Country Report

ITALY

Current pension system: first assessment of reform outcomes and output

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The Institutional Architecture

Since the early 1990s, the Italian pension system comes close to what may be labelled ‘permanent reform’. The traditional, Bismarckian PAYG system, which was completed in 1969 (all funded elements were suppressed) witnessed five reforms in less than two decades: 1992-1993 Amato reform, 1995 Dini reform, 1997 Prodi reform, 2003-2004 Maroni-Tremonti reform and 2006-2007 reform under the Prodi II government. The extremely fragmented, inequitable and fiscally unsustainable system (the first pillar is divided in 50 schemes) has been fundamentally modified in order to: i) render it financially sustainable; ii) increase horizontal equity; iii) tighten eligibility rules; iv) strengthen the contribution-benefit link; iv) diversify risk by introducing a multipillar architecture; v) spur private savings through supplementary schemes. Notwithstanding all the efforts, the first pillar has design flaws, fiscal sustainability is not assured, the coverage of supplementary pensions is patchy, certain categories are inadequately protected. (The fact sheet will relate to rules entered into force in July 2009.)

The **first (state and mandatory) pillar** includes two tiers. The zero tier, introduced in 1995, is basically a social pension (having some Beveridgean features), which ensures a minimum level of income for the elderly. The social check (*assegno sociale*) is granted to any resident in Italy older than 65 who does not have a sufficient contributory record to be entitled to a public pension. The benefit is means-tested and the income threshold for individuals in 2009 is equal to EUR 5,317.65 per year. The *assegno sociale* amounts to EUR 409.05 per month for 13 months.

The first tier covers all employed people, it is earnings-related, financed through social contributions on a pay-as-you-go basis. It covers old-age, disability and survivorship risks. The 1995 Dini reform fundamentally changed the calculation formula by introducing a Notional Defined Contribution system for new labour market entrants (and pro rata for workers with less than 18 years of contributions). This supplanted the extremely favourable defined-benefit calculation formulae for old-age pensions (for public employees based on last-year calculations before parametric changes in 1992-1993) and also so-called seniority pensions, which allowed some categories of public employees to retire after contributing for as few as 20 years. The system is still PAYG, but contributions flow into virtual individual accounts, which are the indexed to the 5-year average of GDP growth. At retirement, the accrued amount is converted through a coefficient related to age – revised every 10 years – into an annuity, which is then indexed to the Consumer Price Index. The are differences between paid and imputed contribution rates. These vary by occupational sector: 32.7% for private employees (8.91% for employees and 23.81% for employers), 32.95% for public employees (8.75% employees and 24.20% employers). Both are imputed 33% on their accounts. The self-employed pay 19% and earn 20%. The contribution rate for *parasubordinati* (particular categories of employees having atypical fixed-term contracts) vary and the difference between the real and virtual contributions are even greater. Eligibility for old-age pensions is a minimum contribution period of 5 years and age 60/65 for women/men in the private sector and 65/65 in the public sector, due to the ECJ sanction against Italy (on discrimination grounds) in November 2008. Women have the right to continue working until 65. All can retire later, but the conversion coefficients stay the same, which is a big disincentive. Eligibility conditions or seniority pensions (abolished for new workers) are being tightened and are a sum between age and contribution years (minimum 35), i.e. 95/96 in 2009 for employees and self-employed, 96/97 in 2010-2012 and 97/98 since 2013.

There are, however, serious flaws in the NDC self-equilibrating mechanisms, implying that neither macro stability nor micro incentives are guaranteed. In particular, the effective and imputed contribution rates create disequilibria, the self-equilibrating mechanisms have not been specified, indexation to GDP growth is problematic, the contribution rates for disability and survivor pensions are not separated.

Finally communication on the new retirement rules was always insufficient. The NDC formula will substantially decrease replacement rates and the purchasing power (with respect to wages) of continuing pensions will decline with price indexation. Both will lead to poverty in old age if people do not contribute longer and have supplementary pensions. An additional problem are the seniority rules ingrained in Italian salary structures. These discourage the employment of elderly workers, hence, neither the effective retirement age nor the contribution period will fall in line with the new expectations. Finally, holders of atypical contracts (*parasubrdinati*) are the least protected of all: their imputed contribution rate is too low and they do not get pension credits for unemployment periods.

The **second pillar** consist of supplementary occupational schemes that can take one of two forms: closed occupational pension funds (managed by social partners) and open pension funds in case of collective affiliation (managed by financial institutions). The former plans had 2,048 million members as of June 2009, the latter 806 thousand. They accumulated together assets worth almost EUR 21.5 billion. Supplementary funds use defined contribution formulae for dependent workers and also defined benefits for self-employed. There are tax incentives for participants. The schemes are Exempt-Taxed-Taxed and contributions are deductible up to 12% of total income, or to maximum EUR 5,164.57. The retirement age as well as contributory requirements are the same as in the first pillar. In addition, as part of the second pillar there is a severance pay, the *Trattamento di Fine Rapporto* (TFR), which is financed by 6.91% of contributions on gross wages. The accrual rate is 1.5% per year plus 75% of the inflation rate. After various reforms, the TFR is through a silent-consent formula being transferred to private schemes and used as an institutional gate to spur supplementary pension provision. This was not appreciated by employers, which used the TFR as a cheap source of internal financing.

The problems in the second are related to the labour market structure. Mainly employees in private medium and large enterprises are insured and they decided to transfer the TFR to supplementary schemes. Small enterprises, the self-employed and the public sector are almost totally excluded. Additionally, atypical workers have too meagre salaries to participate and they do not have the right to the TFR. Hence, the occupational, private component of the Italian pension system reflects an increasingly two-tiered labour market and will, through the lack of coverage, favour poverty in old age.

Finally, the **third pillar** consists of voluntary, supplementary pension schemes, the so-called *Piano Individuale Pensionistico* (PIP), as well as open funds for individual affiliation. Both are managed by financial institutions. The TFR can be voluntarily transferred and the tax advantages as well as eligibility conditions are similar to the second pillar. They are mainly defined contributions. In June 2009, there were 777 thousand PIPs, which accumulated EUR 2.75 billion in assets.

Information needs

The information needs of participants were in Italy handled with very poorly. The government(s) has not undertaken any extensive effort to explain the functioning of NDC and only recently have individuals been receiving a statement of their contributory account presenting their future pension entitlements. There is some lack of clarity about the way the system works. No official document has explained the working of the new system, the formula underlying the conversion coefficients has not been officially published, and the methodology envisaged for the revision of the coefficients has not been specified. Hence, the lack of discussion and explanation did not significantly change the microeconomic incentive structure.

The Administrative Structure

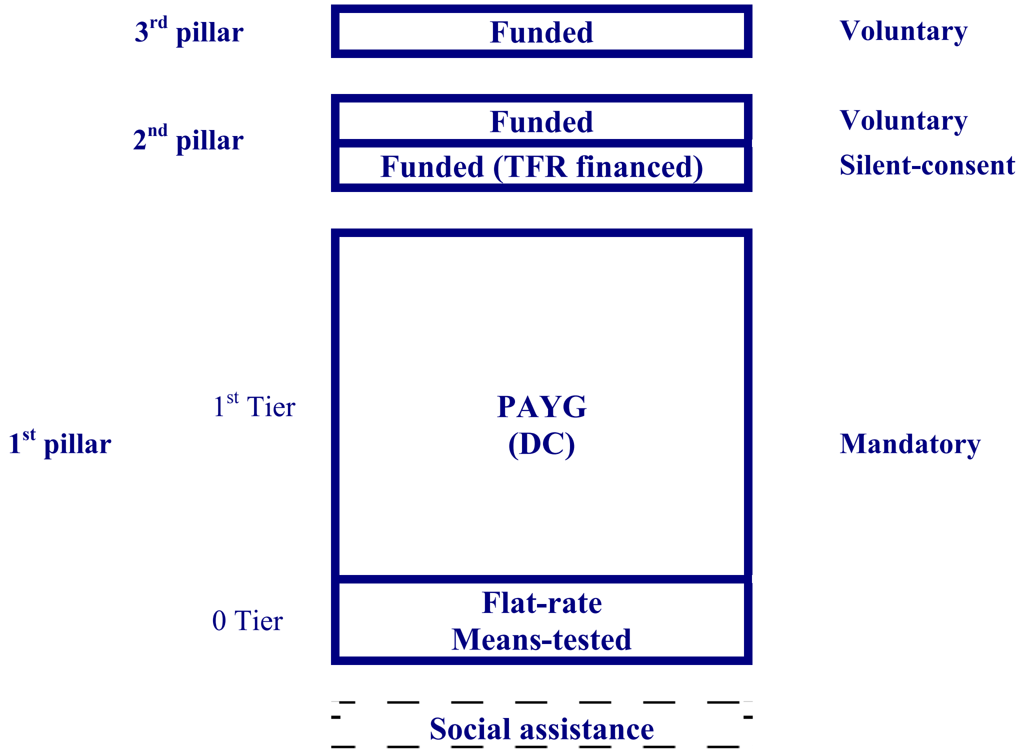
The Ministry for Labour, Health and Social Policies is responsible for legislation. The administration of public pension schemes is particularly fragmented, but most of the schemes are administered by the social security institution for the private sector (*Istituto Nazionale per la Previdenza Sociale*, INPS). This is divided into 4 major pension schemes (which are slowly being harmonized): employees – *Fondo Pensioni Lavoratori Dipendenti* (FPLD), farmers – *Gestione coltivatori diretti, mezzadri e coloni,* artisans *Gestione degli artigiani,* merchants – *Gestione degli esercenti attività commerciali*. INPS accounts for two thirds of public spending and covers the majority of private employees and the self-employed. Public employees are covered by a different institution, the national body for the public sector (*Istituto Nazionale di Previdenza per i Dipendenti dell'Amministrazione Pubblica, INPDAP*). There are various special schemes for small occupational groups. As for the management, the pension fund board appointed by the government and social partners' representatives have a role of supervision, *de facto* participating in their administration in all these institutions.

Assessment and Future Challenges

Even though the continuous reform increase the financial stability of the system, strengthened the incentives to retire later and rendered all schemes more homogeneous, there are several problems that need to be tackled. There are still negative fiscal prospects for Italian public pensions, especially due to the very slow phasing in of the new system. This should be accelerated. The differential retirement age between men and women should be equalized. The design flaws of the NDC formula should be fixed.

Finally, in order to lessen the possibility of poverty in old age, the coverage and development of supplementary pensions should be drastically increased. The introduction of the NDC system will reduce average replacement rates. While this will have a minor impact to employees in a Standard Employment relationship, the effects for workers holding atypical contracts will be detrimental. Pension credits and more homogeneity in treating various working categories should be a priority.

Figure 1 The Main Pillars in the Italian Pension System



1st Pillar, universal coverage (0 tier tax-financed, 1st tier public and contribution-financed);
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in Italy

Contribution rates	**Private employees**	**Public employees**
Total (1st pillar)	**32.70%**	**32.95%**
Employees	**8.91%**	**8.75%**
Employers	**23.81%**	**24.20%**

Supplementary schemes	
Contribution rates	**6.91% in case of TFR, plus minor contributions by employees and employers**
Coverage (of employees)	**13%**
Assets in EUR bln (2007)	**57.77**
Taxation	**Exempt Taxed Taxed**
Investment principles	**Quantitative restrictions and Prudent Person Principle**

Theoretical replacement rates	**Gross**			**Net**
	1st pillar	**2nd pillar**	**Total**	**Total**
2005	**78.9**	**0.0**	**78.9**	**87.8**
2050	**64.1**	**15.5**	**79.7**	**92.0**

SILC income 2004	**Total**	**Male**	**Female**
Relative income of 65+	**0.844**	**0.871**	**0.835**
Aggregate rep. ratio	**0.583**	**0.639**	**0.492**

Eligibility retirement age	
Old age	**60 for women and 65 for men in the private sector 65 for both women and men in the public sector**
Seniority	**Sum between age and contribution years (minimum 35), i.e. 95/96 in 2009 for employees and self-employed, 96/97 in 2010-2012 and 97/98 since 2013**

Indexation	**Prices**

Public pension spending (as % of GDP)	**2004**	**2020**	**2050**
	14.2	**14.0**	**14.7**

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