

# LABOUR AND RETIREMENT CHOICES OF THE ELDERLY IN ITALY

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Summary of research carried out through a collaboration between **CeRP and LABORatorio R. Revelli (CORIPE Piemonte) and R&P Ricerche e Progetti\***, on behalf of the Ministry of Welfare (*Direzione Generale per le Reti Informative e per l'Osservatorio del Mercato del Lavoro*).

The rapid ageing of the population that will affect Europe in the next few decades will have strong repercussions both on the sustainability of social security systems, financed mainly through the pay-as-you-go mechanism, and on the labour market, with possible labour supply shortages. Within this general European picture, not only is Italy no exception; but, according to demographic projections, is among the countries where the dependency ratio of the elderly is expected to grow the most.

Political responses to the challenges, but also the opportunities, posed by demographic change must operate on several fronts: from pensions system reforms to immigration policies; from fiscal incentives to encourage funded pension systems to interventions aimed at encouraging employment, especially with respect to women's labour market participation and an overall increase in labour market activity. This last objective, by reducing pressure on both pension and employment fronts, has been adopted as a key measure of European pension strategy as well as within Italy.<sup>1</sup>

Increasing the effective retirement age by five years (the European average) is an ambitious objective, not easily reached. To this end, an intervention on the different factors that result in early retirement is required. These factors affect both labour supply, where economic incentives (with formulas that implicitly "tax" continued labour market activity at relatively young ages) and psychological motivations overlap; as well as the demand side, where high overall labour costs coexist with a distorted wage structure between the young and the old.

In addition, it should not be forgotten that a considerable fraction of older workers go through a troubled period in the years preceding retirement. We should reconsider the stereotyped image of the 50-year-old living the last few working years simply waiting for the moment of retirement. Such a moment is frequently determined by, not personal choice, but rather a company crisis, often dealt with through such instruments as early retirements or layoffs, disproportionately affecting older workers. The empirical data analysed in this study show that, besides those whose transition from work to retirement occurs painlessly (who nonetheless represent the majority of cases), there is a large number of workers whose final working years are marked by an irregular pattern of labour market activity, some

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<sup>1</sup> See, for example, the recent "National strategy report on pensions", issued by the Italian Ministry of Welfare (October 2002).

with several employment periods, others with alternate periods of employment and self-employment as well as those who spend periods of time on layoff lists, are on temporary lay-off (*cassa integrazione*) or withdraw from the labour market, sometimes voluntarily, but more often not.

## Contents of the research

This report, based on a research series carried out at the request of and on behalf of the Ministry of Welfare, is intended to investigate the labour and retirement choices of older workers in Italy. The first, descriptive part intends to place Italy in the European context considering such features as older workers' labour market participation and employment incomes, retirement ages and relative incomes of pensioners. The second, more analytical part is presented in four chapters. While the first chapter presents a more detailed descriptive analysis of older workers' labour force participation, the other three can be considered a new contribution to the study of older workers' labour market activity and pension choices. The second chapter examines the dynamics that characterize the labour market of the elderly, with particular reference to job mobility and other exit paths into retirement. The third chapter analyses the role of demand-related factors in determining older workers' exit from the labour market. Finally, the fourth chapter examines old workers' retirement choices, and attempts to isolate the most critical factors. A synthesis of these three chapters is presented in the following pages.

### Job careers of the elderly: job mobility and paths towards retirement (chapter 2, part II)

Traditionally, the description of older workers' labour choices is derived from information provided by household surveys. These sources can provide valuable details about the individual characteristics of the interviewees – whether or not they are active in the labour market – and are therefore ideal in providing a snapshot of the social and working conditions of the elderly. However, they provide only limited longitudinal information; this is reflected in the detail with which we can represent labour market dynamics – the data do not allow us to extract the details of workers' individual choices and stories.

A data source which permits us to follow individual working careers over time are the Inps administrative records (*Estratti conto*), which record all private-sector employees pension contributions and events. The extent of matters for which Inps is responsible creates a rich administrative data base, permitting a detailed reconstruction of working careers. Our analysis is based on these data, especially on the combined longitudinal Panel of workers and firms for the years 1985-1996 and on the archive for the *Estratti conto*, which supplies fewer details on each contributory period but provides broader coverage, including periods of self employment and of temporary employment (always excluding however, public sector employment).

In the second chapter, the Inps data source is used to frame the different dynamics related to older workers' job mobility. The questions posed can be summarized as follows: which paths can be observed in the final phase of working careers and in the transition to retirement?

A quite common *a priori* is that these paths are quite linear; in other words, that individuals experience a smooth exit to retirement through the last years of their working life. The evidence we have gathered resulted in a net revision of this *a priori*: beside those workers whose careers passed from work to retirement painlessly, are much more complicated working histories, where we can observe numerous paths through different spells of employment, through alternate spells of employment and self-employment, periods of unemployment, temporary lay-offs (*cassa integrazione*) and inactivity, whether voluntary or not.

The results of our analysis can be summarized as follows.

- In the context of a general reduction in older workers' participation rates from the sixties on, employment in agriculture, commerce and craft has maintained a considerable importance, representing half of the older workers engaged in the private sector;

- Those 'over 50' are characterized by lower job mobility than workers at the beginning of their careers and are less affected by the economy's business cycle.
- For an older worker, the probability of being affected by layoffs mainly depends on the company's size;
- While it is true that in large companies those over a certain age are often 'anchored' to a fixed position until retirement, in small or middle-sized firms working paths reveal considerable job mobility, even among older workers.
- Only 50% of older workers, after leaving small or middle-sized enterprises, retire; the others experience very fragmented exit paths, often marked by unemployment spells or long layoff periods, as well as by short working spells in other firms;
- There are notable differences between the North and South. In northern Italy, a 'regular' career exit characterizes 50% of all retirement paths, while just over 10% of workers retire after a period of unemployment. In southern Italy, these shares are respectively 30% and 20%;
- From the second half of the eighties on, there is a net growth in older workers' incomes compared to other age groups.

#### Older workers' exit from employment: the demand side (chapter 3, part II)

Policies used to increase older workers' employment often conflict with the restructuring strategies of firms that, when facing periodic crises or a downturn in the local economic situation, use retirement and early retirement to absorb the shock; those workers who have not yet attained minimum pension requirements are forced to undergo non-working spells before retiring.

The econometric analysis highlights how companies going through crisis periods manage surplus staff by first eliminating workers already close to retirement: the probability of exit for a (male) worker employed in a firm that is reducing staff is more than twice as high as for a similar worker in a firm with steady employment. The same probability is three times higher for women working in firms that are undergoing drastic employment cuts.

An unfavourable local economic situation also increases, *ceteris paribus*, the probability of a definitive loss of employment. However, the marginal impact is limited compared to that caused by firms facing crisis periods.

An evaluation, even indirect (given the inability to combine both labour supply and demand in one model with current data) of labour demand factors compared to those that depend on workers' decisions has important *policy* implications. One general conclusion we can draw is that policy initiatives intended to affect older workers' labour supply will have only marginal impact when retirement appears to be the least costly alternative for a company's restructuring efforts. It will be necessary, in these cases, to find effective policy instruments that both reduce the social cost of firms' restructuring efforts and ameliorate the effects of economic downturns.

#### Pension choices (chapter 4, part II)

The examination of this complex phenomenon for Italy was carried out at three levels. A first, descriptive level (par. 4.4) aims to discern the existence of "typical" retirement patterns by distinguishing three different periods: the first period before the reforms of the 1990s, the second period during the reform years and the third focusing on the years immediately following. On a second level, we tried to draw general conclusions about the factors that determined and presumably will determine workers' pension choices. In order to do so, we estimated a reduced form model (cf. par. 4.5) instead of explicitly using an inter-temporal optimisation model. The explanatory variables used

consist of money's worth measures, such as pension wealth and its marginal variations, evaluated in terms of its absolute value and relative to remuneration. Finally, on the third level, we evaluated the changes these indicators will undergo in the coming years as a result of the pension reforms and, specifically of the introduction – even though very gradual – of the new contributory formula. The reduced form model provided us with a projection of the effects caused by those changes on pension probability, both for the cohorts involved in the pension transition period and for those that will be fully subject to the new contributory system (par. 4.3 and 4.6).

The analysis of the “typical patterns” highlights that mass exits at relatively young ages (up to age 54) from the labour market are much more characteristic of the reform period than the preceding one. In fact, for private employees, and especially for women, the system imposed a very strict 35-year contribution requirement to access a seniority pension; beyond that constraint – that for women almost always implied a pension at the legal age of 55 – the data show a strong recurrence of “typical ages” considered suitable for retirement according to a sort of socially recognised “norm”. In contrast, the pension reform years are characterised by highly variable exit rates and by mass “flights” each time a new retirement window opened after a freeze period. Considering the entire distribution of retirements at all ages, the net result of stricter eligibility requirements, in contrast to the “flight” induced by fear of new pension benefit cuts, was in each case to increase the average retirement age, despite strong differences among occupational categories. If we turn to the econometric estimates aimed at measuring the role of money's worth measures, we obtain mixed results. Taking into account the limitations of the analysis due above all to the administrative nature of the data base, cfr. par. 4.5.1), we find a significant effect of pension wealth in determining the probability of retirement: an increase in pension wealth produces a positive, though modest, variation in this probability. In contrast, there were disappointing results for the role of a marginal variation in this wealth (accrual and tax rate), whose coefficients are barely significant and even negative for men. These results – matching those of the (limited) existing literature on the subject, applied to Italy – deserve a more in depth analysis.

Finally, in considering the simulation for the cohorts involved in the pension transition and in the new contributory system, the results show an effect – even if modest – due to changes in pension rules (the transition to a contribution-based system) in terms of an increase in retirement age. However the final result is still uncertain for at least three different reasons, a technical one and two substantive ones. The technical reason is that – as discussed in par. 4.6.2 – the simulation methodology tends to underestimate the retirement age.

The first of the substantive reasons is that pension wealth, as we pass from older to younger cohorts, tends to *decrease* because of the progressive transition to the contributions-based formula while *increasing* due to the effect of economic growth (shifting incomes and therefore pension wealth upwards). The second reason is reflected in the fact that – as just indicated and widely discussed in par. 4.1 and 4.5 – money's worth measures seem to only partially capture the real motives that underlie individual retirement choices.

The limits of this analysis – partly due to the database's administrative nature and partly to the methodology used in the simulation – suggest an opportunity for further research.