European Forum

Rescue from Without? Italian Social Policies 1970-1999 and the Challenges of Internazionalization

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EUF No. 99/13

EUI WORKING PAPERS

EUROPEAN UNIVERSITY INSTITUTE

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Ferrera/Gualmini: *Rescue from Without?*
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This Working Paper has been written in the context of the 1998-1999 European Forum programme on **Recasting the European Welfare State: Options, Constraints, Actors**, directed by Professors Maurizio Ferrera (Universities of Pavia and Bocconi, Milano) and Martin Rhodes (Robert Schuman Centre).

Adopting a broad, long-term and comparative perspective, the Forum will aim to:
· scrutinize the complex web of social, economic and political challenges to contemporary European welfare states;
· identify the various options for, and constraints on institutional reform;
· discuss the role of the various actors in promoting or hindering this reform at the national, sub-national and supra-national level;
· and, more generally, outline the broad trajectories and scenarios of change.

EUROPEAN UNIVERSITY INSTITUTE, FLORENCE

EUROPEAN FORUM

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Rescue from Without? Italian Social Policies 1970-1999 and the Challenges of Internazionalization

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Printed in Italy in September 1999
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Badia Fiesolana
I – 50016 San Domenico (FI)
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Abstract[*]

The turbolent 1990s have been a sucessful decade for Italy. Through an impressive sequence of reforms, this country has been able to put in order its battered public finances, to start an incisive modernization of its backward bureaucratic apparatus, its rigid labour market and its unbalanced welfare state, without seriously jeopardizing social peace nor the overall competitiveness of its economy in the global context. The dynamics of internationalization and, especially, of European integration have been crucial for fostering these positive developments. Indeed the Italian experience shows that internationalization may well be a solution rather than a problem. Combining with other endogenous factors and inducing an accelerated dynamic of social and institutional learning, internationalization and European integration seem to have promoted a quality jump in terms of policy capabilities. The reforms of the 1990s have not wholly eradicated the deep rooted contradictions of welfare capitalism "Italian style". But some important "institutional stabilisers" have been put in place, capable of constraining in a semi-automatic way the future development of some delicate policy areas (e.g. pensions or health care) and macro-economic variables (e.g. inflation, public deficits and debt). It remains to be seen whether the new configuration can also reach a firm point of political and economic equilibrium in the medium term.

[*] Forthcoming in F. Scharpf and V. Schmidt (eds.) *Welfare and Work in an Open Economy*, Oxford, Oxford UP, 2000.

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Introduction[*]

For much of the postwar period Italy was regarded as the sick man of Europe. The Italian disease had both political and economic components: harsh ideological divisions, chronic governmental instability, an inefficient bureaucracy, uneven socio-economic development, organized crime and unbalanced public finances – just to mention the most classical stereotypes. In the course of the 1990s, some encouraging signs of a healing process have however appeared on the scene. The most visible and relevant indicator of this is certainly Italy's entry into the Economic and Monetary Union by the established deadline of 1998, at the same moment of the other "core" European countries. Only a few years back this event seemed almost unimaginable to any realistic observer. Respecting the Maastricht criteria would have required in fact a massive effort of macroeconomic adjustment, which would have required in turn both a stable politics and coherent policies: two goods which had always been in very scarce supply South of the Alps. But the entry into the EMU is only the tip of the iceberg. In addition to macroeconomic adjustment, the 1990s have witnessed a multitude of other innovations – some quite big, some small, but nevertheless significant – which have slowly redesigned the country's institutional fabric, greatly enhancing its political and policy capabilities.

"Internationalization" – but especially the dynamics of European integration – has played a major role in fostering these positive developments. In the specialised literature, internationalization is often portrayed as a threat to domestic employment and welfare state regimes. Equally often, what is suggested is that these regimes can be preserved (or successfully adjusted) by mobilizing existing state capabilities in order to neutralize or attenuate exogenous challenges and shocks. With respect to this line of debate, the Italian experience seems to go in exactly the opposite direction. First, the Italian disease (including structural unemployment and an unbalanced welfare system) was there long before the winds of globalization started to blow. Second, the new dynamics of economic internationalization which started to unfold themselves in the 1980s did not produce in Italy those harmful effects on employment and income distribution which made their sinister appearance elsewhere in the OECD. Quite to the contrary, what seems to emerge from the available

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empirical literature on the issue is that, if anything, the process of internationalization has probably benefited the average Italian worker. Third, combining with other internal developments this process stimulated a real "quality jump" in terms of institutional capabilities: in other words, it triggered off a sequence of changes which is transforming Italy into a *state* proper, finally able to act on a par with its political allies and economic competitors in the inter-state arenas (including, obviously, the EU). The transformation is not complete. And there are worries that Italy's vulnerability to exogenous challenges may dramatically increase in the new phase in which the international economy is now entering. But the path to "virtuous statehood" is still visible and open. The sick man can get well – if it so chooses.

This paper is organized in two parts. Part I will illustrate the start-up constellation and discuss the endogenous and original problems of "welfare capitalism Italian style" as they manifested themselves in the 1970s. Part II will reconstruct the winding process of adjustment from its early (and largely unsuccessful) steps in the 1980s to the turning points of the 1990s. The conclusion will present the challenges ahead and the emerging profile of the new Italy – an Italy "European style".

Part 1: The Scene of the 1970s: Lights, Shadows and Thunders

For Italy's political economy the 1970s were a complex decade, characterised by at least three intertwined dynamics: 1) the institutional completion of the keynesian welfare state (in its widest sense), in many respects accomplishing what had been prescribed by the 1947 constitution; 2) the gradual appearance of endogenous strains, largely connected with some peculiar characteristics of those accomplishments; 3) the sudden break of an exogenous crisis, linked with the well-known turbulences of the world economy. The first dynamic culminated in 1978 with a sweeping social reform establishing the National Health Service. The second dynamic became overtly visible in 1974, when the huge debts accumulated by the social security funds had to be repaid. Prompted by the first oil shock, the third dynamic emitted in its turn a dramatic bang in 1976, when the official quotation of the Lira had to be officially suspended for excessive devaluation.

1.1 The Lights: the Rise of Keynesian Welfare ...

In the first two and one half decades after World War II the Italian economy underwent a process of remarkable growth which enabled the country to gain quite a respectable position among the top industrialized powers. Average per capita income grew some 2.5 times between 1950 and 1970. The domestic product boomed especially in 1955-1969, mainly as a result of international trade and the successful penetration of foreign markets. Export-led growth forced the large private industries of Northern Italy to rapidly modernise technologically and financially, aligning themselves with international competitors. The public industrial sector witnessed in turn a marked expansion (more marked than elsewhere in Europe), in the context of a keynesian economic policy oriented towards industrial planning and moderate nationalization. A third sector of small and medium-sized enterprises, increasingly successful in foreign markets, started to flourish in various niches of production, taking roots also outside the traditional industrial triangle of Piedmont, Lombardy and Liguria.

This long "economic miracle" was accompanied by a gradual consolidation and articulation of the state apparatus, putting in place and fine tuning the fairly complex institutional framework designed by the 1947 constitution. Perhaps the major accomplishment on this front was the creation of the regions, which was completed in 1970. The national executive remained firmly in the hands of the Christian democrats (*Democrazia cristiana - DC*), but during the 1960s this party struck a new alliance with the Socialists (the so-called Centre Left, formed in 1962) which was to last for the subsequent thirty years. The opposition remained monopolized by a Communist Party with strong marxist-leninist orientations. Though highly combative in the electoral arena, the PCI was de facto involved in the making of the most important domestic policies, especially in the economic and social field.

The economic miracle and the coming together of the DC and the PSI offered a fertile background for the expansion of the welfare state. The institutional framework inherited by the new Republican regime born in 1947 divided social protection into three separate parts: social insurance (*previdenza*), health and sanitation (*sanità*) and assistance (*assistenza*). Social insurance included six major schemes (for pensions, unemployment, TB, family allowances, sickness and maternity, occupational injuries and diseases), administered by a number of separate agencies and funds for selected occupational categories, often with diverse eligibility and benefit regulations. Insurance coverage was limited to employees, thus excluding the self employed; most benefits were flat rate or related to previous contributions. The provision of health services relied heavily on the private sector. Finally a plethora of public and semi-public agencies provided social assistance for the needy at a national and local level, paralleled by private and church charities.

This institutional setting witnessed only a few alterations during the 1950s and 1960s. The latter were a decade of ambitious reforms plans, promoted by the new Centre-Left coalition. But - as table 1 shows - the record of actual reforms was quite poor until the end of the decade. From 1968 onwards, however, the institutional profile of the Italian welfare state started to change rapidly, in the wake of new and heated social conflicts and under popular and union pressures. Hospital care was thoroughly revised in its administrative and financial status. A major pension reform introduced a very generous "defined benefit" formula, guaranteeing to employees a replacement rate of up to 80% after 40 years of career at the age of 60 (55 for women). This reform also confirmed for employees the possibility of retiring after 35 years of work regardless of age, with a replacement rate of 70%.[1] Unemployment insurance was strengthened, especially as regards the *Cassa Integrazione* scheme (cf. *infra*).

Table 1. Social Policy Reforms, 1950-1970

Social Insurance
1952 Pension reform: improvement of pension formula and establishment of pension minima
1955 Family allowances reform
1958- Pension insurance extended to farmers, artisans
1967 and traders
1968 Unemployment insurance improved
1969 Pension reform: introduction of earnings-related and social pensions; cost of living indexation
1974 Reform of invalidity pensions
1975 Wage indexation of pensions

Health
1968 Reform of administrative and financial regulations for hospitals
1974 Hospital care transferred to regions
1978 Establishment of the National Health Service

Education
1962 School leaving age raised to 14; introduction of unified post-elementary curriculum
1969 Access to higher education greatly expanded
1974 Creation of parent/student representative boards

Social Assistance
1972 Jurisdiction over social assistance and services transferred to the regions
1977 Social assistance "categorical" funds abolished; jurisdiction transferred to local authorities

This reformist zeal continued and indeed deepened throughout the 1970s. Following constitutional provisions, regions and local authorities were transformed into the main loci of welfare policy, gradually suppressing the national health insurance and assistance funds. Social assistance, health care, housing and vocational training thus became the competence of sub-national governments (though their financing remained centralized). In 1978 a sweeping reform led to the establishment of the National Health Service, replacing all pre-existing separate professional insurance funds.

Thus in the second half of the 1970s the Italian welfare state emerged as a relatively distinct and coherent institutional configuration. Though largely centred on the bismarckian principles of social insurance typical of all Continental, conservative-corporatist welfare regimes, in the field of health care this configuration included a "beveridgean" element - or at least a beveridgean aspiration (which was already present in the 1947 constitution). The bismarckian transfer schemes provided relatively generous benefits, most of which were earnings-related and fully indexed. The formerly dispersed health care and social services had been replaced by a relatively unitary - though highly decentralised - national and universal service, based on citizenship rights; education had been reformed and greatly expanded, and housing broadly decentralised.

The institutional growth of the welfare state was paralleled by a rapid and substantial quantitative expansion. In the mid-1950s, total social expenditure (including income maintenance, health care and social assistance) absorbed around 10% of GDP - a relatively low level by international standards (Flora 1983; Flora 1986/87; Ferrera 1987). In 1970 this percentage had risen to 17.4%, reaching 22.6% in 1975 - a level in line with that of France or Belgium and higher than that of Britain (EC 1993).

1.2 ... And of a "Guaranteed" Labour Market

The long economic miracle caused profound modifications of the employment structure. At the beginning of the 1950s Italy was to a large extent still an agrarian country: more than 40% of the labour force was occupied in the primary sector, with a large number of independent farmers and share-croppers. By 1970 this proportion had fell under 20% with the secondary and tertiary sector at about 4% each. Although definitively more modern, in the early 1970s the profile of Italy's labour force continued however to display some peculiar traits, such as the high incidence of the self-employed (about 20) and a very low female participation rate (at about 30%).

In the seventies a generous system of *ammortizzatori sociali* (social shock absorbers) was brought to completion in the field of unemployment. These were entirely based on passive policies and mainly addressed to the regular adult workers which constituted the core of the employment structure. Three different but intertwined phenomena contributed to improve social protection against the risk of unemployment: the extension and improvement of cash benefits; the overall institutionalization of labour relations through the Workers' Statute and the rise in union power.

After the war, state regulation of the labour market rested on three main pillars: a) a general unemployment insurance scheme, b) a scheme for short term earnings replacement in case of temporary redundancies (*Cassa integrazione guadagni ordinaria*) and c) centralised employment services. The insurance scheme was addressed to private sector workers remaining without job and it required at least two years of contributions. The allowance was very low and based on a flat-rate daily amount. The *Cassa Integrazione* allowance was still based on contributions, but was related to previous earning (60-65%) and was aimed at protecting those workers who had been temporarily hit by working time reductions and whose re-entry into the firm was thought to be certain.

Finally, in 1949 the state monopoly on the employment services was established. The unemployed had to register into compulsory lists, their position depending on pre-defined criteria; the employers had to notify to the placement office the characteristics of the worker they needed to hire and the worker was automatically assigned to the firm.

From the fifties to the seventies these three pillars operated in mutual reinforcement. The amount of the unemployment insurance benefit was adjusted several times, but did not keep up with the cost of living, thus eroding in real terms. On the contrary the *Cassa Integrazione* scheme literally boomed and started to function as a substitute for the former scheme.

The unemployment insurance schemes were integrated by the introduction of a new legislation on workers' rights. In 1970 the Workers' Statute, which was the result of a heated political debate, strongly limited the employers' power by imposing constraints and sanctions in case of union activities repression. Individual and collective workers' rights in the factories were acknowledged and widened. The law was to be applied in enterprises with more than 15 employees. It included rules for the protection of the dignity and freedom of the worker, for the defence of union political activities and for the exercise of a rich set of social rights connected to the work life.

In addition, the Workers' Statute reinforced the presence of trade unions in the work place. This was also a result of the changed political and social climate at the end of the 1960s. The explosion of conflicts and strikes during the "hot autumn" allowed the unions to take on a primary role in the battle for reforms (for pensions, housing, taxes) and higher wages. Union demands were unanimous: higher control on income policies, active participation to the firm management, and "egalitarianism" (i.e. the reduction of wage differentials among sexes, categories and qualifications) (Cella and Treu 1989; 1998). The rise in power of national trade unions was reflected in a parallel rise of union membership. Between 1968 and 1975 the members of the CISL, the catholic-oriented union, rose from one million to two millions and a half, while those of the CGIL, the communist-oriented union, grew from two millions and a half to four million and a half (Ricciardi 1986). From 1970 to 1980 the overall Italian union membership rate rose from 33.4% to 44.1%, overcoming the Dutch rate (33.8%), the German rate (34.3%) and the EC average rate (38.1%) (Carrieri 1995: 149).

Table 2.: Labour Policies 1950-1970: a Summary

(1919 General unemployment insurance)
1945-47: Regular short term earnings replacement benefits (*Cassa Integrazione ordinaria*)
1945: Wage indexation (*scala mobile*)
1949: State employment services
1955: Apprenticeship
1966: Law on individual dismissals
1968: Special short term earnings replacement benefits (*Cassa Integrazione straordinaria*)
1970: Workers' Statute
1975: Improvement of wage indexation and unification of the regular and special *Cassa integrazione* scheme to 80% of the previous earning
1977: Law on youth employment
1977: Law on industrial mobility and restructuring
1978: Law on vocational training

1.3 An Internally Flawed Constellation

The socio-economic and institutional dynamics illustrated thus far gave a great and unquestionable contribution to the overall modernization of Italy. They left however a number of unresolved structural questions on the floor. Moreover, they planted some new, dangerous seeds for the emergence of additional problems: as stated at the beginning, the 1970s witnessed the appearance of an endogenous crisis, the most visible symptoms of which concentrated in the sector of welfare state financing.

The unresolved questions had basically to do with the persistence of the country's historical divisions: the socio-economic division between a rapidly industrializing North and a deeply backward South; the ideological and political division between a moderate, largely catholic "white" sub-culture and a radical, largely communist "red" sub-culture.

Despite the huge flows of resources channelled into the Mezzogiorno by the central government, the Southern economy was still lagging far behind at the beginning of the 1970s. North-South differentials were still particularly dramatic in occupational terms. In 1970 the unemployment rate was 4.9% in the South as against 2.3% in the Centre-North. By 1979, these figures had risen to 10.9% and 6.2% respectively (Gualmini 1998). In the early seventies the first statistics on the black economy brought to light almost three millions of underground workers, mainly concentrated in the Southern regions (Censis 1976).

The North-South dualism was only one of the deep and persisting domestic tensions of the hot 1970s. That decade witnessed also a dramatic intensification of the traditional political divisions of the country. The growing competition between the Communist Party and the governing coalitions, the widespread and heated social conflicts and the rise of terrorism were the most visible symptoms of this.

The persistence (and in some respects even the aggravation) of the old questions was not the only shadow on stage during the 1970s. New problems were in fact opening up in the wake of the social policy and labour market regimes built in the previous decades. Using summary formulas, we can say that those two regimes had posed the basis of five "original sins" of welfare capitalism Italian style, which have been (and still largely are) the object of articulated debates and policy actions in the 1980s and 1990s.

1.4 Five "Original Sins" of Welfare Capitalism Italian Style

The first two sins can be characterised as "distortions". The social insurance reforms listed in table 1 originated, firstly, an *allocative* distortion, clearly favouring certain risks/functions of social policy (most notably, old age and survival) at the expenses of certain others (most notably, family benefits and services, total lack of employment/income and the relief of poverty). As mentioned, the 1969 reform introduced what probably was, at the time, the most generous "defined benefit" formula of the Western world (70% of previous wages after 35 years of work *with no age threshold* or 80% at the age of 60 for men and 55 for women). On the other hand the schemes aimed at catering for the needs of large and poor families remained underdeveloped and underfunded. At the beginning of the 1950s, pensions and family benefits absorbed a roughly equal share of GDP (Ferrera 1987). By 1980, pension expenditure was almost seven time higher than that on family benefits: the highest ratio in the EC except for Greece (EC 1993). The 1969 reform set the country on the road to becoming a "pension state" rather than a balanced and articulated welfare state.

The second distortion is of a *distributive* nature. Centred as they are on occupational status, all bismarckian systems give rise to some disparity of treatment across sectors and categories. The fragmented development of Italy's social insurance originated however a true "labyrinth" of categorical privileges which has very few comparative counterparts (Ferrera 1996). The main cleavage (which became easily visible already in the 1970s) opposed workers located in the core sectors of the (industrial) labour market to those located in the more peripheral sectors (semi-regular and unemployed). As this strong dualism has still remained one of the most important features of the Italian employment regime, it may be useful to discuss it in some detail.

The dualism finds its roots in two distinct phenomena: the institutional design of unemployment programmes and the dynamics of wage policies. The system of social shock absorbers illustrated above was mainly centred on insurance mechanisms. The eligible workers were those who had paid contributions for at least two years of regular work. In other terms, the main beneficiaries were industrial workers and state employees belonging to the primary labour market (the so-called insiders). The two major instruments of labour policy, the unemployment insurance and the *Cassa Integrazione* schemes, had adopted this kind of logic. By the same token, the procedures for placement were based on two different trajectories, one for the ex-employed (recipients of insurance benefits) and the other one for the unemployed. The former could move from a firm to another without respecting the rule of the "call by lot" (i.e. the numerical order of the list), but simply responding to the employers' "nominative call" (i.e. a job offer *ad personam*); the latter were instead subjected to the rule of the "call by lot" - which meant no freedom of choice for the employers and automatic placement for workers. The most immediate effect was the propensity of employers to hire the ex-employed (the insiders) to the full disadvantage of the unemployed (the outsiders: young people in search of first jobs, women, peripheral and underground workers etc.)

Such a distortion in the distribution of the benefits was also reinforced by union strategies on wage policy. The social conflicts of the seventies resulted in significant improvements of real wages and of the indexation regime. Earnings were transformed into an "independent variable" (from inflation and from the economy in general) and the immediate beneficiaries of this kind of policy, that has become notorious as "reversed income policy" (Rossi 1998), were of course the members of the unions, the insiders again.

During the hot autumn the union wage claims pursued numerous goals: to extend union control on wage dynamics (i.e. to bring inside the area of collective bargaining the highest number of wage items and the greatest number of workers); to increase the wage scale; to reduce differentials among the various categories of workers; to fill the gap between the less protected workers and the more protected ones; to abolish most of the productivity- and performance-related wage components (Somaini 1989). An impetuous rise in earnings and a higher "egalitarianism" were in fact achieved during that period.[2] Of particular importance was the reduction of wage differentials, resulting from the elimination of the so called "wage cages" in 1969. This system was based on a list of geographic areas characterised by different wage minima. The strikes for the dismantling of the "cages", which were thought to be the most tangible sign of the non democratic backwardness of the past, began in 1968 both in the public and in the private sector. The opposition of employers, who on the contrary considered the "cages" as instruments of flexibility, was strong. The first to surrender were the employers of public firms, followed by the associations of the small- and medium-sized firms and finally by the

Confindustria (Turone 1988). The suppression of the "wage cages" opened the way for national centralised collective bargaining, which is still today regarded as one of the main rigidities of the Italian labour market (Faini, e al. 1998).

In 1975 the national trade unions and Confindustria signed an agreement which established a new system of wage indexation for industrial workers.[3] For each percentage point of increase in the consumer prices, all wages were to increase by a single flat rate amount (the so-called *punto unico di contingenza*). This meant that lower wages were more strongly protected than higher wages, leading to a gradual "egalitarian" ironing out of the earnings pyramid. But the new *scala mobile* concealed many counter effects: it was at the same time a powerful barrier against the inflationary erosion of wages and a powerful incentive for the spiral wages-prices-wages (and thus inflation).[4]

The third original sin which characterised the start-up, "keynesian" constellation has to do with the financing of public, and in particular social expenditure. In 1950-1964 Italy's public finances witnessed a phase of relatively balanced growth, in which the expansion of outlays was matched by a parallel expansion of revenues. The subsequent decade was marked however by a new pattern of unbalanced growth, in which outlays continued to rise while revenues stagnated around a figure of 30% of GDP.[5] This "flat decade" on the revenue side created an "original hole" in Italy's public finances which made things much worse when the exogenous shocks hit in the mid 1970s (Gerelli and Majocchi 1984).

The development during the subsequent decade did not, however, correspond to the intentions and expectations of the keynesian doctrine. It was not public investment that grew, but current expenditure (transfers and subsidies in particular), leading to a rapid erosion of public saving. General government net lending rose from 0.8% of GDP in 1964 (the last "virtuous" year) to 7.0% in 1974 and 11.4% in 1975 - the peak of the first oil shock slump. And public deficits largely served to finance the growth of the welfare state. Starting from the mid-1960s the aggregate balance between statutory contributions and benefits began to be negative for many pension and most sickness funds: contribution rates were in fact kept artificially low, in the hope of stimulating job creation but also to please social categories which were crucial for political stability. Despite repeated ad hoc financial aids from the Treasury, the budgetary situation of the social security sector continued to deteriorate and in 1974/75 the government had to launch an extraordinary operation to repay the enormous debts accumulated by the funds, amounting to 5.2% of GDP (another deep dig in the hole).

The remaining two original sins had to do with legality and efficiency. Though very articulated from a legislative and organizational viewpoint, the social policy configuration built between the 1950s and the 1970s was characterized by high institutional "softness". Especially in some sectors and areas, the degree of compliance with the rules disciplining the access to benefits and the payment of contributions remained very low, not only on the side of the various clienteles of social programmes, but also on the side of public authorities. This syndrome assumed inordinate proportions in the sector of disability pensions, which became the privileged currency of an extended clientelistic market: between 1960 and 1980 the total number of disability pensions rose almost five times and in 1974 (following an expansive reform) it came to surpass the total number of old age pensions: an unparalleled record in the OECD area (Ferrera 1984; 1987; 1996).

As to the efficiency of public services (in virtually all fields of public intervention), the situation of the 1970s came short of all expectations of the keynesian modernizers of the 1960s. The lack of a pragmatic culture, the partisan colonization of the administrative apparatus, the opportunistic use of public employment by the patronage system, the failure to design rational systems of incentives: these and other factors gave rise to an oversized bureaucracy with very low levels of performance (Cassese 1974).

These five original sins of "welfare capitalism Italian style" were partly the result of specific policy choices (or non choices) made in the formative decades 1950-1970: choices that in their turn reflected quite closely the overall "political logic" of what is currently called Italy's First Republic (1947-1992). This is especially true for the aforementioned distortions: the development of a pension-heavy welfare state, financially unsound and inclined towards particularistic-clientelistic manipulations, was highly congruent for example with the competitive mechanics of Italy's polarized pluralism (Sartori 1982) and, more particularly, with the interests of the three major parties (DC, PCI and PSI). The emphasis on pensions as "deferred wages" and the neglect for family policy mirrored in fact the social doctrines of both Marxism and Catholicism. More crucially, the expansion of a highly fragmented social insurance system offered ample opportunities for distributing differentiated entitlements to selected party clienteles. It must not be forgotten, however, that to some extent the distinctive elements of the *welfare all'italiana* (to use a well-known metaphor of the national debate: cf. Ascoli, 1984) find their roots in a number of broader historical features of Italian society, such as the traditional "uncivicness" of political culture, the above mentioned "historical divisions" of economic and ideological nature and the ensuing deficit of "normative" integration, the failure to create a Weberian administration.

Whatever their historical origins and however congruent with the overall complexion of post-war Italy, the internal flaws and malfunctioning of the keynesian-fordist constellation of the 1970s rendered the country structurally vulnerable to the external shocks that appeared on stage at the beginning of that decade. Hitting on friable grounds, the storm thus produced in this country more serious damages than elsewhere in Europe.

1.5 Enter the External Challenges: from Miracles to Chaos

Italy's political economy stepped into the 1970s with the wrong foot. In the wake of the wage rises of 1969, the Bank of Italy and the Treasury decided a monetary squeeze in 1970, which provoked a recession in 1971. This prompted the government to shift back to an expansionist policy in both monetary and budgetary terms. The cycle turned swiftly upwards, but so did inflation, while the balance of payments witnessed increasing strains. With the collapse of the dollar standard (and as a consequence of strong speculative attacks) the lira was devaluated in 1973: a move which did not compromise the upward trend of the cycle, but which reinforced the already existing domestic inflationary pressures due to the price increase of imported raw materials. Severe administrative controls were also introduced on the movement of capitals, to discourage their alarmingly mounting flight abroad. In 1974 the rate of inflation had risen to 19%, up from 2% in 1968. The first oil shock produced a dramatic slump in 1975: in that year GDP fell by almost 4%. Inflation went down too. But in 1975 the above mentioned *scala mobile* agreement created an infernal (with hindsight) stagflation-multiplier whose consequences were to be seriously felt for many years to come. By guaranteeing an immediate adjustment of wages to prices, the new *scala mobile* contributed not only to the spread of inflation throughout all branches of the economy, but fostered an overall climate of self-sustaining inflationary expectations. At the end of 1975 the government lowered interest rates and created new liquidity in order to exit from the recession and support a severely ailing industrial sector. A new massive speculative attack was however launched against the lira and in the Winter of 1976 the official quotation of the national currency had to be suspended for forty days. When the exchange rate market re-opened, the lira had suffered a new heavy devaluation. The vicious circle devaluation-inflation-indexation brought the rate of inflation up to 21% by 1980. In the same year, public debt had mounted to 58.1% of GDP (1970=38.1%) and public deficit to 8.6% (1970=4%).

The macroeconomic policies pursued by the Treasury and by the Bank of Italy in the 1970s have been severely criticized as being inadequate responses to the new international context and thus for being largely responsible for the ailing conditions of Italy's economy and public finances at the end of the decade.[6] This indictment must be tempered with at least two considerations: the initial conditions were characterized by a peculiarly high degree of vulnerability: the social and political situation posed severe constraints to policy makers. To some extent, inflation and deficits were the most viable instruments for dispersing the costs of adjustment in a context which allowed very little room for the ex ante definition of policy priorities and the imposition of explicit sacrifices.

A deliberate attempt at macroeconomic stabilization was indeed made in the second half of the decade. In 1976, following an outstanding electoral success of the Communists, a "National solidarity" majority was formed in Parliament, including the PCI. This coalition took significant decisions in many policy domains (e.g. the fight against terrorism). More specifically, it tried to pursue an explicit policy of "real" macroeconomic adjustment.

The point of departure of this attempt was a fully-fledged neo-corporatist agreement - the first ever experienced in Italy. This agreement has a precise date and a precise venue: February 1978, during the so-called "EUR" union assembly (from the name of the neighbourhood in Rome where it took place). The implicit pact was that the government committed itself to protecting the existing employment levels and to finding innovative solutions for combating youth unemployment while the unions promised to restrain wages. A number of fiscal measures followed, with positive effects on labour costs and productivity. More significantly, some innovative industrial and labour policies were introduced (cf. table 2): the new climate of social cooperation between the unions and the government offered a fertile ground for the development of active labour market policies. In particular, three programmes are worth mentioning: the law for youth employment (n. 285/1977), the law on industrial reorganisation (n. 675/1977) and the general law on vocational training (845/1978).

The "real" adjustment policy of the National solidarity coalition was not very effective. The attempt was short-lived (1976-1979) and crumbled on the continuing political and ideological strains between its main protagonists.

At the end of the turbulent 1970s the Italian economy was thus a real mixture of lights and shadows (with hindsight more shadows than lights). As for the lights after the dramatic effects of the first oil shock, the expansionary macro-economic measures and the strong depreciation of the lira (by 16%) brought some positive effects, safeguarding the competitiveness of Italian products. But the *reprise* was however very shaky: at the end of the 1970s Italy's misery index was the second highst in Europe, after that of Spain. Inflation floated around 15% and the unemployment rate in the Mezzogiorno overcame 10%.

The 1970s closed however with a political *coup de reins*, which was to have significant repercussions in the subsequent period: the decision to adhere to the newly born European monetary system. The issue was quite hot for Italy since it involved the abandonment of the old (and basically successful) devaluation-centred monetary policy in favour of a new (and thus more uncertain) monetary policy. In the European arenas, the debate was in fact led by the French and the Germans and actually followed with resignation by the Italians. The decision to abandon the usual devaluation policies that had functioned as an excellent mechanism for the safeguard of Italy's competitiveness involved the change of the entire monetary and economic policy. It was precisely on this issue that the "national solidarity government" fell, with the PCI joining again the ranks of the opposition.

In the last Months of 1979 the Lira finally entered the EMS with a larger fluctuation band (6% instead of 2.25%). The joining of the EMS marked the beginning of a new phase in Italy's EC membership, which was bound to affect most policy sectors. But in order to analyse the important impact of this new phase we need to turn another page.

Part 2. The Winding Road to Adjustment

2.1 The Impact of Economic Internationalization

The entry into the EMS represents the first stage of a long process of adjustment to exogenous challenges; the second stage coincides with the completion of the internal market in the late 1980s and the third with the convergence towards the Maastricht parameters during the 1990s. The adjustment pressure of the three stages had however a different weight, since it was somehow filtered by domestic dynamics of policy and political change. Already in the first half of the 1980s some important pre-conditions for an effective adjustment of both the economy and public finances were posed. But policy makers, disturbed as they were by high political instability, the persisting challenge of terrorism and the inflationary effects of the second oil shock, did not seem to be prepared (or rather were not capable) to undertake a process of change and persevered instead with the expansionary and distributive policy strategies of the past. The pressures stemming from internationalization became more visible starting from the Maastricht Treaty, when the "restoring to health" (*risanamento*) of public finance and hence of economic and social policies became more a necessity than a virtue. Moreover, in the early nineties, the international pressures to adjust intertwined with the deep institutional changes following the fall of the "First Republic". The rapid transformation of the most familiar rules and ingredients of both the domestic political system and of the international economic environment forced Italian politicians to substantially modify their strategies and to introduce important policy innovations.

2.1.1 *The contradictory 1980s: testing adjustment while accumulating a huge public debt*

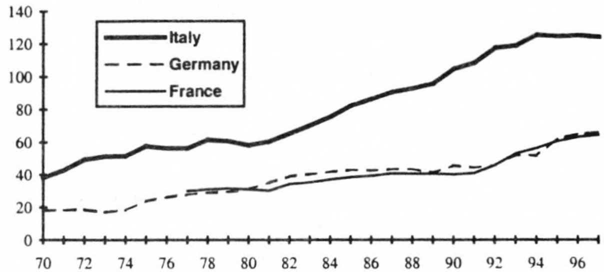
As far as the real economy is concerned the eighties were characterised by contradictory trends. On the one hand the entry into the EMS and the reforms of the Central Bank (cf. *Infra*) made it possible to pursue a rigorous monetary policy whose main goals were deflation, currency stability and the regaining of national credibility after the gloomy performance of the 1970s. On the other hand, the renewed Centre-Left coalitions (under the novel name of Penta-party governments) which remained steadily in power for the whole decade were not able to take advantage of the changed economic conditions (a significant GDP recovery starting in 1983 and continuing with the 1986 oil counter-shock) and kept on playing their traditional distributive games based on easy spending. In terms of policy choices too, as it will be shown in the next section, the eighties distinguished themselves for a similarly ambiguous trend.

Participating to the EMS proved to be particularly important for the Italian economy, since it involved the radical transformation of monetary policy. The entry into a fixed band of currency oscillation, though wider than the standard one, caused the abandonment of those traditional devaluation strategies that had permitted to safeguard Italian competitiveness without implementing strategies of real adjustment. Two years after entering the EMS, in 1981, a "divorce" between the Treasury and the Bank of Italy was consumed: under the new regime the latter ceased to be the last-resort buyer of unsold government bonds and the instruments of monetary and credit policy were modified through the dismantling of direct controls on credit and of administrative obligations, in favour of a more market-oriented regulation (Addis 1987; Epstein and Shor 1987). The most immediate aim after the "divorce" was to curb inflation through a smaller emission of currency. In addition, the new Governor Ciampi began to call for a substantial reform of the budgetary process and for a new bargaining regime in order to keep wages and productivity under control. Ciampi's repeated calls opened the way for the 1988 reform, which introduced new rules and instruments for the planning and control of public accounts (Verzichelli 1999). As for wages and productivity a wide political agreement among the government, trade unions and employers' associations was soon signed in 1983 (cf. *infra*).

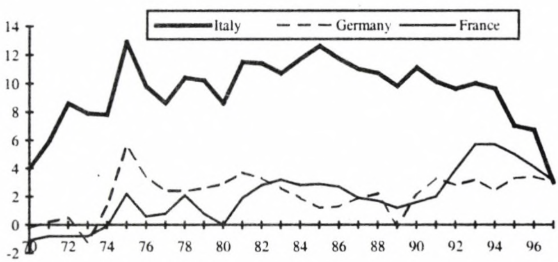
The restrictive monetary policy carried out by the Central Bank had a series of interrelated effects: inflation began to diminish, but the trade balance progressively deteriorated both for goods and for services, mainly due to the impossibility of using devaluation.

But in the second half of the eighties, in the wake of the oil counter-shock, the indicators of the real economy significantly improved. The GDP growth rate surpassed 3% while the inflation rate fell below 6%. The trade balance showed a surplus, investments rose (from 18.8% in 1986 to 20.3% in 1990) and exports boomed.[7] The Single European Act (1986), soon followed by the liberalization of financial capitals (1988), encouraged further mobility of goods and capitals outside the national boundaries. Thus, for example, in the period 1981-1990 Italian FDI amounted to 28.707 million dollars compared to 3.597 million dollars in the previous decade.

These positive economic conditions did not however stimulate national policy makers to seriously tackle the problem of public finances – despite frequent lip-service to this objective. The figures relative to public debt do not need much of a commentary.



Graph 1.: Gross Public Debt as a Share of GDP, 1970-1997
Source: MPIfg- Adjustment Data Base Structure, 1998



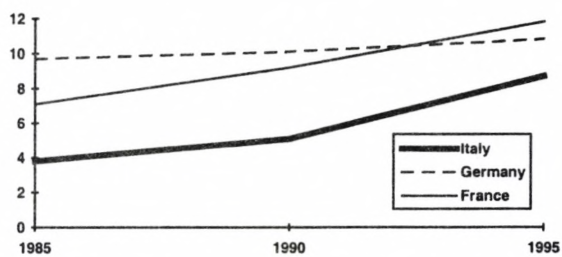
Graph 2: Public Deficits as a Share of GDP, 1970-1997
Source: MPIfg- Adjustment Data Base Structure, 1998

2.1.2 *1992-1998: a Copernican Revolution?*

In the early nineties, besides the alarming conditions of public finances, other additional symptoms of crisis made their appearance: a decrease in production, the fast acceleration of labour costs and the declining competitiveness of the tertiary sector.[8] In such a difficult situation the signature in February 1992 of the European Union Treaty could be seen (and was indeed seen by many national and international commentators) as an act of temerariousness or even folly. And the immediate aftermath seemed to confirm this view. As a matter of fact, in the summer of 1992, after the negative result of the Danish referendum on EMU, a violent speculative attack was launched against the lira. The Central Bank tried to counterattack by wearing out currency reserves and by virtually risking a financial collapse. The risk could be avoided, however, by some interrelated circumstances that, added together, produced a sudden and rather extraordinary virtuous adjustment. The strong devaluation of the lira (by 30%), and the consequent exit from the EMS, was at the basis of a considerable export increase which allowed Italy to catch up and gain a remarkable position in international trade. In the meanwhile the last executive of the First Republic, led by Andreotti, was swept away under the investigations of Tangentopoli and the "technical" executive of Giuliano Amato entered the scene. Amato undertook a portentous budgetary manoeuvre (equal to 6% of the GDP: cf. *infra*) which was the first truly effective step in the correction of public finance imbalances after fifty years of profligacy.

1992 has become a sort of *annus fatalis* in the scientific and public debate, mainly referred to as a watershed between the "maladjustment" and the "adjustment" era. Some authors have spoken of a "Copernican revolution" (Salvati 1997), some of a "big turn" (Bodo and Viesti 1997) or at least of a "big big change" (Graziani 1997). In fact it can hardly be denied that 1992 witnessed a successful combination of various positive events; it was the beginning of a rather fortunate chain of "policy windows" (Kingdom 1984) that offered the conditions for the continuation of financial adjustment and thus for a positive response to international challenges. Indeed, if one considers Italy's economic performance in the rest of the 1990s this view is clearly confirmed. Between 1992 and 1998 inflation went down from 5.6% to 2.5%, public deficit from 9.6% to 2.6% and public debt, after the peak value of 125% of GDP reached in 1994 started a slow but visible decline (1997= 121.7%). In 1996 the lira regained its position inside the EMS. Interest rates started to go down and hopes for investments were revived. Between 1996 and 1997 the amount of Italian privatizations was the highest in Europe: the most important public enterprises (Sme, Enichem, Eni, Telecom, etc.) and the most renowned public banks (Cariplo, Banca di Roma, San Paolo) were sold, thus alleviating the state budget. One year later, in May 1998, under the Prodi government, Italy finally joined the EMU with the first group of countries, in satisfactory respect of the Maastricht parameters. As mentioned above, some pre-conditions for the post-1992 virtuous circle had already been posed in the previous decade; and several shadows still spoil the picture, as will be shown later. But the fact remains that the 1990s will be remembered as a crucial decade for Italy's firm and irreversible "anchoring" to the European core - one of the few national unifying grand objectives of the country ever since the 1950s.

Italy's remarkable macro-economic adjustment has been accompanied by significant changes in this country's international economic profile, especially as regards exports, alliances and partnerships with foreign companies and direct financial investments. Compared to the previous decade, a strong diversification in the geographic areas of destination, in the subjects and in the instruments of international activities can be noticed. While in the eighties most of Italy's trade was concentrated in the EC countries, in the nineties Eastern Europe, the Asian countries and developing countries have become relevant destinations. In addition, big firms, traditionally highly specialised in export activities, have been joined by small- and medium-sized firms. Contrary to what was expected by some analysts, the depreciation of the lira favoured small companies in search of innovative investments (Cossentino, Pyke and Sengenberger 1997; Brusco and Paba 1997). From 1992 to 1995 the openness of the total economy jumped from 35.5% to 45.2%. Besides the export of goods, other forms of foreign direct participations and financial investments have flourished: collaborative ventures, technological agreements, *co-design* and *co-making* (Cominotti and Mariotti 1997). From 1985 to 1995 the stock of Italian FDI grew from 3.8% to 8.7% of GDP (Faini et al. 1998). As it is clearly shown in graph 3., in the early 1990s Italy began considerably to catch up, even though this was not sufficient to reach its European partners.



Graph 3. Foreign Direct Investment outward stock as a percentage of GDP

Source: Faini et al. (1998), p. 53.

This process of internationalization has not however fully alleviated Italy's historical problems. Exports have indeed increased, but the "specialized polarisation" of Italian industry has intensified: maximum export in the traditional sectors (shoes, clothes, textile, ceramic, furnishing) and very small in the other sectors (especially high-tech). In addition, Italy has remained poorly attractive for foreign investors, given the scarce reliability of the state bureaucracy, public services and communication systems. R&D expenditure is still among the lowest in the OECD countries. More seriously, the social and economic gap between a highly industrialised North and a backward South has widened (cf. *infra*).

2.1.3 *Internationalization and National Employment: A Multi-Faced Italy*

It is not easy to explore the relationships between internationalization and the employment/welfare regimes in Italy: empirical investigations of these issues are still scant and the high diversification of Italy's regional and sectoral realities makes it difficult to elaborate unitary interpretative models. This is especially true for the internationalization-employment nexus. The effects of the former on the latter have been multiple and fragmented according to the local conditions of both factors and actors. Large and small firms, exposed and sheltered sectors, Northern and Southern regions have all given their own response to exogenous challenges. Where actors were already showing innovative capacities and were surrounded by a dynamic social and political environment, they were also able to take advantage of the new international opportunities, triggering off virtuous circles of development and growth, also in terms of employment: this was especially the story of industrial districts and small/medium enterprises. Where instead actors were already facing great economic difficulties and showed weak innovative capacities, internationalization has created many more problems than opportunities: this has largely been the story of the Mezzogiorno. In this latter case, however, the blame must be put less on internationalization *per se* than on local conditions and general institutional rigidities.

According to the most recent economic literature, Italian employment has not suffered much from the growing openness of markets.[9] For the Italian case there is no evidence of those trends that are typically associated with internationalization in other industrial countries, such as increasing unemployment among low-skilled and uneducated workers and/or a shift of wages in favour of skilled employees. Moreover, there appears to be no significant correlation through time between the standard set of trade indicators – such as the trade balance or the degree of import penetration – and labour market conditions. In fact the data reveal that Italy has witnessed so far a relatively low degree of import penetration from low wage countries (potentially harmful for national employment) and that the growing internationalization of Italian firms (including the increased number of employees in foreign affiliates of Italian multinationals) bears much less responsibility for the unemployment problems in the manufacturing sector than developments in production technology.

What explains this relatively low vulnerability of Italy's national employment to economic internationalization? According to the debate, the answer lies with the peculiar model of Italian specialization in international trade. This model is primarily based on labour intensive productions in traditional sectors and in some specialized suppliers industries, potentially very vulnerable to the competition of labour abundant, low wage economies. But within these sectors, "Italy is mainly specialized in the top end of the vertically differentiated spectrum of products. Many of these products are characterized by a relatively high level of skill intensity and by a price elasticity which is not high and is decreasing over time" (Faini et al. 1998: 8). It is this peculiar pattern that has allowed Italy to survive well – in aggregate terms – in the new environment, taking advantage of profitable niches in a growing and opening world trade. This favourable match may not last forever. In fact, as will be discussed later, the profitable niches of Italian producers are increasingly at risk in the wake of some forthcoming developments of world trade. Thanks to these niches, however, the Italian economy has been able to withstand in the 1980s and especially in the 1990s the dangerous winds of globalisation. Italy's unemployment problems thus appear to be primarily connected to domestic rather than exogenous factors.

This relatively optimistic assessment must be qualified, however, by geographical area. The intensification of international trade has in fact thrown new light on Italy regional and sectoral cleavages. First and foremost it is necessary to distinguish among "three different Italies": the industrialised North – and especially the historical industrial triangle of Piedmont, Lombardy and Liguria (first Italy); the "classical" Mezzogiorno, characterised by backwardness and underdevelopment (second Italy); and the so-called "third Italy", comprising the North-East, Emilia-Romagna, Tuscany, Umbria and the central Adriatic rim (Marche, Abruzzi). The sectoral composition of the three Italies is also divergent. In the North companies are mainly big-sized and specialized in manufacturing and services. Third Italy is mainly based on family-led small firms and on industrial districts specialized in those products which are at the edge of Italy's competitiveness: textiles and apparel, footwear, ceramics, precision mechanics. Southern regions, though it is not fully correct to consider them as an homogeneous territory, are characterised by a mixed productive profile: large (and declining) firms in the chemical, iron and steel industry (the old traditional sectors of the state-assisted industrial development launched in the 1950s), small firms mainly operating in the (backward) constructions and tertiary sector, and large public bureaucracies.

The growth of employment in small firms has thus not been negatively affected or slowed down by international competition. Compared to Northern and Southern companies, the small and medium-sized companies of the "Third Italy" have registered a remarkably positive reaction to international pressures. Thanks to the high product specialization of small firms on the one side and to the outstanding degree of entrepreneurship and innovation that traditionally characterise the "industrial districts" culture on the other, small firms seem to have successfully exploited the new opportunities offered by internationalization, perceived as a stimulus to expansion and change.

Large firms mainly operating in the North of Italy have given a more variegated response to international challenges. The statement that globalisation has had positive effects on employment holds true in general terms, but it must be qualified by time. The available data on employment in manufacturing reveal in fact a different, time-related, vulnerability to the openness of the economy with both contractionist and expansionary effects. Two different periods can be identified: the first going from 1985 to 1992 and the second starting after 1992. In the first phase the big rise in imports, which was the main result of the export strategies of the "early internationalising countries" (US, Japan, Germany, etc.), reduced the increase in the Italian labour demand (from +9% to +5%). After the devaluation of 1992, however, the trend inverted and export growth permitted to compensate the losses of the past and to have a remarkable impact on labour demand (De Nardis and Galli 1997). It is in fact starting from 1992 that Italy, which is undoubtedly a "late internationaliser", begins to catch up and the nexus between internationalization and employment performance becomes a very loose one. This is particularly shown by table 3. (drawn from the already mentioned analysis by Faini et al. 1998), in which the changes in sectoral import penetration from 1992 to 1996 are connected to employment dynamics. The growth of import penetration, which is particularly remarkable for footwear, leather (11.5%) and for electrical apparatus (8.4%), does not produce a correspondent reduction of employment, which is instead weak (-1.3% and -0.3% respectively) and better than the aggregate one (-1.7%).

Table 3. Employment and Imports: Sectoral Trends

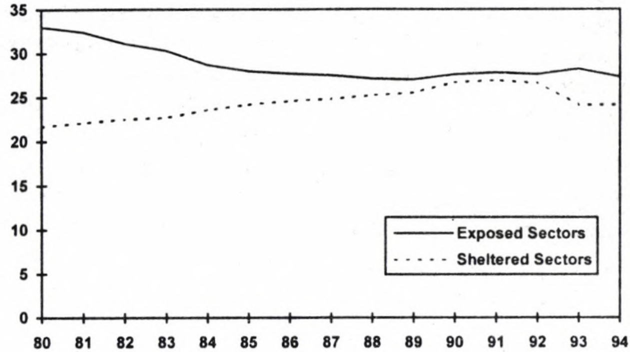
1992-1996	Change in Employment	Change in Import Penetration Level	Import Penetration Level (Average Value)
Mineral & Non Mineral Products	-1,8	4,2	35,68
Non mettalic Mineral Products	-2,4	1,2	10,83
Chemical Products	-3,7	3,8	35,43
Metal Products	-2,1	2,7	8,10
Agricultural & Industrial Machinery	-0,8	3,4	31,53
Office Machinery	-1,5	-0,8	79,33
Electrical Apparatus	-0,3	8,4	14,75
Motor Vehicles	-3,3	4,2	57,75
Food Beverage and Tobacco	-1,7	1,5	17,83
Textile & Apparel	-1,1	3,6	19,68
Footwear & Leather	-1,3	11,5	31,65
Wood & Wood Products	-1,9	1,1	11,23
Paper, Paper products & Painting	-2,0	2,1	11,78
Rubber & Plastic Products	-0,4	2,2	19,03
Total Manifacturing	-1,7	4,2	26,45

Source: Faini, Falzoni and Galeotti (1998), p. 58

International challenges have thus combined with domestic economic dynamics, only indirectly conditioning employment and unemployment performance. Prior to 1992 Italian large firms did not seem to be able to contrast the import boom with expansionary strategies, preferring to stick to domestic markets; only after 1992 did devaluation and economic recovery encourage a fuller exploration of European and world markets. The export boom was so intense to push employers to enlarge and diversify production with positive repercussions on employment levels.

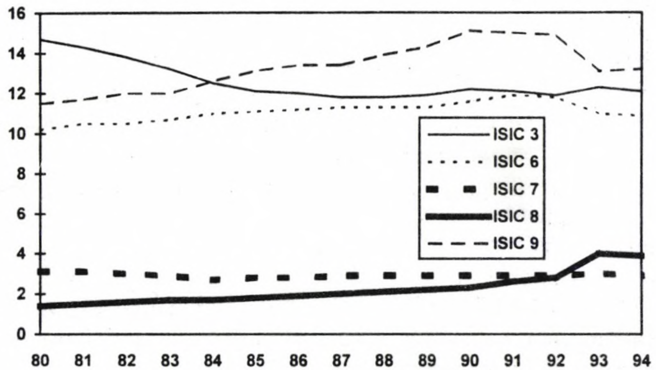
Still different is the picture of the Mezzogiorno, which at first sight may appear as the only loser of globalisation. And in fact the big recession of 1991, the termination of state-aid legislation in 1992, the reform of EC structural funds and the association agreements between the European Union and East-European countries have all contributed to make the "old" problems of Southern unemployment and poverty even worse (Cafiero 1997). In particular, de-industrialization and the end of state subsidies, which are the result of the national legislation of the 1990s, are at the basis of the employment collapse notable in this area of the country. Between 1991 and 1996, 600.000 jobs were lost. Such an employment slump has no equivalents in the past. De-industrialization refers to the dismantling and the abandoning of the big state-assisted industries that had been created in the fifties. But the decline of employment has been particularly dramatic in the sectors which were more strictly dependent on state financial aid: agriculture (-24% between 1992 and 1996), constructions (-19% in the same period) and trade (-9% same period). In 1996 less than 38 Southern people in working age out of 100 had a job (52 in the Centre-North) (Bodo and Viesti 1997: 73). Marked by such a law employment rate and by a high concentration of long-term unemployment, the Mezzogiorno stands out as one of the most backward regions of the EU. In these ailing economic conditions, the establishment of the EMU cannot but aggravate problems (at least in the short run): the disappearance of the exchange rate as a mechanism of adjustment will require higher factor mobility and higher price and wage flexibility – elements which remain quite foreign to the Mezzogiorno's political and economic tradition.

Moving to the sectoral dimension, the connection between internationalization and employment becomes still weaker, because of the clear dominance of the sheltered sectors. In the exposed sectors employment substantially decreased from 33% in 1980 to 27.3% in 1994, remaining below the OECD average. On the contrary, sheltered sectors rose from 21.7% in 1980 to 24.1% in 1994. Also the public sector increased from 8.6% in 1980 to 9.2% in 1994. The importance of sheltered employment is also confirmed by an intra-sectoral analysis. The sectors where labour demand is still high are hotels, restoration and personal services. On the contrary the demand of labour is faltering in advanced sectors which are typically exposed such as communications and transports, financing, insurance and business services. Communications and transport absorbed 2.9% of Italian employment as against 4.3% on average in the OECD area. In the remaining sectors, the figures were 3.9% and 6.7% respectively. The same conditions can be found in some other South-European countries, such as Portugal, Spain and Turkey.



Graph 4. Employment/Population Ratios, Exposed and Sheltered Sectors, 1980-1994

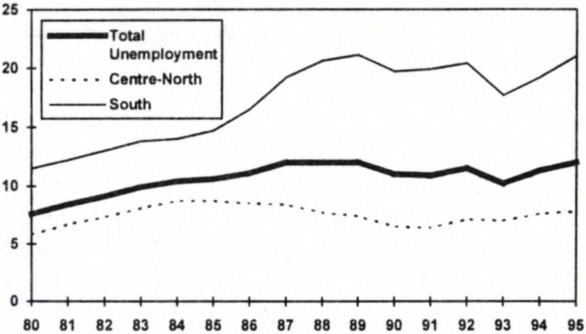
Source: MPIfg - Adjustment Data Base Structure, 1998



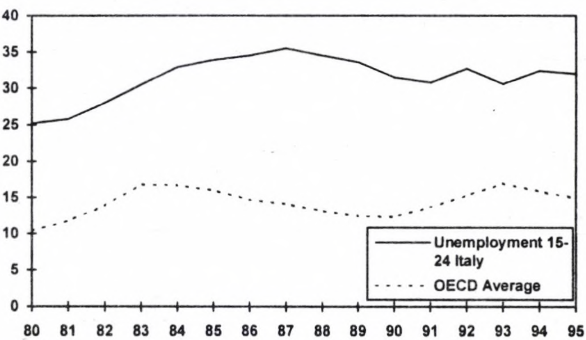
Graph 5. Employment/Population Ratio in Manifacturing (ISIC 3), Wholesale and retail trade, restaurants and hotels (ISIC 6), Transport, storage and communication (ISIC 7), Financing, insurance, real estate, and business services (ISIC 8), Community, social and personal services (ISIC 9), 1980-1994

Source: MPIfg- Adjustment Data Base Structure, 1998

Let us now look at unemployment. As mentioned several times, this is particularly concentrated in the South and in some specific categories of the labour force (women and the young). From 1980 to 1995 unemployment in the Centre-North increased from 5.8% to 7.8%; in the Mezzogiorno from 11.5% to 21% (Gualmini 1998). In the same period, female unemployment rose from 13.2% to 16.2%, while male unemployment rose from 4.8% to 9.3%. The eighties were characterised by a rapid increase of female participation into the labour market (also due to the "baby boom" of the sixties), but the demand of labour was not sufficient to absorb the increased supply. As for youth unemployment, Italy holds a record: it increased from 25.2% in 1980 to 32% in 1995 (while the OECD average is about 15%).



Graph 6. Total, Centre-Northern and Southern unemployment rate, 1980-1995
Source: Gualmini, 1998, p. 271-273



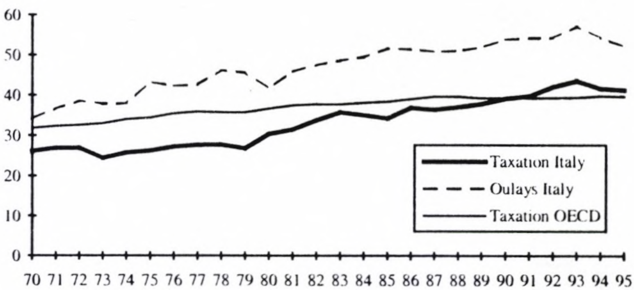
Graph 7. Youth unemployment rate in Italy, compared to OECD average, 1980-1995
Source: MPIfg- Adjustment Data Base Structure, 1998

Besides mass unemployment (12.5% in 1998), a high diffusion of the black economy - 22.7% in 1993 (18% in the North and 33.9% in the South) (Censis 1995) - and the lowest diffusion of part-time in Europe (5.1% in 1980 and 6.6% in 1996) must be noticed. As it will be shown in the next section, the opening of international markets and the related higher mobility of citizens and workers has shaken rigid and protected labour markets, like the Italian one, at their roots. And the adjustment of the Italian labour market and labour legislation has been slow, partial and in some parts ineffective.

2.1.4 *Internationalization and Social Policy*

The impact of internationalization on social policy has been more straightforward – at least in institutional terms. The *vincolo esterno* (i.e. the constraints posed directly or indirectly by international regimes and especially by the EU) has in fact become an increasingly powerful stimulus for pushing through measures of welfare retrenchment and rationalization on the side of the national executive.

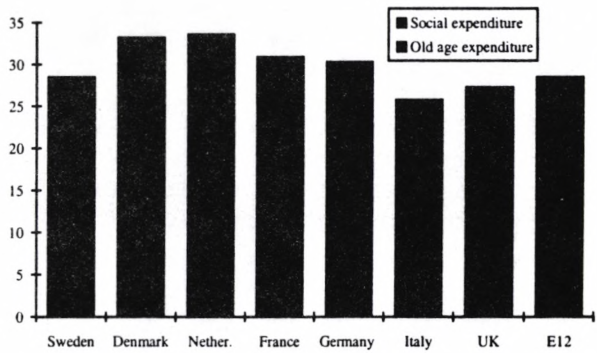
In order to meet the parameters set by the Maastricht Treaty, Italy had to seriously tackle the problems of public debt and public deficit. The pressing need to reduce both, with a view to joining EMU with the first group of countries, fostered a climate of permanent financial emergency. The margin of maneuvre for tax increases was extremely narrow. Public revenues had been growing very rapidly since the early 1980s, turning Italy into a relatively big taxer by international standards. In the early 1990s the high level of taxation, which is clearly showned by graph 8., and its uneven distribution (because of high cheating on the side of certain categories) started to provoke clear symptoms of a tax revolt, especially among Northern taxpayers.



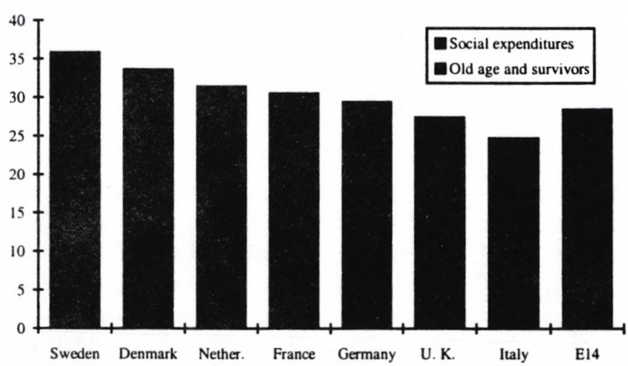
Graph 8. Total taxation and Total Outlays of Government in Italy, Total Taxation in OECD-18, 1970-1995
Source: MPIfg- Adjustment Data Base Structure, 1998

In such an environment, expenditure cutbacks thus appeared as the only viable strategy for containing public deficits and debt: and social benefits immediately became the prime target of the new policy of *risanamento*.

It is true that in comparative perspective the size of the Italian welfare system was (and still is) not out of proportion, as it is shown in graphs 9. and 10.



Graph 9. Old age and social expenditure as percentage of GDP, 1993
Source: Social Protection in Europe, 1995, ch. III, p. 67.



Graph 10: Old age and social expenditure as percentage of GDP, 1995
Source: Social Protection in Europe, 1997, ch. III, p. 6

Yet in domestic public debates welfare programmes were commonly indicted as the main culprit for the country's severe financial problems and, more generally, for its serious politico-institutional predicament. Why this paradox – in the absence of a "New Right" coalition? There were in the early nineties a number of reasons which can explain this. First, despite its comparatively modest aggregate size, social expenditure was still (and by far) the largest item of total government outlays. Second, both the pension and the health system were in rather shaky financial and (in the case of health) organizational conditions. Demographic projections showed alarming scenarios for the future: with no change of legislation pension expenditure was expected to increase from ca.14% to ca. 16% of GDP between the early 1990s and the year 2000, to surpass 20% by the 2020s and to reach 23.2% in the year 2040 (cf. *infra*, graph. 11). Third, the deficits of legality and efficiency (described above in par. 1.4) had fostered a mounting "negativism" against the *stato assistenziale* (a rather pejorative term) in public debates, offering a potential source of legitimation to retrenchment measures. The combination of peculiarly intense fiscal constraints – disciplined by the EU – and qualitative contradictions opened in other words opportunities for a strategy of welfare reform in the name of three (largely a-political) objectives, i.e the *risanamento finanziario*, social equity and efficiency recuperation.

Of course this strategy met a strong resistance on the side of all the affected interests – most notably the trade unions. This resistance has been overcome not only through an open and negotiatory policy style ready to make substantial concessions on the pahasing-in of the reform (as will be illustrated below), but also by persuading the unions about the long-term advantages connected with the *risanamento* and the entry into EMU: revived growth and lower interests on public debt. This latter point has played a crucial role in the reform process: the *risanamento* could be presented in fact also as "fight against rent", involving possible gains for all workers. With interest rates at 9,5%, in the early 1990s a relatively modest bank deposit of Lit 260 million (ca. 135,000 euros) invested in state bonds would originate a "rent" equal to the yearly wage of a metal worker (Pennacchi 1998). The "bet" proposed by the government to the social partners (and repeatedly explained publicly and privately by such figures as Amato, Ciampi, Dini, Prodi) was thus to accept sacrifices (especially benefit cuts and wage restraint) with a view to abating a huge and unproductive debt service, diverting the resources thus liberated to other purposes and triggering off a virtuous circle of revived growth, new public investment and "healthier" redistribution (Ciampi 1998). In retrospective, we know that such bet has maintained its promises: between 1992 and 1998 interests on public debt declined from 10,2% to 6.4% of GDP, with a downward trend expected to continue for several years thanks to the convergence of Italian interest rates to German rates and the gradual restructuring of the debt stock (a sort of EMU "dividend" for Italy's public finances). And it must be noted that the fall of interest rates has produced other advantages too, outside the public budget: for example considerable savings on the side of employers on the debt exposure of their activities, savings on mortgage rates, etc.

At first the trade unions showed some reluctance to accept the bet. The turning point in this respect was however 1995. In the Winter of that year as a consequence of the political crisis and the ensuing loss of credibility, interest rates soared and the lira witnessed an alarming fall as against the Dmark. Thus the unions understood that rejecting the reform was not equal to maintaining the status quo, but to making things much worse. In other words they understood by means of negative reinforcement that the arguments of the government and of the Bank of Italy were well grounded and accepted the bet proposed by them. Throughout the 1990s (and especially in 1992 and 1995) the international financial markets were in fact a powerful actors in domestic dynamics of policy making (and learning).

2.2 Policy Responses and Their Effects: the Influence of Embedded Institutions

As for trends in the real economy, also for public policies the 1980s were a Janus-like decade. On the one side the increasing international integration acted as a positive incentive to tackle employment and welfare problems by experimenting new policy strategies already adopted abroad, mainly centred on deregulation, active policies and restraint. On the other side these new efforts represented only a drop in a sea of passive policies and subsidy-oriented programmes, increasingly expensive for the public budget and increasingly enlarging the welfare state. The policy systems inherited from the 1970s revealed a deeply institutionalized nature and hence high hostility to change and innovation.[10] We have to wait until the 1990s for reforms to be finally implemented.

2.2.1 *The Labour Market: The Uncertain Deregulation of the 1980s and the Reforms of the 1990s*

The evolution of labour policies in the eighties followed two distinct directions, respectively correspondent to 1981-83 and to 1984-89. In the first years of the new decade the government responded to the second oil shock recession and to the loss of employment in large firms in a defensive way, by expanding already existent income support programs and by introducing a new onerous passive policy, such as pre-retirement benefits. In the second half of the decade, in a more favourable economic environment, active labour market policies started to be promoted. In a new consensual social climate both the government and organized interests agreed on the introduction of "atypical" labour contracts (e.g. part time and temporary contracts), work sharing and a reform of employment services. The implementation of these measures did not however fulfil the original expectations.

The decade opened with a severe crisis of large firms and a consequent haemorrhage of jobs (the 1980 Fiat crisis was the most alarming). The slump of large companies was also the slump of national trade unions that exactly in those companies had consolidated their presence. Like the French, the German and the Spanish government, the Italian penta-party coalition tried to face the consequences of increasing unemployment in large companies by encouraging a subsidized exodus from work through pre-retirement benefits (law 155/1981). But while in Germany and France pre-retirement schemes were established for encouraging generational turnover, in Italy and in Spain they soon turned into an instrument for avoiding dismissals with no effects on workers' mobility.

In a context of massive unemployment, also linked with the rapid rise of women participation into the labour market, it was no longer possible however to rely on medium term interventions and on income support subsidies. Especially in the Mezzogiorno it was necessary to radically change the overall strategy of labour policy in order to expand the productive capacity of firms and to foster job creation. To pursue such an ambitious goal the idea of a new social agreement with economic interest groups was launched and the world "deregulation" officially entered the political discourse. In 1983 the national trade unions, the national employers' associations and the Minister of Labour signed an important social pact. The negotiation was in fact a complex political exchange involving income policies, fiscal policies and incentives policies. As for labour policies the agreement introduced a set of new policy instruments favouring higher flexibility in the labour market (law 863/1984).

Law 863 of 1984, following the 1983 agreement, introduced three new instruments, all belonging to the family of deregulative policies: work-sharing agreements (the so-called solidarity contracts), work and training contracts and part time work. Work and training contracts immediately obtained a remarkable success. Part time too was not a success either: it was rarely used, mainly because of its high non wage costs.

Some other active policies were introduced in the second half of the decade. In 1986, law 44 established a set of financial incentives for young employers creating new firms and co-operatives. Beneficiaries concentrated in the Southern regions. In 1987, law 56 reorganised the structure of the Labour Ministry, established the new regional agencies for promoting active employment and modified the procedures for placement.[11] Though rather innovative the new policies of the 1980s did not seem to be enough to affect the structural factors of unemployment.

The new decade opened in fact with alarming conditions. From 1992 to 1995 the fall of the employment rate was continuous. It was moreover accompanied by the increase of unemployment which in 1995 surpassed 12%. The gap between Northern and Southern regions deepened and a new record appeared: in 1995 long-term unemployment reached 63.2% of total employment, the highest level in Europe. In the Mezzogiorno it amounted to 69.8% (55.5% in the North) (Pugliese and Rebeggiani 1997). While economic adjustment was producing its first positive results, the Italian labour market continued to suffer alarming conditions, never so serious in the past.

In such a context, the evolution of labour policies took two different directions: the revival of concerted action and income policies; and the implementation of a substantial labour market reform introducing high decentralisation and privatization.

Between 1992 and 1993 the technical governments led by Amato and Ciampi undertook a series of non-stop negotiations with the unions under the growing pressures of the Confindustria, which saw in the high levels of the labour cost not only a cause for inflation but also the main culprit for high unemployment. The negotiations resulted into two different agreements: the "Amato agreement" in July 1992 and exactly one year later the "Ciampi agreement", which completed the reform. The solutions identified for fighting inflation and unemployment were quite tough: the abolition of the wage indexation mechanism (the *scala mobile*); the reform of collective bargaining and the introduction of income policies.

The *scala mobile* was abolished after fifty years from its establishment. This was perceived as a big victory for employers who, starting from the labour cost agreement in 1983, had fought for a wage cooling. Particularly important was the reform of collective bargaining. The new structure was organized on the basis of two negotiation levels: the national level and the firm- or territorial level. The chaotic overlapping of the pre-existing different levels of bargaining was rationalized and homogeneous standards for the regulation of wages in the different productive sectors were established. Finally, a new virtuous system of income policies that could flexibly adjust to the expected inflation rate was established. Two tripartite "meeting sessions" were instituted in connection with the phases of macro-economic and budgetary policy: the session of May-June for the definition of the objectives of budgetary policies and the September session for the planning of income policies in connection with the financial law. In December 1998, the structure of income policies, disigned by the Ciampi agreement, was completed and strengthened by the so-called "Social pact for economic development", signed by the new Prime Minister D'Alema and more than thirty organisations for interest representation. In that agreement, the two sessions of income policies and the two levels of collective bargaining have been confirmed and the cooperative - corporatist style of policy making has been further formalised and disciplined.

The Ciampi agreement included also a complex and coherent reform of labour market policies, which subsequently resulted in the "Pact for Work" signed by the unions, the employers and the Prodi government in September 1996. The Pact was centred on a strategy of active policy, but at the same time the role of passive policies did not reduce at all. The strategy of the double track continued. In the nineties, public utilities works have been the most widespread labour programme. The so-called "Treu law" (from the name of the Labour Ministry) in June 1996 contained the most important part of the September pact: it introduced temporary work and has prepared the ground for the reform of the training system. The introduction of temporary work is particularly worth mentioning, since it has meant the end of the state monopoly on employment services. Italy was the last country together with Greece to legalise temporary work. One year after the Treu law, decree no. 469/1997 (following the so-called "Bassanini laws" concerning public administration and in particular administrative decentralization) abolished the public monopoly on placement offices, transferred the related competencies to the regions and allowed private agencies to set up placement offices. The law has rightly been perceived as a sort of revolution: the regions have become the most powerful actors of the labour market regulation and the old ministerial institutions have been fully redesigned. Only the responsibility for the *ammortizzatori sociali* has remained under the competence of the central government.

In addition, the "Pact for Work" has instituted some other innovative policy instruments: the so-called policies for local development. They consist of a wide menu of policy measures; among them the main important are territorial pacts and area contracts. They are specifically addressed to the most depressed regions and are already rather widespread in the Mezzogiorno. They consist in bargained agreements aimed at developing business, co-operatives and employability in a particular territory, exploiting its social and economic resources.

During 1997 a political controversy arose on a rather tormented issue: the introduction of the 35 working hours week, inspired by the French experience. The party of extreme left, *Rifondazione comunista*, which was part of the parliamentary majority supporting the Prodi cabinet, obtained an official commitment for the introduction of the 35 hours by law by 1999. The opposition of trade unions - which would like to keep this topic regulated trough collective bargaining - and of employers - which would like no regulation at all - has been harsh. With the fall of the Prodi cabinet in October 1998, this objective has however slipped off the agenda.

The D'Alema government formed in October 1998 has confirmed a strong commitment on the new active policies of employment promotion. The already mentioned "social pact for development", signed in December 1998, aimed at relaunching public and private investments (especially in the South), giving new impulse to training programmes and reforming the traditional system of passive policies.

2.2.2 *The Welfare State: the Chaotic Restructuring of the 1980s and the Breakthroughs of the 1990s*

Despite their unremitting lip service to the exigencies of financial adjustment, the various Penta-party governments which held office during the decade did not accomplish much in terms of structural measures. Since the beginning of the decade proposals of new pension and health reforms started to be discussed in Parliament and to be included in the agenda of the different cabinets. All these proposals went in the same austerity direction: rationalizing the system, raising the age of retirement and trimming benefit formulas in order to restore financial balances (for pensions), reorganization of the Health Service structure and financing (the so called "reform of the health reform"). Neither the pension reform nor the Health Service reform made much progress until the early 1990s. The 1980s did however witness some first "cuts" in both sectors: relatively peripheral and not very effective cuts in the case of pensions, more substantial ones in the case of health.

In the pension field, starting from 1983 a number of measures were taken aimed at subordinating some entitlements to the actual income conditions of recipients and at controlling abuses. Income ceilings were established for maintaining the right to minimum pensions and to multiple benefits (e.g. an old age and a survivor pensions). The rules concerning invalidity pensions were in their turn completely revised, tightening medical criteria and introducing periodical reviews of the physical conditions of the beneficiaries. Though important in symbolic terms, these steps in the direction of a greater "targeting" of Italy's social insurance were only modestly effective in financial terms.

Cutbacks were more substantial and more effective in the field of healthcare. Alarmed by post-reform expenditure increases and aware that a new "reform of the reform" would take its time, the Penta-party government inaugurated a policy of "financial management" of the Health System aimed at curbing the demand for services by imposing expenditure ceilings to the regions and by making users pay in part for services. The annual budget bill became the instrument *par excellence* to run the healthcare system from the centre. Allocations were set on the basis of available public funds, to be shared out among the regions. The savings deemed necessary to remain in line with the ceiling were produced through co-payments and other cuts (reduction of facilities, staff, investments, i.e. the unpopular *tickets*).

If on the expenditure side the 1980s definitely were an ambiguous decade (continuing expansion and chaotic retrenchment), on the revenue side the dominant trend was much clearer: embitterment on all fronts. Contributory rates were repeatedly increased, especially for self-employed categories and the total tax take of general government grew extremely rapidly.

Through the rapid and intense increase of taxation, Italy fully completed during the 1980s its catching-up march with respect to her European partners, filling the distance created by the "flat decade" 1965-1975. But this remarkable tax adjustment did not suffice to cure the structural unbalance of national accounts. As already mentioned, the deterioration was due to a large extent to the self-sustaining dynamic of the "debt spiral" in an unfavourable international conjuncture. But the internal unbalances of the welfare system (especially pensions) did bear a relevant part in the story.[12]

These unbalances became the object of a sequence of reform in the following decade. The sequence started in 1992 with pensions. While maintaining the overall architecture of the system established in 1969 (occupational schemes and earnings-related formulas) the 1992 “Amato” reform introduced a number of significant changes in a restrictive directions after decades of ameliorations. The main provisions of this reform can be summarized as follows: elevation of the retirement age from 55 to 60 for females and from 60 to 65 for males (private employees), to be phased in by the year 2002; gradual elevation of the minimum contribution requirement for old age benefits from 10 to 20 years; gradual extension of the reference period for pensionable earnings from the last 5 years to the last 10 years (and to the whole career for new entrants in the labour market); elevation of the contribution requirement for seniority (early retirement) pensions to 36 years for all workers (including civil servants – though with a gradual phasing in - who enjoyed a much lower requirement of 20 years); a new increase of contribution rates; replacement of wage indexation with cost of living indexation of benefits.[13]

As a follow up of the reform, in 1993 new provisions for supplementary pensions were passed. The "second pillar" had been traditionally underdeveloped in Italy, due to the presence of a highly generous first pillar and of generous rules regarding end-of-career payments. The new provisions introduced a co-ordinated legal framework and fiscal incentives for the establishment of occupational supplementary funds. The Ciampi government decided in its turn a temporary freeze on seniority pensions as well as controls on the beneficiaries of disability benefits, to contain the above illustrated frauds. The persisting crisis of public finances, the upward trends of pension expenditure (in spite of the "cuts") and the pressures of international agencies such as the IMF, the OECD and EU institutions convinced however the government in the course of 1993/1994 that a more incisive reform was needed. In May 1995 the Dini government succeeded in striking the agreement with the trade unions, which was approved by Parliament in the following August. At least two factors explain the attitude of the trade unions. First, the concertational style of Dini (who was "technically" supported in Parliament also by the left), as opposed to the adversarial style adopted by Berlusconi, who had failed in mediating with the unions. Second, the very concrete spurs of "international markets". As a consequence of the political crisis and the ensuing loss of credibility, interest rates started to soar in the Winter of 1995 and the lira witnessed an alarming fall against the Dmark. The unions thus learnt that refusing the reform was not equal to maintaining the status quo, but making things much worse. In other words, they somehow understood by means of a "negative re-enforcement" that the arguments of the governments and of the Bank of Italy were well grounded and accepted the "bet" proposed by them (cfr. above, par. 2.1.4).

The main points of the Dini reform are: the shift from the old earnings-related formula to a new contribution related formula, to be phased in by 2013; the introduction of a flexible retirement age (57-65); the introduction of an age threshold for seniority pensions (57 years) for all workers, to be phased in by 2008; the gradual standardization of rules for public and private employees; the graduation of survivor benefits according to income; finally stricter rules on the cumulability of disability benefits and incomes from work, as well as tighter controls on beneficiaries. Besides changes on the benefit side, the Dini reform also rationalised and raised contribution rates and widened the contribution base by extending compulsory pension insurance to special categories of self-employed workers.[14]

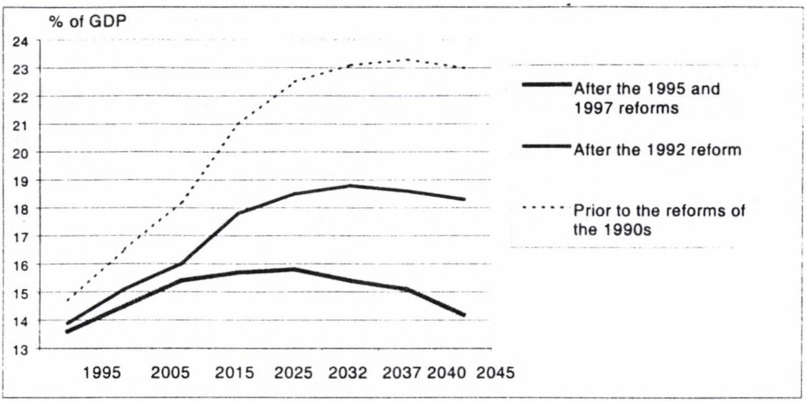
The Fall of 1992 marked an important turning point also as regards health care: the "reform of the reform" was in fact finally approved (with additional fine-tuning provisions in 1993). This reform transformed the local health units (USL, the basic structure of the SSN) into "public enterprises" with ample organizational autonomy and responsibility. The USL are no longer to be run by elective political committees but rather by a general manager appointed by the regions based on professional qualifications and with a private contract, renewable after five years if performance is satisfactory. Larger hospitals, formerly acting as branches of the USL, can now establish themselves as independent public hospitals agencies, with autonomous organization and administration. These public hospital agencies must operate with balanced budgets. Budgetary surpluses can be used for investments and staff incentives and unjustified deficits will jeopardize their autonomy. The reform also brought changes in the financing regulations. The central government maintains overall planning responsibilities; that is it pays for a standard set of services that must be guaranteed to each citizen in each region. In this way, each region will continue to receive a predetermined amount of resources by the centre, in accordance with its own population (with some corrections). However, whatever remains to be paid in each region in addition to its standard yearly endowment must be covered with regional resources (higher co-payments or taxes).

The 1992-1995 reforms represented major breakthroughs with respect to the institutional legacies of the past. They were also, however, the result of social and political compromises in which the government had to make a number of concessions (e.g. on the phasing in of the reforms) with respect to its own original plans.[15] But the approximation of the EMU deadlines was keeping Italian authorities under acute budgetary pressures: so soon after each one of these compromises, the government relaunched its reformist efforts, even widening the scope of its ambitions. In this vein, the new centre-left "Olive-Tree" coalition led by Romano Prodi and voted into office in the Spring of 1996 made of a comprehensive reform of the *stato sociale* one of its highest priority. In January 1997 Mr. Prodi appointed a Commission of experts to draft a broad plan for reform. An articulated report was submitted by this Commission (known as the Onofri Commission, after the name of its chairperson, a Bologna economist). Centred on the idea of re-equilibrating and containing (though not reducing in the aggregate) social expenditure.

The Onofri report was the object of a rather heated debate in the Summer and Fall of 1997. In the budget law for 1997 the Prodi government tried to adopt many of the Commission's recommendations. The fierce opposition of the Refounded Communists (whose votes were crucial for reaching a majority in parliament) and the difficult negotiations with the social partners forced however the government to substantially scale down its ambitions. In the field of pensions, Prodi was able to introduce some cuts of seniority pensions, especially for public employees: their contributory requirement for claiming a seniority pension was aligned with that applying to private employees. Contributions for the self employed were raised, a temporary freeze on the indexation of higher pensions was introduced and some steps were made on the "harmonization" front. However modest (with respect to the government's original ambitions), these cuts had the advantage of being immediately effective and thus gave a sizeable contribution (0.2% of GDP) for reaching the budgetary targets for 1998. The most important recommendation of the Onofri plan, i.e. a much faster phasing in of the new pension formula introduced in 1995, could not be adopted and by opening a cabinet crisis the Refounded Communists were able to obtain the exemption of blue-collar workers from the cuts in seniority pensions.[16] The government was also able to push through some important innovations on the social assistance and selectivity fronts.[17]

This sequence of reforms has not fully eradicated the distributive and allocative distortions of the Italian welfare state which have been described in section I. They have however made significant steps in this direction. More importantly, they have planted promising institutional seeds that may trigger off a sort of spontanoeus and self-sustaining dynamic of internal re-equilibration. On the one hand, the setting of more transparent and clearcut boundaries between social insurance and social assistance as well as the consolidation of new instruments such as the ISE and the RMI will work to strengthen that safety net of means-tested and need-based benefits and services which has been historically lacking (or very weak) in Italy. On the other hand, the new architecture of the pension system will work to gradually downsize (or at least contain the further expansion of) a sector which has been historically hypertrophic. It is true that, in spite of the reforms, at the end of the 1990s, Italy still displays one of the highest ratios of pension expenditure/GDP in the whole OECD area and that the situation is still going to worsen. But the significance of the 1992/1995/1997 reforms must be appreciated by contrast with the status quo. As graph 11 shows, in the absence of reforms pension expenditure would have reached the impressive peak of 23.2% of GDP in the year 2040, before starting to decline. After the reforms, the peak is expected to reach "only" 15,8% of GDP in the year 2032. The virtual stabilisation of pension expenditure may not have been enough to fully cure the long-standing disease of Italy's unbalanced welfare state. But it has certainly contained its fatal aggravation.

Graph. 11
Pension expenditure projections, 1995 - 2045



2.3 Institutional Capabilities: the Slow Beginning of a Learning Process

The adjustment of national economies to internationalization can be considered as a process of institutional change, a highly complex phenomenon combining two levels of change: public policy change and a broader politico-institutional change. What shifts are not only the specific goals, instruments and techniques of public policy, but also the structures and rules in which policy making is embedded. Institutional change takes place through a delicate learning process, in which policy makers learn how to implement new programmes or how to solve specific problems on the basis of the transformations of the external environment, of new available knowledge and information, or by trying to emulate foreign successful examples.[18] But learning processes are particularly difficult, since they involve the restructuring of the norms, strategies and routines that were successful in the past and that have generated widespread trust and loyalty. What is necessary to break up the loop and to bring about institutional change? Historical contingencies, big technological changes or the (more or less) fortuitous combination of exogenous and endogenous challenges can interrupt the institutionalization process and release energy and resources for new activities and experimentations.

Institutional theory seems to be particularly suitable to describe and explain the process of adjustment of Italian economy to international pressures.[19] Up until the eighties the high institutionalization of the keynesian welfare and labour regimes, centred on passive-distributive policies, on disproportionate protection for the insiders and persisting exclusion of the outsiders, originated a highly resistant vicious circle, sustained by an interest coalition including powerful industrial unions, centre-left governments and weak employers' associations. In the nineties, however, some endogenous and exogenous challenges (the crisis of the political system, fiscal strains, the currency crisis, the pending deadlines of EMU and more generally the pressure of economic internationalization) have virtuously combined to produce positive externalities and to stimulate decision makers to undertake a radical process of change. The old, "vicious" circle and the new "virtuous" one still partly co-exist and it remains to be seen whether the latter will be fully capable of displacing the former in the years to come.

2.3.1 *The Vicious Circle: Spoils-Sharing Governments, Inefficient Bureaucracy and Distributive Policies*

Why did the (distorted) "welfare capitalism Italian style" survive and indeed consolidate throughout the 1980s, despite its manifold perverse effects of allocative and distributive nature and its increasing mis-match with respect to rapid social and economic transformations? As already mentioned in part I, the answer lies primarily with the "political logic" of the "First Republic" and more particularly with four interrelated ingredients of it: a spoils-centred model of party government; a weak and inefficient public administration; a highly institutionalized system of political exchanges between the government and organized interests and finally the distributive nature of labour and social policies. In the 1980s some efforts to modify these ingredients were attempted, but their effectiveness was not very high, owing to the strong resistance of the supporters (and obviously main beneficiaries) of the status quo.

As is well known, the Italian political system was characterised - at least until the end of the First Republic - by high party fragmentation and lack of competition (Sartori 1982; D'Alimonte 1978; Cotta 1987). Multiparty coalitions cabinets were not based on clearly defined and shared programmes, but rather on the proportional distribution of offices and spoils. These unstable executives were led by Prime Ministers with a weak role of co-ordination, while the ministers who borrowed their legimitisation directly from political parties enjoyed high autonomy. The best strategy of survival for the government was to respond to all the inputs and micro-demands coming from social and political groups by formulating on the one side general, ambiguous and therefore ineffective public policies and on the other side by multiplying particularistic laws and regulations in order to distribute incentives and benefits to those social categories, whose electoral support seemed to be particularly important.

This micro-sectional style of policy making, characterised by a very low degree of overall substantive coherence, intersected with a system of public administration marked by high centralisation, a top-down, hierarchical implementation style and weak problem solving capacity.

Another important factor for the institutionalisation of welfare capitalism Italian style was the nature itself of social and labour policies. This nature can be referred to as micro-distributive: highly concentrated (selective) benefits and widely dispersed costs. Distributive policies were the main result of the economic miracle of the 1960s and of the political strategies pursued by the centre-left governments of the 1960s and 1970s, which were inclined to incorporate a growing number of social categories in the welfare edifice. Distributive policies are very particularistic; contrary to the universalistic ones, they encourage fiscal irresponsibility and create loyalty and growing expectations in the beneficiaries (Pierson 1993; 1994; Ferrera 1998). They generate incentives for client groups to organize and mobilize in defence of their entitlements.

It is important to remark that the vicious circle we have described so far - vicious because it assured the perpetuation of the same policy path and hindered every attempt at reform - was a perfectly coherent system from an internal perspective, a very "tightly coupled" system. Beneficiaries were keen on supporting it, unions agreed on distributive policies, employers got appealing incentives and the governments of the *Centro-sinistra* or of the *Pentapartito* could meet the demands of their voters and distribute spoils among the various coalition partners. But in the nineties the whole castle began to crumble, under the pressure of growing claims on the side of outsiders, the explosion of costs and the radical transformations of the external economic environment.

2.3.2 *The Virtuous Circle: Government Stability, Economic Integration and Policy Reforms*

In the early nineties the transformations that in the domestic debate have been defined as "the transition from the First to the Second Republic" and the stringent pressures to meet the EMU deadlines have shaken the old model of welfare capitalism Italian style at its roots. The two dynamics have combined to originate a virtuous chain of policy reforms.

In the first half of the 1990s, the Italian party system underwent some rather dramatic and sudden changes. The discovery of an intricated and pervasive system of political corruption involving prominent figures of the national economic and political scene provoked a rapidly growing delegitimazion of the established élite. Under the investigations of "Clean

Hands" (*Mani pulite*) (as the magistrates of the Milan pool came to be known) a widespread chain of illegal practices of party financing and tax frauds concerning both politicians and renowned employers was brought to light, exposing a web of hidden connections between politics and business. Under the axe of "Tangentopoli" (Milan as "Bribesville") several employers and political leaders were convicted and most of the ruling élites of the First Republic retired to private life.

The dramatic effects of Tangentopoli combined with major changes in the structure of the political system. In 1993 a new electoral system based on the majority formula was introduced and one year later, for the first time in Italy, two big party coalitions fought each other in order to gain electoral support. The bipolarization of political competition marked the end of the so - called *conventio ad excludendum,* i.e the unwritten rule according to which the communists were to be kept outside the national executive. This was also a consequence of the end of the "cold war" at the international level, particularly simbolised by the fall of the Berlin wall. The cleavage "pro-system vs. anti-system" on which the Italian party government had been born and had consolidated began to loose legitimacy and opposion parties gained more and more credibility for governing responsibilities.[20]

But let us look in more detail at the profound transformations of the political system. In the first place, after the elections of 1994, the old parties precipitated in an irreversible electoral and organisational crisis. The pillars of the *Pentapartito*, i.e. the christian democrats, the socialists, the socialdemocrats, the republicans and the liberals, practically disappeared. Secondly, the crisis of political parties brought about another related crisis, concerning the overall party system and its already mentioned characteristics: the policentric structure, the lack of competition, the predominance of centre- based coalitions, the low capacity of leadership. In the third place, the crisis marked the turnover of an entire political class. In 1994, 71% of the deputies were elected for the first time. Besides "Tangentopoli" the causes of the dissolution of the old political élite were numerous: the explosion of internal conflicts within the parties, the loss of control on the executive, the inability to change and the entry of new actors in the political arena (Cotta and Verzichelli 1996). Fourth, the demise of the First Republic changed the nature of the relationships among the different political institutions. The relationships between the executive and the President of the Republic have shifted in favour of the latter, the relationships between the executive and the parliament have shifted in favour of the former and finally the relationships between the judiciary and the overall political system have shifted in favour of the judges. The national executive has therefore gained more power. The "technical" cabinets of Amato, Ciampi and Dini, which were somehow detached from a strict party control, could enjoy higher autonomy and exercise a more direct leadership on policy making. The final relevant factor was the entry into the political arena of new parties and movements. After the electoral success of the Lega Nord already in 1992, whose main claims were against the high state centralisation and its "suffocating" system of taxation, in 1994 a new political movement led by Berlusconi, "Forza Italia", in four months organized itself and won the elections. Berlusconi's centre-right government did not however last long, due to harsh conflicts with its ally, the Lega Nord and was replaced by Dini's technical majority (and cabinet) just a year later. The government led by Prodi which was formed after the April 1996 elections, had a longer duration (it fell in October 1998) and was also characterized by a higher political (centre-left) profile.

In such a changed political environment the style and resources of policy making significantly changed. As said, the turning point was 1992 and in particular the "tears and blood" budgetary bill pushed through by the Amato government. In 1993 the Ciampi agreement abolished the notorious *scala mobile* to alleviate labour cost and cool wages, and reformed the collective bargaining structure. In 1993, after a series of non-stop negotiations, a "revolutionary" law completely "privatized" the status of public employees, subjecting them to the ordinary civil code and stripping them of many administrative privileges and protections. In the meanwhile the reform of the Health Service had moved in a similar direction: de-politicisation and professionalization, decentralization and "managed care". Berlusconi's government encouraged some important legislation for small and medium-sized firms based on substantial fiscal incentives. His successor Dini reformed the system of pensions by introducing a new defined-contribution formula. In 1996 a series of important privatizations began, involving most state owned industries and almost the entire system of banks. In 1997 the "Bassanini laws" (from the name of the minister of public administration) have fully reorganized the structure and functioning of central and local bureaucracies, by introducing high decentralization, substantial delegification and greater autonomy for top managers; the same deregulation strategy was applied to the organization of domestic trading activities. Again in the same year the reform of public accounting procedures has brought about a new (simpler and more flexible) organization of the state budget.

All these reforms have been marked by high policy integration and cohesion. First, all of them seem to be inspired by a culture of "managerialism" and "professionality" – not only in rethorical terms, which meant more efficiency and effectiveness in public policies and higher quality in service provision. The capacity of implementing these reforms has greatly increased thanks to higher horizontal co-ordination between the ministries and vertical co-operation between the Prime Minister and his ministers. The strengthening of the executive has given Prime Ministers higher capacity of leadership and has assured major cohesion inside the government and thus inside policy projects, encouraging cross-sectoral policy initiatives. Finally, a more effective role has been played by policy experts, coming from academic and private research institutions.

Another feature of the reform cycle, which deserves separate reflections, is the strongly *negotiated* nature of innovations: these have been almost all introduced through consensual concertation between the government and organized interests. Prime Ministers have played a stronger role than in the past and have really co-ordinated the action of the single ministers. A major consequence of that has been the search for co-operation and consent on the side of trade unions and employers' associations. The agreements of 1992 and 1993, the 1992 reform of both pension and health care and the new reform of pensions in 1997 were the outcome of that strategy. In 1996 with Prodi's "Pact for work" and in 1998 with D'Alema's "Social pact", concertation became a structural strategy.

Conclusion: a New Model, but How Stable?

The turbulent 1990s have been a successful decade for Italy. Through an impressive sequence of reforms, this country has been able to put in order its battered public finances, to start an incisive modernization of its backward bureacratic apparatus, its rigid labour market and its unbalanced welfare state, without jeopardizing social peace nor the overall competitiveness of its economy in the global context. The dynamics of internationalization and, especially, of European integration have been crucial in promoting this quality jump" in terms of institutional capabilities: indeed the Italian experience shows that internationalization may well be a solution, instead of a problem. As illustrated in part I, a major handicap in Italy's start-up constellation was the high weakness and "softness" of the state as such (deficit of legality, of efficiency and of normative integration). In fact the 1970s and the early 1980s were the heyday of a syndrome in which the Italian state acted primarily as a machine for the generation of spoils and as an arena for the predation of such spoils on the side of various socio-political groupings. Solving collective problems through some sort of *zweckrational* solution was only a secondary function of the state. What exogenous shocks and (in the 1990s) the Maastricht process have done to Italy's politico-institutional system is, precisely, encouraging the "hardening" of the state, the strengthening of its capacities: state (but also social) elites learned that "puzzling about problems" and finding effective solutions to these problems was a more important task than (or, at least, a pre-requisiste for) "powering about spoils".[21]

Of course we do not argue that internationalization and European integration have been the sole spurs of this process of institutional modernization. Other factors have played a role as well: the sudden waning of endogenous blocks to change (the demise of the First Republic), the rapid de-ideologization of the political culture (in the wake of the fall of the Berlin wall), as well as its traditional pro-European-integration leanings, the emergence of new actors (fresh politicians, experts, a new "technocratic" elite), new styles of policy-making (the *concertazione*) and – as a result of all this – an accelerated dynamic of social and institutional learning.

The notion of "learning" (both cognitive and socio-political learning) is particularly helpful, we submit, for capturing the nature of Italy's changes and especially the internal dynamic of the process of change. At first the diagnosis emerged that Italy needed an incisive *risanamento* of public finances in order to reset herself on a healthy course of economic growth and social modernization, and that a firm anchoring to the European Community was the best (perhaps the only) way to achieve this.[22] This diagnosis matured into a project for change during the 1980s, when its various institutional implications were unravelled, pre-disposing a wide ranging reform agenda. The project came to be fully shared and supported within the technocratic circles of the Bank of Italy and the Treasury, and started to make its way also within some sector-specific policy networks. The monetary crisis of 1992 convinced all these circles that a failure of the "risanamento in the name of Europe" project would have had disastrous consequences. Thus a campaign started in order to persuade the social partners (and especially the unions) about the long term advantages of the risanamento: revived growth and lower interests on debt. As shown in par. 2.1.4, the campaign was successful . For the *condottieri* of this campaign (the various Amato, Ciampi, Dini, Prodi etc.) but also for their counterparts (the leadership of the social partners) the celebrations of May 1, 1998, when Italy was formally admitted into EMU, were thus well deserved.

True, our positive diagnosis is predicated on the peculiarly bad shape in which Italy found itself not only in the 1975-1990 period, but even at the heyday of the so- called golden age. Measured against this domestic historical record, the whole process of *risanamento* and the final seal of EMU membership cannot appear but a remarkable achievement. The picture would obviously change if we were to take other reference points. In comparison with the pioneers of structural adjustment (e.g. the Netherlands), Italy still appears for example as lagging far behind. Moreover, the reforms of the 1990s have not fully eradicated the old vices. In national public debates it is widely recognized that *la transizione* is not over yet and that the innovative dynamics emerged during the 1990s have not reached a firm point of political and economic equilibrium.

What are the prospects for reaching such an equilibrium, thus positively concluding *la transizione*? It is obviously very hard to say. By way of conclusion, we would like to suggest two conditions which are likely to play a crucial role in this respect.

The first condition has to do with the labour market and the Southern question (which are two sides of the same coin). Unemployment and the North/South dualism are still national emergencies and there are signals that in the coming years developments in world trade and investment will start to seriously hurt Italy's employment.[23] Incisive actions must thus be promptly taken: to overcome the endogenous causes of unemployment and to anticipate future endogenous shocks. The dividends of the risanamento and EMU membership offer a unique chance of pushing through the needed reforms of wage-setting mechanisms and of the *ammortizzatori sociali*. As was mentioned above, to some extent the risanamento was a "bet" from which substantial savings were expected, thanks to a decrease of interest rates. The bet has now been won and the savings are there. If appropriately mobilized in the right direction (public and private productive investments, education and training, incentives to attract mobile capitals, especially in the Mezzogiorno, reducing taxes and especially social charges etc.) this dividend can facilitate the reforms and spur that creation of "jobs, jobs and even more jobs" that has paved the way of the Dutch miracle. Responding to the unemployment and "Southern" emergencies is crucial not only (and obviously) per sè, but also for re-enforcing the dynamics of positive learning on the side of social and political actors: institutional change "pays", it delivers the goods and therefore must be continued. The "Social Pact" signed in December 1998 by the government and the social partners seems to rest on this logic: its aim was precisely to channel resources towards investment, employment and training promotion. But it remains to be seen whether the Pact's provisions will be actually implemented and whether social behaviours will actually follow the expected directions.

The second condition has to do with politics. The so-called Second Republic has witnessed the emergence of new political actors, a new unwritten equilibrium between the executive, the legislative and the judiciary powers, new electoral rules. But despite repeated and grand efforts (such as the establishment of a bicameral commission chaired by D'Alema), the basic Constitutional framework has remained unaltered. This means that the old and "vicious" political logic of the First Republic may easily resurrect – even if in disguised or tamed fashions. True, the new macroeconomic regime put in place during the 1990s is politically much less manipulable than the previous one. As a matter of fact, it contains a number of "institutional stabilisers" capable of constraining in a semi-automatic way the development of crucial policy areas (e.g. pensions or healthcare) and macro-economic variables (e.g. inflation, public deficits and debt). But the margins of discretion are still wide: the return of an unstable, irresponsible and purely distributive politics could seriously jeopardize the effective functioning of the new regime (as well as obstructing progresses on the labour market and "Southern question" fronts). If this is true, then only intelligent *constitutional* reforms will be able to complete the transition , originating and anchoring a new politico-economic equilibrium. Unfortunately, the road toward this destination is still long and rugged.

Endnotes

[1] It must be noted that the pension formula for civil servants was already more generous at the end of the 1960s: it allowed for replacement rates of 100% and for early retirement at any age after 20 years of service. This very generous provision had been originally introduced by the Fascist regime for certain categories of civil servants and was then generalized to all public employees in the early 1950s.

[2] In the period 1970-71 nominal wages increased by 19.9% and in the 1973-75 period by 22.7% (compared to 6.8% in 1968-69). In 1970 real wages rose by 15% (Rossi 1998).

[3] The so-called *scala mobile* had been introduced early in 1945 to safeguard wages against inflation. The level of wages was periodically anchored to the level of the cost of living (which was measured on the basis of a pre-defined "basket of goods"). In 1975 the employers were basically forced to agree on the new instrument (which was clearly going to push up wages) in exchange for the stopping of conflicts and strikes in the firms. But what was supposed to be a temporary agreement became a permanent feature of the Italian wage system - and an object of heated controversy until the early 1990s.

[4] The indexation dynamic was not in fact perfectly aligned with the consumer prices trend. If in the period "A" the inflation had risen, wages would have grown in the period immediately following, that is in period "B", when inflation had probably diminished. And if wages had risen, this was an occasion for firms to push up prices; employers had no hesitations in doing this since they could rely on the lira devaluation mechanism. The 1975 agreement ended up by offering the basis for an uncontrollable wage-inflation rise. It was not for a case that from 1970 to 1979 the percentage of wage increases due to indexations grew from 13.5% to 79.7% (Somaini 1989).

[5] From 1970 to 1976 the total outlays of government rose from 34.2% of GDP to 42.2%; in the same years the revenues remained basically unchanged moving from 26.1% of the GDP to 27.6% (OECD 1998).

[6] For a discussion, cfr. especially Salvati (1981; 1984).

[7] In 1990, 58.2% of the exports was addressed to EC countries, 4.9% to Eastern Europe and 14.7% to development countries (Onida 1993, 192). The Italian share of world export also increased (from 3.8% in 1980 to 4.7% in 1989).

[8] In 1993 the first loss of employment in the tertiary sector, after more than 30 years of positive growth, was registered (from 59.9% in 1992 to 59% in 1993).

[9] The main arguments of the debate can be found in: Barca and Visco (1992), Bodo and Viesti (1997), De Nardis and Galli (1997), Deaglio (1998), Micossi and Visco (1993), Onida (1993), Cominotti and Mariotti (1997).

[10] For a good illustration, see Doogan (1998).

[11] This reform representes the first step of the nineties employment services reform. For discussion cfr. Amendola, Caroleo and Garofalo (1997).

[12] In spite of the huge increase of contributions, the transfer of the central government to finance social protection rose by 76% in real terms between 1980 and 1990, passing from 5.0% to 7.1% of GDP.

[13] According to long-term projections, as a consequence of the Amato reform pension expenditure will be ca. 1% of GDP lower than expected in the absence of reform by the year 2000 and ca. 4% of GDP lower by the year 2035. These figures are inferred from Ministero del Tesoro (1998).

[14] Such as free-lance workers and other semi-autonomous workers (*lavoro para-subordinato*).

[15] The most significant concession was an exemption from the new, less generous defined-contribution formula of all those workers who had already matured an insurance seniority of 18 years in August 1995.

[16] For a full review of the 1997 pension reform and its financial impact, cfr. Mira d'Ercole and Mirabile (1998).

[17] A more detailed discussion of these new developments is contained in Ferrera (1999).

[18] The literature on policy learning and policy change is quite vast. In particular, cfr. Heclo (1974); Hall (1993); Sabatier and Jenkins-Smith (1993); Haas (1992). For a discussion Gualmini (1995; 1997).

[19] For a discussion of this literature, cfr. Hall and Taylor (1996), Immergut (1998).

[20] This process has eventually brought in October 1998 to the formation of the first government in Italy led by a (post) communist Prime Minister (Massimo D'Alema).

[21] For recent interpretations of the Italian experience in similar veins, cf. also Della Sala, 1997, Dyson and Featherstone, 1996 and Walsh, 1999. The puzzling/powering contrast is borrowed from Heclo, 1974.

[22] For a reconstruction of the debates that nurtured this diagnosis and a presentation of its main proponents, cf. Ferrera, 1992. For a detailed reconstruction of the risanamento as an institutional project, cf. Verzichelli, 1999.

[23] This is especially true for the implementation of the Uruguay Round and most notably the phase-out of the MFA. This process will gradually remove barriers to trade from which Italian producers have so far benefitted. More generally, the increased supply of LDCs manufacturers in the wake of global trade liberalization will have a greater impact on Italy's terms of trade compared to other industrialized countries (Faini et al. 1998). The "niche advantages" enjoyed by Italy in the international economy (cf supra, par. 2.1.3) will in other word be gradually lost.

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