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Targeting Welfare in Italy: Old Problems and Perspectives of Reform

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Abstract

This paper has two principal objectives. Using a tax-benefit microsimulation model and the 1998 microdata of the Bank of Italy survey, we first study the distributional effects of the current Italian income maintenance system, and highlight its main defects and limitations, concerning in particular its unequal coverage of the population and its low efficiency in fighting poverty. The second aim is to describe and analyse the reforms recently implemented in this field; in particular, the Italian government has reformed the targeting criteria and introduced three new cash transfers. We describe these reforms both in their institutional characteristics and in their likely distributional consequences, and examine whether and to what extent they are able to overcome the shortcomings of the current system.

Keywords: Social Assistance, Targeting, Poverty, Inequality, Italy.
JEL classification: D31, H24, I32.

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I. Introduction

Common pressures for budgetary discipline associated with structural changes in the socio-economic environment (sluggish economic growth, increase in unemployment and irregular patterns of work, the present and prospective ageing of the population, and changes in family structures) have led most of the European welfare states to exacerbate the degree of targeting in their social policies during the last two decades.

The revival of selectivity in social policy, i.e. the limitation of access to cash benefits and social services on the basis of specific conditions of need, assumes a particular relevance in the case of Italy. The first stage of a novel policy of welfare targeting in Italy dates back to the beginning of the 1980s, when the resource-testing was considerably extended to the majority of social assistance schemes. The issue of selectivity has recently gained a new visibility as the result of the works of a government commission (known as the Onofri commission, after the name of its chairperson) which, in the Spring of 1997, submitted an articulated report on the macroeconomic compatibility of the social expenditure in Italy. As far as social assistance is concerned, the main plans of the commission, which have partially found application in the last three years, dealt with the introduction of an overall regulatory law for the sector as a whole, a gradual unification of the means-tested cash benefits administered by the central government, the introduction of a general minimum income scheme, and a new legislative framework specifying uniform and more equitable criteria of means-testing.

This paper deals with the distributive effects of the current income maintenance system, and evaluates the consequences of the main reforms currently being implemented or under discussion. In the second section we briefly describe how the Italian welfare state compares with respect to the other European welfare regimes, and analyse the peculiar role of selectivity in the Italian context. Using the most recent sample survey of household income and wealth conducted by the Bank of Italy and a tax-benefit microsimulation model, the third section examines the effectiveness and efficiency of current income support programs in alleviating poverty among Italian households. The fourth section describes the distributive effects of the reform strategies now under implementation, i.e. the reform of the targeting criteria, the introduction of two new cash benefits granted under the new means-testing rules and the experimentation of a minimum guaranteed income scheme.

II. The Italian welfare state in a comparative perspective

In the literature on comparative social policy, Italy has mostly been treated as a latecomer on the same path as that followed by other continental, "conservative-corporatist" European countries, with an income maintenance system strongly based on occupational status (Esping-Andersen 1990).

However, it has recently been argued that Italy, along with Spain, Portugal, Greece and Turkey, belongs to a separate cluster in the universe of welfare states, the so-called Southern European model of welfare (Ferrera 1996, 1999; Gough 1996). Some factors seem to be peculiar of this group of countries: i) while the health care system has made the leap from an occupational to a universalistic basis, i.e. it has been extended to all citizens irrespectively of their place in the labour market, the system of cash transfers is still substantially adherent to an occupational framework; ii) the categorical structure of the main social security transfers and their labour market basis have originated a sort of dual system: on the one hand, those who are or have been for a long time in the core sector of the labour market and are generously protected by the main pension and other insurance plans; on the other hand, those who lack this attachment to the labour force, and can rely only on a very weak social protection (typically young and long-term unemployed, irregular workers and self-employed); iii) the levels of benefits are very high for the "insiders" (e.g. old age pensions are, in proportion to average wages, among the highest in Europe) and very low or non existent for marginal subjects. Unemployment benefits are the lowest in Europe, and until a few years ago all the Mediterranean countries lacked a universal safety net to guarantee a minimum standard of living to all citizens; iv) the means-testing criteria are often unable to correctly detect many situations of real need and subject to fraud and abuses, as well as to discretionary interpretations by bureaucrats and local politicians.

A number of social and political-institutional factors seem historically responsible for the departure of the Southern European model of welfare from the continental one. These include the prominent role traditionally played by the family, which still largely operates as a sort of social clearinghouse, a deficit of "stateness", in terms of high vulnerability of the public administration to partisan pressures and political clientelism, and the ideological polarisation of the political spectrum, with the presence, until recently, of a radical and divided Left.

To the structural changes in the socio-economic environment mentioned above (fall in the economic growth rates, demographic ageing, change in family structures, etc.), the social protection systems of Continental Europe have reacted during the last two decades trying to extend the pool of the potential beneficiaries of social assistance, adding to the categorical schemes new, more general programmes or substantially reforming the existing ones. While preserving substantially unaltered the by now secular occupational structure, many significant steps have been taken towards a universal concept of the right to social assistance.

Italy, as well as other Southern European countries, has been left behind, mainly because of the weaknesses described above, and for other specific reasons, like the need to curb high public sector deficit, a low sensitivity in the public debate to the abstract themes of citizenship rights, and the reluctance of the "insiders" to sacrifice part of their prerogatives in order to extend social benefits to the "outsiders", in a context of scarce resources.

A further reason, namely the existence of a causal relationship between the categorical, group-specific nature of the income maintenance system and the presence of rudimentary and unreliable means-testing criteria, makes more difficult for Italy the opening to universalism. The link of reciprocal causation operates as follows: on the one hand, a categorical welfare state does not need to be so crucially dependent on sophisticated procedures of means-testing, since the selection of beneficiaries is strongly based on the belonging to specific population groups; on the other hand, the unreliable character of means-testing criteria pushes the legislator to adopt different and apparently simpler criteria, linked to some non monetary characteristics (old age, invalidity, heavy family burdens), to test the right to social benefits. In this perspective, the reform of the Italian welfare state can have some chances of success only if it succeeds in breaking this link of causation.

If universalism is interpreted not as a route to embrace radical options like the idea of a totally unconditional basic income scheme, but, rather, as the right of every citizen as a member of a community to receive a support if she/he falls in condition of need, then universalism and selectivity are no longer in contradiction. On the contrary, the two principles could ideally find a co-habitation, since a trustworthy means test allows to overcome the defects of a categorical system and to move towards a more socially inclusive welfare state. In fact, the true counterpart of universalism is not selectivity *per se*, but a system essentially based on unsatisfactory categorical criteria and on a plethora of resource-tests. Moving from a categorical system towards a universal one would thus require a new design of selectivity criteria. The final stage of this process would be a sort of “selective universalism”, something quite distinct from the residual and stigmatising welfare state as feared by the critics of means-testing[1].

III. The distributive impact of the current social assistance expenditure

Public expenditure for social assistance in Italy includes targeted programs for specific groups (elderly, invalids, etc.), most of them entailing some kind of means test, either at the household level or at the individual one. The main monetary schemes and their distinguishing features can be briefly reviewed as follows:

- *Family Allowance (Assegno al nucleo familiare)*. It is a transfer reserved to households of dependent or ex-dependent workers with family burdens, and represents by far the main subsidy for households with dependent children. The amount of the transfer is directly correlated with the dimension of the household and negatively correlated with its income. An income test, at the household level, operates since 1983.
- *Supplementary Pension (Integrazione delle pensioni al minimo)*. It is a benefit granted to old-age or invalid pensioners whose accrued pension is lower than a statutory minimum, about 9.4 million lire per year in 2000 (4840 euro). The receipt of the subsidy is conditional on a test, introduced in 1983, on the taxable income of the potential beneficiary (plus that of the partner, if the beneficiary is married). The income test excludes non-taxable forms of income, e.g. capital incomes, and other items, such as imputed rents on owner-occupied house. The pension reform of 1995 has abolished this scheme for the new entrants in the labour market, but it continues to apply for all other cases.
- *Social Pension (Pensione sociale)*. It is a form of minimum income for people over 65 who are not entitled to a contributory pension, and thus neither to the Supplementary Pension. It amounts to around 7 million lire per year (3560 euro), and the receipt is subject to an income test of the single or of the couple, irrespective of the economic conditions of the household where one lives. In 1995 this scheme changed its name to *Social Allowance* (*Assegno sociale*), but its main characteristics remain unaltered.
- *Invalidity Pension* (*Pensione di invalidità*). Like the former programmes, this scheme is provided by the National Institute for Social Protection (*Istituto Nazionale per la Previdenza Sociale*, INPS), the institute responsible for the management of most contributory transfers, and is paid to workers with at least five years of contributions.

[1] For a comprehensive analysis of the pros and cons of targeting, see for example Harding *et al*. (1994), Mitchell (1995), Smolensky *et al*. (1995) and Atkinson (1995; 1998).

Eligibility is conditional on both a medical test and an income test, and the accrued amount is supplemented to the minimum. Although formally a contributory scheme, this program should be more correctly considered as part of social assistance, because there is clear evidence, particularly in the 1970s and the 1980s, of its misuse as a rough substitute for a missing universal safety net in preventing poverty, especially in the South of Italy and in non-industrial areas.

- *Civil Invalidity Pension (Pensione di invalidità civile).* This scheme is very similar to the Social Pension (i.e. it is non-contributory), but it is reserved for the disabled without even a minimal accrued pension. The income test is strictly individual, regardless of the size of the family the beneficiary belongs to.
- *Unemployment Benefits* (*Indennità di disoccupazione, Cassa integrazione guadagni*). These are contributory schemes reserved to those who have lost their previous job. It is notable that those in irregular work and the young unemployed without previous work experience are not entitled to any form of assistance. Despite their contributory nature, these schemes are considered here because it would otherwise be difficult to obtain an appropriate picture of the impact on poverty of the Italian social expenditure.

As anticipated in previous section, a renewed policy of welfare targeting in Italy dates back to the 1980s, when income ceilings were established for maintaining the right to Supplementary pensions, the eligibility rules for Invalidity Pensions were completely revised (by tightening medical controls and introducing periodical reviews of the physical shape of the beneficiaries), and an income test was introduced for potential beneficiaries of the Family Allowance.

The substantial expansion of selectivity in the 1980s, given the unchanged categorical traits of the Italian welfare state, has meant new difficulties. First, unjustified disparities of treatment, in terms of horizontal and vertical equity, have arisen, due to the wide variation in the entitlement criteria used for targeting: variations across benefits in the definition of the resource unit and the monetary variable used in the means test, across the equivalence scales used to take into account the heterogeneity of the households, and across local communities providing the same services. Second, there have been massive problems at the implementation level and in terms of overall reliability of the targeting criteria, because of the shortages of legality and efficiency, at the administrative level.

The unsatisfactory distributive performance of the expenditure for social assistance, mainly due to the above mentioned defects, has been emphasised in a number of studies[2]. Here we present new empirical evidence of the impact on inequality and poverty of welfare expenditure, based on the micro-data of the 1998 Survey on Household Income and Wealth carried out by the Bank of Italy, covering 7147 households and 20901 individuals[3]. The Survey collects information on the main social and economic characteristics of Italian households, among which the various sources of disposable income, and the components of financial and real wealth. Sample weights provided in the survey have been used throughout. Original data on financial wealth, seriously affected by non-reporting and under-reporting behaviour, have been corrected adapting to the data the methodology elaborated by Cannari and D'Alessio (1993). Since data on income are net of direct taxes and social security contributions, these variables have been simulated with a tax-benefit model reproducing in

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[2] See Negri and Saraceno (1996); Marignetti and Roberti (1998); Rostagno and Utili (1998); Toso (2000).

[3] See Banca d'Italia (2000) and Brandolini (1999) for a description of the Bank of Italy Survey.

detail the characteristics of the Italian tax and welfare system (Baldini, 2000). Household characteristics present in the survey have also been used to impute tax evasion and the government transfers not available in the original data-set, namely Family Allowances, Supplementary Pensions and three recently introduced cash benefits (see section 5)[4]. All monetary values are updated to the year 2000.

We have examined the cost-efficacy effects of the system of cash benefits previously described, after having sorted households in ascending order of pre-benefits equivalent disposable income (net of income tax). The equivalence scale is given by the number of family members raised to the power 0.65; its choice will become clearer in section 4, after the discussion of the reform of means-testing schemes. As already mentioned, the set of welfare programmes studied is wider than that traditionally considered under the "social assistance" heading, because a too formal characterisation of the various transfer schemes would neglect from the analysis some schemes which, however financed by contributions, have a clear anti-poverty function.

Table 1 shows the distribution of disposable equivalent income and of each income maintenance program among Italian households, sorted by deciles of disposable equivalent income before transfers.

Table 1 Distribution of disposable equivalent income and social expenditures by deciles of disposable equivalent income

Deciles of disposable equivalent income	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*Total*
Disposable eq. income	1.35	3.34	5.16	6.00	7.28	8.61	10.77	12.07	15.10	30.29	100
Family allowances	22.79	27.41	23.35	11.43	6.58	4.94	2.49	0.75	0.19	0.07	100
Supplement. pensions	17.82	20.01	11.81	8.68	10.83	7.57	7.92	5.95	4.25	5.14	100
Social pensions	34.16	10.12	10.86	10.17	6.52	9.83	7.40	2.90	3.25	4.79	100
Civil inval. pensions	31.77	6.27	7.44	20.39	6.83	3.55	12.20	6.74	3.42	1.39	100
INPS inval. pensions	36.88	11.55	10.14	12.30	5.97	4.59	9.25	1.94	2.63	4.75	100
Unemployment benefits	28.60	17.25	19.35	12.10	4.54	4.49	5.00	4.10	1.83	2.73	100
Total Benefits	*24.39*	*18.26*	*13.60*	*10.53*	*8.44*	*6.53*	*7.20*	*4.08*	*3.05*	*3.91*	*100*

Family Allowances are strongly concentrated in the first two deciles, with more than 50% of total expenditure, and with amounts smoothly decreasing across the whole distribution (with the exception of the first two deciles). The concentration of Supplementary Pensions is much lower than that of Family allowances: more than 30% of the total amount goes to the richest 50% of the population. Since total expenditure for this subsidy in 1999 was about 30.000 billion lire, around half of total public expenditure for social assistance (Mazzaferro and Toso, 2000), this means that nearly 10.000 billion lire used to supplement pensions to the minimum are actually received by persons who cannot be considered poor at all. Social Pensions are evidently skewed towards the poor, but also in this case nearly 30% of total expenditure goes

[4] Tax evasion has been imputed following the results of Marenzi (1996), who compared average incomes from the Bank of Italy survey and from tax administrative data, under the assumption that the "true" income is that declared in the Bank of Italy survey, and found that the propensity to evade is mainly concentrated among the self-employed and non corporate firms, and is inversely correlated with disposable income.

to the top 50% of the distribution. Among the two forms of Invalidity Pensions, those paid by INPS are more concentrated among the poor than the others, and this seems to confirm the widely held suspicion that they have played the role of a surrogate for a missing general safety net. Finally, Unemployment Benefits are the category most concentrated in the first two deciles, which comprises many of the households with a non-working head.

A more precise and detailed description of the ability of social transfers to contrast poverty is provided in table 2, which presents the standard indicators of target efficiency and poverty reduction effectiveness (Weisbrod 1970, Beckerman 1979) for each of the schemes mentioned before. Poverty here is defined in terms of disposable equivalent income before transfers, and the poverty line is given by 60% of median pre-benefits disposable equivalent income.

Table 2 Target efficiency and effectiveness of social expenditure

	VEE	*PRE*	*S*	*PGE*
Family allowances	58.60	53.97	7.89	11.37
Supplementary pensions	43.79	30.53	30.29	17.88
Social pensions	51.96	43.38	16.51	4.99
Civil Invalidity pensions	42.84	35.49	17.15	1.84
INPS Invalidity pensions	54.58	37.84	30.67	7.57
Unemployment benefits	54.22	41.08	24.25	2.49
Total Benefits	*49.35*	*34.18*	*30.73*	*41.84*

The first column of Table 2 reports the values of Vertical Expenditure Efficiency (VEE), meaning the share of total expenditure going to households who are poor before the transfer, and shows that more than 50% of total benefits go to households whose disposable income is above the poverty line even before the transfers. The amount that would be wasted according to this measure is still greater, approaching 60%, in the case of old age Supplementary Pensions. The indicator of Poverty Reduction Efficiency (PRE), i.e. the fraction of total expenditure allowing poor households to reach the poverty line without overcoming it, is strongly correlated to VEE, the formal relation being VEE (1-S) = PRE, where S is the Spillover index, a measure of the excess of expenditure with respect to the amount strictly necessary to reach the poverty line. To sum up the evidence provided by these three indicators, it seems fair to say that the target efficiency of current benefits is low, so there would be room to redirect public assistance expenditures towards the truly poor, without violating the currently tight budget constraints.

In fact, the three measures considered so far are not sufficient to evaluate how good a transfer system is in fighting poverty: a transfer program could be very efficient in reaching the poor, but its amount could be too low to produce a significant increase in the living standards of the beneficiaries. We thus need another indicator, the Poverty Gap Efficiency (PGE), which shows how effective a cash benefit is in filling the poverty gap. The last column of Table 2 thus shows that total benefits manage to fill 42% of the poverty gap. Given the vast amount of resources not targeted to the poor, this share could be significantly increased, with better means-testing criteria, without the need of additional funds.

Table 3 examines the presence and consequences of a basic feature of the Italian welfare state anticipated in previous section: its categorical, group-specific nature, and therefore the significant degree of horizontal inequity whereby households with similar levels of well-being can rely on very different levels of assistance from the State, depending for example on the age of the head, or his/her position in the labour market.

Table 3 Target efficiency and effectiveness of social expenditure by demographic groups

	*% of households with disposable income before transfers below the poverty line**	*% of poor households receiving benefits*	*% of households with disposable income after transfers below the poverty line**	*% reduction in the number of poor households*	*Income gap ratio of disposable income before transfers*	*PGE of benefits*
	a	b	c	d = (c-a)/a	e	f
Profession of the head						
Manual worker	25.79	93.04	19.97	-22.55	31.27	39.44
White collar	7.03	87.23	5.20	-26.06	20.76	37.16
Manager	2.50	100.00	1.23	-50.85	17.94	27.32
Independent	11.48	10.16	11.14	-2.98	29.47	6.56
Pensioner	24.48	93.34	9.63	-60.66	40.84	72.30
Unemployed	73.34	42.32	65.77	-10.32	61.09	16.33
Other	44.73	49.79	40.23	-10.08	59.77	27.19
Area						
North	12.43	73.13	6.22	-49.95	35.94	52.78
Centre	13.23	79.25	7.23	-45.37	30.15	48.21
South	41.45	76.75	29.73	-28.26	46.12	38.39
Age of the head						
<=30	20.65	49.60	17.25	-16.46	54.61	13.14
31-40	23.38	63.23	19.07	-18.43	38.71	28.20
41-50	18.31	70.31	15.20	-16.97	38.09	27.07
51-60	18.30	69.62	13.56	-25.87	45.48	35.42
61-70	21.95	80.33	13.30	-39.39	41.34	55.85
>70	29.17	94.62	9.05	-68.97	41.54	78.82
Total	*22.13*	*76.06*	*14.15*	*-36.06*	*41.55*	*41.84*

The table shows to what extent transfers are effective in reducing, for various population groups, the frequency and intensity of poverty. The first column contains the percentage of households who are poor before the receipt of benefits for each demographic group, and the second how many of these poor households receive at least one transfer. Column c shows the shares of poor households whose post-transfers disposable income is still lower than the poverty line in terms of pre-benefits disposable equivalent income[5].

The fact that social expenditure policies towards the poor have historically turned out to be identified with pension policy can clearly be seen by the different coverage of benefits across

[5] Note that the poverty line is kept unchanged in terms of disposable income before transfers, since otherwise some households who are not poor in the distribution of pre-benefits income would become poor simply because of the increase in the poverty line.

age groups (col. b): the share of poor households who receive any benefit is constantly increasing with age. Among professional categories, the self-employed and the unemployed are clearly under-protected. The reduction in the headcount ratio for pensioners is particularly striking, going from 24.5% before transfers to 9.6% after their receipt, while only a tiny fraction of the self-employed and of the unemployed manages to escape poverty after subsidies. The poverty gap efficiency index for different groups confirms these findings: it is constantly increasing from young to old ages, even though the poverty gap ratios are very similar across groups.

IV. The reform of social assistance: institutional features and distributive effects

From the discussion of previous section, the main weakness of the Italian income maintenance system appears to be the categorical structure of its main schemes, overprotecting some categories and leaving others without adequate protection. This weakness, as explained in section II, is strictly interconnected to the rudimentary nature of the means-testing procedures associated to the various programmes. In such a context, a move towards a more reliable and uniform means-testing appears to be an important pre-requisite for the extension of social assistance to parts of the population so far excluded. Instead of making the Italian welfare state more residual, a widespread use of consistent targeting methods can have the effect of allowing the system to become more universal and less fragmented. This argument has recently been put forward by a government commission (Onofri Commission, 1997) which had been in charge to suggest a reform plan to redesign the social assistance sector as a whole. Indeed, the basic idea underlying the plan was the necessity to move towards a system able to associate universalism, as far as the potential access to the benefits is concerned, with new selectivity criteria in the determination of the deserving households. The two following subsections will then describe, first, the reform of the means-testing procedure, and, then, three recently introduced schemes which represent a significant step towards the creation of a less categorical system.

1. A new targeting method: the "Indicator of Economic Situation"

The Budget Law for 1998 fixed the guiding principles regarding the definition of general criteria for the evaluation of the economic means of applicants for social assistance. These general principles have been clarified and made operative by a decree approved in March 1998, which introduced the "Indicator of Economic Situation", dubbed ISE (*Indicatore della Situazione Economica*), and by a successive decree, approved in May 2000, which has amended some parts of the former one.

In a first stage, the scope of the reform will apply only to social services and cash benefits provided at a local level (kindergartens, local forms of minimum income, nursing homes for the elderly, etc.). The previous means tests continue to apply to the old cash transfers provided by the central government, while also two newly adopted programmes (whose effects will be studied in section IV.2) will be subject to ISE. The spirit of the reform suggests that in the near future the whole welfare expenditure, both in kind and in cash, will be provided according to the new targeting system.

The new targeting instrument has two distinguishing characteristics: first, the economic condition is defined in terms of both income and wealth; second, the reform identifies in the household the appropriate unit of reference to determine the level of individual welfare, thus using an equivalence scale to deflate the sum of its income and wealth components. More specifically, to the sum of all incomes of household members must be added the value of the wealth indicator, given by the product of total wealth by a coefficient α, equal to 0.2. Thus, ISE is a linear combination of income and wealth:

$$ISE = (INCOME + \alpha WEALTH) / EQUIVALENCE\ SCALE$$

The starting point for its determination is the personal income tax base plus the social security contributions paid by the self employed (with rates of 15-16%). In this way, the legislator has tried to allow for the fact that only the tax base of the employees is gross of the expenses necessary to produce it.

The income component of ISE is obtained summing to total income a conventional financial income, given by the application to the stock of financial assets of the average rate of long run Treasury bills. From the value of income thus computed a deduction of 10 million lire (ca. 5160 euro) is allowed for tenants.

The wealth component of ISE is given by the sum of the value of all real (houses, land,…) and financial assets multiplied by α, a parameter set to 0.2. As for real estate, the relevant value is net of residual debts incurred for their purchase. Substantial disregards are provided: 30 million lire (ca. 15480 euro) for financial wealth, plus further 100 million lire (ca. 51600 euro) if the household lives in its own house.

The inclusion of wealth, on its own, in the new means-testing formula can be grounded on different arguments, both theoretical and practical. First, the inclusion of wealth appears consistent, in a comparative perspective, with the logic underlying the means-testing rules of the majority of Oecd countries, which usually employ asset tests to select those eligible for social assistance (Eardley *et al.*, 1996). A second, theoretically-grounded, reason to include wealth is that it increases individual utility in ways which are different from and additional to the simple receipt of capital income: wealth ownership can enter the utility function directly, if its holding generates additional utility, or indirectly, if it provides other benefits (sense of security, economic power and prestige, etc.) which are arguments of the utility function (Musgrave, 1983). According to this view, the autonomous role of wealth in generating utility does *not* imply a double counting of capital income, even though a conventional measure of financial income, corresponding to an estimate of the annuity value of financial wealth, is already present in the income component of ISE.

Finally, to the theoretical justification for the direct inclusion of wealth in ISE one can add a practical but significant argument connected with tax evasion. Since ISE is still mainly based on taxable income, it cannot avoid the distortionary and unfair effects of income tax evasion. However, if stock values are less subject to incorrect statements, then the addition of wealth in

ISE may partially correct for these distortions[6]. Alternatively, it could be argued that the inclusion of wealth in the new means-test may discourage tax evaders from applying for social services, since a significant discrepancy between the declared amounts of wealth and income may stimulate inspections from fiscal authorities.

The equivalence scale used to deflate the sum of the income and wealth components is obtained simply by raising the number of household components (N) to the power 0.65:

$$ES = N^{0.65}$$

This basic scale is then increased when the household is in conditions of particular difficulty, by 0.2 points for single parent households with dependent children, or if both parents of dependent children are working, and by 0.5 points for each member with a permanent handicap or seriously disabled.

Who will gain and who will lose from the adoption of ISE to target welfare services? This question must be clearly distinguished from the other one implicitly raised before, i.e. what will be the distributive effects of the progressive replacement of a categorical income maintenance system with a more universal one. This second problem will also be touched in the following section, but the answer to it has been already, although implicitly, given in section III, where the evidence provided clearly shows that the population groups more likely to benefit from greater universalism are the households now discriminated by the current configuration of the transfer system, i.e. those whose head is self-employed or unemployed, or in the first stage of the life cycle, and those living in the South.

In this section we tackle a smaller problem, i.e. what are going to be the net effects of ISE as a targeting criterion, given the set of cash transfers to which it applies. We thus perform a simple simulation experiment, and ask what are the effects of adopting ISE to select the right to access public services. To this end, it is sufficient to study how alternative means testing criteria rank various economic and demographic subgroups of the population, and then increase or reduce the probability that they may access a given set of transfers in cash or in kind, if the latter are subject to a means test. Those who occupy a low ranking according to a certain classification system may possibly see their relative position increased in the ISE ordering, and could thus lose their entitlement to social assistance.

In other words and to summarise, there are two ideal steps in the reform of social assistance expenditure: 1) the replacement of a categorical income maintenance system with a more universal one; 2) the adoption of a consistent means-testing rule. The analysis of this section concerns only the distributive effects of the second stage, even though one should remember that the first one is very likely to have much more relevant distributive consequences.

To simplify the analysis, we compare the ISE ordering with that produced by the single variable that is most likely to represent a sensible hypothetical alternative to ISE as a welfare indicator, i.e. taxable income; indeed, the base of the personal income tax is now the variable most commonly taken into account by public administration, and so we choose it as the

[6] In this respect, the wealth declared by tax evaders might also be interpreted, at least in part, as the result of the investment of unpaid taxes.

reference variable of the current means-testing system. Taxable income is then corrected by the same equivalence scale used for ISE, to take account of the fact that currently nearly all transfers adopt an equivalence scale.

The change in the welfare ranking, in the passage from income to ISE, could be influenced by many elements, such as the age of the household head, his/her job, and all those variables which are more closely correlated with the possession of wealth. To analyse the specific contribution of each of a set of possible determinants, we ranked households first by deciles of equivalent income and then by deciles of ISE, and selected those households that belong to the first five deciles of each distribution, since currently, according to our microsimulation model, about 50% of Italian households receive a positive amount of at least one of the cash benefits considered in this analysis. Under the hypothesis that the same percentage of households will still receive social transfers after the reform, what are the characteristics of the households who may be eligible to social transfers only under one means-testing regime but not under the other?

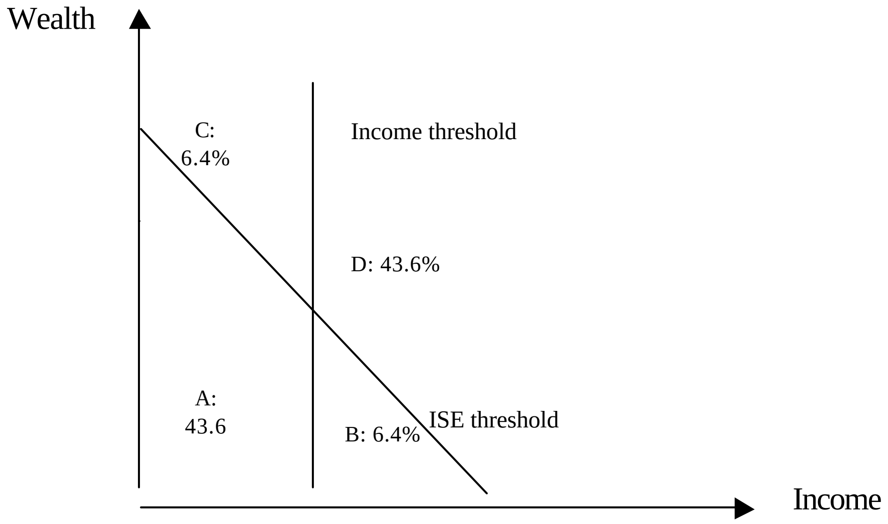
The following table shows how many households would change their position in the passage from income to ISE. If, as explained, we assume that those households who belong to the bottom half of the distribution coincide with the pool of beneficiaries of welfare expenditure, then, the introduction of ISE would imply that nearly 13% of households (6.44% / 50%) who are eligible in terms of income would no longer be classified as such in terms of ISE, thus losing the entitlement to social assistance. On the other hand, an identical percentage of households who are not eligible in terms of income should be entitled to some benefits according to ISE.

Table 5 Beneficiaries in terms of personal taxable income or ISE

		Beneficiaries in terms of ISE		
		No	Yes	
Beneficiaries in terms of taxable Equivalent income	No	43.56% (Area D)	6.44% (Area B)	50.0%
	Yes	6.44% (Area C)	43.56% (Area A)	50.0%
		50.0%	50.0%	100%

The four groups a household can belong to are shown graphically in Fig. 1. The vertical line is the threshold in terms of income, while the other segment represents the ISE threshold, with a slope of $-1/\alpha$. Areas A and C identify the potential beneficiaries of social transfers according to income, and areas A and B the beneficiaries in terms of ISE. Those belonging to area B would thus be favoured by the adoption of ISE, and those in area C would be penalised, evidently owning scarce incomes but substantial wealth.

Figure 1 Beneficiaries of social transfers under alternative means-testing regimes



To identify the characteristics of those who belong to the pool of beneficiaries under only one of the two means-testing criteria, we performed two probit analyses, the first where the dependent variable takes the value of one if the household belongs to the first five deciles of the income distribution but not of the ISE distribution (area C), and the second where the reverse is true (area B). The reference household has the following characteristics: it is resident in the north-western part of Italy, lives in its own house, and its head is male, white collar, and with a high school education.

The first two columns show what are the characteristics more correlated with the probability of being penalised, in the access to social expenditure, if ISE is adopted as a means-testing device in place of taxable income. Not unexpectedly, the age coefficients are not significant, since the regressions contain also a dummy for retired heads, but given the coefficient associated to the pensioner dummy, the probability of not being eligible in terms of ISE is actually increasing with the age of the head, as a consequence of the process of wealth accumulation over the life cycle: ceteris paribus, the adoption of ISE should penalise households in the final part of their life, who on average have access to substantial stocks of wealth. Among the professional categories, independent workers make the biggest upwards leap in the passage from the income to the ISE ordering, followed by pensioners and white collars. The change in ranking shown by independent workers is quite remarkable since it reveals that a joint test on income and wealth, rather than simply on personal taxable income, is potentially able to elicit the effective economic welfare of a category whose fiscal behaviour appears strictly linked with the phenomenon of income tax evasion. This is confirmed by the value taken by the coefficient associated to the variable “tax evader”, a dummy set to 1 if the undeclared income simulated in the model is at least one third of disposable income: the inclusion of wealth in the test of means allows to reduce the possibility that tax evaders may access income maintenance transfers. Those with a bwer level of education appear slightly favoured by the ISE ordering. Finally, being tenant is associated with a drastic improvement in the probability to have access to social services if ISE is used instead of income.

Table 6 Probit analysis of the distributive effects of the targeting with ISE or taxable income

	Dep. Var. = 1 if the household belongs to the first five deciles of the income distribution, but not of the ISE distribution (area C)		Dep. Var. = 1 if the household belongs to the first five deciles of the ISE distribution, but not of the income distribution (area B)	
	Coef.	z	Coef.	z
Age	0.014	1.198	0.004	0.367
Age^2	-0.00009	-0.952	-0.00006	-0.634
Manual worker	-0.260	-2.413	-0.016	-0.190
Manager	-0.662	-2.838	-0.116	-0.838
Independent	0.401	4.143	-0.538	-4.332
Pensioner	0.392	2.696	-0.124	-0.989
Unemployed	0.172	0.915	-0.916	-4.019
Other	0.164	0.899	-0.313	-1.962
North-east	0.074	1.064	-0.098	-1.398
Centre	0.084	1.204	-0.093	-1.315
South	-0.109	-1.67	-0.238	-3.660
Tenant	-0.519	-6.932	0.719	13.909
Female head	-0.055	-0.847	0.028	0.436
<=5 years education	-0.008	-0.113	0.124	1.555
8 years education	-0.013	-0.195	0.158	2.278
>13 years education	-0.187	-1.639	-0.401	-3.078
Tax evader	0.296	3.054	-0.556	-2.901
Couple, one partner works	0.376	3.065	-0.043	-0.414
Couple, both work	0.208	1.701	0.178	1.800
Constant	-2.240	-6.458	-1.618	-5.128
R^2	0.067		0.105	

The results of this analysis, then, imply that the gainers from the adoption of ISE, in terms of a more favourable access to social services, are likely to be households in the first stages of their life cycle and with a dependent worker as the head. On the contrary, the groups who run the greater risk of being excluded from social expenditure are likely to be households with a head not employed as dependent worker (particularly the self-employed) or retired, with a high level of education, residing in their own house and with a high propensity to evade the personal income tax.

2. Towards a less categorical system: the first concrete steps of the reform

Apart from the introduction of a new means-testing regime, the last few years have seen the implementation of three new transfer schemes, of which two apply also the ISE test, which represent a concrete move towards a more universal cash benefits system:

1) A *Special Family Allowance* of 2.6 million lire per year (1350 euro) for households with at least three dependent children, and with an ISE lower than 31.3 million lire for a reference household with 5 members (other thresholds are derived with the ISE equivalence scale). The amount of the subsidy is decreasing with a withdrawal rate of

50%, up to the ceiling of 36.6 million lire (the cut-out point). Total spending for 2000 is estimated in about 600 (310 million euro) billion lire.

2) A *Maternity Allowance* of 1.5 million lire (775 euro) for each new child, granted if ISE is lower than 50.8 million lire for a reference household of three members, and if the mother is not covered by any forms of maternity insurance. Total estimated spending is 350 billion lire (180 million euro) per year.
3) The *Minimum Insertion Income* (*Reddito Minimo di Inserimento*, abbreviated to RMI), which represents a first but significant step towards the adoption in Italy of a universal subsidy for the alleviation of poverty, modelled on the basis of the safety nets present in almost all European countries. The RMI is currently being experimented upon 39 local areas, chosen according to a set of social and economic characteristics, and mainly concentrated in the southern part of Italy, the poorest one. The maximum amount of the RMI is 0.52 million lire (270 euro) per month for a single person, while for other households the corresponding amounts are found with the application of the ISE equivalence scale. The transfer is set so as to cover the difference between the maximum amount and household income. Earnings are counted in total household income only for 75% of their total amount, to attenuate the poverty trap, so that the RMI reproduces a negative income tax scheme with a marginal tax rate of 0.75, covering a constant share of the poverty gap. The entitlement rules for the RMI do not adopt ISE as a selection instrument or as a measure of living standard, even if they share with the ISE legislation the same equivalence scale and the adoption of the household as the resource unit. Any amount of assets, with the exception of the house of residence, is a sufficient condition for losing eligibility. This pre-requisite appears to be consistent with the nature of the scheme, aimed at alleviating situations of particularly harsh poverty and social exclusion. The receipt of the minimum income is conditional on joining an insertion program, devised by the local authorities with the objective of reintroducing the beneficiary in the labour market, through acceptance of any job proposals, attendance in training courses, or involvement in care services. As far as this measure is extended to the whole population (a very likely occurrence, since no political party is against it), estimates with our tax-benefit model show that the RMI will cost about 5.000 billion lire (2600 million euro) per year. After the experimental phase of the RMI, Italy will have a universal scheme of poverty alleviation, with the RMI for the non-elderly and the social pension for the over-65.

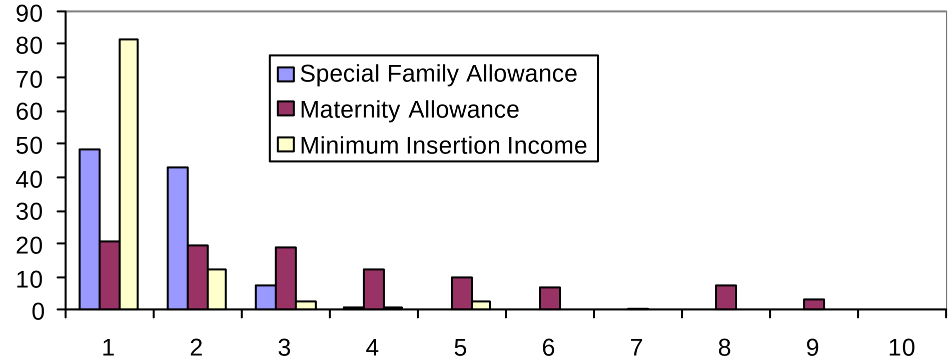
We briefly analyse the distributive effects of these new schemes with the same instruments developed above; table 7 contains the usual indicators of efficiency and effectiveness, and shows that the new instruments are characterised by a very high target efficiency. Due to the higher threshold, the target efficiency is as expected lower for the maternity allowance. The minimum insertion income manages to fill nearly 10% of the poverty gap, even though it should reach about 600000 households, i.e. less than 20% of those who are poor in terms of pre-benefit disposable income.

Table 7 Target efficiency and effectiveness of the three new transfer schemes

	VEE	*PRE*	*S*	*PGE*
Special family allowance	96.44	93.34	3.21	1.18
Maternity allowance	48.48	46.66	7.88	0.32
Minimum insertion income	94.81	90.50	4.54	8.99

As for the distribution by deciles of pre-benefits disposable equivalent income, Fig. 2 confirms that these transfers are very concentrated towards the poor, much more than most old cash transfers: more than 80% of total spending for RMI goes to the first decile, while the special family allowance is actually reserved to the bottom 20% of the income distribution.

Figure 2 Distribution of the three new transfer schemes by deciles of disposable income (per cent values)



V. Conclusions

The Italian public assistance system is currently involved in an intense process of reform, aimed at overcoming its main limitations, namely its categorical nature, the absence of a statutory minimum income scheme, the lack of a national legislation on the provision and financing of social assistance and personal social services, and the rudimentary nature of means tests applied to current spending schemes. The reform in progress should lead to a model of welfare state able to introduce substantial elements of universalism, while satisfying the severe public budget limitations. The reform perspective envisaged by the legislator can be labelled as one of "selective universalism", i.e. a scenario able to associate a wider, less categorical, potential access to social expenditure, with fairer and uniform selectivity criteria in the determination of the deserving households.

In this paper we have focused on the distributive effects of the current income maintenance system, and on the consequences of the main reform strategies under implementation, i.e. the introduction of a new and general targeting system, and the gradual shift towards a more universal system of transfer schemes.

The new means test, the so-called “Indicator of Economic Situation” (*Indicatore della Situazione Economica – ISE),* which is based on a joint test of incomes and wealth of the potential beneficiary household, replaces the plethoric system, currently in use, and at least on paper promises to correct many of the shortcomings of the current system. Furthermore, the reform paves the way for reducing progressively the categorical, group-specific content of the Italian welfare state.

A number of conclusions have been reached in the paper. First, our empirical analysis shows the negative distributive performance of current social assistance expenditure in Italy, in terms both of target efficiency and effectiveness. There is thus much scope for a better targeting of current welfare expenditure in favour of those truly regarded as being in need, without violating the currently tight budget constraints. Second, a comparative analysis of the new means-testing regime shows that the gainers from the adoption of ISE, the new targeting method, are likely to be households in the first stages of their life cycle, residents in the South, and with a dependent worker as the head. Conversely, the losers are likely to be households with a head not employed as dependent worker (particularly the self-employed) or retired, more than 60 years old, resident in the Northern part of Italy. Third, when compared with their predecessors, the transfer schemes recently introduced are not subject to categorical restrictions, and show a much higher degree of target efficiency.

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