Department of *Economics and Finance*

Chair of *Public Economics*

The battle against poverty: the New Welfare State in the European Countries

SUPERVISOR

Professor Valentina Meliciani

CANDIDATE

Giorgio Ferrari

196981

ACADEMIC YEAR 2017/2018

Table of Contents

Abstract

In a capitalistic world like our, the worst event which might happen to someone is to live in poverty. It means to be at the margins of the society, not having the possibility to satisfy its needs nor its desires. When an individual is in such a situation it is not only negative for the individual itself, but also for the government; its role is to ensure the higher possible standard of living to the citizens, and when someone is not able to achieve an acceptable standard it is considered as a failure. This view derives from the negative impact that poverty has on the total welfare of the population both from an economic and from a social perspective. Economically, a poor individual means lower consumption and, consequently, lower circulation of money and lower entries, in terms of taxes, for the government itself, while for the society it is translated in more crimes and higher dissatisfaction among the population. This is the reason why the government enacts policies aimed to reduce the level of poverty through the redistribution of income from riches to poor. These provisions are part of a system defined in the post-war period as the Welfare State, a set of laws intended to grant a minimum level of income to the citizens in order to reduce the impact of poverty on the society. Initially, the methods used to achieve this goal had the focus on granting some economic benefits to the citizens in need, usually through money transfers or through good delivery, but with the new millennium there has been an evolution in the concept of Welfare State. The twenty-first century approach, the so-called "New" Welfare State, is focussed on the reduction of poverty through the activation of poor people and the deregulation of the labour market. Almost every European Country has adopted this social policy view, but the most important examples to explain the differences between the different implementation methods are Germany, France and Italy. The first two have adopted a New Welfare State system in the last two decades: Germany is using a universalistic measure, opened to all the potential claimants not able to self-support themselves, since the promulgation of the Hartz Reform, and France an integrated network of different categorical measures, a complex network of provisions targeting specific categories of citizens, with at the centre the *Revenu de Solidarité Active*. Italy, on the other hand, is one of the Countries which have not already adopted the new system, but that is implementing, since 2012, a series of reforms to align its social policies to the ones of the other States, having with main provision the *Reddito di Inclusione*, the first poverty alleviation benefit of Italian history.

Chapter 1

1.1 Introduction

This first chapter is a description of the passages used by economists and governments to evaluate the level of poverty of one population and of the measures adopted to reduce this event. It is a theoretical explanation of the arguments treated in the second chapter, which is related to the social policies adopted in recent years by some European Countries. This chapter is structured in a schematic way, aimed to devote one section to a specific argument. The explanation of the different measures of poverty is the first argument. The first paragraph of the second section is dedicated to the Poverty Line, the main concept for what regards the measurement of the poverty of a Nation, with its definition and evaluation, while the second paragraph is entirely devoted to the different poverty indexes used in economics, from the simple headcount ratio to the Sen-Shorrocks-Thorne index. Then, in the third section, there is a discussion regarding the role of the government in fighting poverty, seen from an economic and from a social point of view, and the redistribution as main provision to reduce it, concept analysed more in depth in the following sections. The fourth part regards the history of redistribution, focussing on English and German policies of the seventieth century, and on the creation of the so-called Welfare State in the post-war England, while the fifth one is dedicated to the analysis of the structure of the Welfare State and on the steps needed to efficiently redistribute income. The sixth and last section of this chapter is a description of the evolution of the concept of the Welfare State in the "New" Welfare State, the type of social policies that is most common nowadays in European Countries, which is more focussed on the reduction of benefit recipients in favour of a gradual re-entering of not working citizens in the labour force.

1.2 Poverty measurement

From and economic point of view, the concept of poverty is "a property of the individual's situation, rather than a characteristic of the individual or of his patterns of behaviour" (Watts) that consists on the lack of command over resources. We may distinguish between two different definitions of poverty: relative and absolute poverty. Following the relative poverty definition, also known as relative income inequality, a person is poor if his income is below a threshold, usually a percentage of the average income of the Nation, while for the absolute poverty definition someone is poor if he cannot satisfy his physical and social essential needs. The focus of economists and, more important, of the governments while evaluating poverty is on the threshold above mentioned with the definition of the relative poverty. It is considered as a limit below which an individual has to be considered as poor by the society, and so supported.

1.2.1 How to measure poverty: the Poverty Line

The economic concept used to talk about this limit is the Poverty Line. From an individual point of view, it is represented by the minimum bundle of goods that permits to a person to live outside absolute poverty; but it is not only used for individual. Its main objective, as mentioned, is to create a threshold in a community between poor and not poor. Theoretically it is quite easy to evaluate it: once the individual Poverty Lines are known, it is needed to create an aggregate Poverty Line, comprehensive of all the individual's ones. In practice it is not so easy.

The first problem rises with the choice of the method to collect data. It is usually done with a "Consensual Approach", that establish the poverty line considering the view of the society as a whole through a survey. This survey may be done with reference with two different indicators: consumption of goods and income. The first indicator is used in the "deprivation indicator method" (Veit-Wilson), in which the survey consists in the formation by the individual of a list of goods that are considered necessary by him, while the second is used in the "income proxy method", where is asked which level of income are considered bad, sufficient, good or excellent. Both of these methods have their advantages and their limits.

The consumption is the best index because, as written above, poverty is related to the command over resources, the possible maximum bundle of goods that an individual can consume in a certain situation, and there is no better indicator of consumption than consumption itself. But there are some problems with it. The main disadvantage of the "deprivation indicator method" is the difference between individuals. While one person may consider necessary just 5 goods, another one may consider necessary a list of 10 goods that does not include the 5 of the first person. It is not a problem if the focus is on the single individual or on the single family, but if we are considering a bigger community with different tastes and preferences it turns up to be hard to create a basket of goods that is representative of the necessities of the society as a whole. The other disadvantages are due to the nature of the data collecting method: the survey. People may lie about their preferences, they may not even know what they consider necessary to their life or they may take as example the consumption of a friend or of a family member, distorting their real preferences and biasing the data collection.

On the other hand, income is not considered as precise as consumption in representing the preferences of people. Even if to consume a good you have to buy it using your income, there are some variables that have to be considered while using income as indicator of poverty. There must be taken into account the differences in prices that may rise in different zones in which the survey is made, and people should also take into account the inflation while answering the survey, considering that their answers are referred to the past experienced prices while in future inflation will increase prices. And again there are the problematics related to the use of surveys, which may bias the results also in the "income proxy method" procedure. But it is simple to create an aggregate poverty line using income, considering that everyone is representing their preferences with the same, unique indicator, and it is also easy to control who is below this line because of the data collection by the government about income. This is why the usual measurement indicator of the poverty line is income.

1.2.2 The Poverty Indexes

Once the Poverty Line is calculated, it is used in the evaluation of poverty through some indexes, all dependents on its value. The main ones are, from the simplest to the hardest to evaluate, the Headcount Ratio, the Poverty Gap Index and the Sen-Shorrocks-Thon Index

The easier to evaluate, and for this reason the most used, is the Headcount Ratio, which calculate the percentage of the households in the population which are in poverty through the formula

$$P_0 = \frac{1}{N}\sum_{i=1}^{N} I(y_i < z)$$

with I(•) as an indicator that has value 1 if the expression in brackets is true or value 0 otherwise. The main advantage of this index is its simplicity, but it has two important drawbacks. The first one is caused by its main characteristic: because of its simplicity, it just takes into account the percentage of people in poverty and not their level of poverty, and doing so it goes against the Dalton idea of efficient welfare indexes, which states that redistributing to poor increases the social welfare. But it does not happen since, unless the change in income for the poor permits to them to exit poverty, a redistribution of income does not decrease the level of this ratio. This creates an ambiguity since the only situation in which the value of this index changes is when a poor household dies or when he exits from poverty, and so to minimize the Headcount Ratio there should be a redistribution of income only to those who are just below the Poverty Line, leaving alone the poorest. The second one is related to the uncertain percentage of population in poverty that this index provides. In fact, it is related to households, and so it is not possible to say if, for example, 25% of the households represents 20% or 30% of the total population, considering the different household sizes.

Another popular index is the Poverty Gap Index. It is the mean proportionate poverty gap in the population, and derives from the Poverty Gap formula

$$G_i = (z - y_i) * I(y_i < z),$$

used to evaluate the average fall below the Poverty Line of the population, to which is added a part to express it in term of percentage of the Poverty Line, and doing so the formula of the Poverty Gap Index becomes

$$P_1 = \frac{1}{N}\sum_{i=1}^{N}\frac{G_i}{z}$$

It may be considered as an indicator of the potential savings that can be done targeting appropriately people in-need with the amount they need to exit from poverty. But again the Dalton idea is not confirmed by this index, because if there is a redistribution of income from a person who is just below the Poverty Line to someone who is worse off, the level of the index remains unchanged.

A third index used to measure poverty is the Sen-Shorrocks-Thorn (SST) Index, an index that takes into account the income distribution among poor. It is composed by the Headcount Ratio, the Poverty Gap Index computed only among poor and by a version of the Gini coefficient, usually used to evaluate the income inequality in the population, of the Poverty Gap. The SST formula is

$$P_{SST} = P_0 P_1^P (1 + \hat{G}^P)$$

with $\hat{G}^P$ really close to 1, the maximum possible amount of inequality, because of the great inequality in the incidence of the Poverty Gap. It is a good index because it gives a good sense of the sources of change in poverty over time, since it can be decomposed in

$$\Delta \ln P_{SST} = \Delta \ln P_0 + \Delta \ln P_1^P + \Delta \ln(1 + \hat{G}^P)$$

which describes the percentage change in every single parameter. But it is not widely used because it does not divide the different percentages of poverty into the different subgroups of the population.

1.3 Why should Government Intervene?

1.3.1 The Economic Reason

The role of the government is to ensure the higher standard of living for the citizens through an active participation in everyday life thanks to laws and regulations. Economically, it reaches this goal with two main actions: the control over the market failures and the redistribution of income. While the first one is related more on microeconomic, more precisely on the events that do not permit to the economy to deliver an outcome that maximizes the efficiency, and so has nothing to do with poverty, the second is a concept that is based on the shift of resources from a group to another, and the main of its uses is the re-allocation of resources to the poor. This concept is part of the Social Welfare Theory, that studies the level of well-being in the society based on the distribution of resources among citizens. For the second fundamental theorem of welfare economics, any desired Pareto efficient allocation of resources, in which no one can improve his welfare without hurting another individual, can be achieved redistributing the resources among citizens and then giving them the possibility to freely trade, but there must be someone who decides how to redistribute. This “someone” is the Government, which re-allocates the resources in order to maximize the Social Welfare Function (SWF), that represents the utility of the society as a whole.

The process through which the government decides how to redistribute starts with one assumption based on the experience, the Law of Diminishing Marginal Utility. It states that the personal utility provided by the first unit of a resources is higher that the utility of the second and of any subsequent unit, with a constant reduction of the utility given by any added unit. The easier example to explain this concept is using the real-life case of shoes. If a person has no shoes at all, the first pair of shoes has a really high utility for him, who does not have to walk barefoot anymore, while the second pair is useful because now he can change the pair to wear, but it is not so useful as the first pair, and this reasoning may be done countless times, continuously. From a graphical point of view, the Law of Diminishing Marginal Utility is described by the graph below, in which adding a unit of the chosen good causes an increase in total utility that is smaller and smaller as the quantity own increases.

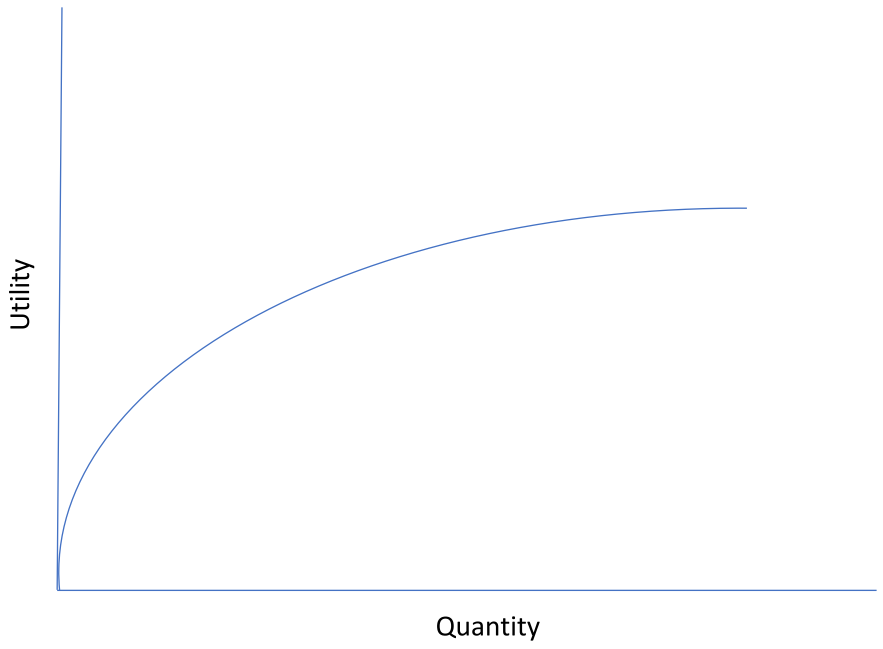

Figure 1.1: The Law of Diminishing Marginal Utility

This concept can be extended to income: the higher income a person has, the less a small increase in income affects the happiness of the individual. This is really important when thinking about the utility maximization of the society: if an small change in income is not so important for rich people but is really important for poor, which is the best way to redistribute resources in order to maximize the welfare of the society as a whole? There are two main theories about the best way through which it may be done: using the Rawlsian Social Welfare Function or using the Utilitarian SWF.

The formula of the Rawlsian Social Welfare Function is

$$W = \min\{U_1, U_2, \dots, U_n\}$$

and has a focus on the risk aversion of people with respect to unknown conditions: considering that a given person does not know if he is the richer, the poorer or someone in between, and also assuming that everyone is risk averse, to maximize the welfare of the society is needed to maximize the utility of the worst one, in order to reduce the risk to be below a certain level of utility.

The Utilitarian Social Welfare Function, on the other hand, states that the welfare of the society is measured by the sum of the individual welfares. The formula that represents this idea is

$$W = \sum U_i$$

where U_i is the utility of the individual *i*. To maximize it, it is important to remind the Law of Diminishing Marginal Utility discussed above: if the change in the level of utility with respect to a small change in the income level is higher when income is low and smaller when income is high, redistributing a certain amount of income from rich to poor would lead to an increase in the social welfare.

The main drawback of these two theories consists on their unit of measure: utility. It is not something tangible, but it is a mix of income, goods and other intangible characteristics, such as happiness or wealth. It is actually really difficult to measure the utility of one individual, and it is not possible to evaluate the differences in utility between different people due to its intangible part. To compute a Social Welfare Function there should some assumptions about the curvature and the comparability of utility among individuals are required. This limit shows how the SWFs are just empirical theories, not practical, and so another perspective is needed to justify government intervention.

1.3.2 The Social Perspective

This justification is the social impact of poverty: there are particular events, derived by it, which harm the satisfaction of the citizens and in general the well-functioning of the society. The two main situation which create these problems are homeless and crimes. The first one is a simple point of view of the average individual: no one would like to have a walk in the streets and being stopped by someone who, because of his poverty, is begging. It is due both to the bother caused by the stop itself and to the hygienic conditions of these individuals, usually terrible. This creates dissatisfaction among the population, with a consequent reduction in productivity. The second situation above mentioned, crimes, is a social plague directly correlated with the income condition of the citizens. There have been various studies since 1968, when Becker published his economic theory of crime, regarding the relationship between poverty and crimes, and almost all of them showed a positive relation between the two events. It is important to specify that this does not mean that every poor person will commit a crime, but only that poor people have more possibilities to do so; in fact, to become criminal, it is also needed to meet other characteristics, such as bad treatment. As it is possible to see in Table 1.1, when the other variables such as the population sample, its density or the presence of police are constant, a county with more poor has more crimes. This positive correlation is shown by the Poverty and the Income Gini variable in the table, representing respectively relative and absolute poverty, which are both statistically significant. This result is important in assessing why the government should intervene: both from a social point of view, related to the satisfaction of people about the town in which they live, and from a safety perspective, poverty has a negative impact on the life of citizens and is considered as a failure for the State that is not able to ensure a good standard of living to the population. This is the main reason why governments decided to redistribute the income from riches to poor.

	All Counties		Largest 200	
	Violent	Property	Violent	Property
Intercept	−5.9314	−2.3003	−6.7852	−1.3564
	(0.9913)	(0.694)	(1.4776)	(1.2345)
Population	1.1664	1.0407	1.1669	0.9918
	(0.0273)	(0.03)	(0.0371)	(0.0311)
Density	0.0437	0.0245	0.0586	0.0678
	(0.0305)	(0.0235)	(0.0371)	(0.0349)
Income Gini	0.4888	0.0507	0.7472	0.119
	(0.2192)	(0.143)	(0.2921)	(0.2305)
Female head	1.2667	0.7199	1.3809	0.6876
	(0.1608)	(0.1321)	(0.2091)	(0.1668)
Nonwhite	0.2285	0.0653	0.232	0.0738
	(0.0429)	(0.0274)	(0.0694)	(0.0553)
Unemployed	−0.198	−0.0676	−0.3393	0.0406
	(0.1201)	(0.0943)	(0.1824)	(0.1514)
Poverty	0.201	0.2335	0.1647	0.26
	(0.0867)	(0.0656)	(0.1252)	(0.0844)
Movers	1.0911	1.2639	1.1598	1.3698
	(0.175)	(0.1853)	(0.2436)	(0.2862)
Young	−0.7622	−0.5534	−0.7209	−0.7926
	(0.1478)	(0.1572)	(0.2177)	(0.2071)
College	−0.2729	0.0533	−0.3816	0.0791
	(0.0909)	(0.0794)	(0.1311)	(0.098)
Police	−0.1938	−0.1089	−0.2455	−0.3741
	(0.1418)	(0.1316)	(0.168)	(0.1804)
J	0.7303	0.0000	0.9558	0.0008
H	0.3967	0.0000	0.0508	0.0595

Table 1.1: Determinant of Crimes in 829 metropolitan counties in the U.S.
Source: Kelly M., (2000). "Inequality and Crime", The Review of Economics and Statistics, Vol. 82, No.4, 530–539

1.4 The History of Redistribution

The first example of redistribution was in 1601 in England, where the first legislation with this aim was promulgated: the Act for the Relief of the Poor, also known as the Old Poor Law. This set of laws, promulgated under the reign of Elizabeth I, gave to the parishes the role of "protectors of the poor", with the focus on the unemployed part of the population. There was a distinction between the unemployed individuals: the vagrants, those who did not want to work even if able to, the involuntary unemployed, those who were able to work and wanted to, but had no work, and the impotent poor, those not able to work. In base on which of these three categories a person belonged to, the effect of this set of law was different. For the impotent poor, the parishes had to make a payment, in form of money, food or clothes, aimed to reduce their poverty, while for the involuntary unemployed the government allocated funds, managed by the parishes, in order to create jobs for them. Different situation was planned for the vagrants, who were put in the Houses of Correction or in prison. The Old Poor Law was used, with small changes, up to the 1834, when the Poor Law Amendment Act replaced the former legislation. The main difference between the New and the Old Poor Law was the different bodies entitled to control the situation and to distribute the benefits: this power passed from the parishes of the single cities and villages to a government department, the Poor Law Commission.

Some years later, in 1842, another legislation was developed with the aim of helping the poorest part of the population. It was promulgated in Germany, and the name of the legislation was "The Prussian Poor Law". It was the first compulsory contribution under the control of the German Empire, and was a law which made the single communities of residence responsible for the poor reliefs, in particular for the sickness one. The burden was on the local governments, which had to subsidize the population with their own funds, and in case it was not possible the law permitted to create a fund financed by workers and employers. This law, at the beginning in use only in Prussia, was extended to the other german territories in the 1870s, and then modified in 1880s with Bismarck to face the industrialization of the Empire. The differences with the previous law were due, as already written, to the industrialization, that increased the number of accidents, leading the addition of an industrial accident insurance to the previous sickness insurance.

Even if the beginning of the twentieth Century brought some new insurances in England such as the Old Age Pension Act and the National Insurance Act, which provided mean-tested non-contributory pensions for people older than seventy and health insurance for all the citizens, the great revolution of that century was the 1942's Beveridge Report, made by a commission with the role to investigate how to rebuild the Nation after the Second World War with the economist William Beveridge as chairman and main contributor of the work. It stated that an efficient reconstruction of the Nation was possible only beating five “giants”, which are poverty, diseases, ignorance, squalor and idleness, and that was possible only through a Welfare State, which grants a minimum level of life to all. It was possible, in Beveridge mind, thanks to a payment made by every employed citizen to the Government as long as he worked, gaining in return the access to aids for unemployment, illness, retirement, and in general all the situation which impede to earn enough money to achieve the minimum level of life. This was the emergence of the new concept of social securities, which became real in 1945 with the election of Clement Attlee as Prime Minister and the consequent promulgation of laws in order to achieve the goal described by Beveridge.

The denomination of the State used above, Welfare State, was used by journalists and politicians to explain the differences between the new and the old type of State. While before that period the State was seen as a “Night-watcher” (Lasalle), a State which only intent was to promote laws to protect people from aggressions and thefts through militaries and police, with the introduction of the concept of the “Welfare State”, a State focussed on the welfare of the population through laws aimed to grant more equality, both socially and economically, the State acquired an active role in the financial life of citizens.

1.5 The Welfare State: characteristics and difficulties

But in what consists the Welfare State? It is a State that uses its powers with the aim to modify the play of the market force with three main goals: to guarantee a minimum income to all individuals and family, independently on their work or their properties, to reduce insecurity among population through social insurances that face social contingencies which make an individual unable to work and to ensure the best standards of social services to all citizens, independently of their social class. The Welfare State adopting process is divided in two parts, the taxation and the redistribution, both of them important, independent one from the other and both with some choices to make.

1.5.1 Taxation

The first passage for the Government is to collect money. It is done through taxes, mandatory financial charges set by the government to finance its public expenditures. There are several types of taxes, but the ones which usually represent the bigger part of the total revenues from taxation, almost the whole amount of revenues, are five: Taxes on Earnings, on Individual Income, on Corporate Income, on Wealth and on Consumption. The first one, also known as Payroll Tax, is a tax levied on the earnings of the taxpayer and in some Countries, such as the United States, it is the main source of revenues to finance social insurances. The second one, the Individual Income Tax, is paid on the total income accrued by the individual during the year, also comprehensive of the earnings, even if there is the

Earning Tax, because it generally takes into account the entire income of the family, which is not only the one taxed by the Payroll Tax. The Corporate Income Tax aim is to tax the revenues of the corporations that otherwise would escape the Individual Income taxation. The fourth type of tax, the one on Wealth, is calculated on the value of the assets own by the individual or the family, both material goods, such as jewels, and lands, which are usually affected by the Property Taxes, a type of Wealth Tax. The last one is the Consumption Tax, that permits to the Government to collect money from the consumption of goods and services of the citizens. The most common Consumption Tax is the Sales Tax, paid by the consumers to the vendors while buying a good. This is why the last one is considered as an indirect tax: the Government does not collect money directly from the taxpayer, but from its transaction. Different is the situation in the other four types of taxes described, which are considered direct because they affect the individual through its own properties.

The distribution of tax revenues across the world depends on the culture and on the different choices made by the governments. The United States most important source of tax revenues, for example, is the Individual Income taxation, which has more than twice the impact of Consumption Taxes.

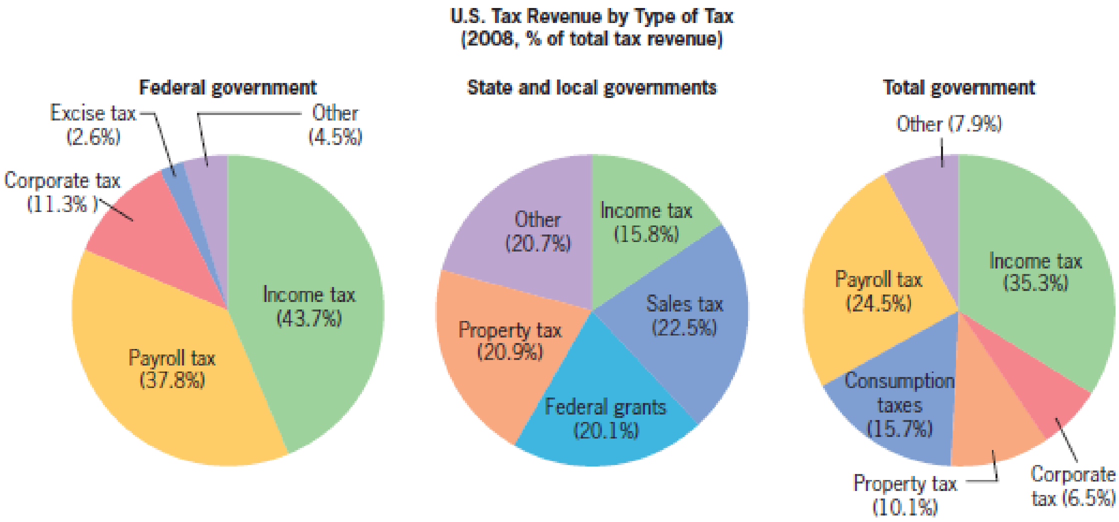

Figure 1.2: U.S. Tax Revenue by Type of Tax (2008)
Source: Gruber J., (2011). "Public Finance and Public Policy", Worth Publishers, New York, USA

On the other hand, the European Countries give less importance to the Individual Income taxation, even if there are some difference also between countries which are really close one to the other. We have in Figure 1.3 the example of Norway and Denmark, the first one that collects money in a more distributed way, with a bit more revenues risen by the Corporate Income Taxes, while the second one collects the most of his revenues from the sum of Individual Income and Consumption taxations.

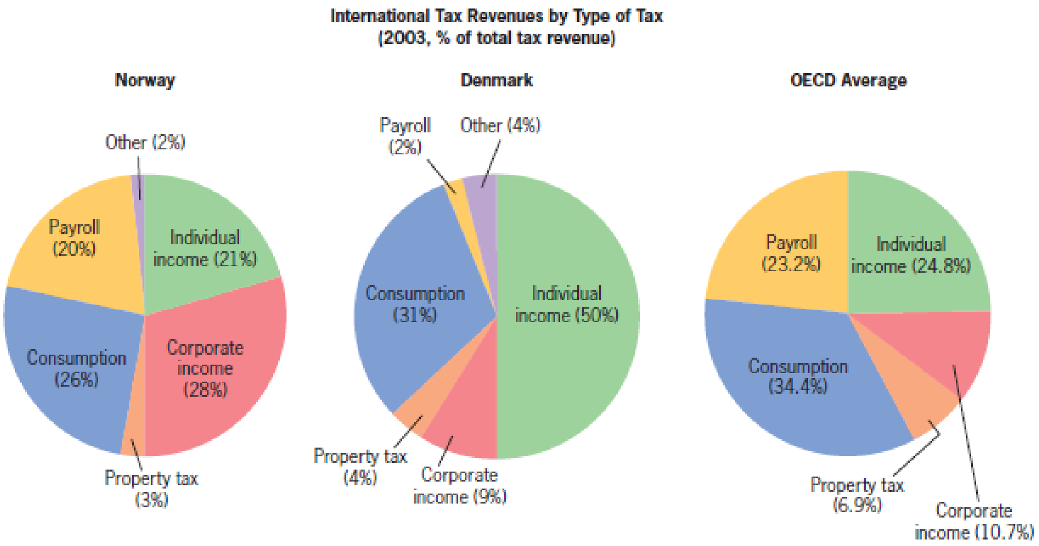

Figure 1.3: International Tax Revenue by Type of Tax (2003)
Source: Gruber J., (2011). "Public Finance and Public Policy", Worth Publishers, New York, USA

1.5.2 Redistribution

The choices that the Government has to face during the redistribution process are several, from its aim to the nature of the program, passing from the type of benefits that are going to be ensured to the citizens in-need.

For what regards the aim of the redistribution, the choice is between the reduction of relative poverty and the abolition of absolute poverty. Intuitively, the one that is used is usually the latter because of the importance of giving the possibilities to everyone to live in a decent way. Once everyone is able to live with an acceptable level of consumption, it is not important how much richer the rich are, and so relative poverty has less importance than absolute poverty. On the other hand, there are two reasons for which the relative poverty reduction is important for a Nation. First, the Poverty Line, the minimal standard of living of a citizen, is calculated on the standard of living of the whole population, and more precisely the Poverty Line can be considered as a fraction of the bundle of the typical citizen, and so strictly related to the relative poverty. Second, the well-being of citizens is negatively correlated with relative income inequality. There is a study made by Luttmer in 2004 that shows that self-reported well-being of individuals increases with an increase on personal income, but decreases with an increase in neighbours' income, meaning that for the well-being of the population relative poverty is important, even if it is not the only variable that affects it.

In choosing the nature of the redistribution, the difficulty consists in deciding who has to be eligible for the benefits. There are two types of programs between which the Government choses: Mean-tested welfare programs and Categorical welfare programs. The difference consists in the way through which the eligible groups are chosen. The first one depends on the level of income and assets own by the individual, and for example may be dedicated only to those below the Poverty Line, while the second restricts the eligibility with respect to some demographic characteristics, which may be single-motherhood or disability.

About the type of benefit granted to the eligible individuals, the choice is between Cash benefits and In-kind benefits. While the former consists in cash benefits for the in-need population, the latter grants goods or services to the recipients, such as medical care in the United States, where it is private, or housing.

The problem of redistribution is the information asymmetry between the two parties involved, the individual and the Government, that may lead to Moral Hazard, a situation in which one of the two parties, the one with more information with respect to the counterpart, behave inappropriately in order to exploit a favourable situation. In this case, it may happen that an individual not in-need but almost eligible for the benefit changes his habits in order to receive it. If we consider a Mean-tested welfare program with cash benefits, with the benefit calculated with the formula

$$B = G - \tau * w * h$$

in which B is the benefit received by the individual, *G* is a predetermined guaranteed benefit, τ is the benefit reduction rate, set at 100%, *w* is the wage rate and *h* is the amount of hours of work per year, that we assume they are 2000, we may have different situations depending on the individual. In figure

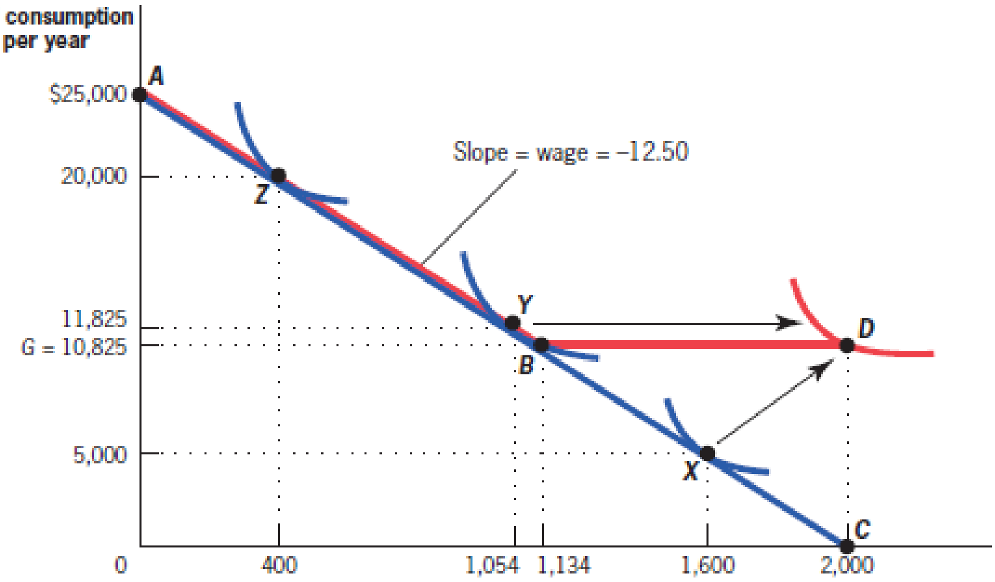

Figure 1.4: Labour Supply Decision with 100% Benefit Reduction Rate
Source: Gruber J., (2011). "Public Finance and Public Policy", Worth Publishers, New York, USA

1.4 there are represented three different individuals, X, Y and Z, before and after the adoption of the welfare program, in a situation in which *G* is equal to 10,825$, supposed to be the Poverty Line, with the hours of leisure per year that are equal to 1-*h*.

As we can see, Z is unaffected by the provision while X is the one who is more affected by the welfare program, since he passes from point X to point D. But the most important response to this benefit is the one of Y. In fact, even if before the adoption of the provision he was not below the Poverty Line, because of his preferences, shown by the indifference curves passing through points Y and D, he decides to drop out of the labour force since the one passing through D, which is the point in which he does not work at all, is more on the north-eastern part of the graph, and so is preferred to the one passing through Y. This result shows what mentioned above about Moral Hazard, considering that with this type of redistribution not only the ones previously below the Poverty Line, but also the ones who are strictly above it, benefit of the program, increasing its cost for the Government and reducing the Labour Force just for the laziness of the individuals.
The solution to this Moral Hazard problem, and also to the drop out issue, may be to reduce the benefit reduction rate τ from 100% to, for example, 50%, creating a situation in which individuals are eligible for the benefit until they earn 21,650$. In figure 1.5 we see how the situation changes for both X and Y, who benefit from the provision but still continue to work, passing from the points X_1 and Y_1 to the points X_2 and Y_2.

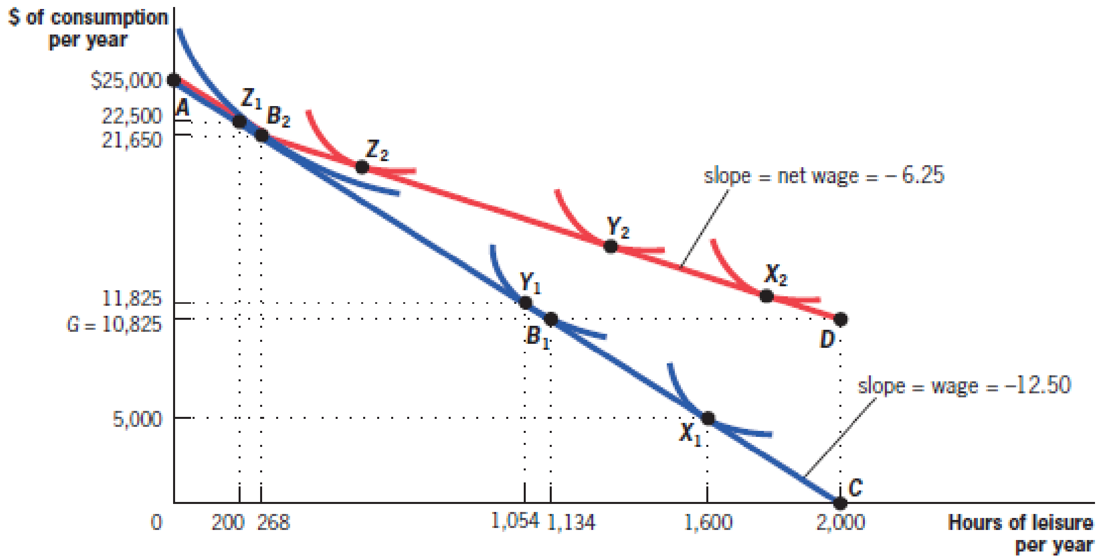

Figure 1.5: Labour Supply Decision with 50% Benefit Reduction Rate
Source: Gruber J., (2011). "Public Finance and Public Policy", Worth Publishers, New York, USA

It may look like the problem is definitely solved, but it is not true. In fact, if we consider Z, we notice how, with the adoption of the welfare program, he prefers to work less, reducing more and more the Labour Force. This effect is due to the so-called Iron-Triangle of cash welfare programs, that states that with simple cash benefits like the one described above, in which the only two parameters that can be changed by the Government, which are G and τ, it is not possible to achieve at the same time to encourage work, to lower the costs of the provision and to redistribute income.
The problem rises because the Government cannot know exactly how much an individual is capable to earn, situation that would lead to the possibility to adopt a welfare program without Moral Hazard. It would be possible if the Government could target only who has less earning capacity using some characteristics which are proved that decrease, or even put equal to zero, this capacity and that are impossible to change, in order to not permit to someone to modify his habits just to be eligible for the benefit. But there is a problem with this type of Categorical welfare program: it is really difficult, if not impossible, to find an observable characteristic which is not changeable and that is prerogative of the low-income part of the population.

The best solution would be to find a way to make the benefit unattractive to the ones who do not really need it. This approach is called Ordeal Mechanism, and is focussed on revealing who really is less able to earn, excluding from the gain of the benefit who is able but lazy. It consists in the use of benefits which are valuable only for the ones who are really not able to earn more than the predetermined threshold, usually in-kind benefits such as public houses, which usually are quite bad apartments. This provision would be really unattractive for the able individuals, even if he is the laziest person in the world, because of the possibility to live in a good apartment just working a bit. This is true because of the high value that everyone gives to cash, while some types of goods are valuable just for those who are really in-need. But this mechanism is not perfect, it has a paradox. It consists in the fact that apparently making those who need worse off will make them better off, since this is the only way through which those who do not really need the benefit will not claim for it. This would lead to a reduction of the number of claimants, and so to an increase in the value of the benefit that every claimant receives. But everyone would prefer to receive cash benefits with respect to in-kind benefits, and this is a problem for what regard public consensus on the provision.

1.6 The “New” Welfare State

The last two decades have seen a new trend in social security policies: even if the goal remained unchanged, to grant a minimum standard of living to all citizens, the methods to achieve it have been different. This new situation is considered by the economists so an important evolution of the previous concept of Welfare State that they attributed to it the name of “New Welfare State”. The addition of the adjective "new" to the previous concept of Welfare State clarifies that they see a continuation between what have been done in the twentieth Century and what is happening in the twenty-first, even if the period we are living, with its transformations and evolutions, obviously leads to some changes in the concept of Welfare State.

1.6.1 The differences with the post-war Welfare State

The evolution mainly consists in the re-orientation of social policies to the participation in the labour market, with a small step back on what regards the Pension system and the Unemployment benefits, especially for the Continental Europe Countries. This happened because of the different role that social policies have in the New Welfare State, the one of gears of the economic machine, which transformed them in productive factors of the national economy, in contrast with the post-wars view of solutions to market failures in the allocation of resources, modification due to the new functions and tools of social policies. In fact, while in the second half of the twentieth Century only the unemployment benefit recipients had to seek employment, the New Welfare State extended this condition also to other social policies beneficiaries, such as disable people and lone parents. Not to talk about the policies aimed to facilitate the conciliation between work and family, such as childcare and parental leave subsidies, which gives to the workers interested in build a family the possibility to do so less problematically. Another important new function of social policies is the income supplement to the working poor, those who earn less than the Poverty Line even having a job, through subsidies or even through a negative tax program. There are also policies aimed to invest in some sectors that are not strictly related to the social ones, but that are considered important for the well-functioning of the whole economy, such as child development and lifelong learning, which create a larger pool of skilled workers.

But the New Welfare State is not only an expanded version of its ancestor. We have to consider that the last decade has been characterized by the financial crisis, that forced the governments to control in a stricter way the investments, and so an expansion of the investment on some types of social provisions must have been balanced by a reduction in the funds provided to other sectors. These sectors are the Old Age Pension and the Unemployment Insurance ones, which have seen a reduction in the public expenditure in order to reduce the costs of public social provision. This decision, also known as Retrenchment, is mainly related to the idea that these two provisions were not sustainable in the long run with the characteristics presented in the Welfare State, especially the pensions, without a reduction in the largesse of the benefits. For what regards the unemployment benefits, they have been cut usually for the long-term unemployed, leading to a reduction of this benefits to the same level of the social assistance one. Different is the situation for the pensions, which cut started in the

‘90s in most of the European Countries, for which the reform consists in the reduction of the replacement rate of the public pensions, cut balanced by the expansion of private-funded pensions. This provision was based on the increasing average life expectation, that leads to an increase in the number of recipients, and on the raising average age of the population in Europe, for which the ratio between taxpayers, those who fund social policies, and recipients, people who receive the pension, is becoming smaller and smaller.

Another difference between the Welfare State and the New Welfare State is the different pool of workers who are eligible for the full benefits in case of unemployment. In the last two decades there has been a deregulation of the labour market, through the introduction of new types of employment contracts which are more flexible with respect to the standard ones, and the facilitation of the access to self-employment, both highly related to the reduction of the percentage of core workers, those who have standard employment contracts. These two evolutions have a social effect on the economic security of the workers: while the core workers are fully covered by the social insurances, the workers employed with the new types of contract, such as time-limited and part-time contracts, enjoy less generous employment securities, not to talk about the self-employed who are not insured. This does not mean that there has been a weakening of employment protection for the workers, in fact the securities for the core workers are the same of the post-wars Welfare State, but that the labour market is facing a dualization, with the core workers on one hand and the new types of workers on the other.

1.6.2 The interpretations of the evolution

The interpretation of the passage from the post-war Welfare State to the New Welfare State is not unique among the economists, who are divided in two big groups: the optimistic and the pessimistic ones. The first group believes that the promotion of the labour market participation and the investments in skill-developing programmes is a positive change with respect to the previous static social policies because the new provisions face the disadvantages that a person might have not through cash, but through education, participation to the labour market and, consequently, to the social life. For the second group, on the other hand, the New Welfare State is leading the economy to the dualization of the labour market with the insiders, the core workers, who enjoy the post-war benefits and the outsiders, the new types of contract workers, who have more economic insecurity. This dualization will lead, in their prospective, to a division inside the labour market, with the high-quality jobs performed by the insiders and the bad quality ones performed by the outsiders, with all the disadvantages of their position.

Obviously, all the consideration regarding the New Welfare State must be done with respect to the period in which we are living. The Great Recession of the 2008 had a big impact on the politics of most of the Western Countries, which had to face some cuts in order to survive to the financial crisis. The policies adopted in the first decade of the twenty-first century focussed on the promotion of the labour market were stopped in the last years of the 2000s and in the first of the 2010s due to the need to reduce the overall public costs, increasing the retrenchment effect in the social policies. We have also to consider that the retrenchment effects have been asymmetric between the European Countries, with a major impact on the Southern ones. The different economic conditions created a gap between the different Countries also visible in the cuts made in the social policies, which have seen a larger reduction in the level of the benefits in the Southern part of Europe with respect to the central Nations.

Chapter 2

2.1 Introduction

The implementation of policies aimed to establish a New Welfare State system is not easy, and depends on the necessities and the of the interested Country. In this chapter there will be analysed the implementation schemes adopted around Europe using three States as examples of different implementation methods. First of all, in the second section, it will be analysed the transformation of the French Welfare State thanks to the adoption of the *Revenu de Solidarité Active* and its impact on the society and then, in the third section of the chapter, there will be evaluated the evolution of the social policies and the effects brought by the Hartz reform in Germany. In the fourth and final section the focus will be on Italy and the reforms of the last decade, with an analysis of the attempt to transform the Italian Welfare State into a modern one through the *Reddito di Inclusione* and the deregulation of the labour market.

2.1.1 The Four Different Programmes in Europe

The New Welfare State, as written above, produced different effects with respect to the Country we focus on, effects reflected in the social policies adopted. Almost every European Member State has a welfare program aimed to grant a minimum income for unemployed citizens, independently on the causes, with exception of Belgium, Greece and Italy. The different types of programmes have been grouped in four categories by Frazer and Marlier in 2009 and by the Hellenic Parliament in 2014, with the distinction based on the type of the measure. The first group is the one that uses "Universalistic measures", opened to all the potential claimants not able to self-support themselves. The Countries belonging to this group may have a unique tool which covers all the needs, such as in Portugal and in Sweden, or two different tools, unemployment benefits and social assistance schemes, such as in Austria and in Germany. The second group, composed mainly by the Slavic Countries, is made by the States who have a "Basic and discretionary measure", with restricted eligibility, simple and non-categorical schemes. The Member States who belong to the third group are those who have an "Integrated network of different categorical measures", a complex network of provisions targeting specific categories of citizens, such as lone parent. An example of them is France, which will be analysed in the next section. The last group is the one formed by the Countries who have not a minimum income program, but who provide "Limited, partial or piecemeal arrangements" to face unemployment and poverty, like Italy. Now we will analyse the effects that the New Welfare State have had in France and Germany.

2.2 The Evolution of the French Welfare State

2.2.1 The composition of social policies until 2009

The first analysis is the one related to France. It belongs to the third group theorized by Frazer and Marlier, and so it has several smaller provisions with different purposes which support the main social insurance. In the French case, the supporting benefits are distributed by the local governments and grant different amount of cash or of goods with respect to the area involved, while the main provision is a national one, directly provided by the State. Since 1988 the main insurance against poverty has been the *Revenu minimum d'insertion* (RMI), accompanied at the beginning by the *Allocation de Parent Isolé* (API-1976) and then also by the *Prime Pour l'Emploi* (PPE-2001), which at the beginning was a post-war type of welfare program, aimed just at alleviate poverty. France started to move towards the New Welfare State in the late 1990s, when the Government decided to increase the incentives for unemployed people to re-enter in the labour force. Until 1998, the citizens receiving the RMI preferred to stay out of the labour force with respect to go back to work because of the loss of the generous benefits provided by the social insurance. But since the promulgation of the law against social exclusion (1998), which made slightly more attractive to re-entry in the labour force, the following governments focussed on increasing the incentives to go back to work. The main step forward has been made in 2009 with the substitution of the RMI and of the API with the *Revenu de Solidarité Active* (RSA), the provision currently in use.

The *Revenu minimum d'insertion*

The RMI has been the backbone of the social assistance in France for two decades. The cash benefits it provided were based on a pre-defined maximum amount of the benefit which depended on the household composition and was paid for a maximum period of 12 months. In 2008, the last year in which RMI was used, the maximum amount was defined by Table 2.1

Family size	Resources threshold
Singles	€447.91
Second person in the household	Add €223.96
Each additional person	Add €134.37
Each child after the 3rd	Add €179.16

Table 2.1: Maximum monthly amounts of Revenu Minimum d'Insertion (RMI) by family composition in 2008
Source: Canova L., Piccoli L., Spadaro A., (2015). "An ex ante evaluation of the Revenu de Solidarité Active by micro–macro simulation techniques", IZA Journal of European Labor Studies, Vol. 4, 1-20

Once the RMI recipient went back to the labour force, the benefits received incurred a modification. For the first three months, the citizen received the 100% of the RMI benefit summed up with the *Revenus d'Activité Professionel* (RAP), the wage received with the new job, independently on the type of it, if part-time or full-time. From the forth to the twelfth month, the value of the benefit depended on the type of work: if part-time, the RMI was reduced by 50% of the RAP, while if full-time it was given as benefit a fixed amount of 150€ or 225€, if single person or larger family, and a bonus of 1000€ at the end of the first continuous year of work.

Part time worker	
Working period	Monthly disposable income
0 months	100% RMI
0-3 months	RAP + 100% RMI
4-11 months	RAP[1] + max{RMI – 50% RAP; 0}
12 months	RAP + max{RMI – 100% RAP; 0}
Full time worker	
Working period	Monthly disposable income
0 months	100% RMI
0-3 months	RAP + 100% RMI
4-12 months	RAP + €150 for a single
	RAP + €225 for larger families
After 12 months	€1000 *forfait* (Prime de Retour á l'Emploi)

Table 2.2: Mechanism to compute the Revenu Minimum d'Insertion (RMI) in 2008
Source: Canova L., Piccoli L., Spadaro A., (2015). "An ex ante evaluation of the Revenu de Solidarité Active by micro–macro simulation techniques", IZA Journal of European Labor Studies, Vol 4, 1-20

Allocation de Parent Isolé

The API was a benefit granted to lone parents who have one or more children. It provided a maximum amount of 566.79€, data from 2008, to a pregnant woman plus 188.93€ for each born child. If the lone parent entered in the labour force, the reduction of the benefit was equal to the one of the RMI, reason why the RSA summarizes both of them in a unique solution.

2.2.2 The *Revenu de Solidarité Active*: an incentive to go back to work

As mentioned above, the *Revenu de Solidarité Active* (RSA) is a provision enacted in 2009 aimed to reduce the administrative costs of social insurances, to minimize their inefficiencies and to facilitate the computation of the benefits to distribute. It is the substitute of the RMI and the API and incorporates both of them in a unique solution, creating a social insurance which provides a benefit to unemployed people and lone parents. The formula used to compute the amount of benefits received by the recipient is

$$RSA = RSA_{max} - 0.38RAP \ ,$$

with the level of RSA_{max} equal to the maximum level granted by the RMI. This formula is much way easier to compute with respect to the RMI and API, and it also adds to its ancestors the important aim, prerogative of the New Welfare State, of incentive citizens to go back to work instead of remaining in welfare protection. It is possible thanks to the second part of the right-hand side of the formula above, which represents the reduction of the benefit perceived in case of re-employment. The fixed withdrawal rate, the percentage of the benefit which is granted even while working, is 62%, higher than the 50% provided by the previous provisions, and is not temporary. So, if an RSA recipient goes back to work, he will save for an undetermined period of time 62 cents for every euro earned with the job. This is a big incentive to re-enter the labour force permanently, event that with the RMI has not been usual due to the characteristic of the insurance. In Figure 2.1 are shown the different approach that the two provisions, RSA and RMI, have with respect to the in-work benefit.

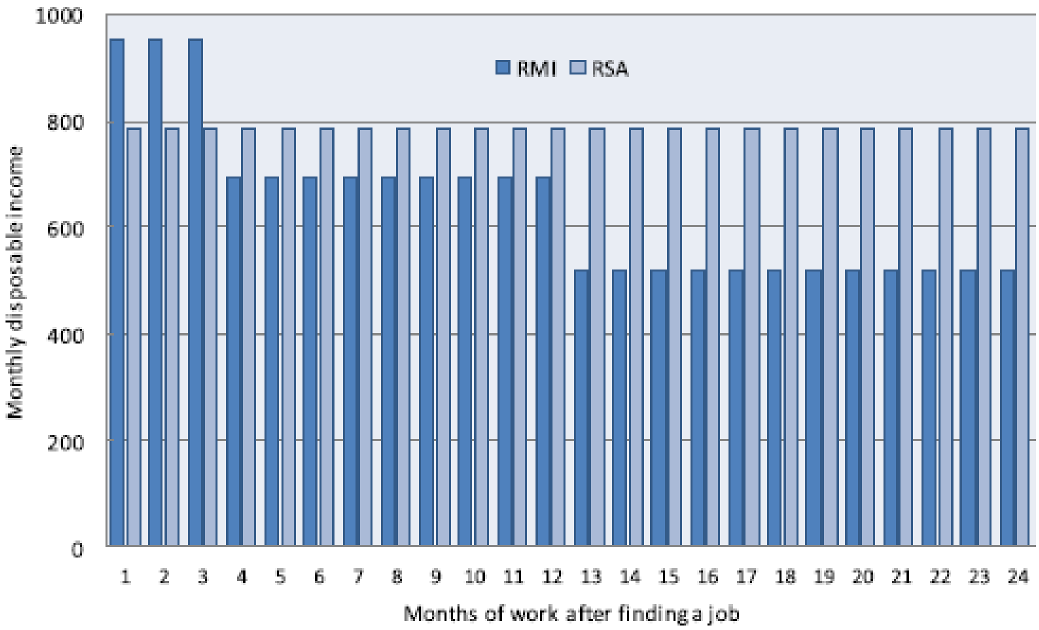

Figure 2.1: Disposable income with RMI and RSA for a single part-time worker
Source: Canova L., Piccoli L., Spadaro A., (2015). "An ex ante evaluation of the Revenu de Solidarité Active by micro–macro simulation techniques", IZA Journal of European Labor Studies, Vol.4, 1-20

It is possible to see how the previous provision was very generous in the first three months, ensuring a surplus to the wages of the entire benefit previously received. It was a stimulus to find a short-term job lasting just this period, since from the fourth month the withdrawal rate fell to 50%. This was an incentive to enter and exit the labour force continuously, working just for three months each time, in order to receive the maximum amount of benefits possible working as less as possible. It is different the situation with the RSA, in which the withdrawal rate is fixed at 62%. This encourages people to go back to work and to remain in the labour force, since the benefit received is equal independently on the working period.

This incentive is also supported by the new social insurance provided by the French Government since 2016, the *Prime d'Activité* (PA). It is a benefit provided to workers who earn less than 1500€ and have worked for at least three months with this salary, and that depends on the household composition. The amount received is calculated from a lump sum, at the moment of 531.10€, to which is summed up the 62% of the salary and subtracted the resources taken into account by the house. It provides a further incentive to remain in the labour force, considering the condition of being working for at least three months. It has been promulgated as substitute of the *Prime Pour l'Emploi* (PPE), a provision enacted in 2001, which provided a tax credit to people below a certain threshold on an annual base, period too long to provide an effective subsidy considering the short-term employment expectation of unemployed people.

2.2.3 The impact of the new policy

The RSA has been promulgated with the aim of reducing the number of poor people and the unemployment rate; these objectives have not been fully accomplished. First of all, the unemployment rate since 2009, the RSA adoption year, has not decreased. As it is possible to see in the graph below, there has been an increase in this index, from 8.75% in 2009 to 10.6% in 2015. Only from 2015 to 2017 there has been a reduction in the Unemployment Rate.

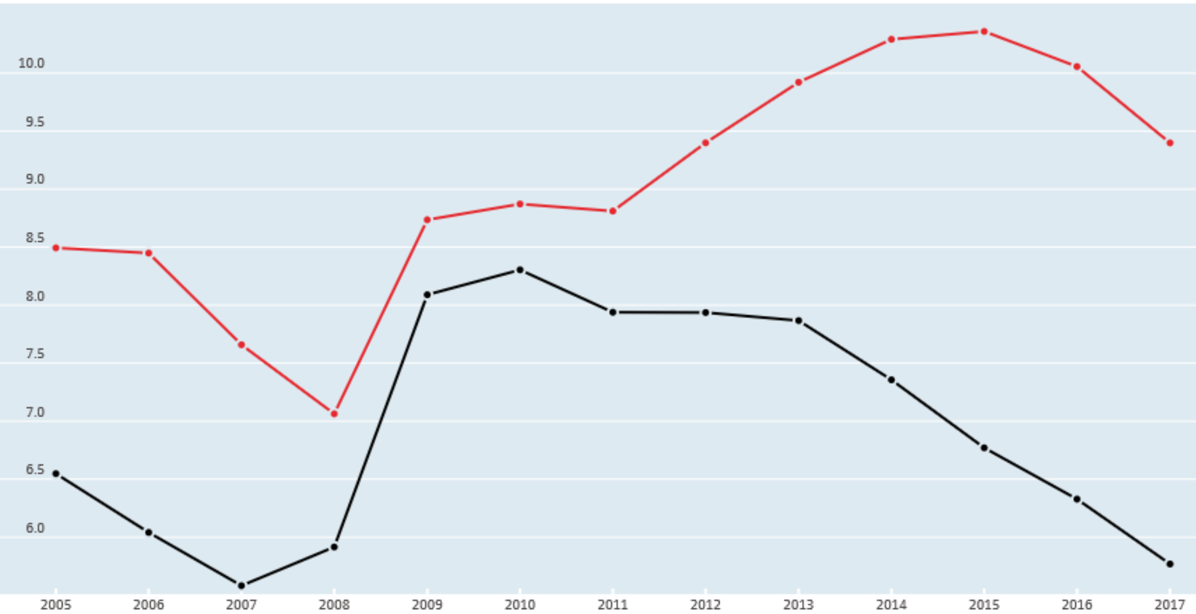

Figure 2.2: Unemployment Rate in France (red) and the OECD Countries average (black) from 2005 to 2017. Source: data.oecd.org/unemp/unemployment-rate.htm

For what regards the Poverty Rate, this index has been constant around 8% (OECD data), and so no reduction happened. But the main reason of these two events is not the inefficiency of the provision: this Social Security Policy has been enacted during the Great Recession, which increased a lot the percentage of citizens eligible for the RSA due to the critical financial conditions. The number of people receiving the benefit passed from 1.1 million in 2008 with the RMI to 1.8 million households in 2010, about 3.8 million of individuals and 6% of the total population, with 1.1 million receiving the basic RSA, the one given to unemployed and so the substitute of the RMI, and the remaining part receiving the *RSA activité*, the one provided to working people. The situation worsened in 2013, when the households receiving the benefit were 2.3 million, 7% of the total population. This had a negative impact on social public spending which, as shown by the graph below, increased from 28.20% to 30.54% of the French GDP with the introduction of the RSA in 2009 and then continued to increase, up to 31.94% in 2014, a value much higher than the average of OECD Countries.

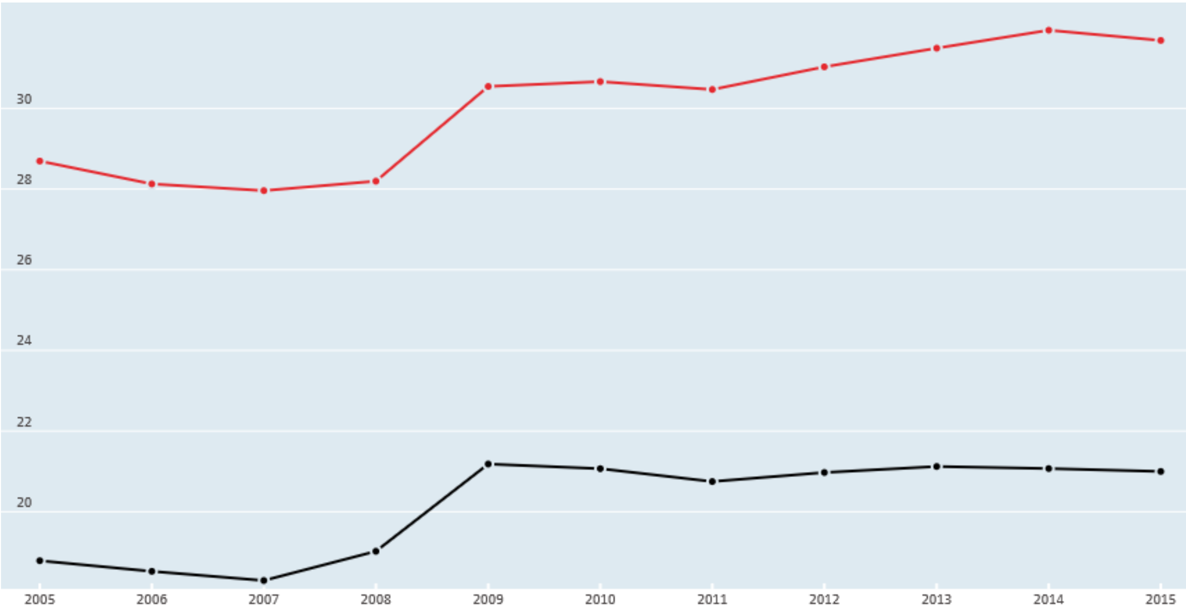

Figure 2.3: Social Public Spending in France (red) and the OECD Countries average (black) from 2005 to 2017. Source: data.oecd.org/socialexp/social-spending.htm

But, as written above, most of these results have been biased by the financial crisis of 2008. In fact, a study made by Canova, Piccoli and Spadaro in 2015 has shown that in a scenario without the Great Recession, the RSA would have brought to a positive impact in the Deficit/GDP, balancing the increase in the public expenditures due to the new policy. This study, based on a micro-macro simulation model, produced a long-run reduction in poverty of 1.6% and a 1.1% increase in singles finding a long-term job. But even if theoretically the RSA would bring improvements, until now the effect has not been positive.

2.3 The New Welfare State in Germany: the Hartz reform

As mentioned above, Germany is one of the countries which have adopted an "Universalistic measure" to what regards social insurances. This happened only in the twenty-first century, with the Hartz Reform, but before the first years of the 2000s the situation was different.

2.3.1 The social insurances in the twentieth century

The German constitution, the *Grundgesetz*, states that Germany is a federal and social state; this implies an important role of the State in ensuring an acceptable standard of living to every citizen. It was provided since 1961 with the *Bundessozialhilfegesetz*, the federal social assistance law, a poor relief benefit granted by local governments to the individuals below a certain threshold of income. Its aim was to be a scheme of last report which supported people in extraordinary conditions, not able to work or with too low earnings, providing them a basic cash amount sufficient to buy basic needs. This benefit was granted to all the citizens below this minimum standard, both to employed and unemployed, and paid the difference between the income of the household and the threshold. This social provision has been the precursor of the New Welfare State, since has been the first one which ensured an incentive to work; it granted the right to retain part of the earnings from work without reducing the benefit received, which permitted to have a total income higher than the benefit entitlement.

For what regards the Unemployment Insurance, in the post-war period the German State used three different provisions, which has been adopted until the reform of the first years of the twenty-first century. One provision was an Unemployment insurance scheme, which granted 68% of the previous earnings from work as benefits for those unemployed for less than 12 months. This scheme has been modified in the 1980s with a reduction of the benefit level to 60% and the increase in the duration based on the contribution record and on the age of the recipient, for a period no longer than 32 months. The second one was an Extended Unemployment benefit, which was provided to those who exhausted their Unemployment insurance scheme. It was again computed on the base of the previous earnings from work, but this time the level of the benefit was 53% and the duration was unlimited. The last one, equal in the benefit computation with the second one at the beginning, was provided to the unemployed citizens who had not sufficient contribution records to be eligible for the Unemployment insurance scheme. This provision, the Original Unemployment assistance, has been gradually eliminated during the decades, and in 2000 was definitely abolished. With the gradual reduction of people eligible for the last unemployment scheme and the unification of Germany in 1981, the number of recipients of social insurance scheme almost doubled, passing from less than 2 million in the beginning of the 1980s to 3.8 in 1993. This also increased the costs of the social provisions by 60%, from 6.1 billion of euros in 1990 to 9.8 billion in 2004, and this caused a financial crisis for the local governments, providers of the insurances. Everyone agreed that reforms were needed.

2.3.2 The composition and the innovation of the reform

The reform started in 1992, when the Christian-liberal coalition government enacted some market deregulations in order to facilitate the access to non-standard jobs, but the real change happened in the new millennium with the red-green coalition government. It was made through a set of new laws, aimed to lower the burden of social insurance contribution and to eliminate the potential inactivity trap that the social provisions caused in the past, called Hartz Reform, from the name of the chairman of the commission which worked on it. The Hartz Reform is composed by four different acts, called from Hartz I to Hartz IV, and every of them, even if focussed on one specific aspect, is complementary to the others. The first three laws are more focussed on active labour market policies, promulgated in order to stimulate employment demand and to increase the efficiency of the labour market itself, while the forth one is a benefit reform related to the activation of the unemployed.

Hartz I is the first law of the reform, and has been promulgated in 2003. Its aim is the one to de-regulate employment contracts, mainly temporary jobs, and to change the regulations regarding fixed-term contracts, both the dismissal and the prorogation ones. For what regards temporary contracts, Germany is following the trend of the New Welfare State of facilitating the access to this type of contracts. Temporary jobs have been legalised in 1967, while during the end of the century they have been regulated in a very restrictive way, especially for what regards constructions. But since the beginning of the 1990s, they have been gradually liberalised, and the last step has been the Hartz I law, which has abolished almost all the regulations related to these types of job. It has also introduced a new rule requiring an equal pay and treatment for temporary and regular workers from the temporary work agencies, the main mechanism through which it is possible to find temporary jobs.

Hartz II has been promulgated and enacted together with the Hartz I law, and part of it is also related to non-standard working contracts. This time the focus in on the low-wage contracts, the so-called mini and midi-jobs, and on the contribution related to them, and the Start-up subsidy. For what regards the low-wage contracts, before the law the workers earning less than 325€ were exempted the social assistance contribution, while now this threshold has been increased to 400€, the limit of the mini-job, and there has been introduced a new type of employment, the midi-job. To be considered so, the earnings must be between 400 and 800€, and the advantages of this type of employment is the inversely proportional reduction in the contribution for social assistance, total for 400€ earners and equal to zero for those with wages of 800€. On the other hand, the Start-up subsidy is a benefit ensured by the State to unemployed citizens who have an idea of business. It grants for 6 months since the start of the business the same benefits received with the unemployment insurance plus a percentage of the previous social assistance contribution of the citizen, but only if the Chamber of Commerce approves the business idea.

The third law of the reform, Hartz III, needed more time to be promulgated, and has been enacted one year after with respect to the first two, in 2004, because of its topic: the reorganization of the Federal Employment Agency. Its board has been transformed from a tripartite administrative to a hierarchical one with a CEO and a management board appointed on the top of the agency for 5 years. The control over the local employment offices has been reinforced through the introduction of quantitative goals, dependent on the type of agency, that every of them has to fulfil. The offices are now more customer-oriented and they provide more services with respect to the past, from counselling and advising to administration of benefits ones. The re-employment market is now split between the public offices and the private ones, and so there has been created a *quasi-market* which reduces the inefficiencies. It is done through a voucher system that permits to the unemployed who have not been placed by the public offices for six weeks to hire a private office, which receives a lump from the public one after the successful placement of the citizen. The Hartz III law also changed the targeting methods for the allocation of measures and resources for the offices. With the reform, every client of the employment offices is profiled through an interview and then sorted in one of the four categories, each of them with different support from the office. The first category is the one of the Market Clients, *Marktkunden*, and is made of the clients who have more possibilities to find an employment and, for this reason, need less help. The second one is the one of the Clients for Counselling and Activation, *Beratungskunden aktivieren,* which members are those who need to be activated in their job search, while the third type of clients are the Clients for Counselling and Support, *Beratungskunden fördern,* who need more attention and usually are assigned to some re-employment programmes. The last category of clients, *Betreuungskunden,* are those in need of supervision, and are usually excluded from the participation in any kind of programme because of the unlikeness of being placed in the labour market. But the most important innovation of the reform is the scientific evaluation of the program made on behalf of the Government, the first of its type in German history.

2.3.3 The evolution of the benefits: the Hartz IV

The most important law of the reform is the Hartz IV, the last one, promulgated in 2004 and enacted in 2005. As mentioned above, it modified the social assistance policy creating two different Unemployment benefits, the Unemployment Benefit I and the Unemployment Benefit II, which substitute the previous provisions. The Unemployment Benefit I, *Arbeitslosengeld I* in German, is the substitute of the Unemployment Insurance described in section 2.3.1, to which just duration modification have been made. In fact, it is a previous net-earnings benefit with the same substitution rate of 60% for single individuals and 67% for those with children, but the maximum duration has been decreased and depends on the age, 12 months for those under 50 up to a maximum of 24 months for those above 58, and on the contribution records. The big difference with respect to the twentieth century is the *Arbeitslosengeld II*, or Unemployment Benefit II, which is a more complicated scheme comprehensive of several previous social insurances. It is a flat-rate benefit with the aim of ensuring a minimum acceptable standard of living, different from the ancestor, the Unemployment assistance, which was aimed to preserve the previous standards. It grants a benefit equal to the social assistance scheme (see section 2.3.1) to all the citizens outside the labour force or with a low-income job, including people older than 65 and disable ones. The benefit has a maximum duration for able-bodied citizens of 12 months, after which they have to search for employment, while all the other recipients, both unable people and low-wage workers, have unlimited duration. This reform has one winner, the low-earnings worker. In fact, the wage can be summed to the Unemployment Benefit II, with a replacement rate that depends on earnings from work, and can lead to an increase in the income of 40% with respect to the benefit alone. This is one of the incentives to go back to the labour force, pillar of the New Welfare State and one of the goals of the reform, that the Hartz IV law ensures.

The other incentives are related to the tightening of the sanctions for those who abuse the social policies, both considering the disqualification periods and the termination of the benefit. For what regards the disqualification, before the reform there were three cases in which it could be disqualified: abandoning a qualifying training program, declining a suitable job offer and becoming voluntarily unemployed. To these, the Hartz reform added other three events, which are the delay in the record of the unemployment, the insufficient search for work and the failure to report sufficiently to the job office. The duration of the disqualification depends on which of the actions described above are performed, while before the reform id was always a period of 12 months. Now for the job declination it goes from a period of three weeks for the first job refused to six for the second and twelve for the third one, while the voluntary unemployment is sanctioned with twelve months. When a recipient collects twenty-one weeks of disqualification, he loses the right to receive the benefit, event that in the past was related to the second sanction. In contrast to these provisions, which are against the unemployed individual, there is a reversion in the burden of proof related to leaving the job or refusing one: now the individual has to prove that he is in good faith.

2.3.4 The effects

The aim of this reform was to reduce the unemployment rate, which was increasing in the years just before and after the new millennium, and to reduce the poverty across the population, but the results for both the goals are different. For what regards the employment, the recent years have seen an improvement in all the related rates. As it is possible to see in Figure 2.4, the unemployment rate had reached the maximum level in 2005, when it was at 11.17% of the labour force. But the implementation of the Hartz reform, especially of the Hartz IV law, have decreased the level up to 3.75% in 2017, of which 42% are long-term unemployed, another rate which is diminishing since 2005.

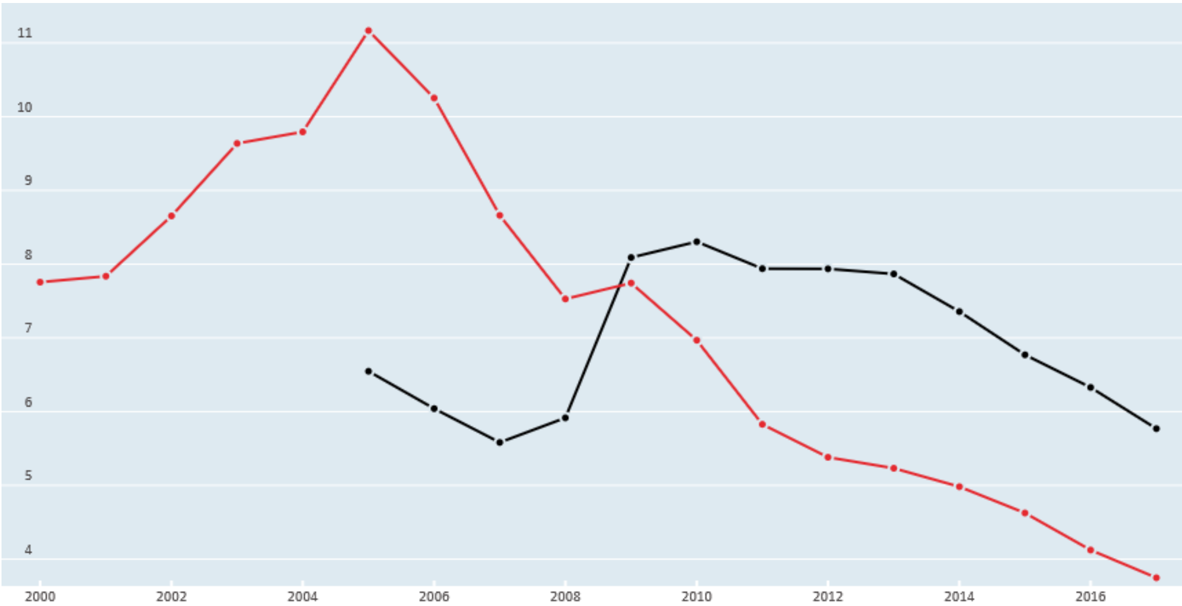

Figure 2.4: Unemployment Rate in Germany (red) and the OECD Countries average (black) from 2000 to 2017
Source: data.oecd.org/unemp/unemployment-rate.htm

The employment rate is constantly increasing since the promulgation of Hartz IV, as it is possible to see in Figure 2.5, in 2008 has reached the level of 70% required by the European Union in the Lisbon Treaty, and in 2017 the employment rate has been of 75%.

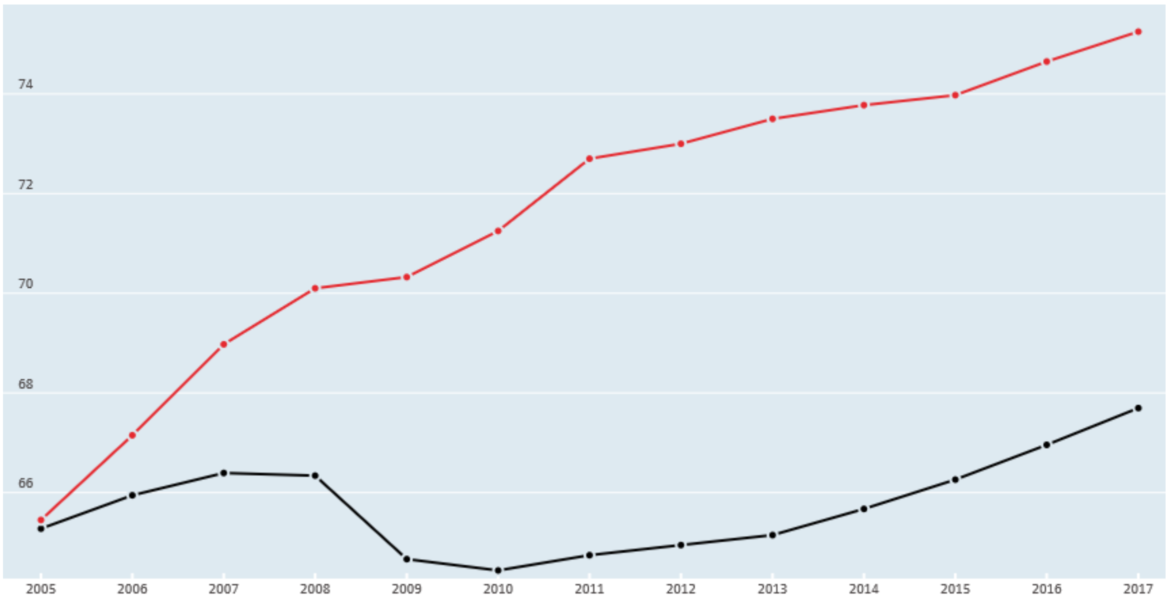

Figure 2.5: Employment Rate in Germany (red) and the OECD Countries average (black) from 2005 to 2017
Source: data.oecd.org/emp/employment-rate.htm

Even if these are great results considering the goal of activating the unemployed, we also have to take into account that a big share of these jobs are non-traditional, short-term ones. In fact, the number of standard employment contracts, both full-time and part-time, has decreased by 1.6 million from 1992 to 2009, and the percentage of jobs which grant full-insurance coverage has passed from 77% to 68% in the same period. This trend is also shown by the percentage of temporary employment contracts, which increased from 12% to 15% between 2004 and 2008 and now is stable at 13%. If we add to these data the increasing percentage of low-wage employment, which has changed from 16% in 1998 to 21.5% in 2008, we find out that the other aim of the reform, the one to reduce the poverty among the population, has not been achieved. Both the Headcount Ratio and the Poverty Gap are stable since the promulgation of the reform, and this may be seen as a negative result. On the other hand, the social expenditures have not suffered the new policy, since both before and after the reform there was used around 17% of the social budget for unemployment and social securities, percentage decreased in the years after the promulgation of the Hartz IV law thanks to the reduction in unemployment and the consequent reduction in recipients. But this last result is a consequence of the high costs of the previous provisions, related mostly on the really high duration of the insurances, which incentivized people to stay out of work for long time.

2.4 The Italian Welfare State: a step toward evolution?

2.4.1 The old-fashioned social policies of the new millennium

As mentioned in section 2.1.2, Italy in 2014 was considered as one of the Countries which did not guarantee to the citizens a minimum income program, but just some limited provisions to face unemployment and poverty. This because of the sense of arrival of the Government after the adoption of the Euro and the supposed stability achieved in the twenty-first century, which led to a stagnation for what regards social policies. While the other European States, such as the previously described France and Germany, changed their policies to face the problems of the new era, Italy remained with the twentieth century vision of social provisions until the crisis of 2008, when the pressures made by the European Central Bank incentivized the Italian Government to reform the Welfare State. The only provisions at that time were the *Cassa Integrazione Guadagni* (CIG) and the *Indennità Ordinaria di Disoccupazione,* two benefits provided to the unemployed workers in different ways. The CIG, still existing, is a benefit provided by the State to the workers employed in medium-large firms who, for economic reasons, have lost or have seen reduced the wages. It is calculated on the basis of the previous contributions, but it grants a low amount of money to the recipients, which are still considered as employed even if they were not working. This has been an important issue during the crisis, since the unemployed rate did not increase until 2012 thanks to the extension of the CIG duration, which became virtually infinite. The second provision, on the other hand, was the real Italian Unemployment Benefit scheme. The eligibility to this benefit was related to the years of contributions, at least two, and to the involuntary unemployment, while it granted a really low amount of money, a percentage of the previous earnings from work decreasing from 60% to 40% depending on the duration of the perception, for a maximum of 12 months of recipiency. In theory both the CIG and the Unemployment Benefit were conditioned to the re-activation of the citizen through training courses, but in practice it was not done since the funds were administrated by the local governments, which did not provide sufficient courses, and was not possible to promulgate any new provision because of the internal conflicts in the government coalition.

2.4.2 Little steps to the New Welfare State

The Welfare system reform began in 2011 with the Monti government. Due to the sovereign debt crisis, Italy suffered an increase in the yield spread which undermined the stability of the whole Nation. For this reason, the ECB required that Italy had to make some social policies reforms to be helped in the reduction of the debt. One of them was a new pension provision which enacted the law, proposed by the previous government, stating that the minimum retirement age was 65 for all the workers from 2018 and 67 from 2021, for both men and women, because of the increase in the life expectancy. The pension passed from a defined benefit based on the earning history of the worker to a Non-financial Defined Contribution (NDC) scheme, which is based on the contribution payed during the working life. This provision was aimed to produce 80 billion of savings between 2012 and 2021, but with some reforms made in the following years the expected savings are 15% lower. Another part of the reform was related to the creation of an Unemployment Benefit scheme for non-standard workers, which had anyway the problem of high standards for eligibility, and the increase in generosity of the main scheme, which was transformed into the *Assicurazione Sociale per l'Impiego* (ASpI). This new provision granted the 75% of the previous salary for a maximum of 16 months to the unemployed citizens whit one year of contributions in the previous two years, while for those with no such requirements was instituted a mini-ASpI with duration of half the contribution records in the previous year. There were also created the *Fondi di Solidarietà*, bilateral funds paid by employers and employees on the basis of common agreements, for the employers with more than 15 employees and no CIG coverage, which have the same role of the *Cassa Integrazione*, while for those without CIG and the bilateral funds it was possible to use public funds. But even if the framework of the reforms has been established during the Monti Government, to have the implementation of these provision it was needed to wait until 2015, when the new government enacted all the previously discussed laws.

In fact, it is just with the Renzi Government that something really changed in Italy. As mentioned above, it is in 2015 that the provisions discussed during the previous government have been enacted, but these are not the only actions taken by the new Prime Minister. The main act is the so-called "Jobs Act", a law aimed to further deregulate the Labour Market. It mainly consists in the substitution of the old-type standard contracts with a new-type, the *Contratto a Tutele Crescenti*, which gives no duties to the employer to reinstate a worker invalidly fired and that, on the other hand, gives the right to the employee to receive two monthly wages per each work tenure year, with a minimum of four wages, and in the further deregulation of the labour market through the elimination of the restriction of maximum 20% of temporary contracts over the whole amount of contracts for an employer, which made cheaper and easier to firm such a contract. But it also changed the Unemployment Benefit scheme, not so developed up to that moment. The Jobs Act introduced two new benefit: the *Nuova Assicurazione Sociale per l'Impiego* (NASpI), which combined the two previous schemes in the way described by Table 2.3, and the *Indennità di Disoccupazione per i Collaboratori*, a benefit addressed to the self-employed workers with at least three months of contributions the year before the unemployment.

	New regime	Previous regime (applying to employees losing their job up to 30 April 2015)	
	New Social Insurance Provision for Employment (NASpI)	Social Insurance for Employment (ASpI)	MiniASpI (allowance similar to ASpI but with less stringent requirements)
Access requirements	13 weeks of social contributions in the four years before termination of employment, and at least 30 working days in the 12 months preceding the termination of employment.	The first social contribution payment must have been made at least two years before the beginning of the period of unemployment. 12 months of social contributions in the two years preceding the start of unemployment.	13 weeks of insurance seniority during the 12 months preceding the beginning of the period of unemployment.
Duration	Half the number of weeks for which social contributions were paid in the four years before the start of unemployment. The weeks which already gave rise to the payment of the benefit are excluded from the computation of its duration. Maximum duration is 24 months in 2015 and 2016 (18 starting from 2017)	In 2015, the duration ranges from 10 to 16 months depending on age (from 2016, these values were to be increased by two months).	Half of the number of weeks for which social contributions were paid over the 12 months preceding the beginning of unemployment.
Amount:	75% of the first €1,195 of wages 25% of wages over €1,195 The maximum allowance is €1,300. The benefit decreases by 3% each month starting from the fourth month.	75% of the first €1,195 of wages 25% of wages over €1,195 The maximum allowance in 2015 is €1,167. The benefit decreases by 15% after the first six months and by a further 15% after 12 months.	75% of the first €1,195 of wages 25% of wages over €1,195 The maximum allowance in 2015 is €1,167.

Table 2.3: Unemployment Benefit schemes before and after the NASpI
Source: www.eurofound.europa.eu/publications/article/2015/italy-reforms-to-system-of-unemployment-benefits

But the main evolution with respect to the past is related to other two aspects: the active labour market policies (ALMP) and the minimum income benefit. It was created a new national agency for the ALMP, the *Agenzia Nazionale per le Politiche Attive del Lavoro* (ANPAL), which has the aim to favour the re-entrance of discouraged citizens in the labour force; it is an innovative solution in Italy, where the activation of citizens was delegated to the Minister of Labour. For what regards the minimum income benefit, the new provision is the *Reddito di Inclusione* (REI), a structural assistance policy that has been enacted at the beginning of 2018. It grants 187.5€ for a single person, a low amount of money with respect to the provisions enacted in other Countries, and its duration is for a maximum of 18 months, but it has as eligibility requirements only to be below the Poverty Line, which in 2018 was of 2250€ in a year for a single citizen.

2.4.3 The possible future

The new policies are a big step toward the New Welfare State system, the evolution that almost every Western Country has faced in the last two decades. It is too early to calculate the effects of the reforms on the life of the citizens, but it is possible to guess the impact of the new laws through their analysis. The new Unemployment Benefit scheme, with the higher duration and the higher benefits with respect to its predecessors, might help in the battle against the poverty because of the higher income for unemployed individuals, but is not useful for what regards the reduction in unemployment. In fact, higher benefits mean lower incentives in finding a source of income alternative to the UB, which consequently leads to a reduction in people going back to work, in contrast with the aim of the New Welfare State. This is translated in higher unemployment rate, which is at a very high level as it is possible to see in Figure 2.6. The costs of this provision are expected to increase for the same reasons mentioned above, and this is not a positive thing for a Country with a high debt like Italy.

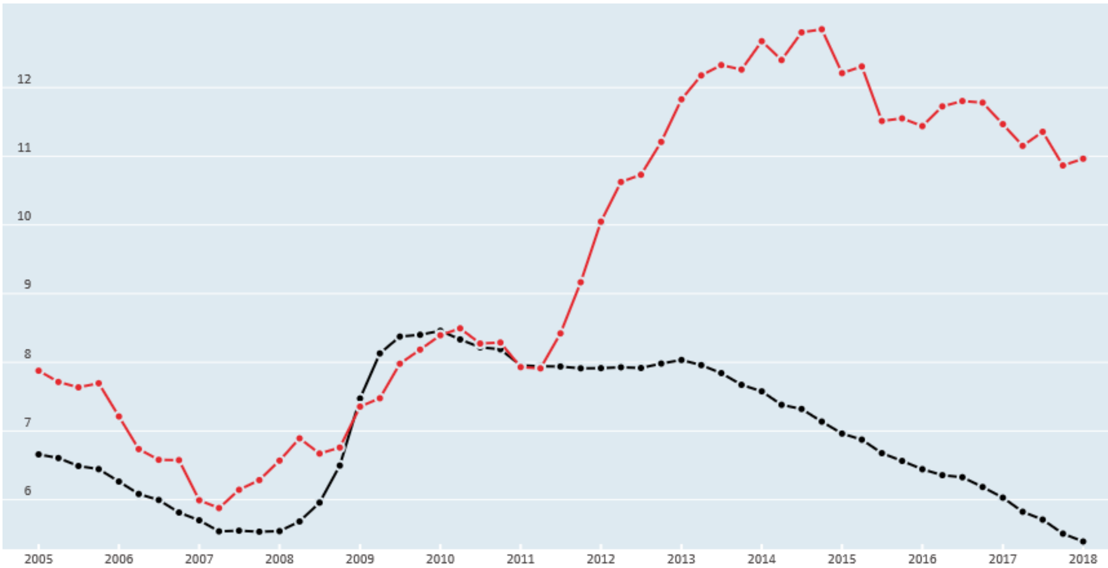

Figure 2.6: Unemployment Rate in Italy (red) and the OECD Countries average from 2005 to 2018
Source: data.oecd.org/unemp/unemployment-rate.htm

It is different for the pension system. The increase in the average age and in the life expectancy of citizens is translated in higher expected costs for the benefit in the future. This is why the increase in the eligibility age for the pensions is a positive first step toward a reduction in social costs without hurting the income of the recipients. The drawback may be the limitation in the young employability: since there are more experienced workers, the demand for new, young workers may fall, especially in the jobs in which experience is more important than youth.

The provision which is expected to have an important impact in the society is the REI: even if the benefit itself is low, it is the first minimum income policy in Italy. It increased the costs of poverty alleviation schemes of almost one billion of euros in 2018, the year of its enaction, and the costs are going to rise until the 2021, as it is possible to see in Figure 2.7. But the social advantages of this provision are higher with respect to the economic costs for the Government, since the consumption of recipients is expected to increase and so the economy is expected to partially improve.

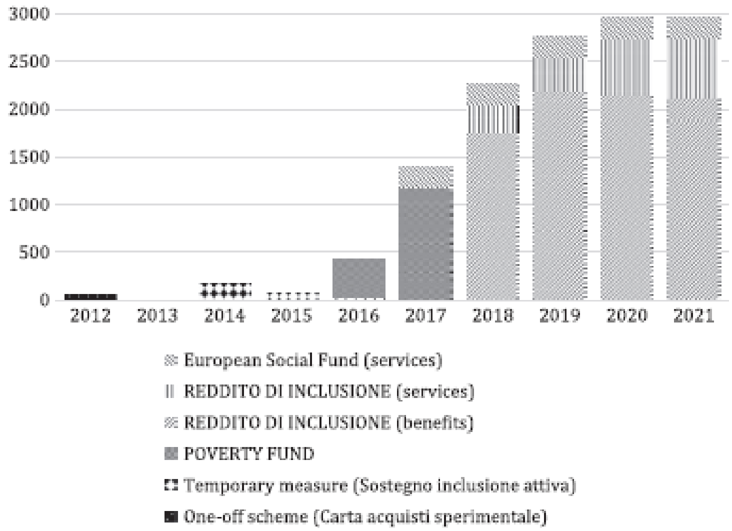

Figure 1.7: Funds for anti-poverty schemes, 2012–2021 (millions of euro). Source: Sacchi S., (2018). "The Italian Welfare State in the Crisis: Learning to Adjust?", South European Society and Politics, Vol. 23, 29-46

The new Government has proposed a different provision to substitute the REI: the *Reddito di Cittadinanza*. It is a benefit, similar to the French RSA, provided to all the citizens with income lower than the Poverty Line, independently from the working experience and from the age of the recipients, which is supposed to grant 780€ for a single individual, a higher level of income with respect to the actual provision. The similarity with the French provision consists in the re-activation program which should support it, for which it is mandatory for the recipients to search and not to refuse more than three jobs. The main problem of this proposal is the high cost to implement it: it should cost to the government between 18 and 30 billion of euros. This is an expenditure that Italy, at the moment, is not able to afford because of the European constraint on the increase in the public debt, which limits the annual rise of this variable to 3%. It has been conjectured to break this limit in 2019 to permit the implementation of the provision, but the tension between Italy and Europe on the migrants' situation is a drawback in the negotiation for the concession of having higher increase in public debt. But this is not the only problem; it must also be considered the possible inactivity trap for the recipients, which would further increase the costs of the provision. It would have been possible to implement such a scheme before the crisis, as done in the other Countries, while today the economic situation and the austerity policy adopted after the Debt/GDP ratio constraint imposed by the European Union make it impossible to invest such an amount of money in public securities.

Conclusion

The evolution of the society has changed the way through which poverty is contrasted. The methods adopted in the twentieth century, derived from the British policies of the seventieth century, were thought to face poverty through social provisions aimed to grant a minimum level of income to all the citizens not able to earn a sufficient amount of money on their own. The individuals below the Poverty Line were subsidized through a redistribution of income from riches to poor, made possible thanks to the taxes collected by the governments. These provisions were quite static, since they were provided to the citizens in need without some activation requirements. But this changed in the beginning of the new millennium, when the method used by the "New" Welfare State to achieve the goal of reduction in poverty has moved to the re-activation of the recipients through the obligation of searching for a job and the limitation of the number of possible contract refusal.

The effects of the provisions enacted in the European Countries analysed in the dissertation, Germany, France and Italy, are different because of the differences in the policies. Italy may be considered as a kid who needs to look around to grow up. Its provisions, both the benefits and the deregulation in the labour market, are similar to the ones adopted by the other Countries, but the full implementation of the New Welfare State is not so easy to achieve because of the European restrictions on the Debt/GDP ratio, which does not permit to Italy to invest as needed in social policies. For what regards France and Germany the situation is different: both of them have adopted the new system in the first decade of the new millennium, and it is possible to check whether the provisions implemented have been positive or not. In both cases the main goal, poverty alleviation, has not been accomplished, partly due to the financial crisis, since both the Headcount index and the Poverty Gap index have remained constant since the promulgation of both the Hartz Reform and the *Revenu de Solidarité Active*, even if the two benefits reforms have some differences between them. While the German one, the Hartz IV, has been enacted to reduce the high costs of social provisions, goal successfully achieved thanks to the cut in duration of the unemployment benefits, the RSA was aimed to incentivize the benefit recipients to work and to simplify the computation of the numerous benefits previously received by citizens. The just mentioned results reached by France with the new benefits have been met by Germany thanks to the other three parts of the Hartz reform, more focussed on the re-activation of citizens through the reorganization of the Federal Employment Agency and the deregulation of the labour market. These two objectives are the main difference between the French and the German reforms: while the benefits are not so different, the surrounding provisions of the Hartz reform have led to better results with respect to the RSA for what regards employment and social expenditures. In Germany, in fact, the effect on the labour force has been positive, with a reduction of the unemployment rate from 11% to 4% between 2004 and 2016, while in France the same rate has slightly increased since the promulgation of the RSA in 2009. It must be also said that the reduction of German unemployment rate does not only depend on the Hartz Reform, but also on other macroeconomic variables such as the level of wages. For what regards the expenditures, the advantage of the Hartz reform is related to the high costs of the previous insurances because of their duration, and so the reduction in this variable led to a decrease in social expenditures, while the French new benefit has led to an increase in costs for the State mainly because of the increase in total number of recipients. So, it is not difficult to say that the German reform has been more efficient than the French one thanks to the provisions which accompanied the new benefit, which have not been promulgated in France. But it would be wrong to state that the French New Welfare State has had a negative impact. In fact, it has to be considered that it has been adopted during the financial crisis, and so the initial results have not reflected the real efficiency of the RSA, which is working in the last years in the right direction.

Sitography

1) www.eurofound.europa.eu/publications/article/2015/italy-reforms-to-system-of-unemployment-benefits
2) data.oecd.org/france.htm
3) data.oecd.org/germany.htm
4) data.oecd.org/italy.htm

Bibliography

1) Alber J., Jan P., (2011). “Do new labour activation policies work? A descriptive analysis of the German Hartz reforms”, WZB Discussion Paper, No. SP I 2011-211, Wissenschaftszentrum Berlin für Sozialforschung (WZB), Berlin
2) Anne D., L’Horty Y., (2012). “The RSA (Revenu de solidarité active) and back-to-work incentives in France”, *International Social Security Review*, Vol. 65, 77-99
3) Bakija J., (2014). “*Social Welfare, Redistribution, and the Tradeoff between Efficiency and Equity, with Developing Country Applications*”, Williams College, Massachusetts, USA
4) Barr N., (2012). “*Economics of the Welfare State*”, Oxford University Press, UK
5) Bonoli G., Natali D., (2012). “*The Politics of the New Welfare State*”, Oxford University Press, UK
6) Briggs A., (1961). “The Welfare State in Historical Perspective”, *European Journal of Sociology / Archives Européennes de Sociologie / Europäisches Archiv für Soziologie*, Vol. 2, 221-258
7) Canova L., Piccoli L., Spadaro A., (2015). “An ex ante evaluation of the Revenu de Solidarité Active by micro–macro simulation techniques”, *IZA Journal of European Labor Studies*, Vol. 4, 1-20
8) D’Apice C., Fadda S., (2003). “The Italian Welfare System in the European Context”, *Review of Social Economy*, Vol. 61, 317-339
9) Fana M., Guarascio D., Cirillo V., (2015). “*Labour market reforms in Italy: Evaluating the effects of the Jobs Act*”, LEM Working Paper Series, No. 2015/31, Scuola Superiore Sant'Anna, Laboratory of Economics and Management (LEM), Pisa, Italy
10) Fleckenstein T., (2008). “Restructuring welfare for the unemployed: the Hartz legislation in Germany”, *Journal of European Social Policy*, Vol 18, 177–188
11) Foster J.E., Shorrocks A.F., (1988). “Poverty Orderings”, *Econometrica*, Vol. 56, 173-177
12) Goedhart T., Halberstadt V., Kapteyn A., van Praag B., (1997). “The Poverty Line: Concept and Measurement”, *The Journal of Human Resources*, Vol. 12, 503-520
13) Gruber J., (2011). “*Public Finance and Public Policy*”, Worth Publishers, New York, USA
14) Haughton J., Khandker S.R., (2009). “*Handbook on Poverty and Inequality*”, The World Bank, Washington DC
15) Jacobi L., Kluve J., (2007). “Before and after the Hartz reforms: The performance of active labour market policy in Germany”, *Zeitschrift für ArbeitsmarktForschung ‐ Journal for*

Labour Market Research, Institut für Arbeitsmarkt- und Berufsforschung (IAB), Vol. 40, 45-64

16) Kelly M., (2000). "Inequality and Crime", *The Review of Economics and Statistics,* Vol. 82, 530–539

17) Klinger S., Rothe T., (2012). "The impact of labour market reforms and economic performance on the matching of the short-term and the long-term unemployed", *Scottish Journal of Political Economy*, Vol. 59, 90-112

18) Krebs T., Scheffel M., (2012). "*Macroeconomic Evaluation of Labor Market Reform in Germany*", University of Mannheim/Department of Economics, Germany

19) Luttmer E.F.P., (2005). "Neighbours as negatives: relative earnings and well-being", *The Quarterly Journal of Economics*, Vol. 120, 963-1002

20) Palier B., Thelen K., (2010). "Institutionalizing Dualism: Complementarities and Change in France and Germany", *Politics Society*, Vol. 38, 119-148

21) Pierson P., (1996). "The new politics of the Welfare State", *World Politics*, Vol. 48, 143-179

22) Ravallion M., (1996). "Issues in measuring and modelling poverty", *The Economic Journal*, Vol. 106, 1328-1343

23) Sacchi S., (2018). "The Italian Welfare State in the Crisis: Learning to Adjust?", *South European Society and Politics*, Vol. 23, 29-46

24) Sen A., (1976). "Poverty: An Ordinal Approach to Measurement", *Econometrica*, Vol. 44, 219-231

25) Vlandas T., (2012). "*The politics of in-work benefits: the case of the 'Active Income of Solidarity' in France*", Workshop on Integrated Employment and Activation Policies in a Multilevel Welfare System, Milan