, particularly in the South of the country. The revenue is further limited by the fact that the patrimonial basis is given by capitalizing cadastral rents, which are largely underestimated with respect to their effective values. The tax is charged on owners of the property at a rate fixed by Municipalities not less than 4 per thousand and not more than 7 per thousand. A deduction is given to the residents in their house and some exemptions are provided for particular types of properties or owners.

4. The fiscal burden

4.1 The distribution of taxation charge

[4] If we fix the income per capita at 100 in Lombardia (the richest region), the correspondent value for Calabria (the poorest) is about 60.

The main general indicator of the distribution of fiscal burden is that by economic functions, which is depicted in Tab. 7. It shows the ratios between the overall tax burden on different factors and a common large basis, given by GDP.

TAB. 7 *Structure of taxation according to the economic function as % of GDP*

	1970	*1975*	*1980*	*1985*	*1990*	*1995*	*1997*
Consumption	*9.9*	*8.0*	*8.1*	*8.6*	*10.3*	*10.5*	*10.6*
Labour	*10.3*	*14.4*	*17.4*	*19.7*	*21.3*	*22.4*	*23.6*
Employees	9.8	13.7	16.0	17.8	19.2	18.8	20.9
Self-employed	0.5	0.7	1.4	1.9	2.1	2.6	2.6
Capital, of which	*5.6*	*3.6*	*5.2*	*6.5*	*7.3*	*9.0*	*10.0*
Real estate capital	0.8	0.3	0.4	0.4	0.6	1.4	1.3
Monetary capital	0.1	0.8	1.7	1.9	2.4	2.2	2.6
Environment	*2.8*	*2.7*	*2.1*	*2.2*	*3.3*	*3.6*	*3.7*
Energy	2.5	2.5	1.9	1.9	2.8	3.2	3.2
Transports	0.3	0.2	0.2	0.3	0.5	0.5	0.5
Pollution	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL	*27.4*	*2.7*	*32.3*	*36.0*	*42.4*	*44.5*	*45.7*

Source: EUROSTAT, 2000. 1997 is the last data available.

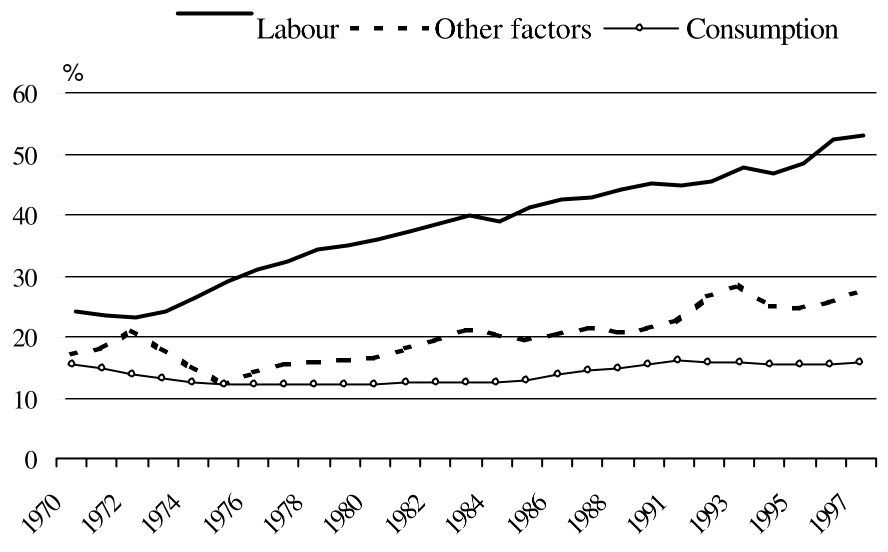
First we find the evidence of the relatively decreasing and currently relatively low role of consumption taxes. Instead taxes (and social contributions) on labour have made a big jump and more than doubled from the beginning of ‘70s to the late ‘90s. At present they give about half of total revenues. This is suffered almost all by employees, while the charge on self-employed increased during the time but it is still at a very low level. Notice in particular that in Italy the legal rate for social contributions on self employed is in effect near half of what is charged on dependent workers, but PIT rates are the same and the self employment account for 1/3 of total employment (standard labour units). Thus a rough estimation gives the result that the fiscal charge on self-employed are avoided by at least 30 per cent.

Also taxation on capital did grow with the time, but it is far quite lower than the burden on labour and made up primarily by incomes and wealth not allocable. The typical tax on capital, real and monetary, gives a very small contribution to total taxes, particularly by the real capital whose taxation is not more than 1 per cent of GDP, due mainly to the Municipalities tax on immovable properties. Taxation of monetary capital is also low. At a rate of withholdings of 12.5 per cent, the most commonly charged in Italy, it is somewhat lower with respect to European standards, even if it is compared to countries which have a final withholding tax (Joumard, 2001). Finally pollution and transport taxes are virtually absent, while the taxation of energy is at a high level, as we had already seen.

This first evidence suggests us to give a closer look at the main headings of distribution of fiscal burdens, i.e. labour, consumption and other factors (= gross operating surplus), as are given by implicit rates depicted in Fig. 1[5] from 1979 to 1997. It is confirmed that the observed time increase in cumulate value should be due mainly to the rate on labour up to a current value really very high. This trend was impressive (30 points) pushed up from 1975 to the beginnings of the '90s by an ever greater burden of income tax. Social contributions were already high at the beginning of the period. It is confirmed also that the contribution of consumption and other factors to fiscal effort has been far more limited. The choice of leaving low consumption taxation has been due mainly to anti-inflationary goals and further to the VAT high avoidance. The implicit rate on other factors has increased far less than that on labour also because of the soft regimes for financial activities and the avoidance in profits of firms and from self-employed (Giannini e Guerra, 2000). One is forced to conclude that during last thirty years tax policy in Italy has been certainly not efficient nor equitable.

To end this subsection we look now at the personal redistributive effects of the tax system and

FIG. 1 *Implicit Rates 1970-1997*



[5] Implicit rates are given by the ratios of taxes on various factors and their own potential basis. Their estimated values are somewhat controversial. The order of their magnitude and trends here presented are however out of discussion. Obviously estimations don't consider possible tax shifting.

particularly of the income tax. In a comparative analysis of twelve OECD countries the distributive effect of income tax for Italy has been estimated in 2.4 per cent of difference between the Gini on gross and net incomes (Wagstaff and others, 1999). It was at the lower bound of estimations for countries selected, but it was also very under Italian estimates of the same time. To mention only our result (Bernardi, 1995), we obtained 4.7 per cent of redistributive effect, while the last available estimate gives for the year 2000 a redistributive effect of 5.1 points: the average rate is at 23.5 per cent, the Kakwani at 22.0 per cent , both high values, if compared with European average (Bosi, Guerra, 2002).

If we instead consider the structure of the whole system and assume the conventional hypotheses of tax-incidence, partial equilibrium and single generation, looking back at Tab. 1 we have to observe that direct taxes, by and large regarded as progressive, are only an half of the sum of indirect taxes and social contributions, usually considered regressive, at least as far as they are passed on prices. The traditional result, of an overall proportionality of tax system of industrialised countries, first obtained by J. Pechman during the '60s, would then not confirmed for Italy whose system at first glance seems to be generally regressive.[6]

4. 2 Tax wedges on labour and corporate taxation

The charge that we have just seen on labour and to a lesser amount to other factors has not consequences only on equity, but also on efficiency. Looking at the tax wedge on labour, we find the confirmation of what we have already observed considering the distribution of tax burden. The average wedge is currently estimated (average) near 50 per cent[7] of total labour costs in industry, both by national (Giannini, Guerra, 2000) and international sources (Joumard, 2001). Its present value increased by almost 20 points from the beginning of he '70s, nearly 12 points during the '80s, and finally stabilised during the '90s. It is worth braking the wedge into its constituent parts, that due from the employers and that from the employees considering possible differences in shifting. Employers contributes for two thirds (almost all social contributions) and employees for the rest (income tax and social contributions). In the whole of Europe the wedge is from many years one of the main problems of the fiscal systems[8], due to the evidence that it depresses employment and growth, both from the point of view of supply and that of labour demand (see for a survey, Petretto,

[6] We are completely aware of how this result is (poor) hypotheses dependent, but have also to note that the hypotheses here mentioned are those commonly used in standard models of taxes-micro simulations.
[7] The marginal rate should be at least 5 point over the average rate (Joumard, 2001).
[8] In the U.S. the wedge is currently estimated at about 30 per cent, a value which has not changed during the last 30 years. Due caution is however needed in comparing European and U.S. data: the last don't comprise the contributions to private health system and pensions plans.

2002): once more Italian case is one of worse one's. We will return to this point when examining tax reforms.

In Italy at the beginning of the '90s the "all-in" statutory rate on corporations was at the level of 46.4 per cent, 10 points above the figure of ten years before and about 6 points higher than the European average (Giannini, Guerra, 2000). Despite a general movement to further reductions, generated by international tax competition, the rate increased up to 53.2 per cent in 1997. This rate surely disadvantaged Italian corporations and the location of productive activity in Italy. The spread was however mitigated by the generous criteria concerning allowances granted from fiscal legislation[9] and by the level of avoidance (see back par. 2.2). Joumard (2001) reports an estimate according to which in the middle of the '90s the backward effective rate of corporate taxation in Italy was near 15 points under the 'all-in' statutory rate.

For the same period (Giannini, Guerra, 2000), it has been estimated (following the Devereux-Griffith 1999 methodology) that the marginal effective forward rates in Italy were -85.5%[10] in the case of debt financing and 40.3 percent in the case of financing with new equities. The corresponding average rates were 34.5 per cent and 47.8 per cent, at a profitability rate of 20 per cent[11]. Notice the jump between marginal and average rates, which is a signal of a tax with high rate and narrow basis (Giannini e Maggiulli, 2001), and makes the country less attractive for most profitable investments. Furthermore the large spread for both the rates between debt and equity financing should be emphasised. Its consequence is the thin-capitalisation of corporations.

This picture was changed by the "Visco" reform of 1997. The "all-in" statutory rate decreased to 41.2 per cent. The rate had to be reduced further by the new preferential taxation of ordinary income from internal sources, which however was frozen in August 2001. After the "Visco" reform (Giannini, Guerra, 2000), the marginal effective rate increased to -27 per cent, in the case of debt financing, but decreased by about thirty points in the case of financing with equity (10.0 per cent). Average rates decreased both in the case of financing with debt (27.8 per cent) and equities (31.7 per cent). Thus a relevant result of the reform has been to reduce the statutory and average effective rates as well as the difference between marginal and average effective rates and moreover to bring rates closer in the cases of equity and debt financing.

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[9] Particularly concerning the regimes of depreciation, interests deductions, and other incentives.
[10] This value might well be negative, due to favourable regimes for depreciation and interests and to the high level of statutory rate.
[11] Remember however that forward looking rates are not influenced by avoidance.

4.3 Taxation by levels of government and fiscal federalism

International sources (Eurostat, 2000; OECD, 2001) apportion total taxes (excluding social contributions) collected in Italy at the end of the '90s between slightly less than 90 per cent to Central Government and slightly more than 10 per cent to Local governments (Regions, Provinces, Municipalities). National estimates (Ministero dell'Economia, 2002) give a somewhat different picture, by attributing 17.5 per cent of total taxes in 1999 to Local governments[12]. This percentage rapidly grew from the beginning of the '90s: it was 12.5 per cent in 1994 and it is projected to reach 21.4 per cent in 2001[13]. The increase in local resources might also become far more dramatic, if projects under way to substantially enlarge the role of the Regions and give rise to a federal state are accomplished.

Currently Regions are in the whole self-financing and an equalising system was activated, taking into account the differences in per-capita resources, health needs and other minor factors [14]. Notice than in 1990 own taxes of Regions were only 1.6 point of the total revenues, while State transfers covered almost all total expenditure (Arachi, Zanardi, 2000). In 1998 the regional tax on business was introduced. At the same time a sharing to national income tax was added at a rate currently of 0.5-1.4 per cent. Small taxes were also started, particularly on energy, motor vehicles and disposal of solid wastes. The last reform arrived in 2000, when a new sharing plan was adopted to VAT (now 38.55 per cent of regional revenue).

However we have already said that this seems not to be the end of the story. An act of Constitutional reform passed by the Parliament in 2001 and the projects of the present Government provide a huge devolution of functions from the State to the Regions, most notably in the domains of health, education and local policy. This change will be dramatic from an institutional point of view and regarding the sharing of resources. The shifting of financing is currently evaluated around 50 Billion Euro, which could be covered by raising to a very high levels regional share of income tax and/or VAT. More autonomous taxes are often invoked, but up now nobody has been able to show what they should be.

A similar story has concerned during the '90s also the Provinces and Municipalities: the second case being the more relevant. At the end of the '90s State transfers and own taxes had about the same value (Cavaliere, Osculati, 2000), while one decade before the own taxes were less than one third of State transfers. The change was mainly due to the introduction in 1993 of the tax on

[12] Two thirds are due to Regions, the remaining to Provinces and Municipalities.
[13] This value does not comprise the recent and large sharing of VAT among Regions that we will mention below.
[14] We remember that the main and growing function of Regions is public health care (more than 90 per cent of the budget), plus other functions relating mainly to land management (agriculture, transports, public works, tourism and so on). Further other minor tasks were recently assigned by the State to Regions (and thus to Provinces and Municipalities) in order to realise the so called "administrative decentralisation".

immovable property and by subsequent adoption of new taxes or revision of those already existing, particularly in the field of energy, advertising, occupancy of public areas, waste disposal and registration fees.

Finally it should be mentioned that from 1997, in view of the requirements of Maastricht Treaty and Stability Pact, strict limits were imposed upon the budgetary independence of Local authorities, somewhat at odds with the process underway to give them more financial autonomy. The so called "Internal Stability Pact" (Fraschini, 2002)consists essentially of ceilings to budget deficits or to total expenditures, supported by a system of bonuses and penalties. Health expenditure is not constrained by the ceilings of the Pact due to its continuous a non foreseeable increase: It account to near 90 per cent of total expenditure of Regions.

4.4 A comparative view with the European average

The indicators of fiscal burden of Italy may now be compared with the correspondent figures of the European average, taking into account that this average derives from a wide cross-section of national data. The general result is that from many points of view Italian case looks worse than European average and deeper reforms seem to be needed.

Italian 1997 values of implicit rates are very high for labour (about 10 points over), not very different for consumption and slightly less for other factors with respect to the European average. Lower taxation of labour characterises not only countries which reduced public welfare (such as the UK and Ireland) but also those which raised other taxes, for example on consumption (Denmark) or on other factors (France). High taxes on labour create a tax wedge in Italy which in 2000 occupies the seventh place in OECD list (Joumard, 2001), some points over the European average and twenty points over the OECD average.

The "Visco" reform has improved the taxation of corporations, making it lightly and more neutral, but most remains to be done to enhancing the competitiveness in a country where many non tax-wedge costs are at work. The statutory "all-in" rate is still over the European average of about 8 points. Marginal effective rates are lower than the average of the countries considered in this research[15], particularly in the case of debt financing, while the average rates are in the same order of magnitude[16].

We are not able to arrive at a firm conclusion concerning the comparison of the redistributive impact of income tax (and of the whole fiscal system) between Italy and the European average. Only some contrasting conjectures may be put forward. As we saw, the mean rate of income tax is

[15] About -21 per cent in the case of debt and about 33 per cent in the case of equity (Giannini, Maggiulli, 2001).

[16] About 33 per cent both in the case of debt and equity financing (Giannini e Maggiulli, 2001).

rather high now in Italy, and the level of progressivity has increased during the '90s, without being reduced by reforms similar to the ones adopted in many other countries. The share of direct and income tax in Italy is somewhat higher than the European average, while that of the sum of VAT and excise duties is slightly lower[17], but the share of social contributions due from the employers is also higher and the distribution of their burden would be regressive if they are shifted on prices.

The available data both by EU and OECD does not allow accurate comparison of the apportionment of taxes by levels of Government between Italy and other European countries. But some countries stand out particularly. Revenues of Central Government are for instance low in Germany and very high in the United Kingdom, while the revenues of Local governments are particularly high in Nordic countries. We know that now in Italy the main sources of Local authorities are the business tax and the share to VAT at the Regional level, the tax on immovable property at the Municipalities level. OECD data (2001) seem to indicate that the share of taxes on incomes is larger for the whole area than for Italy, and so also in the cases of property tax and excise duties: thus, traditional prescriptions of theory should be applied in the last two cases elsewhere but not in Italy.

5. Tax reforms in the '90 and those currently planned

5.1 A quick glance at the budget and the general economic environment

After the fast development of the '50s and the '60s and that lower and more unbalanced of the '70s and the '80s (Graziani, 1979), during the '90s the average yearly rate of growth in the Italian economy fell to around 1.2 per cent, half of the European average and one third of the U. S. rate. There was more than one reason for this breakdown: ten years of tight monetary and fiscal policy to reach the requirements of the Maastricht treaty and of the Stability Pact, a long period of political crisis during the first part of the decade, general rigidity of the markets, privatisation which was not backed up by any suitable industrial policy (Fausto, 2002), the instability of world-wide economy, a prevailing industrial structure of small firms not inducing technical progress (De Cecco, 2000). Thus the vintage of capital became older, decoupling the increase of total factor productivity from the possible advances of technological progress (Basu, Fernald, 2002).

The Government's *Document of Economic and Financial Programming* of July 2002 sets the target of increasing the yearly growth rate to 2.9-3.0 per cent from 2003 (but 0.9 per cent is however the 2002 forecast, 2.1 the 2003 made by the REF of Milan, our reference economic

[17] It is not easy qualify the regional business tax (2.5 points if GNP), included among indirect taxes by National

research centre and similar figures are given by other Italian research centres and international organisations, like EU, OECD and IMF). Potential growth of the Italian economy seems to be dropped to not more than 2.0 per cent.

The Government plans to reduce net borrowing to about 0.8 per cent of GDP in 2003 and to 0.5 per cent in 2004, which are the present EU's requirements. These figures should allow room for manoeuvre (0.5 per cent of GDP in 2003) and to start the program of tax cuts that the Government aims to carry on. Once more REF and the other mentioned centres and organisations are far more cautious. In their opinion net borrowing will decrease much more slowly than envisaged by the Government and the room for tax cuts should be still found, alternatively by reducing expenditures or substituting the planned tax cuts with increases in other taxes. In fact the Government has presented a plan of 12 Bin of Euro to improve the budget trend and reach 2003 targets.

5.2 Tax reforms in the '90s and the "Visco" reform

Innovations introduced into the Italian tax system up to 1997 ("the Maastricht year") were considerable in number by they were in fact almost all devoted to the pressing need of raising more funds in one way or another. Increases affected almost all main taxes, in various ways[18]. A comprehensive reform of the tax system was proposed in 1994 by the Minister Mr. Tremonti also then on charge, but it was not seen through to the end, due to the fall of the Government. Problems in the tax system were however evident (Bernardi, 2000c with bibliography; Pedone, 2000; Giannini, Guerra, 2000). The traditional shortcomings were still at large: the high levels of avoidance and exemptions of the income tax and VAT, the complexity of the system, the persistently inefficiency of centralization of revenues. Other problems accumulated and became even more pressing during the '90s: excess burden on labour, fears for fiscal competitions, lack of neutrality and efficiency in corporate taxation, and then there were changes in the economic environment to be dealt with, which come under pressure from both the internalisation of economies (Tanzi, 1995) and from the diffusion of small firms and services (Pedone, 2000).

The "Visco" reform, launched in 1997, didn't cope with all these issues, but with more than one of them. We now try to provide a summary of the reform's aims, tools and results. The main targets of the reform was to make the system more simple and neutral; to give more autonomy to Local authorities; to reduce fiscal pressure as much as possible, within budgetary constraints,

Accounts.

[18] Income tax was de-indexed to inflation, corporations suffered from a raise in the "all-in" rate and from a new tax on net assets, VAT rates were augmented. Many temporary taxes, advances of collections and delays in reimbursement were also adopted.

without jeopardising social expenditure, but trying to limit avoidance and exemptions. The general reference model of taxation has been indicated in the so called "Dual Income Tax-DIT" (Soerensen, 1994), which was developed by the Nordic countries during the '90s, to find a difficult compromise between equity and the need to avoid capital flights.

As we have seen, the taxation of corporations (and subsequently also of unincorporated firms) has been changed mainly in two ways. Firstly by the introduction of the large basis Regional business tax which substituted previous more restricted basis taxes on profits and net assets, and further by the adoption of the allowance on "ordinary returns" of the increases in capital. There is more than one reason why fiscal burden should have been redistributed in favour of the most profitable and most capitalised firms (Giannini, 1999). These might be the largest ones or those operating in the financial sector. This possible outcome has been largely discussed with reference to the multitude of small firms which characterise the Italian industrial structure (Vitaletti, 2002), but up to now a final judgment is still not possible because of the lack of the information needed.

The new features of corporate taxation however significantly reduced the statutory "all-in" rate, and consequently the average effective rate, particularly for the most productive projects[19]. The level of statutory rate remained however well over the European average, due to budget constraints, and this has contained the improvement of the Italian tax competitiveness and of the reduction of the previous disincentive to locate activities in Italy.

Furthermore the reform has made the financing of firms among different sources far more neutral (a target suggested also by OECD, Joumard, 2001), by reducing tax wedge in case of capital financing. This would favour the capitalisation of firms, the undertaking of new initiatives and the efficiency of capital markets (Giannini, Guerra, 2000). Unfortunately also in this case we still don't have enough information to appraise how these expected targets have been really reached. Results far less satisfactory were obtained for the labour wedge[20]. It remained at a very high level, with respect to the European average, or even increased. This may influence marginal production costs and technological choices by further disadvantaging labour.

Maybe the achievements of capital taxation reform are less complex and questionable than those of corporate taxation. A clear and general identification of all taxation incomes has been attained. Capital gains are now subject to taxation, in accordance with the taxation of capital rents. The number of rates has also been reduced, though not to only one, in order to avoid any increase in the cost of public debt. The role of financial intermediaries has been expanded, with positive consequences on the level of elusion (Guerra, 1998). A debated issue was instead the introduction

[19] For a critical view, particularly concerning the reference to effective rates, see Alworth and others, 1997.
[20] As result the Government was forced to reduce social contributions and raise energy taxes.

of taxation of capital gains at accruals and not at the moment of realising, both from a theoretical and practical point of view (Giannini, Guerra, 2001; Alworth and other, 2001).

The road of decentralisation of State revenues has been covered mainly by means of the introduction of the business tax and of the large devolution of VAT, both of which favour the Regions. As an autonomous tax, devoted mainly to financing health care, the business tax has been criticised (Bordignon, 1997) for its lack of accountability and its poor correspondence to the benefit principle. The basis is furthermore unequally distributed by Regions, whose autonomy to manage the tax is limited. Considering that the devolution of VAT is not more than a transfer, that the Regional surcharge on income tax is very limited and finally that the decentralisation of functions has also been very limited up to now, the final conclusion is that the steps which have been made towards fiscal federalism had the prevailing aim to introduce a cautious financial responsibility to the Regions.

"Visco" reform had to be still completed (Guerra, 2000). The DIT system should have been extended to all capital or mixed incomes. The statutory rate on corporations was planned to decrease and the preferential regime for internal sources to grow as time passed. The rate on capital rents and gains had to be unified around an average of about 19 per cent. The tax reform should finally be completed by evaluating a reform of the role and structure of income tax.

5.3 Planned tax reforms: the "Tremonti" reform and the debate on fiscal system

Despite the recent "Visco" reform (whose innovations are now largely planned to be repealed) Mr Tremonti, the Minister of Finance of the new Government elected in the Spring of 2001, launched his own widespread project of a new fiscal reform. The delegation bill was approved by the Cabinet in December and in July 2002 it is at the approval of Parliament. The reform is based on a four year plan (2003-2006), to make its cost (about 25 Billion of Euro, 2 points of GNP, in Government's estimates) compatible with the strict budget constraints imposed by the Stability Pact. The reform is presented as a step in the directions already taken by other European countries, but in fact it is more radical than elsewhere and two weighty specific aims are added to more common goals (simplification, neutralisation, international standardisation and competitiveness).

The first aim is political-ideological in nature (Bernardi, 2002). The proposal is based upon a pro-market view of the social economy. The ideal of a natural right to have a "just taxation" corresponding to more freedom is affirmed. The roots of this principle could be found in many views on social justice (Granaglia, 1991), but the proponents (Vitaletti, 2002) appear instead to be closer to the Wicksellian and Italian tradition of the voluntary State. Obviously this point is open to question in the light of Beveridgean and Welfarist tradition, the diffused market failures of the real world and the fact that income distribution can be conceived as a matter of collective choices and not a naturally occurring right.

The second and not debatable aim is to enhance growth but it draws substantially on expectation-supply side view. The start up of a credible path of decreasing taxes should trigger a "virtuous circle": "less taxes-more growth", only as effect of gentle across-the-border cuts of the rates (Pedone, 2002). An additional keynesian effect on consumption (Vitaletti, 2002a) should also be welcome. Unfortunately this optimistic view is not easily supported with recourse to more recent literature. The low size of the effects of tax cuts on factors' supply is a well known fact from '80s U.S. debate (Bosworth and Burtless, 1992), that has been fully confirmed by recent analyses (Leifritz and others, 1997)[21]. Labour demand models (see Petretto, 2002, for a survey) show that elasticity of demand is also low. The previous contrasting results of endogenous growth models (still Petretto, 2002) seem to be solved by the most recently updated and sophisticated estimates (Cassou, Lansing, 2000), which show a very low effect on growth of reducing income tax progresivity. The EU estimated with traditional demand models (still Leibrfritz and others, 1997) that a point of GDP cut would deviate growth from base line of an average of 2.0 points in the case of corporate tax and 1.25 in that of labour's taxation. The same already quoted Italian *Document of economic and financial programming* indicates in 0.25 per cent the (not necessarily permanent) increase in growth to be attributed to a tax cut of one point of GDP. Notice that we are speaking of points of GDP: 2.0 points is the total tax cut of "Tremonti reform". We would not conclude that an inverse relationship between taxation and growth doesn't exist at all, but only that it is a magnitude neither not high nor robust to be empirically estimated (Tanzi, Zee, 1996). Taxes should then be cut by relevant amounts and in order to reach carefully selected targets. The simple across-the-board filing of rates would not be enough.

Bearing that all in mind we come now to the other major items of "Tremonti reform". An important aim is the building of a unified and coherent tax code, by filtering the dispersive and at times contradictory present legislation. Other main areas of interventions are the following three.

i) The reform of income tax and the new IRE – A deep reform concerns the income tax and builds upon similar changes already adopted by other European countries during the last years (EU Commission, 2000): even the name of the tax should be changed to Imposta sui Redditi-IRE. The basis and the subjects should not be changed substantially, while the present structure (par. 3.1) should be amended radically. The brackets should be reduced to two, the first up to the high level of

[21] Labour supply elasticity is currently estimated in 0.15 for men and 0.3 for women in the U. S. These figures may be slightly higher in more unionised European labour markets. Elasticity of demand is estimated around the double of the supply average figure (Leibfritz and others, 1997).

100,000 Euro, the second one over and above. The corresponding rates had to be set low at 23 and 33 per cent respectively[22]. The present tax allowances should be transformed from tax credits into deductions from the taxable income and integrated with a "new" deduction, to exempt for instance an income of about 7,500 Euro in case of a single and of about 12,000 Euro earned by a dependent worker in a household supporting a dependent spouse and a child (Vitaletti, 2002). Following the bill's provisions, deductions should be "concentrated" on low and middle incomes and decrease as income increases and disappear at about 40-50,000 Euro (Vitaletti, 2002a). The lack of revenue is quantified by the Government at about 20 Billion Euro[23]. The consequent reduction of the average fiscal pressure and labour cost has been estimated by REF at level of about -3 per cent (Congiuntura.irs, 2002). Such a level is not irrelevant but also not very high, particularly because the projected distribution of gains is in favour of the bottom and top incomes and not of that of the average productive worker[24].

In fact, according to Government's estimates (Vitaletti, 2002b), once fully accomplished, the reform will raise the level of exemption and give substantial gains to households with incomes from about 12,000 Euro up to about 20,000 Euro. The "no tax area" would be widened, particularly for the low income households. Over this threshold the reform becomes progressively neutral, but from about 40,000 Euro advantages increase once more and reach high figures up to over 12 points of the average rate for a low number of the upper incomes[25]. REF has calculated very rough figures of the distribution of overall gains. About an half would benefit near 14 million of taxpayers with about 40 per cent of the total income, situated over the present level of exemption and below 20,000 Euro. The other half would benefit the highest decile of taxpayers: about 3.0 million, with a mean per capita income close to 50,000 Euro. The remaining 13 millions of taxpayers would have no substantial gains and losses, because already exempt or situated in the wide "neutral" area.

Such a radical change proposed for the distribution of the income tax burden has obviously been widely debated. The proponents argue that progressivity (and also personalization) cannot be still justified not only on the ground of efficiency but also from the viepoint of equity (Patrizii, 2002; Vitaletti, 2002a). The main argument is that the basis of the tax is substantially restricted to only labour incomes. Further, redistributive goals are better performed through public expenditure in a non minimal Nozick state. These points are not new and well established in the debate on Dual

[22] Note than the country where the "long" bracket has been invented, i. e. the U. K., the basic bracket ends at a value of about 50,000 Euro, and the subsequent rate is fixed at 40 per cent.
[23] The first step of the reform is planned for 2003 and its lack of revenue is estimated in 5-10 Billion Euro. It should be made up by a mix of the structures of the new and the present income tax, only as to concern low- middle incomes.
[24] This distribution might recall some prescriptions of the optimal taxation theory, but the proponents of the reform explicitly indicate that this theory is completely useless for concrete reforming of tax system (Patrizii, 2002).

Income Tax or Expenditure taxation. The answers might be (Bernardi, 2000; Guerra, 2000) that in any case all efforts should be focused upon making the whole system more equitable, by reducing avoidance and preferential tax treatments and by taxing all incomes (those from capital in particular) at an even rate. Furthermore one should be cautious in removing the only evidence of progressivity present in the tax system and which concerns nearly 60 per cent of net GDP (Bosi, Guerra, 2002). Finally it has been noted that the advantages given by the reform to the rich are very significant (Baldini, Bosi, Matteuzzi, 2002). A minimal suggestion would be to reduce the upper limit of the first bracket to 40,000 Euro and leave the rate of 33 per cent unchanged, being it a political commitment of the Government. A more ambitious suggestion should be to introduce a tax similar to the French tax on large fortunes (see the chapter on France)[26].

Focusing the debate on vertical equity has distracted general attention from horizontal equity by presuming that this would be a minor problem, due to the adoption of such a long basic bracket. Instead the strengthening of decreasing deductions raises again the traditional distortion of households taxation in presence of a different number of earners. For example, if we are right to quantify Government's indications, a household with an income of 40,000 Euro perceived by a single earner will be taxed at an average rate at least double of the rate to which would be subject a family with two earners of 20,000 Euro each. A proposal would be to devote some part of the deductions also to correcting this serious distortion.

ii) The taxation of capital incomes - The Government tax reform also aims to innovate the taxation of capital incomes, even though it was recently modified by the "Visco" reform. The proposed changes are as follows. All capital incomes (i. e., rents and capital gains) should be unified in a single class and converge to the taxation regime of State bonds, i.e. final withholdings at the single rate of 12.5 per cent. "Unqualified" dividends should also be taxed only with at source rate of 12.5 per cent, without tax credit.[27]. The same rate should apply to capital gains realised by mutual funds and taxation should be deferred to the time of sale or redemption of shares. Finally incentives provided for private pension savings should be further strengthened, by eliminating taxation on the interests accrued during capital accumulation. The loss of revenue is estimated at 1.7-1.8 Billion of Euro.

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[25] Some recent indications by the Government seem however to be oriented to distribute more gains also to middle ncomes.

[26] A discussion of different arrangements of brackets and rates may be found in Baldini and Bosi (2002). The rejoinder is in Vitaletti (2002a).

[27] The only exceptions would be "qualified" capital gains and dividends. They should be included in the income tax only for a quota but without tax credit for dividends.

The general target of the reform is to try making financial capital taxation still more neutral, fair and simple, in order also to improve its international uniformity and competitiveness. This would come from the common treatment of all financial incomes and also from the repeal of the at accrual regimes which would be too complex and without precedents in other countries (Panzeri, 2002). The low rate should favour the containment of the cost of public debt, investment activities, higher net revenues on financial assets, while discouraging capital flights from residents (Vitaletti, 2002).

The uniform taxation regimes at a single rate has been generally well accepted in principle[28], but the proposal raised also various criticisms (Guerra, 2002; Congiuntura.irs, 2002). In fact some disparities of treatment of income from different sources remain or increase, particularly between interests and dividends and those due to the different timing of taxation that the at accrual system tried to overcome. The proponents' reasons supporting the adoption of a low rate appear to be questionable. More of all, the fiscal burden on financial capital should still drop at a rate which would be the lowest among European countries (Joumard, 2001)[29]. Finally the gains in competitiveness relate only to residents (non residents are exempt, as we have seen) and may contrast with EU attempts to strengthen capital income taxation of non residents. A progressive converging to the European average of final withholdings (20 per cent) seems to be cautious and more equitable.

iii) *The taxation of corporations* - The delegation bill gives much room to the reform of corporate taxation and its relating proposals radically amend the innovations introduced by the "Visco" reform. The main aim of the reform is once more to simplify the present system and to bring it closer to the European norm (the German system in particular), in order to achieve more efficiency and neutrality. This should be made as follows. Both the preferential taxation on ordinary income from internal financing and Regional business tax should be repealed. Broadly speaking (Vitaletti, 2002a) they would have been unfair, giving a comparative advantage to the largest and financial corporations and penalising small exporting and labour intensive firms. Furthermore the allowance on internal sources would be too complex, without similar schemes in other European countries and not welcome by firms which don't like to increase their capitalisation. The cost of labour should be the first part of the basis of business tax to be eliminated. The statutory rate for corporate taxation should decrease from the present 36 per cent to 33 per cent.

[28] This is a recommendation coming also from OECD, which however is not in favour of excessive incentive to pension savings (Joumard, 2001).
[29] The rate of final withholdings on interest in Europe is comprised form 15 per cent (France and others) to 30 per cent (Sweden). In seven countries interests of the residents are still included in the income tax (Joumard, 2001).

The bill further suggests the adoption of the system of participation exemption, to give a more European and advanced solution to the problem of intra-corporate taxation. Tax credit on dividends should be substituted by an exemption at 95 percent. Capital gains from the sale of shares should not more subject to taxation, with the obvious consequence of eliminating the deductibility of capital losses: this system would also help to avoid elusive practices (Vitaletti, 2002). Further within certain limits the option should be given to the corporations to have a consolidated budget, by adding their taxable basis to those of the controlled companies. Finally the reform means to contrast thin-capitalisation in the case of debt financing coming from or guaranteed by shareholders or inducing a too high level of leverage. The sum of all the parts of the reform should not change tax revenue. These structural changes have in generally been well received. They follow and in some cases anticipate European tendencies and are more suitable for the new internationally environment and allow a better organisation of companies. All these factors may favour the location of corporations in Italy.

The gains coming from the reform on the level of fiscal burden suffered by corporation and on its distribution and effects have however been considered contrasting or small (Giannini, 2002; Congiuntura.irs, 2002). At least in principle, the reduction to 33 per cent of the corporate statutory tax rate would not be more favourable than keeping the allowance for internal sources in force with its expected effect of the allowance to progressively reducing effective average tax rate. The "all-in" statutory rate remains far higher in Italy than the European average[30]. This seems the main drawback of the reform. The rate is also far over those of income tax and of interests, and thus it increases opportunity for arbitrages and elusion. The progressive repeal of Regional business tax planned by the Government might reduce these spreads, but it is not easy to be compensated (also to finance the Regions) without other further charges on enterprises. Finally the just mentioned proposals of the abolishing of the business tax and also of the allowance on internal sources would reduce neutrality of investments financing, while raising capital marginal effective rate.

We tried to discuss at length both the "Visco" and "Tremonti" reforms, by pointing out the main pros and cons, as emerged from a wide debate, without avoiding to give our judgements and suggestions. But our fundamental argument is that both reforms do not enough afford the true priority of reforming Italian (and European) fiscal systems, i. e. the need to reduce the burden on production factors, labour first of all. An obvious difficulty arises from the liability to the budget constraints imposed by the Stability Pact. Further a significant reduction of social expenditure (which needs however to be restructured) would be quite questionable and anyway it is politically almost unfeasible. Other possible cuts of primary expenditure seem possible also if not very large,

[30] 37.2 per cent in Italy and 32.4 per cent as European average are expected for 2003 (Giannini, 2002).

by considering also that its level in Italy has already been compressed by the huge amount of interests.

Overall resources which can be collected from expenditure cuts and a reasonable departure from the most strict implementation of balanced budget European rule can however add up to a not minimal figure. Some further funding could be raised in the middle term, by augmenting taxes on externalities (transport and environment) and on immovable properties up to the European average, while not pulling down capital income taxation and reducing avoidance and exemptions, particularly in the case of VAT and income tax. All these resources can reach the amount needed first to lighten the burden of income tax, but without too gifts to the rich and with more horizontal equity, second to cut down the corporation tax "all-in rate" also below the European average, and finally but more of all to abate markedly the social contributions paid by the private employers. A first part of pensions should be funded by means of general fiscal revenues (and paid only at statutory age of pension) while the contributions should cover only the remaining part in accordance with the contributing history of the pensioner[31].

These suggestions are obviously only a first sketch, which requires many deep checks on their economic effects as well on their practical implementation and above all on their political feasibility, particularly as to regards the radical and non marginal shifting of taxes proposed, the non-parametric changes of the pension system (Galasso, Profeta, 2002). At least some steps have however to be done according to the directions proposed here which are also in line (but far more wide) with recent OECD suggestions (Joumard, 2001).

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[31] A similar proposal has been advanced recently by REF (Congiuntura. Irs, 2002).

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