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# A General Equilibrium Evaluation of the Sustainability of the New Pension Reforms in Italy

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## NON-TECHNICAL SUMMARY

Population ageing, determined by the increase in life expectancy, the reduction of fertility rates and, most of all, the baby-boom produced during the Fifties and Sixties, will be a common characteristic of most of all industrialized countries over the next decades. The aim of this paper is to provide an evaluation of the economic consequences of population ageing in Italy. The Italian case is a very interesting case for two reasons: first, in Italy, the demographic problem is one of the most serious in the world (only Japan will exhibit greater old-age dependency ratios, i.e. the ratio of the number of people aged 65 and more to the working age population); by considering that the Italian pension system is almost entirely composed of a compulsory public Pay-As-You-Go system, it will be extremely exposed to the demographic evolution; second, since 1992, many reforms have been introduced by the Italian governments in order to face the demographic problem: the Amato reform in 1992, the Dini reform in 1995, the Berlusconi reform in 2004 and the Prodi reform in 2007.

The Amato and the Dini reforms induce a strong reduction in the generosity of the Italian pension system by introducing (1) an indexation mechanism of pension benefits to prices instead of to real wages, (2) a new method of computation of pension benefits (contribution based method) where benefits are related to the contributions paid during the whole working life. Even if these reforms would induce a significant reduction in future pension benefits, they are generally considered not sufficient to face the ageing problem, in particular because of the too much long transition phase imposed by the Dini reform: in fact, the contribution based method will be completely applied after 2030. In 2004, the Berlusconi government introduced a new reform that increased the minimum retirement age to 60 from January 2008 onwards while, before the reform, individuals were free to retire at 57. In 2007, in particular given the strong opposition exerted by Italian's trade unions, the Prodi government replaced the Berlusconi reform with a softer one: the minimum retirement age is fixed at 58 from January 2008 and will gradually increase over time up to 62.
Using an overlapping-generations model, we first show that the reforms introduced in the Nineties imply a very important reduction in the replacement ratios. Thus, these reforms allow controlling the evolution of the pension expenditure by penalizing early retirement.

Nevertheless, these reforms fail to ensure long-run solvability of the Italian pension system and, during the transition phase, the pension system would produce deficits higher than 3% of GDP. This implies that over the next decades, the level of taxation will significantly increase in order to reduce public deficits and thus fulfil Maastricht obligations. The analysis of the recent pension reforms shows that the increase in the retirement age induces a significant improvement of the financial conditions of the pension system only in the short and in the medium run. After 2035, the positive effect related to the increase in the labor supply, and then in contributions paid by the workers, is compensated by the increase in the value of 4 A pension benefits perceived by people forced to postpone retirement. In the long run, the increase in the retirement age has no positive impact on the financial conditions of the pension system and the pension deficit remains at about 1.7% of GDP in 2055.

In Europe, even if pension systems remain essentially different, some similar measures have been introduced in order to reduce the pension expenditure burden: the indexation of pension benefits to prices, the increase in the retirement age and the increase of the role of private funding. In France, for example, the Fillon reform introduced in France in 2003 increases the number of years necessary to obtain the full replacement ratio. With respect to the Italian reform that increases the minimum retirement age, with the Fillon reform individuals are free to choose the retirement age. Moreover, the French reform avoids the problem related to the long-run inefficiency of the Berlusconi and Prodi reforms. In fact, with the French reform, if the employment rates of elder workers do not change, the reform permits a strong reduction in pension expenditure because of the application of a penalization while, if the employment rates of elder workers increase, the pension expenditure do not change and the contributions received by the government increase. In both cases, the French reform allows a permanent reduction in pension deficits. However, even if in the French case the demographic problem is less serious than in Italy, the Italian reforms are globally much more efficient that those introduced in France in order to control the evolution of pension expenditures. Of course, the cost associated to this greater efficiency is the strong reduction of the generosity of the Italian pension system produced by the Amato and Dini reforms.

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