Social Security Abroad

Changes in Italian Social Security System*

An initial step in a reform of the Italian social security system, under discussion for some years, was promulgated by the Parliament (Law No. 238) on March 9, 1968. Under the reform, the pension is to be based for the first time on earnings and years of service, instead of on contributions. In relating pensions to the last 3 years of earnings and in providing for an increasing replacement rate for future years, the new law sets the pattern for an improving benefit structure. By doing so, it diminishes the need for frequent changes in types of benefits and for establishment of special benefit groups. Incentives for pensioners to remain in the labor force (except those in agriculture) are curtailed by (1) a retirement test for old-age and disability pensioners; (2) abolition of the "seniority" pension, which had permitted early retirement at any age after 35 years of service; and (3) elimination of duplicate family payments for employed retirees. The government planned to meet the added costs of a current increase in benefits and other improvements through an increase in payroll contribution rates, by "economies within the system" under the new law, and from general revenue of the government.

BACKGROUND

The new law is clearly intended to be an interim measure, and Parliament foresees additional, more comprehensive reform legislation in the next sessions. The specific language of the law calls for such legislation no later than December 31, 1971. The changes reflect an initial move to fulfill the long-felt desire of trade unions and other groups and the government to improve and simplify the system. In 1958 the government had created a technical consultative body—the National Economic and Labor Council, composed of worker and employer representatives and independent experts—to make a thorough study and to present concrete proposals for reform. The Council, in findings published in 1963, recommended that social security reform be undertaken gradually within the framework of national economic development. Among the long-range goals proposed were unification of the numerous pension plans and a consolidation of benefits, extension of coverage to all workers, and automatic adjustment of pensions to changing economic conditions. The ultimate goal was described as a national nonoccupational insurance scheme covering all citizens and granting benefits at uniform rates, regardless of previous income of beneficiaries, in amounts sufficient to guarantee a minimum of security to invalids, elderly persons, widows, and orphans. This generalized scheme would be supplemented by additional occupational schemes granting pensions related to the length of covered employment and earnings of the insured.

The country's 5-year plan for economic development (1965–69), in reflecting these recommendations, forecasts the gradual shift of the entire social security sector from a system based on workers' and employers' contributions to a national service financed by a special tax proportional to individual earnings.

The new law, passed amid threats of a general strike and considerable controversy, represented a compromise between those groups calling for more rapid change and those (the government and coalition parties) who advocated that changes should be influenced by the need to hold down the cost of the reform to manageable proportions, particularly in view of the increasing current deficit of the Italian National Social Security Institute.

The new system is seen as a means of eliminating the need to seek new ways to increase benefits frequently. The improvement is to be brought about through tying benefit rates to the earnings of the last 3 years and through raising the ratio between retirement benefits and preretirement earnings for new retirees. Pensions in the course of payment remain unaffected by this provision but are given a straight 10-percent increase.

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NEW METHOD OF PENSION COMPUTATION

The most significant innovation is the new method of computation, which relates the pension amount to the number of years of covered employment and the average monthly earnings in the last 3 years of work. It applies to workers covered by the general compulsory system[1] who retire after April 30, 1968. New retirees will be given the option of choosing either the old or the new method; current pensioners (about 5.5 million) will not be affected by the new law.

Under the new system the retiring worker with 40 years of credited employment will receive a pension equal to 65 percent of his last 3 years' covered average monthly earnings. This percentage will be reduced by 1.625 percent for each year short of 40 years of credited employment; thus, with 30 years' credited employment, the insured would receive a pension equal to 48.75 percent of his last 3 years' average monthly earnings. That proportion compares with the average pension paid by the Institute in 1966 of approximately 43 percent of the average industrial wage.[2]

The old method of pension computation results in an amount that is only indirectly related to lifetime covered earnings. With increases in prices and productivity, the method of crediting the basic contribution to the insured has become, to an increasing extent, merely a means of keeping a record of the insured's covered employment and earnings. As a source of revenue the basic contribution is minor—about 0.1 percent of the insured's covered earnings, which in recent years has been paid by the employer. The formula used[3] has been increasingly regarded as cumbersome and the link between the initial pension amount and the insured's average earnings considered weak, particularly in the later years of a career.

INCREASING BENEFIT RATES

The second element in the future improvement of benefits is to be the increase in the replacement rate. The law authorizes the government to enact further legislation by July 31, 1970, to provide for gradually increasing the pension, over an unspecified period of time, as a proportion of the earnings of the last 3 years— from 65 percent (after 40 years of contributions) to an eventual 80 percent. Some Italian trade unions estimate that the latter proportion will be attained between 1975 and 1980. The progress in Italian thinking represented by the new legislation can be measured by the fact that now an 80-percent replacement of the last 3 years' earnings becomes the goal for all new pensioners but, before August 1962, the absolute maximum was 80 percent.

DISINCENTIVES TO CONTINUED EMPLOYMENT

The new law introduces a number of measures that will have the effect of lessening employment among old-age, disability, and "seniority" pensioners. The removal of incentives for pensioners to remain in the labor force was evidently related in part to the government's programs for opening up new job opportunities in line with the fight against recent recessionary trends. Agricultural workers were specifically exempted from the limitations. In effect, a retirement test is reestablished for old-age pensioners. Legislation in 1965 had cancelled a previous requirement for a one-third reduction of the pension if the retiree returned to work. Now there is to be a two-stage reduction. Current old-age pensioners under the system who continue to work after May 1, 1968, will be eligible for a maximum pension of only 15,600 lire—70 percent of the normal minimum

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[1] The National Social Security Institute is one of three principal Italian social security agencies. The Institute, which provided more than 90 percent of Italy's old-age, disability, and survivor insurance coverage in 1965, encompasses a general compulsory system, "self-employed" groups, and 10 "special funds." The general compulsory system covers most wage earners and salaried workers. The "self-employed" groups are comprised of artisans, sharecropper and tenant farmers, small fishermen, and owner-operators of commercial enterprises. The 10 "special funds" are operated separately and cover occupational workers such as seamen, telephone workers, etc. Altogether, the "special funds" covered a little over 300,000 workers in 1965.

[2] Data on the average pension are from the Istituto Nazionale Previdenza Sociale, *Bullettino Statistico Quadrimestrale*, No. 55, page 5. The wage data were based upon the average hourly rate and actual hours worked, all industries, for October 1966 (*European Community Bulletin*, No. 110, March 1968).

[3] See Social Security Administration, Office of Research and Statistics, *Research and Statistics Note No. 1*, 1968, page 9.

for pensioners over 65.[4] Those who become eligible for old-age pensions after May 1, 1968, and continue to work will receive no pension while they are employed.

Also in line with the intent to discourage pensioners from working is a provision for a one-third reduction of benefits, after May 1, 1968, for new disability beneficiaries who continue in paid employment. The reduction applies to current disability beneficiaries who work, except that the reduction cannot lower their total income below a minimum of 15,600 lire per month.

Duplicate payments for family dependents of employed pensioners are eliminated. Under the existing system pensioners receive a 10-percent supplement for a dependent wife and for children. If they were employed, they have also been entitled to collect a family allowance for the same dependents. The new law removes the advantage of a virtual double-payment system. It provides that working pensioners will be entitled to receive the family allowance but can no longer get the family dependent supplement associated with the basic old-age, disability, and survivors' pensions.

Finally, the law eliminates the seniority pensions established in 1965 and specifies that current seniority pensioners who continue to work will not receive a pension while they are employed. This provision is designed to eliminate the practice of becoming eligible for a seniority pension at a relatively early retirement age, receiving the full pension, and then taking a full-time, postretirement job.

COSTS AND FINANCING

The changes in the pension system will amount to an estimated additional cost of 728 billion lire for the period from May 1, 1968, to December 31, 1970. The largest part of the rise in costs will be the 552 billion lire for pension increases. All pension recipients under the system received increases of 2,400 lire a month. The minimum pension for those retiring at age 65 and older was increased from 19,500 lire to 21,900 lire a month, paid 13 times a year (extra payment is paid as a Christmas bonus). For those retiring before 65, the minimum pension was raised from 15,600 to 18,000 lire. Pensions for the four self-employed categories under the National Social Security Institute were increased 1,200 lire, and the minimum was thus raised from 12,000 lire a month to 13,200 lire.

The estimated 176 billion lire balance represents the cost of implementing the new method of pension benefit computation. Even though this innovation calls for a relatively small short-run expenditure, the tying of the initial pension amount to the last 3 years' average earnings will result in a higher average level of benefits. The full costs of the higher benefits will be realized in later years as a larger proportion of pensioners come to receive pensions computed under the new method. In 1968 an estimated 400,000 new pensioners are expected to avail themselves of the new method of computation. There are currently about 5.5 million recipients of the general compulsory pensions.

In order to finance the 728 billion lire in additional costs, an estimated 350 billion lire will be obtained by increasing payroll contribution rates. In industry and commerce the employer contribution, as a percent of total payroll, will be increased August 1, 1968, from 12.65 to 13.75 percent. The employee contribution, as a percent of total wages or salaries, will increase from 6.35 to 6.90 percent. In agriculture, contributions have been increased 3 percent, with the employer paying 2 percent of the increase, and the employee 1 percent. The government plans to contribute 300 billion lire out of general revenue, most of it to come from the special 10-percent income tax surcharge imposed in November 1966 after the Florence floods.

In addition, some of the provisions of Law No. 238 are expected to result in reductions in previously anticipated expenditures, and these savings should be more than enough to provide the balance of the 728 billion lire. The elimination of "seniority pensions" is expected to result in a savings of 102 billion lire through 1970. A further cut in costs will be realized as (1) new pensioners are not allowed to collect their pensions and work at the same time and (2) pensioners on the rolls before May 1, 1968, will have their pensions reduced one-third if they become employed.

[4] As of February 1968, 625 lire equal $1.