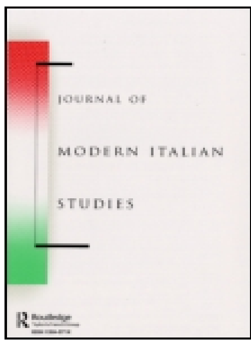

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The Italian welfare state after the financial crisis

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Abstract

The essential characteristics of the Italian welfare state as it developed after the Second World War generated social cleavages and inequities that affected the Italian economy and provided grist for future reforms. At the same time, the welfare state provided political actors with incentives and resources that constrained attempts at reform. With the financial crisis beginning in 2008, serious reform was no longer optional. But austerity politics have generated pressures for changes to the welfare state which are unlikely to moderate most of the underlying inequities generated by the post-war system. Going forward, Italian policymakers must chart a path that is informed by efforts to overcome the pathologies of the past without further undermining the social and economic health of the country.

Keywords

Italy, welfare state, pensions, family policy, unemployment, financial crisis.

How have Italy's past social policies contributed to the current state of the Italian political economy? What, if anything, should be done in the area of the welfare state that might create a path forward? To answer these questions, we need to understand first the essential characteristics of the Italian welfare state as it developed after the Second World War. These characteristics generated a set of social cleavages and inequities that affected the Italian economy and provided grist for future reforms. At the same time, the institutions of the welfare state provided political actors with incentives and resources that constrained attempts at reform. With the financial crisis beginning in 2008, serious reform was no longer optional. But austerity politics have generated pressures for changes to the welfare state that are unlikely to moderate most of the underlying inequities generated by the post-war system. Going forward, Italian policymakers must chart a path that is informed by efforts to overcome the pathologies of the past without further undermining the social and economic health of the country.

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Core characteristics of the Italian welfare state and their effects on the economy

The central characteristics of the Italian welfare state during the 'golden age' of the 1960s–80s, which persisted into the cautious reform era of the 1990s–2000s, were its Bismarckian structure and male-breadwinner orientation. In the Bismarckian model, social policies are financed by contributions from employers and workers; and the level of benefits, eligibility criteria, and the like, can vary from sector to sector and job to job within sectors. The male-breadwinner orientation assumed that the modal family had a husband employed in the formal sector and a wife at home caring for children and elders, resulting in a welfare state heavy on cash transfers and light on services; and tied most benefits to activity in the labour market.

At the level of individual policies, the Italian welfare state was distinctive when compared with the more robust regimes in place in northern and western Europe. At least after the conquests of the 'hot autumn', workers in the formal sector had access to quite generous old-age pensions and strong protection against job loss (via regulation of dismissals and *cassa integrazione guadagni* benefits). But strong employment protection legislation coexisted with miserly unemployment insurance. There was no coverage for first-time jobseekers and only minimal attention to active labour market policies. Family allowances were modest compared with elsewhere on the Continent, and outside of progressive pockets like Emilia-Romagna there was limited access to childcare, elder care and other social services. Some social assistance functions – for example, social pensions and minimum pension provisions for elderly persons with a contributory history insufficient to generate a full pension – were built into the occupational system of social insurance benefits. But Italy had no national safety net for the non-elderly: a national minimum income never developed, and cash allowances and services for the indigent varied widely from region to region. The brightest star in Italy's welfare state, at least after 1978, was the National Health Service (NHS), which provided universal access to medical care, funded at the national level and administered at the regional level.

Why are these dry policy characteristics important for the Italian political economy at large? In the first place, Bismarckian social insurance systems like Italy's come with some built-in features that, over time, come to look more like bugs. Financing social benefits based on the earnings of workers, rather than out of general tax revenues collected by the state on all forms of economic activity and wealth, creates what economists call a 'fiscal wedge'. The total cost for employers of each worker comprises that worker's wages and the social contributions owed to the government on top of those wages to cover the worker's pension, unemployment benefits, family allowances, disability insurance and the like. Despite the strong competitiveness of Italian industry in high-value-added sectors, these additional labour costs have made employers

reluctant to hire new workers, especially at the low end of the productivity and wage scale.

One result, in addition to high unemployment, is a narrowing of the contribution base because there are fewer workers hired; and with the narrower contribution base, social contributions on each remaining employee rise, creating a vicious cycle of 'labour-shedding' in Bismarckian welfare states. Another result is the creation of labour markets in which insiders – those with jobs – have good benefits, while outsiders – those without jobs – have little protection. This insider–outsider dynamic led, in Italy and other countries with Bismarckian welfare states, to pressures to liberalize labour markets in the 1990s.

Fragmented Bismarckian social insurance has also been problematic for Italy's long-term development because the existence of multiple schemes with separate rules for different groups in the population provides a key resource for clientelist politicians. The opportunity to exchange beneficial treatment for political support from specific groups of potential voters proved so tempting to politicians of the Christian Democratic and Socialist parties, in particular, that social insurance programmes were extended and further differentiated even after it was clear that the system was failing to keep up with changing demographic and economic realities. The continued existence of fragmented social programmes in turn perpetuated the grip on power of a rent-seeking political elite that drained resources from other parts of the economy, too.

Another important effect of the 'golden age' welfare state on the Italian political economy came from the pension-heavy balance of social spending. Old-age pensions are the most expensive of welfare benefits, particularly in Bismarckian systems, in which they tend to guarantee a wage sufficient to support an elderly former worker and his (or her, but usually his) family at a level at or near the standard of living while the worker was employed. In Italy, with its long lifespans and an early retirement age, the cost of providing this benefit year in and year out for a growing share of the ageing population put the economy under tremendous fiscal strain and crowded out other needed social spending like social services and policies aimed at enhancing human capital formation (e.g. job training, childcare).

The male-breadwinner orientation of the Italian welfare state also had pernicious effects. The assumption that most women would be available to care for children and ageing parents led to low levels of female labour force participation, resulting in an even narrower contribution base (with all of its attendant consequences for the long-term financial sustainability of the system). Although there is still some uncertainty in the demographic literature about the precise causal effect of inadequate social provision for families, the consensus view is that it has contributed to Italy's very low fertility. And unwillingness to make social investments in children under the male-breadwinner model has further exacerbated the crowding-out effect of a pension-heavy welfare state and resulted in weak human capital formation especially in some southern regions.

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Perhaps more visibly, the absence of a uniform social safety net in Italy has led to very high levels of poverty and deprivation. Italy now has the highest child poverty rate in Europe, but even during the economic boom of the 1990s poverty and inequality in Italy were generally second only to that in the Anglo-Saxon countries. The social insurance system in Italy was used to provide income support to some who would otherwise have fallen through the safety net, but this only increased pressure on the social insurance system and created an even larger fiscal wedge.

The effects of Italy's NHS on the economy are more mixed. The system has been generally very well regarded by international observers, in part because of the combination of below-average health care spending with above-average health. Italy scored second (after France) in the World Health Organization's ranking of health care systems in 2000, an outcome due in large measure to the fact that Italians are in better health than would be expected given the high levels of poverty and inequality (which tend to cause worse population health). Unlike the French, however, Italians do not express high levels of satisfaction with their health care system. From the beginning, the system has made relatively high demands on users for financing, in the form of fees and a private layer of provision to which many citizens make recourse to gain quicker access to care. Corruption and glaring inefficiencies in health care administration in both the north and the south have also negatively affected public perceptions of the system, and undoubtedly impose a drag on the economy. At the same time, near universal access to high-quality health care at a low cost reduces upward pressure on wages at the low end of the pay scale, and has obvious benefits for the Italian economy in terms of the health and well-being of its workforce.

In sum, for a variety of reasons and through a variety of mechanisms, the fragmented social insurance system and weak social assistance functions of the Italian welfare state constituted a liability for the Italian economy and polity. The universal health care system, despite an uneven quality of administration, provided an important backstop. But by the early 1990s, it was clear that the system as a whole required revision – in large part because it imposed fiscal constraints that were incompatible with Italy's desire to enter the European monetary union.

Beginning in 1992, Italy undertook a series of significant reforms of the welfare state. A variety of pension system reforms, mainly aimed at future rather than current beneficiaries, were designed to rein in expenditure. In an effort to reduce the fiscal wedge from social contributions and increase employment, some social assistance functions that had over time been built into the social insurance architecture were removed and financed going forward out of general revenues. There were some improvements, particularly in the north and centre, in the regional supply of social services and safety net income supports – although it is worth noting that Italy has still not decisively transitioned away from the male-breadwinner-orientation. Selective deregulation of the labour market beginning in 1997 aimed to preserve protections for the currently

employed 'core', while loosening up constraints on the 'periphery' to create more, less stringently regulated, jobs for young people. In the health care system, the reforms of the 1990s and 2000s aimed to decentralize further administration and provision of health services, while tightening central control over regional spending.

The reforms of the 1990s and early 2000s resulted in an improved fiscal outlook, with primary budget surpluses that were unthinkable in the pre-pension reform era. And the employment picture appeared to improve. However, much of the job growth, particularly for young people, was in the irregular labour market, in which social protection and long-term employment protection were minimal. Finally, the decentralization of social and health services resulted in intensified regional variation in the availability and quality of services.

On the eve of the crisis, then, the Italian welfare state seemed in fairly good fiscal health, but important dualisms remained. These included inequalities in social protection between pensioners on the one hand, and working-aged people and children on the other; between hyper-protected labour market 'insiders' and under-protected 'outsiders'; between men and women; and between residents of regions of the north and centre, and those living in the south.

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Italian welfare state during the crisis and its aftermath

Employment losses following the financial crisis and Great Recession beginning in 2008 were heavily concentrated among younger workers in temporary and fixed-term contracts. The youth unemployment rate almost doubled from 2008 to 2013, going from less than 20 per cent to 38 per cent (Garibaldi and Taddei 2013, 2). Although among middle-class Italian families consumption was often buffered by family savings, austerity measures reduced the effectiveness of an already weak social safety net, and the crisis ushered in sharp increases in extreme forms of poverty. The incidence of mental illness and diseases of poverty also increased in the period after the crisis.

In August 2011, European Central Bank (ECB) leaders issued a letter to the Italian government urging then-Prime Minister Silvio Berlusconi 'to take immediate and bold measures to ensuring the sustainability of public finances' (*Corriere della Sera*, September 29, 2011). The Monti government complied, targeting health care and pensions, which together accounted for almost one quarter of Italy's GDP.[1] The results were substantial cuts in central government transfers to the regions, and a deep pension reform.

In the health care sector, cuts began under Berlusconi, and in some cases the crisis only intensified cost-containment efforts that were already under way. For example, pay-for-performance measures were introduced in 2011 but would probably have come into effect even without pressure from the ECB, and reforms aimed at reducing the number of hospital beds cut into a supply that

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was already well below the European average. However, the crisis induced cuts in central government investment in health care infrastructure, and regions were given permission to enact higher patient copayments to offset revenue loses from reduced central government transfers to the regions.

Increasing regional variation in the availability of care and in copayment levels were one obvious and easy-to-anticipate result of the austerity measures in health care. There is some evidence that increasing pressure on regions to meet tighter budgets has resulted in beneficial cuts, i.e. reductions in inefficient or ineffective care. However, while it is too soon to know exactly what effects are a result of the cuts rather than of the crisis itself, it seems clear that some post-crisis cuts have clearly gone well past the fat and are cutting close to the bone. There is ample evidence that lower-income Italians face greater financial barriers to accessing care, resulting in decreasing utilization – for example, an 8.5 per cent drop in use of specialist outpatient services after a large increase in the required copayment (Cislaghi and Sferrazza 2013). Cuts have also led to an intensification of the two-tier system in Italian health care, in which almost 60 per cent of specialist visits are paid for out of pocket, and it is now sometimes less expensive for middle-class Italians to seek private care than to pay the copayments for services in the NHS. Declining public support for the NHS is likely to be a long-term consequence of this increasing dualism.

In pensions, a major reform took place in December of 2011 under the Monti government. It increased the statutory retirement age and linked further revisions to changes in European life expectancy; effectively abolished 'seniority' pensions, which had allowed some workers to retire before the normal retirement age provided that they had made a minimum number of years of contributions into the system; reduced the indexation of pensions to inflation; and shifted previously grandfathered pensions from the old defined benefit system to the newer notional defined contribution regime. This meant that, for the first time, pension reforms were not limited to future retirees, but impacted large numbers of current pensioners.

Over the long term, these developments may signal a shift away from Italy's historically elderly-oriented welfare state. However, the reforms may in fact increase other forms of inequity. For example, differences in life expectancy between blue- and white-collar occupational groups and between different regions means that an increase in the retirement age hurts some more than others. Furthermore, reducing benefits for the current and future elderly without doing more for kids and the working-aged population is hardly a recipe for generational equity.

Italian lawmakers have sought to improve the conditions of younger workers mainly through labour market reforms, and in this area the post-crisis reforms have introduced some welcome developments. The Fornero reform of June 2012 increased protections for workers in atypical contracts and unified unemployment insurance schemes to the benefit of younger workers outside of the core of the labour market. Unfortunately, the hoped-for effects of the

reform in terms of increased stability in youth employment have so far been illusory. And by failing to adopt the *contratto unico*, which would have integrated atypical and 'fortress' labour markets, Italian governments since the crisis have missed a major opportunity for enhancing the welfare of younger workers.

What is to be done?

In an ideal world, welfare states should insure citizens (and perhaps non-citizens as well) against social risk, and enhance both well-being and economic functioning by smoothing consumption. Both of these tasks are primarily accomplished in welfare states through redistribution – both vertical (between individuals and social groups) and horizontal (within individuals, over the life-course.) The Italian welfare state has historically done a rather good job of horizontal redistribution, and has assured the welfare of even relatively low-income Italians who are labour market 'insiders'. Critiques of the Italian welfare state have centered, then, on how effectively it contributes to easing three important social cleavages: region, gender and generation.

The welfare state is not by a long shot the only cause of these cleavages. And in fact, many of the 'pathologies' of the welfare state are a result of trying to use social policy to compensate for underlying problems with the labour market and industrial development. With that in mind, what, if anything, can be done within the scope of the welfare state to help, at least not exacerbate, the gender, age and regional cleavages? And can changes to the Italian welfare state help with economic recovery? My remaining remarks should be taken in the spirit of blue-sky thinking, with the issue of political feasibility put to the side for the moment.

Most immediately, three changes could help the Italian economy recover in the wake of the crisis. First, automatic stabilizers – income supports for the poor, the unemployed, and early retirees suddenly left without benefits as a result of the 2011 pension reform – should be bolstered. This will alleviate suffering and boost aggregate demand. Second, more of the Italian welfare state should be shifted away from the Bismarckian social insurance model and towards universal, tax-financed social programmes. This will reduce the fiscal wedge on employment and allow for resources to be targeted towards needy groups outside of the core labour market. Finally, the Italian government should increase public provision of social services. In addition to providing needed relief for (primarily female) caregivers of children, the disabled, and the elderly, these jobs are a source of employment. While at present many care-giving jobs are filled by immigrant workers on low wages, Italians may be induced to take these jobs if the expansion of social services is accompanied by active labour market policies aimed at training Italians for jobs in skilled nursing, rehabilitation and early childhood education.

To minimize existing inequities and to best serve the Italian people over the longer term, several other priorities should be considered. First, to restore generational balance in the Italian welfare state, pension cuts are not enough. The

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resources that are freed up by pension reforms should be invested in children and young adults to ensure the long-term sustainability of the Italian economy. One way to ensure adequate investment in younger generations while also increasing gender equity would be to move away from male-breadwinner model of social provision. Italy would do well to look to Spain, where recent policies have eased the entry of women into the labour force. These policies include a comprehensive, new, publicly funded, universal social scheme for dependent care, significant investment to increase public childcare places for children aged 0–2 years, and a paid paternal leave allowance (Naldini and Jurado 2013).

Adequate health care funding levels must be restored so that the NHS can fulfil its mission of being a truly national system. Italian health care spending was already low by international standards before the crisis. Italy can afford to revert to pre-crisis levels of financing in order to roll back user fees and prevent the development of a two-tier system in which the middle class opts out, while an inadequately funded public layer increasing serves only low-income and elderly patients.

To reverse a growing regional cleavage in health care and social services, strong central government oversight of the implementation of the *livelli essenziali* in health and social care will be required. Equitable mechanisms for interregional fiscal transfers will also be needed to smooth service provision in different areas of the country. Both of these tasks may require a reconsideration of fiscal federalism, or at least of the form that it has so far begun to take.

None of these tasks will be easy. Policymakers can expect opposition from well-protected labour market insiders and their political and organizational representatives, who can rightfully argue that their hard-won social rights must not be undermined. Defenders of northern fiscal autonomy will not be keen to reverse fiscal federalism or even to consider further interregional fiscal transfers, particularly at a time when even those in the best-off regions are feeling the pinch of austerity. Politicians accustomed to using the fragmented system of social insurance and regional health care budgets to reward friends and supporters will welcome neither the universalization of social programmes, nor the increased scrutiny of regional budgets that must accompany further interregional transfers. And Italy's international financial backers, not to mention the European Union, may well balk at any social spending that smacks of stimulus. But if Italy is to prosper again, it will need a welfare state capable of supporting equitable growth.

Note

1 The Organization for Economic Cooperation and Development's (OECD) Social Expenditure Database reports that in 2009, the most recent year for which there are good data, public and mandatory private expenditure on old-age and survivors pensions accounted for 16.7 per cent of GDP, with 7.4 per cent of GDP spent on health.

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