Pension reforms in Europe: beyond parametric changes

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Pension reforms in Italy
from fiscal unsustainability to the risks of individualization

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✓ Before reforms.

- old age protection in Italy
- major problems, early 1990s

✓ The reforms.

- Refinancing, Retrenchment, Restructuring
- a long series, 1992-2009
- the first pillar

  parametric changes....

  beyond parametric changes, the new NDC system
- “ top-down” *multi-pillarization* in adverse conditions

✓ After reforms.

- a new pension architecture
- old age protection in the multi-pillar system
- economic sustainability versus social adequacy ?

- any solution?
- learning from Italy...

Before reforms

old-age protection in Italy

Public, compulsory Schemes

Payg, earnings-related

PRIVATE EMPL.	**PUBLIC EMPL.**	**SELF-EMPLOYED**

COMPULSORY SEVERANCE PAY SCHEMES

TFR for private employees (7% g.w.)
IDB for public employees

Social Pension
Means tested, Very low

1° PILLAR

Hybrid schemes

Before reforms

major problems, early 1990s

✓ ***Economic and financial unsustainability***

- High and rising expenditure for pensions: from 4.5% Gdp (1960) to 11.8% (1991) and 12.8% (1992)
- Growing gap between contributions and revenues
- Growing transfers from the state budget to fill the gap

✓ ***Intra-generational unfairness***

- Favorable treatment for high-income earners
- Favorable treatment for self-employed (since 1990): low contribution rate
- Very favorable seniority pensions for public employees
- Low retirement age for private employees (60M-55W)

✓ ***Lack of supplementary funded pillars***

Before reforms

a high public pensions expenditure

Country	*YEAR 1990*
Austria	12.5
Belgium	10.5
Denmark	10.2
Finland	8.2
France	11.1
Germany	11.2
Greece	11.5
Ireland	5.4
Italy	**13.6**
Luxembourg	9.6
Netherlands	11.1
Portugal	9.8
UK	9,9
Spain	8.3
EU average	***11.0***

early 1990s

"….projected public pension in 2040: 23-24% Gdp…"
General Accounting Office

The reforms

refinancing, retrenchment, restructuring…

✓ **FIRST PILLAR, the critical juncture of the early 1990s**

- **REFINANCING up to 1995**
- **EU constraints ("*vincolo esterno*") and high labour cost call for RETRENCHMENT**

cost containment via harmonization, NDC

✓ **RESTRUCTURING, "top-down" multi-pillarization in adverse conditions**

- **1993 First regulatory framework for supplementary funded pensions**
- **first (occupational) fund set up in 1997**
- **enrolment via "silent-consent" in 2005 (implemented 2007)**

The reforms

a long series, 1992-2009

	First pillar	Supplementary pillars
1992-93	Parametric reform still earnings-related	Regulatory framework Closed & Open funds
1995	Shift to NDC system	Stronger tax incentives to foster funded pensions
2000		More incentives to foster funded pensions / PIP
2004-5	Further adjustment to contain costs in medium-short term	“Silent-consent” mechanism to transfer TFR to funds
2006-7	Partial reversal of 2004 reform	Revision of the “silent-consent” mechanism
2009	ECJ and “direct recalibration”	

The reforms, RETRENCHMENT

parametric changes

- **Retirement age:** 55 (w)-60 (m) ⇨ 60 (w)-65 (m) *automatically linked with demogr. trends*
- **Seniority pensions:** 35 (20/15 PE) ⇨ 40 or "quota 95" "quota 97" in 2013
- **Minimum contrib.:** 10 years ⇨ 20 years
- **Indexation:** wages ⇨ CPI
- **Reference earnings:** last 5 years (1 year PE) ⇨ 10 years

The reforms, RETRENCHMENT

beyond parametric changes, the new NDC system

✓ Still PAYG

✓ Benefits linked to:
- contributions actually paid
- retirement age flexible 57-65 (later removed)
- economic growth
- demographic trends

✓ Applies to private and public employees and the self-employed:
HARMONIZATION based on the actuarial principle

✓ Applies:
- *fully* to new entrants to the labor market after 1.1.1996 only
- *pro rata* to workers with less than 18 years of contributions in 1995

NOT APPLIES - to workers with at least 18 years of contributions in 1995

LONG PHASING IN

The reforms

the agreement between government and unions

Cost containment

in the medium-long term

Protection of retirees and older workers

Harmonization
across professional categories and income levels

The reforms, MULTI-PILLARIZATION

in adverse conditions

Payg system wide and mature	Fully payg since 1969 Coverage 100% of the workforce
Payg system in acute financial crisis	Pension expenditure: 12% Gdp and rising Gap contributions/revenues: growing
Scarce available resources	High contrib. rate: 26% (1992), 33% (1995) High deficit/Gdp ratio: 10.5% (1991) High debt/Gdp ratio: 117.3% (1992) No realistic expectation of sustained economic/occupational growth

Political resistance – *veto points*

→ **TFR chosen as "institutional gate"**

The reforms

"Top down" MULTI-PILLARIZATION

A case of:

- o **LATE DEVELOPMENT of supplementary funded pensions**
- o **transition started in particularly ADVERSE CONDITIONS:**

extremely acute "double payment" problem

o PLANNED development by policy makers since the early-1990s

o "looked for" a SOURCE of FINANCING for supplementary pensions…and they found it: the TFR

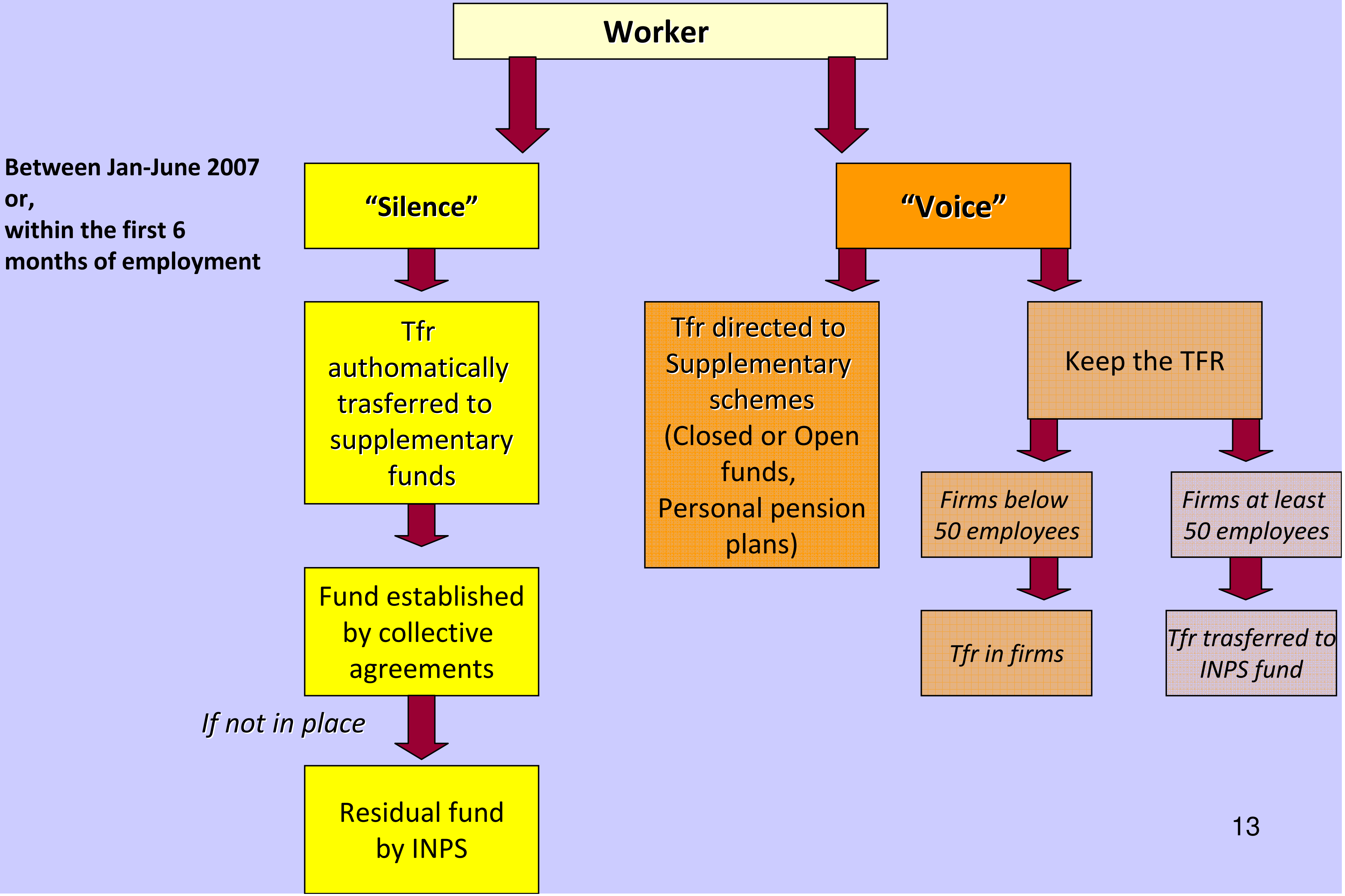
o HIGH regulation and standardization of rules between different types of schemes

FUNDED/DC

o the "CHOICE for the TFR" affects some BASIC FEATURES of funded pillars

- priority to occupational funds
- <u>voluntary and individual affiliation</u>

The TFR and the "silent-consent" mechanism



After reforms

a new pension architecture

Public, compulsory schemes

Payg
NDC

Old age allowance

42 CLOSED FUNDS
DC

memb: 2 millions
Of which
Employees
private sector 1,9 mi.

81 OPEN FUNDS
DC
memb: 800.000
Of which
ca. 400.000
employees

PIP
memb: 1,5 millions
Of which
ca. 700.000
employees

alternatively

Severance pay - TFR

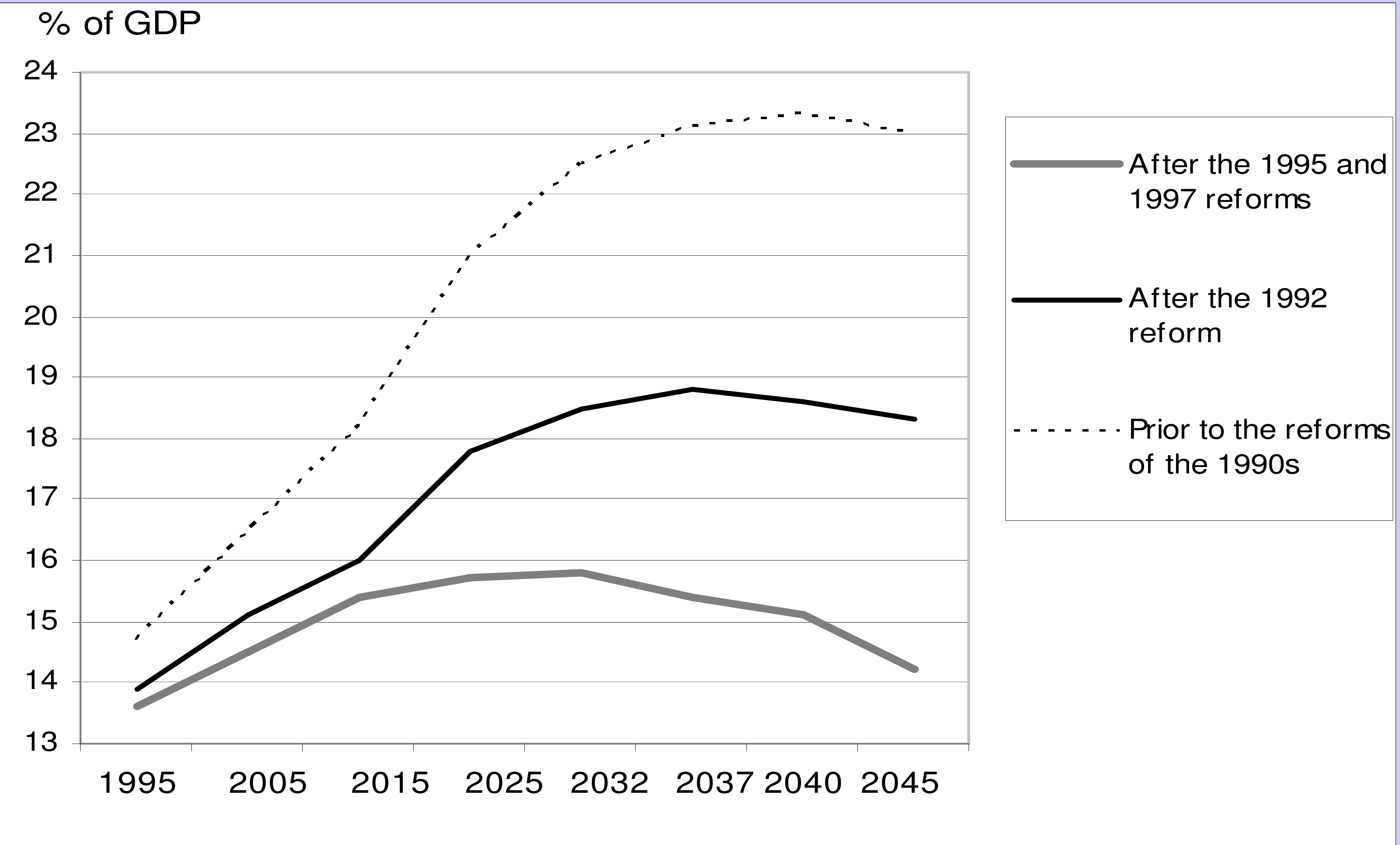
1° PILLAR

2° PILLAR

3° PILLAR

After reforms

economic sustainability



After reforms

economic sustainability

Country	2007	2010	2020	2030	2040	2060	*change*
Austria	***12.8***	12.7	13.0	*13.8*	*13.9*	13.6	*0.9*
Belgium	***10.0***	10.3	11.8	*13.9*	*14.6*	14.8	*4.8*
Denmark	***9.1***	9.4	10.6	*10.6*	*10.4*	9.2	*0.1*
Finland	***10.0***	10.7	12.6	*13.9*	*13.6*	13.4	*3.3*
France	***13.0***	13.5	13.6	*14.2*	*14.4*	14.0	*1.0*
Germany	***10.4***	10.2	10.5	*11.5*	*12.1*	12.8	*2.3*
Greece	***11.7***	11.6	13.2	*17.1*	*21.4*	24.1	*12.4*
Ireland	***4.0***	4.1	4.6	*5.4*	*6.4*	8.6	*4.6*
Italy	***14.0***	14.0	14.1	*14.8*	*15.6*	13.6	*-0.4*
Luxemburg	***8.7***	8.6	9.9	*14.2*	*18.4*	23.9	*15.2*
Netherlands	***6.6***	6.5	7.8	*9.3*	*10.3*	10.5	*4.0*
Portugal	***11.6***	10.8	12.4	*12.6*	*12.5*	13.4	*2.1*
UK	***6.6***	6.7	6.9	*7.6*	*8.0*	9.3	*2.7*
Spain	***8.4***	8.9	9.5	*10.8*	*13.2*	15.1	*6.7*
Sweden	***9.5***	9.6	9.4	*9.5*	*9.4*	9.4	*-0.1*
EU27 average	***10.1***	***10.2***	***10.5***	***11.4***	*12.1*	***12.5***	***2.4***

After reforms

development of supplementary pillars

TOTAL: 5 millions contributing to suppl. schemes

o **Take up rate private employees: 32%**

....in firms with at least 50 employees: take up 42%
....in firms with less than 50 employees: take up 12%

FIRM
SIZE
MATTERS

After reforms

development of supplementary pillars

Total employment: ca. 23 million

Total members of suppl. schemes: 5 million

Comparatively low-medium coverage, but….

	Private sector	**Public sector**	**Self empl.**
N° funds	37	1	-
Take up rate	ca. 30%	Ca. 2%	15%

Private sector take up rate breakdown:

- **> 60%** — *8 funds*: **TFR exploited** Medium/big firms- strong unions .
- **30%-60%** — *12 funds*: **TFR not exploited: Sectors/ dimension/ unions**
- **< 30%** — *11 funds*: **TFR not exploited: Sectors/ dimension/ unions**

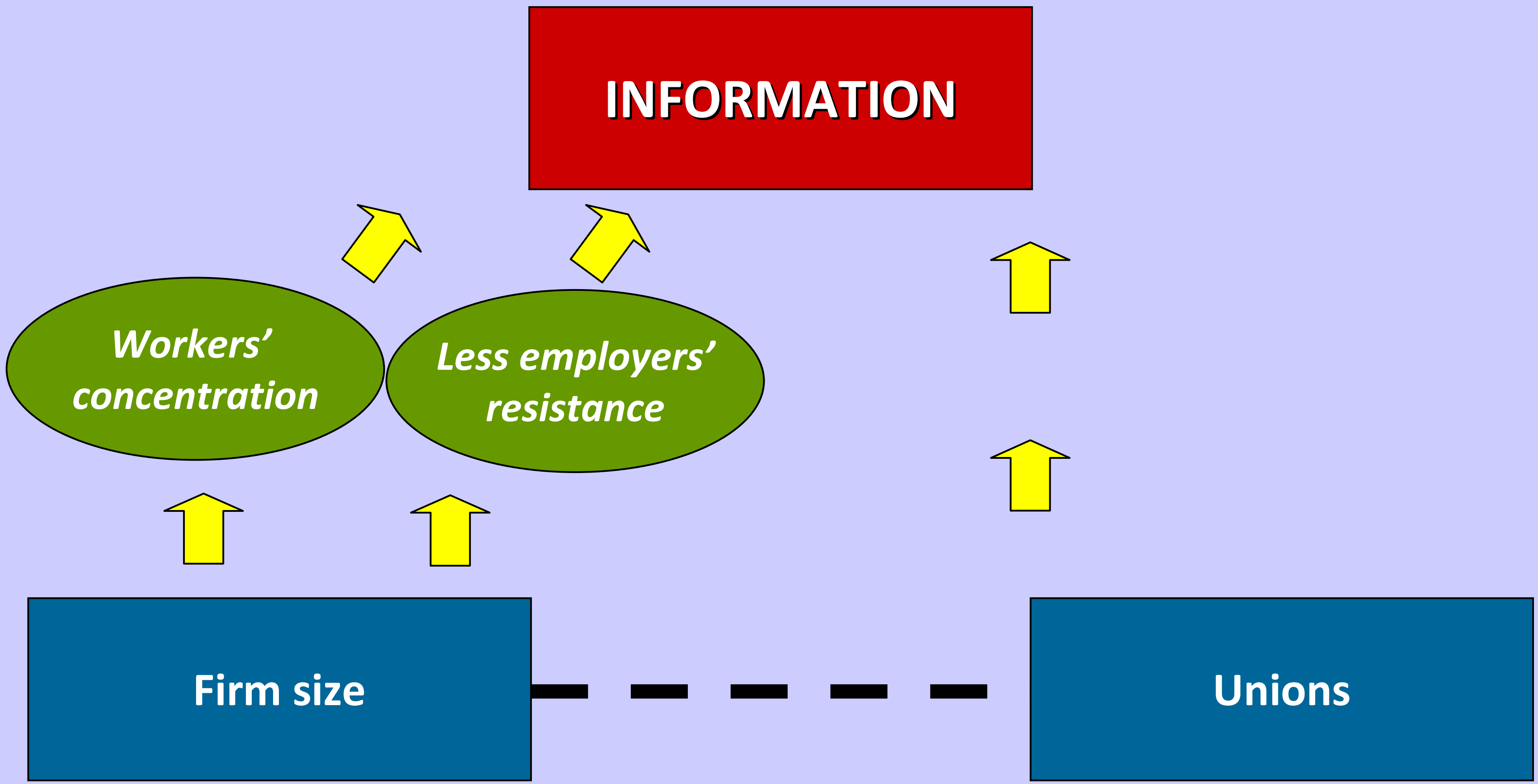
Public sector: TFR available (from 2001), BUT "silent-consent" does not apply and Employer (State) reluctant to set up funds

Self empl.: **6 million**

TFR not available

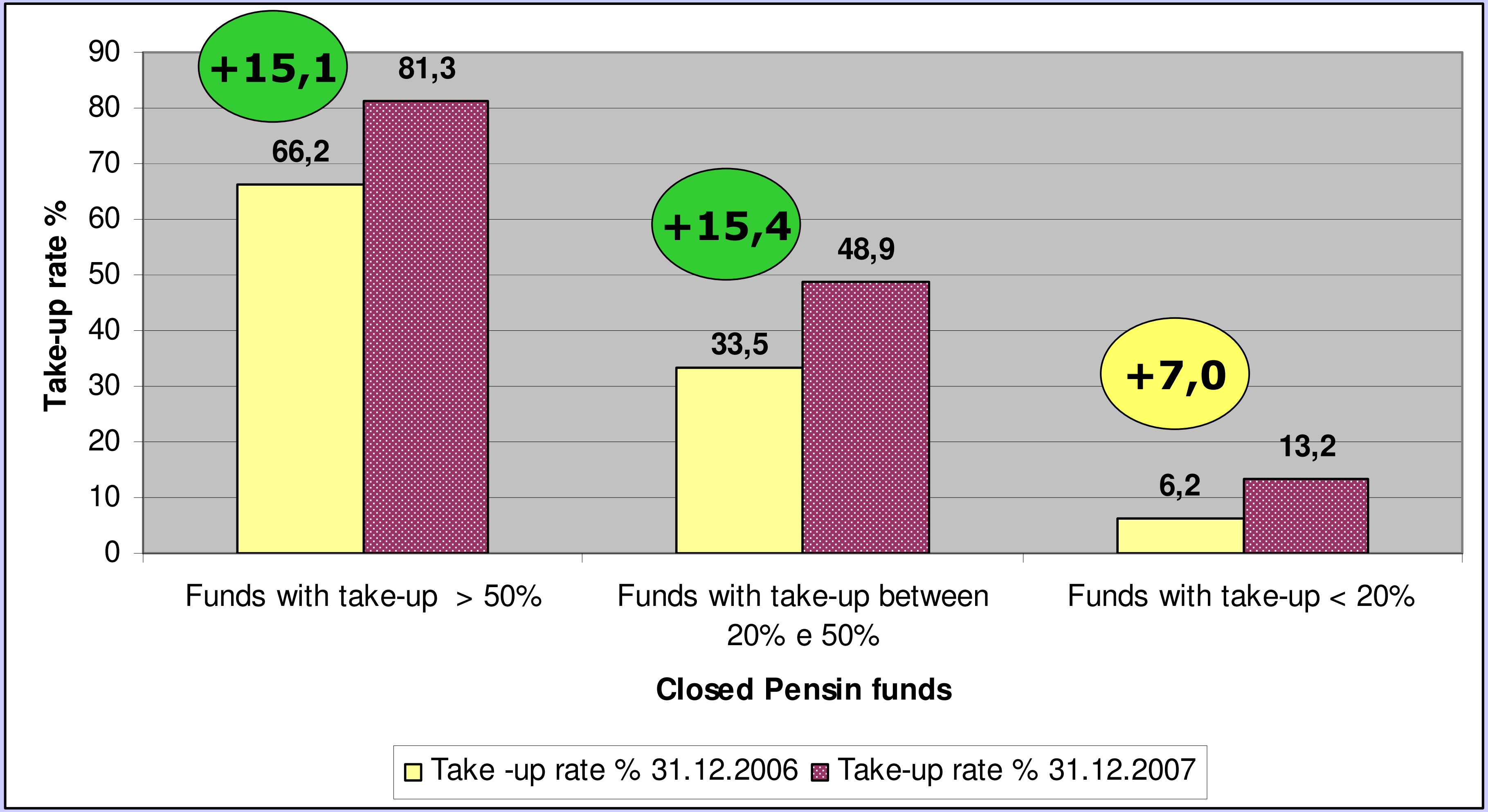
After reforms

conditions for the transfer of the Tfr to suppl. funds



After reforms

effects of the silent-consent mechanism

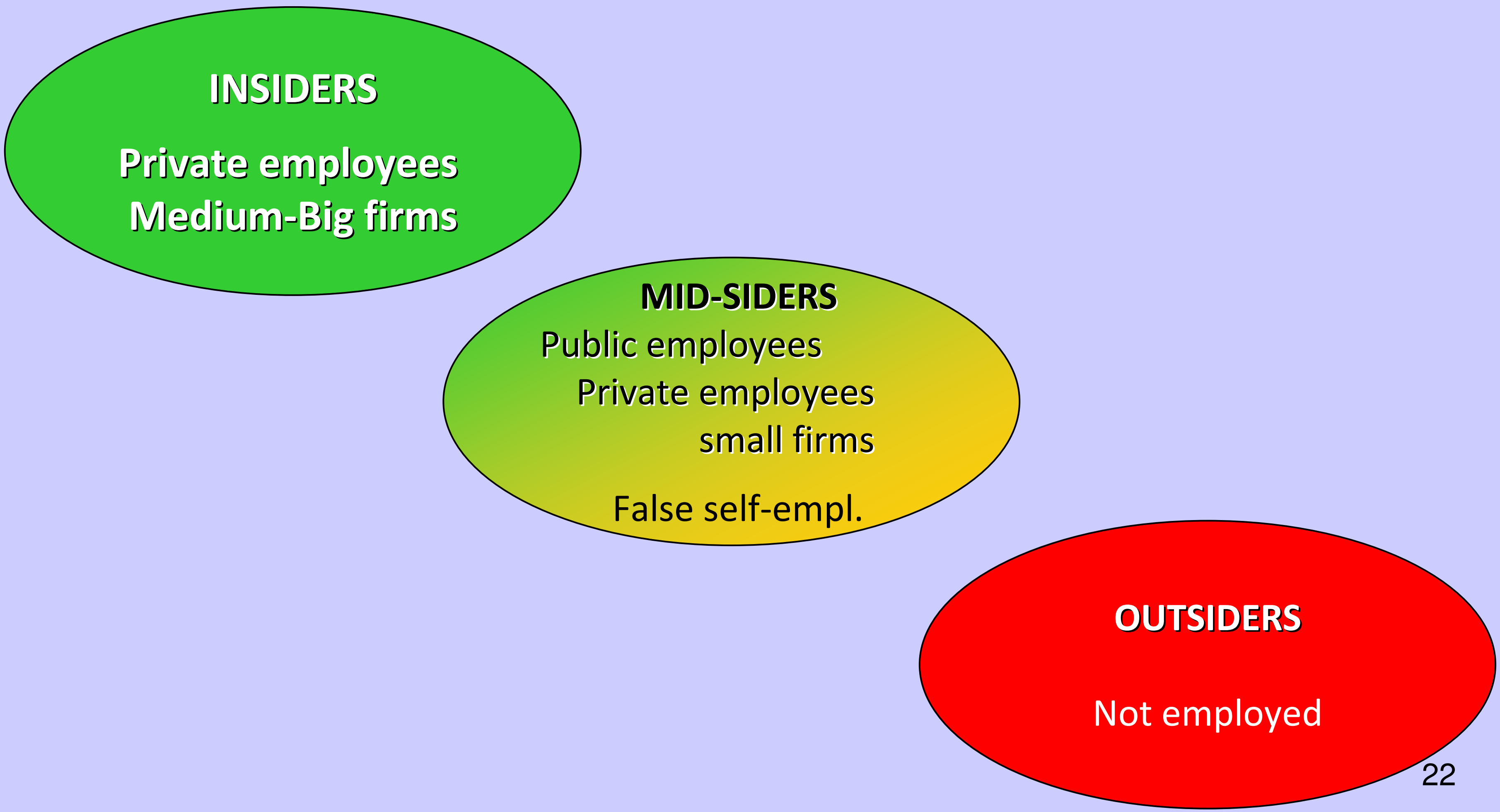


After reforms, social adequacy

	1° pillar public pensions	2°/3° pillars supplementary pensions	TFR
Private employees big firms/unionized sectors	Medium-high (r.r. 50%-55%)	Yes	No
Private employees small firms/ non unionized sectors	Medium- high (r.r.50%-55%)	Generally Not	Yes
Public employees	Medium-high (r.r. 50%-55%)	(Generally) No	Yes
Self-employed	Low (r.r. 30%)	Generally not	No
Atypical workers	Very low (r.r. below 30%)	No	Generally not

After reforms

old age protection in the multi-pillar system



..any solution?

Pension policy

✓ ***Supplementary pillars***

- **extend coverage:** **recurrent silent-consent “campaigns”**
  extension of silent-consent to public sector
  more compulsion?

....nevertheless.....

✓ ***First pillar***

- **more explicitly redistributive elements (contribution credits, progressive r.r.?)**
- **strenghten means tested old age allowance**
- **work longer ....**

Other policies

✓ ***Reform unemployment protection system***

✓ ***Stimulate economic growth, especially in the South***

✓ ***Develop (re)conciliation policies*** → ***raise women empl. rates***

Learning from Italy....

NDC should ensure financial/economic sustainability in the long run....

- Financial sustainability versus social adequacy?
- Pension privatization (even partial and voluntary) hampers old age protection?

....may be misleading

- **The importance of reform design**

combination of NDC + DC eliminates redistribution,

problematic in a period of scarce resources

choice for voluntary supplementary pillars

likely gives rise to coverage problems

- **Crucial interaction with labour market policies (other social policies) and economic policies**