The eurozone crisis has accelerated the reform of public pensions in Italy, but future pensions may no longer provide an adequate income in retirement.

by Blog Admin

For years Italian workers have had access to very generous public pensions, with relatively early retirement ages, and until the crisis, strong interests and the fractious nature of Italian politics made pension reform near impossible. **Leandro Carrera** *looks at the history of post-war pension reforms in Italy and finds that the eurozone crisis and influence from the EU have forced Italy to reform its public pensions system or face unsustainable budget deficits. However, with unemployment on the rise, meaning lower contributions, some may find that the new arrangements mean that their public pensions are simply not enough to live on.*

People are living longer in Europe, and the proportion of older people compared to workers is growing. These demographic and economic trends are putting pressure on public pension systems across Europe and other developed countries, and their reform is now a priority. Economic changes put further pressure on the sustainability of pension systems as people change jobs more frequently than in the past and have longer periods of unemployment, something that the current economic crisis has exacerbated.

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Since the 1990s, the European Commission has issued different recommendations to member-states on the necessity to adapt their pension systems to demographic and economic changes. But pension reforms have often stalled as an issue at the national level as workers and pensioners do not want to see their future or current pension rights affected. When reforms have been passed, they have typically been characterised by a mix of measures that retrench pension rights for some groups and address the demands of strong stakeholders and protect rights for certain groups like older workers or current pensioners. Given the particular evolution of the Italian public pension system and the significant economic and demographic pressures it faces, Italy is a good example of how influence from Europe and the effect of the crisis are changing European pensions.

Italy's generous post-war pension system

In the post-war period, Italy developed a generous public pension system that was linked to the salary levels prior to retirement, with a worker with average earnings receiving a pension of between 70 per cent and 80 per cent of their pre-retirement earnings. The system was unfunded, so the contributions of current workers were used to pay pensions. Any shortfall between contributions received and pensions to be paid had to be met through Government ad-hoc outlays.

In the 1960s and 1970s, the system became even more generous and, under specific provisions, workers could retire before the legal retirement age provided that they had achieved the minimum number of contribution years. These so-called “seniority pensions” became a problematic aspect of the public pension system as they allowed people to retire early at a time in which life expectancy started to rise significantly, which meant that people would spend more time receiving pensions than in work. As a consequence, pension spending rose from 5 per cent of GDP in the 1960s to around 15 per cent of GDP in the early 1990s. Attempts to reform the public pension system during the 1980s failed due to the opposition of the labour movement and pensioners. Moreover, weak governments usually formed by between 4 and 5 parties made it impossible to garner common support for reforms.

The 1990s saw Italy’s traditional party system collapse in a massive corruption scandal and pressure from the EU to put public finances in order mounted to comply with the euro’s convergence criteria. Thus, the crisis and Europe opened the window for significant reform. The reforms adopted by technocratic governments in 1992 and then later on in 1995 were path-breaking. The most important aspect was the introduction of a new contribution-based system, in which pensions are calculated on the basis of the contributions actually paid, GDP growth, and life expectancy at retirement. Thus, the new system pays higher pensions to those who have contributed for a long time and retire later.

The reform was negotiated with the labour movement, which obtained concessions for older workers, the bulk of their membership support. The most important concession was that the system would only apply to new entrants. Workers with 18 years of contributions or more would retire according to the rules of the old system. Those with less than 18 years of contributions would have their pensions calculated on a pro-rata basis. These long transition rules meant that the effect of the reforms would take a number of years to apply to all workers. Thus pension spending would start to decrease very slowly. Moreover the reforms did not eliminate “seniority pensions” but just increased the number of years necessary to qualify for them to a minimum of 35 years.

Pension reform after the 2008 crisis

The economic crisis hit Italy hard in 2008. The Government budget deficit reached 5.2 per cent of GDP in 2009 and domestic and foreign investors started worrying about the capacity of the Italian state to repay its debt obligations, which by then represented around 120 per cent of GDP. The European Commission also made specific recommendations to reduce the Government budget deficit, to which public pension spending contributes significantly. The Commission highlighted the need to eliminate seniority pensions and to reduce the transition to the contribution-based system. In 2010, the Berlusconi Government unveiled a series of measures but none of them touched on these two issues. Short of support from its partners for further reform, the Government fell in November 2011.

The new care-taker Government, led by former EU Commissioner Mario Monti, focused on implementing a budget bill that would address the concerns of domestic and international actors about the sustainability of Italy’s public finances. The government justified these measures on the grounds that they were necessary to save the country from collapse and even labelled this decree as the “save Italy decree.”

The new budget bill included significant changes to the pension system. From 2012, all workers will accrue pension rights in the contribution-based system, effectively eliminating the transition periods established in the 1990s. The measures also include an increase in the minimum years of contributions and in the age needed to access a seniority pension, which in practice means that no worker will be able to retire on these pensions before 66 years of age from 2015. The retirement age is increased to 66 years for men in 2012 while women’s retirement age will be progressively increased to reach 66 years in 2018. Finally, the uprating of pension benefits by inflation is suspended for 2012 and 2013.

Italy is a good example of how economic and political crises, in addition to pressure from the EU, can bring significant change in the area of pension policy. The reforms initiated in the late 1990s and continued in 2011 have been a significant reconfiguration of the pension system from one in which pensions were based on earnings to one based on contributions. For an employee with average earnings growth and 40 years of contributions, it has been estimated that their public pension would be reduced from representing around 70 per cent of their pre-retirement salary in the old system to around 56 per cent in the new one.

However, the new system could lead to even lower pensions for some individuals with an insufficient number of years of contributions who have spent relatively long periods of time unemployed. This is because in the new system the pension paid is related to the total amount of contributions paid. With the unemployment rate hovering around 10 per cent of the workforce and prospects of low economic growth in upcoming years, it is likely that a significant number of current workers will receive a low pension in retirement. Also, some categories of workers like the self-employed, who typically make lower and interrupted contributions, could be worse off than workers with uninterrupted and higher contribution records.

While the Italian public pension system may have been saved from collapse thanks to recent reforms, there is a risk that future pensioners will receive much lower pensions than expected.

Note: This article gives the views of the author, and not the position of EUROPP – European Politics and Policy, nor of the London School of Economics.

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