TWELVE

Fiscal austerity and income distribution in Italy

Massimo Baldini

Introduction

The aim of this chapter is to evaluate the main effects on the incomes of Italian households of the fiscal consolidation measures that the government has introduced since the start of the Great Recession in 2008, with the objective of reducing the deficit of the public budget.

The questions addressed in this chapter can be summarised as follows:

- What is the overall distributive impact of austerity measures on the income distribution of Italian households?
- Which social and economic groups have been more affected?
- What is the relationship between the changes in income distribution over the last decade in Italy and the changes produced by the policy measures?
- When designing which measures to introduce, did the government take into account the underlying changes in income distribution during the crisis?

The second section describes the evolution of income inequality and poverty before and after the onset of the Great Recession, while the third section provides some details of the simulation method and presents the distributive effects of the austerity package on Italian households. Finally, the fourth section discusses these results and puts them in a more general context.

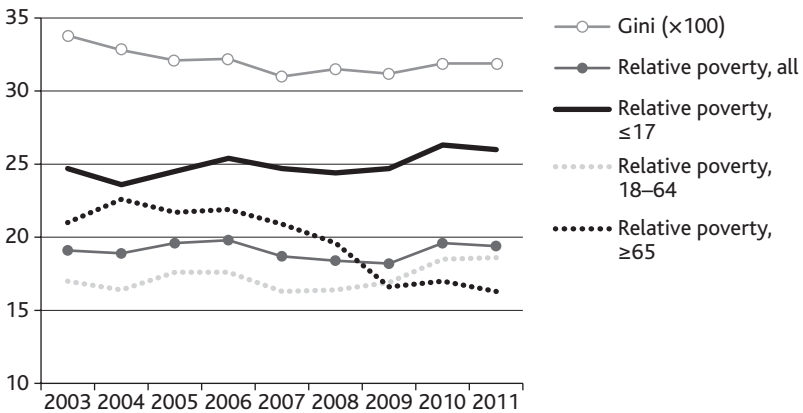
The distribution of income in Italy during the last decade

Italy has been one of the countries most severely affected by the global recession that started in 2008: in 2013, its gross domestic product

(GDP) was still 7.5% lower than the 2008 level, while other countries have been able either to regain the pre-crisis level or to significantly reduce their losses.[1] The recession had immediate consequences for workers, with a strong increase in the unemployment rate and in the number of layoffs. For the whole population, the employment rate fell from 58.7% in 2008 to 55.6% in 2013, while the unemployment rate rose from 6.8% to 12.4% during the same years. Labour-market conditions deteriorated in particular for younger cohorts: the employment rate of the age class 25–34 years, for example, fell from 70.1% in 2008 to 59.4% in 2013. For older workers (55–64 years of age), on the other hand, the employment rate rose from 34.4% in 2008 to 42.7% in 2013.

According to statistics available on the Eurostat website, computed on the Statistics on Income and Living Conditions (SILC) survey, income inequality in Italy was quite stable during the last decade: the Gini index fluctuated around 0.32 (see Figure 12.1), with a slight decline in the first part of the period.[2] This index, like the others shown in this section, is computed after assigning to each person the equivalent disposable income of the household to which they belong. Also, in 2011, the headcount rate for relative poverty, defined as the share of people living in households with disposable equivalent income lower than 60% of its median, is close to its levels before the crisis. If we compute the headcount rate for different age groups, however, some changes start to emerge: the index is decreasing for the elderly and slightly increasing for children. However, the headcount rate

Figure 12.1: Gini index of income inequality and relative poverty rate with variable line



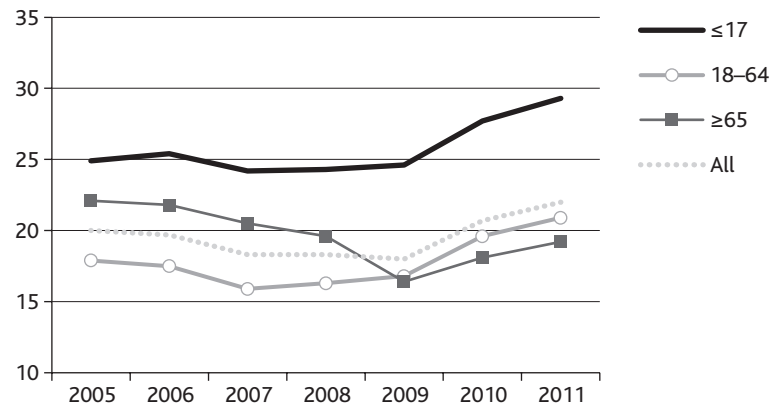
Source: Eurostat database, SILC {permission required/granted?}

computed with a variable poverty line is an unsatisfactory indicator of the risk of poverty when there are significant changes in the overall levels of income, since the poverty line falls during a recession: if all incomes decrease in the same proportion, the share of persons in poverty would not change at all, even in the presence of a generalised reduction in living standards (see, eg, Fields, 2001). In any case, the data shown in Figure 12.1 highlight a change in the relative positions of the elderly and the youth in the global Italian income distribution.

A better indicator of what has been happening to income poverty in Italy can be obtained by keeping fixed over time in real terms the poverty line computed in a given moment. Choosing 2004 as the reference year for this more 'absolute' measure, poverty has significantly increased after the start of the recession for all age classes (see Figure 12.2), in particular, for younger cohorts, while the headcount rate of the elderly in 2011is still lower than its pre-crisis level. From Figure 12.2, it seems that in the first two years of the recession, poverty did not increase, and that only in 2010 does the index start to rise. The fact that poverty among children and youth increased more than for the elderly is common to most Organisation for Economic Co-operation and Development (OECD) countries, with very few exceptions (OECD, 2013).

The Gini index also has some problems as an indicator of inequality, since it is particularly sensitive to income changes that involve the intermediate deciles of the distribution, while it does not change much after movements among the rich or the poor (see Atkinson, 1970;

Figure 12.2: Relative poverty rate with poverty line fixed in real terms at the 2004 level

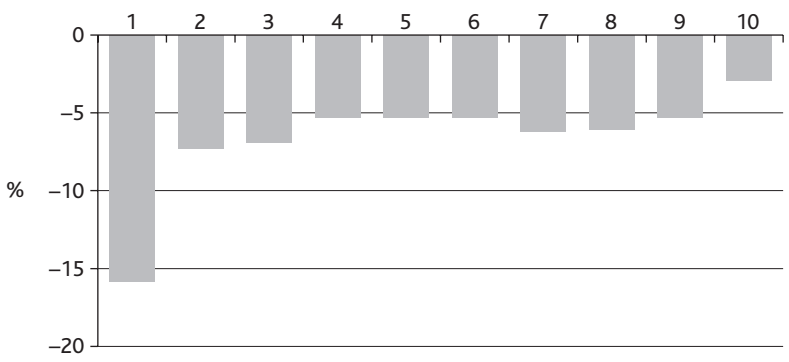


Source: Eurostat database, SILC {permission required/granted?}

Lambert, 2001). In the first four years of the crisis, the Gini index (multiplied by 100) increases from 31 to 31.9, a not-negligible move, but certainly not a clear explosion of inequality. Still using the Eurostat database, Figure 12.3 shows the percentage change in real disposable equivalent monetary income by deciles of persons from 2007 to 2011.[3] All suffered, on average, a decline in their real incomes, but this fall was particularly high for the poorest 10%, while the richest 10% of the population was the least affected. A similar pattern (the first decile losing more than the tenth) has been observed in other Mediterranean countries like Spain and Greece (OECD, 2013) and in the majority of OECD member states. These changes incorporate all factors that may have modified the income distribution over these years, that is, the job losses, the reductions in revenues for those who have maintained their activity and both the automatic (eg unemployment benefits) and the discretionary changes in government policies. The strong reduction in the incomes of the poorest decile can also be explained by the lack, in Italy, of a universal income maintenance scheme, which could have sustained the incomes of households hit by job losses or other income shocks.

The overall stability of the income distribution that the slow evolution over time of the Gini index may suggest, therefore, hides some important changes that have been taking place over the last few years. First, as just seen, the economic conditions of the poor have been drastically worsened by the recession in a short time span. Second, the groups more severely hit by the crisis are the young and, in general, those households that have been most exposed to the global recession and to the reduction in employment levels (Brandolini,

Figure 12.3: Change in average disposable equivalent income from 2007 to 2011, by deciles



Source: Eurostat database, SILC {permission required/granted?}

2014). The crisis in Italy has been mainly not a financial, but a real, event, producing its effects with a reduction in employment levels and thus in incomes from labour, both wages and self-employment income. Incomes from pensions and public transfers, on the other hand, have not suffered a similar fall. In the years since 2008, the first effects of the recession have been particularly felt by the areas more exposed to international trade, that is, the northern part of the country. The groups worst hit by the recession have been the dependent workers of the industrial sector and, in particular, those with lower levels of education or immigrants. Often, these workers are also young, and, in many cases, those who have been laid off still live with their parents. The propensity of many young people to stay in the family of origin for a long time may have mitigated the negative consequences of the surge of dismissals on the living standards of Italian households (Mocetti et al, 2011). The loss of jobs has also affected many families with children, so that the poverty rate of the youngest generations, already high by international standards, has risen further. According to SILC data, before the onset of the recession, from 2003 to 2007, all incomes grew (see Table 12.1) at similar rates, but during the first four years of the crisis, the elderly managed to maintain, on average, their previous living standards, while the other age classes suffered a significant reduction in income. In particular, each person living in Italy has seen her/his equivalent income fall by 5.3% from 2007 to 2011, the latest available year with data on incomes, but for those aged under 17 years, the reduction has been nearly double, by 9.3%. The incomes of the elderly continued to increase even during the recession for a series of possible reasons, for example, the reduction in the household dimension or the entrance, in this group, of 'younger' households (with heads in their early 60s) with incomes greater than the average of the other elderly households.

The other major survey available for the analysis of the incomes of Italian households, the Bank of Italy survey of household incomes and wealth, provides a picture of income changes that is consistent with the SILC data (Bank of Italy, 2014), but with one difference:

Table 12.1: Change in average equivalent income by age groups (%)

	≤17	18–64	>64	Total
2003–07	4.1	1.7	3.2	2.2
2007–11	–9.3	–6.3	1.5	–5.3
2007–11	–5.6	–4.7	4.8	–3.2

Source: Eurostat database, SILC {permission required/granted?}

behind the impression of stasis, before the start of the recession, the distribution of incomes was changing in favour of pensioners and of the self-employed, with employees losing ground. With the beginning of the crisis, these trends did not change for pensioners and employees, albeit that the improvement has only been in relative terms, while the incomes of the self-employed have also started to fall.

Despite the intensity of the fall in GDP since the first years of the recession, the Italian government could not react to it with strong countercyclical fiscal policies, due to the high levels of public debt and of the deficit. The debt-to-GDP ratio increased after the fall in the denominator and the surge in interest rates, while the deficit exceeded the 3% limit in the early years of the recession, even if by much less than in other European countries. The Italian government first limited itself to linear cuts in public expenditure (including the freezing of public sector wages), often delegated to local authorities, and responded to the social stress caused by layoffs by allowing a strong increase in spending on unemployment benefits and on the *Cassaintegrazioneguadagni*, a wage-supplement fund targeted at workers of firms suffering a temporary reduction in demand and aimed at preventing their layoff (see also Chapter Three).

Due to the persistence of the recession and the precarious conditions of the public budget, however, during the summer of 2011, the international financial markets stopped believing in the sustainability of Italian public finances and triggered a political turmoil. Two stabilisation packages adopted in July and August, containing measures on value-added tax (VAT), excise duties, taxes on financial wealth and energy companies, as well as new measures against tax evasion, were not considered sufficient to restore credibility to Italian economic policy. The new government led by Mario Monti that came into power in November 2011 rapidly introduced a third, heavy package of austerity measures, focused, in particular, on a drastic pension reform, on a partial reform of labour-market rules and on new taxes on real estate. In 2013, after inconclusive general elections, the Letta government continued the same restrictive policies, with new interventions on indirect taxation, but failed to maintain the commitment of the grand coalition in power to remove the property tax on primary dwellings. The government also tried a first timid attempt to reduce the tax wedge on labour, through a change in the tax credit for dependent workers in the personal income tax and a greater deduction from the regional business tax on value-added in case of new hirings under open-ended contracts.

The distributive impact of austerity measures

Simulation strategy

Our aim is to study how the fiscal austerity measures introduced by the government after the start of the crisis have changed the distribution of income among Italian households. We therefore need information on the policy changes, and also on the counterfactual distribution, that is, what would have happened to incomes without any fiscal consolidation measures. In very general terms, the differences between the distributions of 'real' disposable incomes observed in two years, for example, in 2008 and in 2014, depend on two sets of variations that have taken place in this interval: a) changes in the structure of original (ie before taxes and transfers) incomes; and b) changes in the rules of the tax and benefit system. If we want to focus on the effects of policy changes in the period, we need to choose a distribution of original income, keep it fixed and apply to it two different vectors of policy parameters, those in force in 2008 and those of 2014. For the reference 2008 original income distribution, we take the 2008 incomes and update them to 2014 using the consumer price index.[4] To this vector of incomes, we apply the policy rules that would prevail in 2014 if no discretionary variation in them had been introduced from 2008 to 2014, so we simply update the policy parameters to price changes when the existing rules provide for that (eg pensions), while keeping the parameters fixed to 2008 levels if no automatic adjustment mechanism exists (eg the bracket limits of the personal income tax) **{changes to sentence ok?}**.

The resulting counterfactual distribution provides the disposable incomes that would exist in 2014 if pre-tax and benefit incomes were fixed in real terms at their 2008 values, without any change in policy parameters over the last six years. The fact that some policy parameters are fixed in nominal terms implies that the net income distribution used as a counterfactual is different from that of the disposable income in 2008 simply updated with the consumer price index; for example, our disposable incomes are lower due to the fiscal drag effect since the parameters of the personal income tax are not automatically adjusted to inflation. The distribution after policy changes that is compared to the counterfactual one is obtained by applying the 2014 policy parameters to the vector of original incomes already described. The difference between the two sets of disposable incomes is therefore due only to the discretionary policy changes introduced over the period. This approach is similar to that followed by Avram et al (2013); apart from other

minor differences, the main ones are the time span covered, reaching 2014 in our case, the different method followed for the simulation of indirect taxes and the inclusion of the change in user fees for health goods and services. Arachi et al (2012) study the distributive impact of the fiscal measures included in the 2011 consolidation packages, focusing, in particular, on changes in the taxes on households and firms. They do not consider the freezing of pensions and public sector wages, and simulate some planned changes in indirect taxation that have been subsequently repealed. We do not try to simulate how the crisis may have changed the underlying market distribution through a reduction in employment (on this, see Baldini and Ciani, 2011; Brandolini et al, 2013) because we are only interested in the effects of policies, and do not have data on 'real' incomes after 2010. To perform the simulations, we need just one data set, and use the 2009 SILC survey for Italy, with 20,492 households and 51,196 individuals, providing data on individual and household characteristics for 2009 and incomes for the year before.

The measures that have been simulated can be classified as follows:

- The freezing of cost-of-living adjustment for pensions above three times the minimum pension level in 2012 and 2013, and above higher limits in 2014.
- The freezing of cost-of-living adjustment for public wages from 2010 to 2014. Public sector employees have been identified according to the following NACE (rev 2) categories: 1) public administration and defence, and compulsory social security; 2) education; and 3) human health and social work activities.
- The increase in the ordinary VAT rate from 20% to 22%.
- The increase in regional and municipal surtaxes to the personal income tax.
- The increase in social security contribution rates for the self-employed (+2.2%)
- Various increases in excise taxes on petrol and gasoline.
- Solidarity contributions on high incomes (3% of income above €300,000). The government also introduced another solidarity contribution only for high pensions and public sector wages (6% of incomes between 90,000 and 130,000; 12% between 130,000 and 193,000; 18% over 193,000), but the Constitutional Court outlawed it with two sentences in 2012 and 2013.
- Reform of the property tax and reintroduction of the cadastral value of the first dwelling in its base.
- Changes in the taxation of the stock of financial wealth.

- The increase in co-payments required to get public health services and drugs.

Here, we provide some details of the simulation choices adopted to reproduce these policy changes in the SILC data set.[5] The SILC survey does not contain information on household expenditure. To also estimate the effects of changes in VAT and excise rates, we therefore matched this data set with the 2008 Household Budget Survey for Italy, a survey carried out every year by the National Institute of Statistics, which collects detailed data on more than 200 goods and services purchased by Italian households. The match is performed with the propensity score method, and allows us to associate to each SILC household a complete vector of expenditures, which have been updated to 2014 with the consumer price index so as to contribute to the formation of the counterfactual distribution. The SILC survey also does not contain data on the value (both market and cadastral) of dwellings and other real estate owned by households. This is a very important piece of information since the cadastral value of real assets is the basis of the property tax introduced in 2011 by the Monti government, one of the most important ingredients of the austerity package. We make up for this shortcoming by imputing to our data set the information contained in the SILC 2008 survey about the property tax (*Impostacomunalesugliimmobili* [ICI], that is, municipal property tax) paid in 2007 on the primary residence. The Berlusconi government abolished the tax only on primary dwellings during 2008. From the amount paid and using its rule of computation, it is possible to obtain an estimate of the tax base, that is, the cadastral value of real assets. The analyses of the effects of fiscal consolidation measures usually take into consideration the changes in taxes and benefits that have a direct impact on household budgets. People, however, may also suffer from austerity measures that produce a reduction in public expenditure, particularly when they result in a cut in public services or in an increase in their (below market) prices. For example, for the first time in 2013, the national health fund was cut in real terms, and over the last few years, the national fund for social policies, which finances local authorities' social expenditure, has been severely cut. These reductions are very likely to produce negative and regressive effects on households' budgets. While we cannot simulate the impact of all the attempts to cut public expenditure in general and social spending in particular, we take at least one step in this direction by taking into account the significant increase in the user fees for public health services and drugs that has occurred during the crisis, in particular, in 2011, when a co-

payment of €10 for each specialist examination or test was introduced by most regions. According to AGENAS, the National agency for regional health services, Italian households spent about €2.6 billion in 2009 on user fees for drugs, visits, tests and emergency aid (see Cislaghi and Giuliani, 2012). This amount is expected to grow to €4.5 billion for each year since 2012. In order to simulate the effect of this increase on household incomes, we first exclude from its payment all households who are statutorily exempt from it for age or income reasons, then distribute the increase in the user fee as a proportion of the amount that each household spends on health services. The match between the SILC database and the Household Budget Survey allows us to attribute to each unit in the SILC survey a complete vector of expenditures, including those for health goods and services.

The pension reform of 2011 had important effects on the retirement age of many persons, and also left without income more than 100,000 individuals who had already left their job but could not immediately obtain a pension (the so-called '*esodati*'). We do not incorporate this effect in the simulations. One of the most important austerity measures has been the de-indexation of all public pensions higher than three times the amount of the minimum pension (€496 per month in 2014) during 2012 and 2013, followed only by a partial indexation of them in 2014. The de-indexation has been complete for all public sector workers, starting from 2010. We simulate these two measures, which are likely to have a progressive impact on the income distribution. In the counterfactual, all incomes of pensioners and public servants are fully updated by inflation, so that the effect of the freezing is a reduction of incomes with respect to the no-policy-change scenario. The personal income tax of pensioners and public employees is therefore lower in the post-reform scenario than in the counterfactual one, despite the increase in local surtaxes. To the reduction of the personal income tax, the two increases in the tax credit for children also contribute, introduced in the period, along with the increase in the tax credit for dependent workers deliberated at the end of 2013.

The effects on the overall income distribution

Consistently with the data presented in the second section, the unit of analysis is the individual. To each person of the sample, we attribute the disposable equivalent monetary income of the household in which they live. Equivalent disposable income is obtained using the modified OECD scale to adjust incomes for differences in household composition. In the definition of income, we do not include the

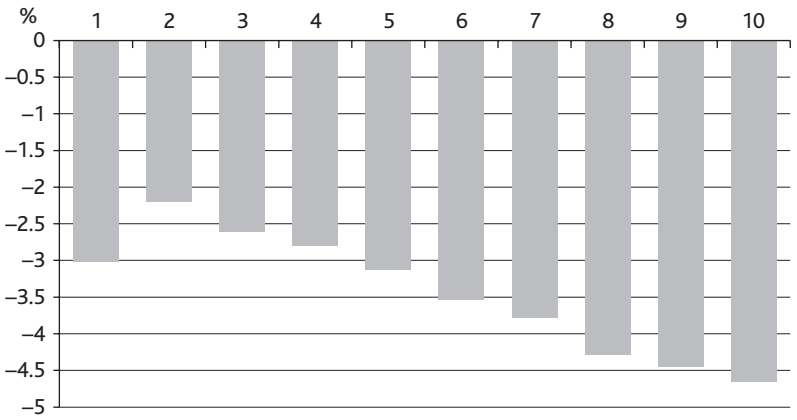
rental value of property because the statistics presented in the second section, taken from the Eurostat online database, exclude this component. This choice is likely to produce some consequences in the distributional results as some households may be poor in terms of monetary income but may belong to higher deciles in terms of an income definition that also includes imputed rents. This may be the case, for example, of some elderly households who have low monetary incomes but live in valuable dwellings. Since a significant part of the Italian austerity package consists of new taxes on property values, the distributive impact of fiscal consolidation may appear more progressive if individuals are ordered in terms of an income definition that includes imputed rents. We will come back to this problem later.

First, let us start with some statistics computed not on individuals, but on households, so as to have a general view of the impact of the measures. On the whole, the average yearly monetary income of Italian households falls after the consolidation package by €1,265. In other words, without these measures, each Italian household would have, in 2014, €1,265 more in monetary disposable income. This sum corresponds to 3.9% of average monetary household disposable income or, in aggregate terms, to about €33 billion, two percentage points of GDP. Among the deciles of disposable equivalent monetary income across households, the first (poorest) one loses €247 in 2014, for the fifth, the loss is €822 and the loss is €3,674 for the richest 10%. It is worth repeating that these changes do not represent the whole losses suffered by Italian households, but only that part which is due to the austerity measures. Since the 2014 real incomes are lower than the 2008 values, the monetary losses, considering the impact on market incomes, would be lower. In this way, we capture only the net impact of the austerity measures, *ceteris paribus*.

Figure 12.4 shows the percentage reduction in non-equivalised disposable monetary income (with respect to the counterfactual situation) by deciles of equivalent monetary disposable income. The distributive effect of the whole austerity package is slightly progressive (the Gini index slightly decreases), but the incidence over the households belonging to the poorest decile is similar to that of the middle of the distribution.

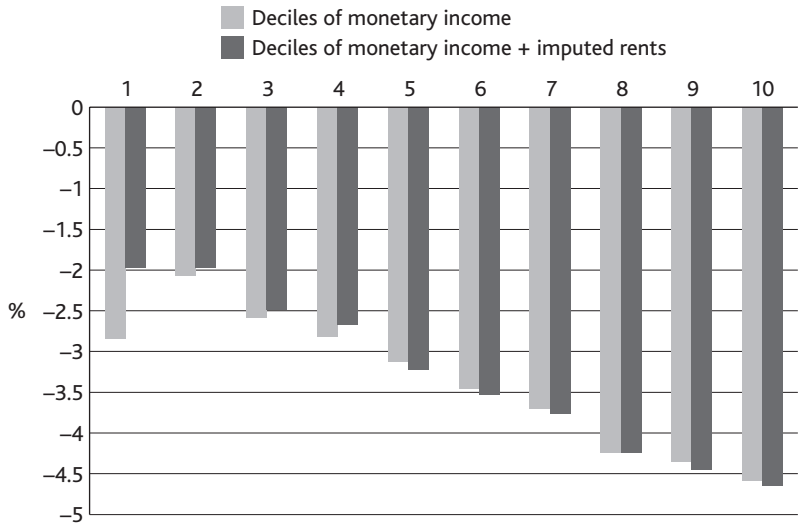
Turning to the individual analysis, Figure 12.5 contains the change in disposable monetary income for each decile of the personal distribution. We show the reductions in monetary income for the deciles of both monetary income and monetary income plus imputed rent. There is an appreciable difference only for the first 10%: in the first decile of monetary income, there are some households who may

Figure 12.4: Percentage change in disposable monetary income for households after the austerity package



Note: Households ordered by deciles of disposable monetary income computed over households

Figure 12.5: Percentage change in equivalent disposable monetary income for individuals after the austerity package



Note: Personal distribution

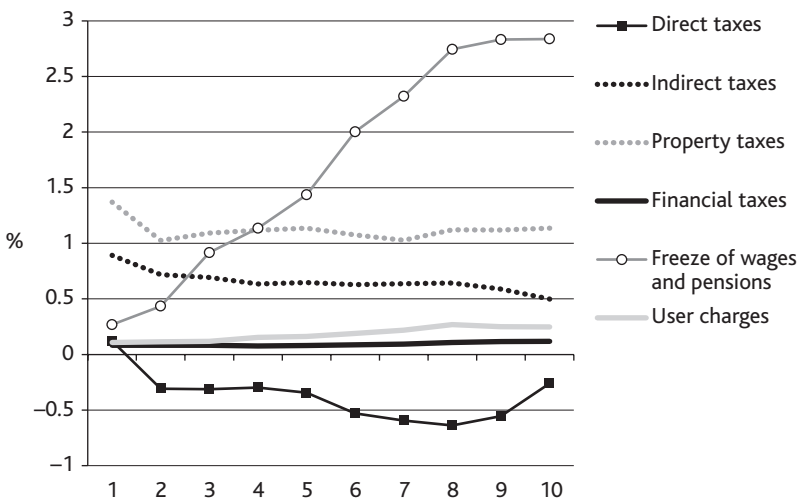
be 'house-rich but cash-poor', that is, with low cash income but with significant real assets. These households are heavily burdened by the property tax; therefore, their presence in the first decile increases the incidence of the austerity package on the incomes of the poor.

When households are ordered by an income measure that includes imputed rents, however, these households fall into higher deciles, and the incidence of the overall package on lower incomes falls. In both cases, the policy changes appear to be progressive.

We can now 'open' the package and gauge the separate effects on monetary income of the various austerity measures on all individuals (see Figure 12.6). The algebraic sum of these curves provides the left bars of Figure 12.5. The dominant impact is produced by the freezing of pensions and public sector wages, which is also particularly progressive. Its intensity is due to the length of the period in which public wages have been kept constant (five years in 2014), therefore producing a cumulative effect over time. If we had chosen 2012 as the reference year, its impact would have been nearly halved. The freezing of public sector wages could also have another effect on the well-being of Italian households, by reducing the motivation and the productivity of workers providing labour-intensive services in sectors such as schooling, health care and social assistance. These effects cannot be considered in our simulations.

The change in property taxation has been slightly regressive due to the ordering of individuals in terms of monetary income, as already explained. The increase in indirect taxation is clearly regressive, while that of user charges for public health goods and services is progressive. Changes in direct taxes have a negative impact, that is, they increase

Figure 12.6: Average incidence on equivalent monetary income of the austerity measures



Note: Personal distribution, deciles of equivalent monetary income

disposable income, because in the counterfactual scenario, the incomes of all public servants and of many pensioners are higher than in the post-austerity scenario, so that in the latter situation, their personal income tax is also lower. This effect, backed up also by the reduction in tax allowances for dependent workers and children, is stronger than the increase in social security contributions for the self-employed and in local surcharges.

The effects by socio-demographic groups

The average loss is lower than 3.5% of income for persons aged less than 40 years (see Table 12.2), while it is around 4.5% or higher for those of more than 50 years of age. This redistribution by age groups is confirmed by the effects across households of different dimension: smaller households (in general, the elderly) contribute more than those with three or more members. The clearest redistributive effect can be found among the different professional conditions of the household head: the groups worst hit by the policy changes are those of public employees and of pensioners, while the incidence is lower than the average for households of dependent workers in the private sector. While the reason for the severe penalty on public employees is clear, pensioners suffered from both the de-indexation of higher pensions and from the reintroduction of the property tax on owner-occupied dwellings, as well as from the strong increase in the property tax rate on other buildings. The share of households that own their dwellings tends to rise with age, and the ratio between the value of real wealth and disposable income is also higher for the elderly. Income losses are greater in the central regions for two possible reasons: the high

Table 12.2: Change in disposable income by various characteristics

Age		Geographical area		Number of household members		Condition of the household head	
≤17	–3.15%	North-West	–3.63%	1	–4.21%	Private employee	–2.53%
18–29	–3.31%			2	–4.35%		
30–39	–3.01%	North-East	–3.62%	3	–3.63%	Public employee	–7.03%
40–49	–3.58%			4	–3.41%		
50–59	–4.29%	Centre	–4.23%	5	–3.36%	Self-employed	–3.52%
60–69	–4.79%	South	–3.74%	≥6	–2.84%	Pensioner	–4.81%
≥70	–4.56%	Islands	–3.68%			Other	–2.99%
Total	–3.78%	Total	–3.78%	Total	–3.78%	Total	–3.78%

Note: To each individual, we have attributed the equivalised monetary income of the household of reference.

cadastral values in Rome and the concentration of many public employees in the capital.

Discussion

The necessity to consolidate the public budget after the crisis that erupted in international financial markets in 2011 prompted the government to introduce a severe set of policy measures, consisting mainly of new or higher taxes, and, in part, also of lower public expenditure. In the first years of the Great Recession, the substantial lack of countercyclical initiatives from the government was motivated by the high level of public debt. The automatic increase in unemployment benefits and the extensions of the *Cassaintegrazioneguadagni* to new industrial sectors and firms contributed to sustain the disposable incomes of many Italian households, which actually fell less than GDP per capita. After 2011, however, personal incomes collapsed under the combined blows of a new recession and of the budget cuts introduced to improve the deficit.

The hasty political process that led to three austerity packages during 2011 and to many other fiscal consolidation measures spread over time was dominated by the anxiety to regain credibility with European partners and international investors, but led to a set of decisions that, ex post, can at least partly be rationalised as being consistent with both the general debate over the policy options open to the government and the dynamics of the distribution of income before the crisis.

As for the first aspect, the economic problems of Italy date back to well before 2008. The Great Recession arrived after at least a decade of stagnation in real incomes, which brought about an intense debate around the Italian 'decline' and how to rediscover the way towards growth. The main recommendations, coming not only from scholars, but also from international institutions, called for a series of 'structural reforms': greater flexibility in the labour market; higher retirement ages; the reduction of non-productive public expenditure and of bureaucratic obstacles to business activity; and lower taxes on firms and labour to sustain competitiveness and increase the very low employment rate.[6] Over the same years, at a general level concerning not just the Italian economy, many have stressed that various types of taxes can have very different impacts on economic growth. Taxes on incomes from labour or profits, for example, have progressive distributive effects, but are considered very distortive and can reduce labour supply and demand, thereby worsening the performance prospects of an economy. On the other hand, taxes on real wealth may

be both equitable and efficiency-enhancing (Johansson et al, 2008). This kind of analysis suggests shifting the tax burden from income to property and consumption. With an increase in indirect taxation, this shift could also have effects similar to those produced by a devaluation of the exchange rate, increasing the relative price of imports. After the financial crisis broke, the succeeding Italian governments did not have sufficient political strength (and enough time) to cut public expenditure, apart from the nominal increase in public wages and higher pensions, so the only escape route was to increase the tax burden. However, they actually followed some of these pressures with a modest reduction of the personal income tax, which is mainly paid by dependent workers, and of IRAP **{please spell out the abbreviation in full at first mention}**, a regional tax on the value-added of firms, and increased revenue from both consumption and financial and real assets. The shift has been only partial because the tax burden on GDP increased to a record height, but it paved the way for future changes in a direction that seems close to the recommendations listed earlier. The Renzi government, which took office in February 2014, seems to share this approach, with a significant reduction in the personal income tax for low incomes and a small decrease in the rate of the tax on firms' value-added, the latter financed with an increase in the tax on bank deposits.

These rebates, in particular, on the personal income tax, are motivated by the aim of not only increasing the competitiveness of Italian firms and the convenience of hiring workers, but also of stimulating domestic aggregate demand via greater household disposable incomes. In this sense, they can also be interpreted as a departure from the influence of the expansionary austerity thesis, according to which budget cuts would have had a positive impact on demand through an improvement in expectations. The experience of the last few years has shown that fiscal consolidation may worsen the economy and delay the return to growth, without increasing aggregate demand per se.

Concerning the evolution of the income distribution, the lengthy stagnation of income and the crisis have had very similar distributive effects: even before the crisis, the dependent workers of the private sector lost ground in relative terms, to the advantage of pensioners, public sector workers and the self-employed.[7] The crisis further worsened the conditions of the first category, and also resulted in a fall in the incomes of the self-employed. The elderly and public employees, on the other hand, were relatively shielded from the recession because their incomes are guaranteed by a set of long-standing formalised rules

of redistribution. The worsening of the poverty and inequality indexes induced by the Great Recession was slow in the first few years, but became more and more clear after the new dip in GDP in 2012. The structural deficiencies of the Italian tax–benefit system, in particular, the lack of a safety-net scheme and an excessive reliance on pensions and forms of family-based solidarity among generations, could not avoid a marked deterioration of the conditions of the poorest part of the population. When the government had to decide who should pay the greater price of fiscal consolidation, it seems to have imposed the heavier burden on the groups that have been less affected by the recession, that is, pensioners and public employees. Of course, there are many pensioners that are poor and households of public sector workers that do not belong to the middle class, so a discussion of who are the winners and the losers of austerity measures based on the occupation of the head is inevitably imprecise in terms of the effects on the overall income distribution. Many middle-class households have been severely hit by the consolidation measures, which managed to maintain an overall progressive stance however, partly counterbalancing the inequality-enhancing impact of the recession.

This chapter has not considered other possible consequences of governmental choices, for example, the further reduction in GDP caused by the austerity measures through a fall in demand, which, in general, has a more pronounced negative effect on low-income families (IMF, 2014). Furthermore, it is worrying that these policy choices did not spare even the poorest households (eg through the increase in indirect taxes), but it is interesting that most of the resources have been collected from the groups that were relatively more protected from the recession.

The income distribution that emerges as a consequence of the austerity package is less unequal, in relative terms, than the distribution that would have been produced by the crisis alone. The adjustment measures reduced the incomes of all Italian households, but they muted the increase in inequality produced by the recession, although the offset was only partial: considering the effects of both the crisis and of the policy changes, the poorest section of the population is still the greatest net loser, together with the youth who have lost their job or could not manage to find another or even their first one. This loss in human capital, also reflected in the decrease by more than 10 percentage points in the employment rate for the age range 25–34 from 2008 to 2013 (from 70% to 59%), or in the strong increase in the poverty rate for the younger cohorts, will be the more long-lasting negative legacy of these years.

Notes

[1] Data from the Eurostat online statistics database.

[2] In this section, we present data obtained from the Eurostat database available online, a particularly useful reference since it contains statistics on income distribution that reach the year 2011, while the most updated database available to external researchers in February 2014 is SILC 2011, with income data referring to 2010. The household income definition used for the statistics in the Eurostat database is monetary disposable income, that is, it excludes imputed rents from owner-occupied dwellings or other properties.

[3] A very similar graph for the interval 2008–12 can be obtained from the microdata of the Bank of Italy survey.

[4] For 2014, we assume a 1% inflation rate.

[5] The simulation codes are available from the author.

[6] See, for example, the various editions of the Annual Report of the Bank of Italy on the Italian economy (available at: www.bancaditalia.it) or OECD (2012).

[7] On the presence of a positive pay sector gap before the crisis in favour of public employees, see Giordano et al (2011). In the years after the start of the recession, public employees benefited from the absence of layoffs, while the unemployment rate for the whole Italian economy nearly doubled from 2008 to 2013.

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