Report on national strategies for future pension systems (ITALY 2002)

(September 2002)

Introduction

Population ageing and its consequences affect every country in Europe. Although based on a common strategic framework, the solutions to such problem must be appropriately calibrated to national realities, taking into account that national pension systems are based on the traditions and on the welfare system each country has chosen to implement. With this aim, and fully respecting the principle of subsidiarity and the national prerogatives on this matter, the EU countries at the Stockholm and Goteborg European Councils agreed to use the open method of coordination outlined at the Lisbon European Council to compare the solutions to ageing outlined by each country and qualify the relative welfare policies. Due to the intrinsically perspective nature of such matters and of the actions each country believes and/or will believe are needed, at the Laeken Council EU countries agreed to write a Report on national strategies for the future pension systems based on common objectives and working methods. This Report was written to describe the current and future situation in Italy; it deals with the main challenges and the strategic directions for past and future reforms. The Legislative and Statistical Appendixes are an integral part of this Report, which has taken into account guidelines draft by the Economic Policy Committee and the Social Protection Committee. In addition to providing information already produced through the pension expenditure monitoring activities (which are systematically and regularly carried out in Italy, and also covers the future evolution), the Statistical Appendix provides a number of statistical indicators - most of which have never been published before - that can be used for comparison with other European countries.

Consistently with the EU guidelines, the Italian Government intends to continue modernising the welfare system. This requires on the one hand, taking into account the need to guarantee financial and economic sustainability, facing the changes of the demographic framework and the more general effects of population ageing on public finances; on the other, ensuring that existing systems continue or become adequate to fulfil the social objectives on which European welfare systems are historically based.

The common element in these objectives is increasing the employment rate. This is a means of fulfilling the conditions for both financial sustainability and higher pensions. Furthermore, it is also associated - especially when focussing on employment for older people – with full participation of older people in social and economic life, which is in itself part of the objective concerning adequacy. The activity level of old people (also as an expression of active ageing) is, in fact, one of the fundamental parameters in the challenges employment policies are facing, not only in relation to extended participation on the labour market but also with reference to postponing retirement. The Council of Heads of State and Governments in Stockholm therefore set the objective for increasing the employment rate of people aged 55-64 at 50% on average throughout the EU and the Barcelona European Council subsequently proposed increasing the retirement age by 5 years (on average throughout Europe), in accordance with the objectives set for increased employment by 2010. There is an obvious link between sustainability and modernisation of the pension system, economic trends and employment rates. A higher employment rate ensures that welfare costs can be spread over a wider range, whereas low contributions can lead to increased employment. This is why appropriate labour and development policies are so important, as are the structural reforms the Italian Government proposed to the Parliament. The “heavy” solidarity models inherited from the past are often inadequate to deal with the current hierarchy of needs and to guarantee that new social rights

are exercised - the reason behind the modernisation criterion. However, they are also insufficiently "proactive", in the sense that they hinder rather than help increase employment. In 1993, the Delors Report noted that "the high level of welfare costs is an obstacle to employment and has a dissuasive effect by encouraging substitution between capital and labour and the parallel economy - above all affecting employment in small and medium enterprises - and, finally, encourages de-localisation of investments and activities". Discouraging regular employment for older people and mobility, which may derive from welfare systems that encourage early retirement or hinder mobility - especially at the end of a career - must also be taken particularly into account. The objectives regarding modernisation for the welfare system pay particular attention to adapting such rules in order to comply with a changing labour market and improve mobilisation of financial resources set aside for welfare purposes.

However, the need to improve forms of protection *in* the market for more underprivileged workers is particularly important in a country such as Italy, taking into account a labour market undergoing extensive change and which should become more flexible and dynamic. For this purpose, resources incorrectly and often misleadingly used to cover insufficiencies in the welfare system should be progressively redirected. Indeed, new priorities in the field of social policies requiring funding are emerging also with regards to the specific segment of population which is composed by older people. Although old age is not generally one of the main factors causing a risk of poverty - which is mainly concentrated in other segments of the population -, there are specific segments of the older population - above all those living in southern Italy and people who are not self-sufficient or simply live alone - at high risk of social exclusion. In the future, longer life expectancy and changes in the family structure will mean that more old people are no longer self-sufficient.

The intrinsic perspective and long-term nature of welfare systems means that not only the current situation must be taken into account, but also demographic and economic trends. This nature – i.e. the fact that they affect the individuals' work and saving decisions throughout their lives - means that the reforms required must be prepared in time and implemented rapidly but gradually, avoiding a stop-and-go approach, or measures that do not allow individuals the time to adapt their behaviour, or that burden only some generation – the current or, as more often happens, the futures.

On this regard, the Italian pension system (both public-compulsory and private-complementary pillars) underwent rather incisive reorganisation during the Nineties[1]. Reforms involved harmonising regulations, overcoming privileges (beginning with those more singular) and gradually re-balancing the system, which also implied the start of a process of "risk sharing" between a reformed compulsory system, financed on a pay-as-you-go basis and apt to contain a more explicit solidarity-based component, and a a private, capitalisation-based, system, based on pension funds with individual or collective membership, that can efficiently mobilise financial resources earmarked for the purposes of retirement. Finally, the redistribution profiles of the system were reinforced through measures to improve lower pensions via public funding.

The reforms implemented helped avoid the system collapsing (without changes, the cost of pensions would have increased to 23.27% of GDP in 2040 - see Ministry of Treasury Document on convergence, January 1998). The peak is now forecast at 16% in 2033 (due to underlying demographic trends), with a subsequent drop to just under 14% of GDP when the new system becomes fully implemented. The savings planned with the reforms were promptly achieved - although with some small differences among the various areas involved - as certified by the Report from the Commission appointed to assess the affects of Law 335/1995, which was established for

[1] The following are particularly worth mentioning: Article 3 of Law 421/1992, Legislative Decree 503/1992, Article 11 of Law 537/1993, Paragraph II of Law 724/1994, Law 335/1995 - with relative provisions for implementation, Law 662/1996 and Law 449/1997.

this purpose last year, chaired by Under Secretary Alberto Brambilla. The total value of such savings for the period 1996-2000 reached Lit. 54,805 billion (Euro 28.30 billion), which was also due to the effects of further corrections and improvements implemented in 1997. The table below shows the progress made over the last decade, highlighing the effects of reforms on pension expenditure and the expected evolution over the next ten years.

Pension expenditure total and net of cost of living indexation (average of the annual variations in %)

	1990-2001	1990-1992	1993-1997	1998-2001	2002-2006	2007-2011
Total	7.3 (3.6)	12.2 (6.1)	7.3 (3.8)	3.4 (1.6)	4.0 (2.1)	3.7 (2.2)
Private employees	6.5 (2.9)	11.1 (5.1)	6.5 (3.0)	3.0 (1.1)	3.8 (1.9)	3.4 (1.9)
Public employees	*9.2 (5.6)*	*16.3 (10.2)*	*8.8 (5.3)*	*4.4 (2.5)*	*4.0 (2.1)*	*4.2 (2.7)*
Self employed	7.7 (4.1)	10.7 (4.6)	9.0 (5.5)	3.8 (2.0)	4.6 (2.6)	4.2 (2.7)
Of which:						
Craftsmen and shop owners	*11.1 (7.5)*	*14.0 (7.9)*	*12.7 (9.2)*	*6.8 (4.9)*	*6.8 (4.8)*	*5.9 (4.4)*
Others(*)	*9.4 (5.8)*	*16.4 (10.3)*	*10.2 (6.7)*	*3.2 (1.3)*	*5.8 (3.9)*	*3.7 (2.2)*

(*) includes professionals' and supplementary funds

N.B. the percentages in brackets net out from the effect of cost of living indexation.

Source: Nucleo di Valutazione della Spesa Previdenziale, 2002 Report.

Nevertheless, pension expenditure is still deeply linked to the overall trends in public finance. For example, in 2001 the gap between pension expenditure in the strict sense and social contributions was 0.8% of GDP, whereas an additional 2.2% of GDP was due to benefits that, although included in the pension expenditure, are classified by the laws as having the nature of social assistance and are consequently financed through general taxation. Indeed, according to the Nucleo di Valutazione della Spesa Previdenziale (NVSP) estimates, an economic growth of 2-2.2% on average per year is required over the current decade to stabilise the pension expenditure at current levels, which is certainly possible and also in line with the forecasts made for Italy regarding potential growth by the European Union. However, there is still much to do in the future to face the challenge posed by demographic ageing processes. As this Report goes on to explain, longer life expectancy - both at birth and on retirement - will cause increased dependency together with to a fall in the overall population. In fact, the ratio between old people and people of working age was just over 1/4 in 2000 and is expected to approach 2/3 by mid-century.

The transition stage set forth in current laws is rather long under many aspects. The maintaining of the past levels of generosity for the generations approaching retirement, if, on the one hand, complies with the needs for gradual change that must undoubtedly be taken into account when planning changes to the pension system, on the other may cause problems in fairness between generations and affects control over spending. Looking to the future, spending for pensions, which absorb almost 2/3 of all social protection expenditures, may not remain untouched by the need to fulfil the objectives of re-modulation of the expenditure towards new social needs and of reduction of the weight of taxes and contributions aimed at encouraging economic and employment growth.

Above all, the complementary pension funds pillar of the system remain to be fully developed, as it now only involves a small, although important, segment of the labour force, whereas it should contribute significantly to supporting the income levels of pensioners in the future. However, merely developing the complementary pension funds pillar cannot guarantee the reaching of the objective of adequacy of pensions. In the long term, income deriving from this source will undoubtedly be substantial - the negative results achieved over the last few years not being

representative of the long term performances of pension funds -, however it would be imprudent to assume returns so high that a public pillar based on pay-as-you-go funding is no longer needed (especially in consideration of the well known problems involved in funding the transition which would otherwise come to light). Outlining a mixed system - involving pay-as-you-go and capitalisation elements - is therefore considered a fundamental strategic option to combine the various objectives of the overall system and diversify the implicit risks in each of the two system's components.

Furthermore, increasing the effective working life and, more generally, rising the employment rate are essential both in order to fulfil the objective of adequacy of pensions and to reasonably limit the burden on the economy of the financing of the overall pension system. Taking into account the current legislation, whereby the pension system is to gradually shift from the so-called earnings-related calculation system to the so-called contribution-based system (see Legislative Appendix), these increases would above all guarantee fulfilling the objectives of sustainability over the next few decades and of adequacy over the subsequent decades, when, the contribution-related system becoming fully operational, its mechanisms ensuring financial auto-regulation will make unitary payments increasing with the number of years of work and decreasing with the remaining life expectancy at retirement.

A number of legislative actions regarding the age requirements and the minimum contribution period at retirement – yet with an earning-related pension system applying to the generations approaching retirement - already appears to have led to an initial, though timid, inversion in the trend for early retirement. One of the current priorities is improving this tendency, through effective incentives and other measures and generally focussing labour policies to encourage employment for old people. Special attention appears necessary with regards to the phenomenon of jobs in the shadow economy, which is particularly relevant for pensioners. There are many reasons for such behaviour, not least of which is the legislation regarding the possibility of cumulating pension and work incomes. In the past, Governments introduced new regulations to limit the possibility of cumulating pension and work income in order to discourage early retirement. More recently these limits have been gradually lessened and, as also stated in the Italian Economic and Financial Planning Document for the years 2003-2006 (DPEF), are expected to be gradually overcome in the framework of a more complex action aimed at encouraging people to remain in employment.

Basically, the following strategic directions aim to solve existing and future problems in the pension system and their effects on the overall economic system and the living conditions of old people:

- **policies to ensure economic development and employment growth, to be attained also by means of reductions in taxes and social contributions;**

- **policies to encourage older people to remain in the regular labour market, which also involves uncovering hidden activities;**

- **policies to ensure rapid development of the second pillar, which also involves the choices made when renewing collective work agreements and the chance to accumulate resources to subsequently use for supplementary allowances;**

- **policies to counter the specific risks of poverty in old people and improve their quality of life and to protect from new emergencies as part of an overall rebalancing of the social protection expenditure. Functional and integrated relations between public and private organisations and between government bodies and families is essential for this purpose;**

- **fiscal policies to protect, above all, people with lower income levels.**

The Government intends to promote further reforms via extensive and unhurried co-operation with Social Partners, being aware that this involves completing and consolidating a process already well underway and which has already achieved important targets.

On the matter of pensions, the Government has asked the Parliament to be anabled to enact interventions aimed above all at strengthening the incentives to extend the working life and at making it easier the development of private pension funds. Commitment to uncovering shadow activities is also to continue. The so-called "Patto per l'Italia" (Pact for Italy) recently signed by the Government and all (except one) of the main Trade Unions and Employers Associations outlined a framework for reforming labour and public policies along these lines.

Government initiatives

- Lower pensions were further improved in the 2002 budget (up to Euro 516.4 per month for 13 months)

- Proposed enabling act regarding the labour market

- Proposed enabling act of reform of the pension system

- Proposed enabling act on fiscal matters

- Preparation of a White Paper on social policies, which is still under discussion with the Social Partnerss

- Project for establishment of a Fund to support non self-sufficient persons

The Government also is committed to implement in full the "Patto per l'Italia".

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A - Adequate pensions

Member States should safeguard the capacity of pension systems to meet their social objectives. To this end against the background of their specific national circumstances they should:

Objective 1 - *Ensure that older people are not placed at risk of poverty and can enjoy a decent standard of living; that they share in the economic well-being of their country and can accordingly participate actively in public, social and cultural life*

The Italian pension system already includes a number of benefits (social pensions and social allowances for old people without income, supplementary benefit up to a minimum treatment for those receiving a pension below a given threshold, family allowances, allowances for non self-sufficient people) for the social purposes of protecting the more disadvantaged old people via cash transfers. The current Government improved these tools recently by increasing pensions under Euro

516.4 per month up to this amount (for 13 months, thereby ensuring an annual income of Euro 6,714), especially focussing on older people without other income and civilian disabled. A precise quantification of the effects of this measure in terms of reduction in poverty of the old people is not currently available[2]. However, it should be noted the positive trend in terms of poverty reduction over the last few years, deriving from other similar though less intense actions implemented in the past (see Table 1.1a in the Statistical Appendix - hereinafter SA).

The living conditions of old people do not depend solely on their pensions and the amount they receive. Other sources of income - from work and capital -and the tax system can and must provide a considerable contribution. More generally, family structure, home ownership, support from efficient social services, health conditions and the concrete opportunity to participate in the economic, social and cultural life also affect living conditions. Taking into account this multidimensionality, the SA provides indicators regarding the risk of poverty for old people from an economic viewpoint (using household income and consumption), as well as the effective participation in social and cultural life of the community and health conditions of old people (also with regards to the quality of assistance).

Considering the risk of poverty from an economic viewpoint, there are a number of differences according to the variable and source taken into account: income - for which the situation available from European sources is outdated and presumably affected by underestimation at both extremes of the income distribution, consequently overestimating poverty incidence,– and consumption – for which national data are more recent. The risk of poverty for old people - which takes into account individuals aged 65 and over both here and subsequently, unless otherwise indicated - stands at around 15-16% (table 1).

Table 1 **Risk of poverty in people aged 65 and over - By sex and family type – Reference variables: income and consumption – 1997 and 2001**

	Income	Consumption	
	1997	1997	2001
North	10.0	10.2	7.8
Centre	17.7	9.1	11.8
South	24.9	29.3	30.3
Total old people	**15.9**	**16.0**	**15.8**
Total population	**19.7**	**13.0**	**13.6**

Source: ISTAT, *ECHP*, UDB 1-5 for data on income, *Survey on Family Consumption* for data on consumption.

Many old people border on the poverty line (see Table 1.2 in the SA) and only a few are extremely poor, thereby demonstrating that age is not in itself an essential element in determining high risk of poverty. This appears to confirm the fact - repeatedly highlighted in analyses by the National Commission of Inquiry on Social Exclusion and paid particular attention in the National Action Plan on social inclusion drawn up by Italy last year – that there is poverty in other segments of the population and in more critical forms and measures than in the case of old people. More specifically, the risk of poverty - also due to the limited extent and importance of policies to support families and oppose poverty in subjects of working age in Italy - mainly impinges upon large families, families with children or single-parent families (see Table 1.1c in the SA).

[2] However, it should be considered that the number of the *maggiorazioni sociali* (the supplementary allowances increased by January 1st 2002 by the Government in order to reach the threshold of Euro 516.4) disbursed by January 1st 2001 by INPS amounted to 440,735, whereas this number increased (due to the increase in the threshold below which these allowances are available) to 1,047,792 by January 1st 2002 (which involved the first set of improvements that are due to cover 1.8 million pensioners, including those receiving pensions in the international system).

The strategy outlined in the Introduction and which will be set forth more precisely in the White Paper on social policies to rebalance the entire welfare system also derives from this consideration.

Although age in itself does not appear to be a fundamental element of the risk of poverty, this risk is rather high in a few specific segments of the old population. More specifically, non self-sufficiency and geographic location in the most underprivileged areas of the country are of particular importance. With regards to absolute poverty[3], this phenomenon is almost inexistent in north and central Italy (with incidence below 2% and approaching 3% respectively, both with regards to old people and the rest of the population), whereas it becomes high in southern Italy, where more than one old person in ten is poor. The condition of people aged over 75 in this area is very worrying as the incidence of absolute poverty exceeds 16%[4].

The SA also takes into consideration a number of non economic aspects in the lifestyle of old people, paying particular attention to their health and the various aspects regarding participation in the social and cultural life of the community. Health and income appear to be strongly related. Generally, the incidence of disability and chronic diseases is greater among old people, which in itself is rather obvious and paradoxically linked to longer life expectancy. This demonstrates that actions to support non self-sufficient persons will necessarily require an increasing amount of dedicated resources, which - as stated in the Introduction - will have to derive from reallocation of welfare and social resources in the future.

With regards to participation in the social and cultural life of the community, the negative gap relating to old people is particularly serious. It is plausible that this phenomenon is partly connected with the gap in education received by different generations, which is particularly wide in Italy at the moment due to the delay in which mass schooling developed compared with other European countries. This component of the gap however should naturally tend to close. However, the trend regarding technical progress operates in the opposite direction: the changes in technological paradigms currently underway – with development of IT - may leave many older (and less educated) people behind unless appropriate policies to develop the lifelong learning processes are implemented. An important and worrying sign from this viewpoint is the huge gap regarding the use of personal computers and Internet: only 1.6 and 1.2% of old people use these tools compared with 20.4 and 15.7% respectively for people aged 45-54.

The Government intends to further improve actions to combat poverty in old people by identifying the areas and topics that appear critical, also with regards to the future. Such improvements must also take into account the fact that other segments of the population currently appear more subjected to the risk of poverty; the Government must therefore operate within the fvrame of an overall rebalancing of the welfare system.

Specific resources must also be increasingly set aside for policies focussing on non self-sufficient old people and involve actions to encourage development of care services and to strengthen the role of family responsibilities. The measures set forth in the new law on immigration involving amnesty for the so-called "home-helps" focusses on integrating the irreplaceable role of the family with an offer of employment (especially for women) to thereby satisfy the new needs of people. From this viewpoint, the Government is also examining together with Regional Councils promotion of a "Fund against the risk of non self-sufficiency", which aims to satisfy the needs

[3] See Table 1.2 in the SA for further details. The absolute poverty line is defined on the basis of a pre-set basket of consumption goods assessed at constant prices rather than on the basis of a percentage of the average (or median), as occurred with regards to the relative condition of poverty referred to until now.

[4] However, neither figures regarding extreme poverty nor those on relative poverty take into account the difference in consumer prices, which exists to a certain extent according to the geographical location and size (small or large) of the towns and cities in question.

for assistance in the home, residences and semi-residences of non self-sufficient persons via services and vouchers as a supplement to existing public funds.

As far as increasing low pensions is concerned, this was effected through the increase in the "maggiorazioni sociali"(supplementary benefits for low pensions) set forth in the 2002 Budget, with resources for this purpose totally amounting to Euro 2,169 million. Being the resources limited in amount, criteria for selection based on age, length of time contributions are paid and income were taken into account. Improvements were also set aside for social pensions, social allowances and civil disability pensions under given conditions. The Government intends to confirm and (in compliance with the financial resources available) gradually extend this measure. The Government also improved in 2002 the tax system for families with dependent children as part of the Tax Reform and intends to introduce a "no tax area" in accordance with the poverty line. The "Patto per l'Italia" (outlined with Social Partners) involves earmarking of Euro 5.5 billion for medium and low income brackets as the first module for Tax Reform in 2003.

As explained in more detail below, the Government intends to once again affirm extension of the working life and postponing the retirement age as the most important means of increasing pensions and improving participation in the social life of the community.

Objective 2 – *Provide access for all individuals to appropriate pension arrangements, public and/or private, which allow them to earn pension entitlements enabling them to maintain, to a reasonable degree, their living standard after retirement.*

In terms of the replacement rate at the moment of retirement - in other words the link between the initial pension and the retribution received just before retirement - the compulsory pension system, which for those currently retiring still involves the so-called earnings-related system for pension calculation, guarantees a high level of protection, despite the introduction of more sever and harmonised regulations for all different pension regimes. Therefore, it is no surprising that pensions - and state allowances in general - count for a large amount of the overall income, especially with regards to the less well-off segments of the population. In fact, such allowances count for between 94% and 77% of the overall income for individuals over the age of 65, according to the income quintile (respectively between 86.2% and 71.9% refers to pensions in the strict sense - see SA, Table 2.1b).

The reforms implemented in the Nineties (see Legislative Appendix), involving a gradual change (using the pro rata method) from the earnings-related system (retribution over the last ten years was taken into account to calculate pensions) to a contribution-based system (whereby the total amount of contributions paid throughout a person's working life are taken into account) will lead between 2010 and 2020 to a significant decrease in the replacements rates calculated for what is currently the standard example of a person going into retirement (table 2[5]).

Table 2: Replacement rate at retirement (initial pension / last wage ratio)

	2000	**2010**	**2020**	**2030**	**2040**	**2050**
Employee in the private sector aged 60 who has paid contributions for 35 years						
Public pension (compulsory)	67.3	67.1	56	49.6	48.5	48.1

[5] The first line in Table 2 describes this evolution for an average person – in other words a person aged 60 who has paid contributions for 35 years and considering the amount in question gross of taxes. The SA provides further details of these trends for other average persons and a calculation of the fringe allowance net of taxes and contributions.

Private pension	0	4.7	9.4	14.5	16.7	16.7
Total	**67.3**	**71.8**	**65.4**	**64.1**	**65.2**	**64.8**

Source: our figures (see SA).

As previously mentioned, the contribution-based system will become increasingly important in determining the amount of pensions people retiring will benefit, although it will affect more slowly the entire *stock* of current pensions, thereby meaning that while earnings-related pensions will drop from two-thirds of the total in 2020 to 5% in 2050, in the same year pensions paid under a mixed regime - partly earnings- and partly contribution-based - will still count for just over half of the total - see Table SA 6.1b). The contribution-based pensions are calculated by multiplying the total amount of contributions paid by an employee throughout his/her working life by transformation coefficients that are calculated using an actuarial type logic. It follows that the pension depends not only on the amount the pensioner has paid in contributions (which induces neutrality in relation to the individual career profile, differently from the traditional earnings-related systems, that benefit the most the workers with a more dynamic career), but also - decreasingly - on the remaining life expectancy at retirement. Current laws also involve revision of these coefficients on a ten-year basis, so that they will be modified to take into account the trend in life expectancy at retirement and the long-term trend of the economic system. Application of the contribution-based method for calculation will therefore lead to further reduction in replacement rates at retirement age due to the increasing life expectancy. Figure 1 provides a breakdown of the fall in replacement rates at retirement in the future between a component that can be ascribed to completion of the move to a contribution-based system and a component deriving from the demographic correction of transformation coefficients, as set forth in the Reform Law. In the second phase of the fifty-year period taken into account, a large segment of the drop has a purely “demographic” origin - in other words it is due to the variation of the transformation coefficients (see AS Table 2.2.c). Should life expectancy fail to improve as forecast (so that the transformation coefficients would remain unaltered), the drop in replacement rates guaranteed for the average person taken into account (a 60 year-old retiring having paid 35 years of contributions) would be much lower even taking into

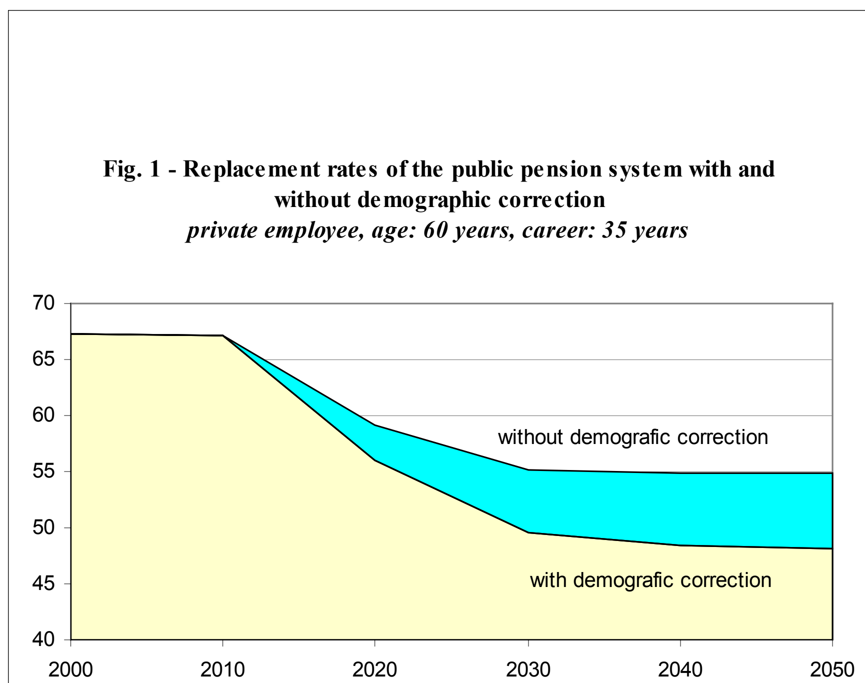


Fig. 1 - Replacement rates of the public pension system with and without demographic correction
private employee, age: 60 years, career: 35 years

account the gradual move to the contribution-based system.

Whatever the origin of the future drop in replacement rates, the previously mentioned importance of pensions to the income of old people make it essential to adopt strategies to deal with this phenomenon. There are two strategic directions to take for this purpose: development of a supplementary pension system (based on capitalisation) and postponment of the retirement age.

The contribution that may be provided by developing a complementary insurance system is shown in Table 2. Taking into account all pensions and prudent hypotheses regarding the rate of return from funds placed on financial markets (a real annual return of 2.5% net of all costs), the drop in replacement rates becomes almost nil for employees, although it remains quite high for self-employed - for whom however an analysis of figures net of taxes demonstrates that the drop substantially corresponds to alignment of these with the conditions currently granted to employees in the private sector[6].

The development of a complementary pension fund pillar was therefore considered a priority by the Government in the proposed enabling act; to this aim the funds currently set aside year by year in order to finance a lump sum superannuation payment (TFR[7]) should be diverted towards complementary pension funds. The reasons behind the objective of developing a second welfare pillar generally derive from the need to create a balanced system in which the risks involved in the various pension pillars compensate each other reciprocally and in which the growth of a capitalisation-based pillar encourages the development of financial markets and capital mobility. That is why a net superiority - still to be demonstrated - of average revenues from capitalisation-based funds has not been assumed, thereby also taking into account the intrinsic elements of financial risk involved in a capitalisation-based system[8]. Furthermore, it must be remembered that developing a private pension system requires in any case diversion of significant funds for this purpose. Even in the case of employees, the TFR funds do not lie unused, as they are a source of low-cost financing for employers and a source of income support for those employees who lose their jobs (and, in many cases, a means of funding extraordinary expenses). This is why the Government hypothesised diverting the TFR funds while reducing the burden on the public pension system and developing more appropriate means of support for those that lose their jobs, as well as tax benefits for businesses.

Even taking into account all the above, the second strategic direction regarding Government reform to guarantee adequate pensions in the future appears crucial, which implies extending the working life of a person and postponing effective retirement. In many aspects, this strategy is the natural reply to the demographic nature of the decrease in replacement rates guaranteed by the public pension system: the increasing life expectancy at retirement for a given age - which (almost automatically) implies a reduction in unitary pensions in the contribution-based system - requires a similar reduction in the length of time a pension is provided to maintain such unitary pensions while safeguarding financial stability. Table 3 shows that when the average pensioner becomes (as soon as possible or when the contribution-based system is fully implemented) a 65 year-old who has paid

[6] The calculation of net replacement rates is necessarily less precise, as explained in the SA, however highly significant in order to understand the ability of the pension system to guarantee the maintaining of the standard of life after retirement. Above all, the figure net of taxes is better for comparisons between employees and self-employed as ittakes into account the fact that a large amount of contributions to the pension funds for employees is not part of the gross earnings on which gross replacement rates are usually calculated.

[7] The TFR (Trattamento di Fine Rapporto) is a superannuation lump sum indemnity paid to the employee when she/he changes/looses the job or retires. It is financed diverting part of the employee's wage year by year. The funds so diverted are accumulated by the employer and gain a rather low return (1.5% per year plus three fourths of the inflation rate). . Some of the funds so accumulated may be used by the employee if in need of funding (some) unusual expenses.

[8] The SA demonstrates that diverting the TFR to the second pillar leads to a lower net increase in the resources available at the time of retirement than the overall figure shown in Table 2. This net increase derives from the higher, although less certain, returns assumed for pension funds compared to those guaranteed at present on the TFR funds of a worker that, staying with the same company throughout her/his working life, could use them for social security purposes.

contributions for 40 years, the replacement rates guaranteed by the public system remain substantially the same as it is now for the typical case of a 60 year-old who has paid contributions for 35 years[9], due, to both the decreasing (coeteris paribus) length of time the pensions must be paid and the increasing length of time the contributions are paid. Extending the working life of a person to the age of 65 would also lead to an improvement in the relative replacement rates from the complementary pension fund pillar of around two percentage points (from 16.73% to 18.75%).

Table 3: Replacement rates taking into account an extension of the working life (ratio between pension and last wage)

	2000	2010	2020	2030	2040	2050
Employee in a private business, aged 65 and who has paid contributions for 40 years						
National insurance (compulsory)	76.9	76.7	72.4	66.8	64	63.4
Private insurance	0	*5.3*	*10.6*	*16.3*	*18.8*	*18.8*
Total	76.9	82.0	83.0	83.1	82.8	82.2

Source: our figures (see SA).

Postponing the effective retirement age therefore becomes crucial not only for the financial sustainability of the system – which would be affected by postponement as long as the earnings-related system remains significant (see below) – but also for guaranteeing adequate pensions – which is (almost) automatically linked with the objectives of adequacy in the contribution-based system. Indeed, the reforms of the Nineties dealt with the problem by increasing the age requirement for old-age pensions (increased to age 65 for men and 60 for women in the general case) and introducing new requirements regarding age and paid contributions in order to harmonise the regulations in different systems with regards to seniority pensions. The first timid results of such actions are evident (see below), both with regards to the rise of the effective retirement age and the slight improvement in the employment trends of older people. However, the employment rate of people aged between 55 and 64 (28%) is still one of the most critical aspects on the labour market.

A further aspect of the ability of the pension system to guarantee the maintenance of an adequate standard of life after retirement concerns the evolution of unitary pensions following retirement. Current legislation for the public pension system ensures maintenance of the value of the pension in real terms, with full price indexation for pensions up to a limit of three times the INPS minimum (subsequently reduced to 90% and 75% respectively for richer pensions). Real wages indexing was also applied until 1992. The application of price indexing alone has guaranteed large savings until now. In many aspects, this de-indexation is counterbalancing the substantial stability in the replacement rate at retirement guaranteed for further fifteen years to newly retirees. It somehow ensures that also the current population of pensioners support the reduction in overall unitary pensions - not in relation to purchasing power but rather in relation to GDP per employee - which is useful in terms of safeguarding the financial sustainability of the system over the next few decades. Consequently, the expected drop in the unitary pensions with respect to the GDP per employee (or also with respect to the GDP per capita; see Table 2.5 in the SA) is more pronounced and comes prior to the fall in replacement rates at retirement provided by the public system discussed earlier.

Once the contribution-based system becomes fully implemented, there is no reason for not applying real indexation to pensions. Otherwise, there would be the risk that pensioners living longer would receive gradually lower amounts in relative terms, which would affect the adequacy of the system and could ask for further interventions.

[9] The drop previously mentioned would still apply for the self-employed.

The Government, being aware of the need to increase the effective retirement age (as was also stated at the EU level) in order to rebalance the pension system has outlined (in the proposed enabling act) a complex strategy aimed at encouraging in various ways the permanence on the workforce (especially with regards to the case of seniority pensions.)

Objective 3 *– Promote solidarity within and between generations*

Income inequality among old people is generally not as wide as that in the rest of the population. Although the income taken into account relates to the entire household - and may therefore comprise income other than pensions and not directly relating to old people -, this result is an indication of the partially re-distributive role of public pensions. Smaller income inequality is particularly evident in the older age group (people aged over 75) and for women, who are also those more likely to be covered by those solidaristic benefits (integration to the minimum pension) in the pensions system described earlier. On the contrary, taking into account younger men - mainly those receiving retirement pension, especially with regards to current old generations - demonstrates that there is slightly higher income dispersion than in the rest of the population. This may be due to the less redistributive nature of retirement pensions.

There are no exact calculations and micro-level simulations regarding the future trends for income distribution among older people and in connection with changes to the pension system already set forth in current laws - especially in relation to the gradual move from an earnings related method of pension computation to a contribution-based regime. As demonstrated earlier, the two systems comprise mechanisms that differ with regards to the pensions given to people with different earning profiles in the course of their working career. The contribution-based system is neutral from this viewpoint, as the contributions from individuals on which future pensions depend are accumulated and “remunerated” at the same rate for everyone. However, in the so-called earnings-related system, pensions depend on the wage of the person in question during his/her last years of employment and the implicit “remuneration” from paid contributions subsequently benefit people with a more dynamic career. Taking into account the fact that such people generally receive higher wages on average, moving from the earnings-related to the contribution-based system should emphasise the redistribution aspects of the pension system, although the system is not actually meant tohave a redistributive nature. It must be remembered that the contribution-based system sets forth a maximum pension and contribution, thereby ensuring it also redistributes to a certain extent (whereas in the earnings-related system, the entire retribution affects determination of pensionable retribution, though with differentiated returns). On the other hand, reducing the importance of the first pillar as a source of income for future pensioners – to help develop supplementary pension schemes, which have no room for solidarity-oriented logic – should operate in the opposite way to that stated regarding redistribution.

The future outlook is made even more complex by two additional aspects, which were already highlighted in the previous paragraph: price indexation only for current pensions (common to both earnings-related and contribution-based systems) and the transition stage from one system to the other and relative drop, with discontinuity over the next few decades, in the replacement rates on retirement. The first factor inevitably involves progressive loss of ground - in terms of relative

income[10] and not in terms of buying power – for those who have been in retirement for a longer period. On the other hand, the second factor goes in the opposite direction: over the next decades, new pensioners will receive pensions that have been (increasingly) calculated using the rules in the contribution-based system and therefore at a lower - coeteris paribus - starting level, whereas those who have been receiving pensions longer - which are calculated using the rules in the earnings-related system - began to receive pension at a higher - coeteris paribus - starting level. It is difficult to assess the complex interaction of the two factors due to the fact that there are currently no suitable models of micro-level simulation. Once the system becomes fully implemented, in other words when the transition to a contribution-based system is completed, the first factor should above all operate under legislation in force, which may lead to inequality and relative impoverishment.

The Government intends to analyse the possibility of reintroducing, although not at the current time, real indexation mechanisms, in other words in which ongoing pensions are both price- and wage-indexed. These mechanisms will be compensated and funded via disbursement of a lower initial payment, at least as an option for the person in question.

More generally, the Government confirms its intention to implement appropriate solidarity-oriented actions - above all for non auto-sufficient old people - as part of the general reorganisation of the welfare system mentioned previously. For this purpose, actions must and will be identified in such a way as to also take into account the complex overlapping that will occur between people with pensions calculated using different systems, with tax benefits.

B) Financial sustainability of pension systems

The importance of a high employment rate was mentioned earlier, where it was noted that postponing the retirement age, with the increase of the employment rate for not-so-young people, should improve unitary pension treatments . This effect on unitary pensions is evident above all in the contribution-based model to be implemented gradually. Currently, being applied an earnings-related system, the main contribution deriving from increasing the employment rate is an improvement in system sustainability. In light of this, the overall situation regarding employment and its trends will be examined in the paragraph referring to Objective 4. The subsequent paragraph will concentrate on employment for the not-so-young and the effective retirement age. The paragraph regarding Objective 6 will then examine the level of pension expenditure as a percentage of GDP, which is the main indicator for financial sustainability in the pension system in Italy. The paragraph relating to Objective 7 looks at means of funding the pension system (as a percentage of the GDP) and highlights the problems involved in view of various economic and demographic perturbations. In both paragraphs 6 and 7, the reference point is always the cost of the first pillar, as this is traditionally taken into account in financial programming documents (see box 6.1 in the SA for further details). The paragraph relating to Objective 8 deals with supplementary benefits.

Member States should follow a multi-faceted strategy to place pension systems on a sound

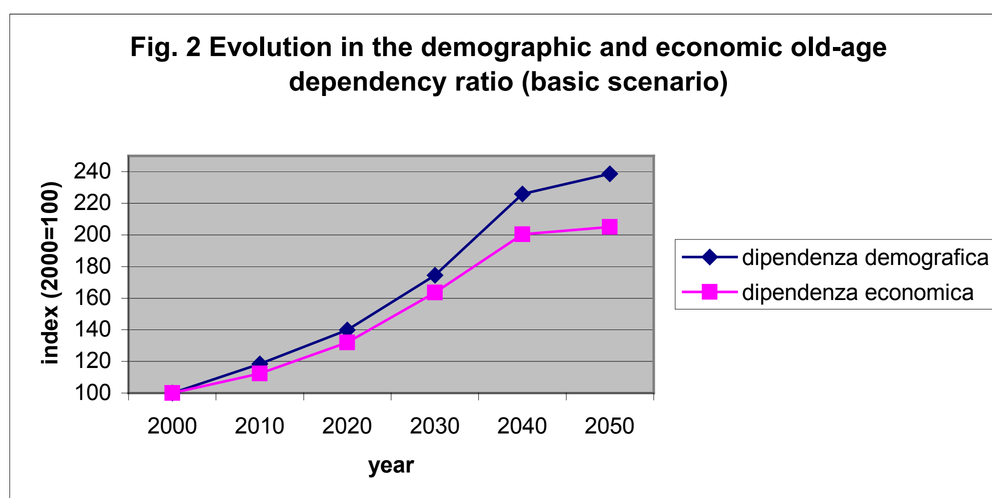
[10] While hypothesising a positive trend in real pro-capita income.

financial footing, including a suitable combination of policies to:

Objective 4 –

Achieve a high level of employment through, where necessary, comprehensive labour market reforms, as provided by the European Employment Strategy and in a way consistent with the BEPG;.

The general framework of the labour market in Italy has improved considerably recently. Despite a slow-down in the GDP growth, the employment growth rate was equal to 2.1% in 2001. The employment rate (with reference to the population aged 15 to 64) reached 54.6% in 2001 (50.6% in 1995) and continued to improve during 2002 (the latest available figures from April stand at 55.2%). The overall unemployment rate dropped below 10% for the first time in ten years. Despite this, Italy was among the last in the European rank of the employment rates and a long way from the level of excellence agreed at the European level, which sets the employment rate at 70%.



The basic scenario used for pension expenditures - which is described in more detail in Paragraph 6 - shows the possibility of an increase in employment, which would reach 59% in 2010 and continue to increase gradually to 64.5% by mid-century. This growth largely derives from demographic trends and evolution in the tendency to retire under the current legislation, which will be affected by the gradual tightening of the minimum eligibility requirements for retirement and - in the longer term - takes into account the fact that the retirement age in the contribution-based system has become flexible, but with obvious effects on returns, in the range of 57-65 years of age . However, in addition to a peak in the demographic dependency ratio (the ratio between over 65's and the overall population), overall demographic evolution will also lead to a large increase in the economic dependency ratio, in other words the ratio between old people (aged over 65) and total employment, increasing from just over 50% in 2000 to 64% in 2020 and leaping to 80% in 2030 and 98% in 2040 (finally achieving a 1 to 1 ratio in 2050; Fig.2).

In order to achieve more flattering results regarding economic old-age dependency ratio, the employment rate must increase more rapidly. The Government set this objective in the National Action Plan on employment, in which Italy set the following three targets regarding the employment rate as a first contribution to the objectives regarding employment that the European Union has set for 2005 and 2010:

Employment rate	Target for 2005	Δ2005-2001	Δ2001-1997
Total	58.5	+4	+3.6
Women	46	+5	+4.7
Old people (aged 55-64)	40	+12	0

The recently prepared National Action Plan on employment should be read for more details on such targets[11], however two aspects must be highlighted here: the both prudent and ambitious nature of the targets in question and the far-reaching nature of the policies to be prepared.

The prudent nature of the targets is highlighted by the fact that it basically involves continuing the efforts and trends already underway. However, a certain ambitiousness can also be gathered with regards to workers aged over 55 – which will be dealt with in more detail in the following paragraph –, which is a crucial segment of the population with regards to the overall result due to the increasing importance this group has on the overall working population.

The far-reaching nature of policies that have been and are being prepared is best demonstrated in the NAP Employment. As the “Patto per l'Italia” recently signed by the Government and all - except one - of the main Trade Unions and Employers Associations demonstrates, this strategy is based on policies that aim to re-launch economic growth, develop southern Italy and reform the labour market in spite of the current phase of the business-cycle. As far as reform of the labour market is concerned, the NAP Employment specifically focusses on the following:

- ***extraordinary measures to ensure rapid uncovering of a large share of the hidden economy;***
- ***reform of the training system to improve the cultural level and skills of people;***
- ***reform of the labour market to improve the chance for employment, develop employability policies and combine flexibility with actions regarding the social protection of workers (beginning with revision of the so-called “ammortizzatori sociali” – the italian unemployment benefits - set forth in the “Patto per l'Italia” with initial additional earmarking of Euro 700 million).***

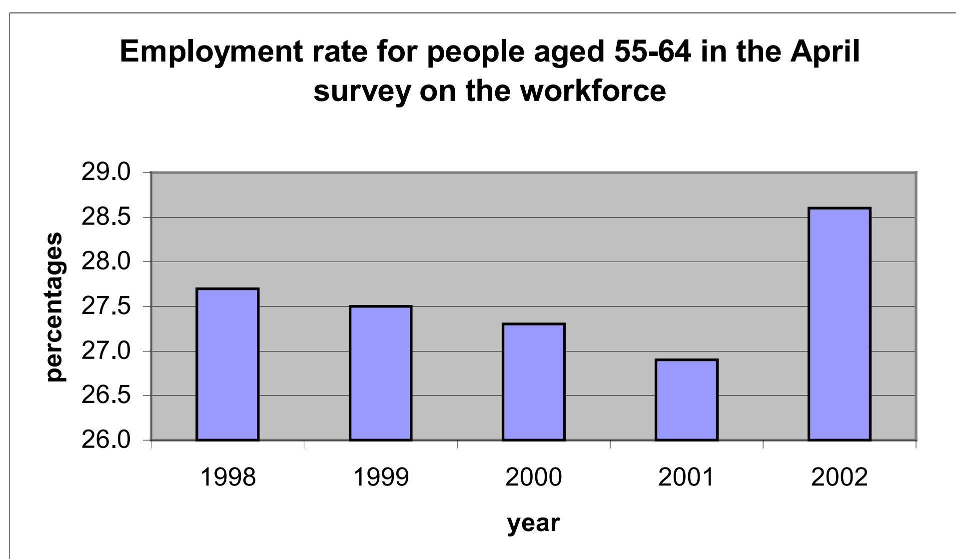
Objective 5 *– Ensure that, alongside labour market and economic policies, all relevant branches of social protection, in particular pension systems, offer effective incentives for the participation of older workers; that workers are not encouraged to take up early retirement and are not penalised for staying in the labour market beyond the standard retirement age; and that pension systems facilitate the option of gradual retirement;*

As described in the previous paragraph, growth in the overall employment rate increasingly depends on development of the employment rate for people aged over 54, which will begin to represent a

[11] The congruity in current tendencies with regards to fulfilling such targets has been regularly analysed and reported in periodic monitoring reports by the Ministry of Labour and Welfare Policies (see 2- 2001 and 1-2002), which should be referred to for more details.

larger share of the population of working age over the next few years. The current employment rate for this age group is rather low, as Italy is one of the countries that was more effected by the phenomenon of early retirement in the Nineties. This tendency continued, although less intensely, following reform in 1995 as seniority pensions continues (with new and stricter regulations - from 1996 to 2000 there were over 1,230,000 new seniority pensions in the main pensionregimes).

The negative inheritance just described highlights how difficult it is to achieve the employment rate set forth in the previous paragraph. However, this must not make us consider this target impossible. Over the last few years, the tendency for the employment rate of over 54's to drop has stopped and actually began to recover as of 2001 (Table 4).



This inverted tendency appears to derive not only from the positive overall trend for employment, but also the gradual action of the constraints set forth in reforms from the Nineties, especially with regards to seniority pensions. The practice of early retirement to act as sort of unemployment benefits that was popular until the mid-Nineties (with a peak in 1992 - see Tables 5.3d and 5.3e in the SA) is slowly dying off. A number of worries over acknowledgement of a bonus pension for those who worked with asbestos in the past - despite their effective health conditions - have come to the fore. Initiatives by Parliament and the Government to ensure stricter governance and protect in a more generous way those affected by exposure to this material are currently underway.

Table 5 shows an original measure of the indicator on the average retirement age, the raising of which the Heads of State made an objective at the Barcelona European Council in March 2002. This table shows that the changes to legislation implemented in 1992 and 1995 led to improvement - increasing from age 57.4 in 1997 to 59.4 in 2001. The more disaggregated figures (see Table 5.2b in the SA) lead to mainly ascribing this tendency to the reduced number of very early retirements: the first quartile in the age distribution of retirement was 54.6 in 1994 and decreased to 53.5 in 1996, returning to 54.6 in 1998 then moving to 56.3 in 2001. The average retirement age provided by administrative sources (tables 5.3a and subsequent in the SA) provides congruous indications (for the difference between the two concepts and the differences in sources, see the SA).

Table 5 - Average effective retirement age – 1994-2001

	Men	Women	Total
1994	58.8	57.4	58.4
1995	58.5	58.3	58.4
1996	58.3	56.3	57.8
1997	57.4	57.1	57.4
1998	58.8	59.3	58.9
1999	59.8	58.3	59.4
2000	59.5	58.9	59.3
2001	59.1	60.4	59.4

Source: information processed by the Ministry of Labour and Social Policies using ISTAT figures (see SA).

In fact, solely taking into account current pensions legislation - and without hypothesising the implementation of ad hoc incentives such as those attempted, though without success, in the Budget Law n.388/2000 (see below) –, the basic scenario created to analyse evolution in pension expenditures estimates an increase in the employment rate for people aged over 54 of up to around 40% by 2010(see Table 5.1c in the SA)[12]. The previously mentioned Government target basically brings forward achieving this level to 2005, thereby appearing demanding though not unrealistic.

In order to achieve this target, the proposed enabling act prepared by the Government involves currently extending, reviewing and improving the effect of the incentives to delay retirement partly introduced through Budget Law n. 388/00, though with little success and therefore of little or no importance in determining the previously mentioned inverted tendency. Basically, new incentives to remain employed are based on a number of specific actions: a) so-called certification of rights: the national insurance organisation with which the employee is registered is obliged to inform him/her when he/she fulfils the requirements for retirement; these requirements will not be changed following implementation of stricter provisions if the worker decides to delay retirement; b) acknowledgement of a share of retribution of at least 50 of the contribution delta (therefore 16.35%) if he/she delays retirement for at least two years with a closed-end employment contract; previously workers could only keep the share corresponding to his/her contribution (8.89%); c) encouragement to delay retirement by developing part time employment, which has basically not involved people over 54 until now (see Table 5.1b in the SA); d) adopting measures to stop pensioners carrying out work in the black economy ; f) gradually overcoming (as set forth in the DPEF) the remaining limits regarding accumulation of pensions and income from work in order to encourage people to continue working after fulfilling the minimum requirements.

Although it is still impossible to assess the effectiveness of such provisions, which are still being defined, the difference that will be involved in the long period in which the earnings-related system for calculating pensions will operate and the future in which there is a contribution-based system must be highlighted. The contribution-based regime involves considerable flexibility in the choices individuals make regarding retirement, which may occur at any time between the ages of 57 and 65[13]. This flexible mechanism itself provides an incentive to postpone retirement, the effectiveness of which must obviously be carefully assessed in the future: delaying retirement from the age of 60 (having paid contributions for 35 years) to the age of 65 (having paid contributions for 40 years)

[12] More specifically, the scenario in question discounts: i) tightening the age requirement for retirement under the current legislation, ii) evolution in the relationship between age and length of time contributions are paid due to delay - also due to longer education - in the entrance in the labour market experimented in the past by generations gradually approaching retirement , iii) progressive depletion of the effect linked to safeguarding the rights acquired with regards to retirement.

[13] Without many constraints in terms regarding the length of time contributions have been paid, which may be just 5 years as long as the pension received is at least 1.2 times the minimum pension.

will lead to an increase of one-third in the replacement rate compared to around just one-seventh in the current situation (under the wage-based system)[14].

The Government has included the following in the proposed enabling act in order to fulfil the above objectives:

a) ***liberalisation of the retirement age*. This measure introduces the possibility for workers who fulfil the requirements for old-age pensions to agree on a way to continue working with their employers, thereby opting to take advantage of the relative incentives indicated below;**

b) ***"certification of rights"*. When a worker fulfils the minimum requirements (regarding age and length of time that contributions are paid) to receive a seniority pension, he/she may ask the relative national insurance agency to certify his/her situation according to the legislation covering the system involved and thereby be protected from any subsequent changes to the relative laws. This regulation thereby appears to ensure that the tendency to retire is not affected by the effects of "announcements" regarding imminent change to legislation - as has occurred in the past;**

c) ***introduction of incentives to encourage postponing retirement*. The Government intends to use this measure to encourage an increase in the effective retirement age, thereby allowing workers that fulfil the requirements to receive a seniority pension to continue working by opting for a special system regarding taxes and contributions, involving total exemption from national insurance contributions. At least half of this reduction is for the worker, whereas the remainder will be used to cut labour costs. Workers may choose this option by undertaking to postpone retirement for at least two years and stipulates a closed-end contract with his/her employer. This criteria completes and improves current legislation (which has not been overly successful) by modulating reductions in contributions to benefit the worker.**

The enabling act proposed by the Government involves implementation of measures to uncover work in the black economy carried out by pensioners via specific actions in line with those set forth in Law n. 383/2001 on uncovering concealed labour. This provision also involves the objective to gradually overcome (in accordance with available finances) the remaining regulations regarding accumulation of income and pensions (assuming - as described in the technical report for the enabling law and the DPEF – application of this new regulation solely when continuing employment). The Government does not exclude the possibility of examining more appropriate solutions to remove obstacles penalising part-time employment for workers approaching retirement age. Finally, it is worth remembering that retirement will become flexible once the reformed system becomes fully implemented(between the ages of 57 and 65), which also involves different modulation of the transformation coefficients of the value of total contribution in pension income.

Objective 6 – *Reform pension systems in appropriate ways taking into account the overall objective of maintaining the sustainability of public finances. At the same time sustainability of pension systems needs to be accompanied by sound fiscal policies, including, where necessary, a reduction of debt. Strategies adopted to meet this objective may also include setting up dedicated pension reserve funds.*

[14] The SA provides assessment of the variation in the so-called pension richness deriving from such postponement in retirement.

The large weight of pension expenditure in social protection expenditure - and consequently total public current expenses - means that its evolution is profoundly linked to general trends in public finances, both in the short- and long-term. As far as the former is concerned, the unbalance between insurance-related pension expenses and social security contributions stood at 0.8% of GDP in 2001, while expenses related to the GIAS (Gestione degli Interventi Assistenziali) - the social assistance component of pension expenditure as identified by current laws and funded through general taxation – have stood at 2.2% of GDP for a number of years now. With regards to the latter, future evolution in pensions expenditure, though not implying public debt stricto sensu, affects public finance choices in the long-term due to its more or less far-reaching predetermination.

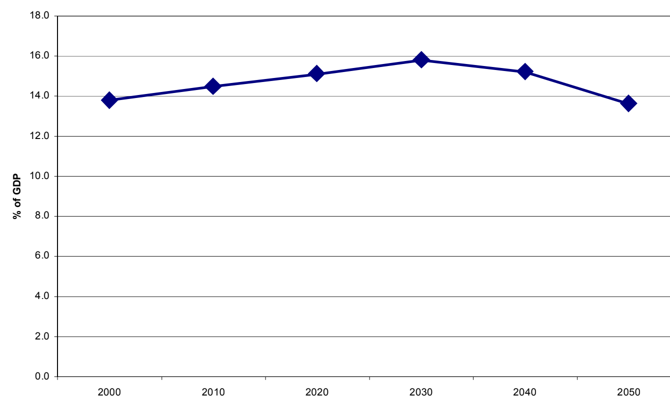
Taking into account this degree of expenditure's predetermination, the economic policy authorities regularly focus upon the future evolution of pensions expenditure as a share of GDP. The first fact to consider is that, over the forthcoming years, the GDP must grow, in real terms, by around 2 - 2.2% per year on average in order to maintain a stable pensions' expenditure to GDP ratio.

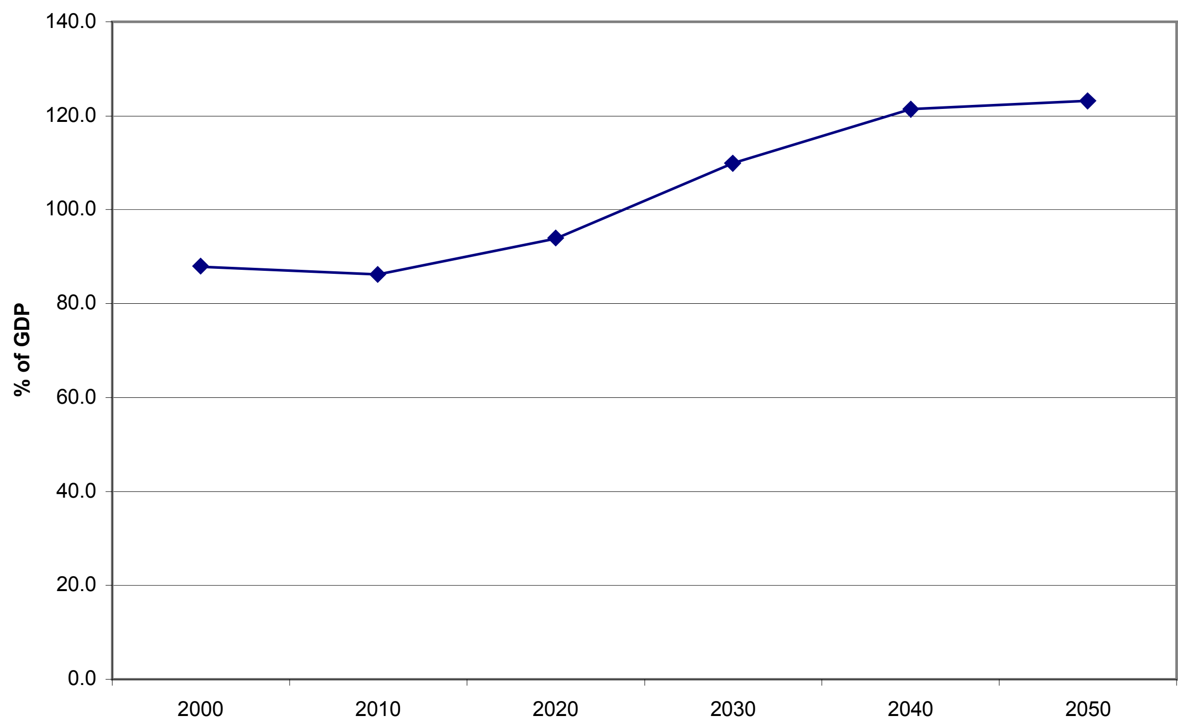
The forecasts here presented - described in more detail in the SA – extend the horizon to cover the next fifty years and mirror what was already set forth in the DPEF 2003-2006, which was based on the General Accounts Office (RGS, Ragioneria Generale dello Stato) model. Figure 3 concentrates on the basic national scenario, which complies with current laws, and - in the medium-term – assumes the macroeconomic outlook of the last RPP (Relazione Previsionale e Programmatica). It shows further growth over the first thirty years under consideration, from 13.8% in 2000 to a peak of 16% in 2033, and a subsequent decline to 13.6% in 2050.

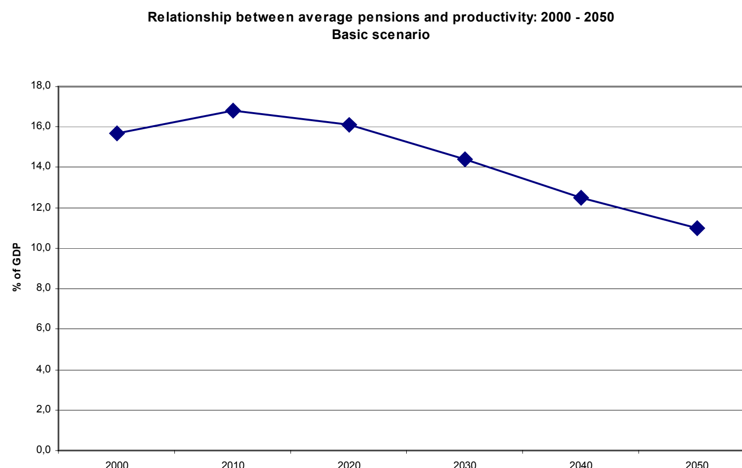
This increase is one of the lowest when compared at the international level, despite the high increase in the underlying dependency ratio (the ratio between old people and the population of working age, which increases from the current 26% to over 60% in 2050; see Table 0.1 in the SA). Growth in the economic dependency ratio(in other words, the ratio between old people and workers, see Paragraphs 4 and 5) is more moderate than this. The ratio between average pension and average labour productivity would also drop - especially in the central period of the fifty years under consideration because of the shift from the wage-based to the contribution-based system (see Paragraph 2.3 for information regarding evolution of average pensions both at retirement - and therefore in terms of initial replacement rate - and following retirement).

The Government is focussing on re-launching structural conditions for economic growth, which should partly recover the effects of the delay with which the international business cycle recovery is currently underway.

With reference to the medium- to long-term, the Government also intends to strengthen the containment of pensions expenditure, so as to take into account the need to re-launch economic growth - to be achieved also by reducing taxes and contributions - and to reform and re-balance the overall welfare system while complying with the objectives regarding improvement in the overall adequacy of the pension system.







***Objective** 7 –Ensure that pension provisions and reforms maintain a fair balance between the active and the retired by not overburdening the former and by maintaining adequate pensions for the latter.*

The issues here concerned are crucial nodes in the debate on pensions in Italy. The Report has assembled a number of assessments that have received general agreement and which can be summarised as follows:

a) the reforms implemented (through a remarkable social consensus) in the Nineties have significantly enhanced the stability of the pension system, which would have otherwise become unsustainable in the future;

b) the financial outlook envisaged for in 1995 proved to be credible and the total expected savings were substantially obtained (although with an internal breakdown different from what then envisaged for and not always "virtuous");

c) the future system – when the gradual implementation of the contribution-based system will have been finally complemented - will ensure (although in a pay-as-you-go funding system) better correspondence between the amount of the pension granted for and the amount of contributions paid over time, also adjusting the pensions to be paid to the evolution in the demographic (and economic) situation;

d) however, the set up deriving from these reforms involves some drawbacks, during the transition phase from the old to the new regime, with regards to the fairness among generations, as the current workers who are not too old have to burden the peak in pension costs for generations that have already retired or are about to retire, whereas their future pensions, when finally retired, will have been adapted following the measures undertaken and because of the ageing phenomenon;

e) in order to correct such unbalance - most of which is inevitable - the legislator set the strategy for a mixed system some time ago. This system is partly based on pay-as-you-go logic and partly on capitalisation and particularly focuses on the younger generations, who are encouraged to take advantage of the "second pillar" to increase their future pensions (see Paragraph 2).

This set up is rather reasonable. However, so far it has remained largely underdeveloped as complementary pension funds have been slow in taking off and, above all, have received little support from younger workers (see Tables 9.2.a, 9.2.b and 9.3. in the SA). Ten years have passed since the organic review of this matter and less than two million workers have subscribed to the various types of complementary schemas available (see Paragraph 8), which include those that have signed individual pension plans (PIP) - an innovative tool (see below) introduced just recently. There are still many problems with respect to civil servants, for whom no pension funds have yet been established despite the fact that the legislator extended to the public sector the same provisions provided for the private sector in order to harmonise the different provisions (including those related to the TFR). Public finance strictness suggested that the move towards the same TFR system operated in the private sector had to be based on a system of virtual earmarking, thereby making INPDAP (Istituto Nazionale di Previdenza della pubblica amministrazione) responsible for the notional earmarking of the funds envisaged for employees in the public sector and for the subsequent payment on retirement.

The Government intends to step up development of complementary pension funds via the proposed enabling act. This involves diverting the funds currently set aside year by year in order to finance the TFR conferring them to complementary pension funds (through modalities to be still defined), as well as a strengthening of tax incentives currently in force as far as investments returns form these funds, contributions paid to them and final pensions' accrual. The sums to be poured into the complementary funds each year - under "equal" conditions, although with particular attention being paid to the role of closed pension funds - amounts to Euro 12-13 billion.

However, such a shift is not without its own problems and difficulties. When moving from a pay-as-you-go system to a system based - even if partially – based upon capitalisation, one generation is affected more than the others as it is required to fund the current pensions' expenditure while accumulating funds to provide for their own future pensions through capitalisation. People, in fact, generally say "there is no free lunch within the welfare system".

Diverting the funds currently set aside year by year in order to finance TFR is not a costless solution, as it involves costs for both workers (who renounce to a postponed wage component) and employers, who are required to make available immediately resources that previously remained under their control being used only when the individual workers retired (or quitted or were fired, see Table 2.2.d). This is a problem at a global level too as having a total contributory burden related to pensions which sums the compulsory pillar rate of 32.7% and the private-complementary rate of 9.25 % (which is the addition of the rate of 6.91% of gross earnings currently set aside for the TFR and the other contributions on average used for complementary funds) would appear rather costly and even far away from the standard prevailing in other countries.

The Government intends to deal with this difficult but essential aspect in effective development of complementary pension funds (while the compulsory pay-as-you-go system continues to drain a significant amount of the available resources, private-complementary capitalisation-based schemes will never have room for developing themselves); the proposed enabling act aims at implementing a partial and gradual reduction (from 3 to 5 percent) of the compulsory social security contributions for newly hired workers, without affecting pensions in the public system.

This operation will obviously lead to less revenues from contributions (once the system is fully implemented, the reduction is estimated at around 0.3-0.6% of GDP, net of tax implications, depending whether the rate's cut is either of 3 or 5 percentage points); over the first few years, such a revenues' loss would be partly compensated by an increase in the contributions for para-subordinate employees (who thereby anticipate the already envisaged gradual rise to the set 19% social security contribution rate) and possibly, in the medium term, by the growth and employment enhancing effects of the reduced contributory burden. In any case, the precise amount of the social security rebate, and its financial coverage, would be pre-set within the existing public finance planning documents.

In order to compensate employers and employees for the envisaged change in destination of the sums currently used to finance the TFR, the Government is also strengthening the unemployment benefits and going to prepare a plan involving tax benefits for employers.

The proposed enabling act also envisages increasing the maximum limit (from 3 to 4% of gross earnings) within which wages paid by companies according to profit sharing agreement are exempted from social security contributions, being subjected only to a contribution for solidarity of 10% from the employer (not due when such amounts are used to fund complementary pension funds).

Objective 8 – *Ensure, through appropriate regulatory frameworks and through sound management, that private and public funded pension schemes can provide pensions with the required efficiency, affordability, portability and security.*

This Report has already provided extensive replies to the requirements set forth in Objective 8 regarding compulsory systems. Because of the strategic importance of the development of the complementary pension funds pillar, the regulatory aspects of such a pillar are becoming particularly important.

The essential framework was defined during the last decade through Legislative Decree 124/1993 and subsequent amendments and integrations, especially those related to Law 335/1995[15]. The regulation introduced in 1993 aimed to support establishment of complementary capitalisation-based pension funds on a voluntary basis for both collective groups and individuals in all production sectors and for all categories of workers - private and public, employees and self-employed. The original regulation allowed for two types of complementary pension funds - "negotiation (closed) funds" and "open funds". Legislative Decree 47/2000 subsequently introduced individual pension plans (PIP) - involving insurance schemes and obliged to act under the same criteria adopted for the two other typologies of funds.

Closed funds for employees have to be established through collective agreements between Trade Unions and Associations, these agreements possibly happening at different levels (within the national industry level contract or also at territorial or corporate level). As far as self-employed are concerned, the associations representing specific categories have the right to establish those closed fund.. Closed funds have to be established as associations or foundations from a juridical viewpoint, are non-profit organisations and generally have autonomous legal status. At the end of

[15] Prior to this regulation, initiatives regarding complementary pension funds developed without any legislative framework and were limited to certain segments of the labour market with higher than average wages (banks, insurance companies, corporate managers). These are called "pre-existent funds" and involve around 600,000 people. The new regulation allows these funds to maintain several special features, which, for sake of simplicity, will not be dealt with .

June 2002, there were 42 authorised closed funds covering around 1,050,000 members and with assets of Euro 2.75 billion. In most cases, these were funds established at the national level for specific categories through the national collective contract, which is the main pillar of the existing collective bargaining framework. Pre-existent funds at corporate level were re-converted and absorbed, whereas social partners organisations (which play a founding role in this matter) mainly opposed establishment of funds at the territorial level. However, it must be remembered that according to the recently reformed Article 117 of the Constitution, Regional Councils have acquired legislative power with regards to complementary pensions funds pillar (whereas the State has exclusive responsibility for compulsory social protection schemes) and that an increased overlap of national initiatives and across industries local initiatives could ensure more flexibility and consequently extended (above all in small enterprises) the system's coverage.

In principle, open funds may be joined by all categories of workers – employees and self-employed. They may be established by financial intermediaries specialised in asset management - banks, insurance companies, Savings Management Companies (socità di intermediazione mobiliare – SIM) and Personal Property Intermediation Companies (società di gestione del ripsarmio – SGR) - and have to maintain separate accounts even if they do not have juridical subjectivity and autonomous decision-making bodies. Employees may join open funds both individually or on a collective basis, however recognition of important tax benefits for them depends on the inexistence of a specific closed fund arranged for them and/or to the earmarking of Superannuation to the open fund itself through a collective agrremeent, which until now has made this form of funds rather unappealing for most employees. At the end of June 2002, there were around one hundred authorised open funds covering around 310,000 members (90% of tem being self-employed) and with net assets of over one billion Euro.

As mentioned earlier, complementary pension schemes also include individual pension plans (PIP) established via life insurance policies and also enabled to get the same tax advantages as afar as contribution payments are concerned. At the end of June 2002, there were around 300,000 of such PIPs and the relative technical reserves can be estimated at around Euro 320 million.

The regulation set forth in Legislative Decree 124/93 stresses the preconditions to ensure that the complementary pension funds system is both secure and efficient. The aim is to strengthen the trust in those funds also as a way to ensure the success of the overall pensions reform. For this purpose, a complex system of regulations has been envisaged: besides the reference to the prudent regulations principles and practices covering the financial intermediation system, attention has been paid to the peculiarities involving pension funds, their non-profit nature, the role of the entities who establish them and the specific source of thecontribution payments funding them. Therefore a specific control authority - the "Commissione di Vigilanza sui Fondi Pensione" (COVIP - Commission responsible for controlling pension funds) - has been established, whereas "ISVAP" (the authority responsible for controlling the insurance sector) is responsible for the PIPs.

The regulatory framework and the monitoring activity follow a modern approach: the goal is to pursue a sound and careful management of pension fundsadministrators are encouraged to carry out their role efficiently, ensuring that internal organisation is appropriate while controlling any activities carried out by outside subjects. The crucial verification of returns from financial management of assets is entrusted, according to the regulatory framework, to specialised financial intermediaries. Funds' administrators are responsible for thefact that overall management is carried out efficiently and exclusively in the interests of the workers enrolled.

Italy's regulations already comply with the requirements to be introduced at the European level via the Directive regarding complementary pension funds, agreed upon at political level by Ecofin in July and possibly enacted by the end of this year. Many aspects of current Italian legislation (for instance the regulation for investments) have been useful standpoints in drafting the European legislation.

The tax system for complementary pension funds is particularly important and may be described - in terms of standard classification schemes - as a "hybrid" type "ETT" system. It differs from the "EET" system adopted in most European Union Countries as returns from pension funds investments are also taxed, thereby anticipating part of the tax burden to the so-called "accumulation stage", a feature due to public finances exigencies. Nonetheless, the Italian system shares a decisive principle with the EET model, as it also aims at avoiding double imposition: in fact, only amounts that had not been taxed during the accumulation stage are subsequently taxed when pensions are paid.

Another special feature of the tax system for complementary pension schemes in Italy derives from the peculiar current taxation of capital gains, a system which is however due to change according to the proposed enabling act on taxes prepared by the Government. At least according to the current legislation also not yet realised capital gains (net of capital losses) are taxed. The tax rate applied to pension funds is 11 percent and is just below the rate (12.50%) applied to investments unrelated to pension funds. The current system, although internally coherent from a conceptual viewpoint, is rather complicated at an operational level; in the specific case of pension funds such a peculiar tax treatment may make difficult for the workers involved to understand the relative benefits and overload the system with considerable administrative costs..

The ceiling to tax deductibility of contributions paid to complementary pension funds has been substantially doubled - up to 12% of gross taxable personal income (overall income and not only income from work[16]), within a fixed limit of Euro 5,164.57 per year - through Legislative Decree 47/2000, thereby enhancing the incentives provided to workers to join complementary funds.

Great relevance has also the issue of complementary pension funds' management costs. The results achieved over the first few years for closed funds are encouraging. At the end of last year, their overall management costs stood at 0.57 of assets (in other words Euro 17 per-capita), with a declining trend, mainly due to the large category funds, the most able to take advantage of economies of scale. With regards to closed funds, it must also be highlighted that social partners' organisations play an important supporting role, rather decisive in containing costs. It must be noticed that the Law allows the existing social security institutions to provide services to pension funds in order to collect contributions and provide pensions under a regime of authorisation from the Antitrust Authority. This provision, when fully operational, will possibly provide significant benefits in terms of management costs due to the use of databanks and communication channels already established for the functioning of the compulsory pension pillar.

Open funds involve considerably higher costs: moreover there is yet no sign of a cost cutting trend due to the exploitation of economies of scale, this being both a cause and an effect of their unrealised take-off. The costs impinging upon PIPs operating via insurance policies are even higher: in this case, a particularly substantial component of the costs accounted for during this very first years derive from the fact that insurance companies traditionally recover placement costs from the very first instalment, a practice which may act as a de-facto limitation to the portability of pension rights.

[16] In the same direction of furthering incentives to join pension funds has also acted the possibility of deducting from taxable income the contributions paid in favour of individuals not part of the same tax unit.

Financial returns play an essential role in determining the appeal of capitalisation-based complementary pension schemes. Financial theory ascertains that, in the long term, gross returns are connected to the investments' riskiness chosen. Investments by pension funds should allow workers to take advantage of this, the portfolio's choice focussing more on investments in shares the further away retirement is. Under this perspective, attention must be paid not on short-term returns, but solely on identifying the *asset allocation* that is more coherent with the level of propensity to take risks and the amount of time left before retirement of the people involved.

However, it is inevitable that short-term returns and financial markets' fluctuations are important in determining the chances of complementary pension funds' take-off, especially with a system such as that in Italy where complementary funds operate on a voluntary basis. In fact, the current depressed level of financial markets has a particularly negative effect on pension funds' accumulation: as far as the last three years are concerned, the returns of pensions funds (the ones already underway) only in 1999 exceeded the returns guaranteed for employees through TFR (the system to be re-converted to fund complementary pensions).

The Government proposed reviewing the regulations on free circulation among the various complementary pension systems available to ensure more mobility in the proposed enabling act. The Government has also proposed extending tax benefits and reviewing the relative methods for control to ensure unity and homogeneity for the system and simplify administrative procedures and means of joining such schemes.

C) Modernising pension schemes to comply with the needs of the economy, society and individuals

Objective 9 *– Ensure that pension systems are compatible with the requirements of flexibility and security on the labour market; that, without prejudice to the coherence of Member States' tax systems, labour market mobility within Member States and across borders and non-standard employment forms do not penalise people's pension entitlements and that self-employment is not discouraged by pension systems.*

There is now more harmonisation with regards to regulations in the compulsory pension system across industries and categories. This has not been easy to achieve, taking into account that the opposition from the segments of the labour market that previously received privileged treatment caused the attempts at reform carried out in the Eighties to fail. In 1992, when commitment to reform began in view of the economic crisis in Italy, the compulsory system comprised 54 organisations and 47 pension schemes - all of which were subjected to different regulations and thereby guaranteed different pensions to people with substantially the same working histories. Employees in the public sector were particularly privileged. The necessary changes were introduced gradually and looking for the consensus of all the parties involved (also thanks to the responsible contribution from Trade Unions). When fully implemented, the contribution-based system will uniformly cover all segments and professional categories. The coverage guaranteed by the compulsory public system is universal and makes no discrimination with respect to the nature of employment - i.e. full or part-time, closed-end or open-end. The flexibility involved in the contribution-based system actually ensures that people can decide to retire from the age of 57 as long as they have paid contributions for just 5 years and their pension is at least 1.2 times the

amount of a minimum pension threshold, thereby eliminating any discrimination in the system while maintaining incentives to continue working, although the efficacy of these may only be assessed empirically in the future.

With regards to the compulsory public pension system, treatments to be funded via social security contributions were separated more definitely from treatments to be funded via general taxation so as to better accounting transparency. The previous situation made trends in pension expenditure and expenditure-contributions balances rather unclear. Currently, the social assistance expenditure as identified according to the law within the INPS budget (GIAS, Gestione degli interventi assistenziali) is balanced through funding from the State. Finally, the governance structure of the Institutions responsible for compulsory schemes were completely reformed, thereby separating the responsibilities regarding strategy and control carried out by bodies where social partners representatives sit from those regarding management for which managers appointed by the Government are responsible.

The establishment of a framework for a complementary pension funds' system – along the lines of what occurs in most developed countries - signals progress of a difficult and contrasted modernisation process. As mentioned earlier, although the relative legislation has been substantially defined (see Paragraph 8) and has no particular negative effects on mobility or discrimination with regards to the right to a pension, the development of complementary capitalisation-based pensions is still in its infancy and the efforts and initiatives to undertake over the next few years are concentrating on just this. Tables 9.1, 92.a, 9.2.b and 9.3 in the SA provide more details, thereby demonstrating that the compulsory system provides general cover (100%, excluding concealed labour, which as such is not involved in the system), whereas the complementary funds cover under 10% (with minimum differences between different professional groups).

Having said that, it is worth re-summarising the strengths deriving from the reforms underway and identifying the remaining weaknesses.

Strengths:

a) The adoption of the contribution-based method not only complies with the needs of financial stability (determining a direct link between paid contributions and pension treatments), but also makes the system more flexible, easing mobility between systems and underlying professional categories;

b) A compulsory scheme for atypical workers (so called parasubordinati) was established at INPS in 1996 (involving around 2 million pensions and net receipts of almost Euro 11 billion). It has been adding to the coverage of the compulsory system, joining the "historical" schemes for craftsmen, shop-owners and farmers;

c) The institutions responsible for the compulsory schemes for professionals and journalists (INPGI) have started a privatisation process since 1994. In such a way it has been enhanced a governance structure capable to foster the financial responsability of each specific category - though within a compulsory system that is controlled by the State;

d) The regulations regarding pensions rights accumulation (so called contribuzioni figurative) during maternity, family care, unemployment, training, and education spells and redemption of periods without paid contributions were improved as part of the reforms undertaken; in those cases in which an individual has accumulated individually insufficient pensions' rights with several social security institutions, it has been established the possibility to turn to so-called

contribution totalling, according to which the pension treatment becomes pro-quota responsibility of the various social security institutions involved;

e) The introduction PIPs via insurance policies subjected to the same legislation as pension funds (also as far as tax treatment) has enhanced the flexibility in the complementary pension funds pillar, thereby potentially allowing coverage - though currently with high management costs - of social groups that would have otherwise remained uncovered by the complementary pillar.

Weaknesses:

a) The rights granted to a number of flexible forms of employment are still inadequate, above all part-time work (in the sense that changing from full-time to part-time work is not convenient from the viewpoint of pensions' right);

b) The initiatives aimed at providing public and private coverage (not only for pensions, but also vis-à-vis work related injuries and diseases) for housewives have not taken off. Current insurance for these purposes have a low and therefore accessible cost, however the treatments guaranteed for do not appear very appealing;

c) Reforms of the public compulsory system must be completed to ensure fairness across generations and to fulfil the objectives regarding adequacy and sustainability; the coverage of capitalisation-based complementary pensions must be increased, first of all by overcoming the existing standstill with regards to the public sector;

d) Apart from the aspects regarding re-distribution implicitly acting in the calculation mechanism, actions of a solidarity nature currently involved in the wage-based system (above all supplementary benefit up to a minimum treatment) have not been confirmed for the contribution-based system.

The Government is open to any innovative experience that may help provide a better solution to the numerous situations deriving from the complexity and differences in the labour market in order to ensure a more constructive welfare to work logic.

Objective 10 *- Review pension provisions with a view to ensuring the principle of equal treatment between women and men, taking into account obligations under EU law.*

Please refer to the quality indicators in Tables 10.1 and 10.2 of the SA and the legislative appendix, which describe the legislation as regards the remaining differences between men and women, many of which specifically aim to safeguard women. The increased age for retirement in the wage-based system did not lead to equality between men and women (the limits for old-age pensions are 65 and 60 respectively). For this reason, women workers receive pensions that implicitly provide for a higher real return rate than men due to both earlier access to pensions and longer life expectancy at retirement. It must also be remembered that men receive around two-thirds of all old-age pensions. Once the contribution-based system becomes fully implemented, the different age limit for retirement in the wage-based system will be overcome (65 for men and 60 for women, which can be voluntarily extended to 65). Furthermore, the transformation coefficients translating contributions paid into pensions to be received depend upon an average (across sexes) life expectancy. It must

also be noticed that a number of specific safeguards regarding parental leave and care services have also been extended to men in more recent legislation. The overall income of both spouses has been taken into account with regards to a number of actions involving assistance (such as integration to the minimum pension and supplementary benefits) over the last few years.

***Objective 11** – Make pension systems more transparent and adaptable to changing circumstances, so that citizens can continue to have confidence in them. Develop reliable and easy-to-understand information on the long-term perspectives of pension systems, notably with regard to the likely evolution of benefit levels and contribution rates. Promote the broadest possible consensus regarding pension policies and reforms. Improve the methodological basis for efficient monitoring of pension reforms and policies.*

Please refer to the Boxes in Paragraph 11 of the SA for a detailed description of the tasks and functions carried out by the main institutions responsible for monitoring pension policies and schemes. RGS, INPS and ISTAT deserve a special mention, as they have been either using models to forecast trends or regularly published data and assessments for some time now. It must also be noted that the General Records Office for Pensioners managed by INPS allows monitoring of pensions and also their beneficiaries. INPS has also adopted its own forecast model for many years. A special unit (NVSP - Nucleo di Valutazione della Spesa Pensionistica) operates under the Ministry of Labour and Social Policies and draws up (for Parliament) an annual report on the progress in the system. INPDAP regularly prepares a report on Social Status.

A bi-chamber Commission to supervise Social Insurance institutions has been established by Parliament to control and verify these via frequent auditions and preparation of documents and reports.

Complementary pension funds are subjected to control by a specific Commission (“COVIP”), which presents an annual institutional report on progress in the sector.

The Government is aware of the importance of pensions and the legitimate expectations this generates in workers and the general public and thereby once again confirms its commitment to profitable and responsible dialogue with social partners to cover even the most difficult problems.