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**The Italian Social Protection System: The Poverty of Welfare**

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**Abstract**

Italy's system of social protection has come under criticism for being fragmented and excessively skewed toward pensioners and "insiders." After setting up a consolidated presentation of the social security accounts, this paper provides an empirical assessment of the effectiveness of the welfare system, relying on a survey of households' incomes and wealth. It concludes that, owing to ill-designed targeting mechanisms, less than a quarter of total spending on the welfare instruments under review accrues to families whose own resources fall short of the poverty line. The paper then proposes a new means-testing formula.

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## Summary

This paper empirically analyzes Italy's model of social protection and indicates some viable avenues of reform. First, the paper assesses the overall financial structure of the system and the main areas of under- and overprotection on the basis of a consolidated presentation, not hitherto available, of the social security accounts. Apart from providing a measure of the large financial imbalances saddling the contributory portion of the system, this exercise broadly indicates how much of the resources specifically committed for the purpose of intragenerational risk-sharing (and possibly vertical redistribution) are actually being diverted to fund intergenerational (life-cycle) reallocations of income.

We then assess the efficiency of the existing welfare apparatus in alleviating poverty by making use of a rich microeconomic data set containing information on households' incomes and wealth derived from a biannual survey conducted by the Bank of Italy. The proposed classification of recipients along a scale of "need" suggests that, owing to the lack of an effective mechanism to calibrate money support according to the gap between each recipient's own income sources and some uniformly defined threshold of deprivation, both the incidence of poverty *after* receipt of public transfers and the amount of resources spilling over beyond the targeted categories are sizable. All in all, for each lira spent on the instruments under review, less than a quarter is used to alleviate poverty, the rest used to subsidize incomes already well above the full protection line. The study concludes with a proposal for a new means-testing formula that is shown to improve on the existing situation, both in terms of equity and of resources spent.

## I. INTRODUCTION

There has, in recent years, been a growing consensus that public expenditure on social protection in Italy suffers from severe shortcomings. These were summarized in a report issued in February 1997 by a special commission on social expenditure, known as the *Commissione Onofri*.<sup>2</sup> The report recognized the system to be inadequately targeted, fragmented, and excessively complex. In particular, it found it to be inequitably skewed toward the elderly and “insiders.” Excess expenditure on pensions overprotects retirees, and other support mechanisms are largely limited to present or past participants in the regular labor force (notably in large industrial firms). The system thus fails in its primary task of providing an effective safety net for those most in need, in particular for those who never joined the formal labor market, notably among women and the young. These failings are evidenced by trends in poverty and inequality indices—hence the characterization of the Italian social protection system as “**the poverty of welfare**.”<sup>3</sup> In addition, the absence of more general support mechanisms has discouraged mobility and risk-taking in the labor market, and hindered labor layoffs where required (for example, at the present juncture, in the banking sector). The consequent recourse to ad hoc early retirement schemes and other special provisions, and the related proliferation of “different rules for different groups,” has distorted intragenerational equity.

This paper after drawing the main differences between the Italian welfare system and those prevailing in other EU countries (Chapter II), further examines some of the issues that arise from this comparison. Chapter III puts forward a consolidated presentation of the social security accounts, which—due to the system’s complexity and the intricacy of financial flows from the government to the agencies, and among the agencies themselves—was not hitherto readily available. This allows to discern the answer to a central question regarding Italy’s welfare system: namely, on which scale, and through which channels, can the pension regime be said to divert resources from other uses, notably from the protection of people in working age and, in particular, of those among them lacking a sufficient record of participation in formal employment? Having ascertained that such diversion does indeed take place on a systematic and nonnegligible scale, Chapter IV goes beyond the traditional distinction between contributory and solidarity programs and seeks to examine the Italian social welfare system from the premise that part of the social insurance system—notably part of contributory

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<sup>2</sup>*Commissione per l’analisi delle compatibilità macroeconomiche della spesa sociale* (1997), henceforth indicated as Onofri Commission. See also “The Welfare System in Italy: Recent Reform Proposals,” in IMF Staff Country Report No. 97/44, May 1997.

<sup>3</sup>OECD data indicate an aggregate poverty rate (defined in terms of the number of persons with equivalent disposable income below 50 percent of the median) appreciably higher in Italy (14.2 percent) than in either France (6.8 percent) or Germany (9.1 percent; data refer to different years in the 1990–94 period). Furthermore, the poverty rate rose by 3.9 percentage points in Italy in the decade to 1993. See OECD (1997).

pensions—is being called upon to substitute for the deficiencies of the social assistance apparatus. To this end, the section presents an empirical analysis of the impact of selected instruments of protection supplied uniformly to the whole territory and subject to (highly heterogeneous) tests of income. A measure of these instruments' effectiveness in reducing the incidence of economic disadvantage among covered populations, and their efficiency in accomplishing that goal at the minimum cost is also provided, together with an estimate of the cost to the budget arising from certain glaring inefficiencies. This analysis finds that the system fails the tests of effectiveness and efficiency. Chapter V reviews recent reform proposals and avenues for further action.

## II. THE ITALIAN SOCIAL WELFARE SYSTEM: A EUROPEAN COMPARISON

The level of social expenditure in Italy, at around 25 percent of GDP, is broadly in line with the EU average. It is appreciably below that of countries with comparable levels of per capita income, notably France and Germany, where social spending exceeds 30 percent of GDP (Table 1). Even excluding sickness payments, likely to be underestimated in the case of Italy,<sup>4</sup> the country's relative position remains broadly unchanged. But the internal composition of social expenditure is clearly atypical in Italy, on three main counts:

- Over 61 percent of total social security outlays are accounted for by old age and survivors' pensions, some 20 percentage points above the EU average. Even after adjusting for differences in definition and coverage, the system's **overprotection of retirees and the aged** remains manifest. Accordingly, the amount of resources left available to satisfy other forms of assistance (notably unemployment, family, and housing benefits) is markedly lower than in partner countries—under 10 percent of GDP, against a EU average (excluding Italy and Greece) of almost 17 percent of GDP.
- The **range of risks** covered is quite narrow by international standards, and the more innovative instruments introduced in some other EU countries (notably targeted to women, the young, and single parents) are either absent or in scant supply. Italy is (together with Greece) the only EU country without a national scheme of **residual protection for the poor** who are not eligible for any of the standard benefits and lack a sufficient record of participation in formal employment. This has led to a proliferation of local schemes managed by municipalities in a discretionary and nonuniform manner.

The peculiarities of social expenditure in Italy are also evident in its evolution over time (Table 2). While rising in all main EU countries as a share of output, the increase in other countries displayed a more markedly cyclical component, with much of the surge concentrated in the recession years between 1990 and 1993 (in Germany's case, clearly reflecting also the

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<sup>4</sup>Certain sickness benefits supplied by bodies outside the general government (*indennità economiche di malattia*) are excluded from the Eurostat definition of Italy's social expenditure but included in the corresponding figure for other countries; see Eurostat (1996).

Table 1. Europe: Social Protection Expenditure by Function (1994)

(In percent of GDP)

	Belgium	Denmark	Germany	Greece	Spain	France	Ireland	Italy	Luxembourg	Netherlands	Portugal	United Kingdom 1/
Sickness	6.4	5.7	8.0	2.3	5.9	7.6	5.9	5.1	5.7	6.7	6.3	5.1
Invalidity	2.3	2.9	2.7	1.4	1.8	1.7	1.4	1.6	2.7	6.7	2.1	3.1
Occupational injuries	0.5	0.2	0.8	0.0	0.5	0.5	0.1	0.5	0.7		0.5	0.1
Old age	8.7	12.0	9.2	8.5	7.4	10.7	4.3	12.8	7.6	9.7	6.1	10.7
Survivors	2.8	0.0	3.0	1.6	2.3	1.9	1.2	2.7	3.4	1.7	1.3	0.3
Maternity	0.2	0.5	0.2	0.1	0.2	0.4	0.4	0.1	0.3	0.2	0.1	0.3
Family benefits	1.9	3.3	2.0	0.1	0.2	2.4	2.2	0.8	2.9	1.5	0.8	2.7
Placement, vocational guidance, resettlement	0.4	1.8	0.7		0.2	0.6	0.8	0.0	0.3		0.1	0.3
Unemployment	2.4	3.7	2.0	0.4	3.9	1.8	2.7	0.6	0.3	3.2	1.0	1.6
Housing		0.8	0.2	0.1	0.1	0.9	0.7	0.0	0.0	0.3	0.0	1.9
Others	0.3	1.8	0.7	0.6	0.2	0.5	0.4	0.0	0.0	0.9	0.2	0.4
Administration	1.2	0.9	1.2	0.9	0.9	1.6	0.9	1.0	0.9	1.4	1.0	1.0
Total	27.0	33.7	30.8	16.0	23.6	30.5	21.1	25.3	24.9	32.3	19.5	27.8

Source: Eurostat, *Social Protection Expenditure and Receipts, 1980-1994*.

1/ United Kingdom, 1993.

Table 2. Composition of Nonhealth Social Expenditure in the Major European Countries (1980–1994)

	1980	1985	1990	1994
Italy				
Total	19.4	22.6	24.1	25.3
Old-age pensions	9.9	11.9	13.6	15.5
Disability and occupational injuries	1.9	2.0	2.1	2.1
Unemployment	0.4	0.3	0.4	0.6
Family and maternity	1.3	1.1	1.1	0.9
France				
Total	25.4	28.8	27.7	30.5
Old-age pensions	10.5	11.1	11.7	12.6
Disability and occupational injuries	2.2	2.3	2.2	2.2
Unemployment	1.0	1.3	1.5	1.8
Family and maternity	3.1	2.8	2.6	2.8
Germany 1/				
Total	28.8	28.4	26.9	30.8
Old-age pensions	11.9	11.5	11.0	12.2
Disability and occupational injuries	3.4	3.3	3.1	3.5
Unemployment	0.9	1.0	1.1	2.0
Family and maternity	2.9	2.4	2.1	2.2
United Kingdom				
Total	20.5	23.8	22.1	27.8
Old-age pensions	8.5	8.8	9.1	11.0
Disability and occupational injuries	2.0	2.3	2.6	3.2
Unemployment	1.5	1.2	0.8	1.6
Family and maternity	2.6	2.5	2.3	2.9

Source: European Commission, *Social Protection in Europe*, 1995.

1/ 1980–1990 figures refer to Western Germany.

impact of unification). In Italy, in contrast, most of the rise in social expenditure took place in a steady, relentless manner throughout the 1980s, and slowed down only after the health and pension reforms of the 1990s—indicating the eminently structural nature of the forces behind the expenditure dynamics. In particular, there was no marked cyclical surge in spending on unemployment compensation over the recession years, nor did the latter play a significant role in explaining the additional, albeit more moderate, increase in total spending since 1990.

A point of discussion in Italy concerns the extent to which classification problems may overstate the system's bias against protection from risks other than old age, given the ancillary "social assistance" function discharged by pensions in the absence of other welfare support mechanisms.<sup>5</sup> But adjustments to enhance the international comparability of spending patterns by taking account of this element still leave Italy as an outlier. Following the so-called Esspros methodology employed by Eurostat, it is possible to disentangle those insurance-based benefits that, while paid on the basis of a past contribution record, discharge a distinctly "social assistance" function.<sup>6</sup> Table 3 illustrates the application of this methodology to break down payments to the elderly (excluding income provisions to survivors). Even after subtracting the means-tested transfers granted to recipients of low value pensions, as well as other social payments for the uninsured elderly, the portion of the "social budget" needed to meet the entitlements arising from the mandatory pension system is between 10 and 20 percentage points higher in Italy than in major partner countries. Another salient characteristic of the Italian welfare system is the limited scope of the nonpension system of protection, and the comparatively narrow range of contemplated contingencies (evidenced also in Table 1). On the one hand, as noted, traditional public schemes targeted to support the active population and families (notably, unemployment compensation, family allowances, and maternity benefits) absorb a markedly lower portion of resources than in partner countries. On the other hand, new forms of public support that have been devised (particularly in northern Europe) to cope with the strains imposed by recent economic and social changes (instability of employment, the influx of women into the labor market, the difficulties faced by first-time job-

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<sup>5</sup>This reality prompted the Onofri Commission to characterize social welfare as having largely grown as a "parasite" of the pension system (Onofri Commission, 1997a).

<sup>6</sup>The methodology defines for each country a three-tier structure of social security comprising (i) a basic scheme, providing protection against insurable risks; (ii) a supplementary scheme, reinforcing the basic scheme; and (iii) a group of means-tested welfare instruments, targeting the needy on a solidarity principle.



Table 3. Payments to the Elderly by Type of Benefit, 1993

(In percent of total social outlays)

	Italy	France	Germany	United Kingdom
Mandatory pension system	42.0	32.9	23.1	20.1
Basic contributory pensions	41.4	25.3	23.1	13.2
Supplementary contributory pensions	0.6	7.6	...	6.9
Social pensions and welfare supplements	0.9	0.8	1.0	2.4
Voluntary contributory pensions	...	0.7	3.7	9.1
Other money transfers 1/	6.1	0.1	2.0	...
In-kind support	0.6	0.5	0.1	1.3
Total	49.6	35.0	29.9	32.9

Source: Onofri Commission, *La spesa sociale italiana in prospettiva comparata*, 1997.

1/ For Italy, it includes severance payments.

seekers, the rising incidence of lone-parent families) are virtually nonexistent.<sup>7</sup> While in some other European countries the emergence of these new challenges, notably affecting women and the young, have led to a reassessment of the appropriateness of the existing welfare mechanisms, in Italy the traditional reliance on derived pension rights has continued to be the prevalent, or even sole, public response.<sup>8</sup> In this setting, active approaches to the design of social benefits, aimed at providing the young unemployed with job search incentives, have been equally lacking. The response in this area has taken the limited form of subsidies to employers of long-term or young unemployed workers (notably through lower social security contributions). More innovative instruments pursuing the same goal by providing advice and orientation to job-seekers, easing the cost of resettlement to adapt to interregional differences in the demand for labor,<sup>9</sup> and subsidizing personal social services to working mothers are either absent or in scant supply.

A system, such as Italy's, basing entitlement exclusively on the occurrence of a narrow range of rigidly defined contingencies, and aimed prevalently at (present or past) participants in the formal labor market, is liable to generate severe gaps in coverage. Italy's position in this respect has been characterized in the following terms (see *Commissione di indagine sulla povertà e l'emarginazione*, 1995): "In contrast to elsewhere in the European Union, Italy does not implement any generalized and universal policy supporting families for the cost of raising children, or any minimum income scheme. Substituting for them are, on the one hand, supplements to income received by low-paid workers and low-pension retirees (family

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<sup>7</sup>The relatively scant attention devoted to policies affecting the family unit is even more evident if the analysis is extended beyond the expenditure side to embrace redistributive mechanisms working on the revenue side, along with the tax treatment of social assistance benefits themselves. Thus, for example, in France, the family burden is explicitly taken into account, through the *quotient familial*, in the marginal tax rate, and in Germany many forms of social transfers are tax-exempt. For an extensive analysis of the "citizen's budget" in his/her relations with the government, see Centro Europa Ricerche (1997).

<sup>8</sup>Most European social security systems were developed on the assumption that looking after children and infirm adults lay with women and that, for them, paid employment had a secondary role. More recently, however, many countries have introduced means to reconcile family and professional responsibilities. In this framework, for example, Germany implements both a transfer system to lone-parent households (*Unterhaltsvorschuss*), and a support scheme for mothers raising children (*Kindergeld* and *Erziehungsgeld*) and for workers caring for adults. Sole parenthood is also targeted in France (*allocation parent isolé*), the United Kingdom, and several other countries; allowances for long-term carers are available in the United Kingdom (Invalid Care Allowance), Germany (*Pflegeversicherung*), and Ireland.

<sup>9</sup>A well-known example of the former kind is the Job Seeker's Allowance scheme recently introduced in the United Kingdom, while examples of the latter are to be found in Germany (*Wohngeld*), in France, and in the United Kingdom.

allowances) and, on the other, forms of income support designed and administered, in a more or less discretionary and diversified manner, by local authorities. For those without even a weak link to the labor market, the only two instruments of income relief subject to sufficiently clear-cut eligibility criteria are the social pension, on the one hand, and the civil disability allowance, on the other.” The need to provide a safety net to the poor left outside the realm of the nationally mandated programs has led to the proliferation of “local systems of citizenship,” managed by municipalities. However, unlike the schemes guaranteeing a minimum level of resources on a municipal basis in other countries, the Italian system has been characterized as a form of “federalism without principles”: it lacks a general framework as to the form of intervention, the entitlement regime, the duration, and the amount of payments.<sup>10</sup> Assistance under this fragmented system is conditional on residence and, again, on the occurrence of particular severe contingencies (being economically dependent on a prison inmate, drug addiction, etc.), or on age and health status. In the latter case, local systems risk overlapping with existing nationwide schemes for the uninsured elderly (social pensions and allowances) and the seriously ill (civil disability and long-term care benefits). In this setting, there is neither a form of income maintenance for all those in need nor the kind of inducements to participation (sometimes taking the form of retraining services) that, for example, accompany cash subsidies in Germany (*Sozialhilfe*), in France (*revenu minimum d'insertion*), and in the United Kingdom.

### III. THE CONSOLIDATED SOCIAL SECURITY SYSTEM

An overall assessment of Italy's welfare system is hindered by the complexity and opacity of the system's accounts. A first step, undertaken in this section, is to arrive at a consolidated presentation of the social security accounts. Such a presentation is set out in Table 4 for the most recent available year (1996).<sup>11</sup> By netting out intricate financial flows and counter-flows among agencies, and between agencies and the general government, the presentation aims to focus the analysis on the net injection of resources from the private sector and from general taxation, on the one hand, and the amount returned to the private sector in the form of final payments, on the other. Outlays include only the final provision of cash transfers to protect recipients against the income consequences of events such as longevity, bereavement, permanent incapacity to earn, or family size, and temporary separation from work due to unemployment, poor health, or maternity. Benefits are grouped by row, according to their duration (permanent or temporary) and the program of reference (old age, disability, unemployment, professional injuries, family, maternity, and sickness). A further level of classification draws a line between benefits paid on account of mandatory contributions, and

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<sup>10</sup>See Onofri Commission (1997b).

<sup>11</sup>The consolidated accounts of Table 4 are net of publically provided in-kind services—in the first instance, health. Figures are elaborations of data from Istituto Nazionale della Previdenza Sociale (1997) and Ministero del Tesoro e del Bilancio (1997), as complemented by information provided directly by the authorities.

Table 4. Italy: The Consolidated System of Social Security (1996) 1/  
(In trillions of lire)

	Social Security Funds		Subsidized Programs		Direct Govt.	Total	Deficits (8)=(7)-(6)	Budgeted Transfers (9)
	Expend. (1)	Contr. (2)	Expend. (3)	Contr. (4)	Expend. (5)	Contr. (7)		
<b>Contributory benefits</b>	<b>285.1</b>	<b>208.0</b>	<b>4.5</b>	<b>2.1</b>	<b>5.1</b>	<b>210.1</b>	<b>-84.6</b>	<b>47.1</b>
<b>Permanent benefits</b>	<b>263.4</b>	<b>184.7</b>	<b>0.2</b>	<b>0.2</b>	<b>5.1</b>	<b>184.9</b>	<b>-83.6</b>	<b>41.6</b>
Of which: Supplementary benefits	31.3					31.3		22.9
Old age and seniority	183.3	172.2			5.1	188.4	-16.2	41.6
Of which:								
Supplementary benefits	10.2					10.2		
Early retirement benefits	3.8					3.8		2.8
Disability	35.7					35.7		
Of which: Supplementary benefits	15.8					15.8		
Survivors	34.7					34.7		
Of which: Supplementary benefits	5.3					5.3		
Permanent work injuries	9.7	12.5				9.7	2.8	
<b>Temporary benefits</b>	<b>21.7</b>	<b>23.3</b>	<b>4.5</b>	<b>1.9</b>		<b>26.2</b>	<b>-1.0</b>	<b>5.5</b>
Support for the unemployed	10.3	8.4	4.5	1.9		14.8	-4.5	3.7
Of which:								
Standard unemployment benefits	7.1	4.2				7.1	-2.9	1.0
Ordinary wage supplement	0.6	3.6				0.6	3.0	0.1
Other compensations	0.7	0.6				0.7	-0.1	
Special unemployment benefits	1.9		2.2	0.1		4.1	-4.0	0.7
Special wage supplement			0.8	1.2		0.8	0.4	1.2
Mobility allowances			1.5	0.6		1.5	-0.9	0.7
Family benefits	6.0	8.1				6.0	2.1	1.8
Maternity	1.9	1.8				1.9	-0.1	
Sickness	2.6	5.0				2.6	2.4	
Temporary work injuries	0.9					0.9	-0.9	
<b>Noncontributory benefits</b>	<b>8.7</b>		<b>3.4</b>	<b>2.1</b>	<b>19.0</b>	<b>31.1</b>	<b>-31.1</b>	<b>13.2</b>
Social pensions			3.4			3.4	-3.4	4.8
Civil disability					7.5	7.5	-7.5	
Pensions for blind or deaf persons					0.9	0.9	-0.9	
Long care allowances					7.8	7.8	-7.8	
Veterans					2.8	2.8	-2.8	
Contribution rebates and others	8.7				8.7	8.7	-8.7	8.4
<b>Total</b>	<b>293.8</b>	<b>208.0</b>	<b>7.9</b>	<b>2.1</b>	<b>24.1</b>	<b>325.8</b>	<b>-115.7</b>	<b>60.3</b>
In percent of GDP	15.7	11.1	0.4	0.1	1.3	17.4	-6.2	3.2

Sources: INPS, *Rendiconto Generale per l'anno 1996 (1997)*; Ministero del Bilancio, *Relazione Generale sulla situazione economica del Paese (1997)*; and data provided by the authorities.

1/ Net of health spending.

transfers made on the basis of the principle of social solidarity.<sup>12</sup> For each scheme, the columns indicate the paying administration (an independent agency or the government itself) and the relative composition of funding (through contributions and/or public transfers). The classification helps highlight three main features of the consolidated system of social security in Italy.

- First, the **principle of contingency on the occurrence of privately insurable events**—being old, sick, disabled, temporarily unemployed, suffering from occupational injuries or diseases—lies at the heart of the entire entitlement system, as shown in the division among rows. Less than 10 percent of total expenditure is made on the basis of a pure solidarity principle, that is, outside the bounds of insurance-based programs.<sup>13</sup> Notably, the uninsurable risk of poverty is covered only if associated with a permanent incapacity to work due to age (through social pensions, accounting for only 1 percent of total expenditure) or serious illness (civil disability and other narrowly targeted schemes paying various allowances in an amount close to 6 percent of total expenditure). Thus distinct criteria of membership and exclusion—depending largely on current or previous occupational status—trace sharp borders between “insiders” and “outsiders.”
- Columns, providing details on the funding regime for each individual program, highlight the **large financial imbalances saddling the contributory portion of the system**. Only 70 percent of the amounts paid on the basis of recipients’ past contributions is actually financed through present contribution revenues. In order to meet its pension liabilities, the system has made recourse to extensive direct allocations and off-budget transfers from the unified Treasury account.
- While not directly observable from Table 4, due to its consolidated nature, the administration of benefits and programs is characterized by a **high degree of fragmentation**. There are three main paying agencies<sup>14</sup> and a plethora of formally autonomous funds operating

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<sup>12</sup>This broadly neutral criterion is the same as that used in the United States (with OASDI on the one side, and AFDC or SSI, on the other) and in Germany (with the contributory *Rentenversicherung* and *Arbeitslosengeld* opposed to *Sozialhilfe*). See Atkinson (1995).

<sup>13</sup>Net of contribution rebates granted both on geographical and sectoral bases (largely for industrial policy purposes), this figure would be close to 7 percent of the total spent.

<sup>14</sup>These include (i) the National Social Security Institute (INPS), by far the largest, which covers both dependent workers in the private sector and certain categories of the self-employed; it currently pays some two-thirds of all pensions, also acting as a government agency for the provision of a number of public assistance programs; (ii) the National Institute of Social Security for Public Employees (INPDAP), paying civil servants’ old-age and survivors’ pensions (and, more recently, also disability allowances); and (iii) the National

(continued...)

within the agencies. Direct government intervention is dwarfed by the amounts administered through the agency system: only some 7½ percent of the total amount spent, or 1¼ percent of GDP (Table 4, row 30, column 5), is directly managed by the central government in the form of noncontributory aid to war veterans and to the seriously impaired.<sup>15</sup>

### **Sources and financing of imbalances**

While complex in principle, the above model of administration, centered on a plurality of autonomous intermediaries to provide coverage against insurable contingencies, allows to assess the role of government in directing the flow of funds to the different social protection programs. This function is accomplished within INPS by a special body (GIAS), established in 1989, which handles financial flows from the state budget to the various funds administered within INPS, providing transfers to virtually all programs and reallocating surpluses among them. A comparison of the purported destination of state transfers (given by the budget allocations—Table 4, column 9) with their effective use (as measured by the difference between each scheme's contribution revenues and spending—column 8) is revealing: a clear pattern of diversion of resources emerges, that penalizes the working population vis-à-vis the elderly and, among the latter, those receiving social assistance payments vis-à-vis the recipients of old age and seniority pensions.<sup>16</sup> All in all (excluding contribution rebates, largely used as industrial policy instruments), almost 60 percent (close to Lit 6 trillion) of total state transfers allocated to programs of temporary support and to noncontributory welfare plans administered outside the government is surrendered by these designated recipients to be ultimately directed to other uses. When these transfers are combined with the allocations explicitly subsidizing the contributory pension system (Lit 41.6 trillion, row 2, column 9), the latter effectively absorbs almost 80 percent of total state transfers to social security, an amount equivalent to 2½ percent of GDP.

The shortfall between overall payments and contributions in the insurance-based system as a whole is sizable, in the order of 4½ percent of GDP in 1996 (or Lit 84.6 trillion, row 1,

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<sup>14</sup>(...continued)

Institute for Work Injuries (INAIL), granting compensation for temporary work-related injuries, as well as permanent disability payments in cases of more serious injuries or illnesses.

<sup>15</sup>In the transition to the new social security system inaugurated by the Dini reform of 1995, whereby all civil servants' pensions are to be paid by INPDAP, a few benefits (Lit 5.1 trillion, row 4, column 5) were still administered by the Ministry of Treasury and Budget in 1996.

<sup>16</sup>Thus, for example, of the Lit 5½ trillion in transfers for temporary benefits targeting people in working age (row 12, column 9), only Lit 1 trillion (column 8) is actually used for the institutional purpose to which it was allocated. In the same vein, social pensions (granted to uninsured people above 65) absorb only some 70 percent of the transfers made available by the budget (Lit 3.4 trillion out of Lit 4.8 trillion; row 25, columns 3 and 9).

column 8). Table 5 provides a further reclassification of the accounts to identify the sources of the imbalance and the pattern of deficit financing. The left-hand side of the table groups programs with a deficit (amounting to Lit 89 trillion), while the upper portion of the right-hand side lists those funds running a surplus (of Lit 4.4 trillion) and thus providing an internal source of funding to the rest of the contributory system. Three main conclusions may be drawn:

- The contributory pension system accounts for the bulk of the imbalance. Even after the additional resources made available with the 1995 pension reform, whereby a part of payroll contributions formerly used to finance family allowances was imputed to pension funding,<sup>17</sup> the various contributory pension funds (old age, seniority, disability, and survivors' pensions) fall short of self-financing by as much as 30 percent of their total expenditure.
- The only schemes in surplus are those of income support targeted to families of dependent workers, working mothers, and for sickness benefits (Table 5, upper right-hand portion). This surplus broadly offsets the small deficit run by the unemployment funds.
- The budget consistently underprovisions for pension spending. With the amount of allocated budget transfers being systematically insufficient to cover the shortfall between overall payments and contributions, an additional mechanism of automatic "advances" from the unified Treasury account to the pension agency (INPS) has, over the years, assured the coverage of mandatory pension spending.<sup>18</sup>

These conclusions provide some insight into the question posed in the introductory section: can the pension regime be said to divert resources from other uses, notably from the protection of people in working age? The above analysis of the composition of funding between self-financing and budget transfers does indeed suggest that resources specifically committed for the purpose of intragenerational risk-sharing (and possibly vertical

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<sup>17</sup>The 1995 reform, while leaving overall contribution rates unchanged, raised the contributions earmarked to finance pension funds from 27 percent to 32 percent of gross earnings (in order to bring them close to the notional rate of 33 percent used to compute a retiree's first-year pension). This was done by relabeling as pension contributions part of the contributions previously accruing to the family benefits plan, given the latter's structural overfunding. The operation resulted in a diversion of resources amounting to almost ½ percentage point of GDP from temporary benefits (with a distinctive welfare feature, as is the case of family benefits) to permanent pension transfers.

<sup>18</sup>This system of ex post off-budget transfers has given rise over time to book liabilities of INPS vis-à-vis the state amounting to about 8½ percent of GDP by end-1996. In the awareness that the pension agency will never be in a position to repay the advances made, the government has put forward draft legislation canceling most of this debt.

Table 5. Italy: The Deficit of the Contributory System: Sources and Financing, 1996 1/

(In trillions of lire)

Sources	Financing
Contributory pensions 2/	4.4
Unemployment benefits	2.0
Temporary work injuries	2.4
	<b>Internal financing from programs in surplus</b>
	Family and maternity
	Sickness
	<b>Financing through budget allocations</b>
	Transfer to pensions
	Of which: for supplementary benefits
	Transfers for unemployment
	Transfers for family benefits
<b>Total shortfall of funds in deficit</b>	<b>50.2</b>
	<b>Treasury advances</b>
	38.8

Sources: INPS, *Rendiconto Generale per l'anno 1996* (1997); Ministero del Bilancio, *Relazione Generale sulla situazione economica del Paese* (1997); and data provided by the authorities.

1/ Net of health spending and contribution rebate schemes granted both on geographical and sectoral basis.

2/ Including permanent benefits for work injuries; excluding social pensions, benefits to war veterans, and civil disability allowance.



redistribution) are diverted in a systemic manner and on a nonnegligible scale to fund an intergenerational (life-cycle) reallocation of income.

What underlies the pension fund's chronic imbalance? There are essentially two factors:

- First, part of the imbalance arises from the fact that the pension agency is called upon to provide, under various mechanisms, for the payment of benefits to certain categories of retirees that exceed their normally accrued amounts. INPS (1997a) estimates that total expenditure due to provisions that raise pension benefits above normally accrued rights amounted to Lit 47 trillion in 1996 (or 56 percent of the overall deficit). The bulk (two-thirds) of such expenditure arises from so-called *integrazioni al minimo* (henceforth indicated as "supplementary benefits").<sup>19</sup> The remainder of what INPS defines as a welfare burden improperly placed upon the insurance system is due mainly to (i) past legislative increases of existing benefits, raising the amount of pensions calculated on the basis of the less generous regimes in place in the 1950s and 1960s; (ii) the financial impact of the secular shift from agricultural to industrial activities on the farmers' pension fund, a burden judged to be of a collective nature; and (iii) ad hoc early retirement schemes granted on a case-by-case basis to facilitate labor shedding and restructuring in mature industrial sectors.<sup>20</sup>
- Second, the imbalance of the pension system is also clearly attributable to its generosity, particularly in terms of the institution of seniority pensions and the high accrual factor in the calculation of pensions. These features have been amply examined elsewhere, and need not be rehearsed here.<sup>21</sup>

While the system's imbalance due to the generosity of the accrual system per se poses a problem of misallocation of resources across generations, the imbalance originating from

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<sup>19</sup>These are means-tested supplements granted to pension recipients in cases where their accrued benefits fall short of a statutory minimum (described further in Chapter IV below).

<sup>20</sup>Such episodes (typically consisting in lowering, by up to five years, the seniority required for retirement) have been frequent. At the end of 1995, the total number of retirees in receipt of pensions awarded before achievement of both the standard retirement age and the minimum contribution period (35 years) was as high as 391,000, accounting for total expenditure in the order of 0.2 percent of GDP; a budget transfer to INPS (Lit 2.8 trillion in 1996) covers part of this cost (Table 4, row 6, columns 1 and 9).

<sup>21</sup>Rostagno (1996), by estimating the implicit average yield rate guaranteed on contribution payments by the various regimes in place since the first pension reform of 1992, provides a ranking of the systems according to an index of financial sustainability: only the so-called Amato reform, subsequently superseded by the 1995 law, was proved to pass the test of financial sustainability, although by a small margin. For critical assessments of the pension systems *before* and *after* the 1995 measures, see also, respectively, Demekas and Canziani (1995) and Hamann (1997).

transfers in excess of accrued benefits draws attention to the pattern of intragenerational (vertical) redistribution of incomes. As noted above, the former set of issues has already commanded wide attention in the literature. The second has received comparatively less attention, and raises the question of whether pensions, as complemented by other means-tested subsidies targeted to low-income retirees, can be thought of as discharging an ancillary “social assistance” function, given the absence of fully developed welfare support mechanisms. This issue is examined in Chapter IV below.

#### IV. SELECTED WELFARE INSTRUMENTS: A MICRO-ANALYSIS OF EFFICIENCY AND EFFECTIVENESS

This Chapter is devoted to an analysis of selected income-tested nationwide instruments, granted either on a previous contribution record or on a general principle of solidarity, and targeted to people not participating in the labor market due either to age or disability. Expenditure on such programs totaled Lit 62.1 trillion in 1996, or 3.3 percent of GDP (Table 6). The instruments examined, featuring highly heterogeneous rules of access, comprise: (i) supplements paid to elderly and widowed pensioners to raise their accrued benefits to a statutory minimum (*integrazioni al minimo*); (ii) subsidized disability allowances for those with a shorter contribution history; (iii) social pensions designed for elderly people in need and not qualifying for any pension; and (iv) civil disability transfers for the seriously impaired with insufficient means.<sup>22</sup> Both the targeted populations and the means-testing mechanisms governing the various regimes are described in Box 1.

The basic source of empirical evidence used in this section is the nationwide survey of household budgets conducted, on a two-year cycle, by the Bank of Italy. By covering 8,000 households, this extensive microdata base provides ample possibilities of matching detailed information regarding incomes, expenditure, and wealth with the personal characteristics of the population surveyed. Although a full account of the statistical problems affecting the survey falls outside the confines of the present study,<sup>23</sup> an initial caveat is in order. The Bank Italy sample shares the same bias of many comparable data bases, in that it excludes—either

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<sup>22</sup>The analysis does not include other welfare instruments, such as family benefits, long-term care allowances, veterans’ pensions, and the multiplicity of schemes at the municipal level. The characteristics and problems of the system of family allowances in Italy has already been extensively studied elsewhere (see, for example, Franco and Sartor, 1990 and 1994), and, for an official view, *Commissione di indagine sulla povertà e l'emarginazione* (1995). Long-term care allowances were not included as entitlement is not means-tested, while municipal aid was excluded because of the high diversity of access rules and the scarcity of observations in the sample used for this study. The latter applies also to veterans’ pensions.

<sup>23</sup>The structure of consistency controls, double checking, poststratification reweighing (to correct for differential response rates by sampling strata) conducted on the raw data, as well as a thorough account of underrepresentation problems of the sample, are surveyed in Brandolini (1993).

Table 6. Italy: Selected Welfare Benefits

	Statutory Amount Granted (Lit million) 1/	Estimated Average 2/	Total Outlays (Lit trillion)
Old age/seniority and survivors supplement to the minimum pension	[A]	47.5	15.5
INPS disability pension		92.8	35.7
Of which: supplement to the minimum pension	[B]	48.1	15.8
Social pension		58.0	3.4
Without supplement	4.8	52.0	
With supplement 3/	6.4	72.4	
Civil disability pension	4.9	55.6	7.5
Total outlays (In percent of GDP)			62.1 3.3

Sources: Data provided by the authorities; and elaborations on survey data on households' incomes and wealth (Bank of Italy, 1997).

[A] Difference between the statutory minimum pension (around Lit 8.6 million in 1996) and the accrued benefit.

[B] The INPS disability pension is granted according to the lesser amount between Lit 8.6 million and the sum of the accrued benefit plus the social pension. Therefore, the supplement granted cannot exceed the social pension.

1/ All amounts are expressed in per annum figures.

2/ Average amount received as percent of individual poverty threshold.

3/ A Lit 1.6 million supplement is paid in addition to the basic benefit if certain restrictive income requirements are met.

### Box 1. Selected Welfare Benefits: Entitlement Rules

The main text reviews selected incomes-tested nationwide instruments, granted either on a previous contribution record or on a general principle of solidarity, and targeted to people not participating in the labor market due either to age or disability. Expenditure on such programs totals some 3.3 percent of GDP. These instruments comprise: (i) supplements paid to elderly and widowed pensioners to raise their accrued benefits to a statutory minimum (*integrazioni al minimo*), with total spending in the order of 0.9 percent of GDP; (ii) subsidized disability allowances for those with a shorter contribution history (1.9 percent of GDP); (iii) social pensions designed for elderly people in need and not qualifying for any pension (0.2 percent of GDP); and (iv) civil disability transfers for the seriously impaired with no accrued pension rights (0.4 percent of GDP). These instruments feature heterogeneous entitlement rules, reviewed below (see also Table 6 for a summary presentation).

- **Supplementary benefits** (*integrazioni al minimo*) granted to recipients of old-age and survivors' pensions in cases where their accrued benefits fall short of a statutory minimum. Eligibility for the supplementary benefit is subject to the requirement that the claimant's personal taxable income (and, if married, that cumulated with the spouse) be below certain thresholds. Specifically, the recipient's individual income cannot exceed a maximum equal to twice the amount of the statutory minimum (around Lit 8.6 million per annum in 1996); also, cumulated incomes accruing to the recipient and his/her spouse cannot exceed four times the same amount (Lit 34.4 million). It is important to note that a wide array of tax-exempt income sources—such as interest earned on government securities, severance payments received upon retirement, imputed rents on owner-occupied property, and the supplemented pension itself—are excluded from this means test. Furthermore, if the above thresholds are satisfied, the difference between the accrued pension and the statutory minimum is paid for the entire amount, regardless of the ex post income situation of the recipient. As a result, the ex post cumulative income—exclusive, it bears repeating, of the tax-exempt sources noted above—can vary within a very wide range. The bottom of the range would be given by the level of the minimum pension itself (just above the individually adjusted poverty line, of around Lit 8.5 million on a yearly basis), in the case of an unmarried person with no additional sources of income, to Lit 34 million, in the case of total taxable incomes (excluding pension) not exceeding four times the level of the minimum. While the 1995 pension reform abolished the institution of the *integrazione al minimo* for new enrollees, no changes were made to the entitlement system for all other cases. The institution will thus continue to operate for the next 35 to 40 years.
- **Disability pensions**, paid on the basis of at least five years of contributions to dependent workers and the self-employed covered by the social security agency, INPS (and, more recently, also by INPDAP). The accrued pension is also supplemented to the minimum. However, subject to own-income thresholds equal to the social pension (see below), for single individuals, and to three times as much for a couple, the supplement paid in this case cannot exceed the amount of the social pension itself.
- **Social pensions** provided an annual transfer (of between Lit 4.8 million and Lit 6.4 million) to people aged 65 or more without an insurance-based pension. The 1995 pension reform, by introducing a newly designed social allowance, grandfathered all present recipients. Consequently, despite the fact that the new instrument was made subject to an improved test of means, its incidence over the total spent will be limited for the next 10 to 15 years.
- **Civil disability pensions**, targeting the impaired with no accrued pension. The amount and award formula replicate the mechanism applied to social pensions. No maximum threshold for the cumulative income of couples is set in this case.

by design or through nonresponse—many of those at the margins of society. As they are not part of a household, it also excludes from its coverage certain categories of people, for example, those living in nursing homes. Since part of the population in receipt of the benefits examined is likely to fall into these categories, the findings are likely to be affected correspondingly.

A further difficulty is attributable to the almost impenetrable complexity of the system of social security in Italy. Given this complexity, no pretense can be made that interviewees correctly identify the nature of the benefit they are drawing. For example, a simple screening conducted on the part of the sample that declared to be in receipt of a social pension revealed that a large number of them either do not meet the social pension's statutory age requirement (above 65 years of age), or draw a pension far in excess of the amount assured by the social pension plan. In a similar vein, many recipients of noncontributory support provided by the Ministry of the Interior to the disabled report their benefits as being paid under the INPS contributory regime. In addition, in the questionnaire, no question is asked—as few individuals would likely be in a position to provide an answer—about the share of the contributory benefit to be traced to the accrual of previous contributions, as opposed to the share due to the supplement provided by the system to bring the accrued benefit to the minimum statutory amount. In order to minimize the error of including in the selected sample observations which should be discarded, and of excluding answers that should instead be taken into account, a series of filters was applied in the process of subsample selection. Once the subpopulations covered by the instruments under review were identified with a sufficient degree of confidence, the problem of estimating the accrued part of the benefits (as opposed to the possible supplement received) was tackled through an imputation procedure. Both the filters employed in assembling the samples and the imputation technique to estimate the composition of the transfers are described in the methodological appendix.

### **A classification of recipients according to “need”**

Data regarding the income of the recipients of the welfare benefits under review provide a basis to classify the recipients according to a measurement of their effective “need” for the benefit they receive. In the case of supplementary benefits to the minimum (*integrazioni al minimo*) for old age, seniority, and survivors' pensions, and of contributory disability pensions paid by INPS, the following three groups are identified, in decreasing order of “need.”

- A group clearly in “need” (Group A): for people classified in this group, the disposable income (net of imputed rents for owner-occupied property) of the households to which they belong remains below the poverty line (defined by family size) even *after* allowing for their accrued pension. They clearly need the supplement to the minimum to improve their overall income situation.
- An intermediate group (Group B), consisting of individuals whose families, while below the applicable poverty threshold before receipt of any benefit, are brought above this threshold after receipt of the accrued part of their pension. The addition of the supplement to

the minimum thus further widens the differential from the poverty line. In this sense, there is clearly a lesser “need” for the supplementary benefit than in the case of Group A recipients.

- A group not in “need” (Group C), comprising recipients of families whose income even *before* the accrued pension is above the relevant poverty line. There is, in this case, no evident need for a supplementary benefit to the minimum.

In the case of people drawing an INPS disability pension, the classification is not applicable to those pensioners who report some form of persistent disability (indicated as Group D). It is applied only to the subpopulation that, while receiving an INPS disability pension, declare themselves to be “without any form of disability.” While such candor may be surprising, it may be ascribable to the assurances of strict confidentiality and anonymity that accompany the survey process and the questionnaire. Noncontributory benefits, such as social pensions and civil disability allowances, also do not permit the same three-tier distinction, given the absence of an accrued pension as a starting point of the classification. Recipients of these benefits were thus divided into two groups: one starting from below the poverty threshold before receipt of the benefit (Group A), and the other already above it even without the benefit (Group B).<sup>24</sup>

The classification described above implies taking a position on a number of controversial methodological issues concerning the measurement of standards of living and poverty.<sup>25</sup> These are worth noting, as they could be deemed to affect the findings and related policy implications.

- The recipient’s family, rather than the recipient alone, is taken as the unit of analysis (that is, the group of persons whose resources are assumed to be combined in the assessment of living standards). This choice is dictated by a set of considerations, the most compelling being the difficulty of reaching a meaningful measurement of the poverty line for a single individual living in an extended household—for example, a widowed person sharing the same dwelling as his/her married children.<sup>26</sup> Of course, using the family as a unit of analysis entails the implicit assumption that intrahousehold inequality is not a significant problem, and that resource-sharing—particularly interspousal obligations of support—is a well-established (and fair) practice. This might well not be the case, particularly for elderly people depending on assistance provided by other household members.

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<sup>24</sup>For civil disability pensions, this distinction was applied only to those declaring themselves to be “nondisabled,” and excluding those defining themselves as currently disabled (included in a Group D, in a manner analogous to that noted above for INPS disability pensions).

<sup>25</sup>For a detailed survey of the methodological problems in this area, see Atkinson (1995).

<sup>26</sup>While there are equivalence scales to bring incomes accruing to families of different sizes to a comparable position, there is no equivalence scale measuring the amount of resources that would suffice to place a single person living in an extended family above a certain minimum standard of living.

- The poverty threshold employed is that put forward by Italy's permanent committee on poverty and social exclusion, which defines the minimum standard of living for a two-member household as equal to nationwide per capita consumption expenditure.<sup>27</sup> The equivalence scale adopted to adjust this benchmark family index for differences in household size treats a couple as being equivalent to 1.66 single adults. Income is consequently defined in "equivalent terms." In order to measure the household living standard, after-tax incomes reported in the survey are deflated by the applicable poverty threshold so as to render them comparable across families of different composition.
- Implicit in the construction of an indicator of "need" is the assumption that the transfer programs under review, even those among them of a contributory nature, should be primarily geared to a more effective fight against poverty. This is, however, by no means an uncontroversial matter in Italy, where both a consolidated jurisprudence and long-standing policy practice seem to espouse a different (and more far-reaching) notion. In particular, there is a widespread view that workers with a significant history of contributions should be granted a higher degree of income maintenance than that afforded to people relying solely on public assistance for subsistence. Under this view, a test of performance of instruments of income support that are viewed as being at the border between social insurance and assistance, such as the one which is proposed in the following paragraphs, should not take targeting efficiency as its point of departure.<sup>28</sup>

### **The destination of outlays according to "need"**

As noted, total outlays on the selected welfare benefits under review amounted to 3.3 percent of GDP in 1996. Figure 1 breaks this amount down among the categories of recipients classified according to their "need," as defined above. It emerges that only some 60 percent (or under 2 percent of GDP) of the amount spent accrues to individuals who may be deemed to be truly in "need," as measured by the official poverty line, or genuinely disabled (Group A in each category, plus Group D for INPS and civil disability pensions). A further small amount accrues to an intermediate category, whose degree of "need" is less clear-cut. All in all, as much as one-third of the amount spent accrues to individuals clearly not in "need" (the black portions of the pies), that is, to individuals who are already above the poverty line even before receipt of the benefit in question—and, furthermore, in the case of INPS and civil disability pensions, also declare themselves to be currently nondisabled.

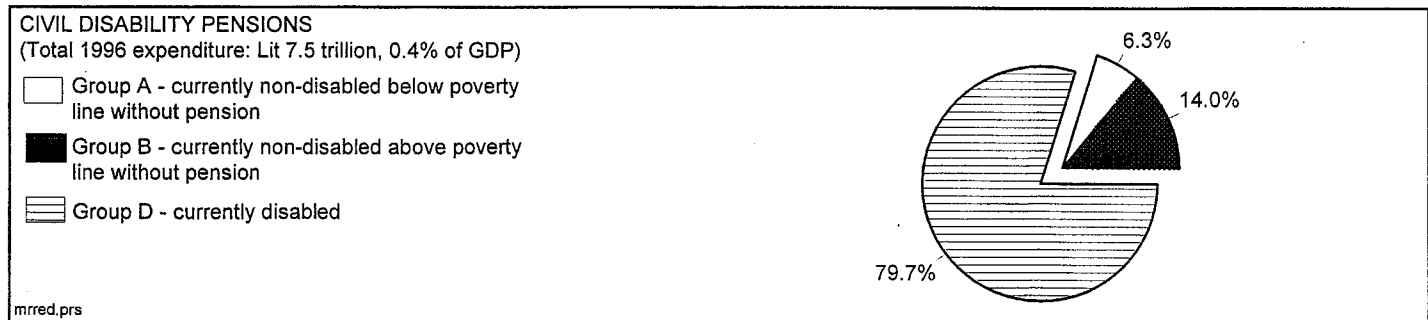
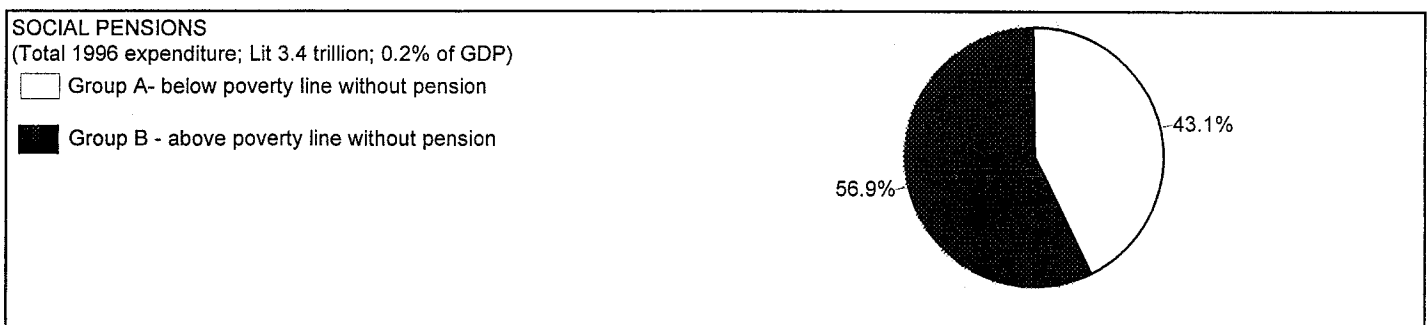
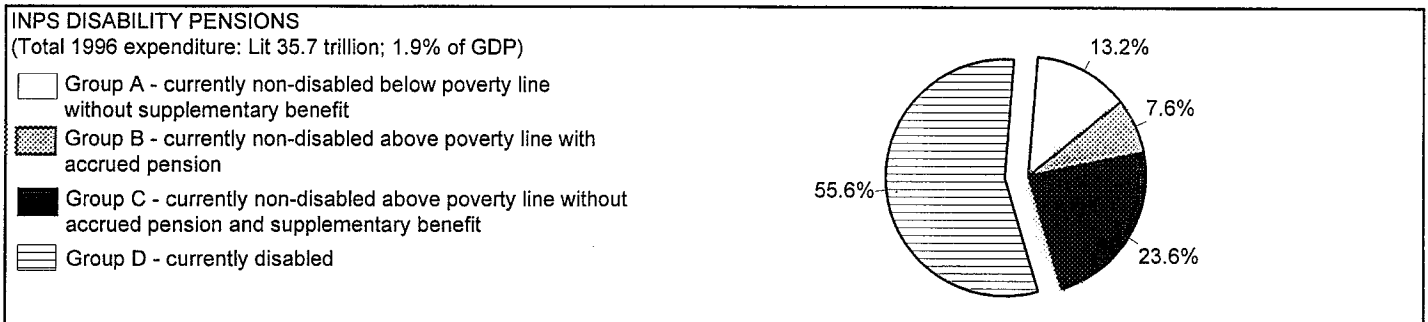
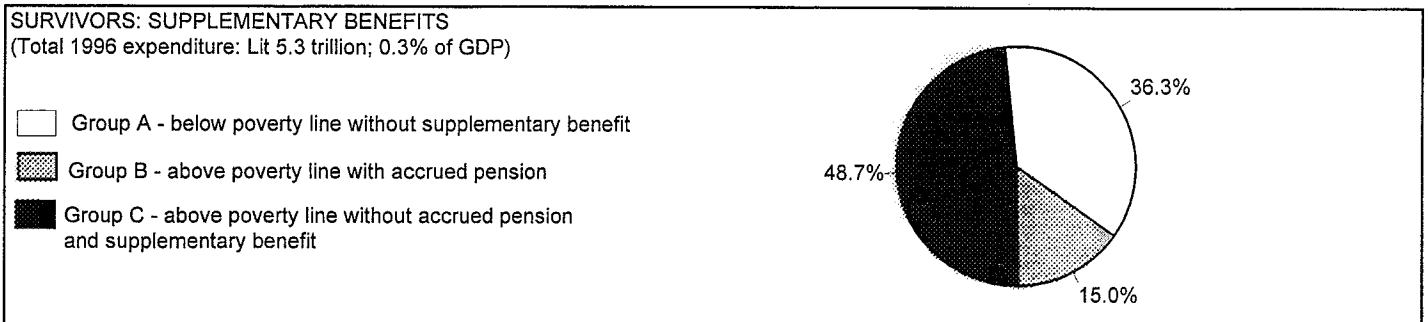
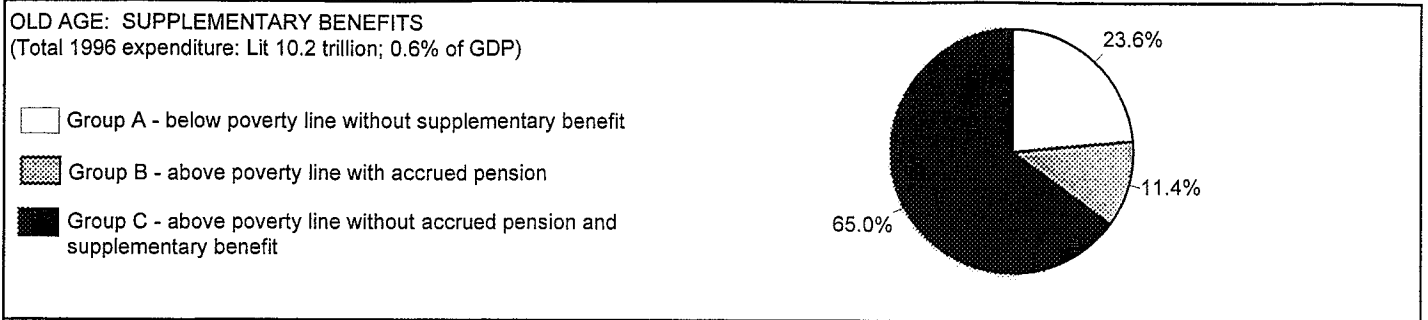
The instrument that directs the greatest amount of resources to people in no apparent need is that represented by the supplements to the minimum (*integrazioni al minimo*) for old age and

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<sup>27</sup>*Commissione di indagine sulla povertà e l'emarginazione* (1995a) provides a detailed account of the hypotheses behind the adoption of this particular poverty threshold. For an alternative view to this approach, see Cannari and Franco (1997).

<sup>28</sup>For a view on the debate on the advisable degree of coverage to be assured to different categories of citizens, according to their working history, see Franco and Morcaldo (1988).

Figure 1. Italy: Selected Welfare Benefits, 1996



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Source: Elaborations on survey data on households' incomes and wealth (Bank of Italy, 1997).



survivors' benefits, and the disability pensions (Figure 1, top three panels). Of a total 2.7 percent of GDP spent on these instruments, only 1½ percent of GDP accrues to people unequivocally in need—inclusive of individuals who are not disabled but would be below the poverty line without the additional supplement to their INPS disability pension. Indeed, as regards the latter, only slightly more than 55 percent of the transfers reaches self-declared “disabled” individuals (Figure 1, central panel, Group D); the remainder accrues to acknowledged “nondisabled.”<sup>29</sup> A large proportion (some 57 percent) of social pensions accrues to people already above the official poverty line, but the amount of outlays involved is relatively small (Figure 1, penultimate panel). Finally, civil disability allowances show a better-balanced composition, and the amounts accruing to people in no evident need is also comparatively small (Figure 1, bottom panel).

Another dimension along which the expenditure programs should be evaluated in order to determine whether they are truly justified on welfare grounds is that of the age composition of the recipients. Figure 2 divides spending on supplements to old age pensions, and INPS and civil disability transfers to the “nondisabled,” according to the age of the recipients in the different groups.<sup>30</sup> The figure illustrates that almost 6 percent of the “most deserving” (Group A) of the elderly in receipt of supplements to their old age pensions (and around 11 percent and 37 percent of, respectively, INPS and civil disability transfer recipients) are actually below the standard retirement age (62 for men and 57 for women in 1995, the year of the survey). Thus, part of the expenditures that, on purely income considerations, were judged above as meeting a genuine welfare target, probably does not stand a broader test of efficiency. Clearly, at least part of these welfare payments has been originated by the claimant's decision to advance retirement—raising the question as to whether, in so doing, beneficiaries might not have partly contributed to their status.

A final point of interest concerns the geographical distribution of welfare outlays. The general picture that emerges (Figure 3) appears reasonable: the bulk of payments under the programs reviewed (with the notable exception of supplements to the minimum for old age pensions) are directed to the poorer regions in the Center-South of the country, mirroring the marked territorial concentration of poverty in Italy. Nonetheless, excluding payments made to the truly disabled, and thus concentrating on the share of spending whose distribution may be better assessed on purely economic grounds, only slightly more than 56 percent of the total

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<sup>29</sup>Notwithstanding assurances about the anonymity of the information provided, evidence on low response rates and systematic underreporting of income sources (see Brandolini, 1993; and Cannari and D'Alessio, 1990) would suggest that the relative incidence of the “nondisabled” may be underestimated by a fairly high number of false returns.

<sup>30</sup>A breakdown by age for recipients of survivors' pensions (widowed and orphans) and for the genuinely disabled is, of course, not relevant.

Figure 2. Italy: Age Composition of Selected Welfare Benefits, 1996

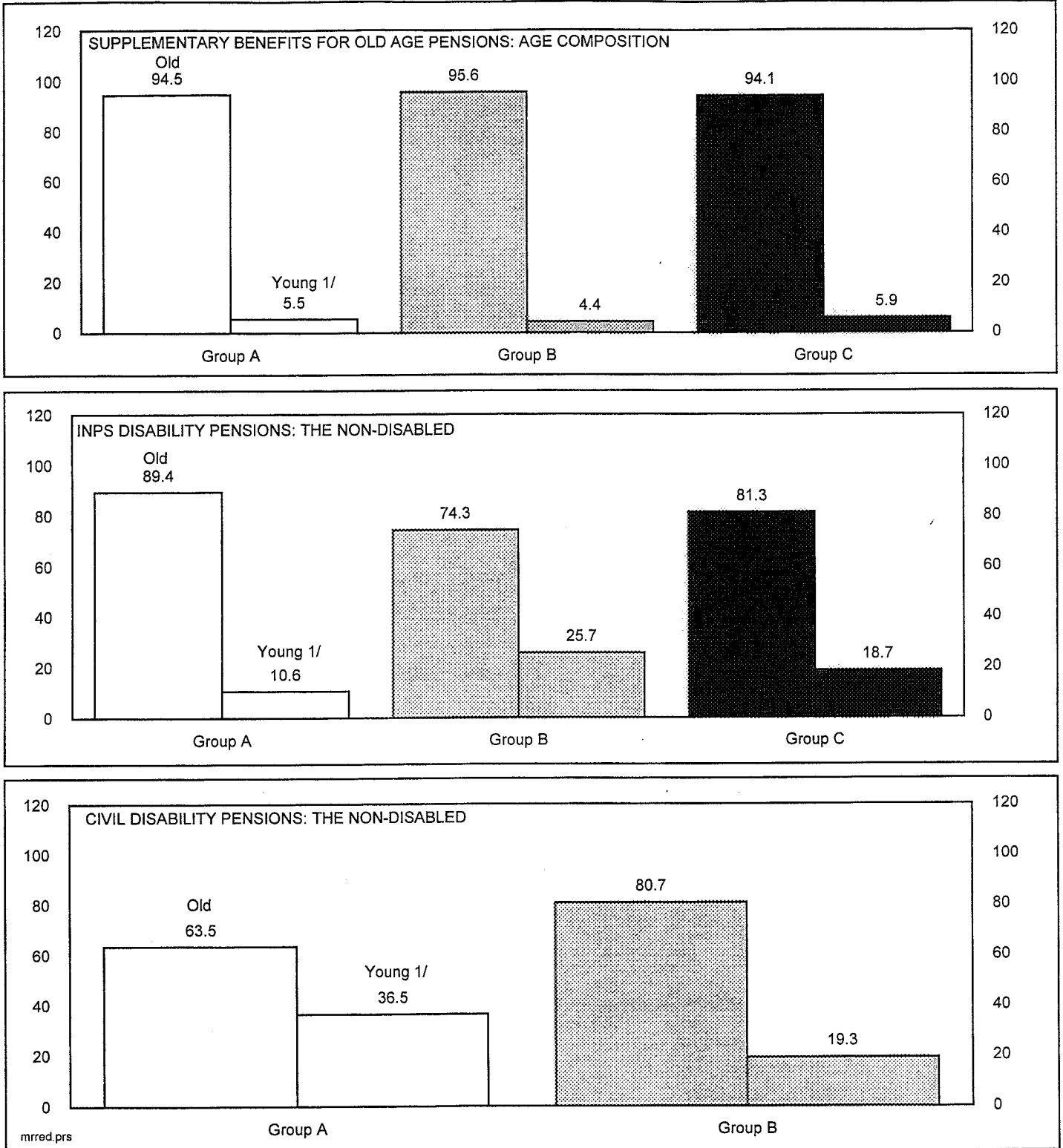
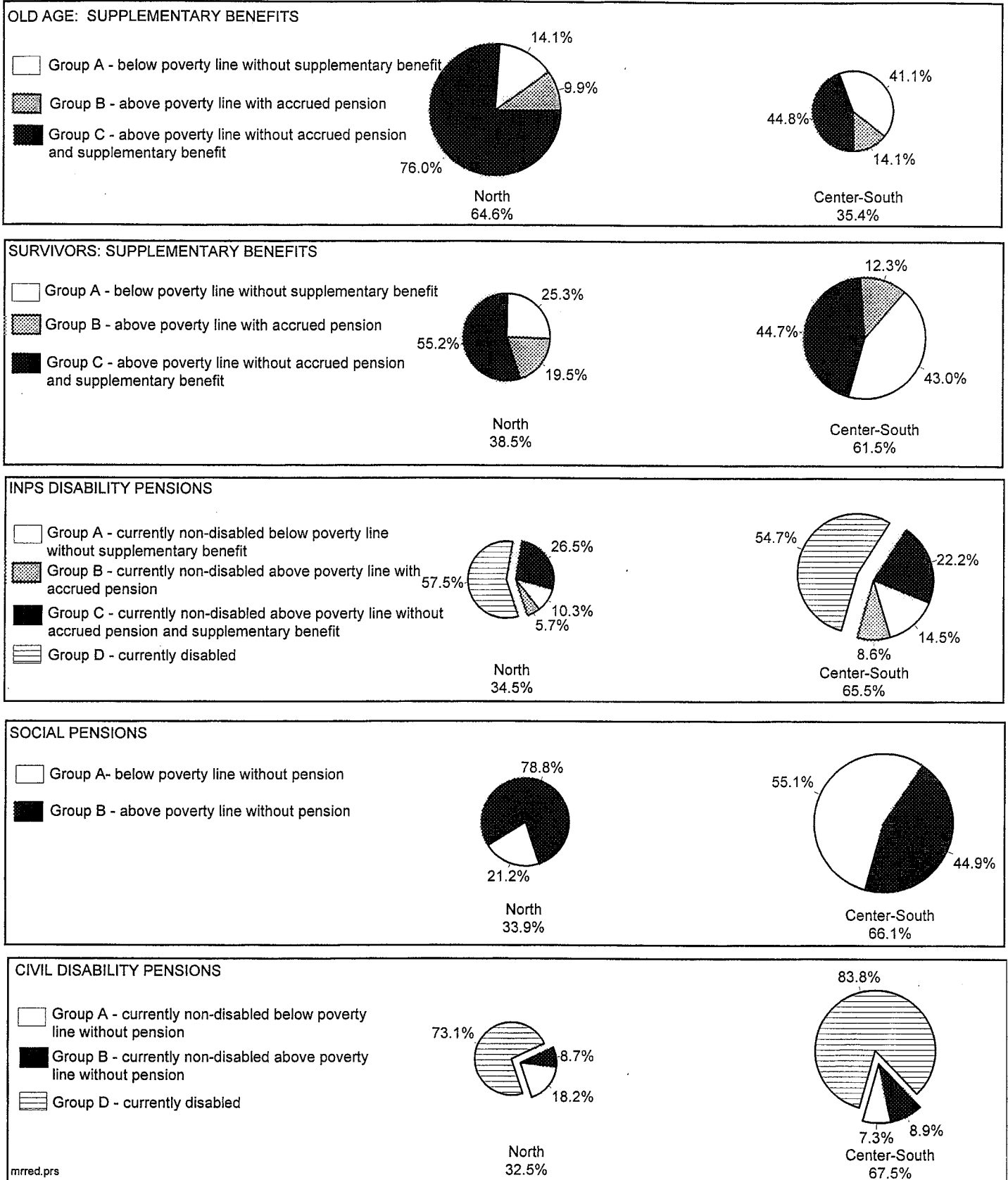


Figure 3. Italy: Geographical Distribution of Selected Welfare Benefits, 1996.



Source: Elaborations on survey data on households' incomes and wealth (Bank of Italy, 1997).

resources spent on the benefits reviewed accrues to the part of Italy where almost 80 percent of poor families are concentrated.<sup>31</sup>

### Measuring the safety net's efficiency and effectiveness

As recognized above, poverty alleviation might not have been the guiding policy objective when the programs examined were first designed: this is probably true for support schemes at the border between social insurance (*previdenza*) and assistance (*assistenza*), such as the supplements to the minimum for old age and survivors' pensions, and certainly true for disability pensions. However, given the scarcity of overall resources devoted to addressing conditions of economic disadvantage, and the absence of a national scheme to alleviate poverty, assessing the targeting effectiveness and spending efficiency of the existing incomes-tested instruments appears to be a relevant exercise. We shall assess the effectiveness of targeting from two different angles:

- **Vertical efficiency:** understood as the existing schemes' ability to minimize the amount of resources spilling over beyond the targeted population, to assist not *only* but at least *primarily* the needy.
- **Horizontal efficiency:** understood as the schemes' ability to provide assistance for *all* of the targeted poor.<sup>32</sup> An estimation of their combined impact on the distribution of "equivalent" income (i.e., as adjusted for differences in family size) among the covered population will complement the tests of effectiveness and efficiency.

The first three columns of Table 7 set out the scale of equivalent incomes before and after public support for each of the different groups of beneficiaries, classified according to the above-described degree of "need." Table 8 does the same for the genuinely disabled receiving disability pensions (denoted as group D). The last columns of both tables provide an "absolute" measure of public intervention by dividing the average benefit accruing to each individual group by the *individual* poverty line (some Lit 8.5 million in 1996). As could be expected, group A is the most "deserving," at least from a narrow economic point of view.<sup>33</sup> Cumulating outside sources of income (column 1) with accrued benefits—when these exist—own resources (column 2) fall short of the minimum acceptable standard of living by between a third (for receivers of old-age and disability payments) and a half (for recipients of survivors' and social pensions). The "final resources" (or ex post incomes) available to beneficiaries (column 3) show a picture of underprotection in sharp contrast to the extent of

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<sup>31</sup>See *Commissione di indagine sulla povertà e l'emarginazione* (1996).

<sup>32</sup>The distinction between vertical and horizontal efficiency was introduced by Weisbrod (1970).

<sup>33</sup>Recall that groups A, B, and C among those receiving INPS disability transfers are actually nondisabled.

Table 7. The Safety Net: Average Incomes as Percent of Poverty Thresholds 1/

	Outside Resources (1)	Own Resources (2)	Final Resources (3)	Public Intervention (4)
Old age-seniority supplements				
Group A	29.2	64.7	96.8	47.4
Group B	75.1	112.8	140.5	38.4
Group C	223.9	252.6	276.6	47.2
Survivors supplements				
Group A	17.2	53.2	93.1	52.8
Group B	80.1	118.3	161.1	54.6
Group C	200.0	235.5	265.5	52.6
INPS-disability pensions				
Group A	43.9	69.1	99.5	58.7
Group B	79.5	118.5	141.7	48.4
Group C	195.4	220.5	243.8	49.5
Group D	134.9	164.3	188.3	45.5
Social pensions				
Group A	54.9	54.9	101.1	64.2
Group B	214.1	214.1	243.7	54.1
Civil disability pensions 2/				
Group A	69.9	69.9	97.0	55.0
Group B	211.9	211.9	246.1	55.0
Group D	146.4	146.4	177.1	55.0

Source: Elaborations on survey data on households' incomes and wealth (Bank of Italy, 1997).

1/ Average income—from outside sources (column 1), from outside sources plus accrued pension (column 2), and after public support (column 3)—as percent of average poverty lines applying to each group. Column 4 gives the average benefit paid to each group as percent of the individual poverty line (around Lit 8.5 million, in 1996).

2/ Outside resources include long care allowances.

Table 8. Italy: The Safety Net for the Currently Disabled: Average Incomes as Percent of Poverty Thresholds 1/

	Outside Resources (1)	Own Resources (2)	Total Resources (3)	Public Intervention (4)
INPS - disability: Group D				
Disabled below poverty line without supplement	33.1	59.6	88.7	52.3
Disabled above poverty line with accrued pension	67.4	126.2	157.9	48.4
Disabled above poverty line without pension	220.0	236.1	252.3	40.9
Civil disability: Group D 2/				
Disabled below poverty line without pension	49.2	49.2	87.3	55.0
Disabled above poverty line without pension	210.7	210.7	236.5	55.0

Source: Elaborations on survey data on households' incomes and wealth (Bank of Italy, 1997).

1/ Average income—from outside sources (column 1), from outside sources plus accrued pension (column 2), and after public support (column 3)—as percent of average poverty lines applying to each group. Column 4 gives the average benefit paid to each group as percent of the individual poverty line (around Lit 8.5 million, in 1996).

2/ Outside resources include long care allowances.

overprotection. Average coverage for low-income families (Group A) is less than full in all cases except for social pensions and the nondisabled in receipt of an INPS disability allowance. Moreover, the system's capacity to provide effective coverage is lowest among people reporting some form of disability (Table 8, column 3). Other groups start from a better-off position before public transfers, to the point that Group C consistently enjoys an income more than twice the applicable poverty line *before* receiving the subsidy (column 2): one may wonder whether ex ante rates of coverage exceeding twice the minimum justify transfers the size of the ones shown in column 4. Such an extent of overprotection **fails the criterion of vertical efficiency**, and points to a serious misallocation of transfers.

An optimal system of public support should also aim, as an intermediate objective, at devising instruments with a fair degree of flexibility. In this respect, the instruments' capacity, on average, to calibrate money support according to the economic conditions of the recipient, granting more when the shortfall of own resources with respect to the poverty threshold is larger, should be the hallmark of the plan. Column 4 measures the extent of the "absolute" public contribution to family welfare corresponding to different ex ante conditions. Clearly, the system **fails the test of flexibility** in virtually all cases: either the range of the transfers made is insufficiently wide—the difference between the highest and the lowest figure within each group never exceeding 15 percent of the individual poverty line; or it is completely unrelated to the demand of protection expressed by the different groups. A striking example of perverse graduation of support is represented by the supplements to the minimum for old-age and survivors' pensions, where the scale of transfers, proceeding from low income to better-off families, is flat or even inverted.

Table 9 (column 1) assesses the degree of horizontal efficiency by referring to the number of families left below the relevant poverty threshold after receiving public support, as a percent of the total populations covered. Column 2 evaluates the extent of the ex post shortfall vis-à-vis the minimum among the most needy (the so-called poverty gap).<sup>34</sup> All indices, except for the one corresponding to old-age and seniority pensioners, are far above the poverty ratio calculated by the Commission on poverty and social exclusion for the entire population of Italian households (around 11 percent, in 1994).<sup>35</sup> The incidence of poverty is widespread among recipients of survivors' pensions and the truly disabled with civil disability allowances, who also exhibit the highest intensity of poverty as measured by the poverty gap. The failure to reduce the diffusion of poverty among targeted households goes hand-in-hand with **sizeable spill-over effects**, as shown by the high incidence of recipients who, after cumulating the transfer with their own resources, are brought beyond 2½ times the rate of full coverage (Table 9, column 3). Even excluding people reporting some form of disability and receiving related payments from INPS (where reference to the poverty line may not be warranted given

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<sup>34</sup>Note that a measure of the average poverty gaps for the entire population targeted by the different schemes is provided by the complements to 100 (if positive) of the figures reported in Tables 7 and 8.

<sup>35</sup>See *Commissione di indagine sulla povertà e l'emarginazione* (1996).

Table 9. Italy: The Effectiveness of the Safety Net—The Current System

	Poverty Ratio 1/	Poverty Gap 2/	Over Protection 3/	Non-Compliance 4/
Old-age seniority supplements	9.1	32.7	84.5	5.6
Survivors supplements	25.0	17.4	39.5	4.9
INPS-disability pensions				
Currently disabled (Group D)	20.6	25.5	73.8	8.5
Currently nondisabled (A+B+C)	15.0	19.2	32.1	9.9
Social pensions	20.7	16.6	30.8	13.1
Civil disability				
Currently disabled (Group D)	26.8	32.9	35.1	0.0
Currently nondisabled (A+B)	15.8	7.7	49.8	0.0

Source: Elaborations on survey data on households' incomes and wealth (Bank of Italy, 1997).

1/ Number of recipients living in households with income after subsidy below corresponding poverty threshold (as percent of covered households).

2/ Average gap between poverty threshold and income after subsidy expressed as percent of corresponding average poverty threshold.

3/ Number of recipients living in households with income after subsidy above 2.5 times the corresponding average poverty threshold (as percent of covered households).

4/ Number of recipients under reporting sources of taxable income (as percent of covered households).



the insurance component of their benefit), there clearly appears to be scope for redistribution among beneficiaries of each program and across different programs. For example, one would wish to shift resources from supporting direct old-age benefits to other programs that fail to bring beneficiaries above their relevant poverty line.

### **The distribution of income**

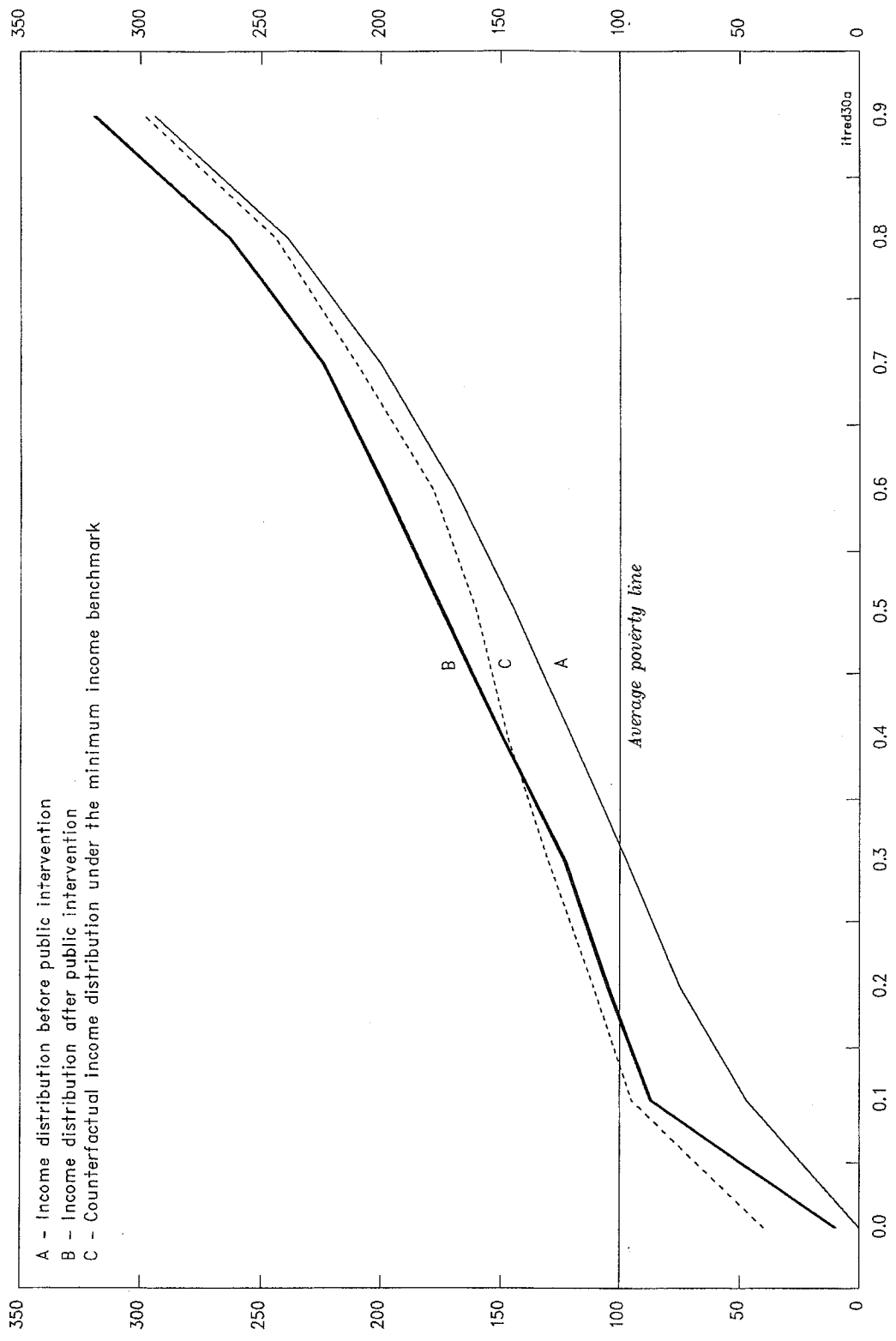
Target efficiency also has an important macro dimension. Besides striving to meet the objectives of vertical and horizontal efficiency—and the intermediate objective of flexibility in the amounts paid—the policymaker also needs to be concerned about the distribution of income *before* and *after* public intervention. In principle, the pursuit of vertical and horizontal efficiency should in itself bring a considerable reduction of income disparities across the targeted population. Figure 4 provides a visual representation of the degree of vertical and horizontal efficiency attained by the existing regime, as well as some insight on the income disparities which it addresses and those which it neglects. In the figure, households covered by the schemes under review have been aggregated and ordered by the levels of income as percent of their average poverty thresholds. The curves connect the equivalent incomes accruing to the richest family of each decile: for example, line A, depicting income distribution of the currently targeted population *before receipt of the public transfer*,<sup>36</sup> indicates that the family with the highest before-transfer income in the first decile has a level of own-income coverage of some 47 percent of its poverty level. Line B corresponds to the new distribution *after receipt of the public transfer*. Following line B, one derives that the system of the combined existing programs of welfare protection raises the coverage of the first decile to some 87 percent.

In assessing, first, the target efficiency of the current regime, two areas of the chart are of relevance. The areas comprised between curves A and B and the horizontal line of full coverage (100 percent), to the left of the points where the curves intersect the latter line, measure the aggregate poverty gaps corresponding, respectively, to the absence of protection (the area above curve A), and to the current system (the area above curve B). On the other hand, the area comprised between the two curves to the right of the point in which line A crosses the horizontal line measures the aggregate amount of overprotection provided by the current system. Table 10 expresses the areas in lire terms: by measuring the “integrals” of the areas below the 100-percent line, it indicates that the current system reduces the aggregate poverty gap of the combined targeted populations from Lit 17.3 trillion, as measured before public intervention, to Lit 7.4 trillion, with an “effective adjustment” of Lit 9.9 trillion (column 2). The effective adjustments in poverty gaps (in column 2) are then compared to the

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<sup>36</sup>Defined by the amount of own resources, that is, the sum of external sources of income and accrued pension rights.

Figure 4. Italy: Measuring Target Efficiency: the Current Regime and the Minimum Income Benchmark System. 1/  
(Percentiles of distributions as percent of average poverty lines)



A - Income distribution before public intervention  
B - Income distribution after public intervention  
C - Counterfactual income distribution under the minimum income benchmark

Source: Elaborations on survey data on households' incomes and wealth (Bank of Italy, 1997).

1/ See text for methodological explanation and interpretation of curves.

Table 10. Italy: The Effectiveness of the Safety Net—The Macro Perspective

(In trillions of lire)

	Estimated Poverty 1/ (1)	Effective Adjustment 2/ (2)	Spent Resources 3/ (3)	Effective- ness Rate 4/ (4) (In percent)	Over- Protection 5/ (5) (In percent)
Before subsidies 6/ Excluding INPS currently disabled	17.3 14.2	0.0	0.0	0.0	0.0
Current system 7/ Excluding INPS currently disabled 8/	7.4 6.0	9.9 8.2	42.2 42.3	23.5 19.4	76.5 80.6
Minimum income benchmark system 7/ Excluding INPS currently disabled 8/	5.6 4.6	11.7 9.6	34.5 32.8	33.9 29.3	66.1 70.7

Source: Elaborations on survey data on households' incomes and wealth (Bank of Italy, 1997).

1/ Total poverty gap of households covered by the current system.

2/ Difference between before-subsidy and after-subsidy poverty gap.

3/ Total amounts spent in 1996 for old-age/seniority and survivors supplements to the minimum pension; INPS disability allowances, civil disability pensions and social pensions.

4/ Effective adjustment as percent of resources spent: (2)/(3).

5/ One minus (4).

6/ Includes income from outside sources plus accrued pensions.

7/ Figure on spent resources excludes accrued disability pensions paid by INPS.

8/ Figure on spent resources includes accrued disability pensions paid by INPS to nondisabled.

amount of resources committed (column 3).<sup>37</sup> The reduction in poverty gaps achieved is less than one-quarter the amount of money spent: in other words, for each lira spent on these welfare programs, less than 24 cents can be said to be used to alleviate poverty (the “effectiveness rate” shown in column 4), the rest being paid to supplement incomes that are already above the full protection line (the “overprotection” shown in column 5). The relative steepness of the two curves is relevant to an assessment of ex ante and ex post distribution.<sup>38</sup> If assessed against this benchmark, the current regime, while substantially reducing the ratio between the ninth and the first decile (from 6.3 to 3.7), does not help to flatten the ex post situation as shown by curve B. Indeed, from the first decile onward, the two lines are virtually parallel. By way of comparison, it may be noted that the average decile ratio, calculated for the *entire* population of a number of European countries does not exceed 3.3.<sup>39</sup> By the same token, making reference to the Lorenz curves (representing cumulative decile shares of total income) attached to the ex ante and ex post situations in Figure 5, one would expect to observe a clear shift toward the diagonal.

### **The cost of an ill-designed targeting system**

What lies behind the existing system’s failure to achieve a number of objectives that should figure prominently in any welfare policy agenda? While fraud in the guise of underreporting of taxable incomes (and, for disability pensions, of unfounded disability claims) is certainly not negligible (see Table 9, column 4), the problem lies primarily in the system’s **ill-designed rules and eligibility criteria**. None of the existing schemes defines a uniform minimum amount of resources deemed to be needed by an individual (aged and/or sick) in order to lead a less deprived life. Consequently, no program is endowed with a mechanism to calibrate the

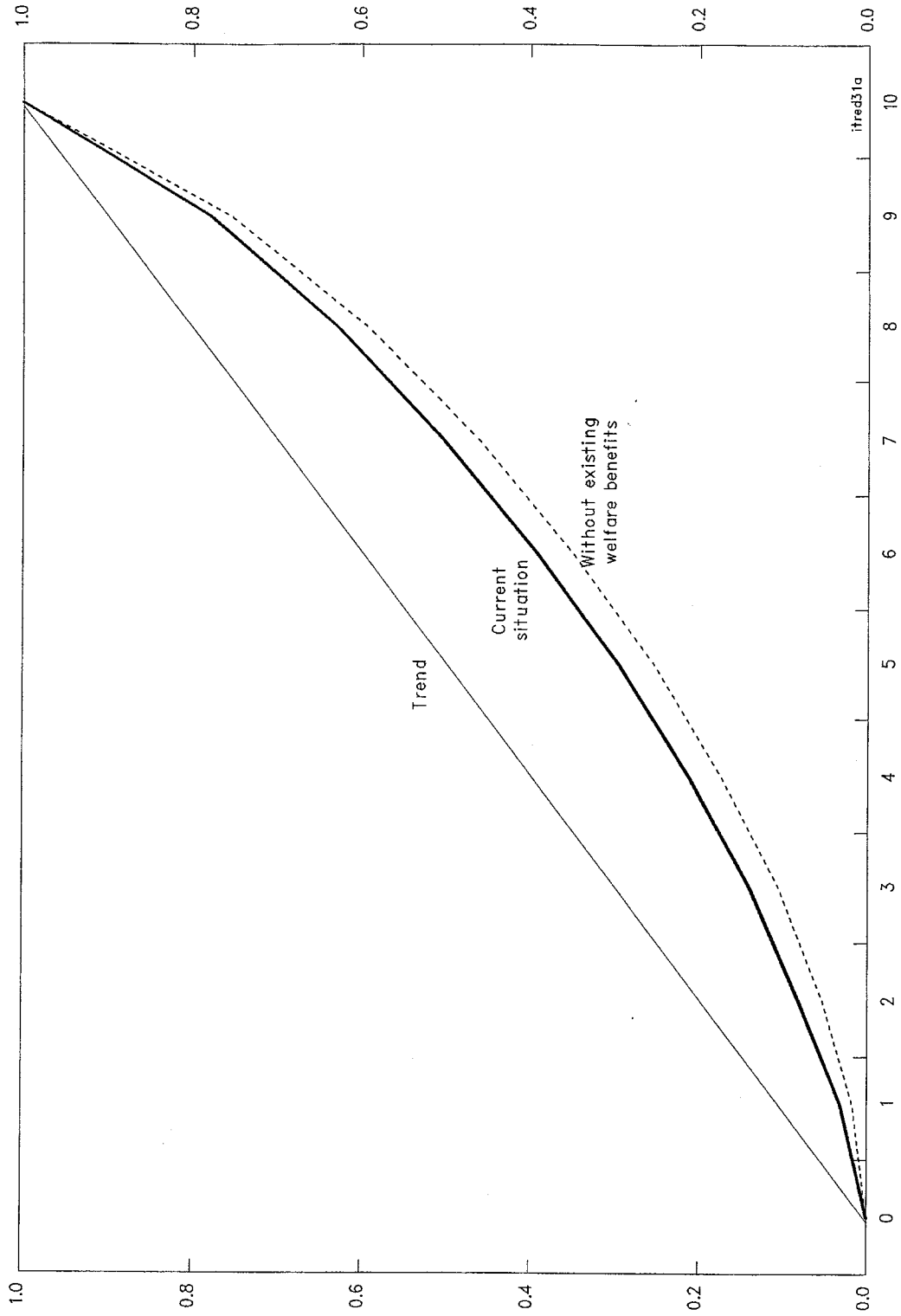
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<sup>37</sup>The table has two levels of aggregation. First, a broader one that concentrates on the totality of expenditure made to subsidize recipients’ own resources (supplements to the minimum paid to old age, survivors and INPS disabled retirees, social pensions and civil disability allowances). Second, a narrower one that excludes the entire transfers (both the accrued pension and the subsidy to the minimum) made to INPS “disabled,” thus eliminating the insurance element present in the latter’s benefits, in order to concentrate on the share of outlays with a pure welfare support function. The results do not change appreciably, and the text reports on the first level of aggregation only.

<sup>38</sup>An ideal scheme should be designed in a way to twist curve B, for a given curve A, to completely fill the gap beneath the horizontal poverty line, and to reduce the distance between the two curves above this line. A situation in which curve B were uniformly flatter than curve A, would indicate that the preexisting degree of income dispersion across the targeted families (as measured, for example, by the ratio of the highest to the lowest decile) had been reduced by public intervention.

<sup>39</sup>As reported in Atkinson (1995). Note that the decile ratio calculated on the entire population should be systematically higher than the one estimated on the portion of the population targeted by public welfare support mechanisms.

Figure 5. Italy: Distribution of Equivalent Income Among Covered Households: Cumulative Decile Shares. 1/



Source: Elaborations on survey data on households' incomes and wealth (Bank of Italy, 1997).

1/ See text for methodological explanation and interpretation of curves.

size of the transfer to the amount needed to fill the gap between the recipient's own resources (however assessed) and such a minimum (however defined). In addition, the claimant's wealth does not enter as an element in ascertaining eligibility conditions. While, as noted by Atkinson (1995), administrative constraints need to be kept in mind when advocating a refinement of targeting systems (and particularly their extension to include wealth parameters), there would appear to remain considerable scope for improvement of the Italian system—even within the confines allowed by the current state of public administration.

To measure the cost of the ill-designed targeting system, we constructed an institutional benchmark featuring a *rudimentary* version of a minimum income guarantee scheme for the aged and the disabled. This **counterfactual system** was purposely kept at an elementary level, to provide a viable alternative to the existing fragmented regime, given the constraints posed by a still scantily efficient assessment and enforcement system. In particular, the devised benchmark would (i) rely on information already available to the paying agencies and on their capacity to process this data, and thus does not assume an improved administrative apparatus; (ii) entail a *minimum standard of living guarantee* as a benchmark to identify target recipients and calibrate the amount of support; (iii) adjust declared resources for an easily observable proxy of families' wealth, while remaining centered on reported taxable incomes; and (iv) not pay any subsidy to accrued benefits before standard retirement age, except for disability allowances and survivors' pensions. The award formula for a single person would be the following:

$$\text{SUBSIDY} = \text{Max}\{0; \text{MY} - \text{Max}[0; \text{AOR}]\} \quad (1)$$

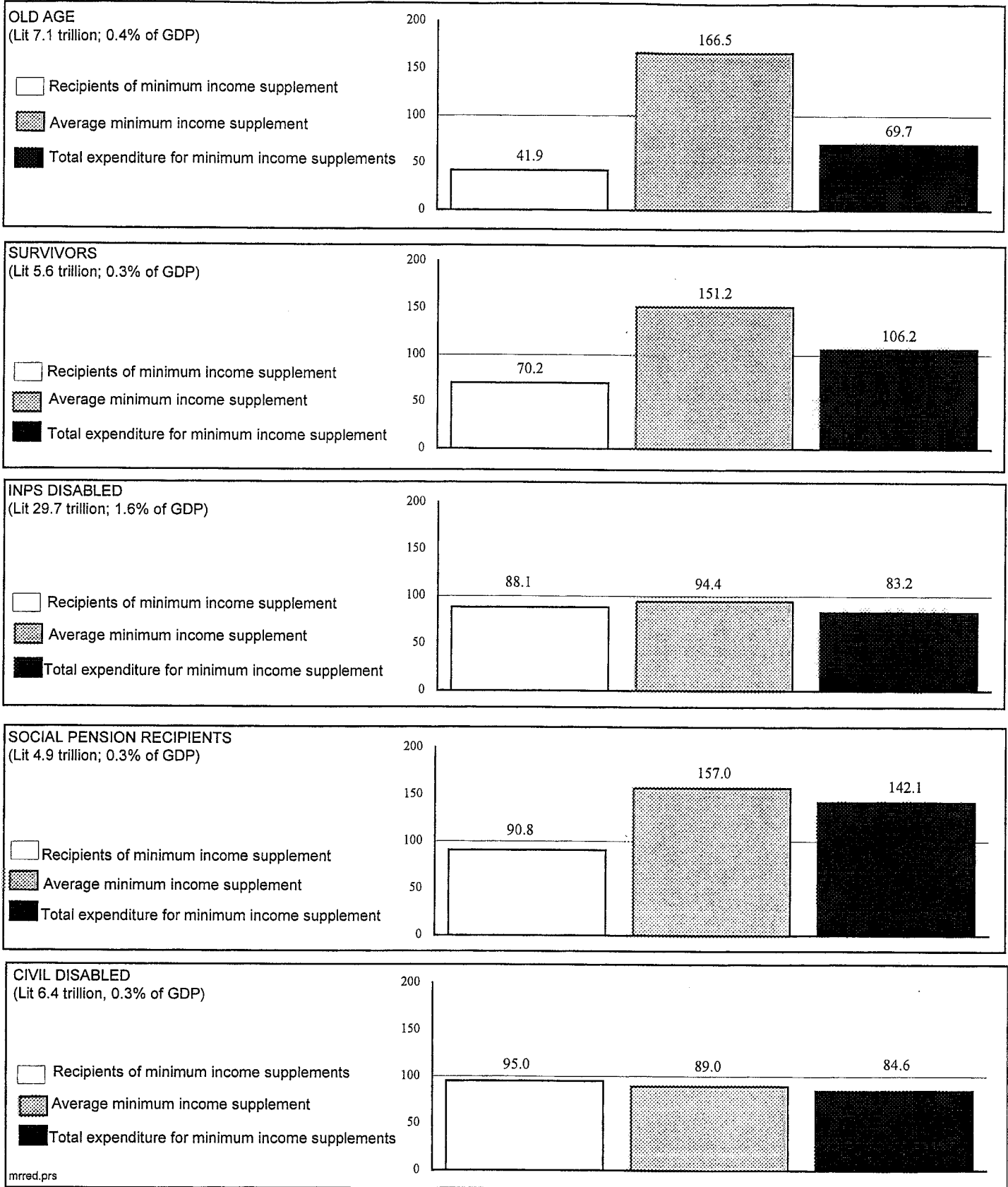
with MY being the minimum guaranteed income on a twelve-month basis, and AOR the "adjusted own resources." These are set equal to the net accrued pension (NAP), where one exists, plus the imputed rents to owner-occupied property (IR) exceeding an ad hoc allowance (AL), plus any other sources of net taxable income reported for personal income tax purposes:

$$\text{AOR} = \text{NAP} + (\text{IR} - \text{AL}) + \text{OTY} \quad (2)$$

In other terms, in topping applicants' own resources up to the defined minimum, the system would (i) include imputed rents (currently excluded) to the definition of own resources, given the high correlation between this easily assessed parameter and families' total wealth (notably, in the form of self-occupied property); and (ii) shoulder part of the claimants' imputed cost of housing through an ad hoc allowance, to improve on the current discriminatory treatment of those claimants who do not own their home.

The award formula described above was calculated on the basis of a minimum income (MY) set equal to the 1996 individual poverty line (around Lit 8.5 million per annum) and an allowance (AL) equal to the average of reported imputed rents in the sample (around Lit 5 million). This counterfactual system was subsequently tested for horizontal and vertical efficiency, as well as on distributional grounds. The results are summarized in Figures 4, 6,

Figure 6. Italy: Minimum Income Benchmark: Populations Covered, Average Individual Payments and Total Spending (As percent of current levels)



Source: Elaborations on survey data on households' incomes and wealth (Bank of Italy, 1997).

and 7; and in Tables 10 and 11.<sup>40</sup> The proposed benchmark system, while operated on the basis of the same administrative structure and with the same information processed by the schemes currently in place, would clearly improve upon the existing situation. The enforcement of a single, uniform measure of minimum income, coupled with a straightforward top-up mechanism of income subsidization, results in (i) a reduction in the number of beneficiaries (drastically so, among recipients of old age supplements; left-hand bars of Figure 6); (ii) an increase in the average transfer paid (except for people currently receiving a civil disability allowance and, to a lesser extent, INPS disability pensions; central bars); and (iii) a reduction in expenditure (except for supplements to survivors' pensions, and social pensions), for an overall amount close to ½ percentage point of GDP (right-hand bars). While, due to the rudimentary nature of the proposed scheme (that does not take into account all forms of income and a full assessment of wealth), benefits would still accrue to families belonging to Group C (defined above as those in no evident need), the amount of resources flowing to this group would be considerably smaller (only slightly more than one-fifth of total spending, rather than one-third under the existing system—Figure 7). The share accruing to the group with an intermediate degree of need (Group B) would also be lower, except among old age pensioners.

The reduction in the number of beneficiaries, and the attendant decline in the amount of resources provided, could in principle be assumed to result in a worsening of the overall indices of diffusion and intensity of poverty among the currently covered population. This is, however, not generally the case. As may be seen by a comparison of Table 9 (the current system) with Table 11 (the counterfactual minimum income benchmark), poverty ratios under the latter are almost invariably lower than corresponding current levels.<sup>41</sup> Aggregate indices of both vertical and horizontal efficiency also improve under the counterfactual scheme (see Table 10, bottom rows). Finally, the ex post distribution of incomes would also clearly improve under the counterfactual scheme. The degree of dispersion among the target population (represented by curve C in Figure 4) would be reduced, as evidenced by the flatter shape of curve C relative to curve B (the current system), notably along the right-hand portion of the chart.

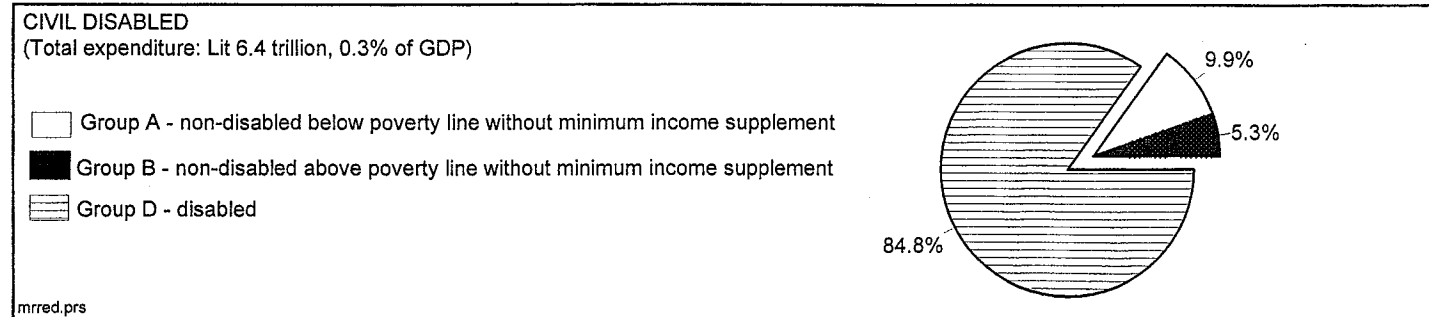
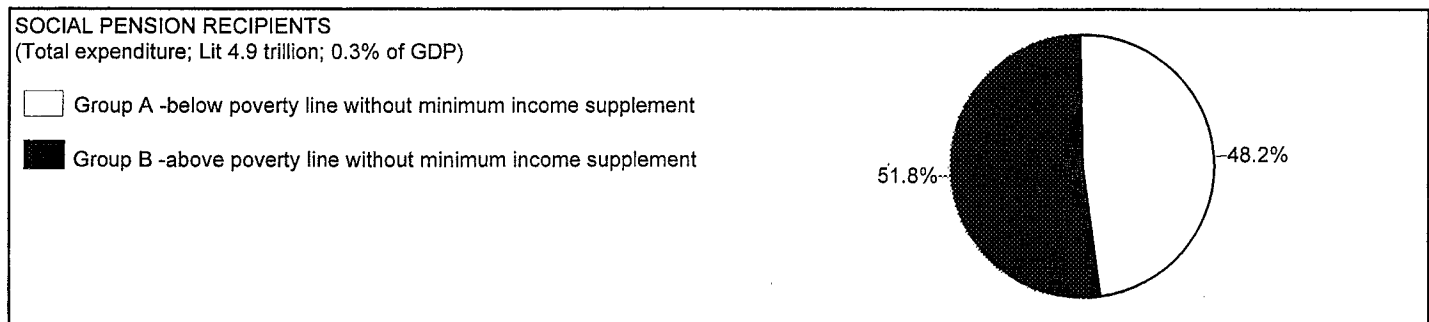
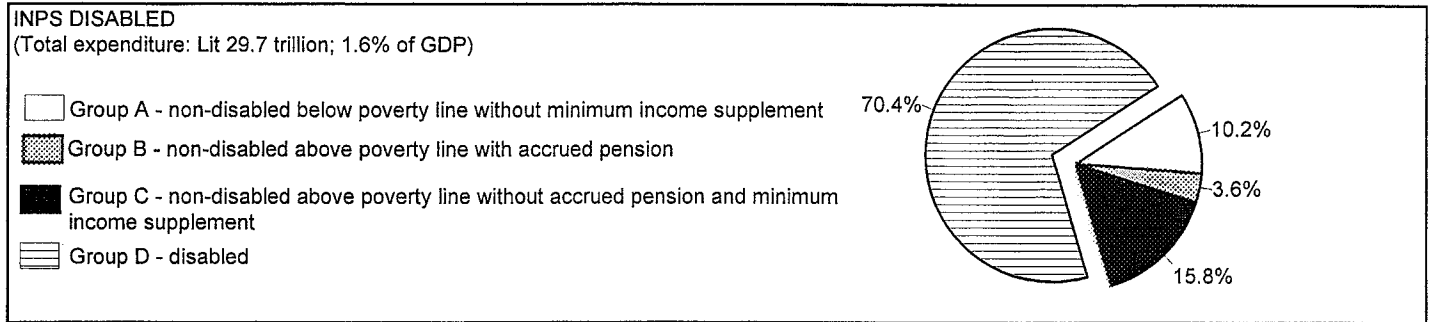
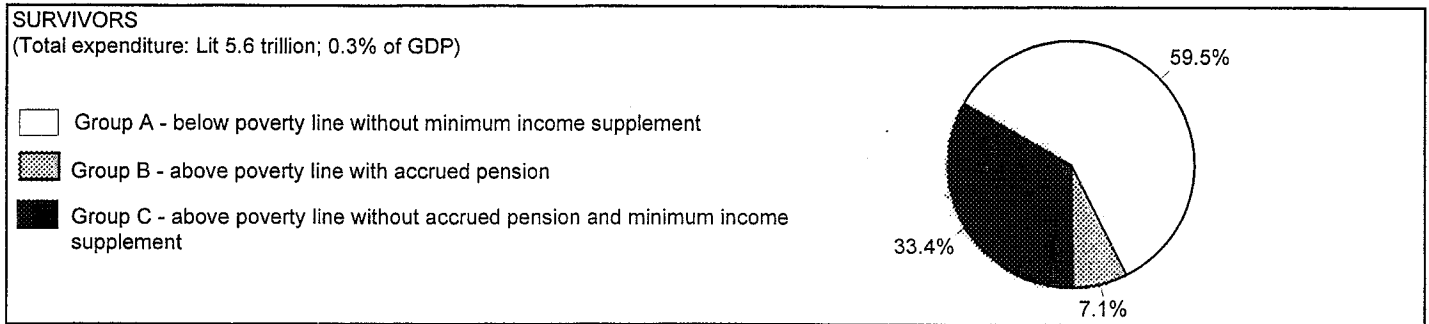
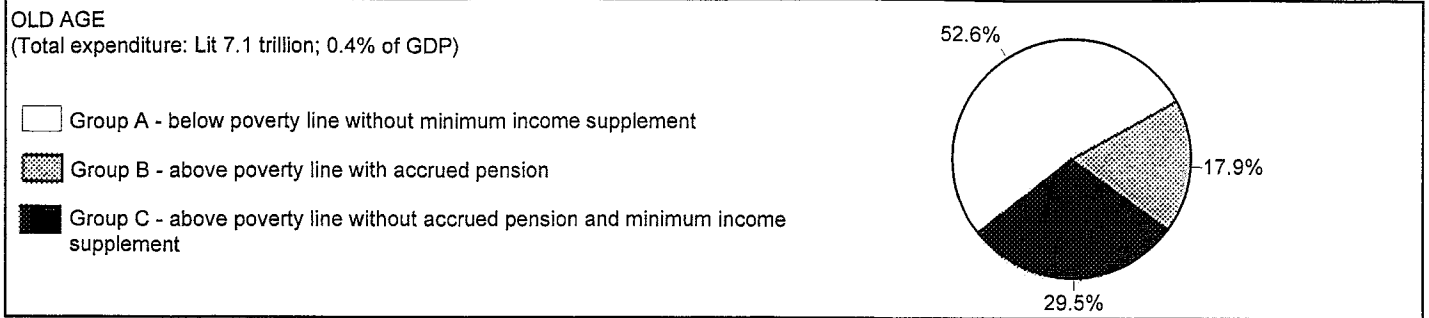
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<sup>40</sup>Figure 6 gives the number of families covered, the average transfers made, and total resources committed, as percent of the current corresponding levels, were the counterfactual system to replace the current one fully and instantaneously. Figure 7 illustrates the distribution of outlays among different income groups.

<sup>41</sup>A notable exception regards Groups A and B among recipients of disability allowances: in this case, however, the worsening of the poverty indicators is entirely due to the exercise's (rather pessimistic) assumption that young "nondisabled" recipients of a disability transfer, once deprived of their pensions, would not find a job to make up for the shortfall in their family income.



Figure 7. Italy: Minimum Income Benchmark: Composition of Outlays, 1996.



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Source: Elaborations on survey data on households' incomes and wealth (Bank of Italy, 1997).

Table 11. Italy: The Effectiveness of the Safety Net—The Minimum Income Benchmark

	Poverty Ratio 1/	Poverty Gap 2/	Over Protection 3/
Old-age and seniority	8.9	22.7	10.0
Survivors	15.2	19.9	29.4
INPS-disability			
Currently disabled (Group D)	6.7	26.8	19.3
Currently nondisabled (A+B+C)	26.1	20.7	13.1
Social pensioners	5.6	20.1	15.9
Civil disability			
Currently disabled (Group D)	24.5	13.5	37.5
Currently nondisabled (A+B)	16.8	9.0	37.4

Source: Elaborations on survey data on households' incomes and wealth (Bank of Italy, 1997).

1/ Number of recipients living in households with income after subsidy below corresponding poverty threshold (as percent of covered households).

2/ Average gap between poverty threshold and income after subsidy expressed as percent of corresponding average poverty threshold.

3/ Number of recipients living in households with income after subsidy above 2.5 times the corresponding average poverty threshold (as percent of covered households).

4/ Number of recipients under reporting sources of taxable income (as percent of covered households).

## V. REFORM PROPOSALS AND PROSPECTS

Awareness of the shortcomings affecting Italy's welfare state has, in recent years, come increasingly to the forefront—first among independent observers and subsequently also among policymakers. This growing recognition led the government to appoint a special commission, known as the Onofri Commission, to investigate social expenditure; the Commission presented its final report, with a number of reform recommendations, in February 1997.

The Onofri Commission's report identified the need to shift expenditure away from the pension system and toward (i) more active labor market policies available for all categories of workers (outside the traditional borders of protection); and (ii) targeted forms of support to cover income risk, designed to build an equitable and effective safety net for the economically excluded. In designing the reform, the Commission stressed the importance of avoiding forms of moral hazard, work disincentives, and welfare dependency. The Commission was also attentive to the macroeconomic constraints on expenditure, and formulated its suggestions within the twin constraints posed by the goal of early EMU participation, and by the recognition that the level of taxation and social security contributions is already excessively high. The Commission's criticisms and its call for action are largely in line with the main findings of this chapter. Its recommendations, while being couched in rather general and cautious terms, would in several respects constitute a first step toward a better system of protection. The recent (November 1997) agreement on pensions incorporated a few of the suggested changes in this area, but fell short of the bolder steps proposed. With the focus of the negotiations in 1997 remaining on pensions, a full policy response to the proposals regarding the welfare system more broadly remains to be formulated.

On the **pension** side, the November 1997 agreement (subsequently incorporated in the 1998 budget) went some way in the direction suggested by the Commission, in terms of a gradual alignment of the contribution rate of the self-employed with the notional rate used to calculate their benefits, a more rapid increase in the minimum retirement age for seniority pensions, and the harmonization of various privileged regimes (notably in the public sector) with that of the private sector. However, the exclusion of blue-collar workers substantially circumscribed the significance of the changes affecting seniority pensions. Nor did the agreement incorporate the Commission's recommended extension of the new contribution-based regime to those categories of workers that had been grandfathered by the 1995 reform, or its call for more timely corrections, based on automatic rather than discretionary criteria, of the demography-related parameters used to calculate a retiree's first-year pension. The limited pension savings officially projected to result from the November 1997 agreement (amounting to 0.3 percent of GDP by 2007) fall short of the Commission's call for a decisive move toward a more balanced pattern of social expenditure as a precondition to welfare reform. The generosity of the system (particularly in terms of the institution of seniority pensions and the high accrual factor), which was identified as a major cause of the contributory system's chronic imbalance (see para. 120 above), remains largely untouched. In this setting, Italy's pension system cannot be expected to free resources in favor of a better-balanced social assistance apparatus in the

coming years—that is, even before the deteriorating demographics become an immediate constraint.

Turning to other benefits, the Commission characterized the current **unemployment protection regime** as a “disorganized and virtually ungovernable system of successively overlapping instruments,” and recommended its drastic simplification. It proposed substituting the existing schemes with a new two-tier regime centered on (i) an insurance-based program of short-term income maintenance to tackle cases of cyclical redundancies and suspensions of activity, financed through a new version of the current Ordinary Wage Supplementation Fund (*Cassa Integrazione Guadagni*), so as to avoid termination of the work contract and the ensuing loss of firm-specific human capital in situations viewed as temporary; and (ii) a uniform two-year scheme for all eligible unemployed, to replace the wide array of discriminatory programs that currently graduate protection according to sectoral and occupational groupings. Although it envisaged a gradual increase in replacement rates, the Commission also recommended that coverage decline with duration and be made conditional on the beneficiary’s efforts in terms of retraining and job search intensity. Finally, it recommended a broadening of the training content of apprenticeship and trainee contracts, the abolition of the public monopoly of job placement, and a decentralization of job matching services. Only the latter two proposals have to date received official follow-up.

It is in the area of **welfare expenditure** that the Commission made its more innovative proposals. The long-standing need to draw a clear separation between social insurance (*previdenza*), to be financed from contributions, and social assistance (*assistenza*), properly funded from general taxation, led the Commission to call for a redenomination of some expenditure items judged to be improperly considered as part of the contributory system and contributing to its deficit. This change, in the Commission’s view, should primarily relabel the supplements paid to low-value pensions (*integrazioni al minimo*) as part of welfare rather than pension expenditure. The analysis presented in Chapter IV, however, fails to provide support for such a conclusion. On the basis of the empirical evidence provided, an instrument that, in some cases, directs more than 80 percent of the resources spent to subsidize families with levels of income already more than twice above their relevant poverty threshold cannot properly be classified as a form of social assistance. But the picture emerging from Chapter IV is also more generally disheartening. The consolidated system of targeted instruments fails the tests of effectiveness in identifying the situations of greater need, and those of efficiency in doing so at the lowest cost. Owing to the absence of a built-in mechanism to adjust a recipient’s benefits in line with the shortfall between his own resources and some minimum income threshold, the available programs lack the flexibility to calibrate their support according to the different income situations of recipients, and are ultimately ineffective in reducing the incidence of poverty among the covered population.

The Onofri report advocated, inter alia, the introduction of a nationally mandated **minimum income scheme** to address the problems noted above. This paper estimates that a substitution of the present instruments targeted on the elderly and the disabled with a unified system of “top-up” transfers to subsidize incomes to the official poverty line would entail savings of the

order of 0.4–0.5 percent of GDP. This amount of resources, freed by eliminating evident cases of overprotection, would be sufficient to finance a new program of support for young adults in need along the lines suggested by the Commission. The new welfare system would thus be organized according to the following two-tier model:

- A unified subsidy for those unable to work (because of age or physical impairment), awarded to people above 65 years of age or disabled, meant to compensate *entirely* the shortfall between (extended) household resources and the official poverty threshold. Chapter IV provides an example of an award formula which could function as a provisional mechanism to allow access to the new scheme, pending a general overhaul of the system of means assessment.
- A residual safety net for the young actively seeking employment. To avoid dependency trap dynamics, this transfer should only *partially* fill the recipient's poverty gap and be contingent on the beneficiary's effort to (re)join employment. As proposed by the Commission, the new benefit targeted on adults in working age would also need to be complemented by a number of changes to the present tax system to avoid high marginal effective tax rates, and the related disincentive effects, as benefits are clawed back.

As this paper was being finalized, negotiations were underway among the government and the social partners on a newly designed means test—a required element of the above proposals. Although details remain sketchy, this test (dubbed *ISE—Indicatore Situazione Economica*) would include some currently excluded sources of income as well as selected wealth indicators. The intention would be to apply it to all instruments of a welfare nature, such as social and civil disability allowances, and supplements to low-value contributory pensions (both to old age, survivors' and disability benefit recipients), as well as for access to certain health services. Broader reform initiatives of the welfare system as a whole remain nonetheless to be defined.

## SAMPLE SELECTION AND IMPUTATION OF BENEFITS

In order to minimize the error of including in the selected sample observations which should be discarded, and of excluding answers that should instead be taken into account, a series of filters were applied in the process of sample selection. Once the subpopulation covered by the instruments under review was identified with a sufficient degree of confidence, the problem of estimating the accrued part of the benefits (as opposed to the possible supplement received) was tackled through an imputation procedure. This appendix describes the filters employed in assembling the samples and the imputation technique to estimate the composition of the transfers.

### Sample selection

The following procedure guided the choice of the observations to include in the five different samples:

- Old-age, seniority and survivors' pensions subject to supplementary benefits (*integrazioni al minimo*) were identified by selecting only people reporting pensions of a unit value comprised within a narrow range above and below the 1996 guaranteed minimum, to allow for rounding and errors in the division of the yearly amounts—paid on a 13-month basis—by twelve.<sup>42</sup> The guaranteed minimum setting the central value of the range has been made conditional on the age of the interviewees, as all pensioners meeting eligibility criteria for the minimum supplements above certain age limits (60 and 65) are entitled to additional supplements conditional on more restrictive income tests.<sup>43</sup>
- INPS contributory disability pensions were identified by discarding recipients below 20 years of age, on the assumptions that a minimum vesting period of five years would rule out the event of an INPS allowance being paid to younger people. The excluded observations were automatically included among the cases of “civil disability” allowances.
- The social pension subsample was constructed by first applying a unit-value test to the reported pension, with the same tolerance interval as for old-age supplements, and by then

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<sup>42</sup>This screening procedure does not allow to identify pensions receiving prorated supplements. Resort to the latter is made when the full payments of the subsidy would cause the cumulated own-plus-pension income to exceed the family income limit. However, since the incidence of such prorated supplements over the total is lower than 10 percent, the error involved in disregarding them is accordingly of limited substance. See Box 1 for the eligibility rules governing supplements to old-age, seniority, and survivors' pensions.

<sup>43</sup>For people above 65 this further allowance amounts to Lit 1.6 million per annum.

excluding people below 65.<sup>44</sup> This reduced the number of observations considered as genuine “social pensions” to almost half the original uninformed selection. Coupled with the more general problem of underrepresentation of very poor people within the sample as a whole, the limited number of observations of “social pensions” may have significantly biased our findings in this area, and should accordingly be borne in mind when interpreting results. Among the discarded observations, the ones passing the unit-value test applied to the old-age and survivors’ benefits (described above) were automatically included in the subsample of reference for the analysis of supplements to contributory pensions.

The raw observations surviving the described subsample selection mechanisms were then grossed-up through a two-stage procedure: first by stratum, using the ratio of total families to interviewed units as weight; secondly, by type of benefit, by multiplying the number obtained in the first stage by the ratio of the total recipients of each transfer—as reported by the National Statistical Office, ISTAT—to the observations in each of the subsamples created. A final re-weighting of the single observations was performed using the distribution of total pensioners by age and geographical area, extracted from the National Pension Registry (*Casellario nazionale dei pensionati*).<sup>45</sup>

### **Imputation of benefits**

Under the household surveys conducted by the Bank of Italy up to 1995, the problem of estimating the accrued part of old age, seniority, survivors’ and INPS disability pensions could not have been solved without relying on external sources. A new question on the years of paid contributions added to the last questionnaire (1995) made it possible to reach an “internal” estimate of the share of the benefit received ascribable to the accrual of pension rights—and thus, by difference, of the amount of the supplementary transfer received.

The estimation procedure followed to solve the problem of imputation involved the following steps:

- (i) The value of the pension received in the first year following retirement was estimated by discounting the amount in payment in 1995 by the average nominal growth factor of minimum pensions between the indicated year of retirement and 1995.
- (ii) An estimate of the last gross earnings received was obtained by dividing the amount simulated in step (i) by the replacement rate reported by the interviewee.
- (iii) The calculation of pensionable earnings—an average of the last five gross wages received before retirement—was conducted by applying to the result of step (ii) the average

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<sup>44</sup>A further test based on the number of years of contribution did not prove particularly helpful.

<sup>45</sup>This distribution was kindly provided by INPS.

nominal growth rate of earnings (as recorded by the National Statistical Office) between the year of retirement and each single year taken into account as part of the individual average.

(iv) The imputed accrued benefit was estimated by multiplying the individual pensionable earnings, as calculated in (iii) above, first by the accrual factor guaranteed by the system to the different categories of workers, and then by the number of paid contributions as available in the new version of the questionnaire.

(v) The difference between the reported pension and the imputed accrued rent, if positive, was considered the value of the individual supplementary benefit to the minimum.

As the response rate corresponding to the question on the years of contributions turned out to be particularly low—probably due to the limit imposed on the total number of questions submitted to low-income pensioners—and since no such question was posed to the recipients of INPS disability pensions, the missing values of the accrued rents were filled by imputing the average yearly amounts distributed by type of benefit and recipients' age as reported in INPS (1996).<sup>46</sup>

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<sup>46</sup>INPS (1996). In the (few) cases in which the imputed accrued pension turned out to be greater than the pension indicated, the supplement was set equal to zero.



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