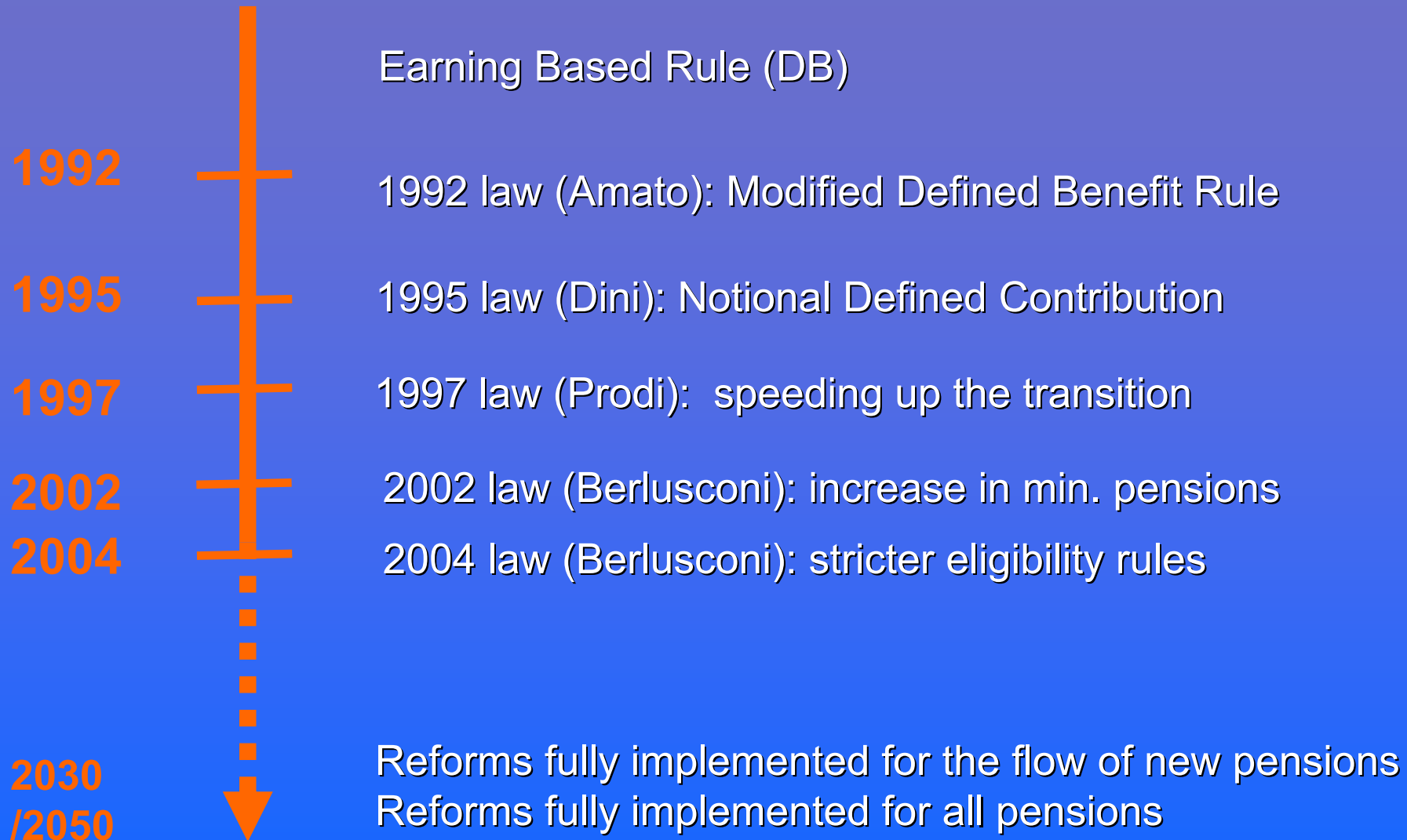


The Italian Pension Reform and Pensioner Poverty Prevention

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Pensioner Poverty Conference, 4-5.12.2006, Helsinki

The Italian pension reform: a very slow and gradual process



The PAYG earning-based system: social protection and redistribution

Right objectives:

- To maintain the relative position of the elderly with respect to the young (pensions indexed to wages)
- To reduce poverty risk among the elderly
- To protect disadvantaged categories (e.g. widows)

But :

- Is the instrument appropriate? (social security contributions vs. taxation)
- The system allows for disparities of treatment, privileges and iniquities

The wrong redistribution

- ✓ favoured by the fragmentation of the system, which reduced transparency
- ✓ to the advantage of
 - steeper earning profiles (typically associated to richer careers)
 - more influential categories (public employees,..)
- ✓ to the disadvantage of future generations who bear the burden of a higher pension debt, due to excessively generous rules for present pensioners

The new contribution based formula

- ✓ Implies a clearer distinction between insurance against longevity risk (which is the core business of a pension system) and assistance towards the less fortunate members of society
- ✓ The basis for pension calculations is actuarial fairness
- ✓ In principle, the distribution of pensions mirrors the distribution (inequalities) of lifetime earnings
- ✓ In practice, various interventions can correct this on the ground of some concepts of social justice

Maintaining assistance features in the public system

- ✓ Recognition of notional contributions (for maternity leaves, care periods and so on), paid for by the general budget
- ✓ Social allowances (financed through taxation) in favour of low income categories
- ✓ Family ties can be recognized through survivors' and other supplementary benefits, incorporated in the transformation coefficients
- ✓ Compensation to more hazardous occupations (to accommodate the differential mortality rates)

Open issues

1. Pension indexation to prices only

- ✓ Is it a real problem?
- ✓ The first pension is higher than in the case of indexation to wages (which explain the political appeal)
- ✓ but... the purchasing power is kept at the initial level in real terms
 - Pensions with different purchasing power coexist
 - Government pressed towards *ad hoc* corrections
(introducing a potential flaw in the actuarial mechanism)

Open issues

2. The pensions of the new generations

The new flexibility in the labour market (i.e. atypical workers):

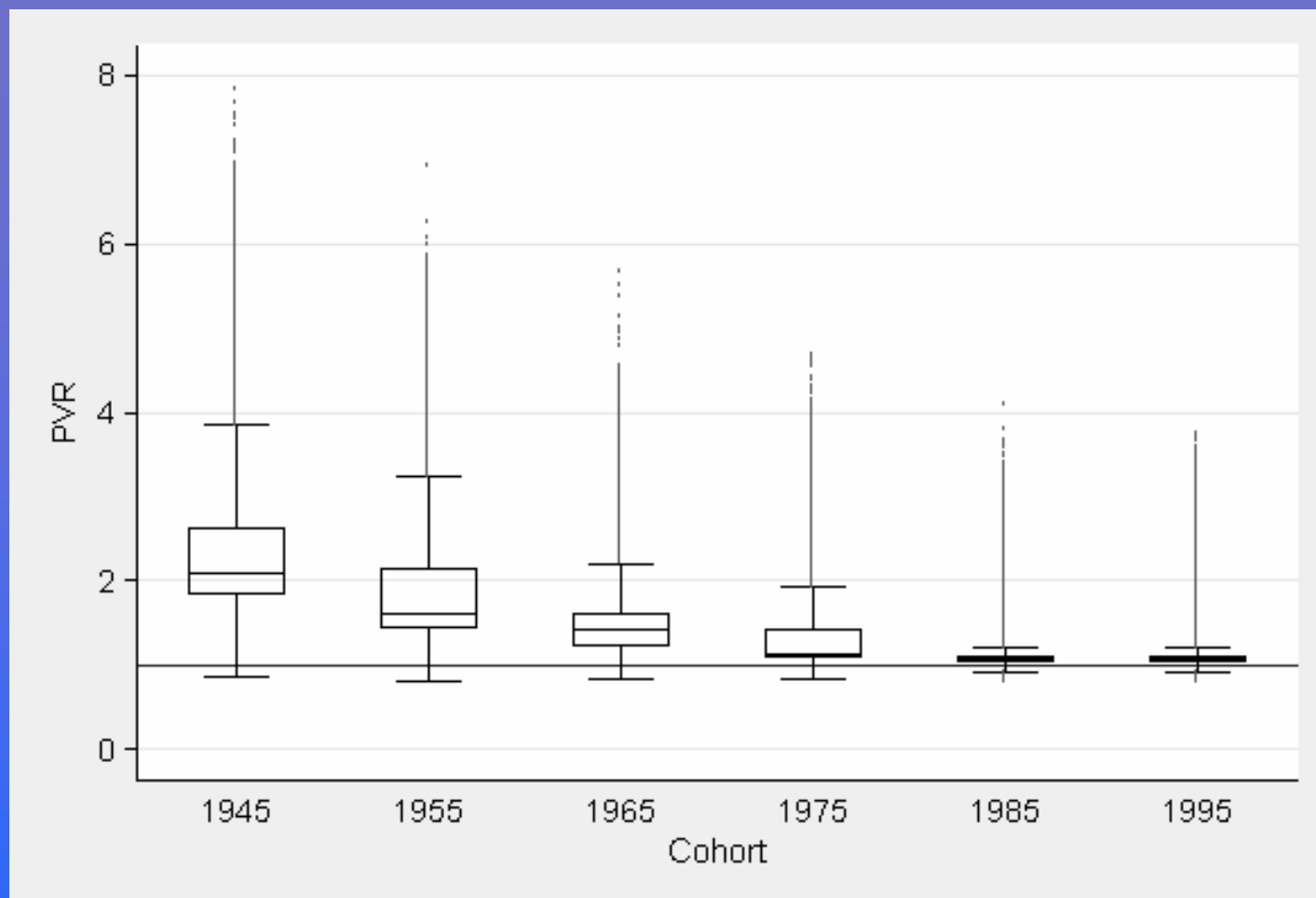
- ✓ more flexible and shorter term contracts
- ✓ lower wages (with consequent lower saving possibilities)
- ✓ lower payroll tax rate (with a consequent pension benefit under the income level)

The problem is the income level and the continuity of careers, but this is a labour market problem and therefore goes beyond the pension system's objectives

Comparing past and future redistributive patterns of the Italian pension system

- Through CeRPSIM micro-simulation model, we have analyzed the redistribution both between and within cohorts, considering the whole transition period and the new “steady state”
- Simulated cohorts : 1945 to 1995 (with a ten year gap)
- Main conclusions
 - by ensuring uniformity of treatment among different categories of workers, the new system dramatically reduces both the perverse and the “virtuous” redistribution of the past.
 - The first effect is certainly positive; the second stems from the aim to separate the insurance from the assistance goal of the pension system, in order to improve its transparency.

Inter – Intra generational redistribution: PVR at retirement



Note: each box shows the interquartile range (IQR) of the PVR, i.e. the 25th and the 75th percentile. The line in the middle of the box represents the median. The lines emerging from the box extend to the upper and lower adjacent values (defined respectively as the largest point smaller than or equal to: 75th percentile+1.5*IQR; the smallest point greater than or equal to: 25th percentile-1.5*IQR). Outside points are individually plotted.

Source: Borella, M. and F. Coda Moscarola, "Distributive Properties of Pensions Systems: A Simulation of the Italian Transition from Defined Benefit to Defined Contribution", WP CeRP 42/05

Inter – Intra generational redistribution the Reynolds-Smolensky index

Cohort	Reform					
	Pre-1992	1992	1995	1997	2002	2004
1945	-	0.004	0.004	0.004	0.007	0.007
1955	-	0.014	0.008	0.008	0.012	0.015
1965	0.04	0.013	0.005	0.005	0.016	0.016
1975	0.039	0.022	0.01	0.01	0.024	0.023
1985	0.042	0.023	0.001	0.001	0.01	0.006
1995	0.045	0.025	0.001	0.001	0.01	0.005

Note: the Reynolds-Smolensky index is the difference between the Gini coefficient of lifetime income under a hypothetical actuarially fair system and under the actual system. The higher the index, the higher is the redistributive impact of the reform.

Source: Borella, M. and F. Coda Moscarola, “Distributive Properties of Pensions Systems: A Simulation of the Italian Transition from Defined Benefit to Defined Contribution”, WP CeRP 42/05

Replacement Rates by categories (%)

	Self-Employed		Employee	
	Male	Female	Male	Female
<u>cohort 1955</u>				
RR	79.10%	80.90%	70.70%	72.80%
YoW	34.9	34.3	36.5	35.2
<u>cohort 1965</u>				
RR	48.70%	49.20%	62.20%	64.60%
YoW	34.6	33.5	35.8	33.3
<u>cohort 1975</u>				
RR	39.70%	39.20%	52.30%	59.30%
YoW	33.8	33.7	34.5	33
<u>cohort 1985</u>				
RR	34.50%	33.60%	48.60%	57.50%
YoW	33.2	33	33.9	33.7

Legenda: RR=replacement rate; YoW=average years of work

Conclusions

- The contribution method, although remaining the main pillar of the system, is coming increasingly under attack by category interests
- It must be defended because it can accommodate notional contributions for workers temporarily out of work and/or engaged in socially relevant activities (children and elderly care)
- More hazardous jobs (with hazard based upon statistical evidence) deserve early retirement provisions and must be dealt with separately
- Social allowances and social services (paid for by progressive general taxation) are called for to cope with elderly poverty
- The temptation to return to use of pension system as a redistributive tool should be resisted