ITALY

Italy: pension system in 2006

The new Italian pension system is based on notional accounts. Contributions earn a rate of return related to GDP growth. At retirement, the accumulated notional capital is converted into an annuity taking account of average life expectancy at retirement. It applies in full to labour-market entrants from 1996 onwards.

Key indicators

		Italy	OECD
Average earnings	EUR	24 600	28 600
	USD	30 900	35 800
Public pension spending	% of GDP	14.0	7.2
Life expectancy	at birth	80.9	78.9
	at age 65	84.5	83.4
Population over age 65	% of working-age population	32.5	23.8

Qualifying conditions

The normal pension age under the new system will be 65 for men and 60 for women from 2008 onwards. However, early retirement will still be possible under various contribution conditions (see below). The baseline modelling assumes that men retire at 65 and women at 60.

Benefit calculation

Earnings-related scheme

Under the contribution-based regime the private and public employees contribution rate is 33%, of which about one-third is paid by the employee and two-thirds by the employer; the amount of pension is calculated as a product of two factors: the total lifelong contributions, capitalised with the nominal GDP growth rate (in line with a five-year moving average) and the transformation coefficient whose calculation is mainly based on the probabilities of death, the probabilities of leaving any widow or widower and the number of years that a survivor's benefit will be withdrawn. As a consequence, benefits are strongly related to retirement age – the lower the age, the lower the pension.

The transformation coefficients are reviewed every three years. They are available for the age bracket 57-65, but workers may not retire earlier than 65 unless they have reached the eligibility requirements stated by the current legislation and an amount of pension not less than 1.2 times the old age allowance.

Age of retirement	57	58	59	60	61	62	63	64	65+
Transformation coefficient (%)	4.014	4.113	4.217	4.328	4.446	4.572	4.705	4.847	4.999

Note: The coefficients above are based on ISTAT 2001 demographic forecasts.

The baseline assumption in modelling all countries is 2% annual real wage growth. Given the projected decline in the Italian labour force, a consistent assumption is that real GDP growth is 1.6% per year.

For employees, in 2006, minimum pay for contribution purposes is EUR 171.03 per week (36% of average earnings). Maximum earnings for benefits are EUR 85 478 per year under the new scheme, or just under 347% of average earnings.

The indexation of pensions in payment is complex, since smaller pensions are accorded a more generous treatment than larger pensions. For benefits up to three times the minimum pension, there is full price indexation of pensions in payment. This threshold is EUR 1 260 per month for 2005 (which is used to index pensions in 2006) and EUR 1 283 for 2006 (for 2007 indexation) or approximately two-thirds of economy-wide average earnings. For benefits between three and five times the minimum pension, pensions in payment are uprated by 90% of price inflation. Above this threshold, indexation falls to 75% of prices. Note that the indexation applies separately to each slice of a large pension.

Given the low coverage, these plans are not included in the modelling of voluntary private pensions.

Social assistance

The minimum pension (see below) is abolished for people covered only under the new system; *i.e.*, entrants after 1996. However, pensioners with incomes below the social-assistance level can claim a means-tested benefit from age 65. Including supplements, the 2006 value of the social-assistance benefit (*assegno sociale*) was EUR 5 130. There is a higher benefit of EUR 7 167 for over 70s. These are equivalent to 21% and 29% of average earnings, respectively.

Voluntary private pensions

There is an additional voluntary, supplementary occupational system. It consists of both open funds and closed collectively agreed funds. The closed funds can be funded by both employers and employees as well as from the TFR. The open funds provide an annuity based on contributions. The current TFR contribution rate is 6.91%. The number of workers enrolled in a private pension fund is still low. For this reason, the Finance Act for 2007 has anticipated (with some changes) the pension reform recently passed (Law 243/2004 and legislative decree 252/2005) which introduced further measures in order to speed up the development of the second pillar: a) higher fiscal incentives and b) silence-as-assent for the transfer of the private severance pay (TFR).The latter means that the current severance pay accumulation will be transferred to a private pension fund, unless the worker communicates his or her refusal. However, enrolment in the private pension funds remains voluntary.

Occupational pension coverage in Italy remains low: around 11% of employees. The government has encouraged workers and employers to switch severance pay schemes (known as the *Trattamento di Fine Rapporto)* to occupational pension schemes, though the coverage figures show that few have done so.

Given the low coverage, these plans are not included in the modelling of voluntary private pensions.

Variant careers

Early retirement

Under the previous system, workers could retire at age 57 if they had contributed to the system for 35 years. From January 2008, minimum age has been increased to 58 years (59 years if self employed). A recent reform, approved as part of the 2008 budget process, has introduced a quota system based on a combination of age and seniority, so the minimum age to request early retirement (seniority pensions) will increase from 57 to 61 years old by 2013. However, it will remain possible to retire at any age with 40 years' contributions.

Late retirement

Women have the right to continue working until the normal pension age for men. Retirement is not compulsory at 65 but employers have the right to dismiss employees reaching that age. From January 2009 it is possible to totally combine employment and pension receipts. Referring to pensions under the contribution-based regime: a) it is possible to totally combine employment and anticipated old-age pension receipts for pensioners who have 40 or more years of seniority; b) it is possible to totally combine employment and old-age pension receipts for pensioners who are 65 years old or more, if male, and 60 years old or more, if female.

It is possible to defer the pension claim after age 65, however the transformation coefficient (see above) remains the same, and benefits increase only because of the accumulation of further contributions and their (notional) capitalisation for one or more further years.

Childcare

The pension is increased for mothers by giving them a more generous transformation coefficient. For mothers of one or two children this is the transformation coefficient of their actual retirement age plus one year. For three or more children this is the actual retirement age plus two years. Thus, according to the projected transformation coefficients, the effect is to increase the pension by around 3% for one or two children, and 6% for three or more children.

Unemployment

All the unemployment insurance schemes – *cassa integrazione guadagni* (CIG), *indennità di mobilità* and *indennità di disoccupazione* – give rise to credited contributions for the time the benefit is received. Previous earnings are used as a base for pension calculation.

The maximum credit period is five years over the lifetime for people that entered the labour market from 1993 onwards. This affects only the right to receive a seniority pension. Furthermore, credited contributions for *indennità di disoccupazione* – the general unemployment scheme – cannot be counted towards the 35-year contribution requirement although they do count (under the 5-year limit) towards the 40-year requirement.

Contributions are normally paid by the government, with the exception of *indennità di mobilità* in the first year of receipt and CIG, which are partially paid by the employee at a reduced rate of 5.54%.

Personal income tax and social security contributions

Taxation of pensioners

In 2006 income brackets and tax rates remain unchanged from 2005: 23% for pension income up to EUR 26 000, 33% between EUR 26 001 and EUR 33 500, 39% between EUR 33 501 and EUR 100 000 and 43% above EUR 100 000. No personal tax is due for pension below EUR 7 500 a year, this amount is progressively reduced as income rises (no tax area). For pensions greater than EUR 7 500, the taxable amount is calculated subtracting from the pension the result of this calculation (till positive):

NO TAX AREA = [(26000+7000-pension)/26000]*7000.

Between EUR 7 500 and EUR 7 800 only the lower between the tax and the pension minus EUR 7 500 is due.

The 2005 Financial Act abolished the dependent relatives’ tax credits and introduced the application of the “Family no tax area” regime, consisting of an income deduction. The amount of non taxable income varies depending on the amount of personal income and other personal expense deductions: EUR 3 200 for the spouse not legally and actually separated, who does not have income exceeding EUR 2 840.51; EUR 2 900 for any child and any other person who lives with the taxpayer or receives alimony not as a result of a judicial measure. In certain cases higher deduction are available for dependent children, for example, EUR 3 700 for the child affected by handicap. These deductions decrease as the income earned increases until cancelling out and they are calculated according to a formula alike the one for calculating the "*no-tax area*":

FAMILY NO TAX AREA = [(78000+deduction-pension)/78000]*deduction

Taxation of pension income

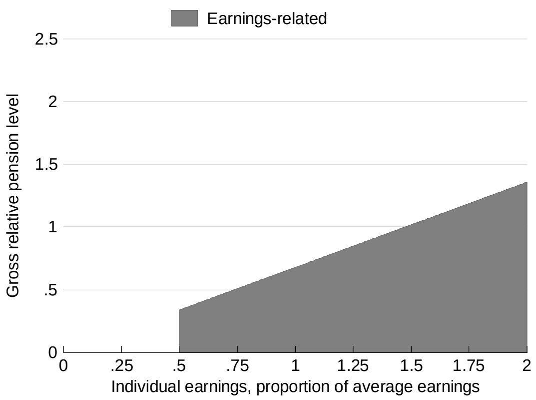
There is no special relief for public pension income. Private pension incomes are only partially taxable reflecting the tax paid by the pension fund on its investment returns.

Social security contributions paid by pensioners

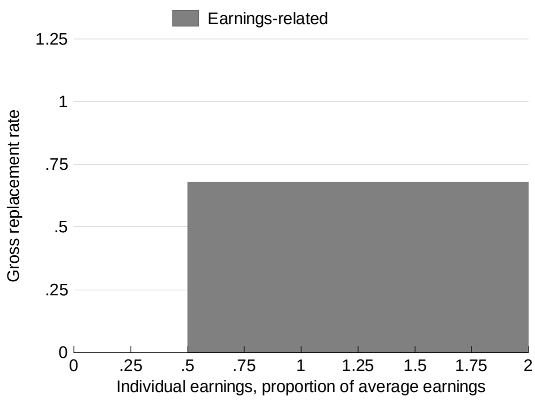
Social security contributions are not levied on pension income.

Pension modelling results: Italy

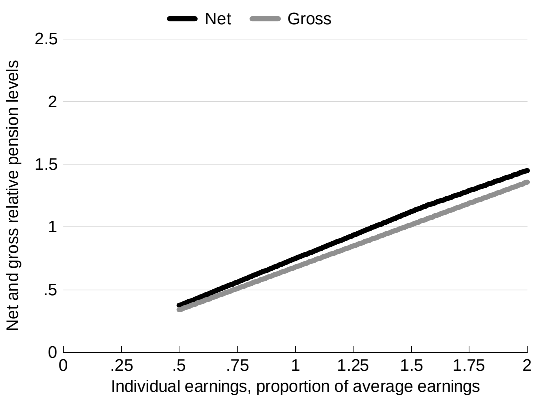
Gross relative pension level



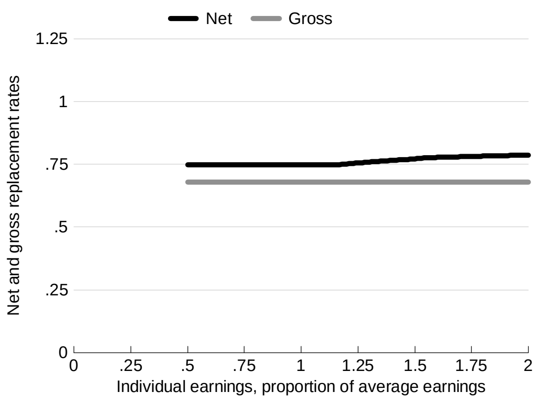
Gross replacement rate



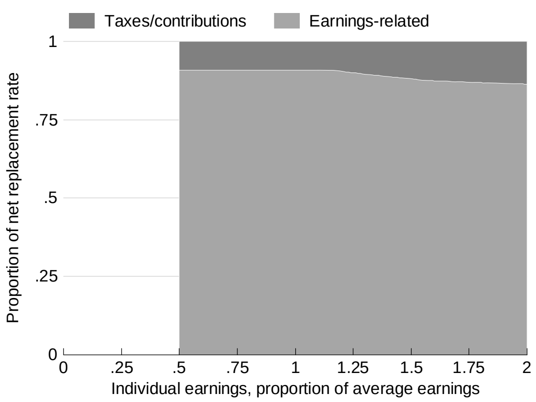
Net and gross relative pension levels



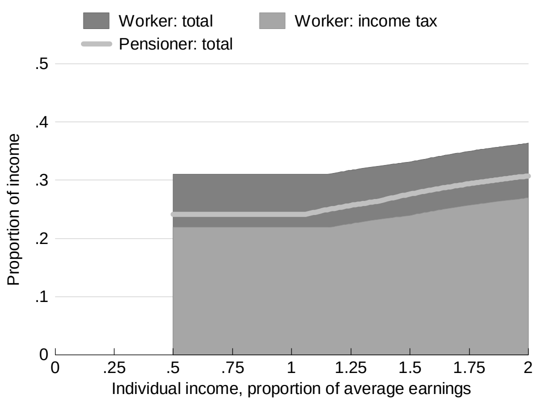
Net and gross replacement rates



Sources of net replacement rate



Taxes paid by pensioners and workers



Men *Women* (where different)	*Median earner*	*Individual earnings, multiple of average*				
		0.5	*0.75*	*1*	*1.5*	*2*
Gross relative pension level	59.8	34.0	51.0	67.9	101.9	135.9
(% average gross earnings)	*46.5*	*26.4*	*39.6*	*52.8*	*79.2*	*105.6*
Net relative pension level	65.8	37.4	56.1	74.8	112.2	145.2
(% net average earnings)	*51.2*	*38.3*	*43.6*	*58.1*	*87.2*	*116.3*
Gross replacement rate	67.9	67.9	67.9	67.9	67.9	67.9
(% individual gross earnings)	*52.8*	*52.8*	*52.8*	*52.8*	*52.8*	*52.8*
Net replacement rate	74.8	74.8	74.8	74.8	77.1	78.7
(% individual net earnings)	*58.1*	*76.6*	*58.1*	*58.1*	*59.9*	*63.0*
Gross pension wealth	10.0	10.0	10.0	10.0	9.9	9.8
(multiple of average gross earnings)	*10.7*	*10.7*	*10.7*	*10.7*	*10.7*	*10.6*
Net pension wealth	7.6	7.6	7.6	7.6	7.5	7.2
(multiple of average net earnings)	*8.1*	*10.7*	*8.1*	*8.1*	*8.1*	*8.0*