EXECUTIVE BOARD MEETING

SM/18/292
Correction 1

January 18, 2019

To: Members of the Executive Board

From: The Secretary

Subject: **Italy—Selected Issues**

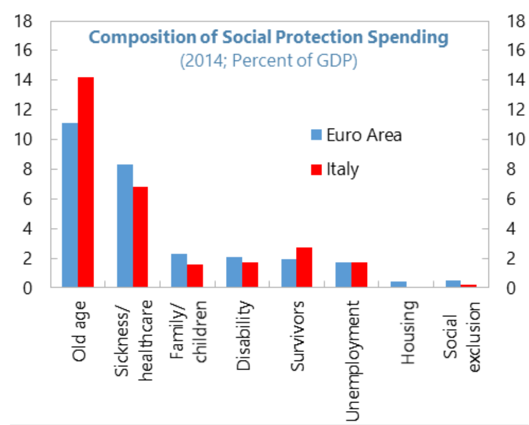
Board Action:	The attached corrections to SM/18/292 (12/18/18) have been provided by the staff:
Factual Errors Not Affecting the Presentation of Staff's Analysis or Views	**Pages 3 and 4**
Questions:	Mr. Goyal, EUR (ext. 36875) Mr. Kangur, EUR (ext. 38597) Mr. Belhocine, EUR (ext. 37075) Mr. Raissi, FAD (ext. 36465) Mr. Crivelli, EUR (ext. 36278) Mr. Garcia-Macia, EUR (ext. 30141)

2. This note evaluates possible reforms to modernize Italy's social welfare system and lower the tax wedge on labor. Potential spending increases (from modernizing the safety net for the poor) and revenue reductions (from lowering taxes on labor) relative to the current baseline would need to be considered, alongside a reform of design features. However, it is important to note at the outset that these measures would need to be fully consistent with a fiscal consolidation path that ensures Italy's public debt declines firmly. In other words, complementary measures are critically needed to lower current spending and broaden the tax base. Tackling these challenges is best achieved as part of a comprehensive reform package to boost productivity, investment, and job creation; see Andrle and others (2018a) for details. The rest of the paper is organized as follows. Section B provides an overview of Italy's welfare system, considers principles for reform based on cross-country good practice, and simulates the cost of a modern safety net using EUROMOD. Section C similarly provides an overview of Italy's personal income tax regime, simulates the cost of moving toward a flatter regime that has previously been proposed by the government coalition, and discusses some key reform principles. Section D concludes.

B. Reforming Italy's Welfare System

B1. Overview of the Welfare System

3. The Italian social welfare system is concentrated on pensions, inadequately supports children and people in working age, and is complex and fragmented. Social protection spending is the ~~fourth~~fifth largest in Europe, accounting for approximately 30 percent of GDP. The bulk of it is in pensions, reflecting a high share of elderly population and generous pension benefits—see Andrle et al. (2018b). High and rising pension spending has, over time,[4] crowded out resources for other priorities, such as public investment, and redistributed resources away from children and persons in working age.[5,6] Correspondingly, non-pension social benefit spending is lower than the euro area average, such as for social inclusion, family/child benefits, and housing.[7] Numerous programs aim to provide social insurance and assistance, but point to complexity, fragmentation, and potential overlaps (e.g., in the various income support schemes at different levels of government)—illustrated briefly in the table below.



Composition of Social Protection Spending
(2014; Percent of GDP)

Source: Eurostat.

[4] While non-pension social spending is discretionary, pension expenditures are based on earned rights, which could take a long time to decrease owing to slow attrition of the pension system.

[5] The Italian welfare state favors pensioners and male individuals in large firms and unionized sectors. The incidence of relative poverty and the in-work poverty rates are higher than the European average and grew during the crisis.

[6] Ravagli (2015) shows that recipients of social pensions and supplementary pensions are frequently not poor and, in some cases, even belong to rich households.

[7] Families have responded by relying more extensively on intra-family transfers for social assistance, although its scope is being reduced by declining family sizes; see Boeri and Perotti (2002).

A Complex and Fragmented Social Welfare System

I. Social Insurance

A. Benefits related to the reduction in working ability or end of the working activity
   1. Old-Age, Invalidity, Disability, and Survivors' Pension
   2. Mobility, collective dismissals, and unemployment benefit (NASPI and DIS-COLL)

B. Benefits related to the temporary suspension of the working activity
   1. Redundancy payment—Cassa Integrazione Guadagni (CIG)
   2. Salary supplement for agriculture workers
   3. Sickness leave

C. Family and social allowances
   1. Marriage leave
   2. Family Allowance
   3. Maternity Allowances
   4. Family leave for severe disability
   5. Inability Allowances

D. Other benefits
   1. Compensation benefit
   2. War Pension
   3. ~~Pensions for Civil Servants~~

II. Social Assistance

E. Family Support
   1. Family Allowance for families with at least three children
   2. Bonus for Babies (to be replaced by REI in 2020)
   3. Allowance for the birth or adoption of minors
   4. Day-care Bonus
   5. Scholarships and Free Textbooks Supplies

F. Anti-poverty allowances
   1. Social Pensions and Social Allowances to individuals older than 65
   2. Assegno di Disoccupazione, or ASDI (to be replaced by REI in 2018)
   3. Minimum Insertion Income (discontinued)
   4. Social card (partially to be replaced by REI in 2018)
   5. Support for Active Inclusion (to be replaced by REI in 2018)
   6. Inclusion Income (REI)
   7. Housing Benefit
   8. Young Culture Card

G. Benefits related to the reduction in working ability
   1. Civil Infirmity Allowance
   2. Monthly Assistance Allowance
   3. Accompany Benefit
   4. Frequency Benefit
   5. Sightless Pension
   6. Special Benefit
   7. Deaf-Dumb Pension
   8. Communication Benefit
   9. Personal, Long-term Assistance Allowance

H. Other benefits

4. **Although Italy is among the largest spenders on social benefits, the coverage of the poor is among the lowest.** In Italy, 27 percent of the poorest 20 percent of the population do not receive any benefits while a further 34 percent receive inadequate benefits. Consequently, Italy excludes about 60 percent of its poorest population from adequate social protection, while the euro zone on average excludes about 40 percent. The most vulnerable categories are working-age