Sketches of Italian Pensions Conundrum

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Despite the long series of reforms, since the beginning of the '90, in Italy pensions continue to be at the core of the policy debate and electoral programs and promises. Giving Italian pensions a final and stable framework implies the solution of, or at least the coping with, a conundrum made up of multiple facets and contradictions. This article proposes a very brief description of the most significant points.

1. ***High percentage of GDP, Poor average pensions -*** Even if Italy has one of the highest incidence of public pensions expenditure on GDP (15,7[1]), the vast majority of pensions are of low / very low amount. Almost 40 percent of pensioners receives monthly gross pension incomes lesser than 1,000 euro, while almost 70 percent stays below 1,500 euros[2].

2. ***High percentage of GDP also after Taxes*** - Net of taxes, Italian public pensions continue to absorb more GDP points (12,9) than EU28 (10,3) and AE (10,7) averages. In the comparison across countries, it is necessary to consider that obligatory pension contributions are deductible from labor income in Italy (EET scheme), while this is not always the case in the rest of EU countries (in some cases contributions are not deductible or only partially deductible).

3. ***High incidence also in the Longrun -*** Though totally stabilized on GDP, the incidence of gross public pensions will remain above 15 p.p. till the end of the 40s and thereafter it will gradually decrease to just under 14 p.p. by 2060[3]. The spreads with respect to EU28 and EA averages will gradually shrink over the projection horizon, anyway without completely disappear. In 2060 Italian gross incidence will be respectively 2,6 and 1,5 p.p. higher.

[1] According to the latest Report by AWG, the Italian 15,7 per cent compare with 11,3 of EU28 and 12,3 of EA.
[2] INPS (2017), "Annual Report".
[3] Projections are from the central scenario developed by AWG.

Specula comparison can be traced for net incidence on GDP[4].

4. ***Higher Pensions, Lower provisions elsewhere in Welfare -*** According to AWG baseline scenario in terms of GDP, Italian higher spending on pensions corresponds to lower spending on the other welfare institutions (acute health care, long-term care, education, unemployment benefits, contrast of poverty, access to home, etc.) that are important not only for redistribution and cohesion but also for promoting productivity and growth. This feature captures a structural characteristic that existed far before the crisis and has been sharpen by the crisis. AWG projections, based on the hypothesis of invariant normative framework, show that also in the longrun (2050 and beyond), despite the full stabilization on GDP, the percentage dedicated to public pensions will be more demanding than elsewhere in Europe[5].

5. ***High pension Contributions, Low Accrual rate -*** Obligatory pension contribution rate levied on employees' wages is 33 per cent in Italy, a very high figure in a double perspective: in comparison with other European countries[6], and in comparison with the final pension workers can receive, having in mind that contributions accumulate at GDP annual growth rate and that, at retirement, capital is transformed into an annuity with a prefixed real interest rate of 1,5 per cent [7]. The disproportion between contribution effort and final provision will become more and more evident as soon as pensions with prevalent contributive part start to be paid. This disproportion is at the basis of the fact that those high pension contributions are, at least in part, more and more perceived as a form of hidden taxation.

6. ***Poor pensions in the future if quality of work and length of careers will not improve -*** The current mix <high incidence on GDP and low average value of pensions> will remain a structural characteristic also in the future. Possibly, this critical combination will be exacerbated if current labor market trend are not changed. In fact, after interrupted careers, with several years spent in part-time and/or low paid quasi-subordinate works, in several cases the notional capital (accumulated within the public pension system) won't be sufficient to pay a reasonable pension, with possible repercussion also on other social security budget items.

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[4] In 2060 Italian net incidence will be respectively 1,3 and 0,8 p.p. higher.

[5] See table at page 9 of "The 2015 Ageing Report" by AWG.

[6] See table at page 73 of "The 2015 Ageing Report" by AWG.

[7] Since 1995, when the notional accumulation computation rule was first introduced, the average GDP annual growth rate has been slightly below 2,6 per cent, while the annual real rate slightly below 0,6 per cent. Pension contributions accumulate at the GDP annual growth rate to constitute a notional capital that, at retirement, is transformed into an annuity indexed to inflation. As from 2012 ("Fornero" reform), this computation criterion is applied to all new contributions paid by all workers irrespective of their seniority.

7. ***Double bladed knife of Prolonging Working life*** **-** In front of these problems, raising pension requirements and prolonging working lives (more than it has been already done by latest reforms) could reveal a double bladed knife. In the short-medium term this sort of measures surely alleviate pressures on public finances but, depending also on their specific design, they could also slow down the entrance of youngsters on the labor market and the turnover between old and young generations, with possible repercussions on the potential growth of the economy[8]. In the longrun, with pensions more and more computed with the contributive criterion, longer careers will imply a rise in the average value of benefits paid to pensioners. If, on one hand, this would contribute to counterbalance the already cited problem of low average value of pensions, on the other hand it is bound to exert further pressure on aggregate pension expenditure, preventing or at least making more difficult any re-composition/re-qualification internal to the social system and in favor of other budget items. In other words, public pensions will ever absorb a higher share of welfare resources in comparison with European standards.

8. ***Overreliance on PayGo and possible sources of Endogeneity -*** Italian high incidence of public pensions on GDP (current and in perspective) should be weighted also in the light of the fact that it is totally PayGo financed. PayGo means, in a very schematic example, that all workers contribute, year by year, to pay pensions to those already retired. PayGo is a "scarce resource", in the sense that there is a reasonable - even if not exactly identifiable - upper limit to the scale at which it operates; beyond that level, the transfer of resources from the employed to pensioners starts plausibly generating distortive effects on labor supply and demand, on production and investment decisions and on effort and productivity decisions. Today Italy is probably very close to this ceiling for two orders of reasons: those already cited in the previous point 5.[9], combined with the fact that, despite efforts provided by the employed, resources collected from them are too much dedicated to pay pensions and consequently few possibilities remain for financing the other welfare instruments. In other words, the other side of this excessive concentration on pensions is the underdevelopment of components of welfare system that are essential to promote today[10] wellbeing across all ages, participation to labor market, employment, formation and preservation of human capital, ultimately to promote growth. Behind this argument there is the idea that the more public welfare expenditure is homogenously spread across functions, the more it can positively combine redistribution and growth purposes.

[8] The so called "lump of labor" theory that underlines that in the short term, and above all during crisis periods, the amount of work (in the sense of working places) available in the economy is fixed or very difficult to increase.

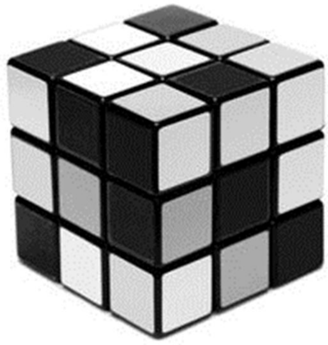
[9] Pension PayGo is not financed only out of obligatory contributions levied on the employed, but also with resources coming from general taxation. Nevertheless, the weak-points of an overreliance on PayGo continues to be valid, even with more strength.

[10] "Today" in the sense "not in 45 or 40 years" as it happens for pensions.

9. ***If GDP had risen or if it rose ... -*** One general criticism to the aforementioned problems points to the fact that sustainability of pensions and welfare expenditure depends also on GDP dynamics per se (i.e. the denominator of expenditure incidence) as well as on the other items that year by year contribute to define public budget balances. Structural reforms regarding pensions and welfare systems are not the only "levers in the bag-of-tools". This argument is of course true and can be agreed on, but only upon the condition it is used to design better and more equilibrate policies and not to avoid tackling problems. Some of the points previously underlined regard directly pensions and characterize Italy since a long time. They have been only exacerbated by the crisis and it would be worth wondering what could have been the response to the crisis in case Italy had already challenged and overcome or scale down them.

10. ***The Tie of Acquired Rights -*** Any solutions to the mentioned points have to respect (as much as possible) the tie of acquired rights, regarding not only pensions in payment to already retired but also (part of) pensions still in the accruing phase under past generous rules and that will be paid in the future.

11. ***No easy solutions -*** A very difficult and intricate conundrum, indeed. Like in a Rubik's Cube, it does not exist a clear-cutting recipe capable of fixing the problem in a single play. Maybe the best strategy is similar to what Italy is already pursuing during the last three years: focusing on young generations (aged 30/35 or less) and trying to reshape public welfare provisions available for them and, at the same time, their charge in terms of obligatory contributions. If such a program were implememeted coherently, step by step it would help regenerating the entire system



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