

The Support of DG Reform to the Department of Finance



Dipartimento
delle Finanze

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Workshop **The Italian Tax CGE model for policy analysis**

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Background

- ❑ The need for improving tax policies aimed at increasing tax compliance, enhancing tax efficiency and equity, and sustaining the fairness of public finances is one of the key objectives of Italy, in line with the EU strategy:
 - Country Specific Recommendation 2018: Shift taxation away from labour, including by reducing tax expenditure and reforming the outdated cadastral values; step up efforts to tackle the shadow economy;
 - Country Specific Recommendation 2019: Fight tax evasion, especially in the form of omitted invoicing;
 - Country Specific Recommendation 2020: Focus investment on the green and digital transition.

Context

- ❑ Since 2016, the Italian Ministry of Economy and Finance (MEF) has requested assistance to improve the methodological and evaluation tools available at the Department of Finance for enhancing the capacity to formulate, develop and implement reform policies;
- ❑ Project outcomes have been useful in supporting effective structural tax reforms by the Italian administration in line with EU recommendations, particularly with regard to the fight against tax evasion and promoting tax compliance of indirect taxes;
- ❑ The five-year old collaboration with DG Reform allowed us to raise the bar in terms of knowledge, technical skills, and ability to support the Italian reform process.

Fiscal policies in the European Semester



One thematic area of analysis is taxation:

- ✓ **What is the impact of a fiscal shock/stimulus in a given market structure and in the other markets?**
- ✓ **What are the effects of tax measures on markets, households consumption and on income distribution and inequality?**
- ✓ **What are the effects of different measures against evasion on households incomes, markets and sectors?**



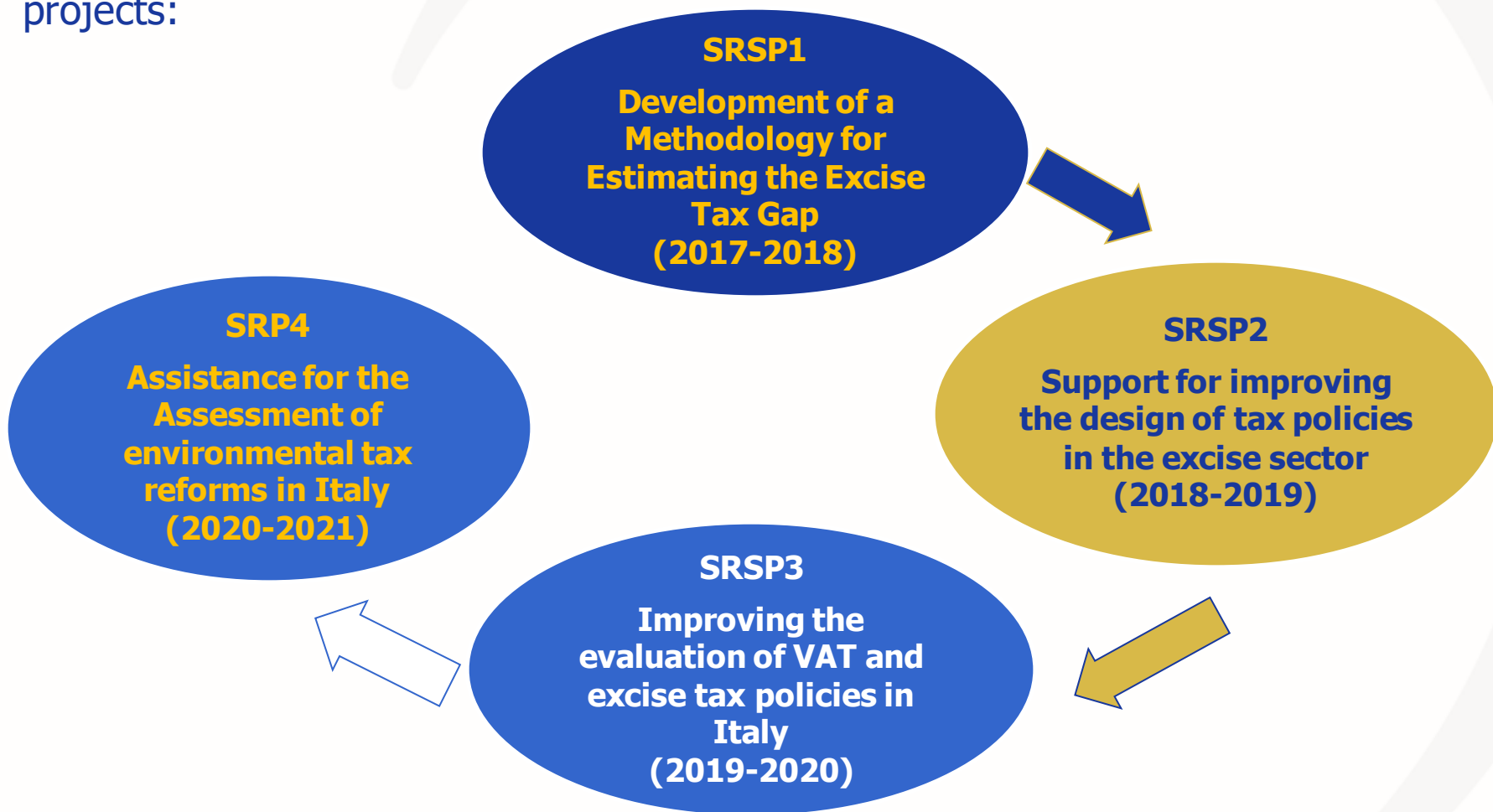
At the Department of Finance we use static microsimulation models (first order effects of policies) to evaluate the impact on revenues and the distributive effects on households/firms of alternative policies



ITAXCGE-DF (Tax-focused CGE model with World Bank and Ecomod) provide a fully-fledged analytical framework to assess the effects of actual or hypothetical tax reform

Projects

Technical support by the former Structural Reform Support Programme (SRSP), now DG Reform Technical Support Instrument, has been received for the following projects:



SRSP1 - Development of a Methodology for Estimating the Excise Tax Gap

Motivation

- Tax and social security contribution gap in Italy is about 108 billion EUR in 2017 (latest available data)
- Despite the importance of tax gap estimates of direct and indirect taxes for Italy, an official calculation of the tax gap for the excise sector was not developed until the year 2017

Objectives

- To develop a method for estimating the excise tax gap, both in overall terms and at sectorial level, in line with international best practices
- To publish official estimates of excise tax gap in Italy for supporting policymaking more effectively
- To use the estimates of excise tax gap for improving tax policy design modelling

Timeline

2017-2018

SRSP1 - Development of a Methodology for Estimating the Excise Tax Gap

Project activities

- Working visits at the UK HM Revenue & Customs (London, January-February 2018), and at the Ministry of Finance of the Slovak Republic, two leading EU tax administrations for the excise tax gap estimation
- Working visit at the Joint Research Centre - European Commission (Seville, March 2018), the leading research institution of the EU for tax policy modelling and evaluation tools
- Participation of the MEF-DF to the HMRC International Tax Gap Conference "Overcoming obstacles to tax gap measurement", invited by the UK HM Revenue & Customs (London, September 2018)
- Active participation in a network of international experts on tax gap issues
- About 10 MEF-DF experts participating in project activities

SRSP1 - Development of a Methodology for Estimating the Excise Tax Gap

Project results

- Acquisition of knowledge, by MEF – DF project team members, about the methodology for estimating the excise tax gap, following the main international experiences (UK, SK, IMF) in this field
- Since 2018, development of an own methodology for producing new official estimates on the excise tax gap (fuel and diesel) in Italy. Series of estimates currently cover the years 2012-2018
- Publication of the new official estimates on the excise tax gap in Italy in the official annual 'Relation on the unobserved economy and fiscal and social contributions evasion', results available online at:
http://www.mef.gov.it/ministero/commissioni/rel_ev/index.html
- Active participation in a network of international experts on tax gap issues (e.g., EU Tax gap project groups, etc.)

SRSP2 - Support for improving the design of tax policies in the excise sector

Motivation

- Need for improving the existing tax policy evaluation tools available to and used by the MEF – DF for conducting indirect tax policy analysis, particularly in the excise sector, also by incorporating new information on excise tax gap

Objectives

- To complete the measurement of the tax gap in the excise sector by integrating the estimation of the compliance gap with an accurate definition and calculation of the policy gap (e.g. taking into account tax deductions and credits);
- To start and conduct initial activities aimed at developing new tax policy assessment tools (e.g. Computational General Equilibrium (CGE) model) to be used by the MEF – DF for supporting tax policy design

Timeline

2018-2019

SRSP2 - Support for improving the design of tax policies in the excise sector

Project activities

- Data collection and database construction to identify and calculate the policy gap in the excise sector: mapping of tax credits and deductions concerning excise duties
- Advanced training activities on macro tax policy modelling and tax policy design regarding the development of a Computational General Equilibrium (CGE) model to be used for policy simulations, provided by leading experts (Ecomod network, ULB Belgium)
- Advanced training activities on micro tax policy modelling and tax policy design regarding microsimulation models that incorporate tools for assessing excises and indirect taxes (e.g., Euromod) to be used for policy simulations, provided by leading experts (Euromod network, University of Essex)
- Active participation in a network of international experts on tax gap and tax policy design aspects
- More than 10 MEF – DF experts participating in project activities

SRSP2 - Support for improving the design of tax policies in the excise sector

Project results

- Construction of a detailed (including sectoral breakdown) database mapping the policy gap and relevant tax credits and deductions for indirect taxes and particularly excises
- Acquisition of advanced knowledge and practical expertise, by MEF – DF project team members, regarding the techniques requested for constructing a Computational General Equilibrium (CGE) model
- Acquisition of advanced knowledge and practical expertise, by MEF – DF project team members, regarding the techniques requested for using and interpreting Euromod microsimulation tools
- Setting up of initial activities for constructing a Computational General Equilibrium (CGE) model for the Italian case, with details on the usage of tax administrative data
- Active participation in a network of international experts on tax gap issues (e.g., OECD Community of Practice on Tax Gap, etc.)

SRSP3 - Improving the evaluation of VAT and excise tax policies in Italy

Motivation

Need for improving the existing tax policy evaluation tools available to and used by the MEF – DF for conducting indirect tax policy analysis, with a particular focus on the general economy effects of VAT and excise tax policies

Objectives

- To construct a dynamic, multi-households, multi-sector Computational General Equilibrium (CGE) model, a unique tool in Italy for assessing indirect tax policy reforms (e.g. VAT and excises *in primis*);
- To consolidate the results obtained under the SRSP1 and SRSP2 projects by using data and information as input for the CGE modelling platform for tax policy design particularly for VAT and excises;
- To implement the new evaluation tool in order to support policymaking for actively designing indirect tax policy reforms

Timeline

2019-2020

SRSP3 - Improving the evaluation of VAT and excise tax policies in Italy

Project outcomes

- The support was provided by DG REFORM over 12 months, in cooperation with the World Bank, and consisted of:
 1. the construction and implementation of a multi-sector, multi-household dynamic Computational General Equilibrium (CGE) model with detailed information on taxes, erosion, evasion, and tax gap
 2. the set up of a user-friendly interface for conducting policy simulations on VAT and excise tax reforms
 3. the provision of capacity building for MEF technical staff
- Thanks to the project, we filled the evaluation gap of tax policies with new knowledge and tools, previously unavailable at MEF
- More than 10 MEF – DF experts participating in project activities

SRSP4 - Assistance for the Assessment of environmental tax reforms in Italy

Motivation

- Need for assessing the shift of the tax burden from labour taxes to environmentally related taxes; importance of evaluating cohesion-friendly tax policies. Lack of adequate methodologies at the Department of Finance

Objectives

- To include environmental data and relations in the new Computational General Equilibrium (CGE) model, with a focus on environmental related taxes
- To integrate the CGE model with regional information in order to quantify the spatial effects of tax policies in Italy
- To enlarge the spectrum of the results achieved thanks to previous SRSP projects
- To adjust our micro and macro models with new environmental and regional information for supporting tax policy reforms

Timeline

2020-2021

SRSP4 - Assistance for the Assessment of environmental tax reforms in Italy

Timeline and outcomes

- November 2020: Starting of project activities
- I quarter 2021: First project outputs (e.g. Assessment Report, Data input, etc.)
- II quarter 2021: Development of environmental and regional modelling
- III quarter 2021: Usage of project outputs for supporting the budget law process
- IV quarter 2021: Project conclusion and final workshop

Final comments and way forward

- We have been honoured to receive support from, and collaborate with, the DG reform (formerly SRSS) since the first years of the launch of the Structural Reform Support Programme;
- In the past years, thanks to the assistance we have received, we made significant progress for supporting the design and evaluation of structural tax reforms in Italy, particularly regarding indirect taxation;
- We have shared, and we continue to share, the outcomes of our projects with a number of colleagues from other EU Member States;
- We hope to continue our constructive relation with the DG reform, which will be particularly useful over the next few years when we will support the government in implementing the Recovery and Resilience plan.