Re-reforming the French pension system: why and how?

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Outline

• A pension system that has already gone through several parametric reforms
  • That have more or less restored long run financial equilibrium
    ➔ Brief presentation of this French pension system and these reforms

• A new structural one is now announced
  ➔ Why one more reform ?
  ➔ What kind of reform ?
  ➔ The problems to solve
Some historical elements (1)

• Failure of funded systems that had been introduced between WWI and WW2
• Social security created in 1946
  • Initial idea was to have a universal PAYGO system
  • But proved politically unfeasible
• What has been created has been a basic scheme for wage earners in the private sector, covering wages up to the social security ceiling: the « general regime »
  • On top of which complementary professionnal schemes progressively expanded: AGIRC and ARRCO, also on a PAYGO basis
  • With public employees keeping their former one pillar regimes
  • And self employed people opting for a less generous coverage
Some historical elements (2)

• A system that remained not that generous until the 1970s
  • Retirement age at 65 with senior LFP rates comparable to those of similar countries
  • High prevalence of poverty among retired people
• Lead to strong revalorizations in the 1970s (« Lois Boulin »)
• With the parallel emergence of a strong revendication for lowering the normal retirement age
  • In a context where senior unemployment and early retirement schemes had started to expand
• « retirement at 60 » was finally introduced in 1984
  • Not fully universal :
    • A length of career condition was also introduced : N* ≥ 37.5 years
    • But not that much constraining at that time
French population ageing (1)

• In the meanwhile, concern with population ageing had started to emerge
• But with a biased initial perception: strong focus on ageing « by the bottom », attributed to below replacement fertility
  • Suggested that pension reform could eventually be avoided through more generous family policy, or higher migration
  • Also fed the position of people wishing to reintroduce a significant element of funding
    • If nobody is here to pay for pensions anymore, capital income can be a substitute
    • ...ignoring of course the fact that generating capital income requires some labour input
• Incorrect representations even for those acknowledging the importance of ageing « by the top »
  • The ageing of baby-boomers viewed as a temporary problem (inverted V), to be followed by a return to « normal » financing conditions
  • But the reality is opposite: a « V » rather than an « inverted V » effect of the baby-boom on the pensioner/worker ratio
    • The problem is the second half of the « V »
    • Necessity of pension reforms with permanent impacts
French population ageing (2)

• It is only progressively that the role of longevity became admitted as the leading cause of population ageing
  • With a shift in formulations used to explain the necessity of a reform
    • From : « tomorrow, nobody will be here to pay for pensions anymore »
    • To : « every year, we are gaining three months of life expectancy »

• Led to relativize the importance of the funding/PAYGO debate
  • The performances of the two systems affected in parallel ways by increased longevity

• And shifted the attention to adjusting the retirement age :
  • With the good news that, under increased longevity, higher retirement ages do not necessarily imply shorter retirement periods
The components of French population ageing (a)
The components of French population ageing (b)
The reforms (1)

• For all of them, common apparent focus on raising this retirement age
• But with some differences
  • 1993, 2003 and 2014 : successive shifts of the length of career condition, from N* ≥ 37.5 to N* ≥ 43 years
    • Initially for private sector employees only, extended to public sector employees in 2003.
    • But without changing the retirement window
  • Changing this window has been the main element of the 2010 reform : from 60-65 to 62-67
• Other specificities of the 2003 reform
  • Incentives around the N* condition made closer to marginal actuarial neutrality
  • One element of automatic stabilization : planned indexation of N* on life expectancy at 60, abandoned in 2014
The reforms (2)

- All combined, these reforms have allowed inverting the downward trend of the effective retirement age
  - Also with the help of a much stronger regulation of early retirement schemes (including UI)
- According to projections, they should reincrease this retirement age up to 64-65 by 2040
  - Allowing a relative stability of the ratio between years spent into retirement and at work
    - As initially targeted by the 2003 reform
    - But with a strong help of the 2010 reform too
    - And only under median longevity assumptions
Senior employment rates have started reincreasing
Share of LE at 20 spent into retirement, by cohort

Source: Aubert et Rabaté, *Economie et Statistique*, n° 474, 2014
The reforms (3)

- These changes in retirement ages, however, explain only one part of financial stabilization.
- For parallel moves of the retirement age and of LE only solve the consequences of post-reform longevity increases.
  - But ageing by the top also includes effects of past longevity increases.
    - Especially those that had been temporarily offset by the descending part of the « V » baby-boom effect.
  - This component of the ageing problem has been -more silently- addressed by two other changes.
    - An increase in contributions or other resources affected to pensions: from 11.5% of GDP in 1990 to 14% now.
    - And a progressive expected decline of pensioner’s relative standards of living.
      - Currently close to 100%, expected to go down to 80% by 2040.
      - Due to a shift to indexation on prices rather than wages for the most important parameters of the system.
Projected relative income of pensioners

Source: Marino, 2014. Growth assumptions are those from the Pensions Advisory Committee. They range from 1 to 2% (C’ to A’).
Reasons for a further reform ? (1)

• To sum up, the French way out of the pension problem has relied in roughly equivalent terms on the three variables of the « pension triangle »

• Why reforming further ? Should we really do it ?

• Equilibrium is attained but only under median assumptions
  • No built-in adjustment mechanism to unexpected demographic changes
  • And indexation on prices has introduced another kind of sensibility to unexpected changes : those concerning productivity
    • Equilibrium reached for a growth rate of 1.5% per year
    • Overadjustement if growth is higher,
    • Deficits reappear in the opposite case

• If we consider that the latter assumption is more likely, new reforms will be unavoidable, unduly feeding the idea that ageing is a problem without solutions
Pensions/GDP ratio before and after reforms, under five economic growth scenarios

Source: Marino, 2014. Growth assumptions are those from the Pensions Advisory Committee. They range from 1 to 2% (C’ to A’).
Reasons for a further reform (2)

• In parallel, except the convergence of age and N* conditions in the private and public sectors, the system remains very fragmented and lacking transparency
  • This applying both to the core of the system and peripherical benefits:
    • End-of-career reference wage in the public sector opposed to 25 best years in the general regime
    • Strong variability of rules for survivor’s pensions and other non contributory benefits
  • Generating suspicions of strong meso or micro-inequalities of treatment that make new parametric reforms increasingly difficult

• Hence the idea of as structural reform that would solve all these problems at once
  • A transparent and unified system that would « ensure the same amount of pension for every contributed euro, whatever the period when contributed », as stated in E. Macron’s electoral program
  • A system that would better address both demographic and economic future uncertainties, avoiding the risk of requiring any further « big » parametric reform
The new reform : where do we stand ?

• Contrary to other reforms announced in E. Macron’s program, this one is managed very progressively

• With obvious reasons
  • A very heavy one
  • With many points to settle

• At this stage :
  • Emerged part of the iceberg : communication and a large online consultation on expectations for the new system
    • An potential capital of sympathy : who could be against transparency and equality of rules ?
    • But will probably become more complicated when running into details
  • And technical work, that also has to anticipate all the implementation problems to come
    • Two major issues : defining the target, and the way to reach this target
Defining the target (1)

• Two big options for the core of the system
  • Notional accounts in the Swedish or Italian style
  • A generalised system of points

• The second option was more likely to be retained, and such seems to be the case
  • One good reason is that this system already exists in France: it is the one used by complementary ARRCO and AGIRC schemes

• But this remains only a general principle, many details are to be settled
  • The most central ones: fixing the rules for determining the evolutions of purchasing prices and service values of points, their modulation according to demographic constraints and the automaticity of these rules
Defining the target (2)

• In a point system without demographic change, the simple rule for warranting financial stability whatever the rate of economic growth is to index both parameters on wages:
  • In that case, people accumulate numbers of points that do not depend upon economic growth
  • But that are then valued according to economic growth
• In case of demographic change, the indexation rule to apply is « wages minus the rate of change of the pensioner/contributor ratio »
  • This manages in real time all kinds of demographic schocks, expected or not: longevity as well as changes in the pop. growth rate
  • Contrarily to notional accounts where changes in LE and n are managed separately, through the conversion coefficient and revalorizations of notional capital
    • And partly ex ante, calling for ex post correction mechanisms in case of incorrect expectations
Defining the target (3)

• Why it is not so simple:
• Too much automatic?
  • No scope for a contribution of pensions to macroeconomic stabilization in case of a new economic crisis
  • More generally, some reluctance to have completely automatic rules leaving no room for social or political arbitrage

• Also the fact that, past the peak of the ageing process, the system would tend toward a quasi indexation of pensions on wages instead of prices
  • i.e. abandoning what has been one of the factors that have helped restore financial equilibrium
  • Would need to be compensated by adopting a lower point of departure for the service value of points, hence a shock on initial replacement rates

• Symetrically, when demographic conditions change, a $\frac{dw}{w} - d\frac{(R/L)}{(R/L)}$ rule may, at some periods, lead to indexation below prices, which is politically difficult
Transition to a generalized system of points: pensions/wage bill ratio under two indexation scenarios (source: Blanchet, Bozio and Rabaté, 2016)
Transition to a generalized system of points: pension/wage ratio
(source: Blanchet, Bozio and Rabaté, 2015)
Transition to a generalized system of points: pension/wage ratio by age of pensioner, in 2055. (source: Blanchet, Bozio and Rabaté, 2015):
Defining the target (4)

• While indexation on wages will probably be chosen for the purchasing price of points, indexation on prices will probably prevail during the retirement period, i.e. the «PTS2» scenario above

• The means looking for a more complex rule for the computation of the first pension
  • That will have to be based on expectations of future differentials between wage and price evolutions
    • If we want to minimize the reapparition of a phenomenon of growth dependency
Defining the target (5)

• And all this forces becoming explicit about what we will be pensioner’s future relative standards of living
  • A point that previous reforms had avoided to address directly
    • The 20% decline will probably leave us above the situation already prevailing in some other countries
    • But difficult to sell
    • And clearly problematic for the poorest segments of the population

• This raises the problem of the redistributive segment of the system
  • The uniformity of returns that has been promised during the campaign can be valid at best for the core of the system, and already with many caveats
  • Need to reproduce part of existing non contributory benefits
    • But with the opportunity to clarify their objectives and their articulation
    • And to make them completely homogenous across pension schemes
The transition (1)

• Probably the heaviest challenge
• People close to retirement (<5 yrs) not going to be affected a priori
• Four options for the rest of the population
  • Making abstraction of the past, i.e. doing as if people retiring from t+5 onwards had always been in the new system: not very realistic
  • Limiting the reform to people at the onset of their careers: will excessively delay the full implementation of the reform
  • Managing a hybrid system mixing existing rules for past careers and the new ones for the rest of people’s working lives: would temporarily increase the complexity of the system
  • Converting accrued-to-date liabilities in the new system of points: intellectually OK but hard to do in practice.
Conclusion

• Past reforms that have been very significant, but without any global perspective, other than saving money

• A new reform whose aim would be to put everything more in order
  • both necessary and hard to implement

• More on this next year...
Some references


• The website of the reform : https://reforme-retraite.gouv.fr/