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OBSERVATOIRE DE L'EPARGNE EUROPÉENNE

How to better save for retirement

LESSONS FROM ITALIAN PENSION REFORMS

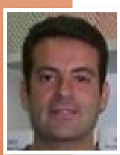
ISSUES AT STAKE

- Economic and financial literacy of individuals in continental Europe is weak, leading savers to decisions contrary to their interest.
- The problem becomes even more acute as unstable pay-as-you-go pension systems require an increase in personal savings to preserve income at retirement.

OEE Partners

Renata Bottazzi
(University of Bologne)

Tullio Jappelli
(University of Naples Frederico II)



Mario Padula
(Ca' Foscari University of Venise)

With the aging of populations in developed countries, reforms of pension systems has been necessary in order to restore the balance of pension schemes since the early 1990s. In addition to the passage of defined benefit schemes to defined contributions schemes, these reforms have mainly resulted in lower levels of pensions, lengthening of the contribution period and an increase in the legal retirement age.

A study for the OEE* focused on the experience of the Amato-Prodi reforms of the pension system, conducted between 1992 and 1995 in Italy. Before these reforms, pensions represented almost 16% of GDP, i.e. the highest level in industrialized countries. The reforms maintained the regime that applied before 1992 for workers with at least 18 years of contributions in 1995.

The authors used data from the Bank of Italy's Survey of Household Income and Wealth (SHIW), which covers a representative sample of the Italian population and which provides detailed socio-economic and socio-demographic information. The survey also includes data on household expectations, especially concerning future pensions and the age of retirement.

The econometric results show that, all things being equal, **a reduction of the accumulated pension rights** of an amount equivalent to one year of income **is offset by an increase in real estate** as well as an increase in financial assets without risk, respectively equivalent to seven months and one month of income.

Italian households have, thus, mainly offset the decline in their future pensions by increasing their investment in real estate, more so than in safe financial assets and much more than in risky financial assets, which increased only marginally after the reforms.

Three remarks emerge:

1. Firstly, reactions to the Amato-Prodi reform are significantly stronger for those who have positive expectations of their future pension.

2. Secondly, participation of households in financial markets after the pension reform is marginal, for safe products as for risky assets.

3. Finally, despite the decline in public pensions, data does not show any significant reallocation of the portfolio towards pension products nor life insurance.

With regard to these findings, the question arises whether savings meet adequately the needs of future retirees. According to this Italian study, **a decline of pension rights equivalent to 45,000 euros** resulting from the Amato-Prodi reform leads to **additional financial and real estate actuarial wealth of no more than 20,000 euros**. Indeed, the actuarial value of implicit rents related to dwellings owned by households is, in general, lower than the market value of such dwellings, taking into account the average life expectancy. Reverse mortgages would theoretically make this asset liquid but it is not widespread (see the fact sheet "Mobilize real estate wealth to reduce poverty?").

** By Renata Bottazzi, Tullio Jappelli & Mario Padula.*

Lessons for savers

Reverse mortgages may reconcile preference for savings in the form of real estate, in turn preserving the standard of living at retirement.

Lessons for authorities

Without intense information campaigns and strong incentives, households do not subscribe to enough individual pension products.

Research done for the OEE

Renata Bottazzi, Tullio Jappelli & Mario Padula, "The Portfolio Effect of Pension Reforms", June 2009