THE LOSS IN PROGRESSIVITY OF REGIONAL TAX POLICIES: THE CASE OF ITALY

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In the last decade, progressive personal income tax systems have been put under scrutiny almost everywhere in Europe with regard to their redistributive effect and their actual degree of progressivity (see, for all, Verbist, 2004; Wagstaff and van Doorslaer, 2001). A non-negligible part of this debate has focused on how to make the personal income tax simpler in terms of tax rate structure and the practical application in many countries has favoured either a reduction of the nominal progressivity or the extension of the area of proportionality.

Italy has not been exception to this debate. In this case, however, after a recently formulated proposal towards a two-rate personal income tax, nominal progressivity at central level has basically been left unchanged. At the same time, since the end of the Nineties, the personal income tax system in Italy has been characterised by a devolution to Regions and municipalities of the power to apply a local income surtax. Over time, this surtax has taken differentiated forms across Regions (either proportional – of various intensity – or progressive). In the same vein, the surtax applied by municipalities are mainly proportional but basically liberalised with regard to their level.

This interaction between central and local income taxes has been widely recognised in Italy, but much less investigated in its effects. Furthermore, the existing literature has mainly focused on intergovernmental relations in terms of tax revenues and tax burden; or on the effects of both national and local income taxes on the distribution of income within Regions; or, finally, on the effects of local income taxes as a whole on aggregate redistribution.

Much less attention has been paid to measuring the potential gain or loss in progressivity that is attached to the isolated action of each Region. When a Region applies a local surtax, indeed, the final effect on the established central progressivity depends on the rank of local residents in the national income scale. The same tax policy may therefore have quite differentiated effects depending on the region actually implementing it. In the case of Italy, this investigation is of particular interest, as average income is quite differentiated among regions, but the dispersion of income within regions is such that there are only few cases in
which regional inequality is greater than national inequality (as measured by the Gini index). The costs and the benefits of a local proportionality and progressivity may therefore be carefully considered.

This paper explicitly addresses this issue on a twofold perspective. On the positive side, by measuring how each regional tax policy modifies the central progressivity in Italy, i.e. by calculating the progressivity cost of having differentiated personal income tax policies rather than an across-the-board alternative. On the normative side, by searching for the conditions under which alternative centralised tax/benefit policies may perform more satisfactorily than decentralised income tax policies (see Cubel and Lambert, 2002, for Spain).

In order to achieve this issue, the paper uses a regional microsimulation model in which the cost of progressivity is assessed on a reference income distribution that is wider than that used by similar studies (e.g. Monteduro and Zanardi, 2005, using a sample of tax returns). The micro simulation model is based on data from the Bank of Italy Survey on Household Income and Wealth (SHIW) conducted in 2000, 2002 and 2004. Available data on net incomes are grossed up with the tax structure in force in 2004. The extension to multiple surveys is needed because a single survey cannot be usually used as a basis for regional estimates due to the relatively small sample size. By combining several surveys, i.e. in a cross-section time series context, estimations may benefit from the advantages of a wider sample, which is proved to be particularly valuable for the Italian case (see Cannari and D’Alessio 2003).

References