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The Reform of the Pension System in Italy

Prepared by A. Javier Hamann[1]

Authorized for distribution by Alessandro Leipold

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Abstract

Italy's pension system was reformed in August 1995. The new system has various desirable long-run properties and, overall, it represents an improvement over earlier systems. However, it fails to address two longstanding problems: extremely high contribution rates, and a lack of provisions for dealing with the substantial deterioration in demographic ratios expected over the next 30-40 years.

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Author's E-mail address: ahamann@imf.org

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[1]This paper has benefited from comments by Alessandro Leipold, Alessandro Prati, Massimo Rostagno and Tim Lane. Any remaining errors are my sole responsibility.

The Reform of the Pension System in Italy

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SUMMARY

A fundamental reform of the Italian pension system was enacted in August 1995 with the approval of Law 355. The law modified substantially the mechanism for computing retirement benefits, merged the old-age and seniority pension schemes into a single scheme that still allows, but also penalizes, early retirement, and introduced measures aimed at closing various loopholes.

This paper argues that the reform--commonly referred to as the Dini Reform--put in place a system with much improved long-run properties: actuarial soundness, an incentive, albeit modest, to postpone retirement, a closer link between contributions and benefits, and a less heterogeneous treatment of different categories of workers. The new system also represents an improvement over the previous one by being more transparent and by being cast in terms of a clear set of parameters that can be modified without need for a full-fledged reform.

Nevertheless, the Dini reform still leaves in place a comparatively generous system of benefits financed by high contribution rates for dependent workers and does not address the problem posed by the demographic transition in prospect during the first half of the next century. Moreover, by adopting the same calendar as the previous (Amato) reform for the gradual phasing-in of the new system, Law 355 missed an important opportunity to lessen the large generational imbalance embedded in Italy's public finances.