Indicators and Policies to Make Work Pay: An Italian Perspective.

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Make Work Pay (MWP hereafter) policies have been at the centre of the policy debate during the last decade. The attention, and the resources, devoted to them have been increasing in many OCED countries as MWP polices have been deemed a possible scapegoat from the labour market distortions of entrenched welfare systems. In many countries unemployed benefits claimants, lone parents and other groups have been intensively "treated" through MWP interventions. From a EU perspective MWP policies have been thought as a way-out from the apparent policy dilemma between social and economic goals, backing the (often moralistic) quest for employment oriented social policies (and social conscious economic and employment policies).

In this short note I will briefly deal with three broad issues. Firstly I will explain why MWP policies may be important also in a low welfare country like Italy, where unemployment benefits claimants, lone parents and low income people are entitled to what, by international standards, is a rather underdeveloped social safety net. Later I will focus upon a few critical aspects of MWP policies. I will stress the general point that there is no one-size-fits-all solution and that design and implementation of MWP policies imply hard decisions based upon a clear identification of the specific goals concretely pursued. Finally, I will consider the issues related to the use of synthetic indicators concerning the MWP effects of tax and benefits systems, a burgeoning area of the literature thanks to the data assembled by the OECD (and the EC-OECD project outlined in this volume).

Why MWP policies - An Italian perspective

As just said, Italy's welfare system does not provide a generous support to unemployed and low income people. Unemployment benefits expenditure is around 0.6% of GDP, approximately one third of the EU average. Social exclusion benefits amounts to less than 0.1% of GDP and the means tested universal scheme of support to low-income households (the Reddito Minimo di Inserimento) envisaged for and tested in a few municipalities at the end of the '90s has been dismantled, while the plans announced by the government to introduce (and co-finance with the Regions) an

[1] The opinions here expressed are exclusively personal and do not necessarily involve the Institutions of affiliation.

alternative scheme have remained overly vague[2]. Moreover, even the weight of those social groups which in other countries are disproportionately represented among welfare clients, for instance lone parents, remains quite small.

Such a state is well reflected in the OECD summary indicators concerning MWP (see third section) which show that in Italy, while the overall level of personal income taxation (and social security contributions, particularly those formally paid by the employers) is quite high, the tax and benefits burden associated with the transition from unemployment to work income is quite low. Moreover, such a burden is relevant only for a limited amount of time, as the ordinary unemployment benefits have rather stringent time limits[3].

From such a brief description it would appear that MWP policies are irrelevant from an Italian perspective. Yet it is not quite so. While no coherent and fully fledged plan has been so far formulated by the current government or its political competitors an increasing attention is paid to MWP considerations in the national policy debate[4]. Behind it there are at least three important factors.

A first reason is very much related to the underdevelopment of the Italian welfare system previously sketched. Italy is experiencing a gradual, albeit discontinuous, transition towards a more flexible labour market. Such a transition is still predominantly taking place through an extension of the possibilities to resort to temporary and ad hoc contractual arrangements, while traditional regulations limiting the dismissal of regular (open-ended) contracts are still a taboo[5]. Such a picture

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[2] The Author of this short note has proposed a concrete design of an alternative scheme (see P. Sestito, *Se il reddito è di ultima istanza*, www.la voce. info, 6th May 2004). The lack of a strong political will and the lack of budgetary resources have curtailed any concrete move. Currently, a few Regions have legislated designing their own schemes, pledging for national funds the central government has not made available also because it is unclear how and why independently designed schemes should be co-financed by central funds. Whatever the details of the schemes under examination (and of the political stand-still between the Regions and the central government), a central thesis of this note is the need to take into account the increasing pressure towards the introduction of some social safety net.

[3] The current government has just extended, and on a temporary basis, ordinary benefits from 6 to 7 months for people under 50 years of age, from 9 to 10 for those above that age threshold.

[4] I have personally advocated the need of MWP schemes in the Italian context in a recent book describing the evolution of the Italian labour market (see P. Sestito, *Il mercato del lavoro in Italia. Com'è. Come sta cambiando.*, Laterza, Bari, 2002). A similar claim has been supported by T. Boeri and R. Perotti, *Meno pensioni, più welfare,* Bologna, Il Mulino, 2002.

[5] During 2002 and 2003 the current government engaged a strong confrontation with trade unions in order to temporarily remove a specific restriction applied to individual dismissals in firms with more than 15 employees. The restriction under consideration under many aspects provides a very inefficient protection to workers, as it amounts to a reintegration clause subject to a judge's pronouncement, a mechanism which, also because of the long lags in the courts' interventions, is quite uncertain and arguably less valuable than a proper compensation mechanism against dismissal risks. As for the firm, it clearly limits its ability to adjust to shocks and the uncertainty features now mentioned (and the costly litigation process) further compounds the negative effects. Empirically, it appears that firms are somehow induced to avoid overcoming the size threshold above which the reintegration clause applies. The negative implications upon firms' growth are however rather limited also because most Italian firms are so small that the 15 employees threshold is far away from them (see upon this F. Schivardi and R. Torrini, 2004, *Firm size distribution and employment protection legislation in Italy,*. Banca d'Italia, Tema di discussione n. 504). So in principle, both parties could have had some interest in revising these regulations, for instance reducing those uncertainties which actually

is confirmed by the OECD Employment Protection Legislation index, unchanged as far as permanent employees are concerned and drastically reduced in the case of the temporary employees sub index (Italy has actually experienced the largest change over time among OECD countries). As part of a necessary transition from *a security on-the-job* to an *insurance in-the market* regime, there is so an increasing social pressure to strengthen unemployment benefits and the (means tested) social safety net. Moreover, such a pressure is particularly relevant for temporary workers, many of whom are made by high supply elasticity demographic groups, whose behavioural response to a more generous welfare system might be particularly intense.

Strategically, Italy will so increasingly need to resort to activation measures and MWP schemes in order to limit the budgetary costs and employment disincentive effects associated with a more generous welfare system.

Even disregarding these likely trends, it has to be said that also now there are areas in which the tax and benefits system weakens work incentives. While ordinary unemployment benefits are quite low as amount and short in duration, there are some special schemes providing for a generous and very lengthy income support. It is so for the employees of large manufacturing firms, for whom income support start with the intervention of the Wage Supplementation Fund – formally envisaged for temporary layoffs, a status which may however last for several years (very often through discretionary extensions granted at the bargaining table by the government) – later on followed by the so-called mobility benefits, lasting up to 3-4 years in case of workers over 50 years of age (and again with discretionary interventions providing for extensions up to retirement age).

Design problems also plague a rather peculiar scheme which provides for an ex-post income support to workers who, having worked at least a minimum amount of time (around 3 months in the year), do not work more than 6 months in the year (it is the so-called ordinary benefits with reduced requirements). This is actually an hybrid between a MWP scheme, as the minimum work requirement acts as an incentive to work somehow and the benefits are parameterised to the days actually worked the year before, and an unemployment benefit scheme, as interventions are carried out insofar there have been a reduced number of days worked. The lack of monitoring and the upward trend in temporary employment has led to a sizable rise in the use of this instrument (in 2003 there were 378 thousands persons covered by such a scheme outside of agriculture, vis-à-vis 225 thousands in 1993), now quite widespread among seasonal and temporary workers who tend to

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negatively impact upon both workers and firms. However, the attempt to put the issue on the policy agenda led to a tough confrontation, mostly driven by political factors as the issue became a flagship battle, the final outcome being a standstill which has impeded the advancement of other (possibly more relevant) issues and has practically frozen, for the near future, the inefficient reintegration clause before described.

use it on a regular basis (around 50% of the people who use the scheme in a given year reuse it the year after).

Sizable problems may also arise because of the tax system for a potential secondary earner in a household where a principal earner is already present. The tax system is not based upon the household[6]. Yet, there are tax rebates which are based upon the presence of dependant persons in the household, the dependant person status being related to the lack of a (large enough) income for that individual. So, not only children, but also a non-working partner may provide for a tax relief which would be lost by the principal earner (and the household as a whole) whenever the partner shifts from a non-working to a working status. Moreover, the tax rebates related to the children's presence are not parameterised to the actual use of outside care services and expenses, being mostly a function of the children's presence (with some additional elements inversely related to the income, as the reliefs provide for additional progressivity in the system, and to the presence of disabilities)[7]. It follows that market-work for a low wage secondary earner may be rather unprofitable, especially when there are little kids to be taken care of. While the pattern of economic incentives is quite complex - as it depends upon the tax rate of the principal earner, the household composition and the potential wage that the secondary earner could get in the market - it is doubtless that such a system and the lack of cheap, high-quality and flexible professional care services both contribute to depress female labour market participation in Italy. This is particularly so for low educated (and low wage) people, as the net earnings reaped in the market are small in comparison with the tax relief lost by the already working partner and the costs of the recourse to privately provided professional care services too high vis-à-vis the earnings available in the market. To put it rather succinctly, while Italy has not a pervasive problem of non-working lone mothers living on welfare rolls – as single parents are still a minority group and no universal welfare scheme

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[6] It has to be noticed that there have recently been many suggestions and pressures to shift to an household based tax system for both equitative and ideological reasons. Quite irresponsibly, such a debate has mostly neglected the issue of the possible perverse labour supply implications of such a shift (and the need to carefully avoid them).

[7] For sake of precision one should say that many parameters of the system have been just changed (through legislative changes enacted in 2002 and 2004), with a shift from tax deductions to gross income deductions, a reduction in the number of tax income brackets and the possibility to freely choose who, among the two parents (if both are working), and for what amount, is using the rebates related to the presence of children. This has produced some bizarre discontinuities in the effective tax rate and, more importantly has somehow reduced the progressivity of the personal income tax system (see for instance M. Baldini and P. Bosi, *Le famiglie dopo la riforma fiscale*, www.lavoce.info, 29.11.2004). The labour supply implications have not been much considered, in the policy debate before the introduction of these changes, and studied, after their introduction. To some extent, particularly the changes envisaged in 2002, may be presumed to have had positive labour supply effects as the threshold below which a person may be considered as a dependant spouse has been increased, so allowing more potential secondary earners to get an income without inducing the principal earner in the household to loose the related tax rebates. From the viewpoint of what here argued, while the details of the system have been changed (with effects to be carefully analysed) the intrinsic logic of the system and its pitfalls have not been changed.

provides for a generous support to them[8] - Italy has doubtless the twin problem of a low female employment rate in couples and of a very low fertility rate. Redesigning the tax system in order to strengthen the support to working mothers (and supporting the use of cheap, high-quality and flexible professional care services) may clearly help in addressing those two issues.

The impact of the tax and benefits system upon the make-or-buy choice extend well beyond the care-or-work choice just discussed. A peculiar choice is that between working in the official economy (being taxed) and working in the hidden economy (with no tax and social security contribution). Notice that the relevant tax wedge is not limited to the tax and social security contributions formally paid by the individual worker; as also the (more sizable) social security contributions paid by the employer matter[9]. When arranged in the hidden economy, the market value of the labour services is fully reaped by the worker, while if those same services are arranged by an official economy employer, a large chunk of that value goes away in social security contributions and personal income taxes. These considerations are particularly relevant in the Italian case because of the pervasiveness of the hidden economy and of the size of the total wedge (including employers' social security contributions). The pervasiveness of the hidden economy implies that it is quite easy and customarily to arrange many labour services in the unofficial economy sector; to put it succinctly, such an alternative is not confined to make-or-buy decisions related to the care of children, home repairs and other personal services: actually, also more complex labour services, for whom it is quite natural that an employer is the "intermediary" between workers and final consumers, are often organised in the hidden economy. The pervasiveness of the hidden economy actually lead to a vicious circle, with employers having both costs and revenues arising from hidden transactions: the easiness to have hidden revenues induce to have hidden costs (i.e. to hire workers unofficially) and the presence of hidden costs induces to look for hidden revenues.

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[8] However, one should consider that there is a positive trend in the incidence of lone parents. The single mothers less than 45 years of age rose from 336thousands in 1995 to 436 thousands in 2003.

[9] More broadly, social security contributions may or may not act as a tax depending upon the way in which they are linked to the future benefits people receive. Insofar as there is a strong link, at the individual level (albeit in an expected sense), between social security contributions (whoever, the employer or the employee, is formally paying for them), and future benefits, those contributions should be considered by the worker as a sort of deferred wage, not as a tax. On actual grounds such a link is often very weak, as access to the benefits in the future is often related to the presence of a minimum amount of paid contributions, the contributions paid on top of such a minimum threshold having no further relevance (being equated to a pure tax by the individual worker). An important change has been envisaged by the Italian pension reforms enacted throughout the last decade (notice that also Sweden has introduced similar principles): the system has been changed to a notional defined contribution system, in which contributions are accumulated over time and the benefits after retirement are computed on the basis of the total contributions accumulated. On actual grounds it is still unclear to what extent this new system may change the nature and perception of social security contributions from a labour supply perspective. In any case, this is an issue for the farther future, as the new system will become effective only in about 20 years time.

Some cautionary tales on MWP design and its institutional interactions.

In the previous section I have argued that MWP principles may be important also in a low welfare system like that of Italy. Yet MWP policies are not a magic recipe.

Important tradeoffs arise between social, employment and public finance goals. Channelling money to low wage people insofar as they work may reduce poverty and increase employment but it may be costly. The French case, in which several schemes have been set up in order to avoid the possible employment disincentives of a relatively generous minimum wage system, is a good reminder of the costly public finance implications[10].

Also because of these budgetary implications it is clear that reshaping the individual worker's budget constraint in order to increase the incentive to work at least up to a given earnings target implies that the work incentives in the subsequent sections of the budget constraint are reduced (as there are sections of the budget constraint where those incentives have to be withdrawn). People may be induced to work but only a limited amount of hours (or picking up low effort and low productivity jobs). Dynamically, people may be induced not to acquire human capital as low skill individuals are disproportionately made better off by the MWP intervention. Dependant individuals in the household may be induced to retire from the labour market because of the income effect arising from the MWP intervention in favour of the principal earner[11]. So it is clear that the actual design of MWP policies has to take into account what are the target groups and the policy goals more relevant in the different specific cases. In the Italian case, it is the increase in labour market participation of secondary earners in couples, mostly females, more than the rise in the number of hours worked among those few who do work, which appears as a possible priority.

Finally, it has to be reminded that while the introduction of MWP principles may lead to what has been called employment oriented social policies, the insurance features embedded into these still need to be preserved. Giving money *only* to the poor people who have been sufficiently determined and lucky to find a job would leave out those people who were not lucky enough to find a suitable job. In a well designed welfare system, incentives like those produced by MWP policies, sanctions and monitoring efforts (and other activation measures) may complement each other but none of them may substitute for the relief component which is the underlying rationale of the welfare system itself. While properly balancing the different tools may well depend upon the institutional background of the different systems - for instance, activation measures may be used only insofar as there are well functioning institutions and a sufficiently high administrative capacity – in general

[10] For a recent assessment of the French dilemmas into this field see the forthcoming OECD survey of France.

[11] This is what has happened to some extent in the US case with the EITC scheme. It is clear that a simple translation of the EITC scheme in the Italian context, where there are relatively few single parents while many wives are not working at all, would produce a disaster in terms of female employment trends.

terms all tools need to be employed. Form an Italian perspective, the importance of MWP engineered through automatic channels (with effects easy to be grasped by workers and firms) appears of paramount importance also as a way to circumvent the lack of administrative capacity, something which only gradually may be enhanced.

In such a broad context, I will briefly deal with two issues which are relevant in concretely designing MWP policies. The first one refers to the presence of time limits, the second to the interaction between MWP policies and the wage bargaining system.

The introduction of time limits to passive welfare schemes is a traditional recipe against the work disincentives created by those schemes. The literature on the optimal profile of the unemployment benefits has suggested the use of benefits declining over time (or even the use of lump sum payments upon firing, with no subsequent payments conditioned upon the permanence in the unemployment status); when taking also account of the insurance goals embedded into the unemployment insurance system, optimal payments may be firstly increasing (so as to concentrate resources upon those people who have difficulties to re-enter into the market) and then decreasing up to ceasing altogether in order to avoid the risk of inducing permanence into the scheme[12]. While the real world interventions have rarely copied these theoretical "prescriptions", many of the reforms actually implemented across EU (and OECD) countries in the past decade have strengthened the presence of time limits[13]. The question then arises whether there is something to be gained from a specular emphasis upon time limits in the case of MWP interventions.

The broad idea behind the use of time limits in MWP interventions is that people would be facilitated and pushed to get a job, still preserving the incentives to acquire more human capital so as to become, in the longer run, more "employable" even in the absence of further MWP interventions. The short run push towards finding and accepting a job - even a low wage one as the net income would be lifted up by the MWP interventions - would not destroy the longer run aspirations to become a higher skill and more employable worker. Furthermore, to the extent that a work experience per se leads to accumulate human capital, the work experience facilitated by the MWP intervention would in itself allow to better the longer run career chances of the affected individuals. So, time limits would be useful and not overly restrictive towards the low skill people

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[12] For a broad overview of the literature on these issues see B. Holmlund and P. Fredriksson, 2003, *Improving Incentives in Unemployment Insurance: A Review of Recent Research,* WP 2003:10, Department of Economics, Uppsala University. A specific proposal of an inverse U shaped time profile of unemployment benefits, with superimposed life-time limits in order to discourage the repeated use of unemployment benefits, was formulated in the Italian context by D. Franco and P. Sestito, 1995, *Il sistema di protezione sociale dei disoccupati: alcune riflessioni su una possibile riforma*, *Politica economica*, no. 3.

[13] Particularly insofar the single spell is concerned. Life time limits have been attempted in social assiatnce schemes in the US.

treated by the MWP interventions. These could and should be restricted to a role of escape route from unemployment and welfare persistence, without permanently altering relative prices.

Such an optimistic view is rather attractive for the policy maker. Somehow it parallels the idea behind the use of the so-called preventative approach in dealing with the risk of unemployment persistence (and long term unemployment). Basically that approach builds upon the idea that people who have lost a job position, if not prevented from becoming long term unemployed, would become disenfranchised, with a progressive deterioration of their job finding chances and of the "effectiveness" of their job search. At the aggregate level, this disenfranchisement would imply a coeteris paribus lower downward pressure upon wages, so that initial unemployment is not restored and persistence mechanisms drift apart the so-called natural rate of unemployment. In order to prevent this hysteresis mechanism to start happening, the best policy would be that of activating the unemployed as soon as possible in order to help and push them to find a new job.

Some doubts however arise, for both the preventative approach and the use of time limits in MWP interventions, because of the presence of individuals' heterogeneity. A well known analytical issue is whether the negative relationship appearing at the aggregate level between the probability of finding a new job and the past duration in the unemployment status is due to the mechanisms above depicted (i.e. what is called a true state-dependance effect) or to individuals' heterogeneity. In this last case, the negative relationship is due to compositional effects, as the more employable individuals leave earlier the unemployed pool, which is so increasingly made by the least employable ones.

When heterogeneity matters, arranging costly activation measures to the whole inflow of newly unemployed people may make no sense as scarce resources would be wasted upon people who would have found anyway a new job. Notice that also for MWP interventions there is an issue of optimal timing. Insofar as the MWP interventions are among those measures envisaged to help people to find a new job, one has to decide whether they have to operate as soon as individuals become unemployed (the risk being that also individuals with high re-employment chances benefit from them) or later on (when the risk is that people have become too disenfranchised from the market so that the MWP intervention is ineffective)[14].

Incidentally, it has to be noticed that given such a problem the strong emphasis put upon the preventative approach in the so-called European Strategy of Employment, particularly at its very

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[14] Notice that also unemployment inflows may be affected by the presence of generous MWP targeted to just unemployed people. So, for MWP as well as for unemployment benefits there may be a rationale in having time limits put upon the cumulative use of them (along the lines suggested for unemployment benefits in the cited Franco and Sestito paper).

beginning, was overly undue: a less extreme view would have stressed the activation approach, and within it, the preventative view, but duly taking account of the cost effectiveness and the targeting considerations just sketched.

Similarly, one has to realise that individuals' heterogeneity implies that in many cases there is no human capital accumulation to be foreseen. So there may be cases in which providing a quasi-permanent support to work income is the only suitable way through which social and employment concerns may be jointly reached[15]. While not denying the potential usefulness of time limits (as well as of the preventative approach), my conclusion is simply to be rather cautious in deriving strong statements upon the cost effectiveness of early interventions and of time limited MWP schemes. Both may be useful but one should clearly identify under which circumstances and how they can improve the overall picture.

So far I have discussed MWP interventions in very abstract terms. Concretely, MWP act either through the individual's labour supply or through the firm's labour demand. In the former case, interventions – often, but not necessarily, made through the tax system - reshape the individual's budget constraint inducing him or her to supply more hours of work; eventually such an effect is then also reflected in a downward pressure upon gross wages (and a widening of gross wage differentials, as the reshape is usually made in order to push low skill people to supply more labour) In the latter case, interventions - often, but again not necessarily, made through the social security contributions collection system - provide for a rebate to the firm who is hiring some groups of workers; if any, such an effect leads to an upward pressure upon gross wages (and a reduction of gross wage differentials). Insofar as wages are fully flexible, the two channels - whatever their administrative differences (which may matter a lot from an empirical point of view also because the visibility of the incentives is a prerequisite for them affecting workers' and firms' behaviour) - are equivalent: by shifting either demand or supply schedules, the net income and the employment chances of the affected workers would be improved.

In practice, the second channel is very often used where wages are not flexible. More specifically, it is used precisely in order to prevent a relatively high gross wage, often a relatively high statutory minimum wage, to cause excess unemployment. However, notice that the reasoning goes also the other way around: from the establishment of MWP interventions to the possible (optimal) introduction of minimum wage provisions, possibly motivated by the presence, in many low skill segments of the labour market, of monopsonistic phenomena. Firms with a monopsony power

[15] This is my reading of the evidence concerning a specific Canadian scheme (the Self Sufficiency Program) as shown by D. Card, and P. Robins (2004), *How important are entry effects in financial incentive programs for welfare recipients? Experimental evidence from the self-sufficiency program*, Journal of Econometrics, Vol. 125, pp. 113-139

might indeed cash in the in-work-benefits created by the MWP intervention nullifying both the employment and the workers' income effects. So, balancing MWP policies and statutory minimum wage provisions may be necessary both when the latter are an inheritance of the past, which for political reasons may not be removed, and when monopsonistic phenomena suggest their introduction.

In the Italian case a further consideration arises in connection to the difficulties experienced during the last 15 years in reforming the collective wage bargaining framework. Even after the incomes policy agreements signed in 1992-93, Italy remains characterised by a widespread presence of unions bargaining, mostly made at the national industry level. National industry contracts tend to act, under many respect, as *de facto* minimum wages. Even if there is not any legislative and administrative extension *erga omnes* of those contracts, towards such an outcome operate many legal provisions and institutions, the role of national contracts as practical benchmark in the myriad of small firms featuring the Italian landscape and the orientation and strength of unions, strong enough to enforce their use but not sufficiently strong to systematically top-up them through firm level bargaining. In playing such a *de-facto* role, national contracts are particularly inefficient as their amount is quite high - as they amount to around 70% of the actual average wage (vis-à-vis standard values of statutory minimum wages in other countries from about 30-35%, in the US, to 50-60%, in some EU countries) – while their enforcement is imperfect – as after all they are not fully supported by the law. The high level is likely to cause excess unemployment, particularly in the least developed regions of the country (the so-called Mezzogiorno); the weak enforcement jeopardises the protection provided to workers against monopsony phenomena.

A way out from such a situation might come from the move to a more decentralised wage bargaining system in which however the unions' fears of being left out from the many small firms which are the majority of the Italian system are taken into account by the introduction of a statutory minimum wage (fixed at a lower level than the currently dictated minima implied by the national contracts). Coupling this with the introduction of MWP policies focused upon low wage workers might help in reaching the necessary social consensus. More importantly, it might help to sustain income and employment chances for the most disadvantaged workers and areas of the country. Indeed, such a policy deal might allow to focus resources upon the Mezzogiorno regions avoiding the distortionary risks of (and the EC complaints about) many other traditional incentives focusing upon those regions.

Indicators of work incentives based upon the tax and benefits statutory rules

The OECD has gradually extended its indicators of the work incentives embedded into the tax and benefits system. The joint account of taxes and welfare schemes, and the distinction between different household types and features (in terms of wage levels as well as welfare schemes under consideration) clearly provide for many important analytical details.

Broadly speaking, measuring the effective tax rate implied by a given labour market change - being it a small rise of the amount of gross earnings or the transition from a non-working to a working position - provides for a summary description of the relevant (convexified) budget constraint of the individual under examination. Each of these summary descriptions is focusing upon a specific situation – as identified by a given household composition and role of the individual in that household, a given slope of the gross of taxes budget constraint (i.e. a given wage level) and a specific margin of choice (i.e. a given transition from a welfare scheme to some amount of work income and given changes in the number of hours of work or other dimensions of work effort). The relevance of those summary measures then depends upon the relevance of the specific situations under examination. The discrete choices and the budget constraint segments have to be empirically relevant (for the socio demographic groups under examination). The groups concerned, as identified by personal and family related circumstances, have to be empirically relevant. Such relevance implies both numerosity of the groups under examination and, given the focus upon labour supply responses, the fact that those groups have a high elasticity of labour supply (i.e. one is considering situations in which a sizable response to the incentives is likely)[16].

A further consideration arises from the static nature of the OECD indicators. The frame used is a static one, in which the effective tax rates are computed assuming that gross earnings, taxes and benefits are given and are not affected by the work-non work choice under examination. Dynamic considerations - including both the effects of time limits to unemployment benefits and entitlement effects related to the accumulation of rights to receive those benefits in the future – are simply neglected. Therefore the empirical relevance of the OECD indicators is limited to those cases where these dynamic considerations are negligible.

Notice that the average effective rates focusing upon a non-work to work transition (whatever the details of the non-work status, with or without the presence of benefits) are already a summary

[16] Notice that the empirical relevance of a given segment of the budget constraint is generally affected by the whole budget constraint shape as the segment of the budget constraint is endogenously determined. More generally, particularly in a cross country context, there may be problems related to the endogeneity of the situations. For instance, the time profile of unemployment benefits may impact upon the composition of unemployment benefits beneficiaries according to elapsed unemployment duration. In such a case, averaging across unemployment duration classes one should take account of the fact that the weights of the different duration classes are themselves a function of the effectoive tax rates relevant for the different duration classes.

measure of the whole budget constraint. On the contrary, the many effective marginal rates computed with respect to the small jumps along a given section of the budget constraint need to be "averaged" in order to provide a summary view of what is going on over that segment of the budget constraint. In order to preserve their nature of marginal rates one could consider the mode/median and the range of the marginal rates over the selected segment.

Both average and marginal rates however refer to very specific groups as identified by household type, level of gross earnings, presence (in the non-work situation) of specific welfare schemes etc. A natural issue then arise whether and how these many summary indicators should be further summarised. Averaging over different cases (different demographic groups, gross wage levels and welfare schemes) may be useful in order to characterise a given country's system. However, I think one has to realise that the advantage of these indicators is precisely in that they allow to identify which are the groups and situations most affected by the presence of weak work incentives. It is so that these indicators top up the aggregate information already somehow contained in the aggregate figures about income taxation and social security contributions (expressed as a % of GDP).

In any case I would strongly argue in favour of averaging over a relatively large number of cases, avoiding to pick up one given case as the common benchmark for comparing different countries. Such a single benchmark would not exploit the richness of the detailed indicators - which allow to identify which groups in the different countries are more or less affected by weak work incentives - and would be misleading when comparing two countries as the salience of that single benchmark case might differ across the two countries and in all the other cases the two countries might well be characterised by a ranking different from that relevant for the selected benchmark case. My conclusion is so extremely critical of the adoption, among the EU structural indicators, of a single benchmark case in order to measure the so-called unemployment trap.

A related issue when averaging across groups refers to the weights to be used and, most specifically, whether these weights should be country specific and selected with reference to the actual composition of the population in the different countries. I would strongly argue against the use of country specific weights when comparing countries for the very simple reason that actual weights are endogenously determined. More specifically, the actual composition of the overall population may be well affected by the very nature of the tax and benefits system. The fact that, for instance, a country has more long term unemployed than short term ones, may be also due to the fact that unemployment benefits last (at a relatively generous amount) for longer periods. Using "arbitrary" but homogeneous weights when producing country averages may so avoid to distort the comparison across countries and over time.

The notional effective tax rates, both when considered into all their details and when averaged into a single country figure, provide for indications about the work incentives and, suitably arranged, the economic support provided by the welfare system. As such they do not allow to gauge the labour supply implications of the tax and benefits system, its distributional and resources implications. In order to allow such a more complete picture to be drawn, one should resort to microsimulation models (with behavioural responses also taken into account). To a good extent this is beyond the reach of these indicators.

Both microsimulation (and other) models and indicators focusing upon policies as the ones here discussed are useful ingredients in order to enhance and make more transparent the policy debate. Actually, increasing their use – by agreeing upon common and transparent criteria and by investing adequate resources in their actual construction - appears to me a very important aspect in order to strengthen the policy processes launched (and now streamlined) at the EU level. Under many aspects, I believe that many of these processes have to be strongly performance oriented. Specifically this is true for the processes governed by the open method of coordination in the fields of employment and social policies, where there is a general agreement upon broad common goals but there is no one-size-fits-all policy package to be pursued, the subsidiarity principle suggesting to leave a large freedom of movement to Member States. Consequently, also the assessment of countries' has to be largely based upon the evolution of their actual performance and not upon consideration of the detailed policies announced and implemented. Notice that this has not been always so, as for instance, at its very beginning the European Employment Strategy was very much tilted towards the preventative and activation approach. Whatever the merits (and pitfalls, as already discussed above) of such an approach, the input orientation of such an approach was intrinsically distorsive as countries were not sufficiently free to identify their orientation[17]. Yet there

[17] Further notice that the policy indicators constructed in order to measure the implementation of that approach were very much unsatisfactory. The preventative approach, as already stressed in the employment guidelines launched at the 1997 Luxembourg Summit, stated that countries had to implement activation and other suitable preventive measures before unemployed had accumulated 12 (6 for the youths) months of elapsed unemployment duration. The indicators selected at the EU level were unduly focusing upon registered unemployment and Public Employment Services (PES) measures (while the PES was one among other possible policy instruments and the target group was that of the unemployed and not only of those reached by the PES). Moreover, they were based looking at the number of unemployed who after 6 (12) months of elapsed unemployment duration had received a measure having no clear economic interpretation as no attention was paid to the effectiveness of measures and to the fact that people who remained unemployed are a selected component of the original unemployment inflow.. An example may clarify this point: suppose that in country A all unemployed persons are offered a preventive measure but only 10% of them, because of the measure's ineffectiveness, escape from unemployment before 6/12 months - the indicator measuring the non-compliance to the guideline would be 0% (0/90); on the contrary in country B only 10% of the unemployed are offered a preventive measure (possibly because the measures are put in place selecting the most disadvantaged people) and that, because of the measure's effectiveness, all of them escape from unemployment, for the remaining people the escape rate being 10% as in country A - the indicator would be 100% (81/81). So while country B is more efficaciously implementing the preventative approach, the non compliance indicator would suggest that country A is in a better shape than country B

is a risk in applying a performance orientation in the EU policy processes: one can easily loose the learning-by-peers component as there is no clear link between performance 8as such affected by a multitude of factors) and policies and the processes orientation may become rather vague, as only a general aspiration towards some broad goals may survive. It is in order to strengthen the policy analysis capabilities within each Member State and at the EU level that the use of analytical tools as the ones just discussed may be very useful. In other words, the game could usefully become one in which Member States are genuinely free to select the policy package best suited to them, but there is a common and transparent reading of the policies actually chosen. Such a common and transparent reading may allow learning form each other and may increase the political accountability of national governments, with respect to partners as well as their own electorates.

While both microsimulation models and policy indicators as the ones here discussed share these prerogatives, there are important differences among the two tools, which make them complimentary and not alternative to each other. Microsimulation models, particularly when taking into account behavioural responses, are much more controversial. Their possible use in an international context in order to compare and benchmark countries is so rather dubious. A different story applies to the indicators here discussed. The relative easiness in constructing and updating them, also taking account of the newly legislated changes of each country's tax and benefits system, might be usefully exploited in the monitoring of the evolution of the EU countries' welfare systems. For instance, when a Member State is going to introduce a tax reform package it could be usefully asked to allow the production of updated tax and benefits indicators for a wide set of relevant cases. This would allow to understand the likely work incentives implications of that package. This could be easily and consistently arranged by the European Commission. A request to provide the country's evaluation of such a package in terms of resources implications, distributional and labour supply implications as estimable by a microsimulation model might be also presented. However, this more detailed evaluation should be mostly done "accepting" what submitted by the individual country on the basis of the models internally used, with limited possibility to critically consider the reliability of these evaluations. While fostering the use of appropriate models would be useful, the degree of transparency would remain rather limited as there is no generally agreed model. On the contrary, the policy indicators here considered could be produced more easily and with much less controversies.