16 ITALY: HOW LABOUR MARKET POLICIES CAN FOSTER EARNINGS INEQUALITY

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Abstract

Italy is characterized by a high level of inequality but is also among the small number of OECD countries where income inequalities did not increase substantially over the course of the past two or three decades. There are two main dimensions of inequality in Italy. On the one hand, there is geography, with the sharp division between a more developed North and a backwards South. The weakness of the state is the second major factor explaining the relatively high level of inequality observed in contemporary Italy. In fact, the general stability of inequality over time hides substantial changes underneath. The most significant change concerns the young generations, which are facing a very different labour market. The so-called flexibilisation at the margin has reinforced the two-tier nature of the Italian labour market. Up to the recent financial crisis, the stability of inequality has been maintained with a combination of high levels of private net wealth and high levels of public debt. Italian families have resisted the decline in income opportunities by running down assets during the previous decade, but now they may have reached the limit and therefore may have reverted to a lower consumption path.

1.Introduction

Compared to other developed societies, Italy is characterized by peculiarities that represent distinguishing features of the country and its socio-economic regime. In particular, two dimensions are crucial to understand the way income inequalities and their impact are structured in Italy: geography and the weakness of the state. On the one hand, Italy suffers from a sharp division between a more developed North and a backwards South. This division has been a feature of the country since the birth of the Italian national state in 1860 and it is still a central topic in the political and public debate today. On the other hand, the state as institution suffers from an intrinsic weakness, as demonstrated by a long series of ineffective, not implemented or poorly-timed reforms. Such weakness has generated a clear dichotomy between the country's formal constitution (the laws of the state) and its material constitution (the way society and the economy actually work).

Both features are useful in order to explain the relatively high level of inequality experienced by Italy compared to countries with a similar level of development. The country is typically classified among the coordinated market economies, but the European social model of relatively low social inequality does not fit the Italian context well, since inequality and intergenerational mobility in almost all social dimensions are more in line with those of Anglo-Saxon economies than with the Continental ones. In particular, the weakness of the state does not facilitate the implementation of redistributive policies that would be effective in reducing all types of inequality. Furthermore, it indirectly increases social inequality because it enhances individualistic behaviours and it strengthens the power of particular social groups, firstly the family followed by interest associations, which makes it very difficult to implement reforms to increase equality of opportunities among citizens.

The data on income inequality show an increase around the previous crisis and Lira devaluation in 1992 and stability thereafter. Furthermore they do not show a particular increase in the recent recession: the effect of the current economic downturn on inequality seems to be mild compared to the effects of the previous recession of 1992, which caused a steep increase in all measures of inequality. In most countries this smoothed effect has been attributed to government redistributive policies and stimulus packages. In Italy a high stock of private savings and diffused house ownership together with extended (but not universal) measures of short time work and wage integration, which avoided mass layoffs (*cassa integrazione guadagni*[1]), as well as the proverbial family network have played a substantial role in smoothing the impact of recession.

The overall stability of inequality hides substantial changes underneath: over the last decades, in line with other countries with a similar level of development, Italy experienced an increase in life expectancy, educational levels, and female labour force participation. Such a pattern is not homogenous within the country: regional disparities did not disappear and in some dimensions they increased. The flexibilisation at the margin of the labour market reinforced its two-tier nature and this change mainly hits younger generations. Consumption increased steadily in the previous decade and was partly independent of wage dynamics (which were hardly affected by the 1993 wage freeze agreement). However, starting from the current decade, per-capita consumption stagnated, clearly indicating that something in household behaviour had changed.

By spreading job opportunities among a larger group of labour market participants, two-tier reforms increase earnings inequality. This does not necessarily imply that the household income distribution becomes more unequal, because this also depends on the distribution of job opportunities within families. However, it is likely that increased income variability translates into a greater perception of insecurity, which induces greater savings in order to achieve consumption smoothing. One should also consider that Italian families may have resisted the decline in income opportunities by running down assets during the previous decade, but now they may have reached the limit of desired indebtedness, and therefore may have reverted to a lower consumption path.

In section 2 we describe the nature of inequality and its evolution over time. We also focus on the interactions with education inequality and labour market reforms. In section 3 we look at the impacts of inequality on various dimensions such as poverty, health and social cohesion and we introduce the role of the family. In section 4 we look at the impact of inequality on political and civic participation. Section 5 describes the main policies adopted in combating inequalities and stresses the weak role of the state and the lack of attention to the younger generations. Finally in section 6 we summarise and give an interpretation of the causes and consequences of the evolution of inequality in Italy in the past decades and identify some likely patterns for the future.

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[1] See below, par. 5.4, for details on this institution.

2. The Evolution of Income and Educational Inequalities

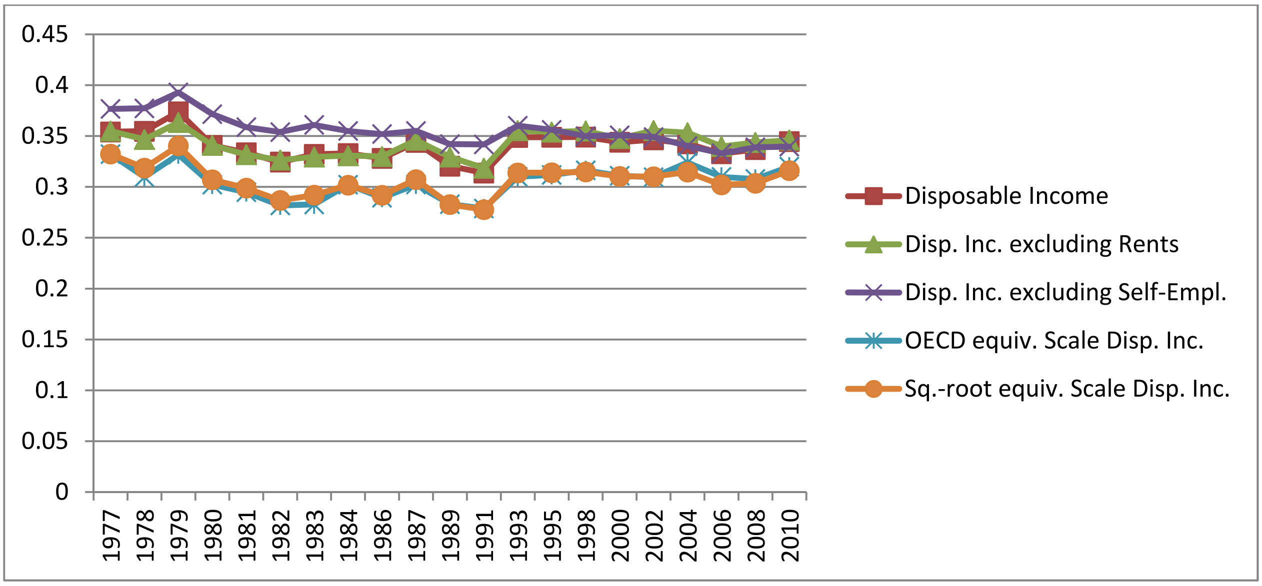
Income inequality

Compared to other OECD countries, Italy appears to be among the most unequal in terms of income distribution. Apart from developing countries (like Mexico and Brazil) and fully free market economies (like the United States), Italy is the most unequal economy in the OECD area together with the United Kingdom. The Gini index for Italy stands at 0.35 while the value for the UK is 0.33 and the OECD average is 0.30.

Historical reasons are certainly important in these patterns. Italy is among the late comer countries in terms of capitalistic development. This process typically requires a strong upgrade of the skills of the labour force in order to permit socio-economic development. The delay in the transition is confirmed by the lack of a robust industrial structure, the large share of small firms and self-employment, the large share of employment in the service sector (exceeding 50 per cent per cent). All these elements are underlying forces that tend to create and perpetuate inequality in income distribution. In addition, Italy has a relatively young history as a national state because the unification was in 1860 and it limits somehow the power of the state. The county also exhibits a very low rate of tax compliance and a huge public debt. Both elements reduce the ability of the public administrations to redistribute incomes and provide adequate safety nets.

While perceived inequality is currently at its highest in Italy, empirical evidence is more controversial in this respect (Fondazione de Benedetti, 2011). Since the end of the 1970s, inequality decreased for about twenty years, but largely increased at the beginning of the 1990s with the recession and the Lira devaluation of 1992, to remain rather stable afterwards at levels similar to those seen before the 1970s. The year 1992 is a crucial year because it also saw the abolition of the automatic system of wage indexation– the Scala Mobile– that contributed to wage compression in previous years. This pattern emerges from Figure 1 irrespective of the inequality index used and whether incomes from self-employment and/or imputed rents are included, two factors which are crucial for Italy, since the rate of self-employment and the house ownership are very high compared to the EU average (respectively 25 per cent of total employment and 80 per cent of house owners). We use both equivalised and non-equivalised household income to account for large families with cohabiting children who may work on temporary jobs. Although the level of the inequality index depends on the measure of income used, the overall trend is roughly consistent whatever income definition is used. In particular, equivalent household income inequality is consistently lower than non-equivalised household income, as commonly found.

Figure 1: Gini coefficients for different measures of income in Italy.



Source: SHIW

Decomposing changes in inequality a few comments arise:

1) Decomposing inequality by deciles, most of the action over time occurs in the bottom part of the distribution, below the median. Wage compression due to the *Scala Mobile* occurred mostly at the bottom of the distribution and its abolition in 1992 penalized mostly workers at the bottom of the distribution. So did the sudden devaluation of the Lira in the same year. The effect of two of the drivers, self-employment income and pensions, is also concentrated at the bottom of the distribution. However, the Italian income distribution also experienced a significant change at its very top (top 1 per cent). Therefore, when inequality is measured focusing on the top 1 per cent of the distribution, it shows some increasing trend.

2) Decomposing the inequality trends of household inequality by main geographical areas (North, Centre and South) we find that changes of inequality in Italy at the end of the 1990s can be largely accounted for by changes in the distribution of household income within the South (Fiorio, Leonardi and Scervini, 2011), with the offsetting effects of self employment and labour income (which tend to increase inequality) and the opposite effects of pension income (which tend to decrease inequality). The Gini index within regions of the South is above 0.35 while the Gini in the North is around 0.3. Inequality between the South and the rest of the country has increased somewhat since the early 1990s. The economic differential in terms of economic activity and infrastructure, together with a much lower internal migration since the 90s, could be responsible for the stable gap and the recent divergence between the South and the rest of the country.

3) Among the possible causes of household inequality trends, demographic changes (household composition) are found to be relatively unimportant, as opposed to female labour force participation. In particular, labour force participation increased largely for women of high-income families while it did not change substantially for women from families at the lower deciles of the

income distribution. The implication is that the increase of female labour force participation tended to increase household income inequality (Fiorio, 2011).

4) The difference between the average income of young and old workers has increased, most likely because of the increased instability of incomes for young workers due to the recent changes in the labour market and the diffusion of temporary contracts, which – on average - affected elderly and young workers differently. No major difference is found between prime age and older workers' average incomes. Most likely these results are due to three factors: the increased coverage of the welfare system since the early 1980s, the larger share of pensioners among Italians, and the fact that pension income has an equalising effect on the overall distribution.

5) The role of self-employment income in explaining inequality trends in Italy is important: changes in self-employment income account for a similar proportion as changes in employment income, even though the total contribution to national income of the former is about one third of the total contribution of the latter. The incidence of self-employment is related to issues of tax evasion and the structure of the labour market, which will be addressed in the next sections.

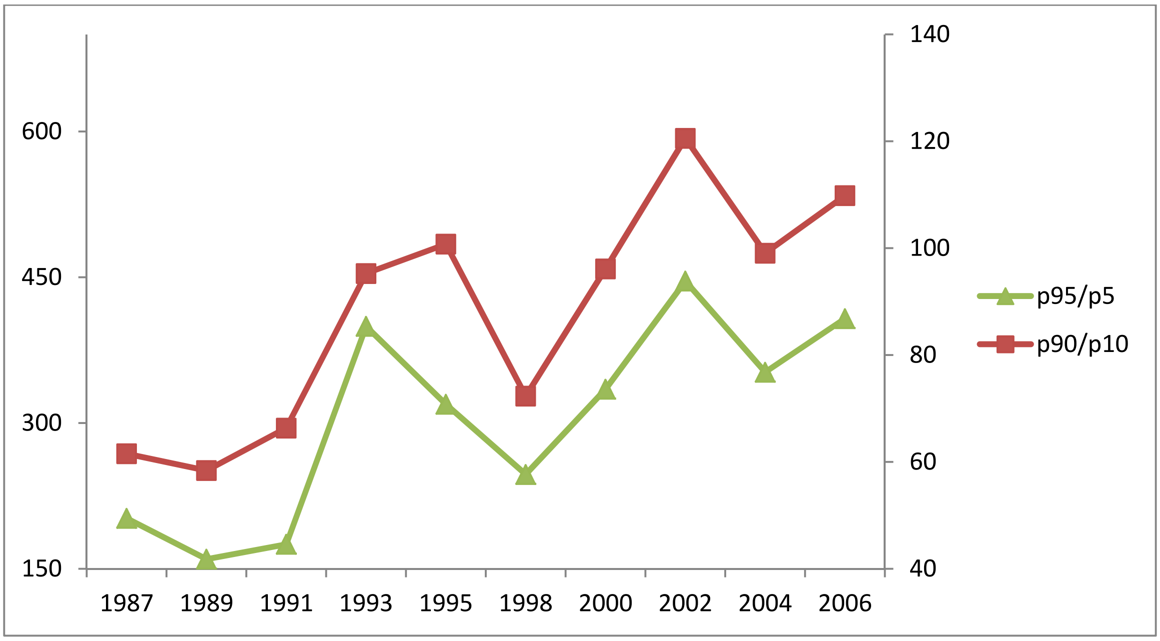
Finally the data on consumption inequality provide a complementary picture. The evolution is similar to the one for income but with reduced volatility: decline in the 80s, increase in the 90s and stable after. Consumption is a better indicator than current income of household living standards in the longer run. In the early 1990s, inequality in income rose sharply while consumption inequality did not because consumers smoothed transitory variations in earnings with savings and new debt. This brings us to wealth distribution.

Wealth and debt inequality

Italy is a country of high net private wealth but also of high public debt. The net total wealth increased over the whole period between 1965 and 2009, though faster between 1985 and 1993 and between 1996 and 2007. The wealth of families experienced also negative growth in real terms in 1977, when it reduced by over 4 p.p. and between 1981 and 1985, when it reduced by about 8.3 p.p., and between 1993 and 1994 when it reduced by about 5 per cent per cent. Only in 2008 did the increasing trend of per capita net wealth slow down, reflecting both the progressive reduction in the growth rate of Italian GDP and the progressive reduction of private savings (D'Alessio, 2011).

Interestingly, the ratio of net wealth to GDP also presents an increasing trend, which is reasonable, as GDP has also largely increased over the same period. Notwithstanding the flatter trend, the net wealth over GDP ratio is roughly doubled, showing that Italy has increased its wealth more than its production. This shows the growing relevance of wealth as opposed to income, which has important implication in terms of overall inequality. Figure 2 also presents some inequality indices (p90/p10 and p95/p5) for net wealth, highlighting the fact that the distribution of wealth became increasingly unequal across the last two decades, reinforcing the trend that we have observed for the case of income.

Figure 2: Quantile ratios in Italy. Source: SHIW



It has to be noticed that while net private debt of households has grown in most countries in recent decades, in Italy it reached much lower levels with respect to other countries. For example in 2006 it was 68.8 per cent of disposable income while it was at 174.9 per cent in the UK. The per capita average value of house loans was 5.100 euro in Italy against 28.800 euros in the UK. This is due to the higher house ownership ratio in Italy and also to a less developed financial market. In any case the low level of private debt helped make the impact of the recession less serious.

Finally an important issue for Italy is the relationship between the wealth of families and the total public debt, which indirectly is a liability of Italian citizens. In the period considered, Italian public debt largely increased. In 1965 the total amount of the public debt corresponded to an average per capita debt of about 2,700 euro (at 2009 prices) and it is more than 10 times larger in 2009, reaching 29,500 euro. Therefore families have weathered the crisis and inequality has not grown thanks to private wealth but the price is paid through a higher public debt.

Labour market inequality

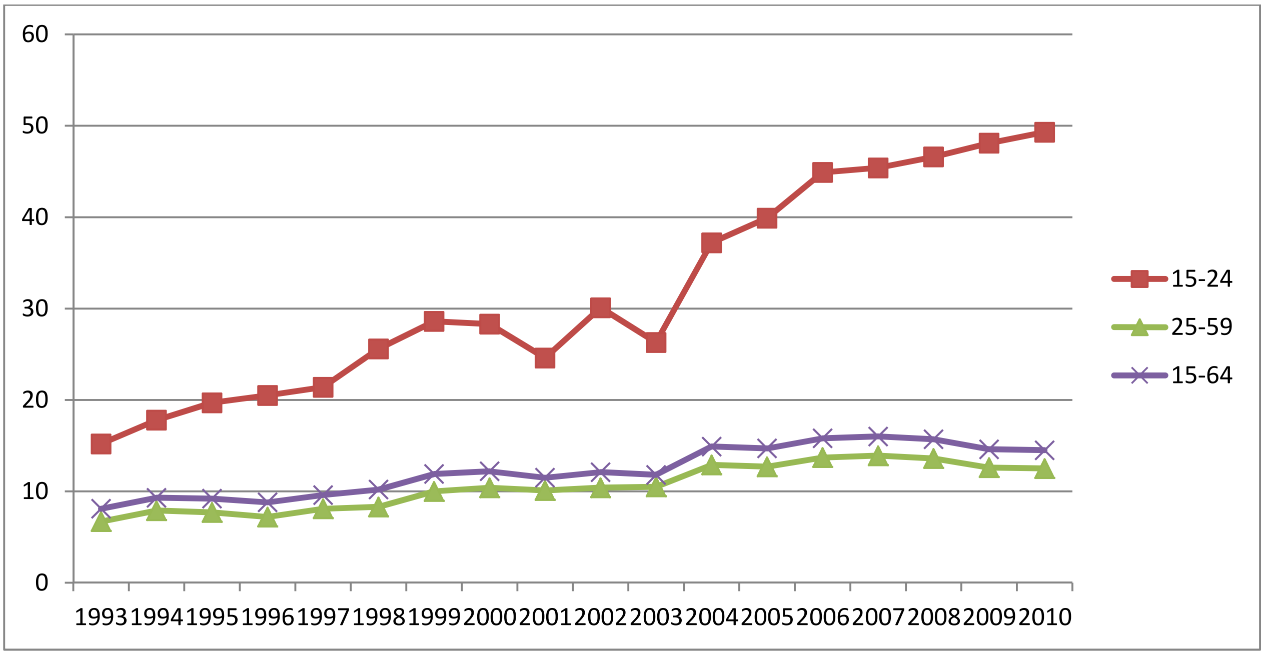
The Italian labour market displays major differences across gender and age groups. According to EU- LFS data, the employment and participation rates for men are stable around 70 per cent and 75 per cent respectively, in line with most European countries. However, labour market participation and employment are particularly weak for women, with participation and employment rate respectively slightly above and slightly below 50 per cent. The mean hides regional differences: while women in the North have an employment rate around 56 per cent, in the South it is around 30 per cent: a large portion of females, mainly in the Southern regions, do not participate in the labour market. There are also major differences between women with and without children: approximately 15 per cent of employed women quit their jobs after giving birth and do not come back to work. The two greatest factors of employment inequality in Italy are the gender and the regional dimension. Furthermore employment rates for the young and the elderly are low compared to many other countries.

A major factor of inequality in the Italian labour market is the diffusion of temporary contracts since the so-called Treu Law of 1997 and the Biagi Law of 2003 (see for a description of the reforms Cappellari, Dell'Aringa and Leonardi, 2012). The stock of temporary contracts of various types reached 13 per cent of total employment after 2005. Temporary workers, mainly young and females, have lower wages on average and a volatile employment attachment. Figure 3 shows that among female workers aged 15 to 24 the rate of temporary contracts has reached 50 per cent of employment in 2010 (only slightly less for males). The figure also shows that temporary employment has a clear generational gradient, as the percentage of temporary contracts decreases rapidly to 10 per cent of total employment among workers aged 15 to 65.

The incidence of temporary contracts in employment is in line with other European countries. However, other contractual arrangements exist, through which firms can use the labour services of external workers. As in many other countries there are temporary work agencies supplying labour services upon the payment of an agency fee. Additionally, and this is mostly an Italian peculiarity, firms can use collaboration contracts. These contractual arrangements provide an employment framework for individuals who are not formally dependent of the firm. Formally, these workers are self-employed, but often firms use their work as if they were normal employees. Thanks to a reduced regime of compulsory pension contributions, and to lower labour costs compared to regular employees (in most of the cases they are not represented by trade unions), many employers, mostly in the tertiary sector, including the PA, use them extensively. Finally, with the same intent of saving on labour costs, firms may simply outsource tasks to single individuals, who act formally as external supplying firms but actually have an exclusive relationship with the firm, thus being in all effects economically dependent from it.

The peculiarity of the Italian labour market concerns the possible inclusion of part of the formally self-employed workers (i.e. collaborators and external suppliers) in the group of temporary employees. In Italy 10 per cent of those aged 15 to 24 are self-employed compared to 4 per cent on average in the EU (OECD 2010). Understanding how many of these are not really self-employed but "economically dependent" from a single firm is not an easy task and depends on the interpretation and the definition of the "economically dependent". The best estimate of "economically dependent" self-employment is probably around 1.5 million workers, i.e. those who work exclusively at the principal office. In this sense, the inclusion of this type of workers in the category of temporary employees makes their incidence substantially higher in the Italian labour market than in other European countries, increasing the share of temporary contracts from 13 per cent to 19 per cent of the employed population aged 15-64 and from 50 per cent to 70 per cent of the employed population aged 15-24.

Figure 3: Share of temporary contracts among women in Italy.



Source: LFS

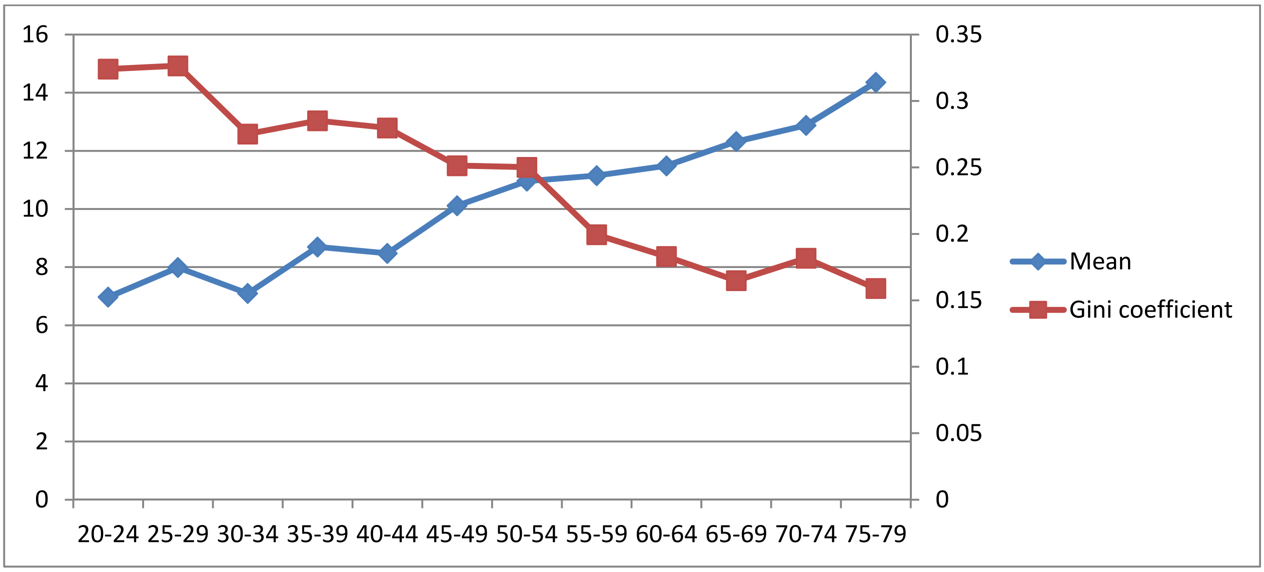
Educational inequality

In line with the global trend, educational attainment in Italy increased substantially over the last century. In about fifty years, the average years of education almost doubled, increasing from around 7 for the cohort born in the first half of the Twenties to around 13 for the 1975-79 cohorts.

The same pattern emerges when educational attainment is measured in terms of school level completion rates. While in the oldest cohorts only 30 per cent of people completed lower secondary education, in the younger cohorts this percentage is close to 100 per cent. Similarly, the completion rate of upper secondary education grew from around 16 per cent to 65 per cent and completion rate of tertiary education has also grown but it is still quite low compared to other OECD countries. The rapid expansion of schooling started in the 1950s after the Second World War in response to the extraordinary growth rates and the new economic and socio-political conditions. During the 1 9 60s governments have implemented several reforms to create a more democratic and universalistic school system. The first reform in this vein was implemented in 1962 and created a unique and comprehensive lower secondary school, de-stratifying the previous tracked system. A second reform in 1969 significantly reduced restrictions to access tertiary level education by allowing graduates of vocational secondary schools to enrol to all university faculties. These institutional changes produced a major expansion in schooling and in substantial reduction in educational inequality. For example, microdata from the European Social Survey indicate that starting from the cohort born in 1920, while the average years of education doubled between 1920-24 and 1975-79, inequality of years of schooling steadily decreased (see figure 4).

Inequality in education can also be evaluated considering its distribution across social groups and evaluating intergenerational mobility in school attainment, that is, the weight of parental background in determining pupils' attainment. Evidence for Italy suggests that educational inequality has declined over time, as the importance of family background decreased. However, while the impact of parental occupation has significantly decreased over cohorts, that of parental education seems to be quite stable over time (Ballarino and Schadee 2008; Ballarino et al. 2009).

Figure 4: Educational levels and inequality in Italy.



Source: Meschi and Scervini (2010)

Drivers and interdependence between inequalities

The substantial stability of income inequality during the last twenty years masks significant changes within the distribution associated with labour market transformations. The increased flexibilisation of labour market regulations has mostly affected the young component, which remain a source of additional incomes within pre-existing families, indicating a reinforced role for the family as income shock absorber. This is interesting, as reforms intended to increase employment, and thus to diminish the role of the family compared with the market in providing economic opportunities to individuals, have had exactly the opposite effect.

The high level of private wealth has allowed families to sustain an extended period of economic crisis, however the data on household wealth growth and distribution indicates that households may be challenged in maintaining this role in the future, since an increasing fraction of them has begun to run down previous savings (as indicated by data on wealth inequality).

Finally, data on educational attainment provide a basis for for some optimism, because education is expanding and the impact of family background is reducing in more recent cohorts thus improving intergenerational mobility. However, this is a situation common to all advanced countries, and Italy is in fact among those where such a reduction has been lower (Breen et al., 2010).

3. Social Impacts

Having analysed the dynamic of income inequality over the last decades, it is important to see how it relates to other features of social life at individual, household and social level. A general point is in order before entering into the detail: we do not find clear correlations over time between the pattern of the Gini index (and of other indices) and most of the social phenomena of interest. This reflects a number of factors. First, we have seen that the Gini index in Italy has been relatively stable in the last two decades. Second, the Gini index is a mean, which can hide important internal changes in the distribution offsetting each other, and most datasets do not allow one to disaggregate this mean enough to compare the pattern of income inequality and that of potential outcomes over different social groups. Finally, and perhaps more importantly, the transmission from income inequality to various forms of social inequality can take time, intervening variables can weaken the impact itself, and the observation window available for most of the outcomes of interest is relatively short. Given these general problems, in this section and in the following we will limit ourselves to describing the relevant patterns of Italian social inequality over time and in comparison with the other European countries.

Consistently with higher income inequality, Italy is characterised by a relatively large fraction of materially deprived families. Risk of poverty is also higher, at 18.3 per centper cent against a EU-15 average of 12.8 per cent (Eurostat data). Moreover, the geographical distribution of (income) poor families, which in the south are six time more frequent than in the north, gives an impressive picture of how unequal are life chances in the country. While the family acts as a shelter against individual poverty, Italian families are changing as elsewhere in Europe, albeit with some time-lag due to cultural factors, related in turn to the importance of the Catholic Church and its influential stance in promoting the traditional family. For instance, the percentage of single households was 5.7 per centper cent in 1983, and increased to 16.2 per cent in 2009 (Istat data). Declining marriage rates and increasing divorce, combined with the increased number of single- parent families, the decline in fertility and increasing births outside marriage, all indicate a reduced capacity for families in attenuating income volatility and deprivation risks. Individuals tend to postpone their marriage, and age at childbearing increases accordingly.

However, familism still emerges as one of the most recurring attitudes among Italian families, as the country scores comparatively low in all measures of social capital based on trusting others (OECD, 2001) as well as on social participation (Eurostat, 2010). Concerning the latter, it is interesting to note that Italy ranks among the countries with the highest frequency of contacts with friends and relatives: the concept of "amoral familism" (Banfield, 1958) seems still useful to describe the way many Italians feel about their social relations. This general situation, coupled with the historical weakness of the Italian state to provide protection against risk, makes for a quite pessimistic forecast concerning the future evolution of both poverty risk and inequality therein.

Besides low fertility, the other main features of the Italian demography are relatively high levels of life expectancy, a negative natural increase and a positive balance between immigrants and emigrants, with persistent regional variability. Such patterns are typical of Southern European states, while the strong and persistent regional variability is typically Italian. Health status as measured by life expectancy and infant mortality rate has improved markedly over the twentieth century. The median age of death during the last forty years increased by 8 years for men and 12 years for women, and is now at 78.3 and 84.1 years (Istat data). A similar improvement can be seen in the number of deaths per 1000 live births. Both indicators display a similar trend for men and women. For what diseases are concerned, in the last twenty years we do not observe a clear improvement in the individual health status. Hypertension and diabetes are increased both for males and females. Breathing problems decrease for males and are fairly stable among females, while cardiovascular problems decline among females and are stable among males. This gender gap might be possibly related to unhealthy habits in eating, drinking and smoking, more frequent among men.

Housing is a powerful channel for inequality reproduction in Italy. With almost 4/5 of the population owning their home, after having received it as gift/inheritance from the previous generation in 3 out of 5 cases, the deprived families tend to be those who cannot obtain a mortgage loan and are forced to live on (increasing) rents. Moreover, a clear social class gradient can be seen in rates of home ownership: the cumulative structure of inequality is quite clear in this case, as well as the low capacity of the state to provide help to the social groups more in need. Social housing, which had been quite important from the early 20th century up to the 80s, has in fact almost disappeared since a couple of decades.

The general trend of all recorded crimes is increasing until early 1990's, when it peaks, probably related to the internal Mafia wars that ravaged the South during that period. Then we observe a stable situation, with some signs of a declining trend in the last years. The downward trend is particularly strong for homicides, also in international comparison. In 1980, the homicide rate in Italy was about the double of that of the other big western EU countries: the figure per 100,000 inhabitants was 1.9, compared to 1.0 in the UK, Spain and France. In 2006, the Italian rate went down to around 0.7, compared to 1.4 in Spain (2004), 0.8 in France (2004), 0.4 in the UK[2]. This general pattern has probably to do, as elsewhere, with the changing demography: while young males are the social group more prone to crime, their weight in the total population has decreased during the last decades.

Life satisfaction is declining, after a long rising trend: its long-term pattern over time is quite close to that of GDP and of life expectancy, while the recent decrease might be related to increasing inequality. Italians are slightly less satisfied with their life than their Northern neighbours, but the rising trend has been stronger in Italy than elsewhere (Veenhoven, 2011). Inside the country, there is something puzzling in the interaction between dimensions of life satisfaction and the geographical cleavage: in fact, while economic satisfaction is higher in the richer part of the country (the North), social satisfaction is higher in the poorer and more unequal regions of the country. A further puzzle is observed when one takes into account data on crime rates: while the latter have been declining lately, while life satisfaction was also declining, they are typically higher in the Southern regions, where life satisfaction (at least from a social point of view) is higher.

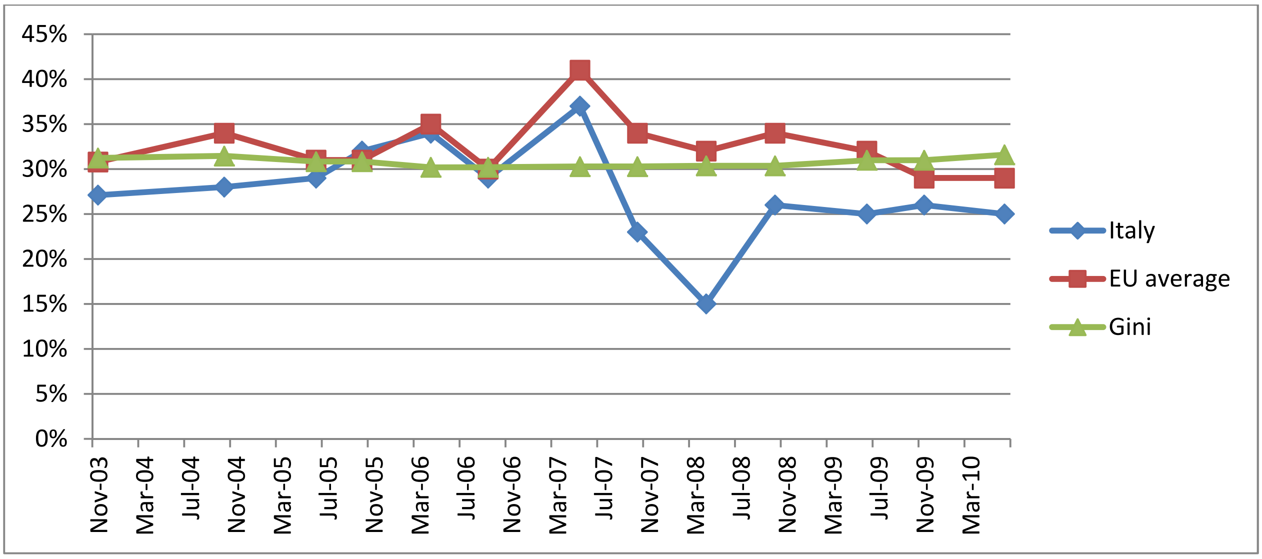
[2] Eurostat data. The figure for the US is 10.5 for 1980 and 5.8 for 2004 (Barbagli and Colombo 2011).

4. Political and Cultural Impacts

When considering political participation, Italy ranks quite high, despite the relatively high level of income inequality that has been documented in the previous sections. It has to be recalled that voting is compulsory according to the Italian Constitution, although this "civic duty" was never systematically enforced and legislation in the 90s has de facto cancelled it. However, there are three issues that should concern Italian policy-makers: first, voting turnout is declining since the early 90s, even if the level is still very high (from more than 90 per cent to around 80 per cent)[3]; second, turnout decreases dramatically among younger cohorts (more than 6 p.p. of difference) and low educated individuals (almost 6 p.p.); third, and more relevant, the correlation between the two issues is increasing over time (Scervini and Segatti, 2012a). The joint effect is that, while elderly cohort experienced a universal and equal political participation, younger cohorts are becoming much more divided, with very high participation rates among more educated and richer individuals and significantly lower voting turnouts among low educated and poorer individuals. In turn, this may result in a worse representation of such disadvantaged classes (see Scervini and Segatti, 2012a, for more details).

By contrast, participation in civic activities, proxied by being a member of any kind of organisation (social services, religious groups, sport and recreation activities and so on), in Italy is lower than in many European countries. Moreover, there is a significant difference between rich and poor (more than 27 p.p. of difference in 1990) and between men and women (around 10-15 p.p., stable over time). With respect to the trend, it is interesting to notice that, after a period of expansion, the share of people participating in civic activities slightly decline in the last decade, with a drop of more than 5 p.p. among women.

Figure 5: Trust in Government.



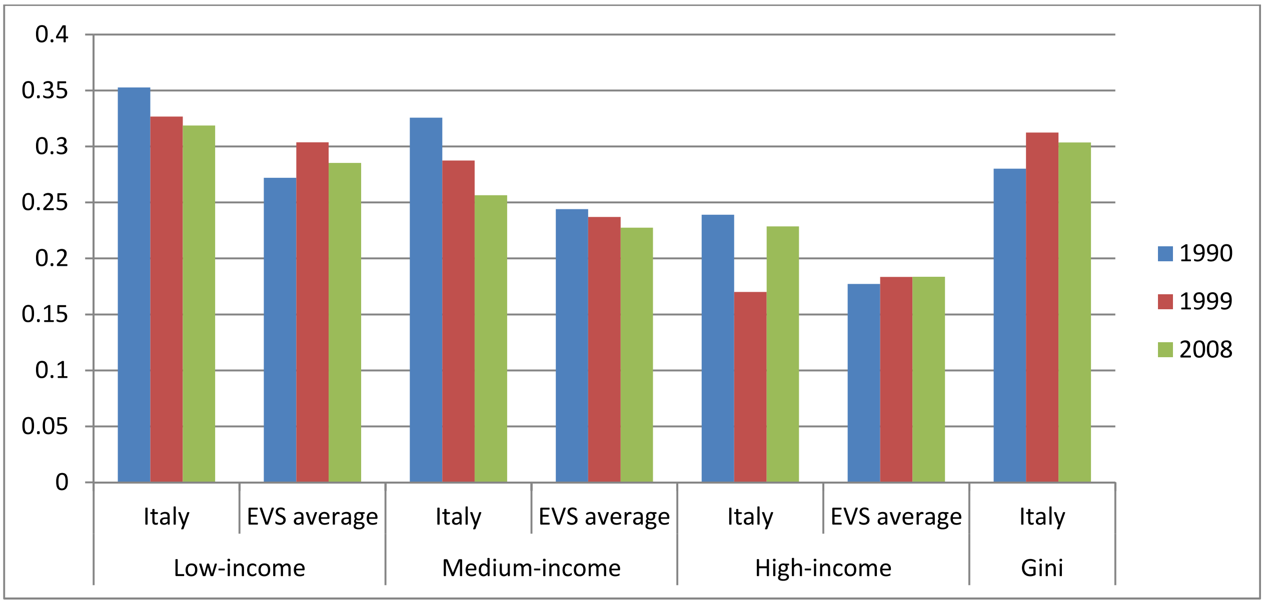
Source: Eurobarometer

[3] A dramatic fall of participation (75.2 per cent) took place in the last election, on February 2013. Scervini and Segatti (2012a) explain also the limited impact of the abolition of compulsory voting on electoral turnout.

The loss of confidence in the government and the disillusionment with political representation may also be responsible for the convergence towards the centre in the political self-assessment. In particular, since the early 1970s, the share of people declaring to be of the extreme left declined steadily, without differentiation by gender and education (also due to the breakdown of the Soviet Union). On the other side, Italy experienced an increase of people declaring themselves to be of extreme right (from 5 per cent in 1976 to 10 per cent in 2008). In this case, however, the increase is much higher among low-educated individuals (7 p.p. of increase, with respect to about 2 p.p. for high-educated ones). Related to this is the increase of xenophobia and the intolerance toward immigrants and foreign workers (in 1981-84, only 3 per cent of Italians did not like an immigrant as a neighbour, while the share was at 16 per cent in 2008-10).

The final evidence we provide concerns the puzzling data on support from redistribution. Among the poorest of three classes of individuals, there is a significantly higher share of individuals believing that poor are lazy and opposing the role of the State in supporting poor individuals (figure 6). Moreover, the support for redistribution from poor interviewees has declined over time, despite the increasing inequality in the aggregate. However, poor also believe that incomes should be made more equal. Therefore, those who would benefit more from a strong government, who could effectively redistribute wealth and opportunities, do not believe in this possibility. Only rich families exhibit more awareness of the changed economic situation (Scervini and Segatti, 2012b, for more details).

Figure 6: Share of individuals who self-positioned as 8-10 on a 1-10 scale between the extreme statements: "The state should take more responsibility to ensure that everyone is provided for" (8-10) and "Individuals should take more responsibility for providing for themselves" (1-3).



Source: EVS

The evidence we presented concerning the cultural and political impact of inequality is in general consistent with that on its social impacts, as presented in the previous section. On its basis, we would suggest that the weakness of the state left Italian individuals and families alone in trying to absorb the employment shocks, which are the main source of income and worked hours' variability. Moreover, being embedded in relatively weak social ties (as witnessed by comparative low levels of social capital), they feel abandoned by their governors, and therefore lose interest in policy. This is particularly clear in the young generation. Not surprisingly, poor individuals seem to lose interest and hope in the redistributive role of the state, while educated/rich individual exhibit the opposite behaviour. We have seen how changes in the political system contributed to this feeling of helplessness: in particular, the weakening of political parties and of their partisan ideology resulted in a decrease of the social and cultural support available to individuals. Not surprisingly, racism and intolerance are on the rise, with right-wing extremism diffusing, and thereby reinforcing the very same feelings it grew from.

Of course, persistently high income inequality does not help in solving the problem, because it exacerbates social distances (thus making more difficult the production of social capital), as well as pushing people back within their homes. Moreover, we have seen that a vicious circle is operating: the economically worst-off people, who would benefit more from state redistribution promoted by the political system, are the very same ones who participate less to the political system. This is a phenomenon widely diffused in contemporary democracies, especially in the US, where the level of electoral participation is particularly low. However, in the Italian case the vicious circle appears to be increasingly important, because of the historical weakness of the state, augmented by the loss of legitimacy of the whole political system, following the collapse of the traditional parties in the early 90s. The parties that have substituted the old ones have been not able, at least up to now, to stop the decline of interest and trust in politics on the part of the Italian public, especially from the lower classes and the social groups more at risk of poverty.

Some cause for hope emerges from the observed correlation between educational attainment and civic participation: since education is expanding and educational inequality is declining, as was documented above, this may partially counteract any further detachment from social participation. We now move to another key topic of the patterns of inequality in Italy, namely the impact of policies aimed at the reduction of inequality.

5. Policy

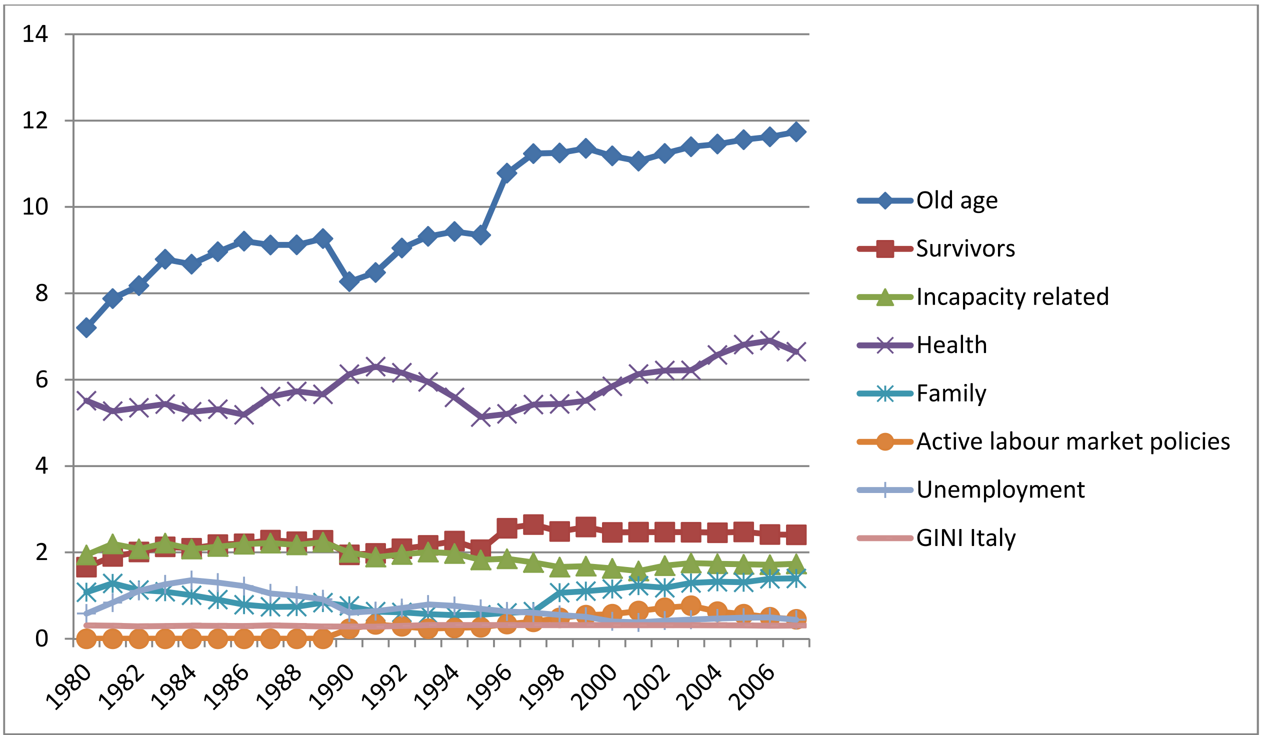
Social expenditure

Italy spends approximately as much as other European countries for social benefits, but the internal composition of this expenditure is biased against the young generation. Expenditure in unemployment benefits and housing appears compressed to leave room for expenditure towards the elderly, through the pension system.

Over the past thirty years social expenditure rose by 7 p.p. of GDP, 5 of which are accounted for by the increase since the mid 90s. The bulk of Italian social expenditure concerns pensions. The increasing burden imposed by old-age pensions, and the unsustainable social security system of the 80s, motivated several reforms that were introduced in Italy by governments since the 90s.

Social expenditures that are likely to benefit younger people and families – whose job security was sensibly reduced by the recent labour market reforms – are very low and stable over time. Branches such as family, unemployment, and active labour market policies account for less than 2 per cent of GDP each. Unemployment benefits (in particular the *cassa integrazione guadagni*) tend to protect more those who lost a job than first-time job seekers, and youth unemployment rates in Southern Italy are among the highest in Europe, both factors meaning that there will be pressing needs in the future for adequate forms of income support for young unemployed people and families.

Figure 7: Public total social expenditure by branch.



Source: OECD – SOCX database

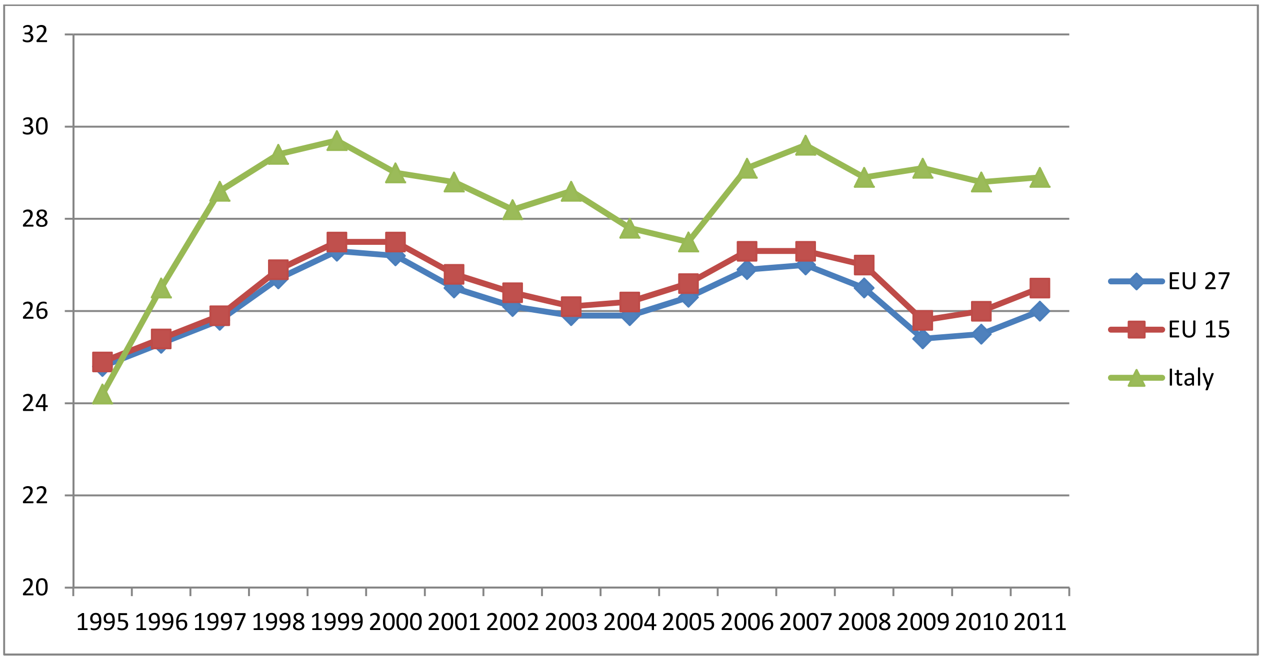
Note: The figure reports public total social expenditure (all types) by branch as percentage on nominal GDP. Housing and Other social policy areas always account for 0 per cent of GDP.

Taxation

On the revenue side, apart from the highest incidence on GDP, the tax burden is unequally distributed (leaving large room to indirect taxation). Italy is one of the countries in the EU with the highest level of taxation. Its tax burden increased significantly since the currency and fiscal crisis that hit it in 1992, as a key component of the more general social and political crisis. Since 1998, total tax burden remained at about 2 percentage points higher than the EU averages. If social contributions are also taken into account, labour income is taxed much more (around 20 per cent of GDP and 50 per cent of total tax and social contribution revenues) than consumption and capital (each about 10 per cent of GDP and about 25 per cent of total revenues).

Tax evasion in Italy is estimated over 25 per cent of total tax revenues, a very large share compared to EU27 average, and it could significantly alter the distribution of incomes, if only seriously tackled by policy makers. Tax evasion is much stronger among self-employed workers such as entrepreneurs, professionals, owners of small shops and businesses: this difference may have played a part in the increase of inequality among self-employed workers, that we have seen, in the first section, to have been significantly higher than that among dependent workers.

Figure8: Tax burden as GDP percentage, Italy vs. EU average.



Source: Eurostat

Benefits and welfare

With respect to fighting inequality and social exclusion, the main problem is the lack of measures against poverty regulated at the national level. The existence of regional programs minimises any redistributive aim of these initiatives. Benefits in kind are still a minimal part of the public support to the needy, while pensions remain the main channel of monetary transfer. Italy does not have measures against poverty defined and regulated at the national level (Kazepov, 2011): those who are in a situation of economic distress are not covered by generalized national measures of social protection, but only by local-level ones, with a strong variation among territories. The only exception to this situation is a national program to support the income of individuals aged more than 65 who do not have an occupational pension or have one that comes under a given threshold. This program, called *pensione sociale* up to 1995 and *assegno sociale* thereafter, is managed by the national pension fund (INPS).

Between 1999 and 2000 a centre-left government attempted to introduce a universal income support program for those under a giving income level, modelled on the French *revenu minim d'insertion*: besides income support, the program provided assistance in job search, re-training and other active labour market policies. The program was experimented in a selection of municipalities, but unfortunately there has been no systematic evaluation of its outcomes. After the end of the experimentation, the program was due to be generalized nationwide, but it was not, because of a change of government.

As it is typical of the Mediterranean version of the "Conservative" welfare regime (Esping-Andersen, 1999; Ferrera, 2006), the core institution providing care to those in need is the family: most of the assistance to children and the elder is carried out by unpaid female members of the households.

Pensions still constitute most of the social transfers in Italy. Their internal composition has changed: the weight of the integration to the low pensions have decreased while pensions to the disabled have notably increased. It has to be noted that the latter include transfers toward the familiars of the disabled person (called *indennità di accompagnamento*, accompaniment allowance). This program is managed at the local level, and is often criticized as its management involves a lot of discretion on the part of its managers, who are typically controlled by the local government. This makes this kind of pensions a frequent object of political exchange and an important resource in the building of clienteles on the part of local politicians (Madama and Ferrera, 2006), especially in the poorest areas.

In the conclusion, we shall come back to social transfers and their effectiveness, giving a general picture of the extent of redistribution provided by the Italian government.

Labour market and active labour market measures

Historically, Italy has always presented very low expenditure on active labour market policies compared to other European countries, around 0.5 per cent of GDP, half of other countries such as France and Germany. The definition of active policy, however, is quite contested, because many of the policies that are considered "passive" contain some form of activation, in the sense of being contingent on labour market search. However, this is not the case of Italy, where unemployment benefits are not conditional on job search. Also the definition of active policy is subject to some caveat, in as much as it contains policies like public job creation.

Most Italian expenditure in labour market policy is allocated to passive policies (early pensions and unemployment benefits). Historically, they constitute around 60 per cent of total expenditure on labour market policies, but during the crisis this share went up to 78 per cent, as payments to the short time work program soared. The *cassa integrazione guadagni*[4] is similar to the German *Kurzarbeit* but usually – unlike the German case – puts workers on total suspension from work, while in Germany the system more often implies a partial suspension. But this makes a big difference: while the German system allows firms to increase their internal flexibility, pushing them to redistribute tasks and workloads among employees, the Italian system increases external

[4] Literally: wage integration counter.

flexibility. In fact, it incentivises firms to substitute older dependent workers (with standard employment contracts), who exit via *cassa integrazione* or early pension schemes (*prepensionamenti*), with younger workers hired with the new "atypical" fixed-term contracts. But in this way the Italian policy, besides reducing labour costs to the firm, also weaken the relation between firm and workers and thus the propensity of both parts to invest in human capital, with negative outcomes on the propensity to innovate. The very different performance of Italian and German firms observed during the last years is probably related to the different labour market reforms experienced by the two countries.

Labour market institutions should be inequality reducing, but the decline in union membership and coverage (union density went from above 50 per cent at its 70s peak to around 33 per cent, still high in comparison), coupled with the absence of a minimum wage scheme raises strong doubts about the effective ability to prevent further increases in earning inequality. On the contrary, the outcome of neo-corporatist bargaining (*concertazione*) from the early 90s, has produced a new cleavage, between younger and mature workers, that adds up to the already existing inequalities.

Italy does not have a legal minimum wage, but has a system of collective bargaining agreements based on two levels: the first or centralized level where firms and trade unions define wage and employment levels and general working conditions and the second or firm-level bargaining where the firm and the local unions bargain over the rents produced at establishment (or firm) level. Italy is a country with little decentralization of contracts, as only little more than 15 per cent of firms (especially large firms) have a firm-level bargaining system. It is unclear whether these institutions had a direct impact on inequality. Given that, as we have seen above, inequality in Italy has increased in the crises of the early 90s, but has been stable since then, it is likely that institutions have had a minor effect on the trend in inequality but may have had an important effect in this discontinuity. As recalled above, in that year the entire system of wage indexation rules was reformed.

Schooling institutions

Among the policies that may help combating and reducing inequalities, the design of the educational system certainly plays a prominent role. The Italian school system is unified and comprehensive until age 14, when pupils have to choose between academic and vocational tracks.

In this sense, the Italian system is less stratified compared to many other European Countries, where the age of first selection into school tracking is lower (e.g. at age 10 in Austria and Germany, 11 in Czech Republic, Hungary and Slovakia, 12 in Netherlands and Belgium). Nevertheless, Checchi and Flabbi (2007) argue that in Italy (compared to Germany) parental education is more relevant than ability in determining the choice of different tracks, which tends to reinforce intergenerational persistence. This depends on the mechanisms allocating 14-years old pupils to the different tracks: while in Germany this allocation depends to a big extent on teachers, whose indication are binding in most of the German Länder, in Italy the allocation depends almost exclusively on the family, whose choice is not constrained by the school. Thus, ability does not pay a big role in this process, while familiar aspirations and motivation do.

In Italy, pre-primary education lasts 3 years and is addressed to children from 3 to 6 years of age. The pre-primary level is part of the education and training system, yet it is not compulsory. The state took over complete responsibility in the sector of pre-school education only in 1968, when it recognised its educational value. Since then, even if not compulsory, pre-primary education has been provided free of charge by the state, and the only things families have to pay are small contributions, from which low-income households are exempted, towards transport and canteen services. Over the last 10 year, several laws have stressed the objective of generalisation of the offer and a widespread attendance of pre-primary school. In this spirit, the reform of the education system in 2003[5] provided for the full introduction of pre-primary education in the education system. As a results of these policies participation in pre-primary education increase substantially until around 100 per cent of participation[6].

Other dimensions that may affect educational inequality are related to the school admissions arrangements and school competition. Public school admissions can be broadly organised around two models of school provision: i) neighbourhood-based systems, where admission is purely determined by where pupils live, typically with rigidly defined catchment areas; ii) choice-based systems that are meant to give parents a wider choice set not limited to neighbourhood schools. Choice-based systems are found to increase social stratification of schools along lines of ability, ethnicity and socio-economic status, since families with higher socio economic status benefit at the expense of the poor, because they are advantaged in their ability to exercise choice as they are better equipped at making good decisions and they are also less constrained by transport costs (see for example Gibbons and Silva, 2006). In Italy, enrolment in state schools doesn't depend on catchment areas and the families can choose whether to enrol the pupil at the school of the area of residence or in any other school they may prefer, provided a place is available. When available places exceed demand, priority is given to those who live in the local area.

Related to the question of school competition, the proportion of private school enrolment (that implies that public schools face more competition) is found to increase the effect of students' social origins on their school performance, thus reducing social mobility (Ammermuller, 2005). This problem is not relevant for Italy, that has a relatively small private school sector. Moreover, Italian public high schools are associated on average to better performance than private schools that appear to focus more on the recovery of less brilliant students than on high quality education (see Bertola and Checchi, 2002).

6. Conclusions: appraisal of the interdependence and the 'national story' of inequality drivers in relation to policies (causes and effects)

There is a well-established consensus among economists that inequality in Italy has been stable over time since 1992. In 1992 a significant institutional change was implemented. After a severe

[5] Law no. 53 of 28 March 2003

[6] Gross enrolment ratio is defined as the percentage of pupils enrolled in pre primary of education regardless of their age over the population of the age group which officially corresponds to that level of education. Since pre primary schools also accept early enrolments (pupils aged less that 3), this percentage can potentially be higher than 100 per cent.

economic recession, the wage indexation mechanism (*Scala Mobile*) was abolished. As a result, inequality jumped upwards and has remained there since then. The overall stability hides changes within the distribution.

Two powerful dimensions of inequality are gender and the geographical divide. In the Italian case, gender inequality is decreasing over time, as women labour force participation is increasing. However, it is still higher compared to other countries, especially the Northern ones. However, this trend is fully coherent with the global trend and we do not expect the Italian case to be significantly different from other countries that experienced an earlier process of equalization of labour market opportunities between genders. By contrast, the geographical cleavage has not changed over time, as GDP per-capita in the Southern region is stable at 65 per cent of the North.

The main recent driver of inequality in Italy has been labour market reforms, which worsened the relative position of the younger generation. Labour market inequality increased with the implementation of the Treu Law in 1997 and the Biagi Law in 2003. On the one hand, these reforms increased employment and slightly decreased informal work (still significant in Southern regions and especially for females). On the other hand, the reforms have increased the diffusion of temporary contracts among younger workers (50 per cent of females and 40 per cent of men aged 15-24 in 2010). These reforms increased earnings inequality and instability, in particular among the younger cohorts (Cappellari and Leonardi 2012, Comi and Grasseni, 2009; Ballarino and Barbieri, 2012). More than by the incidence of temporary employment, Italian policymakers should be worried by the widespread use of self-employment instead of the dependent contracts. If added to the number of temporary contracts, the 1.5 million self-employed with characteristics similar to dependent employees would dramatically increase the number of young people at risk of precarious work and would push Italy at the top of the incidence of temporary employment in Europe (along Spain).

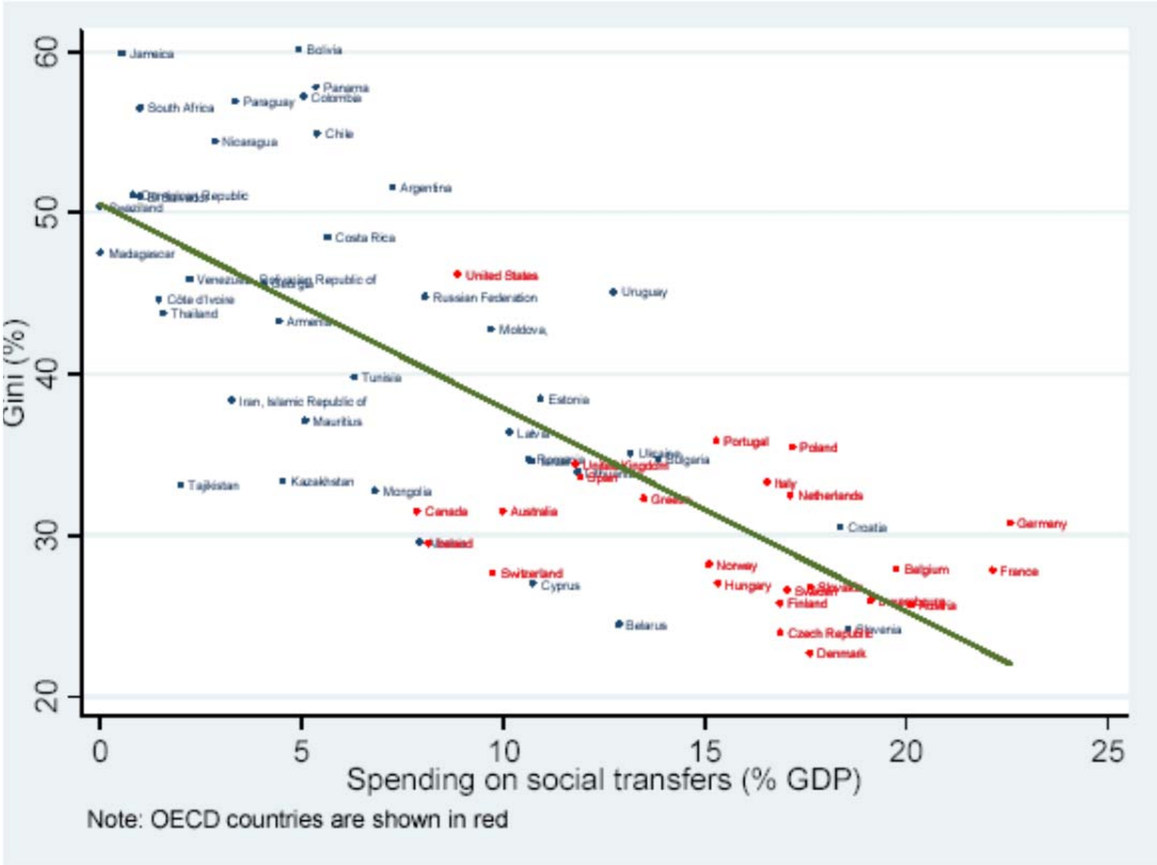
Another crucial dimension of inequality in contemporary Italy is related to workers' condition as employees and self-employed: self-employment is a key factor in explaining the growth of inequality. It is not clear instead in which way institutions, such as unions and collective wage bargaining, affected inequality. Given that inequality in Italy has been stable since 1992, it looks like those institutions have had a minor effect on the trend in inequality but may have had an important effect in the discontinuity in 1992. After that date inequality went back to the levels observed before the 1970s.

Finally, the almost stable level of inequality could depend on the distribution of net wealth in the Italian population. Italy has a very high saving rate that has buffered transitory volatility of income and guaranteed stable consumption. The distribution of wealth is very unequal but a peculiarity of the country is the large diffusion of home ownership (80 per cent of households) and this has also guaranteed stable consumption. However, high savings and house property are typical of individuals in the central part of their life and the situation might be radically different for the young generations with temporary contracts, low saving and inability to buy houses.

To conclude the chapter, we present a summary assessment the effectiveness of Italian public policies to reduce inequality. In fact, there is a strong negative cross-country correlation between social transfers and indicators of income inequality. Figure 9 reports, for instance, a cross-plot of the Gini coefficient versus spending in social transfers as a per cent of GDP. The graph shows a negative correlation: countries that spend more have lower inequality.

However, this association could be interpreted in two ways. On the one side, it may suggest that countries with high inequality lack the economic and political means to fund social programmes, the so-called "Robin Hood paradox" according to which redistribution is lacking where is more needed (Lindert, 2004). It is a macro version of the "vicious circle" cumulative mechanisms we repeatedly described in this report.

Figure 9 - Social transfers and income inequality.



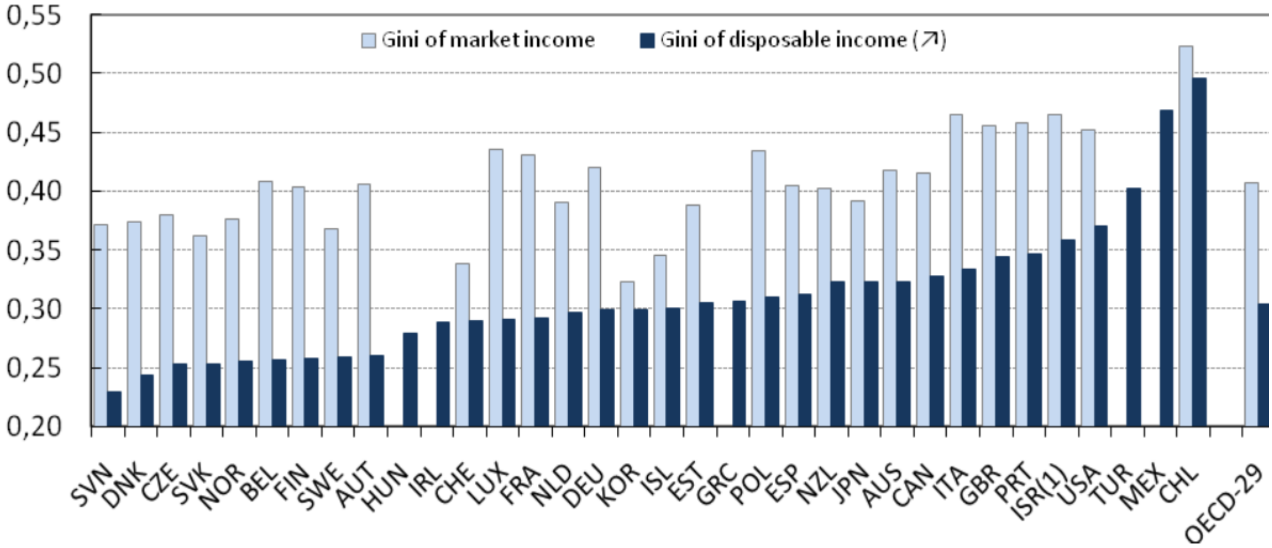
Source: Prasad (2008)

On the other hand, the same association could be interpreted as evidence that social transfers are effective in reducing inequality. In general, it is difficult to establish a clear causal link along with its direction, without exogenous variation either in inequality or in social expenditures. This argument, here for social expenditures, can be generalized or expanded to the other components of policies aimed at reducing inequality.

According to the OECD, in Italy income taxes and cash benefits contributed in the late 2000s to reducing inequality by close to 30 per cent, which is higher than the typical OECD country in which the corresponding figure is about 25 per cent (OECD, 2011). This is shown in Figure 10. Moreover, the effectiveness of the tax-benefit system at fighting inequality increased over time. Indeed, while only half of the rise in market income inequality was offset by taxes and benefits prior to mid-1990s, the rise in inequality since then was completely offset. However, we have seen that during the last two decades, the relative stability of income inequality went along with an increase of wealth inequality and of consumption inequality.

OECD (2011) also states that the contribution of social expenditure to the decrease income inequality in Italy was close to 20 per cent in 2007, a level similar to that of many OECD countries. This figure declined since 2000, in which the contribution of social expenditure was about 25 per cent.

Figure 10 - Gini coefficients of inequality of market and disposable incomes, persons of working age, late 2000s.



Source: OECD (2011)

At first glance, the evidence reported in figure 10 represents good news concerning the capacity of the Italian state to reduce, via taxation, the income inequality produced by the market. OECD (2011) itself, in fact, puts this interpretation to the forefront. From this point of view, that may seem to be at odds with much of what we have observed and commented on concerning the weakness of the Italian state and its socio-economic implications.. However, the figure also confirms what we observed earlier, namely that in Italy income inequality, be it pre- or post-taxation, is at its highest among OECD countries, and a fortiori among European countries.

How can those two, somehow opposite, interpretations be put together? One could say that a strong Italian state is able to significantly reduce a relatively high level of income inequality produced by a very anti-egalitarian market. However, this interpretation ignores the fact that the role of the state in the economy is not limited to taxation. The state also regulates the economy, in two ways: directly, via laws and administrative regulations concerning economic life, and indirectly, via the provision of incentives who shape the behaviour of economic actors. Considering this, one could first observe that the Italian state regulates the economy in such a way that the market produces more inequality than it does elsewhere: even more than in the US, according to the OECD figures.

So, despite being very high, the tax burden heavily weighing on Italians can eliminate only a relatively small part of the large income inequality produced by the market, because the state is unable to regulate it as to produce a level of inequality similar to those of the other European countries (with the exception of the UK). Thus, this reduction, despite being relatively large, comes at a substantial cost in terms of tax-paying citizens, who feel the burden of heavy taxation without getting its benefits in terms of the provision of services and efficiency in administration.

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