Less Pensions, More Welfare[*]

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Abstract

A well-known feature of the Italian social welfare system is its concentration on pensions. A much less documented characteristic of Italian taxes-and-transfers are their poor targeting properties among people in working age, and in general their weak anti-poverty properties. The attempts made since 1995 to remedy this situation and rationalise the welfare system have been too partial and largely unsuccessful. Moreover, we have learned too little from these failures due to the de-facto non-experimental design of the Reddito Minimo d'Inserimento "experiment".

A number of proposals to improve targeting involving relatively low administrative costs are outlined in the final section of this paper. We propose a minimum guaranteed income scheme coupled with employment-conditional tax credits for low wage earners and with the introduction of nationwide statutory minimum wage. We also advocate a thorough overhaul of the unemployment benefit system, involving an extension of the coverage offered by unemployment benefits to jobseekers with relatively short work histories, and a rationalization of the existing vast array of income support schemes for the unemployed; a set of child care benefits to promote the participation of women in the labour market; and a set of activity requirements and employment services to minimize the disincentive effects of the welfare state.

The kind of welfare policies we advocate are consistent with a labour market where decentralised wage bargaining takes place, allowing for more wage differentials in the formal sector and a smaller "shadow sector".

INTRODUCTION

The current policy debate on social welfare reform in Italy focuses almost exclusively on the financial viability of public pensions. This approach ignores two important issues:

i)   public pensions have poor redistributive properties and crowd out resources which would otherwise be available to fight poverty much more effectively

ii)   public pensions will not be actuarially fair all along the transition to the new system introduced with the 1995 Dini reform, until the steady state is reached in 2035.

In other words, there is a serious crowding out problem and one bound to persist for a long time. This paper aims at contributing to the ongoing discussion on the "verifica previdenziale" by presenting a coherent set of proposals for a reform of the welfare state that would use the resources freed by the pension reform.

Although we will expand on this later, it is important to set out from the beginning a few of the methodological principles underlying our approach and proposals. First, any proposal for welfare reform cannot ignore the present macroeconomic constraints: for various reasons, in the current situation it is unrealistic (and probably unadvisable in itself) to increase government spending. While we have not carried out a full-fledged simulation of the costs of our proposed reform of the welfare state, we believe it might imply some increase in spending relative to the present. It is then all the more important to associate the reform of the welfare state with a cut in pension spending.

Second, a credible reform of the welfare state must start from a thorough investigation of the specific features of the Italian labor market and poverty. For a number of reasons - both demographic and institutional - the Italian labor market is different, in many respects, from Anglo-Saxon labor markets on which much of the empirical and theoretical literature on the welfare state is based. Similarly, poverty in Italy is concentrated in different categories of individuals than in most non-Mediterranean countries, and has different causes. No serious proposal for reform can ignore these specific features of the Italian society.

Third, the instruments of a welfare state interact with each other and with the working of the labor market. Thus, a proposal for reform of the welfare state cannot be limited to a few instruments: a systematic approach that takes into account social assistance programs, pensions, and labor markets is required.

Fourth, we take the incentive effects of welfare programs on labor supply seriously. Although these have generically been recognized in the Italian debate, they have played a very minor role relative to distributional aspects. While there is considerable uncertainty about the empirical magnitude of these effects, we think this is not a good reason for neglecting them; in addition, they are likely to become more important as the Italian labor market is liberalized.

The plan of the paper is as follows. Section 1 characterizes the distributional features of Italian pensions and of the other social spending. Section 2 discusses the main features and trends of poverty and labor markets in Italy, and compares them with the other countries. Section 3 evaluates the recent developments in the Italian welfare system. Section 4 expands on our methodology and briefly highlights the main trade-offs that are involved in our proposals. Section 5 presents our proposals taking a stance as to where policy should locate along these trade-offs. Section 6 concludes. Annex A presents a brief summary of the most relevant features of the main programs of the Italian welfare state; Annex B summarizes briefly some of the empirical literature on employment conditional schemes and wage subsidies. Annex C presents a glossary of the acronyms we use throughout the paper.

I.   DISTRIBUTIVE PROPERTIES OF THE ITALIAN WELFARE STATE

I.1   WHY WE NEED LESS PENSIONS

As it is well known, Italy has the largest share of public pension spending in GDP (from 14 to 16 per cent, depending on whether the non-contributory, income support component is included or not) among all OECD countries; it also has the largest share of public pension spending in social expenditure (roughly 65 per cent) and in disposable income among all Luxembourg Income Study (LIS) countries. The large size of the pension system implies a well known and much discussed large redistribution to pensioners and away from children and persons in working age; moreover, this redistribution has been increasing over time. This is not an inevitable byproduct of the ageing of the Italian population: the opposite trend occurred between the mid-1980s and the mid-1990s in the Nordic countries and in the US (see Foerster [2000]) in spite of increasing shares in the total population of individuals aged 65 and over.[1]

But the system prevailing before the Amato and the Dini reforms operated two more, and much less discussed, types of perverse redistributions: by personal characteristics of individuals, and by income. These perverse redistributions will persist for a long time, at least until the system reaches the steady state in 2035. [2]

A. Distribution by personal characteristics

We recall here only some of the many peculiarities of the Italian pension system, whereby individuals are treated differently only on the basis of their type of occupation or sector or other characteristics. None of these differences can be justified by standard economic criteria; all are the byproduct of a political and bargaining process.

These peculiarities include: the seniority pension mechanism, generously granted to civil servants (allowed until recently to retire on a full pension after just 15 to 20 years of work) and other special categories (like journalists and bank clerks), without any actuarial correction;[3] the selective use of early retirement options for specific categories of workers involved in redundancies (e.g., railway workers largely benefited from this "soft-landing" scheme); the preferential treatment traditionally offered to the self-employed in terms of rates of returns on contributions; the use of the final salary formula to calculate benefits, to the

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[1] The extent of this intergenerational redistribution is striking. Balducci and Proto [1999] show that the equivalised disposable income of families with pension or capital income but no labor income is the same, decile by decile, as the equivalised disposable income of families with labor or capital income but no pension income; the only exception is the first decile, which has a higher equivalised disposable income if there is only pension or capital income than if there is only labor or capital income. However, families with only pension income have a higher rate of home ownership, hence lower housing expenses.

[2] However, and contrary to the prevailing opinion, Angrisani et al. [2001] argue that some of the intergenerational and intragenerational iniquities of the Italian pension system will persist even after the transition to the Dini system will be completed.

[3] Gronchi [1995] calculates that the implicit rate of return for a seniority pension with 35 years of contributions is about 1 percentage point higher than the implicit rate of return on an old age pension starting at 65 years of age with the same years of contributions. Using current life expectancy tables, this implies that the seniority pension is 34 percent higher than what would be required to ensure the same implicit rate of returns!

advantage of individuals with steep earning profiles -- usually the higher-skill and higher-income individuals -- and that was defined in even more favorable terms for selective categories, like journalists and air pilots.[4]

These asymmetries will be somewhat less marked, but still present (notably the preferential treatment provided to the self-employed vis-a-vis the employees)[5] during the long transition to the Dini regime. Only at the steady state there will be uniformity of rules and actuarial fairness both across and within generations.

B. Distribution by income

There are several ways to bring home the poor distributive properties of the Italian pension system. In evaluating all these numbers, one should keep in mind an important limitation: they all refer to the spending side. It is extremely difficult to assess whether differences across income quintiles in benefits reflect equivalent differences in the PDV of contributions.[6]

- Pension benefits tend to provide a higher premium on education than wages, that is, pre-retirement inequalities in the distribution of earnings are accentuated after retirement. Among the 14 countries of the European Community Household Panel (ECHP), Italy is the only one in which regressions of the pension replacement rate yield statistically significant and positive coefficients for both tertiary and secondary education (Nicoletti and Peracchi [2001]). Put another way, ceteris paribus, pensions are relatively more generous for highly educated people in Italy than in the other countries of the ECHP.

- Among all LIS countries, Italy has the second lowest ratio (after Poland) of the share of pensions in the disposable income of families below and above the average disposable income (see ISAE [2000]). This pattern persists if one looks only at the subset of pensioners: old-age pensions amount to a higher fraction of total pensioners income in the third and fourth quintiles than in the first quintile of the pensioners' income distribution (see Brugiavini and Fornero [2001]).

- Among the countries in the ECHP, Italy has the lowest ratio of the share of pensions in the labour and interest income of the lowest quintile to the same share of the highest quintile (see Eurostat [1999]). Table 1.1 shows that the pension to income ratio for pensioners above 65 declines in Italy as one moves upward in the distribution of income, but at a much slower rate than in the other ECHP countries, particularly the Nordic countries. [7]

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[4] Consider a "flat" earning profile, where the wage increase at .5 percentage points faster than the sum of inflation and contractual salaries; and a "steep" earning profile, where the wage increase at 3 percentage points faster than the sum of inflation and contractual salaries. Gronchi [1995] calculates that, under the Amato reform and its amendments, the implicit rate of return of old-age pensions in the former profile was .6 percentage points lower than in the latter. Using standard life expectancy tables for men, this would imply that the old age pension of a "flat" career should increase by 17 percentage points to ensure the same implicit rate of return as the old age pension of a "steep" career. This difference becomes even higher for categories like journalists and air pilots, who were granted even more generous formulas to discard their worst salaries and usually have steep earning profiles.

[5] After 1990, the entitlements of the self-employed were equalised to those of the employees in spite of substantially lower contributions. Asymmetries in the treatment of civil servants vs. private employees have been instead significantly reduced by the 1997 Prodi reform, as documented by Fornero and Castellino [2001].

[6] For this, one would have to calculate the implicit rate of return at different income quintiles; we are not aware of the existence of a systematic exercise of this type.

[7] For pensioners under 65, the pension to income ratio first declines and then increases in all groups of countries. The average pension to income ratio of pensioners under 65, however, is much higher in Italy than

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Table 1.2 shows that in Italy a lower fraction of individuals in poor households (located in the lower quintile of the pre-pension income distribution) receives a pension than in Nordic (Finland, Denmark, The Netherlands), Continental (Austria, Belgium, France, Germany, Luxembourg) or Anglo-Saxon (UK and Ireland) countries. Significantly, the fraction of low income people receiving a pension (either personally or within her/his family) is in Italy even lower than in the other Southern European countries (Greece, Portugal, Spain), which share some of the characteristics of the Italian welfare state. At the same time, Italian pensions go to a larger fraction of rich (fifth quintile of the pre-pension income distribution) retired people than in all the other groups of countries.[8]

C. The role of intra-household redistribution

It is often argued that in Italy the welfare state is operated by the family more than the state[9]. It is true -- the argument goes -- that the Italian welfare state favors pensioners and male individuals in large firms and unionized sectors; but the same individuals then redistribute their benefits within the family. This argument can be used to downplay the need to reform the Italian welfare state. Thus, it deserves careful consideration. There is no question that pensions are better distributed when looking at families than when looking at individuals. If one repeated Table 1.1 with the share of equivalised pensions to equivalised household income, the drop as one moves from the first to the last quintile would be more marked, and closer to what is observed in Nordic and Anglo-Saxon countries.

However, intra-household redistribution requires large families. True, Italy has the largest average number of non-pensioners living with the pensioner (2.5 on average against 2.1 in the EU) and the second youngest average age of the pensioner (60.5 against 64.2 for the EU as a whole) in households with pensioners (Table 1.3); moreover, after Spain, Italy is the country where the difference between personal and equivalised (household-scaled) incomes of pensioners is more marked and positive (see Table 1.4), as one would expect when pensions go to individuals living in relatively large households. However, family size is rapidly shrinking in Italy, as documented in Section 2.

In addition, efficient intra-household redistribution requires, ceteris paribus, larger transfers being provided to larger families and this is something pensions are not designed for. Indeed, while Italian pensions play an important role in reducing poverty in workless families without children or with just one child, they appear to be much less effective in reducing pensions in households with many children, as we document in section 2.

The scope for intra-household redistribution also decreases as the adult unemployment rate increases in Italy. The unemployment rate of those aged more than 35 increased from less than 4 to more than 6 per cent in the course of the last decade. Currently one in three unemployed is aged more than 35, compared with one in five at the beginning of the 1990s. Adult unemployment is predominantly long-term: between 7 and 8 out of 10 jobseekers in this

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elsewhere: it is 77 percent in Italy against 23 percent in the Nordic countries and 48 percent in the Anglo-Saxon countries.

[8] These patterns have become more marked over time: Lorenz-curves displaying the distribution of old-age pensions among the retirement age population shifted to the right from the mid-1980s to the mid-1990s, pointing to an increased "regressivity" of the pension system (see Foerster [2000]).

[9] For instance, Castillo et al. [1998] and Bentolila and Ichino [2001] attribute to family networks a key role in reducing the social costs of unemployment in Mediterranean countries. Dragosei [1999] documents the significant contribution by elderly family members to household incomes, notably in the Mezzogiorno.

age class have been unemployed for more than a year (compared to about 6 in 10 for the unemployed population as a whole).

Finally, there are high efficiency costs associated with intra-household redistribution. One of these costs is that family-based income support is conditional on sharing the same dwelling, which hinders the mobility of the workforce in a country which already suffers from significant regional labour market imbalances.. Figure 1.1. suggests that this effect may indeed be important in Italy: ceteris paribus, the fact of receiving a pension in the household reduces the propensity to move by half a percentage point, in the case of active individuals (those more likely to move for work-related reasons).

Fig 1.1. Impact of pension transfers on the probability of changing residence[1] in Italy
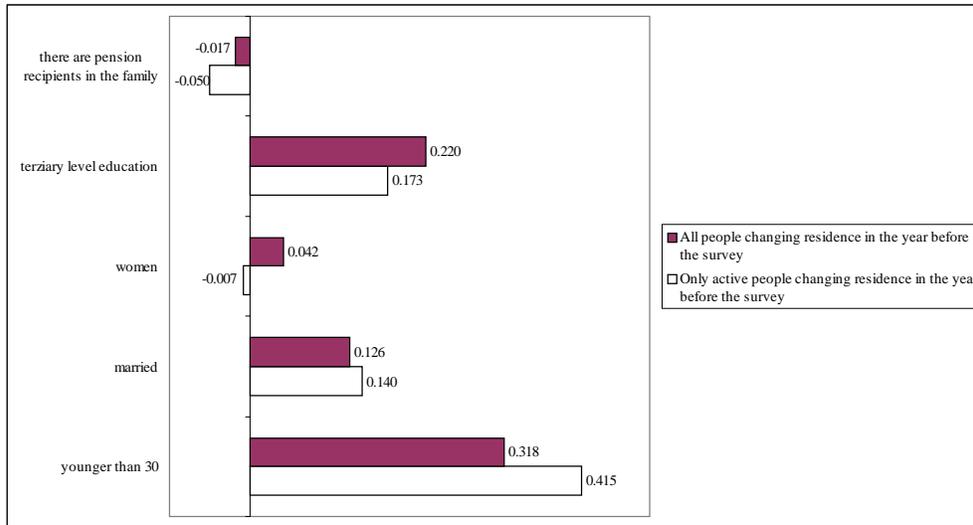
[1] ECHP Survey, waves 1994,1995,1996.

Other efficiency (and equity) effects of family-based redistribution arise with respect to women participation because this type of redistribution assigns to wives important functions in producing and allocating in-kind benefits. These issues are discussed in Section 5, in the context of policies balancing work and family life.

Overall, Italian public pensions have poor redistributive properties, due partly to erratic rules for the calculation of pension benefits and early retirement and partly to the low coverage of the poor households by public pensions. The ultimate cause of the several perverse redistributions that this system operates has to be found mainly in the bargaining power of specific categories of workers and the slow pace at which these asymmetries are being removed. Intra-household redistribution of pensions cannot remedy these iniquities, its scope is being reduced by declining family sizes, and has high efficiency costs.

TABLE 1.1. Ratio of personal pension to personal income by quintile. (PPP amounts in 1996, all pensioners aged above 65)

quintile	Nordic Countries ratio	Continental Countries ratio	Anglo-Saxon Countries ratio	Southern Countries ratio	Italy ratio
1	0.893 (400)	0.906 (1163)	0.928 (417)	0.912 (1188)	0.944 (462)
2	0.856 (368)	0.929 (1129)	0.865 (434)	0.931 (1170)	0.929 (478)
3	0.818 (322)	0.926 (1046)	0.832 (410)	0.911 (1120)	0.915 (406)
4	0.809 (298)	0.899 (995)	0.762 (366)	0.913 (1046)	0.886 (364)
5	0.662 (273)	0.780 (965)	0.702 (309)	0.815 (966)	0.819 (347)
Total	0.785 (1661)	0.867 (5298)	0.793 (1936)	0.880 (5490)	0.889 (2057)

Sample sizes in parenthesis
quintiles are computed on the basis of total equivalised disposable income
Nordic Countries: Finland, Denmark, Netherlands, Sweden
Continental Countries: Austria, Belgium, France, Germany
Anglo-Saxon Countries: United Kingdom, Ireland
Southern Countries: Greece, Portugal, Spain
ECHP - wave 4 (income data refer to 1996)

Table 1.2: Coverage rate of pensions (1)

quintiles	Nordics personal pensions	Nordics pensions in the family	Continental personal pensions	Continental pensions in the family	Anglo-Saxon personal pensions	Anglo-Saxon pensions in the family	Southern personal pensions	Southern pensions in the family	Italy personal pensions	Italy pensions in the family
1	0.189 (6097)	0.263 (6097)	0.183 (7344)	0.282 (7344)	0.214 (3193)	0.294 (3193)	0.273 (7423)	0.466 (7423)	0.144 (3306)	0.340 (3306)
2	0.290 (6096)	0.352 (6096)	0.216 (7351)	0.319 (7351)	0.247 (3193)	0.352 (3193)	0.234 (7421)	0.448 (7421)	0.219 (3264)	0.413 (3264)
3	0.244 (6095)	0.316 (6095)	0.229 (7336)	0.331 (7336)	0.185 (3194)	0.286 (3194)	0.235 (7424)	0.442 (7424)	0.262 (3283)	0.479 (3283)
4	0.201 (6097)	0.271 (6097)	0.209 (7344)	0.303 (7344)	0.181 (3191)	0.284 (3191)	0.211 (7420)	0.431 (7420)	0.249 (3284)	0.469 (3284)
5	0.200 (6095)	0.271 (6095)	0.224 (7343)	0.307 (7343)	0.172 (3192)	0.256 (3192)	0.184 (7421)	0.365 (7421)	0.231 (3282)	0.425 (3282)

Notes: (1) Percentage of individuals in each quintile receiving an old-age or a survivor pension either individually or in the family
Sample sizes in parenthesis
Quintiles are computed on the basis of total equivalised disposable income
Nordic Countries: Finland, Denmark, Netherlands, Sweden
Continental Countries: Austria, Belgium, France, Germany
Anglo-Saxon Countries: United Kingdom, Ireland
Southern Countries: Greece, Portugal, Spain
ECHP - fourth wave (income data refer to 1996)

TABLE 1.3: Households where at least one member receives personal pensions

country	number of non-pensioners	average age in the household
Germany	1.88	65.35
Denmark	1.59	71.24
Netherlands	1.72	68.87
Belgium	1.77	67.61
France	1.88	67.31
United Kingdom	1.74	68.01
Ireland	2.20	63.43
Italy	2.53	60.51
Greece	2.43	62.95
Spain	2.55	62.67
Portugal	2.38	62.99
Austria	2.28	61.78
Finland	2.16	58.05
Sweden	1.74	66.12
Average	2.13	64.19

TABLE 1.4: Equivalent and personal income of pensioners relative to the mean

country	relative equivalent disposable income [1]	relative personal income [2]	diff. [1]-[2]
Germany	1.06	1.04	0.02
Denmark	0.88	0.82	0.05
Netherlands	1.04	1.10	-0.06
Belgium	1.09	1.09	0.00
France	1.07	1.07	0.00
United Kingdom	0.96	0.92	0.03
Ireland	0.90	0.90	0.00
Italy	1.07	1.21	-0.14
Greece	0.90	0.97	-0.07
Spain	1.01	1.24	-0.22
Portugal	0.92	0.93	-0.01
Austria	1.00	1.03	-0.03
Finland	1.04	1.03	0.01
Sweden	1.02	0.95	0.07
Average	1.00	1.04	-0.04

ECHP – fourth wave (income data refer to 1996)

I.2   WHY WE NEED MORE (AND A DIFFERENT) WELFARE

In one respect, social expenditure other than pensions is the mirror image of pension spending: exactly because Italy spends more than any other OECD country on pensions, it has one of the lowest levels of spending on non-pension social programs.[10] This also is well known. But in one other respect, non-pension expenditure is very similar to pension expenditure: it has very poor distributive properties. We can appreciate this along the same dimensions we highlighted for pensions: distribution by personal characteristics, and distribution by income.

A. Distribution by personal characteristics

Italy is quite unique among the developed countries in the role individual characteristics other than income or family status play in determining the beneficiaries of its welfare system.[11] The result is selection rules that are very difficult to justify under any reasonable economic or ethical criterion. We now describe the main anomalies in selection

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[10] OECD [1999c] calculates that the net replacement rate for unemployed workers at 2/3 APW with less than 6 months of unemployment   is the lowest among OECD countries for singles, married individuals without children, and lone parents with two children; it is the second lowest for married individuals with 2 children. This result is highly influenced by the low level of UI benefits in Italy. In fact, Italy fares slightly better for the same typologies, but after 36 months of unemployment, when UI benefits have been exhausted virtually everywhere. Still, the Italian replacement rates are at the low end of the international distribution, because of the low levels of social assistance and housing benefits.

[11] We are of course not the first to emphasize the categorical selectivity of the Italian welfare system. Among many others, this aspect has been emphasized by Commissione Onofri [1997], Ferrera [1998], Rostagno and Utili [1998], Baldini, Bosi and Toso [1999], Toso [2000b], and Dipartimento per gli Affari Sociali [2000b],

rules for each type of social expenditure. Annex A presents the main features of the various social programs.[12]

Family Allowances. For a long time, Assegni per il Nucleo Familiare (ANF) were paid only to dependent employees, unemployed individuals with unemployment benefits, or retired former dependent employees with a pension. This rule has no obvious economic rationale, but it is the product of history: the ANF were developed from a bargaining process between trade unions and big business and have ever since been heavily influenced by the pressures of organised labour (see Matteuzzi [1996]). Since 1999, the ANF have been extended to some categories of self-employed, but with more restrictive criteria and higher income thresholds; the take-up by self-employees has been minimal.

Invalidity benefits. Invalidity benefits are extremely low if an individual has never been part of the workforce.

Social Assistance. Except for the Reddito Minimo di Inserimento, there is no universal income support scheme in Italy for individuals with no history of work in unionized sectors. Only Pensioni Sociali come close to this role, but again they were not meant to cover the entire population, but only those aged 65 and above. Income support of the last resort can be provided at the local level in the absence of national guidelines, but coverage is extremely low and erratic and the amounts involved are small (see Kazepov and Sabbatinelli [2001] for a thorough comparison of local social assistance in Italy and in other countries).

Housing Benefits. Historically, state-owned dwellings (e.g., those owned by the social security agencies) have been offered at rents significantly below market levels mainly to civil servants.[13]

Unemployment Benefits. Only employees in large manufacturing firms were protected against the risk of job loss and were offered strong protection. Those involved in redundancies were offered very generous treatment ending in an early retirement scheme. "Seniority" pensions were regularly made available especially to civil servants, allowing them to stop working and draw a full pension after just 20 years of service (15 for married women). Changes in the structure of employment (mainly the shift from manufacturing to services) have resulted in the steady increase in the share of employment in small firms where the strictest employment protection norms do not apply. The policy response has not been a change in the overall design of benefits, but simply a selective extension of the instruments used in the past, for instance to workers in the large-scale retail sector and the creation of new unemployment benefits schemes, accessible to workers involved in collective redundancies (the so-called "mobility allowances"). The current (rather messy) design of unemployment benefits is summarised in the Annex. Those outside manufacturing (and large units in trade and tourism), can, at best, have access only to the "ordinary unemployment benefits", offering a very low replacement rate (30 per cent, compared with an average of 50-60 per cent in the European Union) for 6 months (6 unemployed out of 10 on average search for more than a

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[12] Other good descriptions of the Italian welfare system and data on individual items can be found in Bosi and Ricci [2000], Dipartimento per gli Affari Sociali [2000b], Commissione Onofri [1997], Matteuzzi [1996], Mazzaferro and Toso [1999], and Monacelli [1998].

[13] Tax credits on rents and rental subsidies have been recently introduced for individuals whose household taxable income falls short of twice the amount of the minimum pension (roughly 18.5 million liras). "Social" rents have also been offered by municipalities based on rankings in principle taking into account of family size and needs, in the absence of national guidelines.

year).[14] All the benefits are not means-tested and, unlike other EU countries, there is no unemployment assistance segment for those falling into long-term unemployment.

It is difficult to quantify the consequences of these anomalies in allocation rules. Perhaps the best way to appreciate their consequences is to consider a simple example, from Bosi et al. [2000]. Consider two families, that are identical except for the source of their incomes; both have two earners and three children, both have a total income of 25mln; the first family is composed of employees, the second of self-employed. The first family receives about 12 mlns in total family benefits (the sum of ANF, AM, A3F, and tax credits); the second only 4 mlns, of which 1.2 from tax credits and about 2.8 from A3F (which is exhausted at 40 mlns).

B. Distribution by income

Given this seemingly erratic distribution of entitlements, the poor income targeting of the Italian social spending should surprise no one. There are various ways to appreciate this; we begin by providing a few statistics on the incidence of the various benefits, and then present some international comparisons.

Toso [2000b] presents a comprehensive investigation of the distributive effects of the main social assistance programs (assegni al nucleo famigliare, integrazione al minimo, pensione sociale, pensione di invalidita' [escluse indennita' di accompagnamento], and pensioni di guerra), based on the 1995 Banca d' Italia survey of the Italian households. The main findings of this study can be summarised as follows:

- Only the Assegni al Nucleo Famigliare (ANF) have relatively good redistributive properties: 30 percent of their total amount accrues to the first decile, and this share decreases very steadily up to .3 percent to the last decile; 90 percent of the ANF are perceived by the first five deciles.
- The other instruments have very poor redistributive properties: the 1st and 9th decile perceive the same share -- about 7.5 percent -- of total spending on *Integrazioni al Minimo*, the largest social expenditure item, and all deciles except the last two perceive a higher share of this item than the 1st decile; similarly, the 9th decile perceives a largest share of *Pensioni Sociali* and of *Pensioni di Invalidita' Civile* than the 1st decile.[15]

A more coincise view of the redistributive properties of these expenditure items can gathered from various indicators of target efficiency. Table 1.5 reproduces a table from Toso [2000b], and displays the total amounts spent on each item in 1995 (1999 for AM, A3F and RMI), according to the Banca d' Italia survey.[16,17]

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[14] Seasonal workers in agriculture can have access to ordinary benefits, since eligibility controls for this type of workers have always been rather loose.

[15] For pensioni di invalidita' civile, the distribution would probably be even worse if one included the indennita' di accompagnamento, which are not means-tested and are excluded from the computations. The pensioni di guerra accrue overwhelmingly to the top deciles; this is not surprising, since these pensions, unlike all the others, do not have any means-test feature in them.

[16] Note that in this sample, spending on ANF and pensioni sociali is overestimated by 34 percent and 17 percent, respectively, while spending on pensioni integrate al minimo and pensioni di invalidita' is underestimated by 37 percent and 79 percent, relative to official INPS and ISTAT statistics.

[17] For completeness, we should mention that these figures are subject to considerable uncertainty. Baldini, Bosi and Toso [2000] show that the share of total non-old age pension social spending accruing to the first decile is 24.4 percent, declining monotonically to 3.9 percent in the last decile. Baldini, Bosi and Toso

continued

Table 1.5

	Vertical expendit. efficiency	Poverty gap efficiency	Total amount, mld
ANF	40.7	12.7	7,360
Integrazione al minimo	42.7	21.9	19,665
Pensioni sociali	39.6	5.6	4,070
Pensioni di invalidita'	32.6	1.7	1,615
Pensioni di guerra	6.7	.05	470
A3F	96.44	1.18	370[1]
AM	48.48	.32	60[1]
RMI	94.81	8.99	476[1]
All[2]	45.1	35.3	33,180

Source: Toso [2000b], Table 3.6, first five lines and last line. A3F, AM, RMI: Baldini, Bosi and Toso [2000], Table 7

1: 1999

2: excluding A3F, AM, and RMI

To understand these figures, the *Vertical Expenditure Efficiency* represents the share of spending on each program that goes to households who are below the poverty line before the transfers; a value of VEE of 45 percent means that 55 percent of the expenditure of these instruments accrues to households above the poverty line. A high value of the Vertical Expenditure Efficiency would not per se guarantee that the instrument has strong anti-poverty effects, if total expenditure on that instrument is low. The *Poverty Gap Efficiency* measures how much of the total poverty gap is filled by each instrument. Clearly, this measure is influenced by the total expenditure on each item; in fact, the most effective instrument according to this measure is the *Integrazioni al Minimo*, by far the largest item. On the other hand, note the excellent properties of A3F and RMI in terms of VEE, but their very poor performance in terms of PGE, precisely because their budget is minimal.

To put these few figures in an international perspective, ISAE [2000] has calculated that, among the ECHP countries, Italy has the lowest share of non-pension social benefits in the income of the lowest quintile. The share of non-pension social benefits to total disposable income for the three bottom deciles is in Italy about one-third than in the other OECD countries and this gap has increased over time (see Foerster [2000]). Indeed in Italy, unlike most OECD countries non-pension cash-transfers became over the 1990s increasingly concentrated on the middle classes and away from the poor just while in the other countries, there was a marked trend towards increased progressivity of these programmes (see Foerster [2000]).

All these figures refer to the spending side only. As usual, obtaining reliable estimates of the net effects of taxes and social benefits is extremely difficult. An attempt has been made by Foerster [2000]. In Italy, pre and post-net transfers poverty rates for persons in working age are remarkably close, denoting a low effectiveness of taxes and transfers in alleviating

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[2000] refer to the distribution of benefits in 1998, instead of 1995; they use a slightly different equivalence scale; and they impute tax evasion. Yet, we doubt that these differences alone can generate such different results from Toso [2000b]; hence, at this stage we cannot reconcile these differences.

poverty.[18] For some categories of individuals, like children and single parents, post-net transfer poverty rates were, in the mid-1990s, equal or even larger than before the net transfers. This limited equalising contribution is caused mainly by taxes rather than by transfers, i.e. taxes, as opposed to transfers, were responsible for the redistribution that is there.[19]

C. An international perspective: some new statistical evidence from the ECHP

More detailed information on the targeting properties of the Italian welfare state compared to the other countries can be gathered from the ECHP. Tables 1.6 through 1.10. display probit regressions of the probability of receiving different types of cash transfers against family characteristics and income.

All cash transfers appear to be poorly targeted by income and by personal characteristics. If benefits were targeted by household income, the coefficient of the household income variable should be negative; in fact, in Italy it is *positive* in the case of unemployment benefits, family related benefits, and housing benefits, and it is negative but considerably smaller than in the other countries (including the other Southern European countries) in the case of sickness/invalidity benefits and social assistance benefits. The coefficient of the home-ownership dummy variable is positive (for housing benefits!) or a negative but very small (for family related benefits and for social assistance benefits), indicating that not only income, but also asset tests do not perform well in the Italian welfare system.

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[18] Transfers are defined as the sum of old-age, survivor and disability pensions, sickness benefits, family allowances, unemployment benefits, and housing benefits and isolates direct taxes and employee social security contributions.

[19] Another limitation of these figures is that they refer to a point in time, rather than to lifetime taxes and transfers. Falkingham and Harding [1997] show that the distribution of lifetime cash transfers and taxes in Australia and the UK is very progressive. We are not aware of a similar exercise for Italy. But for the distribution by households, it is unlikely that the lifetime and the point-in-time distributions differ too much; hence, it is unlikely that the Italian distribution of net transfers come even close to the British and Australian ones in terms of progressivity.

TABLE 1.6: Probit estimation for Unemployment Related Benefits (1)

Dependent variable=1 if received unemplyment related benefit in 1996 (2)	Italy	Nordic Countries	Continental Countries	Anglo-Saxon Countries	Southern Countries
1=female	*0,0693*	-0,0164	0,0076	*-0,0790*	-0,0180
Age	**0,0425**	**0,0127**	**0,0491**	**0,0625**	**0,0366**
Age^2	**-0,0004**	*-0,0001*	**-0,0005**	**-0,0007**	**-0,0003**
1=primary education	-0,0271	**-0,0486**	*-0,0651*	-0,0018	**0,0659**
1= tertiary education	**-0,1494**	**0,0465**	**-0,1158**	**-0,1180**	0,0217
Family size	*-0,0279*	0,0025	-0,0083	**0,0765**	**-0,0409**
number of kids (<16)	0,0342	0,0154	0,0239	**-0,0733**	**0,0461**
HH non-transfer income	**0,0424**	-0,0067	-0,0093	**-0,0416**	**0,0213**
1=self employed (3)	(4)	*-0,0998*	**-0,2083**	-0,0899	**-0,1372**
1=working in public sector (3)	0,0478	0,0097	**-0,0939**	0,0791	-0,0060
1=part-time worker (3)	*-0,0864*	**0,0204**	**-0,1080**	-0,0298	**-0,0685**
1=working in agricolture (3)	**0,4417**	-0,0424	0,0977	0,2411	*0,0818*
1=working in services (3)	**0,0967**	-0,0319	0,0114	-0,0694	**-0,0849**
Pseudo R2	0,2187	0,0846	0,0876	0,1003	0,1238
Number of Obs	504	937	774	656	2067

Notes:

(1) unemployment related benefits=unemployment insurance and unemployment assistance (in those countries where it exists) but also temporary redundancy benefits

(2) only people who have been unemployed in 1996 have been included in the estimation

(3) if the person is employed at the time of the interview, these variables refer to current job otherwise to the previous job

(4) dropped because of collinearity (i.e. none Italian ub recipient is self employed)

Nordic Countries: Finland, Denmark, Netherlands, Sweden

Continental Countries: Austria, Belgium, France, Germany

Anglo-Saxon Countries: United Kingdom, Ireland

Southern Countries: Greece, Portugal, Spain

Coefficients in bold are significant at the 5% level. Coefficient in Italics are significant at the 10% level.

ECHP, fourth wave (income data refer to 1996)

The benefits are also poorly targeted by personal characteristics. In the case of unemployment benefits, the implicit allocation mechanism is mostly explained in Italy by the industry of affiliation. In particular, agricultural workers display, ceteris paribus, a much higher likelihood of receiving unemployment benefits than other types of jobseekers in Italy. For family related benefits, the "number of children" variable has the smallest coefficient among all the panel countries and personal characteristics account for a lower fraction of the variance in the degree of coverage of these transfers than in the other countries. For sickness/invalidity benefits, "bad health" has the lowest coefficient, while age has a positive and significant coefficient, indicating that these transfers often are really disguised early retirement pensions or permanent unemployment benefits. For social assistance benefits, Italy is the only country where, holding household income constant, the "tertiary education" dummy variable has a positive coefficient; moreover, the latter is almost eight times as large as the "primary education" dummy variable coefficient. In other words, individuals with a tertiary education are significantly more likely to receive a social assistance benefit not only than individuals with a secondary education (the benchmark case), but also than individuals with a primary education, holding constant the household income. Finally, to confirm that social spending in Italy is biased in favor of the elderly, notice that Italy is the only country where "age" does not have a negative coefficient for social assistance benefits.

TABLE 1.7: Probit estimation for Family Related Benefits

Dependent variable=1 if received family related benefit in 1996	Italy	Nordic Countries	Continental Countries	Anglo-Saxon Countries	Southern Countries
1=female	**-0,0172**	**0,1648**	**0,0724**	**0,3569**	**-0,0351**
Age	0,0001	**-0,0021**	**0,0008**	**0,0004**	0,0000
1=primary education	-0,0002	**-0,0631**	**-0,0823**	**-0,0189**	**0,0385**
1= tertiary education	**-0,0083**	**0,0386**	0,0075	-0,0008	**-0,0155**
Family size	**-0,0030**	**0,0077**	**0,0070**	**-0,0093**	**-0,0104**
number of kids (<16)	**0,0136**	**0,0885**	**0,1377**	**0,1131**	**0,0489**
HH non-transfer income	0,0006	**-0,0039**	**0,0221**	**0,0139**	**0,0074**
1=own house	**-0,0074**	-0,0026	**-0,0308**	**-0,0134**	**-0,0294**
Pseudo R2	0,1009	0,2815	0,1811	0,4300	0,1125
Number of Obs	12923	26428	29751	13566	31568

Notes:

Nordic Countries: Finland, Denmark, Netherlands, Sweden

Continental Countries: Austria, Belgium, France, Germany

Anglo-Saxon Countries: United Kingdom, Ireland

Southern Countries: Greece, Portugal, Spain

Coefficients in bold are significant at the 5% level.

ECHP, fourth wave (income data refer to 1996)

TABLE 1.8: Probit estimation for Sickness/Disability Benefits

Dependent variable=1 if received sickness/disability benefit in 1996	Italy	Nordic Countries	Continental Countries	Anglo-Saxon Countries	Southern Countries
1=female	**-0,0095**	-0,0023	**-0,0189**	**-0,0106**	**-0,0082**
Age	**0,0004**	**0,0008**	**0,0003**	**0,0006**	0,0000
1=primary education	**0,0085**	-0,0051	**0,0094**	0,0071	**0,0148**
1= tertiary education	-0,0077	**-0,0284**	**-0,0092**	-0,0056	-0,0013
1=bad health	**0,0630**	**0,2327**	**0,0796**	**0,1928**	**0,1205**
Family size	0,0007	**0,0081**	0,0008	0,0029	**0,0034**
number of kids (<16)	-0,0020	**-0,0092**	-0,0004	-0,0037	**-0,0051**
HH non-transfer income	**-0,0025**	-0,0022	**-0,0052**	**-0,0112**	**-0,0039**
Pseudo R2	0,1758	0,0427	0,0750	0,1268	0,1741
Number of Obs	12921	22465	29612	13557	31018

Notes:

Nordic Countries: Finland, Denmark, Netherlands, Sweden

Continental Countries: Austria, Belgium, France, Germany

Anglo-Saxon Countries: United Kingdom, Ireland

Southern Countries: Greece, Portugal, Spain

Coefficients in bold are significant at the 5% level.

ECHP, fourth wave (income data refer to 1996)

TABLE 1.9: Probit estimation for Social Assistance Benefits

Dependent variable=1 if received social assistance benefit in 1996	Italy		Nordic Countries		Continental Countries		Anglo-Saxon Countries		Southern Countries	
1=female		0.0003		-0.0008		0.0009		0.0072		0.0002
Age		**0.0000**		**-0.0013**		**-0.0003**		-0.0004		**-0.0001**
1=primary education		**0.0024**		0.0023		**0.0050**		**0.0527**		0.0000
1= tertiary education		0.0188		**-0.0063**		-0.0014		**-0.0499**		-0.0019
1=bad health		**0.0034**		0.0134		0.0054		-0.0028		**0.0036**
Family size		0.0001		**0.0140**		0.0021		**0.0150**		0.0015
number of kids (<16)		0.0009		**-0.0079**		0.0016		**-0.0074**		0.0014
HH non-transfer income	-0.0021	**-0.0008**	-0.0103	**-0.0125**	-0.0051	**-0.0047**	-0.0567	**-0.0493**	-0.0023	**-0.0025**
1=own house		-0.0018		**-0.0423**		**-0.0125**		**-0.1503**		-0.0019
Pseudo R2	0.0556	0.2027	0.0263	0.1525	0.0411	0.1319	0.1647	0.2470	0.0219	0.0656
Number of Obs	13955	12921	27425	22373	33671	29603	6038	5558	32169	31015

Notes:

Nordic Countries: Finland, Denmark, Netherlands, Sweden

Continental Countries: Austria, Belgium, France, Germany

Anglo-Saxon Countries: United Kingdom, Ireland

Southern Countries: Greece, Portugal, Spain

Coefficients in bold are significant at the 5% level.

ECHP, fourth wave (income data refer to 1996)

TABLE 1.10: Probit estimation for Housing Benefits

Dependent variable=1 if received sickness/disability benefit in 1996	Italy		Nordic Countries		Continental Countries		Anglo-Saxon Countries		Southern Countries	
1=female		0,0000		**0,0217**		0,0030		0,0020		0,0005
Age		0,0000		**-0,0017**		**-0,0017**		**-0,0002**		0,0000
1=primary education		-0,0002		0,0055		**0,0288**		**0,0058**		**-0,0022**
1= tertiary education		-0,0023		0,0011		**-0,0162**		0,0055		**-0,0023**
1=bad health		-0,0020		0,0163		0,0022		**0,0114**		-0,0019
Family size		**-0,0018**		**0,0208**		0,0057		-0,0013		-0,0004
number of kids (<16)		**0,0020**		0,0056		**0,0357**		**0,0030**		**0,0008**
HH non-transfer income	0,0010	0,0010	**-0,0362**	-0,0439	**-0,0163**	-0,0218	**-0,0106**	-0,0049	0,0001	0,0001
1=own house		0,0018		**-0,0905**		**-0,0647**		**-0,0843**		**-0,0084**
Pseudo R2	0,0031	0,0212	0,0578	0,1278	0,0165	0,1585	0,0656	0,2271	0,0001	0,0510
Number of Obs	13955	12921	27425	22373	33671	29603	14406	13554	32169	31015

D. Perverse equivalence scales

The Italian welfare system has been criticised often for the use of complex and seemingly unexplainable equivalence scales, to adjust benefit amounts to the size and characteristics of households.

What are the equivalence scales implicit in the various programs? This question has at least two immediate dimensions: (i) the threshold values of income above which a household or individual is not eligible to a certain benefit, and (ii) the amount of the benefit. Because the amount of the benefit at the threshold level of income is often minimal,[20] the first question is not very interesting. More meaningful is a comparison of the equivalence scales implicit in the benefit amounts (which in turn vary with the level of income) with the main existing equivalence scales. [21]

Table 1.11 represents the absolute amounts and the implicit equivalence scales of the ANF, starting July 2001. The table uses as a comparison the new ISE and the Carbonaro equivalence scales: note that the new ISE equivalence scale assigns a higher weight to disabled minors than the Carbonaro's.

The table shows that the equivalence scale implicit in the ANF for a few family types has very little to do either with the new ISE or with the Carbonaro scale, or with any other conceivable scale. The equivalence scales are most easily interpretable at 0 income, because the poverty line is itself influenced by the equivalence scale utilized (in this case, Carbonaro). At 0 income, ANF assigns a very large weight to each additional child, while it assigns a very marginal weight to the event of a disabled child. This changes drastically at 1.5 poverty line, where a disabled child is assigned an enormous weight relative to a non-disabled child. It is not clear what the rationale of this disparity is -- if anything, one would expect the opposite

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[20] For instance, a family of three with two parents and one able minor would perceive Lit. 300,000 per year at the upper threshold level of income of 72.7mn in 2001.

[21] There is an additional conceptual difficulty, which we do not pursue here further: should the income used in the comparison be total income or total equivalised income? In other words, should implicit equivalence scales for benefit amounts be computed holding constant the total household income for different family compositions, or the equivalised household income?

ranking: a higher relative weight to a disabled child in poorer households. [22] Also, up to 1 PL a single parent with 1 dependent child receives a smaller ANF than a couple with a dependent child; at 1.5 poverty lines, it is the opposite; again, we believe it is virtually impossible to think of a reasonable approach that would rationalize this pattern.

More generally, the structure of ANF seems to be largely erratic. Given income, the benefit does not increase monotonically with the number of children; and given the number of children, it does not decrease monotonically with income (see Matteuzzi [1996]). Surprisingly, the latest revision of ANF does not seem to have corrected this well understood and very apparent problem.

Tax credits for dependents and children also follow a seemingly erratic behavior. They assign the same weight to a dependent spouse and to a child (for a lone parent); they are also proportional to the number of children, assuming away economies of scale in child care; finally, tax credits for the second and third child are independent of the income level, implying higher implicit equivalence scales for higher income levels.

In principle, social assistance provided at the municipal level implicitly adopts equivalence scales which bear a close correspondence with the new ISE scale. However, due to budget constraints and the discretionary power of local administrations, there are significant discrepancies between legal and actual rules of allocation of benefits. Kazepov and Sabbatinelli [2001] for instance document that in Milan the same benefit is provided to singles and couples without children, while by statute the couple should receive a benefit roughly one third higher.

Table 1.11

	ISE e.s.	Carbonaro e.s.	At 0 income		at 1 PL (Carbonaro)		at 1.5 PL (Carbonaro)	
Couple	1	1	1,080	1	1,080	1	600	1
single, 1 minor	1,77	1	2,316	2.14	2,316	2.14	1,848	3.08
couple, 1 minor	1,57	1.33	3,036	2.81	3,036	2.81	1,020	1.70
couple, 1 disabled minor	2,07	1.33	3,240	3	3,240	3	3,240	5.40
couple, 2 minors	2,46	1.63	5,820	5.39	4,428	4.10	1,896	3.16
couple, 2 minors, 1 disabled	2,96	1.63	6,276	5.81	6,276	5.81	4,752	7.92

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[22] However, this case also illustrates the perils of this type of comparisons. The large increase in the relative weight of disabled minors at 1.5 poverty lines is influenced mostly by the large fall in the reference point, the benefit for a couple without minor at 1.5 poverty lines. In turn, this reference point is of little significance, because it is very small to start with.

II.   MAIN TRENDS OF POVERTY AND NEEDS IN ITALY

II.1   INCREASING INCIDENCE AND CHANGING COMPOSITION

All data sources point to an increase in the incidence of poverty in Italy from the beginning of 1980s to the mid-1990s. According to Istat data -- which are based on consumption -- the relative poverty rate[23] in Italy increased by almost three percentage points in the period between 1980 and 1997[24] (Istat [1999]). According to Luxembourg Income Study (LIS) and aggregate data collected by OECD -- which are based on incomes -- both the relative and absolute poverty rates increased: in particular, "absolute"[25] poverty raised by 2 percentage points, just while in all the other West-European OECD countries it was decreasing; relative poverty increased by almost four percentage points (see Foerster [2000]). Furthermore, poverty increased both in terms of headcounts and of income gap measures (the income distance between the average income of the poor and the poverty line).

Unfortunately, Istat data are not comparable with data from other countries while LIS data (as well as data from the OECD questionnaire) cover only a subset of European countries and are available only up to 1993-4. For a comparison with other European countries, it is better to draw, once more, on ECHP data[26]. These indicate that over the 1993-96 period Italy had an average poverty rate (defined as the percentage of households with equivalised income below 66 per cent of the median) of 13.9, the highest poverty rate after Greece and Portugal (Chart 2.1), and only slightly lower than that of the US[27].

Longitudinal data obtained by matching records across ECHP waves indicate that poverty is also more persistent in Italy than in the other EU countries, except Portugal. In particular, Italy has the second largest share of "always poor" (individuals whose income has been below poverty lines for three consecutive years) in the working age population (5.6 percent compared with a EU average of 3.8). Significantly, the persistence of poverty is relatively low among the retirement age population. The always poor are concentrated in central age groups (31 to 50) as well as in workless and one-worker households.

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[23] The relative poverty rate is defined in terms of a "relative" definition of the poverty line, typically half or two thirds of the median income.

[24] The Istat series has a break in 1997, when the survey was adjusted to meet the EU standards.

[25] The "absolute" poverty rate is defined in terms of an "absolute" definition of the poverty line, i.e. a constant poverty line in real terms over time.

[26] Sample size is an issue in the case of ECHP data. For this reason, we always report the number of observations available and compare our results with those from other data sources.

[27] These rankings are robust to changes in both equivalence scaling methods and income thresholds (for instance, using 40, 50 or 60 percent of median incomes: see OECD [2001], Annex 2.B).

Chart 2.1: Relative poverty rates, average 1993-1996

(ECHP - waves 1994, 1995, 1996, 1997)

Note: The relative poverty rate is defined as the percentage of individuals having an equivalised household income smaller than half of the median household income
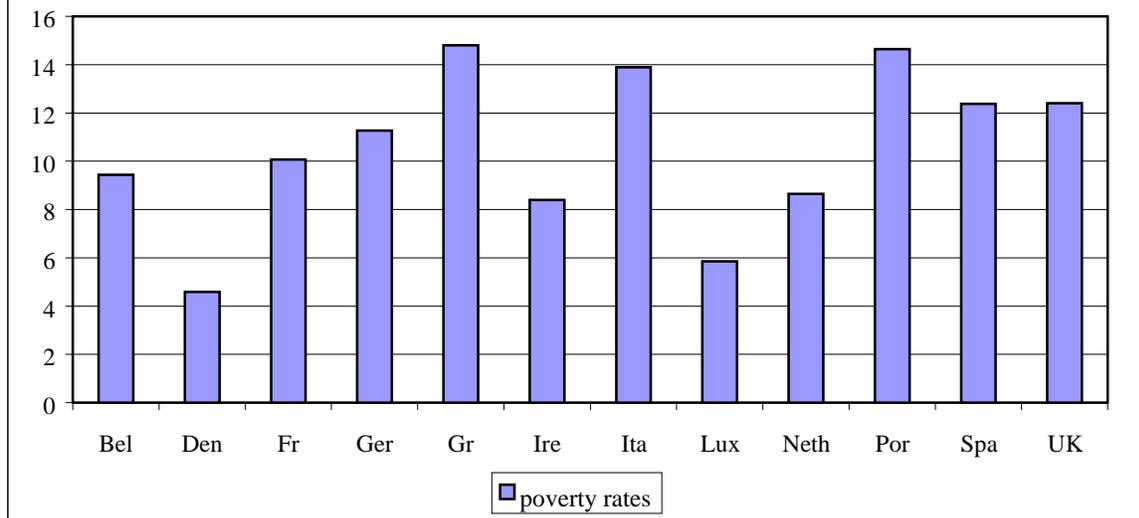
There are three distinct patterns underlying these developments. The first is the changes intervened in the family size and structure. The second relates to the polarisation of employment, with an increase in the share of workless households and of households in families in which both adults are working, and a parallel decrease in the percentage of households in which workers and non-workers coexist. The third pattern is the limited coverage offered by pensions to households with children where only one person is working and to workless people aged 51 to 65. In summary, the increase of poverty in Italy has a demographic, labour market and social policy dimension.

A**.** Demographic Dimensions

Family size and lone parenthood. Between 1977 and 1995, the average family size decreased in Italy from 3.2 to 2.8, still the largest average size in the LIS countries after Ireland and Spain. This is mostly the result of a large decline in the share of families with five or more members (from 6.1 to 9.9 percent) and a large increase in the share of singles (form 9.7 to 18.3 percent). Of these one member families, more than half is females over 65; only 6 percent of all families is singles under 65: this is the key difference with Continental and Nordic countries, where typically between 15 and 30 percent (as in Sweden) of all families is singles under 65 (see Brandolini and D' Alessio [2001]).

Single adult families with children were in 1995 6.8 percent of the total -- the second largest share among LIS countries, after the UK (see Brandolini and D' Alessio [2001]). However, this figure reflects the large number of pensioners living with their children, many of whom are adults; only 6 percent of these single adult families with children (or .4 percent of all families) are single adult families with one child under 17[28], the lowest share among LIS countries. Similarly, if one restricts the sample to families with all members under 60

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[28] Available ECHP data do not allow to apply a similar decomposition to families with two or more children.

years of age, in 1999 only 3.1 percent are single adult families with children under 6, the third *lowest* share after Greece and Spain, and only 5 percent (or .8 percent of all families) are single adult families with at least one child under 6, again the third lowest share after Greece and Spain (see OECD [2001a]).

Thus, compared to other countries, Italy has a rather large share of singles with and without children. But this largely reflects the high incidence of single elderly females living alone or with their children; if one considers only the share of single adults under 60 with children under 6 -- the relevant figure to assess policies that encourage employment by single mothers -- this is below 1 percent of the total, among the lowest in the OECD group. In contrast, the share of single adult families with only one child who is over 17 -- the relevant figure to assess policies to encourage employment by youngsters living with their parents -- is 3.7 percent, by far the highest of all LIS countries.

Incomes, poverty and children. In two parent families, an increase in the size of the family is associated with a large decline in equivalised disposable income: among LIS countries, Italy has the lowest equivalised disposable income of two parent families with 3 or more children relative to the average disposable income. In contrast, Italian single parent families with one and with more than one children have the highest and second highest, respectively, relative equivalised disposable income among LIS countries (see Brandolini and D' Alessio [2001]).

These patterns persist when looking at poverty rather than income. It is useful to break down patterns of poverty according to three distinct criteria: (i) two- vs. single adult, (ii) families with children vs. families without children, (iii) and the interaction of the two.

(i) Among European countries, Italy is an outlier in that the relative (to the average) incidence of poverty is higher among two- than among single adult families (see Table 2.1).

(ii) Like in most other countries, in Italy families with children have a significantly higher risk of poverty than families without children (see Table 2.1 and Forster [2000] Table 5.5), although the difference is more marked in Italy than elsewhere. It becomes even more marked when the focus is on long-term poverty, that is families who have been below the poverty line for three consecutive years (second column of Table 2.1); now the relative risk of poverty for families with children in Italy is double the European average.

(iii) However, this pattern masks an important difference between two- and single adult families. In the former, the poverty rate is significantly higher for families with children than without children: while this is not uncommon, Italy is, after the Netherlands, the country where the ratio of the poverty risks of the two family types is highest. In contrast, Italy, Greece, Portugal, and the US are the only countries where the poverty risk is higher among single adult families without children than with children (see Table 2.1).[29] As a result, Italy is one of the very few countries where the poverty rate is higher among two adult families with children than among one adult family with children (see Table 2.1).[30]

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[29] The presence of the United States in this selected group is probably due to the operation of AFDC (now TANF) and several other programs aimed exclusively at families with children.

[30] In a different sample of 6 countries, and using different data, Bradbury and Jannty [1999] also show that in the mid-nineties 20.9 percent of minors in two-parent families lived in a poor household - the highest percentage among the 6 countries considered; but 20.2 percent of minors in lone-parent families lived in a poor household - by far the lowest percentage, and in fact the only case in which the poverty rate of minors is lower in lone-parent families than in two-parent families.

Table 2.1A: Relative risk of poverty for short-term poor and long-term poor, 1993-1995: Italy

Characteristics		relative risk of being poor at least once	relative risk of being permanent poor
head gender	men	0.977	1.003
	women	1.163	0.976
	women over men	*1.190*	*0.972*
head age	less than 30 years old	1.098	1.000
	31 to 50 years old	0.951	1.010
	51 to 65 years old	1.092	1.115
	above 65 years old	0.932	0.735
	above 65 over less than 30	*0.849*	*0.735*
work attachment	no worker	1.493	1.502
	one worker	1.265	1.334
	two worker	0.405	0.358
	more than two worker	0.413	0.127
	at least one worker	0.871	0.869
	at least one worker over no worker	*0.584*	*0.578*
family type, no children	single adult	1.044	0.691
	two adults	0.545	0.336
	total without children	0.706	0.450
family type, children	single adult	0.917	0.950
	two adults	1.082	1.195
	total with children	1.067	1.173
	with children over without children	*1.511*	*2.605*
education: level of head	low	1.309	1.409
	middle	0.573	0.392
	high	0.416	0.360
	low over high	*3.150*	*3.920*

Table 2.1B: Relative risk of poverty for short-term poor and long-term poor, 1993-1995: all ECHP countries

Characteristics		relative risk of being poor at least once	relative risk of being permanent poor
head gender	men	0.931	0.928
	women	1.451	1.466
	women over men	*1.559*	*1.579*
head age	less than 30 years old	1.254	1.151
	31 to 50 years old	0.919	0.965
	51 to 65 years old	0.987	0.965
	above 65 years old	1.092	1.062
	above 65 over less than 30	*0.871*	*0.922*
work attachment	no worker	1.828	1.991
	one worker	1.068	1.058
	two worker	0.405	0.318
	more than two worker	0.420	0.300
	at least one worker	0.748	0.699
	at least one worker over no worker	*0.409*	*0.351*
family type, no children	single adult	1.224	1.143
	two adults	0.724	0.602
	total without children	0.891	0.782
family type, children	single adult	1.556	1.556
	two adults	0.977	1.028
	total with children	1.035	1.081
	with children over without children	*1.161*	*1.382*
education: level of head	low	1.367	1.510
	middle	0.839	0.710
	high	0.531	0.455
	low over high	*2.576*	*3.317*

Source: ECHP - waves 1994, 1995, 1996

Thus, relative to the other countries, in Italy the poor are much less concentrated[31] in single adult households with or without children, and more concentrated in two-adult households, particularly with children. This largely reflects the patterns of families with children, where single-parent families have a much lower relative poverty rate than two-parent families, the opposite pattern to most other OECD countries; for families without children, the risk of poverty is higher among one-adult families, as in most other OECD countries.

Overall, because single adult families with children[32] are rare in Italy, it is still true that families with children face in Italy a comparatively higher risk of poverty than in the other ECHP countries.

B. Labour Market Dimensions

Low-paid employment and wage dispersion. Compared with other countries, Italy has a high degree of wage compression in the formal sector. In fact, after Sweden Italy has the lowest Gini coefficients of the distribution of yearly wages for full-time employees in ECHP countries (see Table 2.5).

This high degree of wage compression is caused by a centralised collective bargaining system covering a much larger fraction of the workforce than the unionised segment. While about 36 percent of workers are members of a trade union and 40 per cent are employed in firms joining employers' associations, the estimated coverage rate of collective bargaining is in Italy of the order of 85 per cent (see OECD [1997]).

Because of this high wage compression in the formal sector, Italy still has one of the lowest the incidence of "low-paid" jobs (defined as those jobs paying less than 2/3 of the median) among employees: in 1998 it was 12 percent among full time employees, and 18 percent if part-time and occasional jobs are also included.[33] Low pay among employees is concentrated among youngsters and women: in 1998 roughly 60 percent of the working poor were under 25 years of age, by far the largest percentage among OECD countries. The incidence of low-pay employees among women was between 16 and 26 per cent depending on whether one considers only full-time jobs or also part-time and occasional jobs. As Italy has among the lowest shares of single mothers (O'Donoghue and Utili, 2000), low-paid jobs seem to be a problem largely among married women.

Low-paid employment, however, is rising among employees, by about 2 percentage point in the in the 1986-98 period (see Brandolini [2000] and see Lucifora [2000]). The increase is even more marked if one includes also part-time and occasional jobs: in this case the incidence of low-pay increases from 13 to 18 per cent.[34]

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[31] The relative poverty risk of a given category is defined as the ratio of the poverty risk of that category (the share of poor households in that category) to the average poverty rate. The concentration of poverty in one category is a direct function of the relative poverty risk of this category.

[32] From now on, "children" are defined as individuals under 16 year of age, or under 6 if specifically noted.

[33] Data on hours worked, however, are not always reliable.

[34] The gap between part-time and full-time wages is however limited by OECD standards, notably at the lower end of the distribution (the maximum earnings of bottom decile of hourly earnings of part-time were in 1995 just 3 percentage points lower than those of full-time workers, while in other OECD countries the difference was of 12 percentage points: see OECD [1999]). One of the reasons for this small part-time/full-time gap is that part-time workers typically had much longer tenures in Italy than elsewhere (62 per cent of part-
continued

The incidence of low-paid employment is much higher among the self-employed, at about 25 percent.[35] This is important because, as it is well known, self-employment is in Italy large by OECD standards: in 1998 non-agricultural self-employment reached 22.7 of the non-agricultural civilian employment, the 4th largest share after Turkey, Korea and Mexico.

Thus: low pay among employees has traditionally been low in Italy and concentrated among youngsters. Its recent increase was parallel to the rise of jobs which are, at the same time, temporary and part-time. As a consequence, the number of low-paid women, notably married women, is increasing.

The incidence of low pay among the self employed is about double than among employees.

The distribution of employment within the household. Like in many other countries, in Italy too there has been in the last decade a "polarisation of employment" with an increase of the share of two-adult households in which either nobody works or both adults are employed.

In fact, in 1996 Italy had one of the highest shares of workless households in two-adults families: 14.9 per cent, against an OECD average of 13.8. Importantly, this share has been increasing over time (+4.3 per cent in the 1986-96 period, while it was stagnant in the OECD area) in spite of a modest increase in the country-wide unemployment rate (+1 percentage point over the decade). The share of workless two-adult families with children under 6 is also high and increasing: it was 6.3 percent in 1999, up from 2.6 percent in 1984, and among the highest in the OECD group (see OECD [20001a]).[36]

Importantly, the share of workless one-adult families with children has actually *decreased:* We have seen that Italy had of the lowest share of lone-parent families with children under 6; the proportion of workless households among these is 30.5 percent in 1999, among the lowest figures in OECD countries, and down from 41.1 percent in 1984.[37]

"Mixed" two-adult families (with just one adult, out of two, who is working) are still the predominant family type (46 per cent against an OECD average of 38 per cent, in 1996)[38] but have been declining faster (-8 percent in the 1986-96) than elsewhere.

Thus: "mixed" two-adult families, in which one adult works and the other does not, are still the predominant family type in Italy. However, as in many other countries, in the last decade there has been a "polarization of employment" in two-adult families, i.e. an increase in the share of two-adult families with no worker and with two workers, and a corresponding

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timers had tenures longer than 5 years compared with 46 per cent in the other OECD countries). However, part-time employment is in Italy increasingly associated with temporary contracts: in October 2000 more than one third of part-time jobs were in fixed term contracts or temporary work agencies.

[35] It is true, however, that the relative poverty risk for households headed by a self-employed is lower in Italy (1.6) than in the other ECHP countries (1.9).

[36] In the US, the same share had fallen from 5.4 percent in 1984 to 2.6 percent in 1999.

[37] Many single mothers work in the public administration. Often they have a full-time job: in 1999, after Portugal Italy had the highest proportion of single women with children under 6 working full time (58.7 percent), one of the lowest proportion working part time (10.8 percent), and the third lowest proportion not working (30.5 percent). Still, most women employed full time would prefer a part-time occupation (see Cnel [2000]).

[38] Although widespread, this family type does not seem to be enjoy much popularity: only 10.7 percent of all families actually indicate this as their preferred family type; 16 percent would have preferred a part time occupation for the woman, and the remaining part a full-time job.

decline in the share of mixed families. These patterns hold for two-adult families with and without children.

In marked contrast, worklessness among single adult families with children is among the lowest in OECD countries and has been decreasing. In addition, adult families with children under 17 are a very small share of all families in Italy.

Poverty, employment and unemployment. In Italy, the share of workless families is low (albeit increasing), and so is their risk of poverty relative to the average. As a consequence, the share of families with at least one worker is high (albeit declining) and so it their relative risk of poverty; this pattern is due in particular to "mixed families: with only one worker. How do we explain these patterns?

Workless households in Italy face a lower relative risk of poverty than in the other ECHP countries: 1.5 against an ECHP average of 1.8 (see Table 2.1). However, this is largely due to the good treatment of pensioners: when measures are confined to households where nobody receives a pension, the relative risk of poverty among workless households is in Italy 4.68, *higher* than the ECHP average of 4.53 (see Table 2.2). In terms of absolute poverty rates among workless households, it jumps from 15 to 68 per cent when moving from workless household receiving some pension to workless households without pensions: in the ECHP counties it increases by much less, from 12 to 50 per cent (see Table 2.2).

Another factor reducing relative poverty rates among workless households in Italy is the low proportion in this group of single workless parents. Like in other countries, the relative poverty risk of this group is very high: in 1993 it was 5.6 compared with 5.3 on average in the OECD area (see Foerster [2000]). However, as we have seen there are very far fewer workless lone parents in Italy than elsewhere.

Table 2.1 also shows that in Italy the risk of poverty for families with at least one worker, relative to families with no worker, is about 50 percent higher than in other countries, and that this difference is all due to families with only one worker, most of which are two-adult families.

Thus, on one hand Italy has a relatively low incidence of low-paid employment among employees, on the other hand it has a high concentration of poverty among mixed families. There are two explanations to this apparent puzzle. First, self-employment is large in Italy, and as we have seen low paid employment is widespread among the self-employed; second, the low rate of employment in Italy, which implies that each worker must support on average a larger number of inactive individuals.

As we know, poverty is positively correlated with the number of children, but the impact of children on poverty rates is comparatively stronger in workless families than in mixed families. The ratio of the relative risk of poverty rates for workless families with and without children was in the mid nineties 1.26 percent in Italy and 1.66 percent in the ECHP countries; for mixed families, this figures were 1.13 and 1.05, respectively.

Thus: the relative risk of poverty among workless households is comparatively low in Italy; however, this is due to the presence of a generous pension system; among families without pensions, the relative risk of poverty among workless families is comparatively high.

The relative risk of poverty is comparatively high among working families, particularly mixed families, despite the low incidence of low paid employment. This is explained by the large share of self-employment, which has a high incidence of low-pay; and the low rate of inactivity among working age individuals.

As a consequence, for couples with children, only one income from work is often not sufficient to raise the equivalised family disposable income above the poverty rate.

Table 2.2A: Poverty rate of pensioners and non-pensioners in the households, 1996: Italy

Characteristics	somebody in the household receives a pension	*nobody* in the household receives a pension
men	9,99% (5371)	17,7% (8323)
women	12,5% (1720)	16,65% (1033)
less than 30 years old	20,59% (34)	20,92% (674)
31 to 50 years old	15,98% (657)	15,03% (5528)
51 to 65 years old	9,98% (2845)	23,3% (3133)
above 65 years old	9,68% (3441)	24,11% (282)
no worker	14,64% (2998)	68,03% (244)
one worker	10,83% (2428)	25,76% (4205)
two worker	4,38% (1278)	7,6% (3985)
more than two worker	0% (448)	10,81% (1008)
single adult, no children	4,52% (663)	19,37% (382)
two adults, no children	6,89% (1394)	10,5% (971)
single adult, with children	16,16% (755)	24,48% (339)
two adults, with children	10,07% (2761)	18,78% (7469)
low education	11,5% (4747)	23,89% (5043)
middle education	4,81% (1101)	8,02% (3004)
high education	4,44% (270)	4,35% (850)

Table 2.2B: Poverty rate of pensioners and non-pensioners in the households, 1996: all ECHP countries

Characteristics	somebody in the household receives a pension	*nobody* in the household receives a pension
men	9,22% (31052)	11,58% (63967)
women	9,07% (15061)	12,60% (17949)
less than 30 years old	10,47% (1461)	19,8% (12454)
31 to 50 years old	11,84% (6276)	11,18% (47493)
51 to 65 years old	7,51% (14361)	12,44% (22343)
above 65 years old	9,03% (25868)	14,01% (8089)
no worker	11,79% (23654)	49,16% (4809)
one worker	8,36% (14214)	18,05% (30187)
two worker	3,82% (8378)	4,85% (41671)
more than two worker	2,73% (3368)	3,12% (12064)
single adult, no children	8,63% (7279)	21,95% (7775)
two adults, no children	7,43% (16410)	8,03% (15882)
single adult, with children	10,17% (4030)	21,49% (4198)
two adults, with children	7,86% (10647)	11,87% (57898)
low education	11,42% (28417)	17,94% (31556)
middle education	5,55% (10712)	8,13% (28584)
high education	2,75% (5156)	5,15% (17928)

Sample sizes in parentheses.
ECHP - wave, 1997.
Note: the relative poverty rate is defined as the percentage of individuals having an equivalised
household income smaller than half of the median of the household incomes.
The overall poverty rate for Italy and for all ECHP countries was in 1996 15% and 11.5%
respectively.

C. Social Policy Dimensions

Income, poverty and age. As a consequence of the generosity of the pension system, Italy has the highest relative equivalised disposable income of households with head over 65 among all LIS countries (see Brandolini and D' Alessio [2001]) and of pensioners aged 50 to 65 (see Section 1).

These patterns persist when looking at poverty rather than income. Poverty rates in families in which the man head of the household is not a pensioner or where no family member receives a pension are in Italy twice as high as in families where someone is receiving a pension (Table 2.2A). In the other ECHP countries, differences in the incidence of poverty between pension and no-pension households are much less marked (Table 2.2B).

We have seen already how pensions contribute to reducing the risk of poverty among workless households. To repeat, the incidence of poverty in workless and no-pension households was in Italy in 1996 indeed almost 70 per cent compared with roughly 50 per cent in the ECHP countries on average; but if the family received a pension, the difference between poverty rates in workless households between Italy and the ECHP average was much smaller (see Table 2.2).

Pensions also very much affect the age profile of poverty in Italy[39]. In the case of households with pensions poverty in Italy is monotonically decreasing with age while elsewhere it is close to "U-shaped" in age (see Table 2.2 and Cannari and Franco [1997] and Atkinson et al. [1995]). However in no-pension households almost the opposite pattern is true: in Italy the poverty rate of households whose head is aged 50 to 65 is significantly higher than in the case of households with head aged less than 30; the reverse is true in the other countries. The relative risk of poverty for no-pension households, whose head is aged 50 to 65, was in 1996 1.6 in Italy compared with 1.1 for the ECHP average. Conversely, households with heads over 65 have in Italy a relative poverty risk less than 1, while in Europe it is above 1. In fact, the Italian share of elderly poor is also one of the lowest in Europe (see Istat [2000]).

Thus: pensions contribute significantly to reducing poverty in Italy, notably among individuals aged 65 and over. Pensions cover only a minority of the individuals aged 50 to 65 and those not covered face a relatively high risk of poverty by European standards. This is important to keep in mind in view of ongoing reforms of the pension system.

Pensions and unemployment. Pensions have in the past contributed to reducing unemployment-related hardship mainly via intra-household redistribution. This is because, unlike in most European countries, long-term unemployment in Italy is concentrated among the youth: two unemployed out of three are aged 35 and less; as a result, in Italy youth and long-term unemployment are almost synonymous: about 60 per cent of youth unemployment lasts more than twelve months. In addition, youngsters stay for long in their families (the average age of entry in the labour market is 25) who provide their income while they search for a job corresponding to their aspirations. In Italy 56 percent of unemployed workers live with their parents, against 20 percent in France and less than 10 percent in Nordic countries (see O'Donoghue and Utili [2000]).

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[39] ECHP data provide a different age profile of poverty than Istat data. The former point to relatively low poverty rates for the over 65 and also for the over 75 (both of the order of 10 per cent compared with a country average of 15 per cent in 1996). The source of these discrepancies is that Istat data draw on consumption, while ECHP on incomes. Similar differences were found comparing (income-based) Bank of Italy data with Istat data.

However, pensions are much less effective in reducing the poverty rates of children: poverty rates do not decline proportionally more than in the ECHP countries moving from households with children and no pensions to households with children and at least a pension (Table 2.2).

Thus: pensions have in the past reduced unemployment related hardship, largely because Italy has the largest share of youth unemployment and the largest share of unemployed youths living with their families.

However, pensions do not provide more poverty relief to children than in the other ECHP countries.

II.2   OTHER IMPORTANT FEATURES FOR THE DESIGN OF ANTI-POVERTY PROGRAMS

Modes of exit from unemployment. Part time employment is a dominant gateway from unemployment. According to the Italian Labour Force Survey, in 1999 two-thirds of yearly exits from inactivity to employment were represented by flows into part-time jobs. These shares have increased over time as a result of the partial labour market liberalisations introduced with the so-called "Pacchetto Treu" in 1997.

How do these developments compare to those in other countries? Tables 2.3. and 2.4. show the type of contracts held by individuals who were unemployed one year ago, building on the longitudinal features of the ECHP. They show that part-time and fixed-duration contracts (often the two features coexist in the same job) offer jobs to a relatively large portion of unemployed. Compared with other European countries, the Italian labour market seems to offer part-time jobs to a relatively small fraction of unemployed women. Part-time is also a marginal source of employment for older workers: only about 5 per cent of the employed aged 55 to 64 had a part-time job in the year 2000, compared with about 25 per cent on average in the EU (EC [2001]).

Table 2.3: The part-time jobs gateway (percentage of individuals in part-time jobs, after being unemployed one year before)

Country		percentage	sample size
Germany	males	2.19%	(685)
	females	16.61%	(578)
Denmark	males	2.01%	(348)
	females	16.36%	(330)
Netherlands	males	8.64%	(463)
	females	44.32%	(361)
Belgium	males	3.00%	(300)
	females	29.82%	(332)
France	males	1.86%	(539)
	females	19.21%	(458)
United Kingdom	males	5.24%	(210)
	females	23.86%	(88)
Ireland	males	11.13%	(503)
	females	29.13%	(254)
Italy	males	3.05%	(1312)
	females	15.33%	(946)
Greece	males	3.15%	(444)
	females	10.70%	(374)
Spain	males	3.15%	(1366)
	females	17.03%	(828)
Portugal	males	3.23%	(526)
	females	6.59%	(546)
Austria	males	3.61%	(305)
	females	25.53%	(282)
Finland	males	3.31%	(393)
	females	11.56%	(398)

Source: ECHP - fourth wave, 1997

Note: based on retrospective information and matched records across 2ECHP waves

Table 2.4: The fixed-term contract, occasional job gateway (percentage of individuals in short-term and occasional contracts, after being unemployed one year before)

Country			percentage	sample size
Germany	males		13.14%	(685)
	females		14.01%	(578)
Denmark	males		13.51%	(348)
	females		18.79%	(330)
Netherlands	males		7.56%	(463)
	females		13.30%	(361)
Belgium	males		10.67%	(300)
	females		18.98%	(332)
France	males		9.28%	(539)
	females		11.57%	(458)
United Kingdom	males		5.24%	(210)
	females		4.55%	(88)
Ireland	males		14.31%	(503)
	females		20.87%	(254)
Italy	males		16.01%	(1312)
	females		14.80%	(946)
Greece	males		26.80%	(444)
	females		26.20%	(374)
Spain	males		44.73%	(1366)
	females		45.53%	(828)
Portugal	males		25.86%	(526)
	females		25.46%	(546)
Austria	males		11.15%	(305)
	females		8.51%	(282)
Finland	males		21.37%	(393)
	females		39.20%	(398)

Source: ECHP - fourth wave, 1997

Note: based on retrospective information and matched records across 2ECHP waves

Thus: part-time and temporary contracts are becoming an increasing gateway from unemployment and inactivity in Italy. However, this holds mainly for the youngsters as older workers rarely hold part-time jobs. Unemployed women also have access to part-time positions much less than in the ECHP countries on average.

Table 2.5: Gini coefficient for yearly (full-time employees)

Country	1993	1994	1995	1996
Germany	0.379	0.376	0.366	0.291
Denmark	0.291	0.253	0.248	0.243
Netherlands	0.284	0.323	0.332	0.300
Belgium	0.275	0.272	0.267	0.263
Luxembourg	0.343	0.331	0.329	-
France	0.386	0.356	0.362	0.353
United Kingdom	0.401	0.391	0.388	0.396
Ireland	0.388	0.375	0.369	0.381
Italy	0.285	0.269	0.288	0.258
Greece	0.326	0.328	0.362	0.351
Spain	0.370	0.391	0.384	0.396
Portugal	0.372	0.375	0.378	0.376
Austria	-	0.349	0.342	0.315
Finland	-	-	0.294	0.330
Sweden	-	-	-	0.255
All sample	0.362	0.357	0.358	0.339

ECHP - waves 1.2.3.4

Regional concentration of unemployment and of the shadow economy. A well-known feature of Italian labour markets is the concentration of unemployment in Southern regions. Whatever measure of regional unemployment differentials is used, they appear very large by OECD standards (see OECD [2000]). Even more marked are North-South differentials in employment rates: they peaked at 20 per cent in the year 2000 as in the Centre-North 60 per cent of the population aged 15 to 64 was at work compared with 42 per cent in the South. Unemployment cannot entirely account for these differentials in employment rates. Low recorded employment rates in the South are also a byproduct of the presence of a sizeable shadow economy in this regions, which goes hand-in-hand with large scale and long-duration unemployment.

The Italian statistical office (Istat) provides estimates of the number of irregular jobs (``posizioni lavorative irregolari'', including multiple job holding) by sector and macro-regions (see Calzaroni [2000]). Such estimates are mainly based on the comparison of data reported by enterprises (mainly within the enterprise Census) with those collected in the context of surveys or censuses having as statistical unit the household. The rationale behind this procedure is that enterprises report only ``regular'' jobs, while individuals provide information on all kind of jobs, regardless of their position in terms of fiscal compliance. Istat estimates suggest that the shadow rate (the share of ``irregular'' jobs in the total number of positions estimated by Istat) was in Southern regions in 1995 as high as 20 per cent, compared with 5 per cent in the Centre-North. The correlation between the informal sector and unemployment holds not only across regions, but also over time: in the years where unemployment is on the rise, the shadow rate is also increasing (Boeri and Garibaldi, 2001).

Overall, the rise of poverty in Italy has been associated with an increase in the number of workless households. The distribution of employment across households is in Italy getting more similar to European countries where unemployment and poverty are strictly correlated, in that there are less and less "mixed" households where one adult is working and the other is not. Unlike other ECHP countries, however, in Italy there are fewer single parents not working. Poverty risks are in Italy disproportionally high among couples with many children, where one adult only is working and among older workers (aged 50 to 65) who do not receive a pension. Low-pay has not been a major issue until the mid-1990s, but there are indications

that it may become more relevant with the spread of temporary contractual arrangements. Part-time employment may ease problems of both the risky groups characterised above, but so far it has not been for them as much a gateway from unemployment and inactivity as in other countries.

III.   A FEW LESSONS FROM RECENT DEVELOPMENTS IN SOCIAL POLICY

How did policy respond to the developments in the incidence and profile of poverty we have highlighted above? In this section we briefly review the main recent developments in social policy. These are:
- The introduction of ISE
- The introduction of RMI
- A renewed emphasis on tax credits for dependent minors
- The introduction of A3F and AM
- The review of ANF
- The "Legge Quadro" on Social Assistance

We discuss here only the actual developments in social spending. In section IV we discuss the main features of the recent debate and the main proposals of reform.

III.1   THE RMI: A MISSED OPPORTUNITY

In 1998 (DLgs 237 18 giugno 1998) the Reddito Minimo d'Inserimento (RMI), a new social assistance scheme of last resort, was introduced "experimentally" for two years in 39 municipalities, predominantly located in the Southern parts of Italy.[40] For a childless single, it pays the difference between Lit. 510,000 and income (with a 25 percent earning disregard). Thus, it is equivalent to a NIT with a 75 percent withdrawal rate and a maximum labor earnings of Lit. 680,000. All individuals with any non-labor and non- social assistance income or any asset (except a owner-occupied home of a maximum value to be established by the municipality) are excluded. Unlike in ISE, social assistance benefits (like ANF) are included in income. The unit of the entitlement is the family, not the individual, which raises issues of incentives to work for the secondary earner.

Eligibility is conditional on participation in an activation program, designed by local social assistance authorities, involving job referrals, training courses, or care services.

The original intent of the RMI was to replace the plethora of programs that characterize the Italian welfare system, and eventually become the key element of an effective safety net that is currently missing in Italy. However, it has never been exactly clear what programs it should replace, either in the transition or in the steady-state.

A. An experiment?

The intention was good, but the implementation has been dismal. Studies after studies have emphasized that we currently know little about the quantitative effects of the European welfare systems on labor supply, labor force participation, schooling, and fertility. Yet these

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[40] Like for ISE, the discussion of RMI has been extensive. RMI is essentially a negative income tax (with a labor market activation component), hence the literature on the latter is also relevant for the former. Matteuzzi [1996] and Commissione Onofri [1997] are probably the most direct proposal of the instrument. For a description of the institutional features of RMI and of the main elements of the debate, see Bosi et al. [2000], and Dipartimento per gli Affari Sociali [2000a]; the latter also contains some data for 1999 on various aspects of the program.

are precisely the issues one should worry about when designing a welfare program: without any data on these effects, one cannot even evaluate the distributional properties of an instrument. It is well understood nowadays that the best way to study the incentive effects of welfare programs is via well designed randomized experiments. Yet, in spite of the name "sperimentazione", the collection of data that could be used to evaluate the program was wrongly devised and carried out. The "sperimentazione" itself had nothing to do with what is conventionally called an experiment. The benefits have not been randomized among the applicants, hence there was no comparison group.

The costs of running and evaluating a true experiment would have been small, and the benefits potentially enormous. Without this evaluation, Italy runs the risk of embarking in a major extension of the program, like that envisaged by the legge finanziaria 2001 and, eventually, an extension to the whole country, without being able to meaningfully predict its costs. [41]

But even in the absence of a well designed experiment, some useful data could still have been collected, which could have been used with "quasi-experimental" methods that have become increasingly popular in evaluating non-experimental social programs. This has not happened: the collection of data seems to have been a haphazard process at best. For instance, there are data on the total (very small) number of beneficiaries who have left the program, but we do not know what fraction have left because they have found some sort of employment, and what fraction have returned to the program after an interval. Clearly this type of information is fundamental to get an idea of the impact of the program: evidence from other countries suggests that social assistance rolls are subject to high turnover rates and that repeated benefit spells are frequent.

Finally, to cap it all, the evaluation commissioned to a group of experts coordinated by IRS has not been made public by the new government.[42] The new Minister of Social Affairs has not yet replied to repeated requests, including from leading newspapers, to disclose the document. This evaluation had access to whatever data have been collected, and it is the only source of knowledge for an informed public debate on the program. Because no national security issue is involved, it should be made public without any further delay: RMI has been already mismanaged badly enough, there is no need to discredit it further.

The above notwithstanding, the comments below draw on the little which it is possible to put together on the RMI experiment so far.

B. Labor market activation

Following the lead of many other countries, RMI has been linked to individualized projects. All beneficiaries enter a "contract", with the ultimate goal of putting them back into work or schooling. Here again, the intentions are good, but the reality seems to be more complicated.

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[41] Other countries are currently undertaking large randomized experiments with similar programs, that have been carefully designed for several years: Mexico, Honduras, Chile, and Colombia. The Mexican program, PROGRESA, is particularly large, and is targeted specifically at incentivating school attendance: the benefit is conditional on continuing attendance by the family minors. After 2 years of existence, PROGRESA has accumulated a wealth of (truly) experimental data, which is currently under statistical analysis by some of the leading academic experts in the field.

[42] The "official" argument is that the deadline for the submission of the evaluation report had been improperly set after a general election.

The official numbers show that in 2000 the percentage of individuals with an individualized project ranged from 5.9 percent in Caserta to 100 percent in Naples, with an average of 42 percent (see Dipartimento per gli Affari Sociali [2000a]). The figure for Naples, however, is certainly fictitious, since in this city an RMI client is considered to be part of an individualized project if his RMI claim is approved and he is assigned to a social worker. More deeply, the RMI "experiment" suggests that local administrations, especially in the South, have been largely unable to provide and monitor these "activation" services effectively. For instance, more than 50 percent of the population over 14 in the RMI municipalities in the South does not have a junior high school diploma, a prerequisite to have access to training programs; yet, many Southern municipalities have not organized courses for the fulfillment of the school obligations. In any case, many recent studies have conclusively discredited the effectiveness of training programs per se, particularly those of short duration and for young individuals (see section 5); and there is little doubt that in areas with a 50 percent unemployment rate, as in some of the RMI municipalities, training programs can hardly have an effect on employment, besides providing employment to the teachers involved in the courses.

The application of the activation part of RMI seems to have been inspired by something very different from the "back-to-work" strategy that characterizes most Anglo-Saxon countries (see Section 5). It appears that few RMI beneficiaries are in fact assigned to an individualized project with the labor market as the immediate outlet: percentages range from1.4 in Rovigo to 32.8 in Genova. The majority seems to be assigned to projects of various nature, including projects aiming at "restoring health"; taking care of minors or elderly individuals at home also counts towards an individualized project (see Alti and Maino [1999]). The nature of many of these projects is often fuzzy, which makes it obviously difficult (besides the lack of data) to evaluate them: for instance, some municipalities have reported "good results", but when one investigates more deeply what exactly this expression means, one finds that it includes vague concepts like "recovery of self-esteem" etc.

Poor incentives to local administrations concur in exacerbating these design problems. While 90 percent of the cash component of RMI is funded by the central government, the in-kind services to RMI beneficiaries are not funded via state transfers and there are no incentives to municipalities in the provision of these services. This induced many municipalities to provide only the cash-transfer component of the RMI, underproviding in-kind benefits. In addition, many municipalities are just too small to be able to provide anything but cash transfers effectively.[43] There are reports of attempts by a few municipalities to link up and coordinate, but so far these attempts have not generated any tangible result (see "Welfare, nuovi strumenti sotto esame", in Il Sole 24 Ore 6/08/01, p.15).

C. A program for young unemployed

As we mentioned, very little quantitative information is known as to the features and the effects of the RMI "experiment" so far. One thing is known: the average age of the beneficiaries is extremely low: in Naples, it is 24 years for men and 23 years for women.[44]

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[43] In fact, 2 of the original 39 municipalities did not even have an "assistente sociale" at the time of the introduction of RMI.

[44] Naples is admittedly a rather extreme case, but also the largest municipality involved in the experiment.

This is likely to be the result of the very stringent means test, by which any individual with any mobile or immobile asset (except for owner-occupied housing below a certain value established by each local administration) is excluded from RMI.[45]

This feature has been little noticed, but certainly deserves, if confirmed, very careful consideration: it implies that RMI is, in its current shape, and for all practical purposes, an instrument directed mainly at the unemployed young individuals. If this is intentional, then one should be aware that activation strategies directed at the young unemployed are well known to be among the most problematic and the most difficult to implement: a number of studies have shown that very few results can be obtained, unless one is willing to spend a considerable amount of resources on individualized projects that involve job search assistance, specialized training, and other features (see section 5). These programs are much more sophisticated than anything that has been implemented in the RMI experiment.

The UK experience with the New Deal is particularly relevant here.[46] Experience in active labour markets like Birmingham shows that substantial incentives in term of employment subsidies are needed to encourage employers to hire unemployed youths from the "Gateways" pool (i.e. the young unemployed who go through a first period of 4 months of job search assistance and counseling); in addition, administrative effort in motivating New Deal clients has to be substantial, notably requiring more than one personalised interview in the gateway period (see Walsh, Atkinson and Barry [2000]). Note also that the beneficiaries of these activation measures are youngsters who have been unemployed for at least 6 months. Although many of them may receive means-tested social assistance and housing benefits, there is no formal selection of beneficiaries on the basis of income thresholds. Employers may be less keen to co-operate with administrations sending them for job interviews only low-income individuals, like RMI individuals.

If instead one wants to reach a larger share of the poor, as in the original intentions, the means test as it is currently designed will have to redesigned. But a larger, more diversified clientele requires an even more sophisticated approach. As we discuss in section 5, activation strategies that work for some categories do not work for others. For instance, job search assistance seems to work quite well with women who try to return to employment, provided it is closely linked to the local labor market conditions. But how many "assistenti sociali" are currently prepared for this market oriented intervention? How many municipalities have a modern Public Employment Service?

D. A hasty expansion

One of the positive features of RMI is that it breaks away with the Italian tradition of linking the welfare state to the labour market status. Unfortunately the Budget Law for the year 2001 (Legge 588/00, art. 80) has gone in the opposite direction, extending the experiment to May 2002 with no evaluation available, and to those areas where a Patto Territoriale has been signed (if there is already at least one municipality in the area where RMI has been established already). There is no apparent rationale for this decision, as there is no obvious connection between signing a Patto Territoriale and the demographic and social characteristics of a locality; at best, this decision creates horizontal inequity on the basis of a

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[45] We would like to point out that, taken literally, this condition probably makes virtually all beneficiaries of RMI illegal. We believe there are very few or no individuals in Italy with literally no assets of any type.

[46] In section 5 we expand on public employment services and the New Deal.

completely extraneous criterion; at worst, it creates room for involvement by actors that should have nothing to do with the welfare state.

E. Unclear legislation

RMI was supposed to be a wide-ranging program; yet, it is not clear what it will replace, in the short or even in the long-run. In the proposal of Commissione Onofri, RMI should have replaced all social assistance programs, including ANF. The schema di decreto legislativo 5 maggio 1998 would have kept all *Integrazioni al Minimo*, *Pensioni Sociali* etc. and would have abolished only ANF. The Commissione Povertà would abolish ANF but would introduce RMI with a new child allowance.

III.2 FAMILY POLICY: THE INTRODUCTION OF A3F AND AM

In 1998 (legge 448/98) two new instruments were introduced, A3F and AM. A3F is a subsidy to families with at least three dependent minors: it consists of a benefit of lit 200,000 per month (in 1999); it decreases with income, up to a maximum income of 36mlns for a family of 5. It is paid by INPS on the application submitted to and reviewed by municipalities. AM is a very small program representing a limited attempt at addressing the issue of child care and support for non-working families with children.[47] It pays a maximum amount (in 1999) of Lit. 300,000 per month, for a maximum of 5 months; the recipient must have an income of less than 50 mlns for a family of three, and is equivalised using the ISE scale. It is targeted at mothers who do not have other forms of support for maternity, essentially housewives and unemployed for more than 6 months.

Although these instruments are often regarded as first implementations of the principle of the Commissione Onofri of "selective universalism" (see Mazzaferro and Toso [1999]), in our view they belong to the tradition of a chaotic and piecemeal approach to welfare state reform. It is difficult to see why A3F could not be integrated into the ANF, with a simple change in the implied equivalence scales of the latter. True, A3F is based on a different definition of income than ANF,[48] but this is certainly by accident and must be regarded as a problem, not as a virtue. In fact, as Bosi [2000] argues, two similar instruments based on different definitions of income cannot coexist for long. Also, unlike ANF, A3F is not financed by earmarked contributions, but by general revenues, and it covers self-employees as well. But the contributory nature of ANF is only formal, because contributions are not an upper limit to spending on ANF; in addition, the contributory nature of ANF is mostly an accident of history, and is the key reason for its unfortunate selective nature.

While AM recongnizes the issue of child care costs for unemployed women or women who do not participate in the labor market, much more intellectual and financial resources will be needed to address what is increasingly recognized as a key aspect of a modern welfare state. In the meantime, the little is known about this program points to some administrative problems: for yet unexplained reasons, 30 percent of applications have been in Campania; and in 2000 the number of applications has decreased relative to 1999, perhaps because applicants

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[47] In 2001, tax credits for expenses for baby sitters and other child care expenses were also introduced.

[48] ANF is based on IRPEF income plus non taxable incomes; A3F is based on a variant of ISE: see Bosi et al. [2000] for a description of the main differences from ISE, mostly concerning the value of the exemption for owner-occupied housing.

did not known that they had to apply every year, or perhaps because of other administrative problems.

Be as it may, these instruments are minuscule: in 1999, expenditure by INPS on the two combined programmes has been approximately 430mld. An interesting feature of these programs is that they seem to be fixed budget, a specific Fund opened with the Prime Minister Office; the 2001 budget (as of 1999) for the two programs was 150mld for AM and 405 mld for A3F. It is not clear what will happen if the expenditure on total accepted applications exceeds the budget. We could not find any discussion of this case, but we note that a fixed budget open-ended program is a contradiction in terms.

We see no reason to keep A3F alive, while we advocate integrating AM in a more systematic approach to the problem of child care, as we discuss in section 5.

III.3   FAMILY POLICY: A RENEWED EMPHASIS ON TAX CREDITS FOR FAMILIES

Dipartimento per gli Affari Sociali [2000a] calculates that, between 1996 and 2000, an extra 9,800 mld have been spent on families; of these, 5,800 mld (more than 60 percent) are in the form of higher tax credits. Tax credits were increased with the 1999 and especially the 2000 budget laws. [49]

Bosi et al. [2000] have calculated, simulating the DIRIMOD model, that the main beneficiaries (in absolute terms) are the third decile and the deciles from the 5th to the 7th. Bosi and Ricci [2000] calculate that about 6,000 mld accrue to taxpayers with above average income.

A more precise idea of the effects of tax credits can be gathered from a comparison of the distributional impacts of the 1999 Budget Law, whose family policy provisions consisted almost exclusively of higher benefits, and the 2000 Budget Law, which instead relied almost exclusively on tax credits. Atella, Berliri and Parisi [2000], using the EUROMOD simulation model, calculate that, although the 2000 Budget Law had a larger positive impact on the average household disposable income and caused a slightly higher reduction in the incidence of poverty, it caused a considerable increase in the *intensity* of poverty (by about .6 percentage points), while the 1999 Budget Law did not affect it. Thus, tax credits, even when geared towards the poorer *taxpayer*, are unable to reach the poorest segments of the *population*. A second consequence of the reliance on tax credits is that mono-income families with the same earnings but headed by a single parent can be treated worse than two-parent families, largely because the latter cannot invoke the tax credit for dependent spouse. It is not clear why and how this enthusiasm for tax credits for minors came about. One possibility, suggested by Bosi [2000], is that it reduces the official tax / GDP ratio, a goal of economic policy in itself. However, the distributional properties of tax credits are not widely discussed, let alone apreciated. While we believe the goal of a substantial cut in taxes is worthy, we believe tax credits for minors are not the instrument to achieve it: they are a very poor substitute for an explicit and well designed welfare policy for indigent families.

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[49] The 1999 Budget Law introduced a small extra credit for the poorer pensioners. The 2000 Budget Law introduced tax credits for poorer home leases, for the poorer divorcees and for seasonal workers, an increase in the tax credit for pensioners above 75, an increase in the tax credit for dependent family members and for children under 3.

III.4 FAMILY POLICY: THE DEBATE ON ANF

Waiting for RMI to be extended (or in alternative to an extension of the RMI, as sometimes advocated by the union of Catholic inspiration, CISL), ANF is now widely considered the single most important anti-poverty program, besides social pensions.[50] Among the main instruments, ANF has better targeting properties than other schemes; AM and A3F are better targeted at the poor, but their budget is so minimal that they make very little difference in terms of poverty (see Table 1.4 in section 1). One should keep in mind, however, that by design ANF can reach only families with at least one worker or one pensioner; hence, ANF have no impact on the poverty of workless families (see Marignetti and Roberti [1998] for a quantitative analysis of the impact on poverty of ANF, by family type.

A hotly debated aspect of ANF is their extension to self-employees. Currently only lavoratori parasubordinati are covered (before 1999 not even them), and with more stringent rules than the rest of the population; in fact, by 2000 only about 300 had enrolled (see Bosi et al. [2000]) The main opposition to an extension of ANF to self-employed is based on the contributory nature of its financing, whereby the program is funded with a 2.38 percent wage tax on employers.[51] This is not convincing: the true incidence of a wage tax is a complicated matter. In any case, these contributions are not earmarked, and the link between contributions and spending is not immediate: if spending were ever to exceed contributions, the difference would be financed by general revenues.[52]

III.5 OTHER FAMILY POLICY INTERVENTIONS

Recent years have seen a number of interventions in the field of family policies. Among the most important are: (i) legge L162/98 on handicapped individuals, with a budget of 100 mld; (ii) legge L 285/97, on "diritti e opportunità per infanzia ed adolescenza, realizzazione di servizi socio-educativi per la prima infanzia" etc.; it also created a Fondo Nazionale per l' Infanzia e l'Adolescenza, with an initial budget of 750mld to be allocated over three years, to be given to regions and main municipalities; (iii) legge L 449/1997, which started a Fondo per Politiche Sociali; (iv) legge 53/2000 "Disposizioni per il Sostegno della Maternita' e Paternita', ed Ampliamento del Diritto a Cura Familiare e Congedi Parentali"; (iv) legge 328/2000 establishing the "Fondo Nazionale e Sociale" encompassing the Fondo per le Politiche Sociali and the Fondo Nazionale per l'Infanzia e l'Adolescenza.

Unfortunately, little is known on these interventions. In particular, we are not aware of any follow-up study on whether and how the budgeted money for the Fondo Nazionale per l' Infanzia e l' Adolescenza has been spent.

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[50] See Matteuzzi [1996] for a detailed and interesting history of family allowances in Italy, and for a discussion of the current institutional setting.

[51] This mode of financing is a remnant of the original motivation for ANF in the thirties, the sharing of forgone income of lower working hours.

[52] In addition, one clause of the 1998 Patto di Natale stated that any revision of ANF must "avvenire nel pieno rispetto delle prestazioni gia' accordate ai lavoratori dipendenti". This is the type of clause that can be invoked to veto any revision of ANF: there is always some assumption on the incidence of benefits and taxes that would involve a violation of the clause.

III.6 THE ISE

The debate on ISE or the so-called "Riccometro" has been extensive, and continues seemingly unabated. We take up the main issues here.[53]

A. The definition of ISE and the treatment of assets

The main point of contention is the definition of ISE, specifically: how wealth should (not) be accounted for; the use of exemption thresholds; the definition of income used. ISE is based essentially on the sum of something close to IRPEF income plus 20 percent of assets above a certain threshold for owner occupied houses. We agree with many commentators that ISE should be as close as possible to a definition of disposable income, hence it should include public transfers as well. More contentious is the issue of the appropriate definition of wealth. A proper consideration of wealth would be justifiable theoretically as a way to capture something close to the permanent income of an household. However, this assumes liquidity unconstrained individuals, which is obviously an unrealistic assumption for poor households. But exactly how should one value wealth under this assumption? Ideally, at the prevailing rate of interest, perhaps risk and liquidity adjusted. In any case, it is hard to find a justification for the 20 percent weight on wealth, as in the most recent legislation.[54]

Ultimately, the issue boils down to who benefits from the inclusion of wealth. In general, it is easy to show that, for any given value of the parameter, the higher the ratio of one's ratio of wealth to average wealth to the ratio of one's income to the average income, the higher the resulting ISE. Baldini et al. [1999] show that the application of ISE would benefit large families[55], households in the South and employees; it would work against households in the North-East and pensioners in small households (because of their large wealth relative to income).

Perhaps the most heated debate has centered on the role of exemption levels. In particular, the exemption level for owner occupied houses has been seen as a spurious subsidy to home ownership, which some regard as extraneous to the purposes of ISE and may have adverse on labour market adjustment[56]. The exemption level has been justified in terms of the

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[53] The ISE is well known, and to conserve space we refer the reader to Baldini et al. [2000], Bosi [2000], CNEL [1999], CTSP [2000], and ISAE [2001], for an exhaustive description and a more extended presentation of the debate.

[54] One possibility is to do away with criteria based on income (and even worse, on nominal wealth, which is almost impossible to detect and assess) and move to more sophisticated software to assess the condition of a household, or use both in combination. These systems have been fine-tuned in Chile, Colombia and Mexico, and have given good results. Essentially, each household is evaluated on the basis of a number of variables, many of which include easily observable durable goods (such as the type of floor, the existence of a car and other durables); these variables are then combined in what is essentially a principal component method, but depending on the purpose and the program can also be kept separate, to emphasize some and de-emphasize others. Households are then assigned to one of a number of levels, from Level 1 to Level N, based on the value of the principal components; different social programs can select levels as their potential beneficiaries, and possibly select even more finely based on individual series.

[55] This is because of the use of a generous equivalence scaling. We do agree with the use of a rational equivalence scale, and its premium on some typologies like a disabled minor. Several reforms of the ISE equivalence scale have been proposed. But there is no "right" or "wrong" equivalence scale; we believe that as long as one uses a sensible scale (as in the case of ISE), it is more important to make ISE effectively operative than to debate endlessly on these details.

[56] Oswald [2001] documents a strong relationship between the percentage of owner-occupied dwellings and unemployment at the regional level.

illiquidity of houses and of precautionary savings. Such exemption levels are common to many countries that apply meaningful asset tests, such as the US and the UK.

However, the point is often forgotten that perhaps the main original motivation for including immobile assets was to take a first stab at the issue of tax evasion (based on the idea that immobile assets are less prone to being hidden away: see CNEL [2000]). This view has merit only insofar as asset tests are meaningful, which is far from being the case (see below).

B. Controls

All this debate on the definition of ISE will be nearly irrelevant unless one solves a fundamental issue not only with ISE, but with the whole welfare state: the reliability of means testing. ISE and most means-tested programs are now based on a system of self-certification; while this is part of a welcome simplification of bureaucracy, such a system is virtually guaranteed to generate a large scope for leakage unless effective controls are in place.

It is customary in this respect to emphasize the difference between formal and substantial controls. The former imply just a check of the personal data provided by the applicant (such as number of family members, age, etc.) against the data easily available at municiplaties or INPS etc. It is commonly agreed that this type of checks is, in principle, easy, although even this is not always implemented. The latter involves checking the self-certified data on income and assets. This is much more difficult, for two reasons. The first is that municipalities and the paying agencies do not have the legal authority to investigate the applicant's income and wealth: only the GdF and the Procure do. However, the GdF has repeatedly stated that it does not want to get involved: for instance, in 37 of the 39 municipalities where the RMI has been experimented, the GdF has refused to run *any* check, get involved in this type of checks, citing the lack of a proper authorization (of the two remaining municipalities, one did not bother to ask the GdF; in the last the GdF did intervene, and some cases of cheating were uncovered).

These problems with (the lack of) substantial controls seem pervasive of the whole welfare system. In nearly all the municipalities studied in CTSP [2001] there was virtually no control on income or assets data of applicants to the various programs, such as kindergardens etc. This type of controls would be easier if the municipalities were able to collaborate effectively with the Anagrafe Tributaria. It is not clear how extensive this collaboration is; in any case. CTSP [2001] reports that in 1998 Anagrafe Tributaria provided the taxable income data for 1995, while the self-certification referred to the 1997 income.

But there is a second, less well known reason why controls of substance are difficult to implement: even in the worst possible outcome for the applicant, the penalties are so small that cheating is always a dominant strategy. Consider the case of Florence, one of the few municipalities that seems to have tried to take controls seriously. In 1998 and 1999, it ran 205 and 303 checks on the incomes reported in the applications for Asili Nido. In spite of this, 17 applications were still found inexact at the end of the process. The actions the municipality could undertake were: first, withdraw the subsidy, plus accrued interests; second, impose an administrative sanction equal to double the subsidy. However, by art. 114, legge no. 689/81, the maximum administrative penalty for violating municipal regulations is 1 million Liras, and by art. 16, one can avoid the sanction by paying one third of the sanction. Thus, the most one can lose by cheating is the interest on the subsidy plus about 300,000 Liras. Although a penal sanction could also be applied in principle, a penal procedure was

never started because the municipality had not been able to indicate the office that should locate the "dolo".[57] It is self-evident that cheating is nearly always a dominating strategy. In addition, note that the municipality of Florence, like nearly all other municipalities, could not run any asset test.

How extensive is cheating? From the few indications available , it is likely to be rather extensive, notably in the Southern regions. There are little systematic data for RMI, but reports of cheating in many municipalities are pervasive. There are municipalities – like Orte di Atelle, 12,154 inhabitants – where 50.9 percent of the population receives the RMI. In the Enna Province 859 individuals were legally pursued because of fraud against the state, after controls of the fiscal police (Guardia di Finanza).

C. The "babele dei riccometri"

Although the original intention of ISE was exactly to unify the criteria for access to the various benefits and services, the last few years have witnessed a proliferation of criteria, in terms of definitions of income, of earnings and asset disregards, etc.. This has occurred at two levels: vertically, as different programs at the central government level use different "riccometri", and horizontally, as different municipalities use different "riccometri" for the same programs.

This proliferation is not necessarily as problematic as most seem to believe. In principle, one could justify vertical proliferation because different criteria can be optimal for different programs serving different clienteles; for instance, in programs aimed at youths asset tests could be less important. It can also be desirable for different municipalities to use different criteria. In practice, however, we find it more difficult to justify the existing proliferation of criteria. To date, the four central government programs that were supposed to use ISE all use some variant of it; there is no apparent rationale for this, except incompetence, bureaucratic activism, or both.

More serious and insidious is a problem that can easily be confused with the first two: the lack of a centralized information system. To date, there is little or no sharing of information for different programs, even at the local level: the same family applying to two different services in the same municipality usually must submit two separate self-certifications. This is a true waste. The self-certification for ISE involves a number of variables (in the latest rendition, the document is about 4 page long). In principle, one could collect the information on all variables in a centralized system; each program and each municipality could then select the variables of interest among those stored in the system. Countries that have used similar instruments (like SISBEN in Colombia and CASBEN in Chile) have found that they work well only if their information system is centralized.[58]

DLgs 130 has introduced the "sistema informativo ISE" and a centralized computerized data storage system at INPS**.** There have been many complaints from municipalities that the system is far from up and running. Doubts exist that it will cover effectively all the national territory. One reason for these doubts has to do with how the

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[57] The "Direzione Entrate" has since been appointed as such office; but this situation must be very common to most other municipalities. In addition, given the long and uncertain penal procedures in Italy, it is very unlikely that a penal action will ever be successfully pursued in these matters.

[58] In addition, Colombia has learnt quickly that if the system is administered only at the local level, this creates strong incentives to manipulate or withhold relevant information in the presence of nationwide welfare programs. This is another reason why one has to be extremely cautious with decentralizing the welfare state, as discussed in Section 4 below.

information is collected at the local level: many, perhaps most, municipalities have contracted out the collection of ISE data to CAAFs. This is a serious mistake, for three reasons. First, unions should be left out of the design and running of universal income support schemes, to avoid that collusion of interests which is at the root of the perverse selectivity of the current system. Second, CAAFs are unlikely to be at the technological level required for a modern centralized system to work. Third, CAAFs might not have the legal authority to access and manage the information stored in a centralized system, which is a key requirement for the administration of the system to work effectively.

III.7 THE LEGGE QUADRO

The recently approved "Legge Quadro" (framework law) for the reform of social assistance defines broad principles for the reshaping of many social benefits and services and a long list of implementation rules (about 15 are the responsibility of the government and a dozen or so of regional authorities). As most Leggi Quadro it is close to a grand declaration of good intentions with little operational content. As such, it is fairly innocuous, except that, by advocating virtually any policy that "looks good", it neglects the importance of several trade-offs in the design and implementation of social policies.

IV.   THE KEY TRADE-OFFS AND OUR PROPOSALS

Public finance and welfare economics, or any other branch of economics, do not provide an unambiguous framework for setting up a welfare state. Ultimately, the choices depend on a number of merely subjective considerations. Thus, at the outset it is fair to state the normative criteria that drive our proposals, as well as our methodological approach and our preferences (or biases). We also consider what we perceive as the main constraints to a reform of the Italian welfare state. In doing all this, we address some of the key points of the recent debate about the welfare state.

IV.1   THE FISCAL CONSTRAINT

Welfare state reform must be viewed against the background of overall fiscal policy. Any realistic proposal on the Italian welfare state must face a binding constraint: for several reasons, of various nature, there is no room presently for any increase in the overall tax pressure. As it is well known, Italy has the 5th largest share of government spending in GDP among OECD countries. In the current climate, it is clear that any new resource for the welfare state must be obtained by shrinking some other spending item.[59]

IV.2   THE ADMINISTRATIVE CONSTRAINT

The RMI experiment points to poor administrative capability at the local level, particularly in the South. The ongoing decentralisation of the Collocamento has certainly not reduced the dramatic weaknesses in the administration of income support and "active" policies for the unemployed which were highlighted by the OECD review of the Italian Public Employment Service.

For this reason, we emphasize that no meaningful reform of the welfare state can be accomplished without a thorough overhauls of its administration. In addition, any reform proposals should also be aimed at achieving as much as possible administrative simplicity. This does not mean avoiding at all means-testing, but certainly avoiding the interaction of many targeted programs, which could lead to very different incentive effects from those originally intended. In addition to introducing potentially high marginal effective tax rates on work, a complicated system makes the calculation of income out of work uncertain, and social welfare recipients might choose to stay on welfare rather than accept a job with an uncertain associated income. [60]

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[59] Independently of the political climate, there are good macroeconomic reasons not to increase the share of government spending in GDP.

[60] Blundell and McCurdy [1999] emphasize the disastrous effects of several uncoordinated means-tested programs. In California in the early nineties, the interaction of just 6 social assistance programs that an increase in family earnings from $750 to $1500 would incraese the METR from 23 percent to 89 percent. In addition, any increase in the generosity at the bottom without changing the income at which benefits are withdrawn entirely necessarily entails an increase in the METR at the end of the benefit range, Thus, well intended reforms can have distastrous effects on a large range of income. Similarly, Harding [1997] shows that in Australia (where nearly all social assistance programs are means-tested) METRs can easily exceed 100 percent; the administrative complexity created by the interaction of these programs has almost become almost unmanageable in some areas.

IV.3 UNIVERSALISM VS. TARGETING

One of the key elements of the recent debate on the welfare state has been a revival of the fortunes of universalistic approaches. In practice, this has manifested itself as a number of proposals in favour of various forms of universalistic benefits, such as the "negative income tax", the "citizen income", the "social dividend", etc.[61] The common rationale of these proposals is that they ensure a minimum income to individuals without any labour or financial asset income, and try to minimize the disincentives to work implicit in all means-tested programs.

Specifically, the typical list of advantages of universalistic approaches runs more or less as follows:[62]
(i) they are less distortionary;
(ii) they do not have a stigma problem;
(iii) they do not have a low take up problem;
(iv) they enjoy more political support, as it is easier to cut programs for the poor.
(v) they are simpler and cheaper to administer
In our view, these arguments are not convincing.

It is not true that a universalistic benefit does not involve labour supply distortions. Like targeted benefits, it does exert a negative wealth effect on labour supply; but it usually does imply a lower effective marginal tax rate on some range at the low end of the distribution of earned income. Moreover, these are only the partial equilibrium effects; in general equilibrium, universalistic benefits imply a much higher total spending, hence taxes, than targeted benefits with the same redistributive effects at the lower end of the distribution[63].

The stigma problem is a rather elusive concept: poverty is largely a stigma by itself. Evidence on the (few) targeted programs currently existing in Italy, like Integrazione al Minimo and Pensioni Sociali, does not point to stigma effects. Rather, the abuse of the self-reported eligibility to the Reddito Minimo d'Inserimento which has been discussed above suggests that the stigma effect is limited if not at all absent.[64] Such an elusive concept like social stigma cannot justify spending several percentage points of GDP more than other available programs with similar redistributive characteristics.

Low take up problems, above a physiological threshold, are largely due to three reasons: lack of information, administrative complexities, and stigma.[65] The first two problems can be overcome by keeping the system and the administration of the programs simple, as is advocated below. Besides, there is little evidence of low take up problems for the main targeted programs in Italy; in the RMI experiment take up rates were, if anything, often underestimated.

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[61] See Haveman [1995] for a good description of the various instruments.

[62] See Mitchell, Harding, and Gruen [1994], Smolensky, Reilly, and Evenhouse [1995], and Toso [2000a] for an exhaustive analysis of the debate.

[63] The many evaluations of the negative income tax experiments (typically below the state level) in the US always emphasize the very large budget costs of these schemes. See Atkinson [1995] for a discussion of the NIT proposal and a survey of the evidence from some of these experiments.

[64] The stigma problem may be relevant when other private sector agents are involved besides the recipient; for instance, there is evidence that employment bonuses to be cashed by the employer or the employee have low take up because of the negative signal they convey.

[65] A different consideration might apply to immigrants, particularly the recent ones. Because of self-imposed limits on space and topics, we do not address the problem of immigrants and the welfare state in this work.

The notion that universalistic programs enjoy more political support and therefore have larger budgets is largely based on cross - country empirical evidence by Saunders [1994]. The inference, however, is only indirect, and it is based on the empirical observation that universalistic programs tend to be larger in this cross section. Besides suffering from an an obvious endogeneity problem, this inference has been challenged by Mitchell et al. [1995], who show that it is no longer true when spending in each program is decomposed by type of recipient.

Ultimately, the argument on administrative simplicity of universalistic programs has the most merits. However, there is sufficient experimentation with selective programmes in Europe to draw upon which could be of guidance in reducing the administrative costs associated with the running of such programmes. Moreover, Mitchell et al. [1995] show that administrative costs in Australia -- the country with the most extreme application of the targeting argument -- are not, on average, higher than in other countries.

But aside from these theoretical considerations, there is a deeper reason why a universalistic approach is not a realistic proposition in the current Italian situation: it is simply not compatible with any plausible macroeconomic constraint. A simple back of the envelope calculation shows why. Consider a "citizen income" program, whereby each individual is entitled to a monthly payment, regardless of his income. Suppose the monthly payment is Lit. 1,000,000 (a conservative number), and suppose 20,000,000 individuals, out of a total population of 60,000,000, are entitled to it (another conservative estimate). The total amount to be spent only on this program would be 240,000,000 mld, or about 12 percent of the current Italian GDP. This percentage would more than double if every Italian citizen above a certain age were entitled to it, as in certain proposals.

Recent proposals for more universalistic programs have been less radical than a "citizen income". Baldini and Bosi [2001] calculate the proposal by the former Treasury minister Vincenzo Visco of Social Dividend, consisting in a subsidy of 6 mlns. to singles, then increased for other families according to an equivalence scale. In the original proposal, this instrument should replace social assistance spending for 80,000 mld, although Baldini and Bosi compute a total social assistance spending of only 62,000 mld. If Dividendo Sociale replaces all this social assistance spending, including RMI, they calculate that total revenues (net of tax credits) will increase relative to IRPEF in 2003 (the steady state of changes in Finanziaria 2001) by about 138,000 mld, while spending would increase by about 171,000 mld; hence the deficit would increase by about 33,000 mld. (and by about 67,000 mld relative to 2000). In terms of distribution, Dividendo Sociale would benefit mostly the first decile (+44 percent disposable income relative to 2000), then the second (+11 percent), the third (+8 percent) and the fourth (+5 percent); the disposable income of the others quintiles would increase by below 5 percent.[66]

The key problem with a proposal like Dividendo Sociale is that it is not obvious what other programs it will replace. In the original Visco proposal, it appears that it should have replaced virtually all programs except old-age pensions. This is unrealistic. Proponents of the various forms of universalistic programs ignore that they cannot realistically replace every other type of social expenditure: to give a few examples, one could not entirely dismantle certain services for the disabled or the elderly; the education and the health system would remain largely publicly-provided; and the bulk of pension spending would be unaffected. In any event, there is no realistic scenario as to the transition from the current system to a universalistic one.

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[66] One should however be cautious in interpreting these calculations, as *all* deciles appear to gain.

Thus Italy does not seem to have alternatives to targeting. The issue is not universality vs. selectivity, but how to best target at the poor the limited resources available.

IV.4   MEANS TESTING VS. CATEGORICAL TRANSFERS

As discussed in Section 2, a key characteristic of the profile of poverty in Italy is its marked association with joblessness and its high incidence among mono-income families with many children. Under these conditions, targeting can be achieved by categorizing the transfers rather than by means-testing, i.e. there may be scope for transfers that are conditional on personal characteristics like the number of children in a family or the employment status -- rather than income. The advantage of categorical transfers is that they are easier to administer.

Categorical transfers and means-testing are not mutually exclusive, and indeed all countries that use the latter also use the former. But an exclusive or excessive reliance on categorical transfers can be dangerous or ineffective.

Consider first categorical transfers conditional on unemployment. One proposal could be to increase the generosity of (ordinary) unemployment benefits, allowing the more generous unemployment insurance and short-time working schemes (Cassa Integrazione Guadagni and Liste di Mobilità) to become voluntary programmes, self-financed by employers and introduce an open-ended unemployment assistance segment offering flat rate benefits to the long-term unemployed.

However, like all open-ended transfers offered to jobless individuals, unemployment assistance reduces work incentives. Estimates from ECHP suggest that the duration of unemployment benefits may indeed play an important role in affecting flows from unemployment to employment. In addition, the work disincentive effects of unemployment assistance may become more serious with the ageing of the population of jobseekers. Most jobs offered to the long-term unemployed involve fixed-term contracts. While in the case of youngsters, temporary jobs represent often a "port of entry in the labour market" (Contini et al. [1999]), in the case of adults, temporary jobs are not a prelude to good, permanent jobs. This may increase disincentive effects of open-ended unemployment assistance. In the light of all of these problems, there may be a strong case for offering unemployment assistance only as a temporary extension of unemployment insurance and enforcing tight work-tests on beneficiaries. Finally, unemployment benefits would miss entirely the large fraction of the poor who are outside the labor market.

Now consider categorical transfers based on the number of children. Most countries subsidize families with children for a number of reasons. But using the number of children as the only criterion would produce a program with very poor targeting properties: unlike in developing countries, in Italy there is little difference in the number of children per family at the different income levels. If anything, the distribution of the number of children by deciles is U-shaped, with the larger number of children in the poorer and richer households.

IV.5   DECENTRALISATION

There seems to be an almost universal consensus that the welfare system in Italy should be decentralised., a view that seems to be inspired by the recent enthusiasm for decentralization in general. This view should not be applied to the Italian case uncritically. To see why, note that there are two dimensions to the notion of decentralization. The first refers to the financing of the programs, the second to their administration.

Decentralizing the financing of social programs has a key rationale: it forces local administration to internalize the costs of the social programs they often administer. While this is an important point, there are two reasons to be cautious. First, many Italian regions are extremely small, and therefore subject to large idiosyncratic shocks of all sorts. Because of their limited ability to borrow, making social programs dependent on each region's own revenues would defeat the purpose of social programs, which by their nature tend to be counter-cyclical and operate as stabilizers. Second, there is a large disparity in the revenue raising capacity of the different regions. The poorer regions would simply not be able to put in place a modern welfare system.

Perhaps the strongest reason against excessive decentralization is that a large evidence has accumulated in recent years about a dismal inability of many regions and municipalities to administer many social programs. The RMI "experiment" discussed in Section 3 sounds as an alarming bell in this respect.

In terms of incentives, the worst combination is decentralization of administration with centralised funding: the incentives by local administration to be extremely generous are obvious: once again the RMI experiment is revealing in this respect. Unfortunately, this seems to be the implication of the recent law that has decentralized the administration of the Prestazioni di Indennità Civile. Because a full localisation of funding is unlikely, for the reasons discussed above, local administration of welfare benefits must be taken with extreme caution.

IV.6 GENERAL REVENUES VS. EARMARKED TAXES

The recent debate has displayed what we believe is a frequent misunderstanding of the notion of an earmarked tax (as in the case of ANF). There seems to be a belief that social assistance programs financed by contributions are less distortionary. However, unless there is an actuarially fair relationship between lifetime contributions and lifetime expected benefits for each individual, it is not clear that contributions reduce distortions. The fact that current spending on a program is financed by current contributions is entirely consistent with the contribution being perceived as a distortionary tax like any other (this is similar to the difference between a "pay-as-you-go" and a "fully funded" pension system).

A second argument in favor of earmarked contributions is that they create a political constituency for the program, which otherwise will likely be underfunded. We are not indifferent to the second argument, although again it is difficult to find hard evidence for it. However, we believe an earmarked contribution defeats the purpose of a social assistance program, by perpetuating one of the key problems of the current Italian welfare system, namely its selectivity based on a continuous work history in the formal, unionised sector. A general anti-poverty program financed with a contributory system is a contradiction in terms, and would reintroduce the selectivity of access based on labor market participation that has characterised negatively the Italian welfare state and that RMI has tried to eliminate. How would one treat, for instance, an individuals who has never made any contribution?

In the case of unemployment benefits – which, given the characteristics of poverty in Italy, can play an important role in reducing poverty – the case for linking explicitly contributions to benefits is stronger. This is because of the size of the informal sector in Italy. The emergence of the shadow sector is often the by-product of a joint (privately) efficient decision by workers and firms. If unemployment benefits are to be collected only by workers with official employment history, the workers' incentive to enter the shadow sector would be reduced, and would have to be compensated in terms of higher current wages. The firm, in turn, would perceive such a policy as an increase in the costs associated to underground activity, and would tend to stay in the official sector.

V. HOW A NEW WELFARE SYSTEM COULD LOOK LIKE

We now present our proposal for a thorough overhaul of the Italian welfare system. In doing this, we constantly try to relate our proposals to the demographic and social features of Italian poverty and labor market that we have discussed in section II, and to keep in mind the experience of other countries.

We should also point out that much of the debate on the welfare state has been driven by speculation rather than facts. We know very little about the effects of welfare state programs; experimental evidence is very sparse in the US, virtually non-existent in Europe. We are thus keenly aware that our proposals too are driven by speculation and prejudice more than facts. We thus strive to present the possible downsides of our proposals and to highlight the major areas of uncertainty. We address here the "more welfare" component of the reform. The "less pension" part goes much beyond the scope of the present paper. The only area where our proposals dictate reforms of old-age pensions is in replacing the so-called "pensioni sociali" with a general social assistance scheme covering individuals of all age groups. This would complete the separation between old-age insurance and assistance initiated with the Dini reform. We think a coherent set of programs that would fit the main features of the Italian poverty and labor market could be described as follows:

- A Minimum Guaranteed Income (MGI) scheme.
- An Employment Conditional Incentive (ECI) scheme, supported by a statutory Minimum Wage (MINWA).
- A generalised Unemployment Benefit (UB) system.
- A system of child and child care subsidies, based on three different programs replacing all existing benefits and tax credits.
- A system of invalidity and disability insurance.
- A differentiated set of Activity Requirements and Employment Service (ARES) policies, aimed at beneficiaries of MGI, UB, and youths.
- A coherent set of sanctions for the various programs.

We now detail more extensively our proposals.

V.1 THE MGI

Italy needs an instrument that can take care of the non-working poor, and a MGI is the most transparent such instrument. In light of the above discussion of the recent experience, we propose a thoroughly modified version of the RMI. We advocate one general means-tested program both on grounds of efficiency and administrative capacity. As we emphasized above, the interaction of many targeted programs can lead very rapidly to extremely high MTRS, as several benefits are withdrawn simultaneously. In addition, Italy has less experience with a sophisticated welfare system and a lower administrative capacity than most other OECD countries, as the recent experience of RMI has clearly shown.

The MGI has a negative incentive on the participation of those individuals who were previously not working, because it makes them richer. It also affects negatively the labor supply of individuals who were previously working and now are eligible for MGI at the existing earnings: both the income and substitution effects work in this direction, because they face a higher implicit tax rate and earn a higher income ("windfall" beneficiaries). Finally, it might affect negatively the labor supply of those individuals who were working and would not receive MGI at their previous hours, but might decide to reduce labor supply in order to

benefit from MGI ("opt-in" beneficiaries). To mitigate the problem of windfall and opt-in beneficiaries, we propose a standard approach in OECD countries: to associate MGI with an activation and work requirement strategy, albeit different from that attempted unsuccessfully in RMI. One key lesson from the recent experience of OECD countries is that "one size does not fit all": programs that work for one category do not work for others. In particular, there is no question that a program which simply gives a certain amount of money to young individuals is a recipe for disaster: it has large distortionary effects, it teaches no usable skills, and in the long run it can foster a culture of welfare dependence that will generate a backlash against all welfare programs, as the US experience has amply taught.

The problem with the RMI "experiment" -- from what we can gather -- is precisely that it is a cash disbursement almost exclusively to young individuals with a largely unsuccessful activation component. Thus, we propose an MGI that is not aimed primarily at the young, and is differentiated by categories. Specifically:

(i) Unlike in the RMI experiment, which is de facto a negative income tax, eligibility should be conditional on an income and asset test. This is indispensable as its clientele will not be young individuals for which asset holding is generally limited. However, we believe a house of "reasonable" value should be exempted from the asset test, for several reasons: (a) the liquidity argument in our view carries some weight, particularly in a country like Italy where the real estate market is less developed than in other countries, notably in the poorest urban areas; (b) for a number of reasons, Italy is one of the OECD countries with the highest percentage of owner-occupied dwellings (about 70%); (c) perhaps most importantly, the house could only be valued at its *valore catastale*, which as we know is extremely erratic and would introduce enormous horizontal inequities among individuals in different regions and even in different houses in the same area.[67]

(ii) It should include a premium for (a) children, both age-related and order-related; (b) household members with disabilities; (c) lone parents;

(iii) It should absorb all the *Prestazioni di Indennità Civile* (*Assegno di Assistenza*, *Indennita' di Frequenza Minori*, *Pensioni di Inabilita'*, and *Indennita' di Accompagnamento*), the current social assistance, non-contributory programs for disabled individuals. They cater to different typologies: *Assegno di Assistenza* to partially disabled (74 percent minimum) unemployed individuals; *Indennita' di Frequenza Minori* to disabled minors with "problems to perform the typical tasks of their age"; *Pensioni di Inabilità* to 100 percent disabled poor individuals; *Indennita' di Accompagnamento* to non-walking, non self-sufficient individuals. All these programs except *Indennità di Accompagnamento* are means tested, and all have worthy goals that should be preserved. But they, like other programs, have grown in a haphazard; in addition, very little is known on them, except that the *Indennità di Accompagnamento* is widely regarded to be "ineffective".[68] This is unfortunate, because *Indennità di Accompagnamento* is by far the largest component -- perhaps not surprisingly, since it is not means-tested -- at roughly 8,500mld, or about 2/3 of total spending of *Prestazioni di Indennità' Civile*. We propose to include all these programs into the MGI, with a premium for each typology; as a consequence, any premium for non-walking, non-self-sufficient individuals will become means-tested. However, the asset test for disabled individuals should be less stringent than for other individuals.

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[67] Most countries exempt houses from asset tests in social assistance programs: this is the case for instance of Income Support in the UK and SSI in the US.

[68] We should point out, however, that this large program seems to have been forgotten in the debate, except for generic statements about its "ineffectiveness" (which we have no trouble to believe). We could find almost nothing on this program, largely, we suspect, because very little is known about it.

(iv) It should absorb *Pensioni Sociali* and *Integrazioni al Minimo*.

(v) Part time work and casual work are the main sources of occupation for a large part of the clientele of an MGI. It is important to design the MGI in such a way as to encourage these types of occupation. Thus, the MGI should have a generous fixed earnings disregard and a low withdrawal rate, at about 60%.[69] One possible problem with this feature is that, while it encourages part time work, it somewhat discourages full time work. As an alternative, MGI could have a 100% withdrawal rate, but it could allow the recipient to accumulate the unused benefits into an employment bonus to be cashed when finding a full employment occupation, as in Income Support in the UK. A second alternative, probably simpler to administer, and hence preferable on the basis of the criteria discussed in Section IV, is to allow the recipient to keep receiving MGI for one year after finding a full time job, at descending amounts each quarter, as in France. One possible problem with the last two alternatives is that somehow one should determine when a full time job starts, and how long it lasts. Involvement of temporary work agencies in the administration of this "extended benefit period" can be useful in this respect to encourage occasional and temporary work. In Helmond[70], in the Netherlands, the TWA receives from the local government social assistance and pays it to the client together with a bonus for hard-to-place individuals. The TWA then repays the governments with the earnings of the clients involved up to the social assistance level. This stabilises income and provides access to work at the same time, while shifting the administrative burden on a private entity (the TWA).

(vi) Like the RMI, the MGI will also involve "reintegration" or "activation" measures. However, it is essential to recognize that the same activation measures do not work for all categories. In particular, there should be a clear differentiation in the activation strategies for three classes of individuals: youths, long-term unemployed, lone mothers. We deal with these in section 5.6 below, because they are largely common to the activation strategies for UA beneficiaries. Given that this is an area of experimentation, some discretion should be allowed at the local level in the implementation of these activation measures, while making sure that adequate information is collected about their effects. Much can be learned by cross-regional differences in the design of activation measures.

(vii) Only lone parents with children under 6 years of age should be exempted from the work requirement or its variants for this specific category of individuals.

(viii) The financing of the MGI should be studied carefully. The present arrangement of RMI provides skewed incentives to localities: they essentially pay no costs in the cash assistance component, and the full cost of the in-kind service component. The two components should be closely linked. However, full local financing is unthinkable, and would defeat the purpose of an anti-poverty measure; thus, we believe there is no alternative to a centralized financing of both the cash and the in-kind components, perhaps with a 10% local share as in the Netherlands.

(ix) The administrative constraints in providing these services should also be clearly recognized. There is a well recognized trade off here: on one hand, activation services work only when they are tailored to the local labor market conditions; on the other hand, the RMI experiment has demonstrated very clearly that some localities are simply unable to provide these services according to any minimal standard. This trade-off has no simple solution. One strategy is to rely on financial incentives: the activation measures are administered at the local

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[69] Blank et al. [1999] estimate that up to half of the dramatic increase in labor supply of single mothers in the recent years in the US may be due to the enhanced earnings disregard adopted in most states, first in AFDC, then in TANF. Earnings disregards for welfare benefits have also been adopted in most Canadian states.

[70] See OECD [1998b] for details.

level, and resources -- including those for the cash component -- will be preferentially allocated to those municipalities which offer the best performance in reducing the number of type I (eligible families that are not awarded the benefit) and type II (false positives) errors as well as in terms of activation strategy A set of "performance indicators" for the local administrations will be defined with this purpose.

(x) A key feature that has undermined all the RMI experience is the controls of eligibility. These have two components: the detection and sanctioning of fraud in the application procedure, and the control of the beneficiary's behavior in the activation strategy. Italy has basically no experience in either of these fields; hence, it should largely rely on the best practices of other countries. We deal with these in section 5.7, because again they are common to both the MGI and the unemployment assistance schemes.

V.2   FINANCIAL INCENTIVES TO EMPLOYMENT

A MGI, as we have seen, has negative effects on participation of low-skill individuals, and has potentially high costs in terms of the windfall effects on workers who become eligible for the MGI. A common approach to the first problem is activation strategies, which has been incorporated into RMI and we propose to incorporate into the new MGI. A second approach to the first problem is represented by financial incentives to work, whose main difference from a NIT is precisely that they have positive effects on participation, at least of the primary earner. As we will see, these financial incentives can also be designed to address the second problem, namely the large windfall effects on workers.

There are two possible, radically different types of financial incentives to employment: an Employment Conditional Incentive (ECI) and a wage subsidy.[71] The former is a subsidy to labor supply, the latter to labor demand. We emphasize that we do not have enough empirical basis to advocate one over the other. Thus, we limit ourselves to present the main pros and cons of both measures, and finally we present our (admittedly tentative) arguments on why we believe that Italy should try an ECI.

A. The ECI[72]

An ECI can be of two basic forms: it can be based on tax credits (ECTC) or on benefits (ECB). We discuss the pros and cons of the two in a box below. Our discussion in this section applies to both.

The basic idea of an ECI is to subsidize the earnings of individuals who work. As such, an ECI has a *positive* income effect on the incentives to participate, rather than a negative one like in a MGI; however, it still has the problem of windfall and opt-in beneficiaries. This problem can be addressed in two ways: by restricting eligibility to some classes of individuals (like long-term welfare recipients or unemployed), or by imposing a full-time work requirement. Box 5.1 describes briefly the main effects of an ECI (for

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[71] We do not consider here employment bonuses to be redeemed by the employee, or wage subsidies to the employee. Experiments with this type of subsidies have consistently shown that they carry a strong stigma effect, and eventually they might hurt the employment prospects of low wage individuals (see Katz [1996] and Fay [1996] and Annex B).

[72] For a general description of how a typical ECI works, see Bassanini et al. [2000], OECD [1996a], Blank et al. [2000], Bell, Blundell and Van Reeman [1999], Pearson and Scarpetta [2000].

simplicity, we consider the case of an ECTC, although an ECB has much the same effects) and how these strategies can help in minimizing windfall and opt-in beneficiaries.

Although little noticed, Italy also has already its own version of an ECB: the ANF, which is given to workers with children and is withdrawn at rather steep rates. However, the ANF is also given to some unemployed and to retirees, and most certainly was not designed (and never thought of) as an ECI.[73] The ECI we propose for Italy has the following features:

(i) In combination with MGI, it replaces ANF, A3F and all tax credits for children.

(ii) If the ECI is a ECTC, the tax credit should be refundable, i.e. it should be paid in full even to individuals whose tax liability is smaller than the tax credit.

(iii) To improve its targeting properties, the ECI should be based on all income, not just earnings.

(iv) As all schemes of this type, it involves a phase-in region, a constant region, and a phase-out region. Suppose the income tax rate is 20%. If the phase in region is, say, between 5 and 10 thousand Euros and the phase in rate is 30%, an individual who earns 5,000 will receive a net income of 5,500 (5,000 less 1,000 in taxes plus 1,500 in tax credit), and an individual who earns 10 mlns will receive a net income of 11,000 , inclusive of the tax credit. If the flat region is between 10 and 15,000 Euros , an individual with earnings in this region will receive a tax credit of 3,000 (30 percent of 10,000 , the end of the phase in region), regardless of her actual earnings. If the phase-out region is between 15,000 and 20,000 Euros, the tax credit is exhausted at 20,000 Euros; hence, an individual who earns 15,000 will receive 15,000 (her earnings less 3,000 in taxes plus 3,000 in tax credit); an individual who earns 20,000 receives a net income of 16,000 (her earnings less her taxes). It is readily apparent that the ECTC reduces the overall tax rate in the phase in region (in fact, in our example it is negative), but it increases it in the phase-out region. The case we have illustrated closely mimic the US *Earned Income Tax Credit* (EITC).[74] The British *Working Family Tax Credit* (WFTC),[75] in contrast, does not have a phase in rate: it starts at the maximum -- about 250 Euros per month for a family with two children) and is phased out progressively starting at the end of the MGI phase-out level.

(v) It should be available to singles. For families with children, one could think of three alternatives to take into account child care costs for working parents: (i) phase in and phase out regions graduated on the number and age of children; (ii) a child care credit as in WFTC, which subsidizes 70 percent of child care costs up to a limit (iii) a "universal child care credit", as in the scheme advocated by Cherry and Sawicky [2000] which essentially shifts up the ECTC schedule for each child in the family (see Cherry and Sawicky [2000] and Ellwood and Liebman [2000]). We defer a more complete treatment of the issue of child care to the next subsection.

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[73] Several Anglo-Saxon countries have tax or benefit incentives designed specifically to enhance the income of the working poor with children: the US, the UK, Ireland, and Australia have some version of these programs. In the US, in addition to ECTC there are several child-related tax exemptions or credits The Dependent Exemption is worth more to higher income individuals. The Child Tax Credit is a non refundable (if the household has less than 3 children) $1000 tax credit per child, phased out gradually; hence, it does not apply to families who do not owe taxes. The Dependent Care Credit gives a credit of up to 30% on certain qualifying expenses; it is also non-refundable, hence again it benefits only families who owe a tax liability.

[74] For specific descriptions of EITC, see Eissa and Liebman [1996], Scholz [1996], and Eissa and Hoynes [1998]. Liebman [1998] and Hotz and Scholz [2001] have a good historical review of this programme and a good discussion of the main issues.

[75] For a description of WFTC, see Blundell et a. [1999], Gregg et al. [1999], and Dilnot and McRae [2000].

(vi) A number of outstanding issues remain: whether ECI should be based on tax credits or benefits, whether it should be assessed on individual or family incomes, and how it should be integrated with MGI and the tax system. These are complicated questions, and none has a clear-cut answer; we discuss the trade-offs involved in Box 5.2 below.

Box 5.1: Effects of an ECTC

Theoretically, the introduction of an ECTC has several effects on participation rates and hours of different types of individuals. Consider first the effects on singles or primary earners in couples. For individuals who are currently not working, both the income and the substitution effects contribute to encourage participation in the labor force. For individuals who are working, and at the existing earnings qualify for ECTC ("windfall beneficiaries"), the incentives depend on the level of their earnings. If they fall in the phase-in part of ECTC, the income and substitution effect on hours go in opposite directions; if they fall in the phase-out region, the income and substitution effect on hours both contribute to reducing hours, albeit disincentive effects are smoothed by the gradual increase of the tax rate, and hence may be fairly limited. Finally, individuals who at the existing earnings do not qualify for the credit might decide to substitute leisure for work and decrease hours ("opt-in beneficiaries").[76] Now consider the partner of the primary earner in couples: given that the primary earner does work, the ECTC has an unambiguous negative income effect on participation of the partner, as the income of the family is increased by the ECTC. If the secondary earner also works, the effects on hours are the same as for the primary earner. [77]

We do not know how important the problem of windfall beneficiaries is in an ECTC; but the NIT experiments of the seventies suggested that the problem can be considerable (see Blank et al. [1999]). There are two basic approaches to this problem.

(i) Impose full-time work requirement, or at least minimum hours requirement, as in WFTC and the Canadian Self Sufficiency Project, SSP. However, some individuals who in the absence of the program would have worked less than the minimum amount of hours might now choose to remain on welfare. On balance, this requirement could lead to a *decline* in the fraction of incentivised versus windfall beneficiaries (see Blank et al. [2000]). Another downside of this proviso is that it does not incentivate part-time and casual employment, increasingly a mode of exit of the unemployed. In spite of this, most ECTC impose a minimum hours requirement, and we advocate the same feature, in light also of the costs in

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[76] Note the key difference with a NIT like RMI: in the latter, the income and substitution effects on windfall beneficiaries unambiguously contribute to decrease labor supply.

[77] These are only the short-run effects of an ECTC. Next to nothing is known about the long-run effects. Because an ECTC is a subsidy to low productive workers, it could decrease the incentives to accumulate human capital. This, however, depends very much on one's views about the sources of individual human capital growth. If it is mainly on the job training, then an ECTC could have positive effects on human capital acquisition (see Bertola [2000] for a survey of the arguments). We have little empirical evidence on this point: Cossa, Heckman and Lochner [1999] show that, if on-the-job training is the prevailing form of accumulation of human capital, positive participation effects are likely to prevail in a life-cycle model, while the opposite is the case if off-the-job training is the prevailing form of accumulation of human capital. They also provide a first empirical investigation, and find no evidence of a negative effect of EITC on human capital accumulation. In any event, a widening of the wage distribution -- which could be expected from the introduction of a minimum wage and from decentralising collective bargaining in the formal sector, as we propose below -- would reduce any disincentives to on-the-job training associated with the presence of an ECTC.

administering this system (incentives to take-up part-time jobs are taken care by the UB system, see below).

(ii) Restrict eligibility to some classes of individuals. For instance, in the Canadian Self Sufficiency Project only individuals who have been on welfare for at least 1 year are eligible to financial incentive; the Canadian Earnings Supplement Project is restricted to UI recipients. But again this type of targeting presents downsides (see Blank et al. [2000]). It can be seen as inequitable, since a person who stays on welfare for a year is treated better than someone who never enters welfare. Also, it can screen out windfall beneficiaries if their behavior is static over time; but in the Canadian SSP experiment, about 15% of beneficiaries for more than a year would have been working after 18 months; with the SSP rule, they are windfall beneficiaries in the second year of the program. To our knowledge, SSP is the only program that imposes such requirement; lacking any evidence on its effects, we do not advocate this feature in our proposal.

It is important to note that a ECI works best when the wage distribution at the low end is sufficiently dispersed, and when taxes on labor income are sufficiently low. With enough dispersion at the low end, the "phase-out" region – and its associated disincentive to hours and upskilling (e.g., via investment in training) -- involves a relatively small share of the workforce. The programme is also less costly in this case. In addition, the wage at the low end of the distribution is relatively low, hence a small increase in taxes at the high end can imply a large relative increase in benefits to the low end and therefore strong incentives. When taxes are low, the distortions generated by higher (implicit) taxes in the phase out region and (explicit) taxes in the financing region (those not affected by ECI) are lower.[78]

Box 5.2: Trade-offs in the design of an ECI

(i) **An ECTC or an ECB?** Some countries use ECI based on tax credits, or ECTC (like US and more recently the UK), others using benefits, or ECB (Italy and New Zealand). One advantage of an ECTC -- and a big one, in the current climate -- is that it does not increase public expenditure. A second advantage is that it is administered through the tax system, hence it requires very little new apparatus in place. Yet, this is also a potential disadvantage in the Italian case: to work effectively, an ECTC must rely on very prompt refunds; this is not going to happen in the near future in Italy: it is well known that the tax administration is particularly slow in refunding credits, although there has been some progress in speeding up tax (not social security contributions!) refunds in the last two years.[79] A third advantage of an ECB is that it can be received periodically throughout the year, hence it makes clearer the connection between work effort and financial reward; an ECTC is typically received as a lump-sum at the end of the year. In principle, an ECTC could also improve the connection between work and reward if it is based on an *advance* tax credit; in fact, WFTC is

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[78] See the simulations in Bassanini et al. [2000].

[79] In the US, 95% of ECTC recipients would be required to fill out a tax return or an over-withheld tax form anyway. Hotz and Sholz [1999] estimate that the cost to the IRS is also very small, much smaller than the cost of administering the other major welfare programs. These figures and these considerations are unlikely to apply to the Italian case.

formally an ECTC but it is paid incrementally, based on the six weeks earnings and family conditions before the last 6 months. This lends itself to some risk of manipulation: someone who worked six months ago and then became unemployed could still receive WFTC for six months. We do not know of any evidence on the extent of any manipulation, but Fry and Stark [1993] suggest that half of the recipients of Family Credit were not entitled to it based on their current income.

A fourth advantage of an ECB is that tax non-compliance is very high in Italy, hence a system entirely based on the tax system might run into problems. [80] However, note that for low-paid workers in the underground economy, the MGI is still available, essentially with a withdrawal rate of 0 (informal sector workers, by definition, do not declare their labor income). Hence, either an ECTC provides an incentive to come above ground -- and some features of our ECTC go precisely in that direction -- or it has no effects on participants in the underground economy.

The choice between ECTC and ECB in Italy should therefore be made exclusively on the basis of considerations concerning the formal sector. Currently, ANF are paid by employers and reimbursed by INPS; we are not aware of any major complaint with this arrangement. Overall, the choice between ECB and ECTC should be based on the speed at which progress in the administration of tax refunds is achieved. Unless tax refunds can refunded within at most a year (currently they take, on average, two years) it would be advisable to rely on the current system, and use an ECB instead of an ECTC.

(ii) **Family or individual entitlement?** In a system of family taxation, like in the US, an ECTC can easily have a negative effect on the incentive to participate of a spouse, or more generally of a secondary earner in the family. Suppose the husband's (or the primary earner's) earnings are in the phase out region: the ECTC has negative income and substitution effects on the incentives to participate of the spouse; conditional on participating, the ECTC has a negative substitution effect on the hours of work of the spouse. As Hotz and Sholz [1999] argue, these disincentives are stronger, the greater the disparity in the wages of the two spouses. In Italy the gender wage gap is close to the ECHP average (OECD, [2001]) but is widening over time (the difference between the median wages of men and women as a fraction of the men's median wage was about 26% in 1997 from 20% in 1994, according to the ECHP data), probably as a result of the growing association between the part-time jobs accessible to women and temporary employment Preserving good incentives to participate for the secondary earner is particularly important in Italy, because as we have seen poverty seems to be largely concentrated in two-parent families with children and only one worker. In addition, In Italy 56% of unemployed workers live with their parents, against 20% in France and less than 10% in Nordic countries (see O'Donoghue and Utili [2000]).

There are two ways to tackle this problem. The first is to reduce the withdrawal rate in the phase-out region, and increase the flat region; this is the solution adopted in the US recently, but it has the downside of extending the phase-out region further, with all the associated distortions. The second approach is to base the ECTC on individual earnings (in fact, this might be the only option in a tax system, like the Italian one, which is based on individual income). This, however, would cause a deterioration in the targeting properties of the ECTC, as low-paid spouses of millionaires would be entitled to ECTC. As Hotz and Sholz [2000] notice, "the tax system cannot simultaneously be progressive (have increasing average

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[80] In the countries where tax compliance is high, as in the US, ECTC does not seem to have run into major compliance problems.. A recent study on 1994 returns found that 25.8 percent of the total EITC claims exceeded the correct amounts (Internal Revenue Service, 1997). Of these, about 70% are caused by qualifying child errors (Mc Cubbins [1997]). The reason is that in the US the IRS has very little ability to determine who can rightfully claim a child as a dependent. This should be less of a problem in Italy.

effective tax rates), treat the family (as opposed to individuals) as the unit of taxation, and be neutral with respect to marriage. Hence, either penalties for singles or marriage penalties are inevitable, unless the structure of individual income taxation is dramatically altered.".

Overall, the choice between family and individual entitlement involves a trade-off between better targeting and better incentives to participate. Here again we do not have strong views on this trade-off, partly because of the scarcity of data at our disposal to assess the elasticities involved. Because of the importance of getting secondary workers to work, we might be inclined towards an individual assessment. In the current legal framework, this might also be the only choice available.

(iii) **Integration with MGI.** There are several thorny issues when both an ECI and an MGI are present. Should the phase-in region of the ECI start before or after the end of the MGI? At current RMI benefit levels, the minimum hours requirement in our proposed ECI would probably imply that the two programs virtually do not overlap. But with a more generous MGI, the issue does arise. If the phase in region of ECI starts after the end of MGI, there is virtually no interaction between the two. A similar arrangement would be very costly, however. In addition, it would create a highly kinked budget constraint, and it would not encourage work by many MGI beneficiaries. Hence, we advocate starting the flat region of ECI near the end of the phase out region of MGI (see O' Donoghue and Utili [2000]), so that MGI recipients face a lower METR than the MGI withdrawal rate. The cost of this solution, however, should be verified carefully.

In this case, one must also decide if welfare benefits of all types should concur in the income that is eligible for ECI.[81] The mirror image of this question is whether the ECI should be counted in the income tests for the MGI. A positive answer would diminish the participation and labor supply incentives of the ECI. Suppose an individual on MGI earns an extra dollar and becomes eligible for an ECTC in the 40 percent phase in region; and suppose these earnings are above the earning disregard of MGI. The extra $1.40 (the wage plus the 40% phase in ECTC or ECB) are then taxed at the MGI withdrawal rate, say 60%: this leaves the worker with an extra $.56 cents instead of $1.40. If the tax credit or benefit where not counted in the MGI test, the worker would keep $.80 of the $1.40. In recognition of this problem, the US legislation changed in 1993, prohibiting the inclusion of EICT in the eligibility tests for AFDC. However, with the abolition of AFDC in 1996, states have now the authority to include EITC in the eligibility tests for TANF.

(iv) Integration with the tax system. To avoid extremely large tax rates in the phase-out region, the ECI should be based on after-tax earnings, not pre-tax earnings (see O'Donoghue and Utili [2000]).

B. Wage subsidies

As an alternative to the ECTC, we propose a standard wage subsidy for low-wage employees.[82] We consider two types: employment subsidies to employers, and reductions of employers' social security contributions. The first type comes in several forms: tax credits, subsidies proportional to part or all of the annual wage, lump-sum amounts (including re-

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[81] This is the case, for instance, of Family Support in New Zealand.

[82] As Hotz and Scholz [2000] emphasize, an ECI and a wage subsidy are not necessarily mutually exclusive. Virtually all countries that have an ECI also have some wage subsidy, but the latter have often been designed in a rather fragmented fashion and their integration with the ECI has never been well thought out.

employment bonuses to be redeemed by employers). They can also be targeted at specific categories of individuals : as for financial incentives, we consider low-paid individuals, unemployed, youths, welfare recipients. The second type -- specifically, a reduction in social security contributions for low-wage workers -- has been advocated by Dreze, Malinvaud, and Phelps, among many others. The working of the two types of subsidies is similar: the box below briefly illustrates their theoretical effects. [83]

Like the ECB, wage subsidies of both types are far from unknown in Italy: in 1999 about 0.35 of GDP was spent on various kinds of incentives to job creation, mainly consisting of tax and social security rebates, involving about 1,800,000 individuals. There is limited evidence on their effects, and what is known is not altogether encouraging. In particular, subsidies to employers hiring from the so-called "mobility lists" (the most generous unemployment benefit being provided in Italy) did not seem to stimulate additional outflows from unemployment, either in Northern or in Southern regions (Brunello et al. [1997], Caroleo et al. [1997]). There are simply too many employment subsidies (the most recent inventory listed about 100) and they frequently end up crowding out one another. Take up is frequently low, largely due to the inordinate amount of red tape involved.

We propose a wage subsidy patterned after the most successful (at least in terms of take-up) recent experience among the European countries, the Dutch SPAK (see Doudeijns, Einerhand, and Van de Meerendonk [2000]). Our proposed wage subsidy should have the following features:

(i) Permanent. Several European countries have used temporary wage subsidies; but temporary wage subsidies provide perverse incentives, namely they increase turnover, and in general benefit more high turnover sectors and units (e.g., small and medium-sized enterprises).

(ii) Disbursed immediately to the employer

(iii) Involve a very small administrative burden: the only criterion for eligibility should be the wage

(iv) It should replace the plethora of implicit and explicit subsidies currently existing in Italy. In particular, it should not be directed at any specific sector.

(v) Like MGI and ECI, it should be associated with activation policies and work requirements, which we discuss in section 5.6.

(vi) We deal with other design issues -- including the choice between an employment subsidy and a reduction in social security contributions -- in Box 5.4 below.

Box 5.3: Effects of wage subsidies

The effects of wage subsidies are simple: they shift out the labor demand. Hence, the effects of a given subsidy on employment and earnings are larger the more elastic the labor demand is; the effects on employment are larger and those on earnings are smaller the more elastic labor supply is. Hence, the evidence on these elasticities, particularly for low-wage individuals, is of paramount importance in assessing the likely effects of a wage subsidy. For the US (with a very different labor market from ours) Katz [1996] has summarized the evidence as follows. Many studies agree that the labor supply elasticity of low-wage workers

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[83] One can further distinguish among a "wage subsidy" - an employment subsidy assessed on the whole wage -, and an "hourly wage subsidy" - an employment subsidy assessed on the hourly wage.

is between .3 and .4, and even higher for women and youth. There is more uncertainty on the labor demand elasticity for low-wage workers. From the literature on minimum wages by Card and Krueger, it is 0; but in reality it is likely to be higher, between -.1 and -.6. If the labor supply elasticity is .4 and the labor demand elasticity is -.5, a 10% wage subsidy implies a 2% increase in employment and a 5.5% increase in wage. Hence, at these elasticities the earning effect of a wage subsidy might be larger than the employment effect: focusing on employment might miss the point.

How relevant are these figures for Europe? It is hard to say; but we note that many calculations underlying the proposal for payroll tax reductions in Europe have made probably unrealistic assumptions about the relevant elasticities. In particular, the Malinvaud proposal assumes demand elasticities of -1.1 at the low end and of -.7 at the high end, which seem high. Even with these high elasticities, Malinvaud's simulations predict a 2 percent net increase in employment with a scheme that should cost about 1.3% of GDP. Thus, even under optimistic assumptions it is unlikely that an employment subsidy will be the miracle cure.

In general equilibrium, and when one takes into account the participation decision, wage subsidies have other effects: (i) Like an ECTC, wage subsidies generate deadweight losses in the form of windfall beneficiaries, i.e. individuals who would have found employment anyway; (ii) Substitution between subsidized workers and other groups, like employed young workers etc. (iii) Displacement effects, as firms using subsidized workers might crowd out other firms; (iv) Fiscal crowding out effects, associated with the financing of the scheme. The deadweight costs generated by windfall beneficiaries could be eliminated by using true marginal employment subsidies, i.e. subsidies only to job openings beyond those that would have occurred in the absence of the subsidy. But clearly the informational requirements for such subsidies are unattainable. Many countries have proxied marginal subsidies with incremental subsidies, i.e. subsidies to employment beyond a certain increment over the previous year's employment and restrained access to firms that did not layoff workers in the previous year. But these subsidies can generate perverse incentives for firms to implement large layoffs followed by large hirings, and more generally subsidize high turnover sectors and firms. As Fay [1996] observes, when firms refuse to hire unemployed unless they receive a large subsidy, or set aside positions that are contingent on a subsidy, the programme effectively becomes a long-term subsidy to firms. In Finland, employment subsidies are now available only for permanent hirings, but it is not clear how this can be enforced.

Box 5.4: Trade-offs in the design of wage subsidies

Employer contribution reductions or a standard wage subsidy? Conceptually, there is no difference between the two. A subsidy is the negative of a tax, and both measures shift out the labor demand curve. Given that a system of social security contributions is already operating, there seem to be obvious administrative advantages in choosing a reduction in employer contributions over a standard wage subsidy. The only downside is that an employer contribution reduction has an upper limit: the implicit subsidy cannot exceed the current rate of contribution, which is 32 percent. For larger subsidies, one should have an explicit subsidy. Indeed, the *New Deal* for young unemployed in Britain is based on (large) explicit subsidies to the young unemployed.

Targeted or general subsidies? Like the ECI, a wage subsidy can be targeted tightly to avoid deadweight losses and substitution effects. But there are at least four downsides to targeted wage subsidies. First, they can induce the state to engage in industrial policy; they can displace other workers, creating problems of horizontal equity; they can have a low take-up, because of information and paperwork costs[84]; and perhaps most importantly, they can stigmatize the target of the subsidy. To avoid the last two problems, it might be better to subsidize the first fixed amount in each employee's wage (as in the US *New Jobs Tax Credit*), so that the subsidy is more valuable when hiring a low-wage employee, or to subsidize all low wage employees.

Subsidizing the initial portion of all wages also has the advantage that it avoids the high marginal rates of payroll taxes implicit in schemes that subsidize only the wages up to a given value (as in the current French legislation and in the Dutch SPAK). The downside of this is that it is very costly; but one could mitigate this problem by designing a scheme that pays a fixed fraction of the wage for all wages below a rather high value, which is unlikely to be affected by the subsidy. [85] A second alternative would be to devise a linear reduction in the subsidy, as in the Malinvaud proposal for France.

Hourly wage subsidy? Phelps [1994] has proposed a very ambitious graduated hourly wage subsidy that would encompass most current welfare programs in the US. Its advantage obviously is that it is better targeted than the a standard wage subsidy. However, its informational requirements are far superior to those involved in a standard wage subsidy. In addition, it reduces returns to education, because it decreases the returns to investment that leads to higher wages per hour, as opposed to returns to increasing hours at existing wages.

C. The minimum wage

As a part of our proposals, we believe that a statutory minimum hourly wage (MINWA) should be introduced in Italy, which should cover all workers independently of their industry of affiliation.

To understand the likely effects of a minimum wage in Italy, it is important to begin from a key institutional feature of the Italian labor market. As it is well know, the strong degree of wage compression in Italy documented in Section 2 is induced by the extended coverage of collective bargaining. In turn, the extension of this coverage is induced by jurisprudence taking the minima established by industry-level bargaining as a reference in determining the "fair wage" in case of labour disputes. A MINWA would become the new reference in this case, giving a boost to greater differentiation in pay levels across firms in the same sector (e.g., by region). Clearly, the MINWA may also play against the increase in wage dispersion insofar as it puts a floor to the earning distribution. The key is to set the MINWA at a sufficiently low level to prevent this. Under these conditions, a statutory MINWA will encourage the decentralisation of collective bargaining in Italy because it will reduce the degree of "excess coverage" of collective bargaining.

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[84] In Australia, a subsidy of 30% for long-term unemployed had a very poor response (see OECD [1997b]). The JOBS subsidy to train and hire disadvantaged workers of the seventies had a very low take-up.

[85] However, this arrangement would generate administrative problems for workers who have more than one job or that change job during the year.

In turn, a more decentralized bargaining is an important precondition for exit from the informal sector. This is where introducing a MINWA can help an ECI work more effectively, for two reasons. First, as discussed in section 2, the Italian labor market has a very sizable informal sector. This implies that the extent of low-pay is much larger, and the anti-poverty effects of an ECI potentially more significant, than what can be grasped by statistics covering only employees in the formal sector. The effectiveness of an ECI will very much depend on whether this informal sector is reduced. Second, by breaking the hold of the centralized bargaining, the introduction of a MINWA would make the wage distribution in the formal sector more dispersed at the low end; as we have argued above, this is a precondition for an ECI to work effectively.

A third rationale for the introduction of a MINWA is purely distributional, and is common to both an ECI and a wage subsidy. An ECI essentially reduces the reservation wage of a worker: this shift of the labor supply can reduce the market wage; a minimum wage prevents an ECI from being captured by the employer. [86] A MINWA shifts out labor demand, hence it should not have similar effects; yet, there might be distributional or political reasons to impose a floor on wages even in the presence of a wage subsidy. In fact, in Europe many countries have moved to a policy of wage floors combined with reduction in payroll taxes at bottom of earnings distribution (Belgium, France, Netherlands). The MINWA sets a floor to lower wages for low-skill individuals; payroll reductions avoids disemployment effects of the minimum wage. As Box 5.5 shows, however, if the goal is to fight poverty a MINWA has the worst targeting properties among the different instruments, essentially because it does not screen out low-paid members of well-off families.

We should emphasize that a MINWA carries with it considerable risks.[87] We cannot be entirely sure that a MINWA the "bargaining decentralization" effect will prevail over the "disemployment effect" of a MINWA. Politically, there is always a temptation to set it at a very high level, which would be disastrous. The MINWA should be set at a level that makes it only marginally binding in Southern Italy, so that it still provides some incentive to go formal.[88] It should also be differentiated by age, like the statutory minimum wage in the Netherlands: as we have seen, in Italy youths have a very large incidence of low-paid employment; but low paid employment among youths is also the least problematic, because it is usually only a stepping stone towards better jobs.

D. Choosing between an ECI and a wage subsidy

There are several reasons why an ECI may be appropriate for Italy:

(i) As we argued in Box 5.1 an ECI is particularly effective in stimulating the participation of primary workers. Thus, an ECI is particularly suited for a situation where the elasticity at the "extensive" margin (whether to participate or not) is high and/or the elasticity at the "intensive" margin (how many hours to work, given that one participates) is low. [89] Italy

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[86] See OECD [1997b] and Gregg [2000].

[87] In fact, this is perhaps the only issue where there is still some (limited) disagreement between the two authors of this paper.

[88] In fact, ideally the MINWA should be differentiated by region, although we realize this might be politically unrealistic.

[89] Saenz [2000] shows that the choice between a MGI and a ECTC depends, among other things, on the elasticities at the intensive and extensive margins. "A MGI program with a substantial guaranteed income level
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has a highly unionised labour market, with restrictions to employment adjustment and with low participation rates -- suggesting that adjustment along the "extensive" margin is more likely than along the intensive margin.

(ii) The very reason that makes an ECI well suited at stimulating participation of the primary earner makes it a poor instrument at stimulating participation of the secondary earner, if it is assessed on family income (see Box 5.2). To the extent that poverty in Italy is particularly concentrated in two-adult families with children and one worker, ECI might not be the best instrument to cope with this feature, unless one is willing to assess it on individual income.

(iii) If assessed on family income, an ECI has better targeting properties than a wage subsidy (see Box 5.5 below on the relative targeting proeprties of an ECI, wage subsidies, and the minimum wage), because it does not subsidize, say, children in rich families; this targerting advantage of an ECI is no longer there if ECI is assessed on individual income, to avoid negative incentives on the participation of secondary earners.

(iv) An ECI is less prone than wage subsidies to manipulation by companies; for instance, it does not create incentives to create fictional unemployment; this is important in light of the documented administrative weakness of Italy.

(v) Unlike wage subsidies (unless the latter are truly marginal, which is nearly impossible to achieve), an ECTC does not subsidize sectors with high turnover. We have seen that incremental wage subsidies can also generate perverse incentives to increase turnover.

(vi) As we have seen, Italy has a relatively high rate of poverty among families with at least one worker; subsidizing the working poor is the primary intent of an ECTC.

(vii) A wage subsidy is usually temporary. For the subsidized employee to be retained after the subsidy has expired, his productivity must have increased a lot.[90]

(viii) Empirically, wage subsidies seem to have large deadweight costs and substitution effects.

(ix) We believe wage subsidies are more prone to manipulation as a surrogate industrial policy, as governments with a history of industrial policy activism invariably choose certain sectors over others.[91]

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and high phasing out rates is optimal when behavioural responses are along the intensive margin. However, when behavioural responses are along the extensive margin, then the optimal transfer is similar to an ECTC with negative marginal tax rates at the bottom and a smaller guaranteed income for non-workers. so as to shift transfers away from non-workers toward low income workers. As redistribution is financed by middle and high income earners, the higher are the behavioural responses at the middle and high income end, the higher is the cost of redistribution and thus the smaller is the optimal transfer program. The main lesson from the numerical simulations is that the optimal program is fairly sensitive to the size of the participation elasticity. When the participation elasticity is zero, the optimal program is a large Negative Income Program with a guaranteed income in excess of $10,000 and a high phasing-out rate (around 70%). However, if the participation elasticity is substantial, then the guaranteed income level should be lower but the first $5,000 to $7,000 should be exempted from taxation (or even slightly subsidized). The guaranteed income should then be taxed at a fairly high rate for incomes between $6,000 and $15,000."

[90] These partial equilibrium effects are only a lower bound on the effects of wage subsidies. Even if it just results in the substitution of long-term unemployed for short-term unemployed, a wage subsidy has the positive effect of "reshuffling the queue" and avoiding the labor market detachment of long-term unemployed. This view is based essentially on evidence on duration dependence, which in turn is based on the notion that human capital depreciates fast. But most studies find evidence of duration dependence only after one year of unemployment; controlling for observed and unobserved characteristics often eliminates duration dependence (although not so in UK studies: see Bell, Blundell and Van Reeman [1999]).

[91] This selection can also be well-intended, as in the suggestion of Fay [1996] that wage subsidies should target growing sectors in order to minimize substitution effects.

Wage subsidies also have advantages over an ECI:

(i) A general wage subsidy, like a cut in social security contributions, usually costs less and is simpler to administer

(ii) As we have seen, in general equilibrium, an ECTC can lower the wages of low-skilled individuals, unless it is coupled with a minimum wage.

(iii) If unemployment is regionally concentrated, an ECTC might not work. In this case, wage subsidies might work better, if they can be differentiated by region (see Bertola [2000]). However, differentiating a wage subsidy by region may expose this instrument to political manipulation as a substitute for industrial policy.[92]

(iv) With France, Italy has the largest social security contributions; hence, a given proportional cut in social security contributions would reduce the tax wedge most significantly in Italy and France.

(v) As we have seen (Box 5.1), an ECTC works best when there is sufficient dispersion in the earnings distribution, particularly at the bottom, and taxes are moderate. This is the typical situation of an Anglo-Saxon country, but not of Italy, which has high labor taxes, and a compressed wage dispersion.

(vi) If there is a binding minimum wage, a wage subsidy may be more effective than ECI both in raising employment and in raising wages. This is because with a wage subsidy, the relevant wage to satisfy the minimum wage legislation is the post-subsidy wage, which might still imply an employer-wage much lower than before the introduction of the subsidy. Hence, both employment and wages are stimulated.

Box 5.5: Comparing the distributional and antipoverty effects of the various instruments

ECI. Although an ECI is not primarily a poverty alleviation instrument, if well designed it has good targeting properties. The simulations in O' Donoghue and Utili [2000] show that, with a US style EITC, in four European countries the deciles form 2nd to 6th gain the most, typically with an increase in the equivalised disposable income by 3 to 5 percent. The first decile gains less because typically it has little labor income. The only exception is Italy, where the first decile gains the most, almost 8 percent; the reason is that Italy has a high risk of poverty among low-paid workers (in a regime with a functioning RMI, it is likely that the first decile in Italy would also be occupied by families with little labor income, and the distributional effects of an EBTC would be similar to those of the other countries). Poverty among families with only low-paid work would be reduced from 44.1 to 38.4 percent.

For the US, Liebman [1997] calculates that EITC offsets 19% of the fall in income -- by .7 percentage points -- of the first quintile of the population between 1976 and 1996. Council of Economic Advisors [1998] calculates that in 1997 EITC lifted 4.3 million persons above the poverty line. Using variation in EITC rules across states, Neumark and Wascher [2000] find that an increase in the phase in rate of 4 percentage points -- the average (over all states) increase between 1985 and 1994 -- is associated with an increase of the probability that poor families rise above poverty by 6 percentage points. The mean of this transition is

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[92] In addition, differentiating wage subsidies or cuts in social security contributions geographically might not be feasible under current EU rules.

.21, hence this is an increase by about 30%.[93] Note that these figures are based only on the effects on earnings; the effects on poverty would be much larger if one also considered the additional increase in disposable income resulting from the tax credit itself. In fact, some have argued that programs that withdraw benefits faster generate less total distortions, because they concentrate the distortions over a more limited range: see Aaron ([1985] and Dilnot and McCrae [2000].

Note that, as Blank et al. [2000] emphasize, in terms of anti-poverty effects the presence of windfall beneficiaries is not a bad feature. For instance, in SSP and MFIP, income increased more than earnings and poverty declined. This anti-poverty feature of FIP is in contrast to welfare -to-work programs of the 80's that increased earnings, but had little effect on income and poverty, and to the NIT experiments of the 70's, that increased income, but reduced earnings, with very modest reductions in poverty.

Payroll tax reductions or employer wage subsidies. An ECTC is targeted at total earnings, hence it does not distinguish between those who earn little because of low skills or because they choose to work less. Instead, a payroll tax reduction is targeted at the wage rate and can target low-skill individuals better. But because it is aimed at individuals, not families, it can subsidize low-skilled or part-time working members of rich families. Simulations in O'Donoguue and Utili [2000] for the Malinvaud-Dreze proposal show that, in most European countries including Italy, the biggest reductions (in absolute terms) of labor costs would typically be in the 6th to 8th deciles.[94]

Minimum wage. Like a wage subsidy, the minimum wage targets all low paid workers individually. But in OECD countries, many low paid workers live in well off families, and conversely, many poor families have no workers.[95]

How do an ECTC and the Minimum Wage compare in terms of their distributional features? The key difference is that the minimum wage helps families already in the labor force, the EITC mostly helps families without workers; it follows that the targeting properties of the minimum wage are poor. Using simulations, Burkhauser, Couch and Glenn [1996] show that the minimum wage increase of 1989 benefited mostly relatively high income families. In fact, in 1990 83 percent of working poor households earned wages above the minimum wage. On the other hand, the increase in EITC between 1989 and 1992 benefited mostly poor families with children, as we have seen. In addition, a binding minimum wage can crowd out low-productivity labor. Neumark and Wascher [2000] find that EITC has a much larger effect on the earnings of poor families than the minimum wage. OECD [1997a] argues that several studies have shown that MW has equalizing effects on income distribution; but all the effects come form workers in working families: the impact on poverty is minor. This is the same conclusion as in Card and Krueger [1995].

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[93] However, these results refer to the state component of EITC. An increase in the federal component of EITC is estimated to have a small negative effect on earnings.

[94] It is still true that, in proportional terms, lower deciles would probably have a larger reduction in employment costs.

[95] See for instance the arguments in OECD [1997a].

V.3   POLICIES FOR CHILD CARE AND LONE PARENTHOOD

Until recently, family policy in Italy was all based on ANF, and almost by accident. In the last few years, there have been several interventions, which we have discussed in section III; unfortunately, while better than nothing, these interventions have been highly fragmentary and uncoordinated, and have been based on very limited financial resources.

Family policy can be justified mainly on three grounds: equity, efficiency, and demographic incentives. The first has been recognized for long, and is based on the simple notion that children should be given a minimum of resources regardless of the condition of their parents. The second is based on the recognition that child care costs are increasingly an important determinant of labor supply decisions; this view has made some inroad in the debate onl recently, but the key trade-offs are rarely spelled out explicitly. The third, incentives to fertility, is becoming increasingly popular, but is in our view based on flimsy empirical foundations and potentially dangerous. Thus, we will ignore it and deal only with the first two.

We have seen that poverty in Italy is highly concentrated among two-adult families with only one worker. It makes little sense to incentivate labor supply or demand, as we propose, unless one also addresses one of the main potential obstacles to labor supply, namely child care costs. In fact, formal day care for children aged 0, 1 and 2 covers in Italy about 6 per cent of children for 9 to 11 hours per day, the lowest coverage rate in Europe after Spain and Greece (see Adema [2001]). However, one should not jump immediately to the conclusion that the supply of formal child care is an absolute priority, for several reasons.

(i) The (mostly international) evidence on the elasticity of labor force participation to child care supply and price is mixed: there is no conclusive evidence that participation rates are greatly affected by the availability and the price of formal child care.[96] However, the few studies available on Italy (e.g., Del Boca, [2000]) found a strong effect on women participation of the provision of child care (generally measured as the number of child care places available for children aged less than 3 by area of residence). (ii) The low coverage rate for children under 3 may reflect demand rather than supply considerations: for a variety of reasons, Italian families might have a preference against placing small children in formal child care facilities. On the other hand, child care for children under 3 *is* more costly.[97] Here again, we have virtually no evidence in one sense or another. But we note that Italy, while it has one of the lowest child care coverage rates for children under 3, has one of the *highest* coverage

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[96] See OECD [2001a] and Dobbelsteen et al. [2000] for surveys. The evidence from the US is also mixed. Under PRWORA, working poor families who do not receive cash assistance can receive Child Care Subsidies for children under 13 if their income is below 150% of Federal Poverty Line. Witte et al. [1999] estimate that these had substantial effects (in the order of 5%) on the earnings of the working poor. Mayer and Rosenbaum [1999] estimate that an increase in child care expenditure per single mother by $500 per year is associated with an increase in the participation rate of single mothers by .7 percentage points. Lemke et al. [2000] use data from Massachusetts, a state with advanced child care policies. Among other programs, Massachusetts offers vouchers that can be used for formal or informal childcare if the parent is working or attending job training. They find that increasing the median time of operation of child care providers from 3 to 6 years (a proxy for quality) increases the probability of employment by 11.1%, while increasing spending per poor child or moving from part-time to full-time kindergardens have much smaller participation effects. In summary, of the "child care trilogy": availability, cost and quality, the paper estimates that cost, but especially quality, are the key determinants of participation rates.

[97] We do not mean to imply that the supply of child care facilities is not a possible constraint in Italy: given the minimal coverage rate, it is unlikely that a supply component is not present. However, the current enthusiasm for an expansion of child care facilities as a solution to all labor market problems is naive and has no empirical basis.

rates for children from 3 to 6 (see Adema [2001]). In addition, Italy is one of the few OECD countries (together with the other Southern European countries, Austria and Belgium) where the employment rate of mothers with children under 6 is higher than that of all women without children in working age.

(iii) The literature on the effects of formal child care is immense, well beyond the scope of this paper, and mostly outside the domain of economics. But one conclusion is clear: the advantages of formal child care over informal child care have never been proven convincingly, and certainly so for children under 3. There seems to be little conclusive evidence that growing up in kindergarden rather than with a mother or grandmother has positive effects on future educational achievement, earnings, or personal development.[98]

Based on these considerations, we now detail our proposals for child care policies. To understand our proposals, it is important to keep in mind also two key trade-offs in the design of child care policies, which we discuss in detail in Box 5.6 below:

(i) should one subsidize all child care or only formal child care? Roughly speaking, two approaches can be detected. In Scandinavian countries, where female labor force participation is extremely high, the welfare state incentivates external, formal child care, especially by providing an extensive network of child care facilities. In UK and Australia, the recent reforms have tried to be more neutral with respect to the choice between formal and informal child care. Note that informal child care can in turn be of two types: by the mother, and by family or friends; in practice, it is possible to discriminate between the two types of informal care only if the subsidy to informal care is conditional on employment. Hence, we will distinguish between *child benefits* (neutral as to the choice between formal and informal child care), *child care benefits* (conditional on the use of formal child care), and *home child care benefits* (for mothers who decide to stay home to care for their children).

(ii) If one subsidizes formal child care specifically, should one subsidize the demand or the supply of formal child care?

In no OECD country is family policy implemented via only one instrument. Box 5.7 surveys the main types of benefits in the various countries. For Italy too we propose three instruments:

(i) To prevent extreme poverty among children, MGI has a premium for the number and age of children and for lone parents. This payment is not conditional on working, although the version of MGI we propose has a built-in activation strategy. Parents of small children, and especially lone parents, should have the choice between the exemption from work requirement and a child care voucher if they work.

(ii) To incentivate participation among two-parent families (that have a higher relative poverty risk than in most OECD countries), we propose to subsidize formal child care when both parents work. If the ECI option is adopted, this can be incorporated directly into it as a further tax credit for children (recall that our proposed ECTC is refundable); if ECI is not adopted, this subsidy can take the form of a Child Care Voucher to be used at any facility. A child tax credit, however, has a serious downside: it is paid to the primary earner, who almost by definition is not the primary child care giver. If the goal is to fight child poverty, there are serious reasons to direct the child subsidy to the primary child care giver; this might be an important motive to have a working parents child subsidy separated from the ECTC.

If neutrality of child care policy with respect to the choice of the type of child care is a priority, working parents should be given the choice between these subsidies and a (possibly

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[98] There is one possible exception to this generalization, child care for highly disadvantaged youth with extreme family situations: see Currie [2001]. This situation is probably much more common in inner cities in the US than in Italy.

means tested) child care voucher that can be cashed even when the child is taken care of informally (for instance by a grandmother); if budget considerations are a priority, informal child care might be left unsubsidized.

(iii) The two instruments above would probably cover a fraction of the population that is much smaller than the current ANF. While there is nothing wrong with this *per se*, there should be another means-tested child care voucher or a means-tested child benefit to address situations of need that are not well covered by the two previous instruments (for instance, lone mothers who do not qualify for MGI and do not have access to the ECI because of the minimum hours requirement of the latter). This instrument can also be used to subsidize families up the income distribution, as far as it is deemed equitable or financially feasible.

(iv) In view of the likely role of supply constraints, we propose a two-pronged approach, which includes subsidies to the supply of child care facilities. One possibility here is to copy the Dutch approach, whereby the government and firms buy large amounts of child care at a discount and resell it at cost or at a subsidized price (see Dobbelsteen et al. [2000]).

(v) At this stage, we do not envisage a specific subsidy for home child care, like the French *Allocation Parentale d' Education.* This is a costly instrument, might cause a labor force detachment by mothers, and especially it benefits mostly families up the income distribution (see Box 5.6).

Box 5.6: Trade-offs in child and child-care benefits

Subsidize all child care or only formal child care? A key issue in designing child care subsidies and child subsidies is whether the subsidy should be neutral as to the type of child care that it encourages. Clearly different types of child care subsidies can have very different effects on the participation rates of women in the short run: a subsidy to formal child care enhances the participation of women (especially if conditional on work), a subsidy to home care decreases it.

There are two key reasons to subsidize formal child care: quality and efficiency. On efficiency grounds, the lack of formal child care is likely to be an impediment to geographical mobility and job search. If one believes that formal child care has beneficial effects on child development, then the goal of subsidizing formal child care is worthy per se; we have argued above, however, that at best the evidence is inconclusive on this point. A second objection to subsidizing formal child care is that this might not increase the participation rate of women, but merely cause child care to "go formal", involving large deadweight costs to society.

Subsidizing both formal and informal child care is more neutral as to the choice of child care a family might make. Yet there are a number of possible objections also to a subsidy to informal child care. First, it too can entail a deadweight loss to society: if a grandmother takes care of her grandchild, this informal child care would presumably have occurred anyway. Second, if it is not conditional on work it may just lead to labor work detachment if available for too long:[99] for Finland, Ilmakunnas [1997] reports high take-up of the "home care allowances" for parents who do not use public care facilities; most recipients choose to look after chidlren themselves, leading to substantial reduction in female participation rates. Afsa [1999] and Fagnani [1998] report similar results for France; in particular, when *Allocation Parentale d' Education* (until 1995 for parents of at least 3 children and with previous work experience who opt to stay at home) extended to parents

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with 2 children, there was a   significant drop in the employment rate of mothers. Third, if it is conditional on previous work as in the case of the *Allocation Parentale d' Education*, a subsidy to home child care benefits less the low end of the income distribution, because it does not benefit women who have never worked.

However, in a high female unemployment, low female participation rate country like Italy, it probably makes little sense to incentivate work by mothers at all costs. In view of this, we believe that child policy in Italy should be as neutral as possible regarding the type of child care it incentivates.

Subsidize demand or supply of formal child care? If one chooses to incentivate formal child care, there is also an issue of how to do it. Many non-Nordic countries have chosen to provide subsidies or tax credit or earning disregards for child care costs. However, as Dilnot and McRae [2000] note, this might not be an efficient arrangement: it might be more efficient to subsidize the supply of services directly.

Tax credits or cash benefits? Several countries have built subsidies to children and child care into the tax system via tax credits or into means-tests via earnings disregards. But only a cash benefit can be targeted at the primary care giver, a feature that study after study have found to be important in reducing child poverty. In addition, unless the tax credit is refundable to all individuals (even those who do not owe any tax), a tax credit has poor distributive properties.

Box 5.7: Provisions for child care

Universal child benefits

UK: universal child benefit, order related (the marginal subsidy per child decreases with the order of the child)

Sweden, Finland: universal child allowance, order related (monotonically increasing)

Means-tested child benefits

Australia: (i) Basic Family Payment to all except top quintile, order related (x to first child, x+y to each following child) (ii) Additional Family Payment, for low income families, age related, first increasing then decreasing with age (iii) Parenting Allowance, given to primary caregiver in couples with children

UK: IS premium for children, age related (monotonically increasing)

Sweden, Finland: social assistance premium for children, age related (monotonically increasing)

Canada: National Child Benefit

Work-conditional child benefits
Italy: means-tested
UK: child credit, in addition to child care earning disregard

Child care benefits
Belgium, Canada, the Netherlands, New Zealand, Ontario: Some or all expenses for formal child care can be deducted from personal income tax liabilities.

Work-conditional child-care benefits
Australia: Child Care Rebate: for work related child-care expenses, formal and informal. Both parents must be working.

UK: In WFTC, there is a childcare credit of 70% of costs, up to a limit; both parents must be working at least 16 hours per week (it replaces an earning childcare disregard under FC, which had low take up).

Ontario (means-tested): refundable tax credit to low income working families using child care

Canada: Child Care Expense Deduction: deduction for child care expenses from employment income which is subject to tax, when both parents are working

USA: Child Care Development Fund (CCDF): part of PRWORA. Two goals: facilitate transition from welfare to work; quality improvement and consumer education activities. Certificates (formerly vouchers) to allow families to purchase care from any provider that meets state regulations and licensing standards. Parents must be employed, in training or at school.

Childcare earning disregard
New Zealand: earning disregard for parents with child care costs.

UK: Family Credit used to have a childcare disregard, but it was discontinued in WFTC because of low take up.

Ontario: 75% earning disregard (in addition to child care credit), also available to parents caring for children at home.

Alberta and Sasketchawan: allow inclusion of registered child-care costs in earnings disregard, on top of standard disregard

Subsidies for home child care

Finland: home care allowance, in alternative to right to place in public facility; conditional on parents not using public child-care facilities

France: Allocation Parentale d' Education: for parents of at least 2 children and with previous work experience who opt to stay at home;

Denmark: subsidies to parents who take care of children at home; conditional on parents not using public child-care facilities

Norway: subsidies to parents who take care of children at home; the benefit rate decreases with hours of public child care use.

Public-service conditional benefits

Australia: Child Care Benefit for low income families using approved services

Exemptions from labor market conditions

New Brunswick: does not require job search for SA recipients until youngest child is an adult; Alberta: requires job search after 6 months of giving birth, because it has extensive child-care facilities and large help for families with children.

Lone parents (see especially Kalish et al. [1998])

UK: Income Support has a premium for lone parents not in work. In addition, they can get IS until youngest child is 16, and they are not required to meet any labor market condition.

Australia: Sole Parent Pension, means tested; recipients not required to look for a job

Sweden: same

New Zealand: from April 1997 lone parents need to look for work when their youngest child turns 14. Income test arrangements for lone parents were relaxed in 1996 to encourage greater part-time employment. Domestic Purpose Benefit: for lone parents older than 18 with at least one dependent child and lone parents or divorced women older than 50.

Netherlands: since 1996, has required lone parents on social assistance with children aged 5 and over to look for work, in association with additional resources directed to improve access to day-care facilities. These benefits are generally means tested, which may introduce financial disincentives for lone parents to get paid work.

Australia: comprehensive programme for lone parents, the *Jobs Education and Training* (JET) programme, which has been in place since 1989, with emphasis on improved access to education and training, child care, and employment opportunities, managed through a JET Adviser who has the role of assessing the needs of the lone parent and co-ordinating access to whatever assistance is necessary. A 1996 evaluation of the JET programme concluded that the scheme contributed to higher employment rates and earnings among sole parent pensioners.

In general, lone parents benefits or supplements are paid until child is 16 or 18; in France, until 3.

V.4   THE UB SYSTEM

We have argued in section I that a key feature of the Italian welfare state is its selectivity based on personal characteristics other than income or family status. This feature is nowhere more evident than in the unemployment benefit system, which has always privileged workers in highly unionized sectors and in large firms. Thus, the UB system we propose has the following features:

(i) Unemployment benefits should be generalised to the non-unionised segment of the workforce, with an initial earning-related unemployment insurance (UI) component (e.g., 60 per cent of previous earnings in the first six months of unemployment, as in most UE countries, and then declining to 40 per cent) with a maximum duration dependent on the length of the contribution record. These benefits will not be means-tested.

(ii) The hardest-to-place category of unemployed is probably mature long-term unemployed workers. In recognition of this, we propose a second component, a flat unemployment assistance (UA) extension of UI benefits (as advocated in the Onofri report), to be granted to those long-term unemployed that have accumulated enough seniority to be eligible for the maximum UI duration. The purpose is indeed to cover the increasing share of unemployed aged 50 and above, who have relatively low re-employment opportunities. The UA benefit also is not means-tested, mostly for administrative reasons; it should be established above the MGI benefit, to avoid replacement rates that increase with the length of the unemployment spell; for the same reason, it should be below UI benefits.[100] Precisely because it is mostly a screening device, UA should have limited duration. (iii) The UB will replace all the existing short-time working and unemployment insurance schemes (e.g., Cassa Integrazione Guadagni Ordinaria and Straordinaria as well as the Liste di Mobilità) which could survive only as voluntary and self-financed (by employees and employers and their organisations) insurance schemes. This will likely result in a reduction of the replacement rate offered in the unionised segment, which in turn should strengthen the incentive effects of the ECTC on participation.

(iv) As documented in Section II, part-time work is becoming a predominant mode of exit from unemployment, notably in the case of women; for this reason we propose an earnings disregard, a common feature of countries that have strongly encouraged the spread of part-time jobs. For instance, in the Netherlands -- where almost 50 % of women move from unemployment to part-time jobs (see Table 2.3) -- up to 70% of income earned in the first five hours of work per week is disregarded when establishing eligibility to (means-tested) unemployment assistance.[101] As we do not envisage a means-tested UB segment, we suggest that UB be terminated when earnings from part-time and occasional jobs exceed a fraction of the minimum wage. Alternatively, and to avoid the threshold and disincentives effects of this proposal, a portion of the earnings of the unemployed could be accumulated and paid out when they find a full-time job, as in Australia, UK, Canada, Finland, Iceland. This alternative however requires determining when a full time job starts and is held for enough time, which might be informationally demanding and litigation-prone.

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[100] Vroman and Brusentsev [2001] compare the Australian UA and the US UI system convincingly showing that a UA system can be worse not only in terms of work incentives, but also of costs.

[101] Earnings disregards were also introduced in 1994 in the Australian unemployment assistance benefits (the NewStart allowance).

(v) Both UI and UA should have an activity requirement and employment services component. For this reason, UA should be introduced only after sufficient administrative capacity is built in local Public Employment Service administrations, until they are able to administer effective work-tests for the unemployed. to implement work-tests. Because they are of paramount importance, but have been largely neglected in the Italian policy debate, we now turn of a discussion of work tests for MGI, UI and UB.

(vi) We will see in the next section that several activity tests can be designed to reduce the reservation wage of unemployed individuals. Another policy with this goal is to allow the continuation of UI payments to individuals who find a job, for a limited time and at a decreasing rate.[102]

It should be emphasized that our proposals for a reform of the UB system have several interactions with and implications for the reforms of pensions and of employment protection regulations, which we do not discuss in this paper. Insofar as our UB proposal removes the many existing types of "soft-landing" schemes to retirement, it reinforces the the incentives to a longer working life introduced by the reform of public pensions, in particular its move to more actuarial fairness. The increased coverage of unemployment benefits that we envisage would also make it politically easier to reform employment protection regulations; there is evidence that the demand for tight barriers to dismissals is lower if unemployment benefits offer a good insurance against the risk of job loss (Boeri, Boersch-Supan and Tabellini [2001]).

V.5   INVALIDITY AND DISABILITY PENSIONS

The current setup for invalidity and disability pensions is basically sound, and we only propose one major modification: the two instruments should be combined, as it was the case before 1984, and graduated on the degree of invalidity.

Total expenditure on these two instruments has suffered in the past from very lax tests, that effectively have made these instruments into disguised early retirement schemes, notably in Southern regions. It seems that the tests have become more stringent in recent years, although not much can be done on the stock of existing pensions (despite official rhetoric to the contrary) because of the high rate of administrative litigation. Our proposed changes to unemployment benefits should also affect the role of invalidity and disability pensions.

V.6   ACTIVITY REQUIREMENTS AND EMPLOYMENT SERVICES (ARES)

The international experience and the best academic literature all concur in the importance of *some* activity requirements and employment services (ARES) in supplementing wage subsidies, UB systems, and, *a fortiori*, MGI-type schemes. The debate is on what types of ARES work and what do not; while there is, predictably, some disparity of opinions on this, there is a consensus that different categories of individuals -- youths, married women returning to the labor market, the long term unemployed -- require very different ARES (see Martin [2000], OECD [1998b], Katz [1996], Lalive [2000]).

Historically, Italian active labor market policies have taken the form of targeted wage subsidies, subsidized public employment, and training; the first, as we have argued, have been extremely fragmented, with different subsidies cannibalizing each other, and a heavy red tape.

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[102] Variants of this scheme have been adopted in the UK, Ireland, Australia and Germany.

The last two forms of ALMP are among the most discredited by virtually all the available empirical evidence. Only belatedly, in the recent RMI experiment, has there been some recognition of the role of ARES; but, from what we can gather, the actual implementation has been amateurish at best. RMI has relied mostly on local social workers (when they existed) to implement very generic ARES guidelines; but social workers are unequipped to deal with labor market issues: modern ARES require an entirely different and more specialized Public Employment Service.

We now formulate our proposals for ARES for MGI and the UB system. In doing so, we once more have to rely mostly on empirical evidence from other countries: experimental evidence is limited mostly to the US, and non-experimental evidence to the US and to European countries other than Italy. Nevertheless, the picture that emerges, while it still has some gray areas, is quite clear, and at a minimum allows us to rule out some popular policies that seem to have minimal effectiveness.

To understand our proposals, it is important to be clear about who is covered by the various instruments associated with ARES. UA will cover mainly older workers who have been unemployed for a long time; UI the other unemployed workers, who have accumulated enough contributions to access UB; and MGI the other individuals without occupation -- youths with no or limited labor market experience, mothers returning to the labor market after exhausting maternity protection, disabled individuals, and older long term unemployed who have exhausted UA. In recognition of this, we advocate different ARES strategies for each instrument and each category.

(i) UA recipients are older individuals with long unemployment spells, whose employability is questionable. The evidence on what really helps these individuals is extremely mixed, if not downright disappointing: no strategy seems to really work.[103] In order at least to avoid wasting human and financial resources, it is therefore important to test the willingness of these individuals to actively look for a job. Hence, the strategy for UA recipients should emphasize offering slots in active labor market programs, like training programs and, if necessary, subsidized jobs or direct job creation schemes as in the UK[104]. This strategy has to be understood mainly as a screening device. Refusal to co-operate on the part of the jobseeker should be sanctioned by a reduction of the duration of UA, if not altogether the interruption of the benefit. In the latter case the individual sanctioned could still apply, conditional on passing an income and asset test, to the MGI.

One should not expect too much from this strategy, however, and there should be considerable flexibility in changing it *en route* if it proves excessively costly. The experience of Australia, one of the countries that has experimented most with policies for long-term unemployed, is interesting. The Australian New Start allowance for long-term unemployed also emphasized an "activity agreement" which could include paid work experience or unpaid volunteer work proposed by the recipient. This was part of a "case management" approach to long-term unemployed, involving increased administrative oversight of the long term unemployed and increasingly frequent interviews with the PES. But the strategy has proved very costly and the results far from encouraging. In 1996, this approach was scaled back by

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[103] In Australia "older unemployed workers have generally not faced the activity test requirements applied to younger workers. Those aged at least 50, but younger than retirement age frequently have been exempted from active search and have been allowed a wider range of acceptable alternatives to searching for paid work. The Mature Age Allowance, paid since 1995, goes to dislocated workers aged 60 and older and effectively functions as an early retirement benefit" (Vroman and Brunstsev [2001]).

[104] See Anderton [1999], Walsh [1999], Atkinson [1999], and Boeri, Layard and Nickell [2000].

the new Labor government, and the intervention was increasingly decentralized to private and not-for-profit organizations, with premia for the placement of older workers.

(ii) UI recipients are individuals with relatively short unemployment spells, whose employability (or lack thereof) must largely still be assessed. ARES strategies for these individuals should therefore rely less heavily on activation measures and more on job search assistance and tests, which have widely proved to be among the effective instruments.[105] Hence, for UI recipients we propose:

(ii.a) *Job search assistance and tests*. After the disappointing experience of the 1980s, many Anglo-Saxon countries have moved increasingly towards a "shortest route to re-employment" approach that, rather than placing the unemployment on hold in large scale training or work-experience programs, tries to reintegrate them into a job as fast as possible.[106] This strategy relies heavily on job search assistance and tests. Experimental evidence supports the role of job search assistance and tests for women and non-long-term unemployment benefit recipients. The Canadian Self Sufficiency Project and the Minnesota Family Investment Project in the US (both targeted at welfare recipients) were designed specifically to test the *incremental* effect of policies aimed at an early reintegration into employment, primarily job search assistance, then short-term training and job counseling, over and above the effects of financial incentives. Blank et al. [1999] report high estimates of the incremental effects of these features on employment: 7 percentage point increase in employment rate in the case of SSP, and almost 10 percentage points in the case of MFIP. They also report positive effects on earnings. For various reasons (see Annex B) these estimates should be interpreted as upper bounds; still, job search assistance and related activities are increasingly regarded as very cost-effective. Other experiments conducted in cooperation between several US states and employment services have shown considerable cost savings from job search requirements (see Grubb [2000]). Thus, in Switzerland, the United Kingdom and the United States individuals must now achieve a minimum frequency (usually determined by the PES based on each individual case) of job applications.

(ii.b) *Job counselling*. Experimental evidence from Maryland is supportive of significant effects of job counselling efforts on outflows from unemployment to jobs (Benus et al. [1997]). Significantly, most of the increase in exits from unemployment occurred just before a compulsory four-day job search training workshop, which acted as an increase in the opportunity costs of drawing unemployment benefits. The workshop attendance itself did not have a significant effects on outflow rates. In other words, it is the "help and hassle" approach followed in that case that stimulated exits from unemployment, rather than the job search training scheme per se.

(ii.c) *"Suitable job" tests*. Insufficient action to prevent the loss of a job and refusal to take-up a "suitable"[107] job or to be involved in training schemes should be sanctioned with a reduction in benefit amounts. These UI sanctions (ranging between 5 and 35 per cent of the

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[105] Standalone wage subsidies for unemployed individuals (or re-employment bonuses) have a mixed track-record (see Meyer [1995] and Katz [1996]), largely because they carry a stigma effect. ARES strategies are then important for this class of individuals too.

[106] This is perhaps best exemplified by the Alberta overhaul of its unemployment benefit system, and by the introduction in 1996 in the UK of the Job Seeker's Allowance that emphasizes job-search assistance over training or work experience programs.

[107] Among the most relevant issues to be addressed by the definition of a "suitable" job offer, the amount of travel time required to get to the workplace. In the UK and the Netherlands, no more than two hours travel daily are contemplated. In Belgium and Switzerland, the upper limit is four hours, although it is rarely enforced. Occupational protection (allowing unemployed people to refuse job offers involving a change in occupation) is typically provided only at the beginning of an unemployment spell (OECD [2000]) .

benefit amount) proved rather effective in The Netherlands (Abbring et al. [1999]; Van den Berg et al. [1999]; Engelen et al. [1999]): transition rates to employment were significantly enhanced by the imposition of sanctions.

(iii) MGI recipients are a more diversified group of individuals. Among them, ARES for women returning to the labor market have empirically been the most successful. For this group, job search assistance, counseling and training directed at the immediate return to work have been found successful in several experimental evaluations, like SSP and MIFP.

(iv) A second group of MGI beneficiaries is unemployed youths with limited or no labor market experience. Successful policies for this group have proved to be extremely elusive. But there is increasing evidence that training per se has very little effects on this group: constant monitoring and testing of their activity is crucial[108]. For young unemployed, whether they are MGI beneficiaries or, in a few rare cases, UI beneficiaries, or they do not receive any benefit, we propose a scheme patterned after the British New Deal, perhaps the most articulated effort to deal with this problem to date. Key features of the New Deal are: (i) the combination of lump-sum wage employment subsidies with job search assistance and on the job training;[109] (ii) the initial 4 months Gateway period, to screen out individuals who are more easily unemployed and minimize deadweight costs; (iii) a separation of young unemployed into two types, according to age and duration of the unemployment spell. We describe the New Deal in Box 5.8 below. We should also warn that, to date, there is virtually no empirical evidence on the New Deal, except for some - encouraging – evidence on outflows from unemployment in the Gateway period: Blundell et al. [2001] and van Reenen [2001] estimate that the New Deal is responsible for an increase in the probability of exiting unemployment by about 20 percent, of which one fifth can be attributed to the stricter job search requirements.

Box 5.8: the New Deal

(i) **U**nemployed youths aged 18-24 who have been unemployed for more than 6 months first enter a "gateway" period of 4 months, during which each client is given a specially trained "personal advisor" to do a job search, with at least a biweekly meeting. At the end of the period, many unemployed find a job, are moved off the programme and will not be offered any of the four options.

If they have not found employment after the gateway period, they are given 3 options: (a) A subsidy of £60 per week[110] for 26 weeks to be given directly to employers; (b) A job for 6 months at the Environment task force or with volunteer sector employer with wage equal to unemployment benefit + £400; (c) Enter full-time education and training for 12 months without loss of the unemployment benefit. In the first 2 options the employer must provide one day of education or training per week, paid £750 by the government.

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[108] According to surveys of young unemployed people in Britain (Atkinson et al., [1994]), many jobseekers feel that unemployment benefits are an entitlement with few obligations. Thus if a person's benefit is £200 and he is offered a job paying £240, he will often say 'I will be working for £40.'

[109] Note that this is exactly the policy package recommended for youths by Katz [1996], after a thorough review of US based programs.

[110] £60 per week is a substantial amount: about 40% of gross wage for bottom decile for 21-24 year old males, or 54% of weekly earnings for people on minimum wage.

By January 1999, 108,000 young people went through the Gateway; 40 percent moved into unsubsidized jobs, 30 percent into full-time education, 1 percent into subsidized jobs, and 17 percent into the other two options. Note that the take up of the subsidized employment option has been very low; possibly because of disruption and fixed cost of one-day-a-week training requirement, and more generally of the red tape involved.

(ii) Unemployed individuals aged 25 and over with more than 24 months of unemployment are given two options: (a) A subsidy to employer of ₤75 per week for 26 weeks; (ii) Entry into full-time education for 12 months without loss of the unemployment benefit.

If the client refuses to take one of the options, he must take up a position identified for them by Employment Services: if he still refuses, benefits are withdrawn at increasing frequency.

One general lesson from the evidence is that training and work experience programs, that seem to enjoy a never-ending popularity in Italy, should be used with considerable caution. Several surveys (more recently, OECD [1999b], Fay [1996], Katz [1996], and Friednlander et al. [1997]) concur in the following conclusions:

- Short educational training programmes, not geared toward immediate labor market reintegration, have virtually no use;
- training should not be used as a precondition to requalify for benefits, because this sends a very negative signal to both employers and beneficiary; this is a very robust conclusion from several studies (see e.g. Rosholm [1999], Kluve et al. [1999], Sianesi [2001], Regner [2001]).
- training should lead to some recognized qualification;
- it does not seem to work by itself with youths; it works much better with prime-age women
- long-term labour market programmes (for instance, four-six months vocational training or work experience programmes) reduce open unemployment mechanically, but there is mixed evidence on whether they reduce total unemployment. In Finland and Sweden, the policy of placing the long-term unemployed into labour market programmes lasting about 6 months has come increasingly under criticism, and has been radically modified in 1993 in Finland.
- Meyer and Rosenbaum [1999], using difference in mandatory requirements for WINS and JOBS (the two training programs for AFDC recipients), conclude they that had very limited effects, certainly compared with EITC.
- Gueron and Pauly [1991] and U.S. Department for Human Services [1997] find that job training programs emphasizing job search assistance are much more effective than training programs emphasizing education.
- Training programs should be closely tied to labor market conditions. For the same reason, large scale training programs are rarely effective.
- Training can work for women, it almost never works for young unemployed.

V.7   SANCTIONS AND CONTROLS

ARES policies do not occur in a vacuum. There are two fundamental prerequisites for these policies to work: an effective Public Employment Service, separate from but communicating with the administration of social assistance benefits, and an effective and fast systems of sanctions.

The whole approach of ARES is based on a "hassle and help" or "back to work" approach that cannot work without a clear legal framework and effective sanctions.

Responsibilities and prerogatives of the various agencies should be clearly identified; in particular, the PES should be able to sanction violations of the "suitable work" criteria and "job search" requirements quickly and terminally, without endless administrative litigation. One survey of eligibility requirements for unemployment benefits concluded that "the surveillance of independent job search can be the most important intervention by the PES to activate the unemployed" (Grubb [2000]).

International experience supports these conclusions. A well known study in the US concluded that the enforcement of stricter sanctions for suitable work criteria was the single most important reason for the decline in welfare caseloads in the recent years.[111] A study by Ernst and Young Consulting commissioned by the Swiss government found that in some Regional Placement Offices "the implementation of a sanction takes several months, and recommended that employment counsellors should be able to implement sanctions independently and immediately, without any need for prior authorisation by another part of the organisation." Auer [2000] observes that "all [four European countries that have had some labor market success] resorted to a much stricter enforcement of job search and suitable work provisions" . Recently, a report National Audit Office of Sweden, as summarised in Grubb [2000], concluded that "institutional arrangements are a fundamental obstacle to the development of effective control mechanisms for unemployment insurance and leave room for wide fluctuations in the interpretation and application of suitable work criteria, and that the application of suitable work criteria should be overhauled as an urgent matter of national significance".

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[111] It is important to note, however, that this study has been challenged on several grounds.

VI.   CONCLUSIONS

The Italian welfare state is heavily concentrated on pensions and, for the remaining part, dispersed in a large number of small, fragmented programmes. The interactions among the various instruments are numerous and yet often overlooked by a political process which has tended to generate incremental, uncoordinated reforms. In this paper we have tried to bring together various strands of the literature and use it, in combination with evidence on income distribution and transfers in Italy and EU countries, to assess the overall design of social policies in Italy and propose directions of change.

We have concluded that the existing system is ineffective and inequitable. It provides little poverty relief and operates a number of perverse redistributions.   Intra-household redistribution has partly remedied the failures of our welfare state. However, the ageing of population, the decline of family size and the increasing "polarisation" of employment are bound to reduce the scope for intra-household redistribution in the future.

In the light of this assessment, we outline a proposal for a thorough overhaul of the system. Inevitably, our proposals involve trade-offs. In order to best choose along these trade-offs, more information than currently available is needed in many areas. We indicate the type of information which is required and how to best gather it.   This is important as our administration has wasted many opportunities to draw from experience, even when the stated purpose of some programmes was explicitly experimental, as in the case of the Reddito Minimo d'Inserimento.

Our proposals have much in common with the recommendations of the Commissione Onofri. Above all, we share its philosophy of making room for universal-selective instruments providing income support of the last resort. We also agree on the need to replace the many selective "ammortizzatori sociali" currently at work with a generalised unemployment benefit system.

In other respects, we differ from the recommendations of the Commissione Onofri. We are in favour of replacing ANF, A3F and all existing tax credits for children with a family-based Employment-Conditional Tax Credit combined with a system of child and child-care subsidies, whilst the Onofri report is much less radical with respect to the reform of family allowances. We assign a crucial role to activation and to the buildup of administrative capacity to enforce benefit sanctions, an issue which is not addressed by the Onofri report. We also disagree on the emphasis placed by that report on the training of the unemployed, whether young or adults. We argue that there is just no evidence indicating that training of youngsters and unemployed adults has been effective and suggest that there should be two different strategies for young people (mainly activation strategies), and unemployed adults (mainly based on work-tests). Finally, unlike the Onofri report, we propose to have in place subsidies to low-wage unemployed youths, accompanied by rigorous activation policies, and to introduce of a statutory minimum wage.

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Annex A

Main welfare programs

	Description	Conditions for receipt	Maximum duration	Calculation of benefit amount
Unemployment insurance	a) Ordinary unemployment benefits	Paid to workers after permanent, individual or collective, dismissals and not receiving other benefits -- excluding young workers in vocational training -- with contributions for at least 52 weeks during the 2 year period preceding unemployment or at least 78 days worked over the last year. For part-time workers the requirements are reduced: at least 78 days over the last year preceding unemployment, provided that the person was registered on a placement list for at least two years.	Full benefit: 6 months Reduced benefits: number of days worked, during the previous year	The benefit amounts to 30 per cent of the average gross earning received over the last three months, with a maximum benefit of L. 423 713 per month, raised to L 1711 1666 for gross earnings exceeding L. 3080 098 per month For part-time workers what is relevant is the number of days worked, regardless of the number of hours that anyway affect the income and indeed the amount of the benefit. Moreover, the benefit cannot be paid for a period longer than the number of days worked.

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Main welfare programs

	b) *Cassa Integrazione Guadagni* – henceforth CIG (either Ordinary or Special)	Ordinary benefits are paid for temporary lay-offs (excluding "apprendisti" and managers) in manufacturing. Special benefits are paid when the interruption of the activity is not temporary. Recipients are workers of firms with more than 15 employees in manufactoring and construction and more than 200 employees in trade and tourism.	Ordinary benefits: 12 months (not necessarily continuous) in two years. Special benefits: up to 4 years.	The benefit amounts to 80 per cent of the average gross earnings paid for non worked hours, with a maximum level similar to that of the unemployment benefit. There is a partially price indexed maximum level of benefit which was in 1999 about 60 per cent of the average wage in the sector. It is the same for ordinary and special benefits.
	c) Mobility benefits.	Provided in case of collective dismissals by firms eligible for benefit from the CIGs and in case of individual dismissal of workers already in CIGs or under bankruptcy proceedings. A special unemployment allowance is paid to workers after the period of CIGs and mobility benefits is elapsed or to unemployed workers. Moreover, the recipients have preferential access to *Lavori Socialmente Utili*.	From 1 year (for young workers in the North) up to 4 years (for older workers in the Mezzogiorno). In some special cases ("long mobility") the duration is extended up to retirement.	For 12 months the amount of this benefit equals the CIG zero ore allowance (80 per cent of the average gross earnings paid for non worked hours). After one year it is reduced to 64 per cent.

Main welfare programs

Social assistance	Since 1998 the *Reddito Minimo di Inserimento* is paid in 39 municipalities.	1) Having resided in Italy at least 12 months for EU citizens and 3 years for non-EU citizens; 2) Being considered at risk of social exclusion, having income lower than a given threshold (500.000 1998 ITL for a single) and being registered at the public employment service.	One year, though it may be renewed as long as the eligibility conditions are met	The beneficiary receives an amount equal to the difference between the income threshold and the household income. Threc is a 25% earning disregards. The household is supposed to possess no income from real estate or financial assets. The threshold increases with the number of family members.
Housing benefits	This schemes include rent assistance provisions and tax allowances on home ownership.	1) Means-tested tax credits are granted to people who rent a house; 2) Rent subsidies are granted for low-income households.		1) Tax credits amounts vary with the household taxable income; 2) Rent subsidies depend on the rent paid and the presence of disabled or old people in the household; 3) State-owned dwellings are rented to families in need, generally for an amount set under the market-value.
Family allowances	*Assegni famigliari* targeted to families of employees and former employees pensioners. Maternity allowances to mothers with children	The benefit is paid according to the household taxable income and social demographic conditions	Open-ended as long as categorical conditions persist	The benefit consists of single cash transfers granted to each family. The amount varies with the number of family members, and the household income.

Main welfare programs

	below one year of age. Allowances to household with at least 3 children under 18			
	Beneficiaries of th*e Assegni per il Nucleo Famigliare* are employees, unemployed and pensioners. Since 1999 also self-employed are eligible	The benefit is paid according to the household taxable income and social demographic conditions	Open-ended as long as categorical conditions persist	The amount varies with the number of family members, and the household income.
	Assegni al Nucleo Famigliare con almeno 3 figli minori		Open-ended as long as categorical conditions persist	The amount varies with household income.
Child-care benefits	The eligibility criteria are set by regional laws and implemented at municipal level	. Free access to nurseries for children below 3 years of age.		In-kind and means-tested benefits, taking into account household income and composition.
Social Minima for Pensioners	*Pensioni sociali and Assegno Sociale*.	Individuals aged 65 or more not receiving contributory pensions, and having income lower than a given threshold		The payment tops-up the income of the beneficiary to the level of the Assegno.
	Integrazioni al Minimo.	Pensioners with contributory pensions lower than a given amount	.	The payment tops-up the pension of the beneficiary to the level of the Minimo
Invalidity Benefits	Monthly benefit paid to different categories of invalid people.	Verified status of invalidity, income ceiling and registration in public job registries for disabled. A contribution record is required.	The benefit is paid for three years and can be renewed for a maximum of three times upon request, after that it becomes definitive.	The amount of the benefit is calculated with the same criteria of the old age pensions, based on the contribution record and the last income. It is reduced if

		Moreover, Italian citizenship and residence in Italy are required.		the recipient has an income from work.

Annex B

Empirical evidence on employment conditional schemes and wage subsidies

We summarize here the main empirical evidence on wage subsidies and employment conditional schemes. We emphasize once again that much of the evidence -- and almost all of the experimental evidence -- applies to the US, or at most to Anglo-Saxon labor markets, with very different institutional and behavioral characteristics from the Italian labor market.

We divide our presentation by instrument, and within each instrument by category of targeted individuals, if applicable. For each item, we also note whether it is based on experimental or non-experimental evidence.

Evidence on employment conditional schemes

To all low wage workers

EITC (US). Non experimental. EITC is a standard ECTC with a phase in, a flat, and a phase out region. It is available to couples and singles with and (since recently) without children. The tax credit is refundable (i.e. it is available even to individuals without tax liabilities); the credit applies to all income, but there is a limit of $2,350 on non-labor income. The recent enlargements of EITC have been the subject of much empirical work, all of it nonexperimental goven the natuire of the program. First, the effects on the participation rates of single-parents are positive and quite large. Meyer and Rosenbaum [1999] estimate that EITC is responsible for up to 63 percent of the increase in single mothers' labor force participation between 1984 and 1996. Eissa and Leibman [1996], Blank, Card and Robbins [2001] and Ellwood [2000] find similar positive effects on the participation rate of single parents. Second, because of the "marriage penalty" discussed above, EITC has much smaller effects on the labor force participation of secondary workers in two-parent families. In fact, Eissa and Hoynes [1999] and Ellwood [2001] find *negative* effects on the participation rates of married women. Third, there is little evidence on the effects on windfall beneficiaries; in general, the estimated effect on hours of those already working is negative but small. In total, taking into account the effects on participation rates and on hours, the aggregate number of hours increases. [112]

Ultimately, however, the effects on participation and labor supply might be limited: the main effects of such reforms might be distributional. For instance, Dilnot and McCrae [2000] have argued that the change from FC to WFTC had little effect on labor supply and particpation, but increased drastically the income of workers in the first and especially the second and third deciles, by 200 percent and 130 percent respectively. These distributional

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[112] Neumark and Wascher [2000] find similar results, suing state variation in EITC. There are positive effects on the particpation rate in families with no workers initially, and no effect on the participation rate in families with already one worker. The effect on hours in families with already one worker is negative, as in Eissa and Hooynes [1998]. For the same reason, they find a positive effect on the earned income of families with no workers, but no effect on the earned income of families with two workers.

changes are much larger, and very different, than those achievable with tax allowances, which typically benefit the 6th and 7th percentiles.

Working Family Tax Credit (UK). **Non experimental**. In contrast to EITC, it only has a flat region and a phase-out region. Very little evidence avilable.

Jobstart (UK). **Non experimental.** Offered a subsidy to the employee, not to the employer. 69 percent indicated that they would have taken the job anyway (the claimant had to accept the job before applying for the allowance). It had an upper limit on earnings: it appears to have created problems with employers, because it effectively disallowed overtime work (see Fay [1996]).

To unemployed

Earnings Supplement Project (Canada). **Experimental.** The supplement makes up 75 percent of the difference between the earnings at the new job and the earnings at the previous job, subject to a cap. The make-up feature was inspired by the experience of the US employment-bonuses, which were lump-sum; a variable make up was hoped to induce the recipient to take up a job that would be otherwise unacceptable, and therefore to reintegrate them faster in the labor market. The job must be full time. Recipients could not go back to their previous employer (to avoid obvious collusion problems). Limited period to find a job: 12 weeks for repeat EI users, 26 weeks for displaced workers. In the meantime, could receive unemployment insurance. Not very successful. Low take up: only 41 percent participated, and of these only 4.7 percent returned to work before 12 weeks. The main reason was that most potential applicants thought they could go back to their previous employer (see Greenwood and Voyer [2000]).

To welfare recipients

Self Sufficiency Project (Canada). **Experimental.** It pays 50 percent of the difference between actual earnings and a reference level of income to single parents; the latter is above the average earnings of full-time females, hence the scheme typically it doubles earnings. The recipient must have been on welfare for at least one year to avoid windfall benefits, and must get a full time job within a year of being selected for the program to avoid opt-in and windfall beneficiaries. The entitlement is individual: the earnings of other family members do not affect the payment, and neither does unearned income. One group in the experiment received no treatment; the second group received financial incentives; the third group received financial incentives + employment services (job search assistance, job coaches, referreals to community-based employment and training services). Minimum hours requirement of 30 hours per week.

Results: group II (receiving financial incentives only) doubles percentage of proportion working full time (from 14 to 29 percent) relative to group I (the control group); earnings increased by 61.5 percent. Group III had even stronger effects: earnings increased by 79.2 percent over the control group; the additional effect in employment was smaller. However, there is one important caveat: we do not know the long-run effect, since individuals are entitled to the payment for 3 years, and we do not know whether after 3 years there has been a large relapse into welfare. See Greenwood and Voyer [2000], Blank, Card and Robins [2000] and Card and Robbins [1996] for a description and an evaluation.

Minnesota Family Investment program (MFIP) (USA). **Experimental**. It increased the basic welfare grant by 20 percent if the welfare recipient became employed; and reduced the implicit tax rate on earnings to 68 percent (32 percent earning disregard) from 100 percent. It was one of the few programs also designed to evaluate effects of employment services

(specifically, job search and case management, by dividing into 3 groups, like SSP: job search assistance, short-term training, and educational activities, with strong focus on re-entering labor market quickly).

New Hope (Milwaukee, Wisconsin, USA). **Experimental.** Similar to SSP: in addition to financial incentives, it include job search assistance and temporary job placement fro those who could not find a job. The design was also similar to SSP, with 3 groups. Like SSP, it also had minimum hours requirement of 30 hours per week.

Welfare Restructuring Program (Vermont, USA). **Experimental.**

Family Transition Project (Florida, USA). **Experimental.**

Job First (Connecticut, USA). **Experimental.**

These last three programs had earning disregards plus lower benefit reduction rates only. No minimum hours requirement.

All six programs have been evaluated by Blank, Card and Robbins [2000]. We summarize here their main findings.

<u>Effects on employment and earnings:</u> Since all programs enrolled only individuals on welfare, there were very few windfall beneficiaries in the sample; hence, the negative labor supply effects might be underestimated because the programs did not include as many windfall beenficiaries as would be eligible if the program were available as a general welfare system.

Using the control group, one can estimate the fraction of windfall beneficiaries even for the group who was not in the labor force at the time of the introduuction of SSP, because a fractionof thatgroup would have found a job within a year even without SSP; this fraction can therefore be regarded as windfall beneficiaries. Windfall effects are limited by 30 hours requirement in SSP and NH. For the others, ambiguous effects on full-time employment. The important result is that the estimate of the number of windfall beneficiaries vary dramatically by subgroup. For SSP, the estimate ranges from 4 percent for those not in the labor force at the start of program to 76 percent of those employed full time at the start of program, and from 23 percent of those without training diploma to 50 percent of those with a training diploma. This suggests that a way to minimize windfall participants is to target less-educated groups of welfare recipients not already working.

Because all these programs apply only to existing welfare recipients, the results may underestimate the costs: if they were open to all, some non-welfare recipients might decide to enter program (opt-in beneficiaries). The one-year welfare requirement of SSP has the goal of creating obstacles to entry; Blank et al. [2000] estimate that 3 percent of new welfare applicants prolong their stay into income assistance to reach the 1-year threshold. Therefore, the entry effects appear to be modest; but Moffit [1996] emphasizes potential importance of entry effects.

Tthere can be incentives to reduce hours for full time employees: some people who would otherwise work long hours might decide to reduce work effort. In fact, MFIP without employment services had a small negative effect on employment. However, all programs except MFIP without employment services are estimated to have positive employment effects, but only in SSP is the effect large (11.8 percentage points). In fact, SSP is the most generous, has full-time working requirement, and targeted to long-term welfare recipients.

In the two programs that also tested effect of employment services (SSP and MFIP), additional effect on employment from employment services.

All programs except MFIP without employment services also increased earnings. Again, the positive effects were strengthened by employment services in SSP and MFIP.

<u>Effects on caseload and total cash expenditure</u>: The effects on caseloads and cash payments are important because of their political feasibility: a political condition for these programs to be feasible is that they should not increase the number of people on welfare and

welfare spending too much. A goal of no increase in the caseload is virtually impossible, at least in the short-run, because by their nature these programs extend the availability of benefits to a larger subset of the population. Regarding total cash payments, aA program like SSP that combines a reduction in the implicit earnings tax with a *rise* in the basic welfare grant does not necessarily lead to reduced benefit payments, even to people who move from unemployment to work. In fact, SSP and MFIP were estimated to have raised total cash payments.

Enhanced Earning Disregards in TANF (since 1996)**.** By comparing early adopters of enhanced earnings disregards with late adopters, Blank et al. [2000] estimate that EED might have had an even stronger effect on the labor supply of welfare recipients than even EITC (in the range of a 5 percent increase in weeks of work).

To youth
See the box on the British *New Deal.*

Evidence on employer subsidies

To all low-wage workers

New Job Tax Credit (tax credit, USA, 1977-78). Non experimental. One of the few subsidies tried in the US; however, because of its design, it was directed mostly at low-wage workers. Tax credit of 50 percent of first $4200 per employee in employment over 2 percent above pervious year's employment. Difficult to evaluate, because non experimental. Some evidence of limited employment effects. (Katz [1996])

Job Training Partnership Act (wage subsidy, USA) **Experimental.** Aimed at low age in general, but most valuable to adults who are not welfare recipients, because non-welfare recipients were not eligible for TJTC; but available also to youth. Temporary wage subsidy for 6 months, 50 percent of the wage. Treatment group: had access to job services (in particular, OJT training: employers using JTPA were expected to provide OJT, and would lose the subsidy if they did not) and would get subsidy and on the job training if get employment; control group: get nothing.

Bloom et al [1994] estimate large effect on earnings of women (+15 percent) -- particularly welfare recipients -- and men (+10 percent, marginally significant), which persisted 2 years after subsidy. But no effect on earnings or employment of out of school disadvantaged youths.

National Supported Work (late seventies): **Experimental** single parents who were long-term welfare recipients: support services and up to 18 months of subsidized employment in projects developed by the demonstration's operators. Increased earnings by $6000 (300 percent), and by 20 percent in first 2 years after participation in project, and by $400 up to 8 years after.

Homemaker-Home Health Aide (mid eighties). **Experimental.** Up to two months of training and up to one year of subsidized employment as home health aides woth proivate nursing homes. Unlike NSW, usdes ubsidies to private sector; significant earning gains.

To LTU (= re-employment bonus if lump sum)

Job Compact (Australia) for long term unemployed. **Non Experimental** Low take-up. Considered unsuccessful. Bell, Blundell and Van Reeman [1999].

Workstart Pilots (1993, UK). **Non Experimental** Description. Large deadweight loss. Evaluation of the 1993/94 pilot experiment: 18 percent full additionality, 43 percent pure deadweight loss, 28 percent pure substitution (see OECD [1997b]). Atkinson and Meager [1994]: only 17 percent of Workstart vacancies represented new employment that was generated by the subsidy.

Employer Bonus Experiment (Illinois, USA). **Experimental.** Random sample of UI beneficiaries were told their employer would get a $500 bonus if they; a second sample was given a $500 re-employment bonus to be cashed by themselves. A third sample was given nothing. First and second group: small decrease (by about one week) of unemployment duration, and slightly lower UI benefit paid over a year; effects slightly larger for second group. Employment bonus to be cashed by employer was not taken up much by higher-skill workers, possibly fearing stigma. Also, only 3 percent of employers claimed it. Mayer [1995]: mixed evaluation of re-employment bonuses.

To welfare recipients

Job Training Partnership Act (USA). **Experimental.** Also aimed at welfare recipients, who got largest gains (especially women: see above).

Other programs: **Experiments.** Similar positive effects on earnings of female welfare recipients form experiment in New Jersey and Maine, like JTPA emphasizing OJT provided by employer who benefits from the subsidy. See Katz [1996]

Targeted Jobs Tax Credit (tax credit, USA, 1979-94). **Non experimental.** Explicitly targeted at disadvantaged youth and welfare recipients. Tax credit, to be claimed via vouchers to be redeemed by employer. Originally: tax credit of 50 percent of first year wage and 25 percent of second year wage (later abolished) up to $6000. Reduced employer costs on participants by 13 percent on average. At its peak in 1985 subsidized .4 percent of workers. 9 percent take up rate only. No convivincing evidence either way on welfare recipients. (Katz [1996]) Low take up rate (for instance, only 9 percent of eligible and employed disadvantaged youths were subsidized by the program). Probably due to regulatory burden and/or stigma effect, as suggested by next two experiments in Dayton and Illinois.

Dayton (Ohio, USA). **Experiment.** Voucher for TJTC-eligible individuals to be redeemed by employer for a group of welfare recipients, other group gets nothing; Burtless [1985]: Negative effect: carriers of vouchers less likely to be employed; likely to be stigma effect.

Wisconsin. **Experiment.** Holonbeck and Willke [1991]: similar experiment in Wisconsin with economically disadvantaged groups (welfare recipients). Were trained to announce to prospective employers their eligibility for TJTC. Negative effect: carriers of vouchers less likely to be employed likely to be stigma effect. See also Katz [1996].*Illinois.* **Experiment.** Group 1: were given employment vouchers that they copuld cash if found job within 11 weeks; Group 2: were given employment voucher to be redeemed by employer. Group 3: control group. Found positive employemnt effect for group 1, no effect fro groups 2 and 3. Minimal take up of group 2: only 3 percent of the sample claimed empoyment bonus: probably stigma effect: skilled workers more likely to refuse bonus. Woodbury and Spiegelman [1987]

To youth

Job Training Partnership Act (USA) **Experimental.** Most valuable to adults who are not welfare recipients, because not eligible for TJTC. Katz estimates large effect on earnings of women (+15 percent) and men (+10 percent, marginally significant). But no effect on earnings or employment of out of school disadvantaged youths. Similar positive effects on earnings of female welfare recipients form experiment in NJ and ME, emphasizing OJT.

Targeted Jobs Tax Credit (USA). **Non experimental** Targeted at disadvantaged youth and welfare recipients. For youth: DDD evidence by Katz [1996] using change in eligibility conditions for disadvantaged youth: own-age labor demand elasticity of -.5 (under assumption of infinitely elastic labor supply elasticity) $\Rightarrow$ suggests 50 percent of youth getting job with TJTC subsidies were net additions; estimates TJTC increased employment rate of disadvantaged 23-24 year olds by 3.4 percentage points, marginally significant. (Katz [1996])

Youth Incentive Entitlement Project (YIEPP, USA, 1978-81). **Experimental.** Guaranteed full-time summer jobs and part-time school year public-sector and subsidized (at 100 percent rate) non-profit sector jobs to disadvantaged youth. Seems to have increased substantially earnings and employment rates if disadvantaged youths. Paid minimum wage

New Deal (UK). **Non experimental.** see Box.

Reductions in employer contributions

SPAK (Netherlands): **Non experimental**. Reduction in employer contributions. Huge success, for three reasons (i) permanent; (ii) simple very small administrative burden: only criterion for eligibility is the wage (below 115 percent of MW)   (iii) firms get money immediately

Not associated with particularly high growth of low wage sectors. Microevidence (non experimental): no evidence of effects on employment or wages. M hlau, P. and Salverda, W. [2000]:

Fay [1996]: survey of evidence. Belgium: found 53 percent deadweight loss and 36 percent substitution effect; similar effects to those in several evaluations reviewed in the 1993 *Employment Outlook*. But programmes in Australia, US, and UK tend to find better results, in particular high percentage who are still employed after 1 year.

Annex C

List of Abbreviations

ANF = (Italian) Assegni al Nucleo Famigliare.

A3F = (Italian) Special Family Allowance for households with at least 3 dependent children.

ARES = Activity Requirements and Employment Service policies,

ECI = Employment Conditional Incentive scheme,

ECB = Employment Conditional Benefit

ECTC = Employment Conditional Tax Credit

EITC = (US) Earned Income Tax Credit.

ISE = Indicatore della Situazione Economica.

MA = Maternity Allowance.

METR = Marginal Effective Tax Rates.

MFIP = (US) Minnesota Family Investment Project.

MGI = Minimum Guaranteed Income scheme.

MINWA = statutory MINimum WAge.

NIT = Negative Income Tax.

RMI = Reddito Minimo d'Inserimento.

SSP = (Canadian) Self Sufficiency Project.

SPAK = (Dutch) Special Reduction of Contributions program.

UB = Unemployment Benefit system.

UI = Unemployment Insurance.

WFTC = (British) *Working Family Tax Credit*