Italy: The good, the bad, and the pension policy

By Editor Test *Wed, Jul 27, 2011*

Many Americans yearn to vacation in romantic Italy, But, as this essay from IPE.com explains, Italians yearn for a less stagnant economy, cleaner politics, more jobs and a pension that replaces 60% of final salary.

Economic growth is the crucial issue for Italy and specifically for pensions. Without growth, pension costs – which are now 11.4% of gross domestic product (GDP) – will increase in relative terms. Pension benefits will reduce because they are linked to GDP, not inflation, and many young people cannot find a regular job that allows them to pay pension contributions.

The Italian economy is failing to deliver: it is anaemic, and it grows at a much slower pace than expected – worse than that of similar European countries like France as the Italian central bank's governor Mario Draghi pointed out in his last annual report.

In order to stimulate the economy Draghi suggested cutting public spending ''selectively" and reducing taxes on workers and companies. How "selective" these spending cuts could be, and who would benefit from tax cuts, is now the focus of the political debate.

"Everybody claims that the Italian pension system is well balanced and doesn't need to be corrected, but if the government must save €40bn in public spending to fulfill its European obligations, how is it possible not to affect also the pension sector, which represents a large share of public spending?" asks Giuliano Cazzola, vice-chairman of the House of Representatives' labour committee and member of Berlusconi's People of Freedom (PdL) party.

Still, after the elections Berlusconi himself promised not to touch the pension system: "It would be easy to cut taxes if we do what other countries do about public employees or pensions," Cazzola continues. "But we are not willing to do so, even if we reform the tax code." The welfare minister Maurizio Sacconi reaffirmed that there was no need to interfere again with the pension system after the changes introduced last year. These will provide around €1bn in targeted savings.

A tax reform could mean many things for the pension system, depending on political point of view. It should be used to redistribute income in favor of workers and the retired, according to Susanna Camusso, the national leader of CGIL, the left wing union organization that supports the Democratic Party (PD).

She says that the unions' goal should be to guarantee future pension benefits that represent at least 60% of final salary, so that "we avoid building a country of poor people."

Camusso recalls that because of 2008-09 financial crisis, the new pension rules and the difficulty of finding steady employment, young Italians will enjoy meager retirement benefits, based entirely on their contributions.

She adds that the social consequences could be serious: "Pension benefits, even if low, have ensured social cohesion in Italy. It's the retired people in the households who supplement young temporary workers' income, offer them a home and babysit their children." The CGIL leader thinks that fighting tax evasion may be sufficient to get the resources necessary to finance richer pensions, because tax cheating is such a huge phenomenon in Italy. On the same page is Raffaele Bonanni, the leader of the other important Italian union, the Catholic-centrist CISL, which is more favorable to the government: "We need to tighten the fiscal clamps to find means for workers and retirees."

However, fighting tax cheaters has been a 'top priority' of many Italian administrations of all political colors without visible results. On the other hand, it remains to be seen whether cutting taxes on earned income will foster economic growth, as foreseen by Renato Brunetta, the minister in charge of public employees, who last year succeeded in raising the retirement age for women employed in the public sector to 65 years. This will be effective from 2012.

"Reducing the tax burden on labor, we create incentives to work, hire, produce and invest more," said Brunetta, clarifying that these cuts will have to be compensated by raising taxes on consumption.

Tax reform may solve a problem that afflicts Italian pension funds: they pay taxes on virtual annual earnings, while in most European countries pension funds enjoy better fiscal treatment.

Another possible change for pension funds regards their investment limits: Antonio Finocchiaro, the chairman of the pension authority COVIP, advocates more freedom for the funds' managers in order to achieve better performance and attract more members. He is working with the treasury to decide which new assets and financial activities should be included in a fund's portfolio.

Indeed the mediocre competitiveness of the pension funds that have the largest membership (around two million employees) – the so-called closed funds that are co-managed by employers and unions – may be one of the reasons why Italian workers don't run to join them: in 2010 their average return was 3%, compared to the 2.6% revaluation of trattamento di fine rapporto (TFR), which is the money that employers put aside to give as a lump sum to employees when they leave and which is an alternative to pension funds. With memories of the 2008 financial market crash and of pension funds' losses still fresh, one can understand why 77% of Italian eligible pension funds' members prefer to keep their TFR. Among actual fund members, only 17% are under 35 years old.

So on 25 May 2011 the government launched a new campaign to inform young people about what to expect for their pensions and how to start early to build up their retirement savings. 'One day for the future' was the slogan of the initiative, which is supposed to go on all year around under the responsibility of INPS, the Italian Social Security system, with lessons in schools and online educational material.

Teaching teenagers that their future is their pension reveals a typical Italian state of mind: it emphasizes the importance of relying on the welfare state from cradle to grave, more than the value of being creative and productive as early as possible in order to generate wealth for oneself and society.

It's a mentality common to both left and right in Italy and it can explain why the country is stagnant. Even Berlusconi, the self-made entrepreneur who 17 years ago became a politician with the promise to shake the status quo, has not been successful in introducing structural changes in the system. Now that Berlusconi's star is declining, it's unlikely that in the next two years – if he stays in power – he will be able to achieve a fiscal reform that sparks a recovery for the economy and for pension funds too.