Reforming the French Pension System in the Context of an Aging Society

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Facing Aging

Like most developed countries, France is facing the problem of an increasingly aging population. This aging process is driven both by continuous gains in life-expectancy and by the high share of baby-boom generations — born since 1946 and now progressively reaching retirement age — in the total population. Life expectancy after the age of 65 has been constantly rising over the past decades, and is projected to keep on rising at a rate of approximately +1 year every 10 years. From 17.6 (men) and 22.2 (women) in 2005-2010, it should rise to 21.2 and 25.5 years respectively in 2045-2050, according to the OECD. In the same time, cohorts born after 1945 — who have started reaching the age of 65 since 2010 — are more than 40% larger than those born before that date. As a consequence, the old age support ratio, i.e. the share in the population of people aged 20-60 divided by the share of 65+, has declined from more than 4 at the beginning of the 1990s to 3.5 today. It is projected by the United Nations' World Population Prospect to fall below 2 by the beginning of the 2040s.

Population aging mechanically implies increasing public expenditures for elderly people. In the long term, this may threaten the sustainability of social security schemes. Current expenditures for elderly people amount to roughly one-fifth of French GDP: about 14% for retirement pensions and old-age dependency expenditures, and about 5.5% for health expenditures for people aged 60 and more. For the pension system alone, the share of GDP may — under the more pessimistic hypotheses — increase by up to 2 percentage points by 2060.

Ongoing Political Agenda

This concern has brought policy makers to lead France through a process of reforms of the public pension system, which has been going on over the last 20 years. However, the issue has proven very sensitive in French public opinion, and all prospects of reforming retirement schemes have met strong opposition. This has led policy makers to avoid drastic modifications of pension rules, and to favor progressive adjustments of pension parameters instead. The result is that several successive reforms have been needed, in such a way that retirement reforms in France now appear to many as a continuous and everlasting process.

Three major retirement reforms have been approved in 1993, 2003 and 2010. A less influential one was also passed in 2008, targeting specific pension schemes only — the so-called "*régimes spéciaux*" which only concern workers in some large public firms, and whose rules differ from the rules applied in the general regime or in the civil-servant pension regimes. Other minor changes in pension parameters have been made between 2003 and 2010, and since 2010. A new reform was being discussed in parliament at the time this article was written and is expected to be passed before the end of 2013 — thus becoming the fifth French retirement reform in a span of 20 years.

Beyond the question of retirement, other topics linked to aging are also going through a stepwise process of reforms. For instance, regarding old-age dependency, a specific benefit — called the "APA" benefit — was created in 2002, but the need for a more ambitious reform is acknowledged. A national debate on the issue took place in 2011, but it failed to give birth to a reform. A new reform in 2014 has now been announced by the government.

A fully detailed description of all the changes in pension rules in France is beyond the scope of this article. I propose instead to focus on a few specific topics at the center of debate in preparation for the 2013 retirement reform, as well as the previous reforms.

How to Increase the Retirement Age?

Although the three main pension parameters (contribution rates, retirement age and amount of pension) have been affected in some way by all the reforms, the increase in the average retirement age has been constantly put forward since 1993 as the main mechanism for restoring sustainability and is preferred by most policymakers over increasing contributions or decreasing benefits. This preference for raising the retirement age is all the stronger in that this age remains relatively low in France compared to other countries. On average, men left the labor market at the age of 59.1 and women at the age of 59.5 in 2011, compared to 63.9 for men and 62.8 for women on average in OECD countries.

This aspect has therefore been one of the most debated and most criticized. In particular, concerns have focused on the idea that inequalities in life expectancy should be taken into account in retirement reforms: more precisely, that the retirement age should increase less for low life-expectancy workers — who also often happen to be lower educated, receive lower wages and face harder working conditions — than for high life-expectancy workers, since the latter already enjoy a longer average retirement duration and a larger retirement-over-career duration ratio. Indeed, life expectancy after the age of 60 in France is estimated to be about four years higher among white-collar workers than among blue-collar workers.

This debate actually has a very technical counterpart in France: indeed, the rather complex framework of pension rules in France means that several distinct parameters can be used to increase the retirement age. Since the 1983 retirement reform, the pension rate depends not only on age, but also on the number of years of contribution. As a consequence, the age at which a worker can retire with the reference "full rate" pension — i.e. a level of pension equal to 50% of the reference wage in the general regime — varies across the population and can be anywhere between 62 (the minimum age) and 67 (the normal age), or between 60 and 65 before the 2010 reform, according to the length of career. Therefore, two different solutions are offered to policymakers in order to increase the average retirement age: increasing the minimum and/or normal ages, or increasing the required number of contribution years.

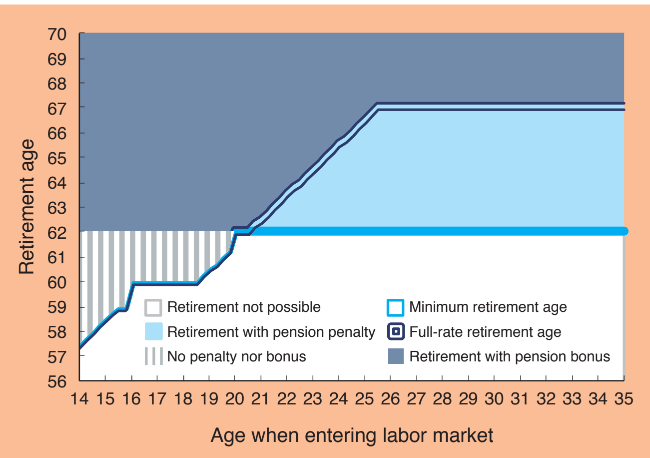
Debates in France have often concluded that the second solution is more redistributive, on the ground that most low-wage low-educated workers, who enter the labor market early, exceed the required number of contribution years before they reach the minimum age. Increasing the required contribution duration should hence have no (or a smaller) impact on them, whereas it should increase the retirement age of higher-educated workers, who enter the labor market older. This reasoning has led policymakers to modify only the required number of contribution years — while leaving minimum and normal ages unchanged — in the 1993, 2003 and 2013 reforms. Only in the 2010 reform was a different choice made, with a two-year increase in both minimum and normal age. But the justification that was put forward by the government then was that it was supposed to have a much faster impact on the effective retirement age, while discussion over the redistributive impact was carefully avoided.

Pension reforms have actually sought to strengthen even more the link between retirement age and length of career. In particular, the 2003 reform created exemptions from the minimum age for workers who entered the labor market very young and thus contributed a large number of years. For instance, it allowed workers who started to work before the age of 16 to retire up to four years before the minimum age. This contributed to creating a close-to-linear relationship between the age when workers entered the labor market and their full-rate retirement age *(Chart 1)* — provided workers have no career breaks.

CHART 1

Minimum age & full-rate pension age in France according to age when entering labor market

(for a worker born in 1955 with no career break)



Source: Pension Advisory Council (2013)

Since having worked in arduous jobs is one important determinant of a shorter life-expectancy, a way to go even further in compensating differences in life-expectancy across social groups is to take work conditions into account in the definition of pension rules. This has been on the agenda in France since 2010. The 2010 retirement reform first created new exemptions from the minimum age for workers who faced arduous and hazardous work conditions — the so-called "*pénibilité*" scheme. Those exemptions were, however, conditional on very strict prerequisites — in particular, only workers who had become disabled because of their past work conditions could claim for them. It therefore concerned only few workers. Nevertheless, eligibility for the exemptions is now supposed to become easier after the 2013 reform. The condition of being disabled will not be required anymore, and the eligibility for an exemption from the minimum age will depend only on the number of working years facing hazardous and arduous conditions.

Sharing Efforts Between Pensioners & Contributors?

Another questionable issue could also be about how much effort should be shared between contributors (and thus, as such, future pensioners) and current pensioners, in order to overcome deficits in pension schemes. Since pensions cannot be re-calculated or decreased in the French pension system, there are actually not many ways by which efforts could be made to weigh on current pensioners only. The main way would be to apply yearly increases that are smaller than inflation — the current norm being that pensions are increased each year according to inflation. By contrast, several potential changes would weigh on contributors only: increasing contribution rates, delaying retirement age or decreasing future replacement rates.

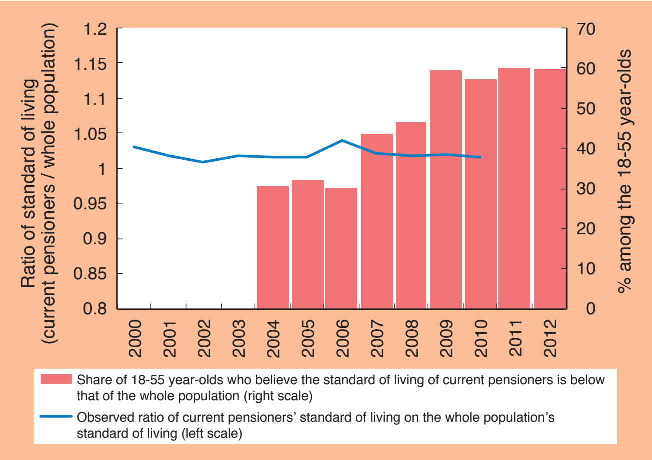
There actually happened to be little room for this debate on effort sharing in France, since many people are of the view that current pensioners already have a lower standard of living — implying that little effort only, if not no effort at all, could be asked to them. This view became widespread in the middle of the 2000s, although it is quite contradictory with statistical evidence showing that the average standard of living of pensioners has actually remained very close to — and is on average slightly higher than — that of the whole population *(Chart 2)*.

Consistent with this widespread opinion, no measure specifically targeting current pensioners was decided up until the 2010 reform. The debate was, however, opened before the 2013 reform, with some people advocating that applying smaller-than-inflation yearly increases should now be considered. The fact that the idea could be discussed was strengthened by a decision at the beginning of 2013 by social partners in charge of monitoring the second-stage occupational pension schemes for private sector wage-earners: they decided that pensions paid by those schemes will temporarily increase 1 percentage point less than inflation. This decision seemed to show that social partners — and more widely public opinion — might now be more ready to accept the idea that efforts should be sought from current pensioners.

This idea was eventually discarded by the government in the 2013 reform. Only minor measures targeting pensioners were taken: the

CHART 2

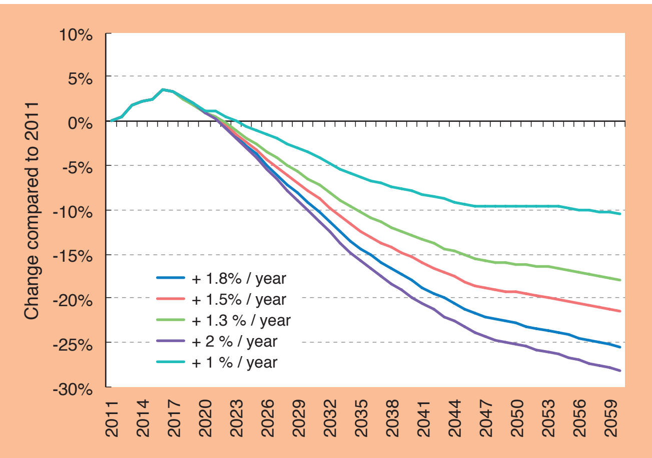
Perceived vs. observed standard of living of pensioners compared to that of the whole French population



Source: Ministry of Social Affairs and National Institute for Statistics & Economic Studies (INSEE)

CHART 3

Forecasted change of average pension/average wage ratio, according to several hypotheses for long-term increase rate of real wages



Source: Pension Advisory Council (2012)

date when pensions are increased was delayed by six months (Oct. 1 instead of April 1), and some tax exemptions for pensioners were removed.

Monitoring Public Pension System

The inflation rate is not only used to determine the yearly increase in pensions. It is also used as the discount factor in the calculation of the reference wage, which determines the amount of pension for future pensioners. In the general regime, this reference wage corresponds to the average of the 25 best contribution years — i.e. the 25 years with higher wages. But it relies on the inflation rate, rather than on an average wage rate, as the discount factor.

This has a strong implication as regards the replacement rate (defined as the ratio of the level of pension to the level of wage just before retiring): the higher the increase in average wages, the lower the replacement rate, and reciprocally. A similar result holds as regards the ratio of the average pension of retirees to the average wage. Long-term forecasts by the French Pension Advisory Council (COR, to give it its French acronym) showed that this ratio should fall by 2060, but with the extent of the fall being very hard to predict, since it varies between –30% and –10% according to the long-term increase rate of real wages *(Chart 3)*.

In contrast, resources for the pension system mainly rely on workers' and employers' social contributions, which are proportional to wages. The share of resources, as a percentage of GDP, therefore remains roughly constant whatever the increase rate of real wages. This discrepancy between the dynamics of resources and expenditures of the pension system results in a balance of the system that is highly sensitive to the increase of real wages *(Chart 4)* and hence highly unpredictable.

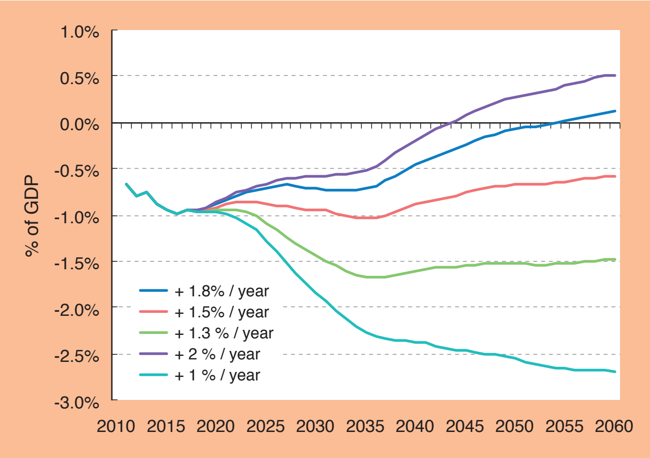
A simple and straightforward way to address this sensitivity and unpredictability of the pension system's balance would, of course, consist in changing indexations of pension increases and reference wage calculations in a way that correlates them to the increase rate of wages. However, indexing pensions on an index that increases more than inflation would prove very costly, while indexing them on an index that rises less is rejected by policymakers — as has been discussed — due to public opinion concerns. This implies that deficits have to be addressed periodically by adjusting other pension parameters, or by adding other resources to the pension system. This is part of the explanation why several retirement reforms have had to be performed in France in quite a short spell of time, and why it remains an ongoing political agenda.

The repetition of reforms is seen by many as inefficient, as it implies considerable preparation time (debates in parliament, etc.) and gives the impression that the system always remains in deficit whatever governments do. Hence, many advocate a better monitoring of the French pension system, allowing regular but smooth — and hopefully more consensual — adjustments of pension parameters, instead of successive reforms.

In practice, implementing such a monitoring process has proven tricky. According to the 2003 reform, it was supposed to take the form of meetings every four years — labelled "*rendez-vous quadriennaux*" — between the government and social partners (unions, etc.) The first meeting occurred in 2008: it resulted in no consensual decision and was described as "anxiety-generating" by some unions. The principle of *rendez-vous quadriennaux* was thus removed by the 2010 reform, which instead created a pension monitoring committee — or COPILOR — in charge of analysing indicators and making propositions every year. The composition of this committee, however, proved to be too large — 45 members — to enable efficient decision-making. The committee actually held only one meeting in 2011, and did not meet again in 2012, although it was supposed to get together at least once every year. It was hence removed by the 2013 retirement reform. According to the latter, starting from 2014 the monitoring process will involve both the COR, which will be in charge of analysing indicators and assessing their

CHART 4

Forecasted expenditures-contributions gap, according to several hypotheses for long-term increase rate of real wages



Source: Pension Advisory Council (2012)

consistency with the pension system's objectives, and a new "pension follow-up committee" — or "*comité de suivi des retraites*" — in charge of making recommendations about pension parameters' adjustments. This new committee is hoped to prove more efficient then the former COPILOR committee, due to its much smaller size — five members — and composition, with only experts. Its output is supposed to be mere recommendations, with no mandatory status, final decisions remaining in the hand of the government and of parliament.

Family Pension Benefits

Of course, retirement reforms in France have involved many more aspects than those listed above. One of them is the importance and efficiency of non-contributory benefits, and especially those targeting mothers and parents. Non-contributory benefits account for a relatively large share of total pension expenditures in France: survivor's benefits (for widows and widowers) amount to about 12% of total retirement expenditures, and other non-contributory benefits amount to close to one-fifth of it (7% for non-contributory benefits targeting mothers and parents specifically).

There is actually little debate on the total size of non-contributory pension expenditures — "solidarity" is explicitly mentioned among the goals of the pension system and the amount of expenditures made on this ground is questioned by only a minority. Debates rather focus on their forms and targets.

During the 2013 reform's debate, this especially held for mothers' and parents' specific benefits — often called "family pension benefits". Such benefits include additional years counted as contribution years for mothers, some of them conditional on the fact that they have temporarily left employment to bring up children, while others are unconditional — proportional to the number of children. They also include a 10% pension bonus for parents of both sexes with three children or more. As the gap in average pensions between women and men remains high — above 30% among younger generations of pensioners — some advocate that reducing this gap should be a priority goal and that family pension benefits should be targeting mothers only, not parents of both sexes, on the ground that almost all the negative impact of bringing up children on the parents' career is born by mothers. Other claims are that family benefits should take the form of pension bonuses, rather than additional contribution years only, and that the bonus should be a fixed amount per child, rather than being proportional to the level of contributory pensions.

A reform of family pension benefits was initially announced by the government as part of the 2013 retirement reform. However, it was eventually postponed under the pledge that the issue should be addressed in 2014.

Unifying All Pension Schemes?

Another issue is the convergence that should be sought between pension schemes. There are currently more than 30 different mandatory pension schemes (first-stage or second-stage) in France, according to professional status. The general regime accounts for about three-quarters of workers. It covers most wage earners in the private sector and some of the workers in public administration, but a fairly large minority of wage earners remain out of it: civil servants, wage earners in agriculture, wage earners in some large state-owned firms, etc. — all having their own specific "special regime". Moreover, it is complemented by second-stage schemes, which are considered part of the public pension system given their mandatory status. Non-wage earners also have special regimes of their own — distinct for farmers, physicians, architects, etc.

Some of the rules are the same in all pensions schemes, especially as regards minimum and normal ages, as well as the required number of contribution years, but others are different, in particular as regards the calculation of the amount of pension (often regarded as more generous in special regimes, although this remains questioned, since there is actually no clear and conclusive statistical evidence one way or the other), exemptions from the minimum age (more generous for hazardous jobs in the public sector) and survivor's benefits for widows and widowers.

The existence of several distinct pension schemes raises strong concerns among the public about potential inequity issues between workers — some strands of public opinion seeing allowing special regimes for some wage earners as giving them unfair "privileges" — and higher administrative costs. During the preparation of the 2013 reform, much of the debate focused on this issue, probably well beyond its true financial stake and the true differences between regimes. Up to now, this has mainly led to increased convergence of pension rules among regimes, but not to the extinction of special regimes. However, advocates of further convergence, leading to an eventual merger of all regimes into one unique pension scheme, are numerous. JS

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