fondazione RODOLFO DEBENEDETTI

The Current Italian Pension Reform: Another Partial Solution?

CEPR – Watson Wyatt Pension Policy Seminar

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Outline

- A decade of reforms
- A never ending transition to a NDC system
- The costs of the long transition:
  - Public and pension debt
  - The missing pillars
  - Contributions still perceived as a tax
  - The ageing of the median voter
- The Tremonti reform

The reforms to date

	Pre-1993 regime	1992 reform	1995 reform
Normal retirement age	60 (men) 55(women)	65 (men) 60(women)	Any age after 56 (for both men and women)
Transitional period		Until about 2032	Until about 2035
Pensionable earnings	Average of last 5 years real earnings (converted to real values through price index)	Career average earnings (converted to real values through price index + 1%)	Career contributions (capitalized using a 5-year moving average of GDP growth rate)
Pension benefit	2%*(pensionable earnings)*(t), where t is years of tax payments (at most 40)	2%*(pensionable earnings)*(t), where t is years of tax payments (at most 40)	Proportional to capitalized value of career contributions, the proportionality factor increasing with age at retirement (from .04720 at age 57 to .06136 at age 65)

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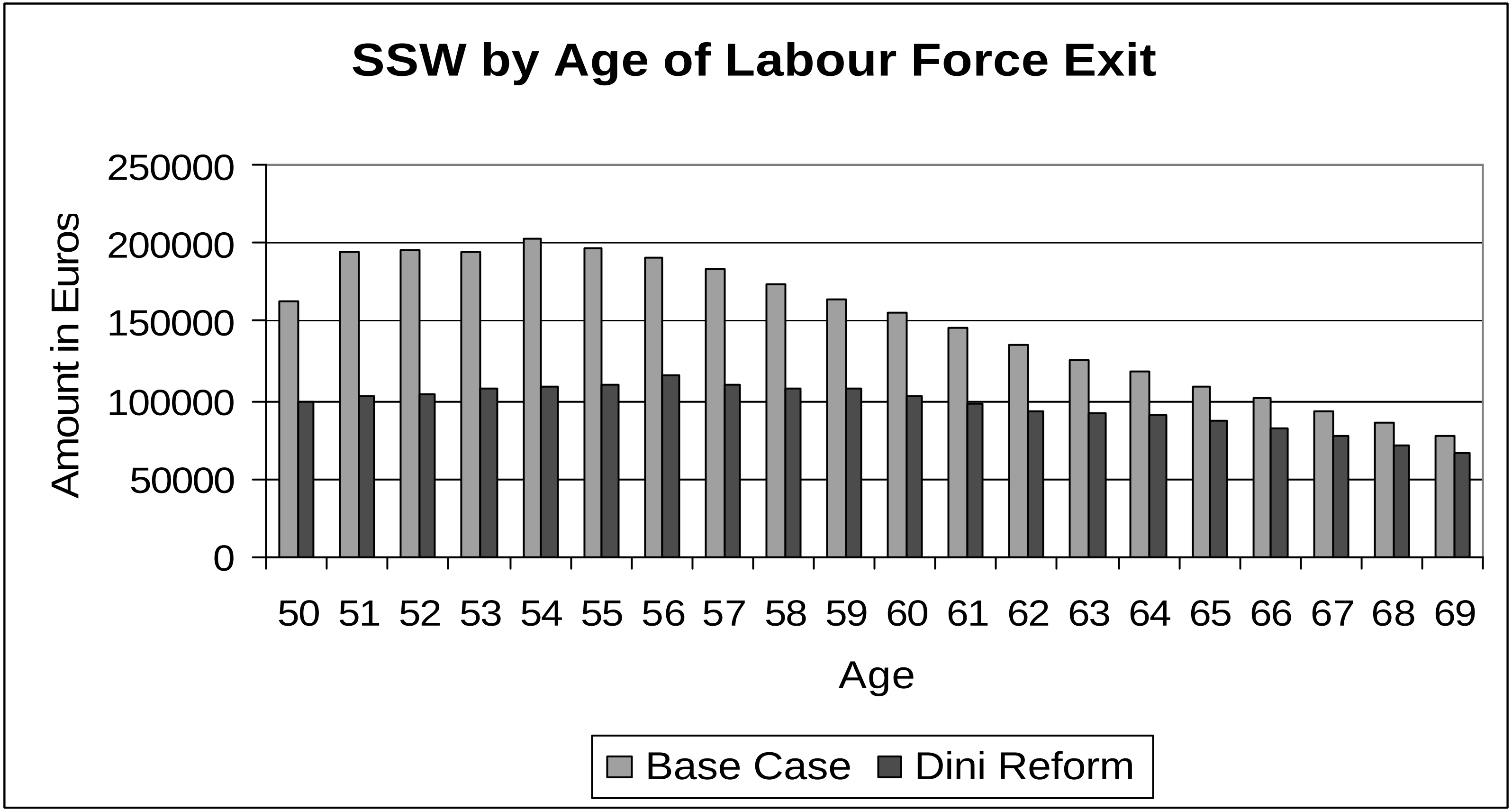
Pension indexation	Cost of living plus real earnings growth	Cost of living	Cost of living
Pension to survivor	60% to spouse 20% to each child 40% to each child (if no spouse)	Same	Same
Years of contributions for eligibility	15	20	5
Early retirement provision	Any age if contributed to SS for 35 years or more, no actuarial adjustment	Any age if contributed to SS for 35 years or more, no actuarial adjustment	No early retirement provision
Total Payroll tax	24.5% of gross earnings	27.17% of gross earnings	32.7% of gross earnings

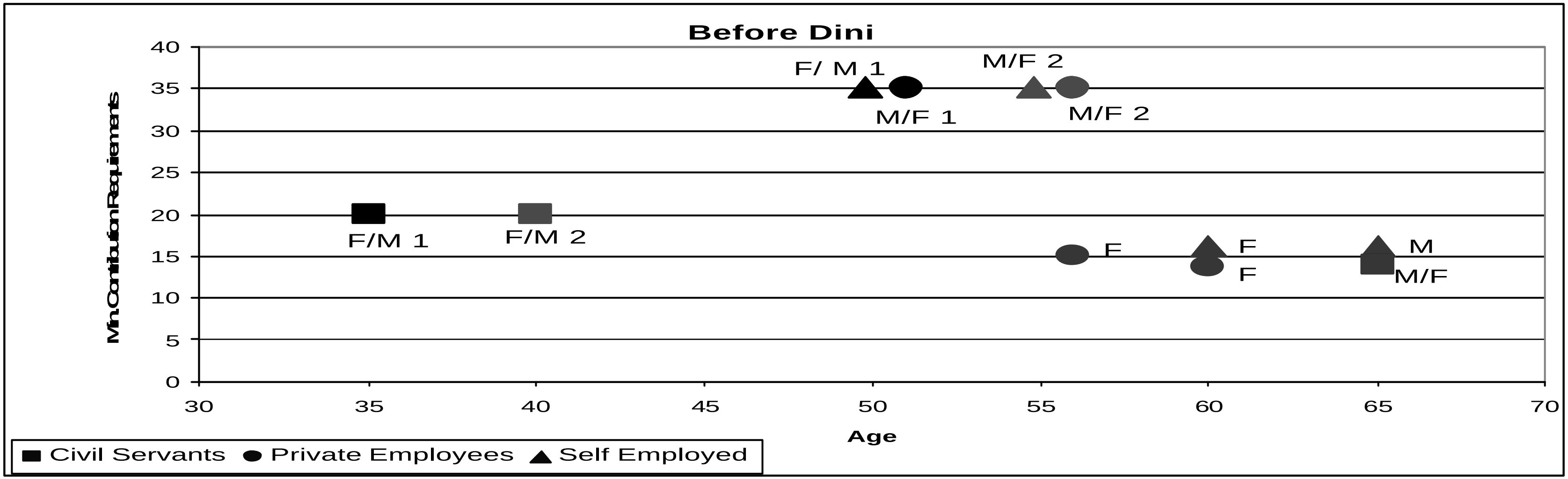
The Dini reform: getting closer to actuarial fairness and neutrality…



Cohorts, 1944-48. Brugiavini-Peracchi, 2000

..and phasing out of asymmetric retirement rules

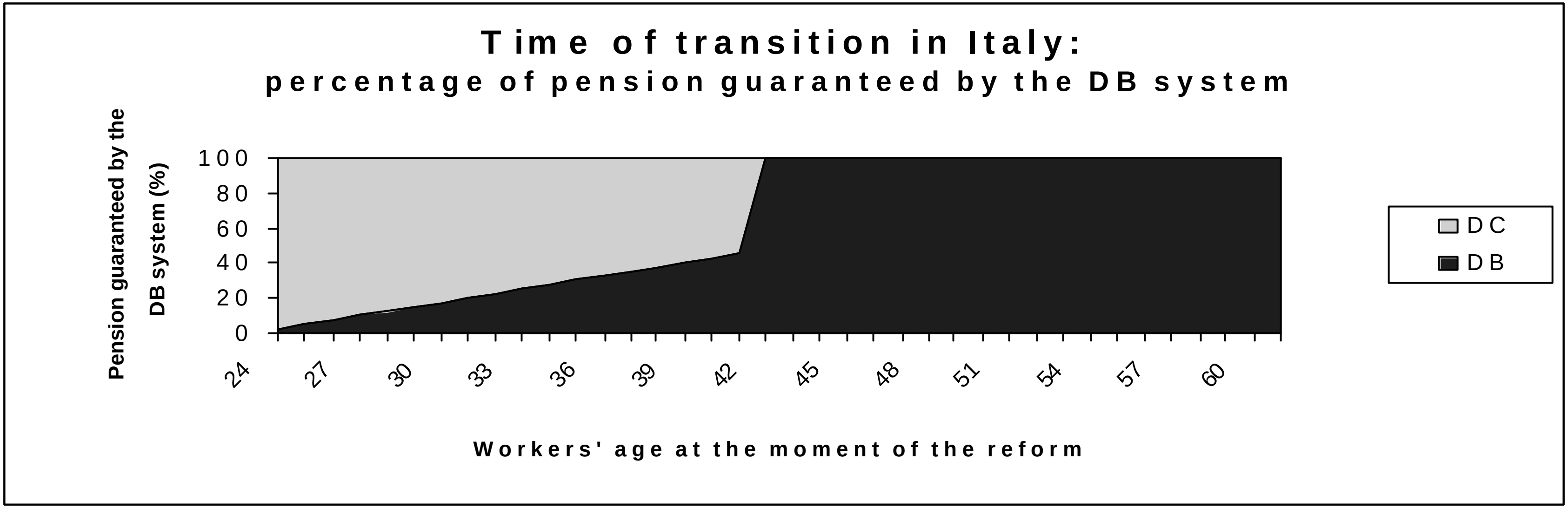
Minimum requirements for seniority pensions

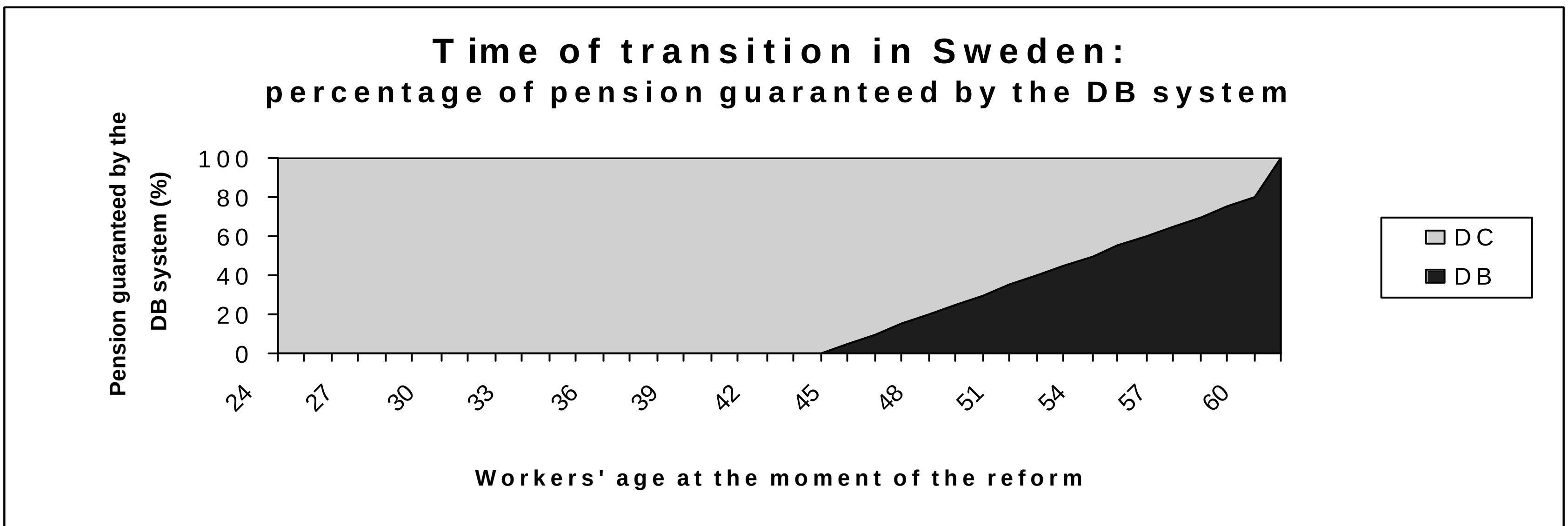


But a never ending transition

- NDC system, introduced in 1996 for those with less than 18 years of contributions
- All under the new rules by 2065.
- About 40% of those employed in 1999 could retire fully under the pre-1992 rules
- Much stronger degree of grandfathering of entitlements than in other pension reforms (e.g., Sweden)

In Sweden much faster transition to NDC





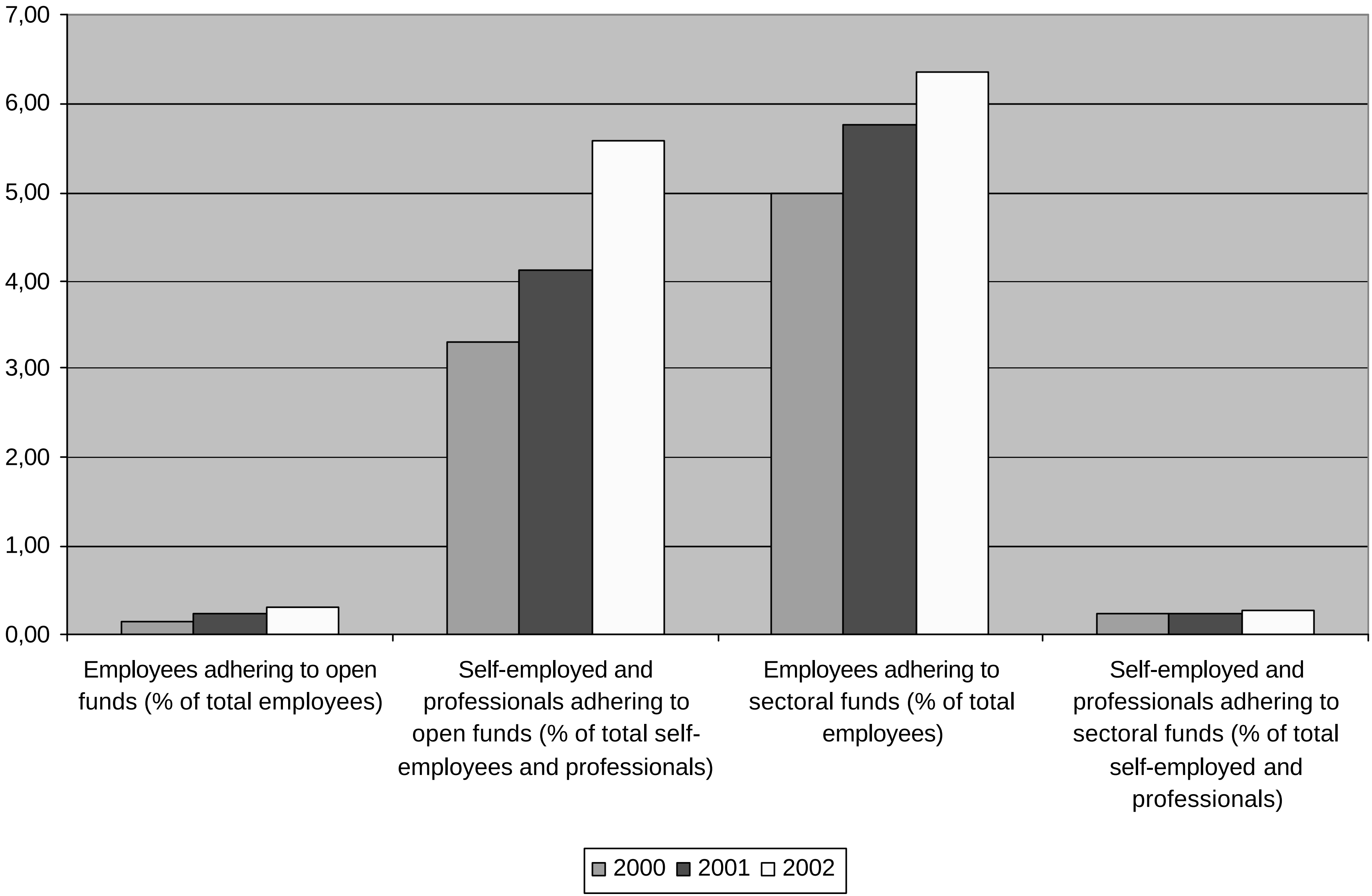
The fiscal costs of the transition

- If Dini applied to everybody since 1995:
  - Realignment of the equilibrium payroll rate (45%) to the effective contribution rate (33%)
  - no public deficit (the current deficit of public pensions is roughly 3,3% of GDP; with Dini to everybody, it would have been possible to reduce taxes/increase expenditure by about 3% of GDP within the SGP)
  - those exempted in 1995 by the reform received a “gift” of about 12,000 Euros, that is, 15% of the transfers that she/he will receive for the rest of her/his life

The missing pillars

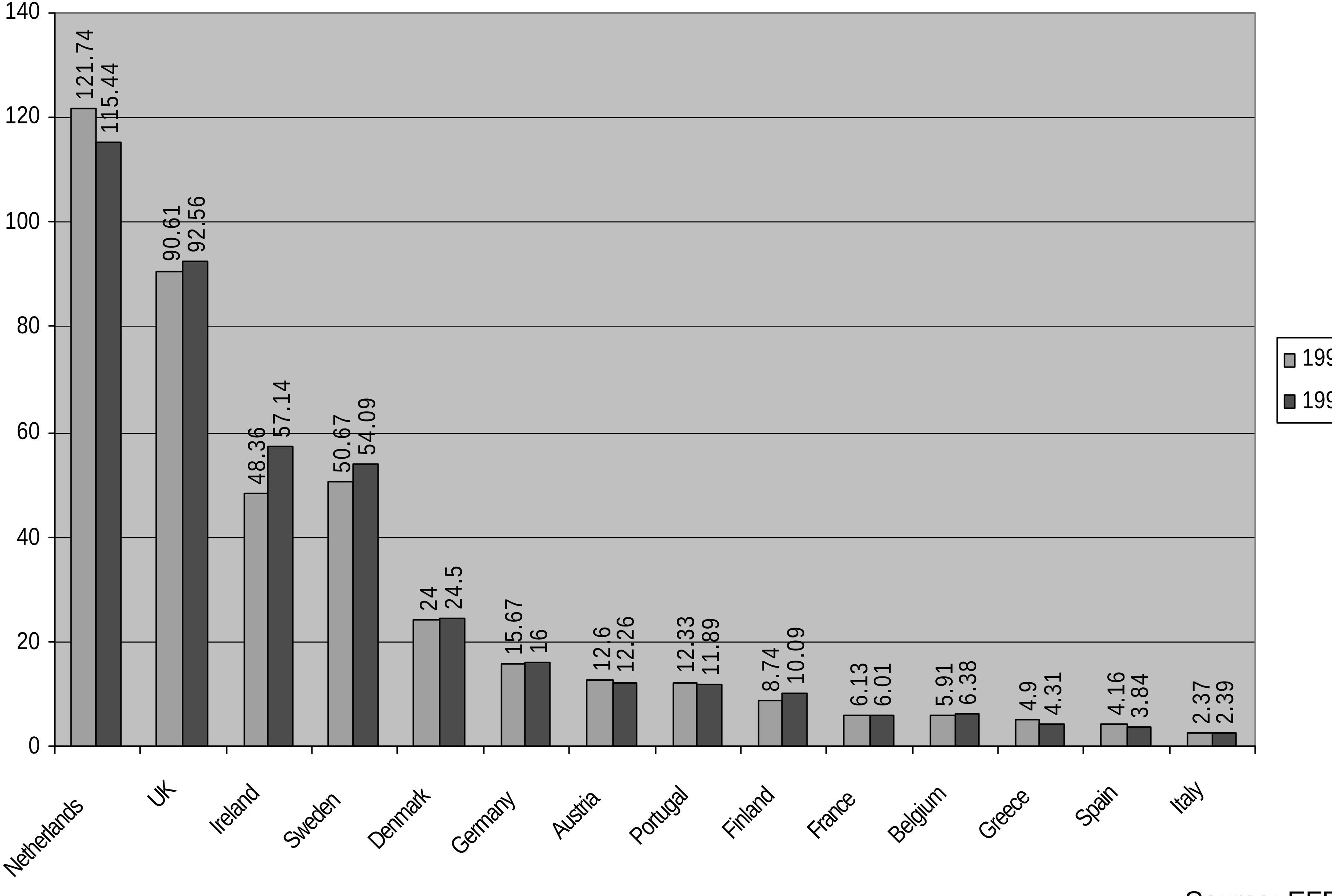
- An unexploited opportunity: the TFR, “Trattamento di Fine Rapporto” (Severance Pay Fund, with no actual accumulation of reserves), is not being diverted to Pension Funds by workers who can do it.
- Could be the missing pillar:
  – stock is about 125 billion euro (14% GDP)
  – flow is about 13 billion euro (1.5% GDP)

The sluggish growth of Pension Funds in Italy



ource: Authors' calculations on COVIP data

Pension fund assets as a percentage of GDP



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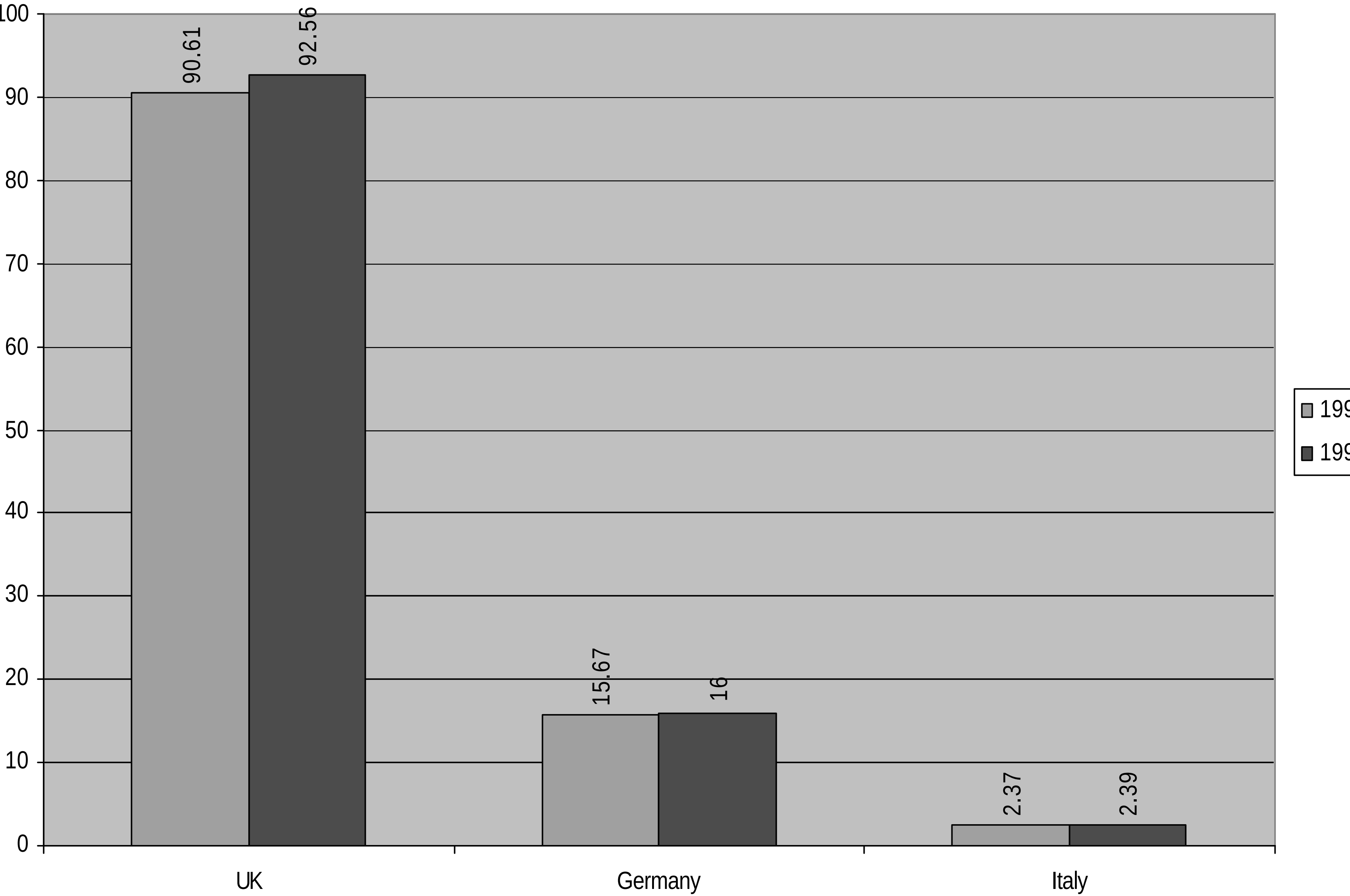
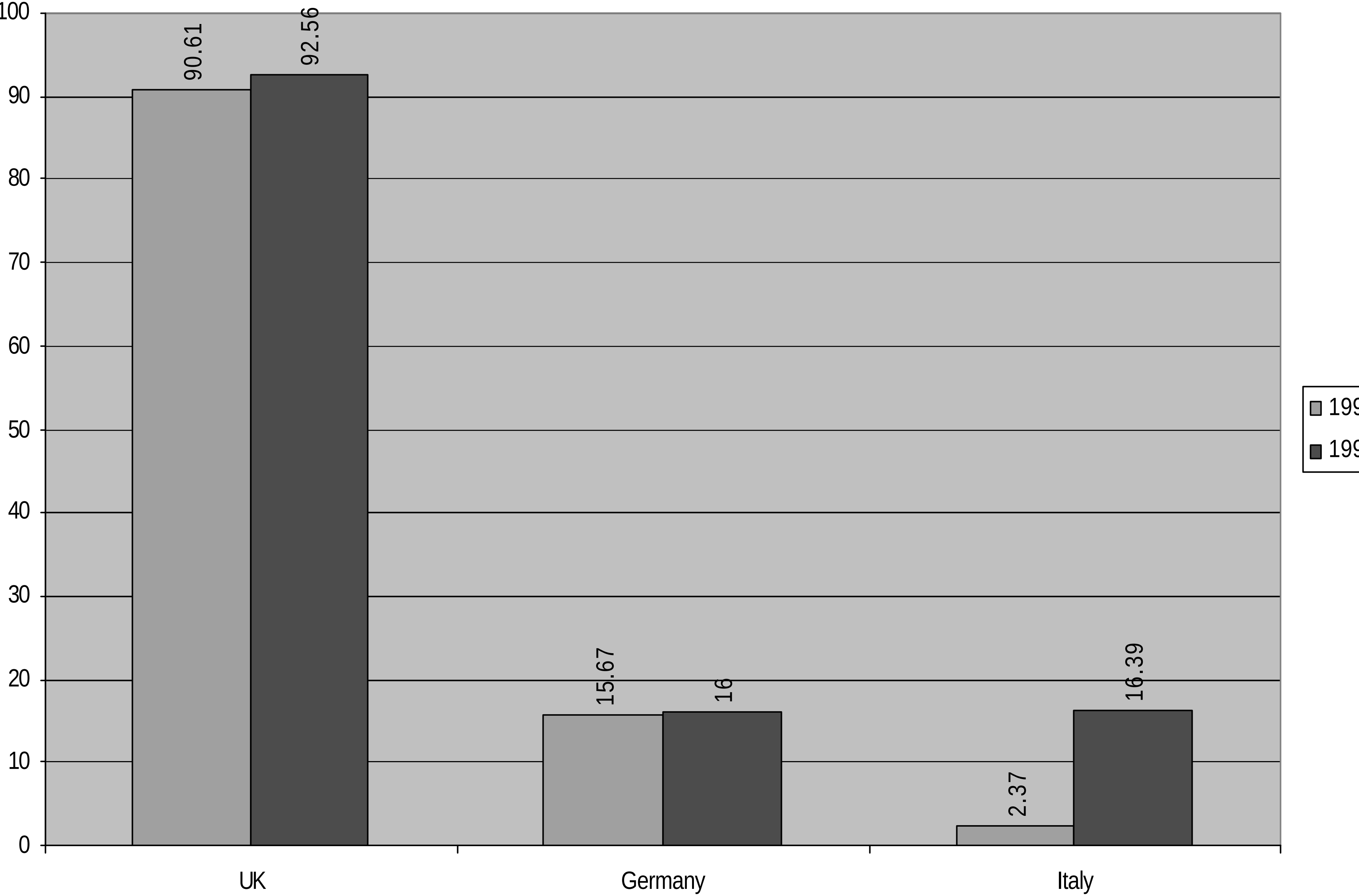
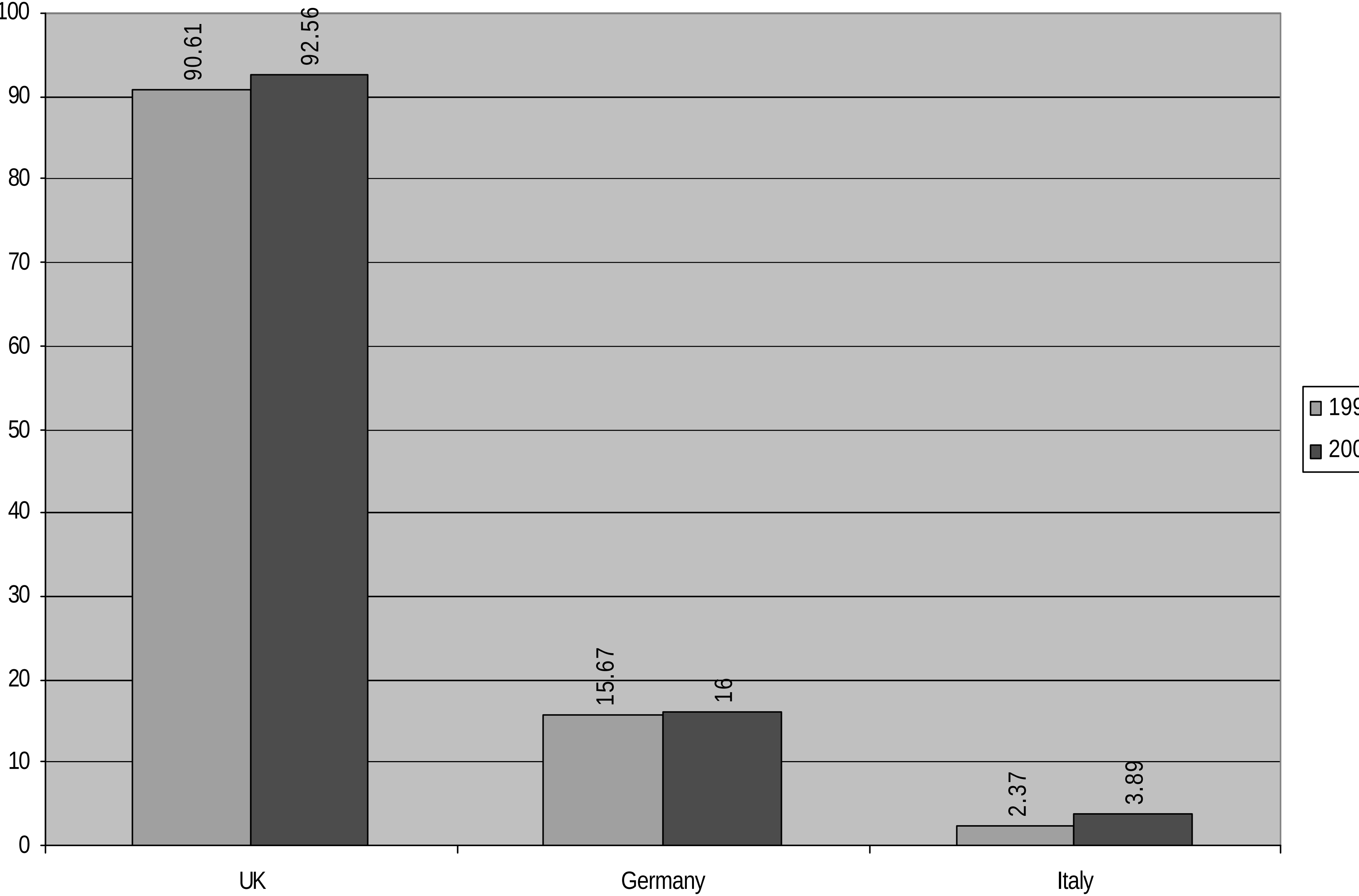


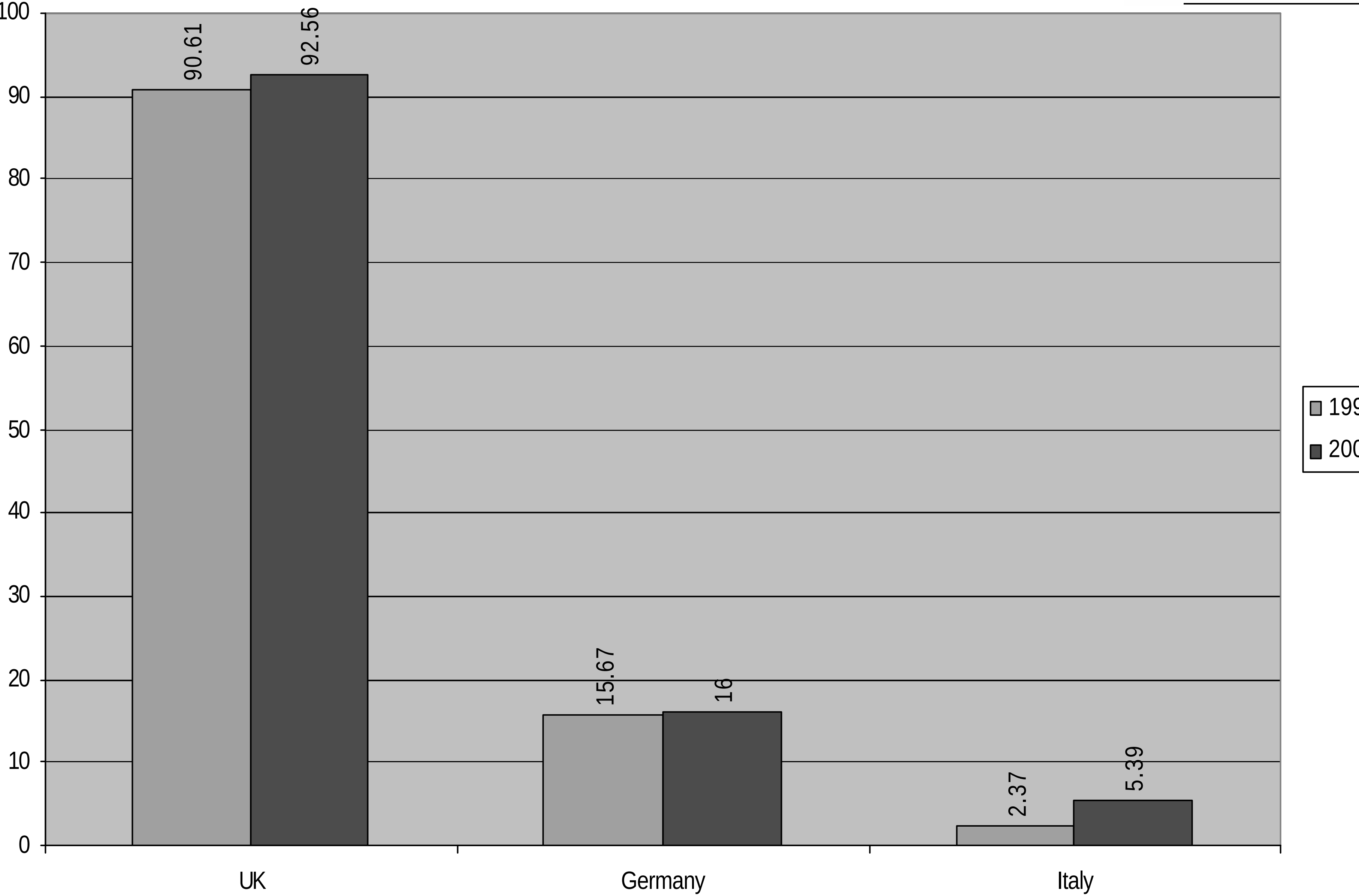
Pension Fund Assets as a percentage of GDP (including all the stock of TFR for Italy)



Pension Fund Assets as a percentage of GDP (including the TFR flow of 1 year)

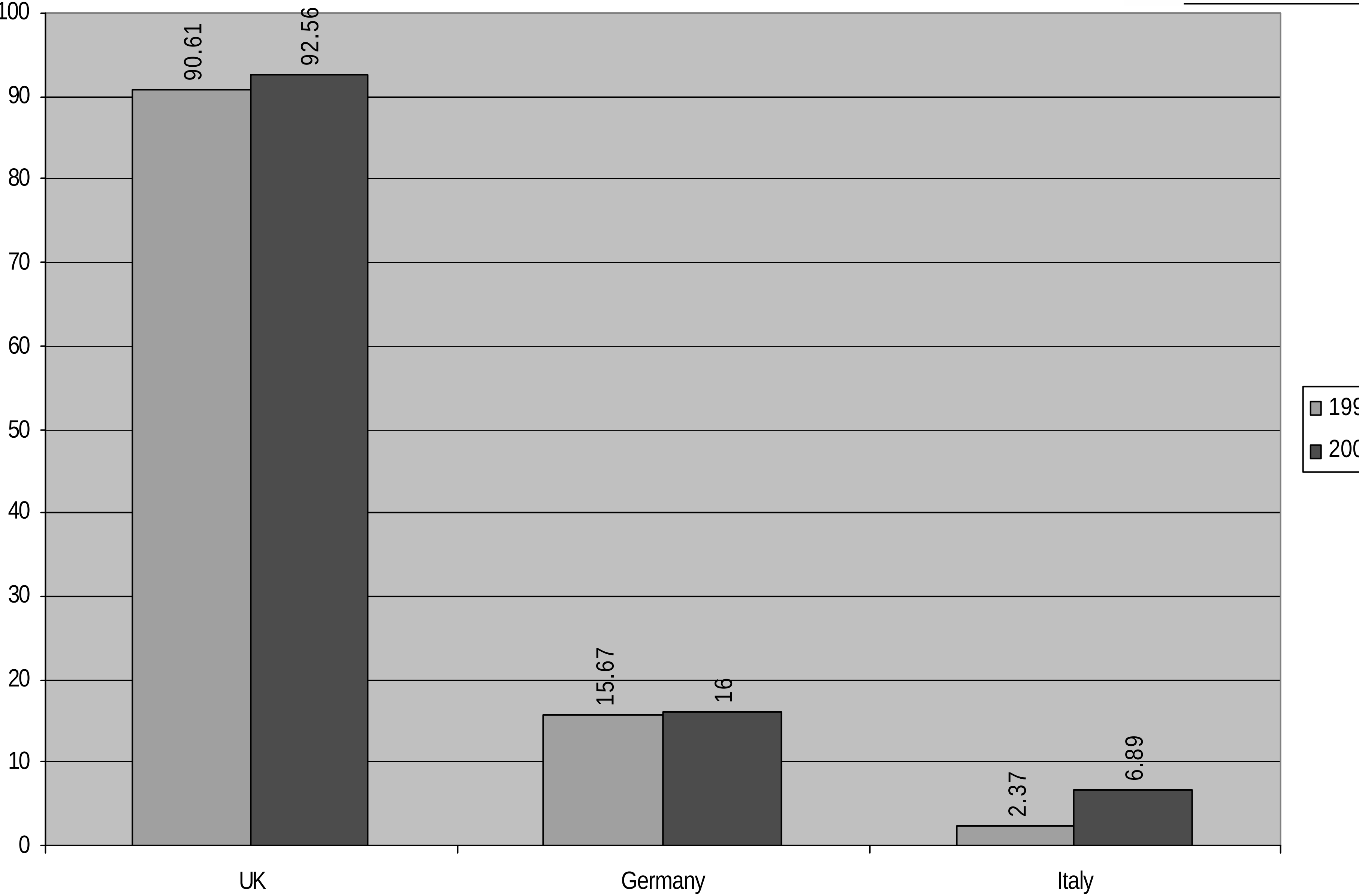


Pension Fund Assets as a percentage of GDP (including the TFR flow of 2 years)

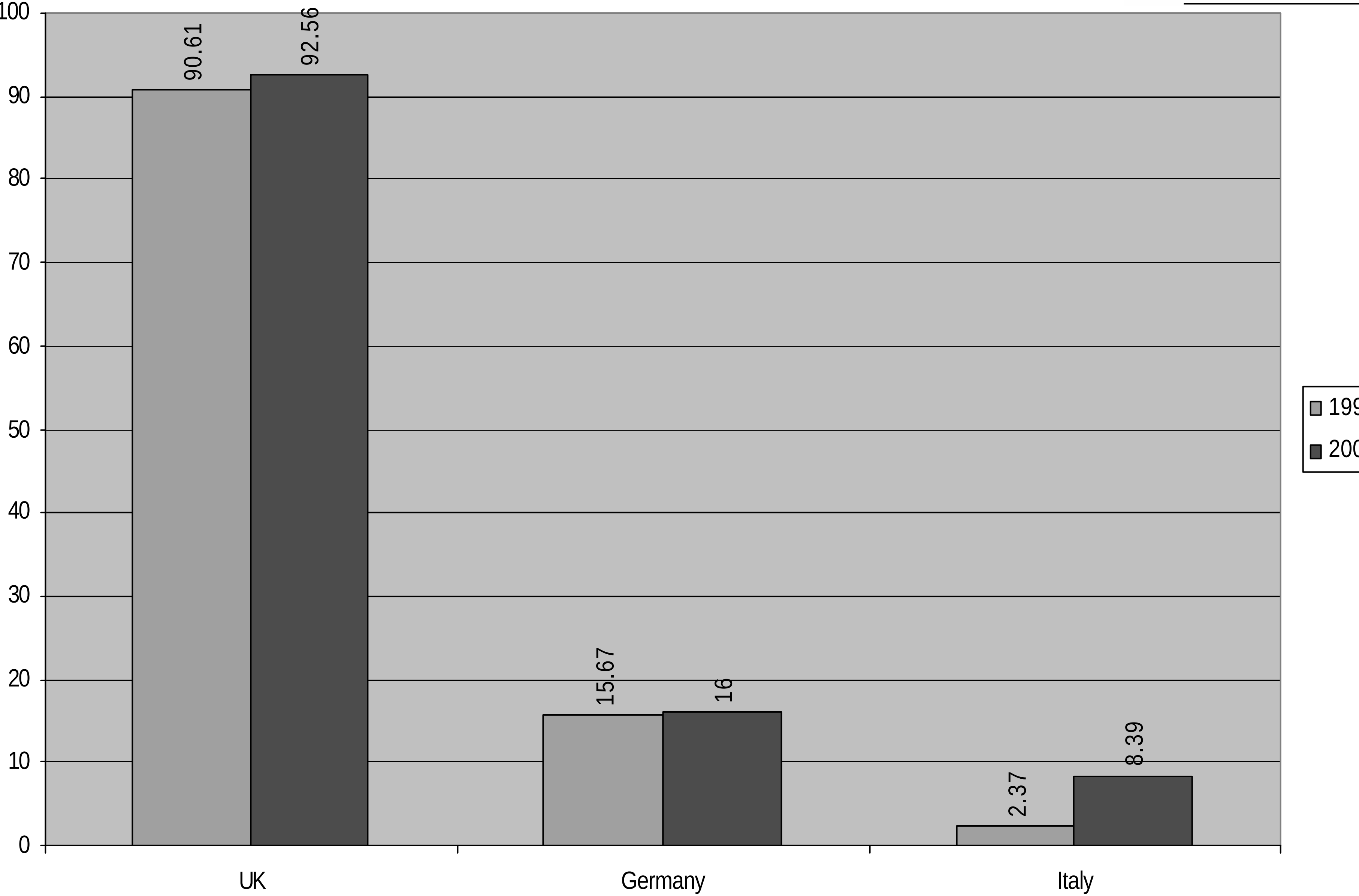


Source: EFR

Pension Fund Assets as a percentage of GDP (including the TFR flow of 3 years)



Pension Fund Assets as a percentage of GDP (including the TFR flow for 4 years)



Source: EFF

Contributions perceived as a tax

- Pensions crowd-out other social programmes (2/3 of social spending to pensions) and about ¼ of pension expenditure is non-contributory
- Still perverse intra-generational redistributions to the most unionised segments of the workforce
- Old system: weak link between contributions and pensions; likely not to be perceived as deferred wage, but as taxes
- Dini-cohorts: aware of unsustainability; even if system is closer to actuarial fairness, contributions may be still perceived as taxes.

Replacement rate by quintile

TABLE 1.1. Ratio of personal pension to personal income by quintile. (PPP amounts in 1996, all pensioners aged above 65)

quintile	Nordic Countries ratio	Continental Countries ratio	Anglo-Saxon Countries ratio	Southern Countries ratio	Italy ratio
1	0.893 (400)	0.906 (1163)	0.928 (417)	0.912 (1188)	0.944 (462)
2	0.856 (368)	0.929 (1129)	0.865 (434)	0.931 (1170)	0.929 (478)
3	0.818 (322)	0.926 (1046)	0.832 (410)	0.911 (1120)	0.915 (406)
4	0.809 (298)	0.899 (995)	0.762 (366)	0.913 (1046)	0.886 (364)
5	0.662 (273)	0.780 (965)	0.702 (309)	0.815 (966)	0.819 (347)
Total	0.785 (1661)	0.867 (5298)	0.793 (1936)	0.880 (5490)	0.889 (2057)

Sample sizes in parenthesis

quintiles are computed on the basis of total equivalised disposable income

Nordic Countries: Finland, Denmark, Netherlands, Sweden

Continental Countries: Austria, Belgium, France, Germany

Anglo-Saxon Countries: United Kingdom, Ireland

Southern Countries: Greece, Portugal, Spain

ECHP - wave 4 (income data refer to 1996)

Moreover young (under NDC rules) are aware of unsustainability

- fRDB survey: 75% of individuals aged 35 and less (Dini cohorts) believe that the pension system will undergo a major crisis in the next 10-15 years (vs. 65% for the whole population)
- those working are also better informed about the actual costs of the system (at least they know the amount of their contributions)
- they know that it is a PAYG system, while parents thought of having an individual account

An ageing median voter

Year	Median voter's age
1992	44
2002	46
2006	47
2012	49
2022	53
2032	56
2042	57

The Tremonti Reform

2004-2008

- “Super-bonus” for those staying longer (32,7% tax-free)
- Higher contributions for some
- Taxation of “golden pensions”
- “Certification” of entitlements for those postponing retirement

2008 onwards

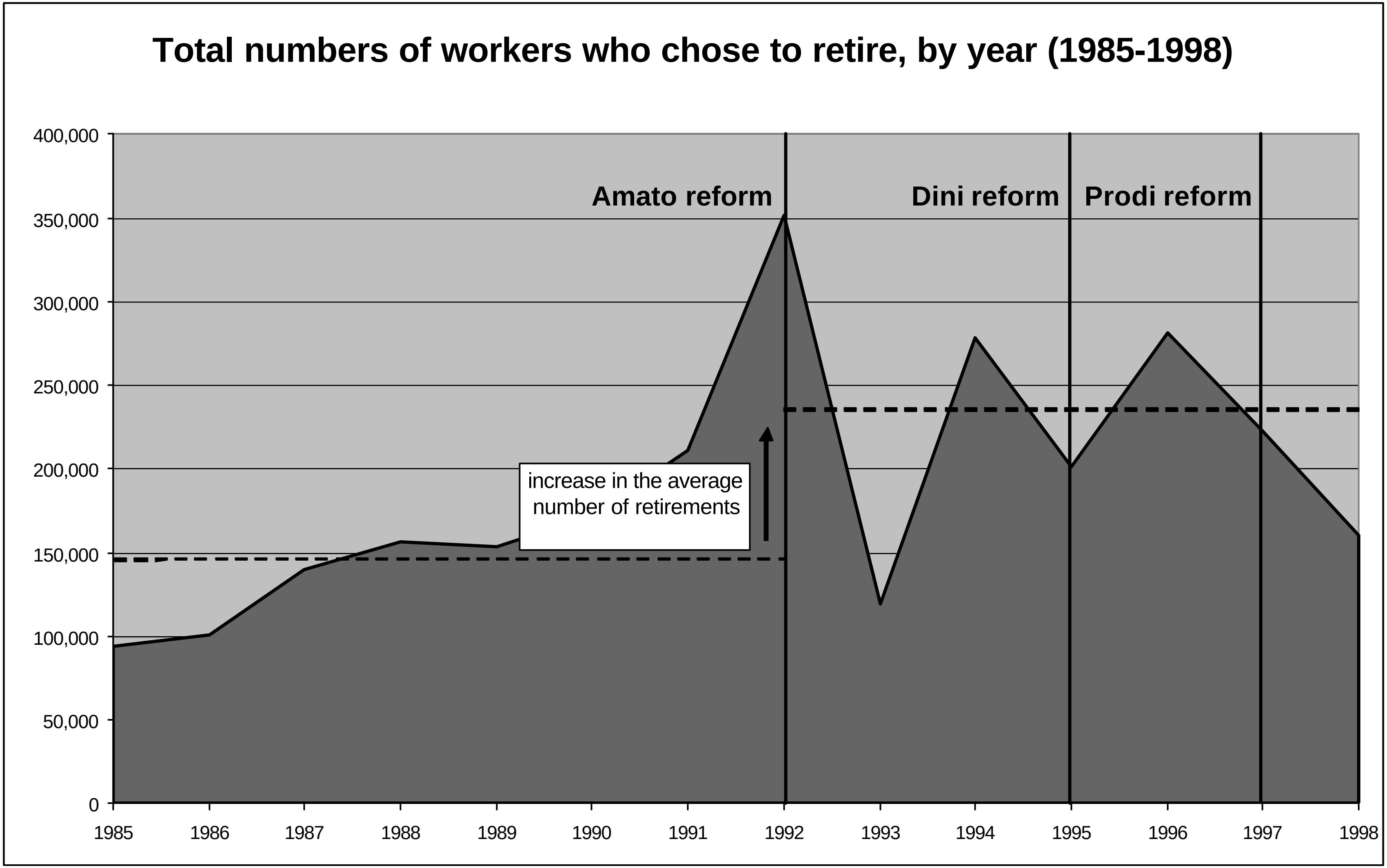
- Closed one of the two “windows” for seniority pensions
- Minimum contribution record raised to 40 years (from 35)
- Bringing effective retorement age to 62-63 (from 59)
- In one night!

Before 2008: the “super-bonus”

Earnings of a male worker aged 57 with 35 years of contributions which keeps on working, according to the new law instead of the old one: values given for every 100 euros of annual gross wage						
		Postponement of Retirement (years)				
		1	**2**	**3**	**4**	**5**
Marginal Rate (once retired)	**23%**	-13,7	-24,6	-32,6	-37,8	-40,2
	29%	-10,1	-17,6	-22,5	-24,8	-24,5
	31%	-8,9	-15,3	-19,1	-20,4	-19,3
	39%	-4,1	-6,0	-5,6	-3,1	+1,64
	45%	-0,5	+1,01	+4,49	+9,93	+17,33

Sandro Gronchi, www.lavoce.info

The “announcement effect”

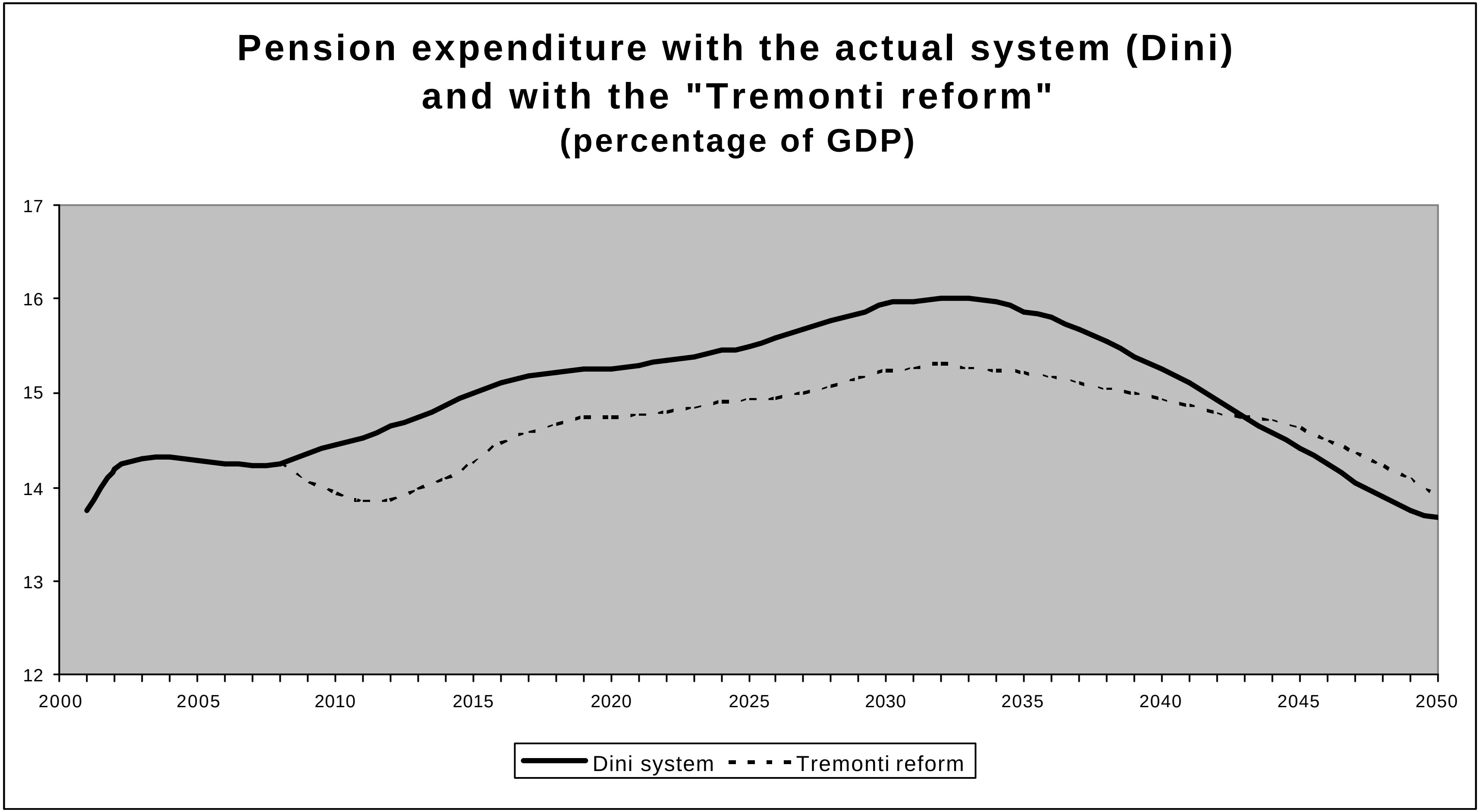


Source: fRDB – CeRP calculations on LABOR – Inps data

After 2008

Year	INPS (Private Sector) Age and years of contribution	INPS-(Private Sector) Only years of contributions	INPDAP (Public Sector) Age and years of contribution	INPDAP (Public Sector) Only years of contribution	Self-employed Age and years of contribution	Self –employed Only years of contribution
1998	54 and 35	36	53 and 35	36	57 and 35	40
1999	55 and 35	37	53 and 35	37	57 and 35	40
2000	55 and 35	37	54 and 35	37	57 and 35	40
2001	56 and 35	37	55 and 35	37	58 and 35	40
2002	57 and 35	37	55 and 35	37	58 and 35	40
2003	57 and 35	37	56 and 35	37	58 and 35	40
2004	57 and 35	38	57 and 35	38	58 and 35	40
2005	57 and 35	38	57 and 35	38	58 and 35	40
2006	57 and 35	39	57 and 35	39	58 and 35	40
2007	57 and 35	39	57 and 35	39	58 and 35	40
2008…	57 and 35	40	57 and 35	40	58 and 35	40
Tremonti reform”	---	40	---	40	---	40

Estimated effects on pension expenditure (Treasury)



Not simple acceleration of transition

- With Dini minimum contribution record was 5 years; now raised to 40 years
- With Dini flexible retirement age for men and women: 57 to 65; now different age limits for men and women (65 and 60)
- However (temporary measure) NDC could be *fully* applied to those who decide, after 2008, to retire using the 57-35 window (administration is not equipped for this task)

Summary

- Italy has dealt with the long-term, not with the short-term, namely with seniority pensions
- Need to accelerate transition to NDC
- Tremonti reform postpones to 2008 the reform, may well increase the pension deficit before that date, and departs significantly from actuarial fairness (NDC).

….moreover

- Political risk of derailment of the reform itself:
  - 2005 new “verifica”
  - 2006 political elections
  - 2007 another “verifica”….

  and in 2008 median age of the political voter will be 48

- If so will we have just the “announcement effects”?