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Italy's Reforms Are Bearing Fruit

The changes passed by the Monti government corrected decades of political promises that had resulted in a large 'pension debt.'

By ELSA FORNERO

Last week the European Commission decided to close the so-called "excessive deficit procedure" it had opened against Italy in 2009. As a member of Italy's former government, responsible for drafting two major laws—the pension and labor-market reforms—I breathed a deep sigh of relief when I heard the news. Brussels's decision shows that the sacrifices we had to impose on Italians in order to realize fiscal consolidation are starting to pay off.

Our reforms were in response to a deep emergency. When Mario Monti's government took office on Nov. 16, 2011, Italy's public finances were near collapse and politics were at a stalemate. Financial operators were turning their backs on Italian sovereign-debt auctions. The few who took part were demanding spreads of 500 basis points over German notes for 10-year borrowing.

It is not hyperbole to say that financial breakdown was around the corner. The possibility that interest might not be paid and that expiring bonds might not be rolled over was very real.

In such a scenario, civil-service salaries might have been at risk. Central and local administrations were already unable to pay suppliers, whose claims exceeded €70 billion. The plea "FATE PRESTO!" (Act Immediately!), which the economic daily Il Sole 24 Ore splashed on its front page on Nov. 16, reflected the mood.

The financial crisis, however, was only one side of the coin. The other was a slow industrial decline that had afflicted Italy for about 20 years, reducing what was once Europe's most buoyant economy to a shadow of its former self. Both the public and private sectors cut research and development expenditures. Italian firms got out of high-productivity sectors like electronics, chemicals and drugs to concentrate instead on labor-intensive, fashion-oriented "made in Italy" products—where they encountered increasingly stiff competition from developing countries.

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Politicians refused to recognize these changing realities and persisted in making unrealistic promises. Self-indulgence prevailed.

In my new role as labor minister, the day the new government took office, Mr. Monti asked me to take on the restructuring of Italy's pension system. It was a reform that the former Berlusconi government had promised in the summer of 2011 but didn't tackle before the administration collapsed.

Predictably, the overhauls sparked widespread protest.

I had studied pension systems for more than 20 years. I was now charged with reshaping the Italian one in less than 20 days.

The reform had to be severe, allowing very little in terms of a transition period. It extended to all workers, for future seniorities, the contribution-based method of calculating benefits. It raised retirement ages and indexed them to changes in life expectancy. It profoundly restructured pensions accrued by seniority. It aligned the retirement ages of women to those of men starting in 2018. It increased payroll-tax rates for the self-employed and imposed special solidarity taxes on high pensions. It froze, for two years, the indexation of pensions to prices, excluding only the lowest brackets of pension benefits.

Most Italian families had to revise their lifetime savings strategies to take account of the new, harsher situation. Predictably, I became the target of widespread protest. It is a tribute to the Italian people that I also received widespread support, mainly by ordinary citizens who realized that this was a necessary sacrifice to clean up the country's financial mess.

But it went largely unnoticed that the reform was rebalancing the burden of Italy's aging population in favor of the young. This corrected decades of generous political promises that had resulted in a large "pension debt," which reform efforts of the past had reduced insufficiently. My inability to clearly convey this message to the public remains for me a source of regret.

Like the pension reform, the subsequent labor-market reform was structural in nature and was introduced at the stringent request of the EU, international institutions and of financial markets. Ideally it would have been scheduled during times of economic expansion rather recession. Its aim was to fix the major inefficiencies of the labor market: segmentation, rigidities, precariousness, low participation of women and selective social-protection schemes.

On the whole, Italy's labor market had been geared toward defending specific jobs rather than enhancing workers' employability through efficient labor agencies and services. This had to change.

While the pension reform was enacted in emergency and could therefore be introduced by decree, the labor-market reform had to go through a difficult confrontation with unions and employers, as well as a bitter parliamentary discussion. Not being a politician or a trade unionist myself, I failed to realize how far Italian labor relations were embedded in rituals. Employers and unions were used to thrashing out matters by themselves. The government appeared only in the final rounds to smooth out differences using public subsidies.

Unions opposed my proposals to do away with the guarantees that made it practically impossible to fire anyone in Italy. Employers opposed my proposals to limit abuses of labor "flexibility" that had for years fueled an abnormal proliferation of short-term, unstable and badly paid jobs, particularly for young people and for women.

The negotiations went on for almost three months, followed by three more months of Parliamentary discussion. When the reform was finally approved, in July 2012, I believe that it had taken the right direction and that it reflected a satisfactory compromise. Like the pension reform, the labor market reform will rebalance the Italian economy in favor of younger generations. The reform strengthens apprenticeships, for example, as a way both to increase worker productivity and to enable easier and more stable entry into the workforce.

Of course, reforms are living organisms. They need to be implemented effectively, and adjustments must be made as needed. It is encouraging that the new government in Italy talks not of overturning the Monti reforms, but of using a "screwdriver" to fix them by improving monitoring and evaluation procedures.

Has all this medicine been too harsh? In hindsight, the recession would have been less severe had the spending cuts been smaller. However, had fiscal consolidation been less clear and credible, last week's green light from Brussels may never have come.

Italy's exit from the excessive deficit procedure is both a sign of hope for Italian households—and a warning to Italian politicians not to fall back into old habits. I wish them, and the country, the best success.

Ms. Fornero is a professor of economics at the University of Turin and was Italy's minister of Labor, Social Policies and Equal Opportunities from November 2011 to April 2013.