

Fiscal policy for low income households and public budget constraint in Italy

Topic: 811C CGE/econometric IO Modelling (2)

Author: Irfan AHMED

The recent prolonged global financial and economic recession has significantly affected the Euro Area economies. The continuing fragility of Euro area economies has reduced the propensity of businesses and households to invest and to consume. The scarce sources of income have reduced the spending capacity which ultimately reduces the final demand in the Euro Area. Against this backdrop, the government of Italy has contemplated a potential recovery and has introduced a stability law for 2015-2017 which aims at reducing the public expenditures and promoting the investments and to revising the personal income tax bonus for low and medium income brackets for 2015. The government decided to pay 80 Euro per month to the low income households in order to boost the productivity of the economy.

This study aims to investigate the impact of tax-cut policy on the disposable incomes of the institutional sectors, value added by commodities and GDP of the country. The study constructs Social Accounting Matrix (SAM) for Italy with the disaggregation of low level, medium level and high level income households. A neo-classical computable general equilibrium (CGE) model is employed. Two policy scenarios are simulated. The first simulation includes the transfers of 6 billion Euros to the low income households and this tax-cut is compensated by the tax transfers from other institutional sectors. Findings confirm increase in the disposable income of low income households. On the other hand the GDP has a decline of 0.04 percent. The value added by commodities undergoes mixed results wherein some commodities have increased value added while the value added by few commodities evidence a decline. The second simulation evidences increase in GDP by 0.03 percent. The disposable income of all institutional sectors, except high income households, has been increased. The value added undergoes the changes similar to the changes in first simulation.