Retirement Security and Pensions: The French Experience

Pierre Concialdi, IRES[1]

Paper presented at the conference

Financial Institutions and Economic Security

London, 21-22 May 2009

Abstract

Among developed countries, France offers a very particular case for the provision of pensions insofar as the place of funded schemes is marginal: they account for less than 2 % of all pensions paid to retirees. Almost all retirement pensions, including supplementary pensions, are financed on a pay-as-you-go basis.

The paper will first present a brief history of pension schemes in order to analyze some of the reasons that might explain this atypical situation. The failure of previous funded schemes implemented in the first half of the twentieth century is one of the most important explanations.

Despite this feature of the French pension system, the savings rate is quite high in France according to international standards. As a consequence of the high savings rate of households, overall income of French pensioners is considerably higher than their pension income. Overall, income from property (defined in a wide sense) is equivalent to about 45 per cent of income from pensions. Therefore, financial markets and institutions may play a significant role for the economic security of retirees, at least for the most well-off among them.

Successive changes in the French pension system have led, and will continue to lead to cutbacks in mandatory retirement scheme replacement rates. In this context, the 1990s witnessed much debate over whether or not funding for pensions should be expanded. Developments in regulations concerning funding over the 1990s pointed to the future shape of new funded schemes set up by the 2003 law. However, the size and coverage of these funded schemes remain small. In the near future, one may reasonably argue that there exist several obstacles to the development of funded retirement pension schemes in France.

---

[1] Economic and Social Research Institute, Noisy-le-Grand (France). Email address: pierre.concialdi@ires-fr.org
Large parts of this paper are taken from an article written with Lucy apRoberts and to be published in a forthcoming book (*Personal Provision Of Retirement Income*, Edited by Gerard Hughes and Jim Stewart, Edward Elgar).

Introduction

In developed countries, the organization of economic security in old age relies mainly on pensions. However, this is not the only source of incomes. Depending on this mix of income sources, the place of pensions in income security for old age is more or less important across countries. Moreover, the sources of pensions may also vary, depending for instance on the scope of the basic scheme, on the way schemes are financed and organised, etc. Economic security in old age will depend, in each country, on these particular features.

In this paper, the focus is on the organization of French pension schemes and, more generally, on the economic security of French retirees. The paper starts with a brief overview of the first attempts to create pension schemes in France and goes on analysing the main reasons that can explain why French pensions today are still financed predominantly on current earnings. It then analyses the main sources of income of French retirees. In the next sections, we provide some insight on the changes that have taken place in the French retirement system over the past 20 years and their likely consequences on pensions. We end with an analysis of the likely development of savings' plans and some general concluding remarks.

1. The Predominance of Pay-as-you-go Financing

Before the creation of today's Social Security system in 1945, there were two main attempts to establish retirement schemes for private sector employees in France. The first dates back to 1910 when legislation set up a scheme for manual workers in industry and farm laborers (*Retraites ouvrières et paysannes*). This scheme was funded. Financing came from employee and employer contributions. However, many workers were opposed to paying contributions and the mandate was not effectively enforced. Hence, many eligible workers never contributed and benefits were very low. This scheme virtually disappeared during the 1920s.

Legislation established a new social insurance scheme in the 1930s. As in the 1910 scheme, pensions were to be funded. Social insurance was made compulsory for all employees with earnings below a ceiling. At the same time, some companies set up occupational pension schemes for employees with earnings above the ceiling, mostly managerial staff and engineers. These higher paid employees are often referred to as *cadres*, a term which to this day refers to managers and highly skilled technical staff. All of these occupational schemes were funded.[3]

During the Second World War, inflation caused drastic depreciation of the assets of both occupational schemes for *cadres* and social insurance. The social insurance pension scheme was disbanded in 1941 and its funds were used to finance a means-tested benefit, which is now part of the minimum income guaranteed to people age 65 and over.

Funded schemes hence proved unable to guarantee adequate pensions for private sector workers. Rejection of funding explains why the Social Security General Scheme for private sector employees, established in 1945, was designed to operate on a pay-as-you-go basis, like social insurance general pension schemes in most countries. What is distinctive about the French retirement system is that the supplementary pension schemes created subsequently for private sector workers were also established on a pay-as-you-go basis. Today, these mandatory supplementary schemes play an important role in the French retirement system. The pensions they pay out represent around one third of total pay-as-you-go pensions for an average worker in the private sector, and much more for *cadres*.

Overall, if we include all the schemes covering civil servants and self-employed, pay-as-you-go plans predominate in the French retirement system. In 2006, mandatory schemes paid out a total €215.5 billion in pensions, while non mandatory schemes (retirement savings plans and company retirement schemes) paid out only €4.2 billion, that is, less than 2 per cent of total benefits (Table 1). The contributions collected by non mandatory schemes came to 4.8 per cent of total contributions, a figure that reflects the fact that these funded schemes are small and/or have been operating for a short period (see section 5).

*Table 1: Financing of retirement pensions in France, 2006**

€ billions

	Contributions	Benefits
Basic schemes	142.4	159.5
Mandatory supplementary schemes	52.3	56.0
Non mandatory supplementary schemes	9.3	4.2

**Note*: In addition to contributions levied on earnings, mandatory retirement schemes derive some revenues from other sources: general taxes and earmarked taxes for basic schemes, returns on assets in the case of mandatory supplementary schemes.

Source: DREES 2008

Before going on giving some explanations on this particular feature of French supplementary schemes, it is worth noting that the French language reflects a rather positive attitude towards pay-as-you-go financing and a rather negative attitude towards funding (apRoberts 1993). The French equivalent to 'pay-as-you-go' is *répartition*.[1] It comes from the verb *répartir*, which means 'to share,' in reference to the practice of sharing out contributions from those currently working among those who are retired. The French equivalent to 'funding' is *capitalisation*, a term associated with 'capital' or 'capitalist,' words that do not have particularly positive connotations given French cultural and political traditions. In contrast, the English term 'funding' suggests sound practice with a solid foundation.

2. Why did French supplementary schemes develop on a PAYG basis

One reason is that, just after the Second World War, the French had a very negative opinion of funded schemes, since they had experienced the failure of funded social insurance schemes and funded occupational schemes to provide adequate pensions. Because of the failure of their earlier occupational schemes, a whole generation of *cadres*, both those who were already retired and those approaching retirement, faced a future without any prospect of an adequate pension. Creation of new funded schemes could not solve this problem. From its inception in 1947, the scheme for *cadres* paid out pensions to current retirees and paid out pensions to new retirees based on full past careers.

Another reason for the success of *répartition* was that the scheme for *cadres* benefited from favourable economic conditions in its first decades of existence. The ratio of contributors to pensioners was high because the proportion of the labour force classified as *cadres* increased greatly over the 1950s and 1960s. In addition, many of the new entrants to the scheme were young. Furthermore, up to the end of the 1950s, employers and employees successfully pressured the government to keep the Social Security ceiling relatively low, which meant that the wage base for contributions to the scheme, which consisted of wages above the Social Security ceiling, expanded during this period.

Another factor behind the success of pay-as-you-go supplementary schemes, which still holds true today, was their sheer scale. This enabled them to keep administrative costs very low, much lower than for schemes restricted to the personnel of single companies.

A further advantage of pay-as-you-go supplementary schemes lay in the fact that they allowed employers and employees who wanted to obtain higher pensions to make extra voluntary contributions, above the minimum obligatory rate (8 %). With the agreement of their *cadres*, employers could choose to contribute at a higher rate, up to a maximum of 16 per cent. Hence, employers and employees could increase pensions within a company without resorting to a company pension scheme, which would have had to be funded in order to be viable. This possibility was phased out in the 1990s.

French mandatory supplementary pension schemes provide for greater flexibility in benefit levels than is usually the case in pay-as-you-go schemes. Pensions are not computed as a percentage of a reference wage with a formula based on an accrual rate for each year of contributions. Instead, each employee's pension depends on the number of 'points' he or she has accumulated in an individual account over his or her working life. There are two key parameters in this system: the amount of contributions necessary to acquire one point (the 'cost' of a point) and the value ascribed to each point once employees retire (the 'value' of a point). The pension is equal to the number of points accumulated multiplied by the value of one point. Both of these parameters vary from year to year in such a way as to balance scheme finances in each period. In addition, supplementary schemes may adjust effective contribution rates without changing the 'contractual' contribution rate, which is used to calculate benefits. In the first years of existence of the schemes, effective contribution rates were lower than contractual rates. Effective contribution rates were gradually increased in relation to contractual rates, a policy which has allowed supplementary schemes to stabilize replacement rates.

Overall, French supplementary pension schemes have distinct advantages both for employers and employees. Until the 1990s, they offered employers the option of making additional contributions to raise benefit levels. They offer employees fairly secure pensions. While workers are not one hundred per cent sure of the future value of their pensions, pension levels vary according to rules that are transparent and negotiated. In any case, fluctuations in the value of pensions are never as drastic as the changes that affect the level of benefits paid out by funded defined contribution schemes when financial markets collapse or when inflation rises.

3. Sources of income of old age people

Because French employers and employees have chosen this particular way of providing supplementary pensions, there is virtually no space in the French pension system for funded schemes. However, contrary to the mainstream economic wisdom, the household savings rate in France is one of the highest among developed countries (Table 2). In other words, one cannot identify any "crowding out" effect.

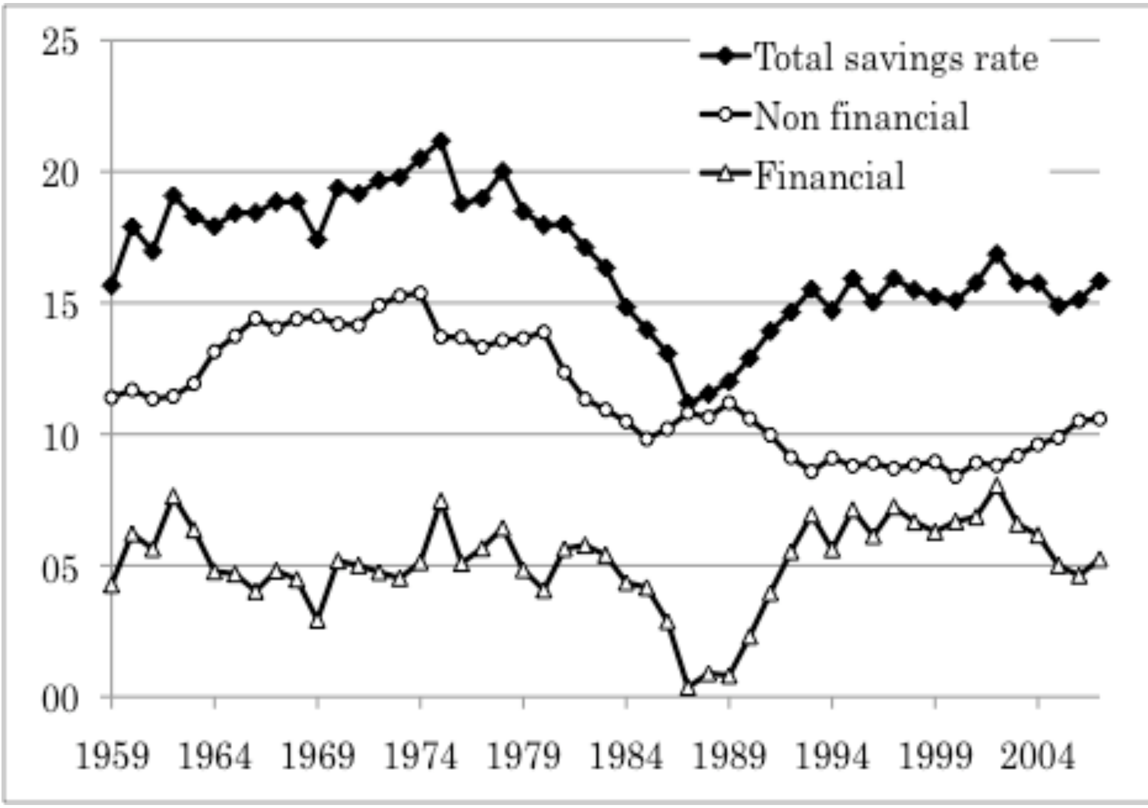
Table 2 - Household savings rates, 2006 (per cent of gross disposable income)

Germany	16.2
France	15.3
Italy	14.9
Austria	14.1
Switzerland*	14.2
Belgium	12.5
Netherlands	12.5
Ireland	11.0
European Union (27)	10.9
Spain	10.5
Sweden	9.8
Portugal*	8.9
Norway	5.6
Finland	5.6
United Kingdom	5.0
Denmark	4.0

**Note:* Data refer to year 2005
Source: European Commission

Such a high savings rate is not a new phenomenon. The household savings rate was around 20 per cent until the end of the 1970s and then dropped sharply in the 1980s. There has been a slight upswing since the beginning of the 1990s. The savings rate of French households has been around 15 per cent since then. Financial savings account for one third of all savings today (see Figure 1).

Figure 1 - French household savings rate, 1959 – 2007

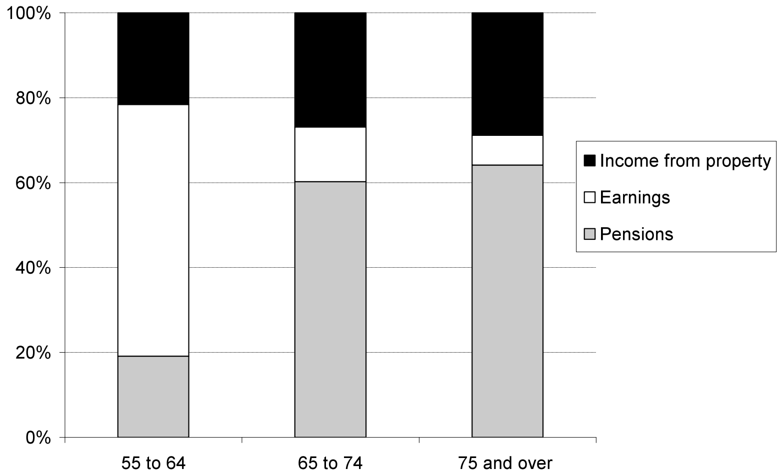


Definitions:
Total Savings Rate: Gross savings/Gross disposable income
Financial: Net lending/ Gross disposable income
Non financial: Gross fixed capital formation/ Gross disposable income.
Source: INSEE, national accounts.

As a consequence of the high savings rate of households, overall income of French pensioners is considerably higher than their pension income. Income other than pensions accounts for 40 per cent of the gross disposable income of the population age 65 to 74 (Figure 2). A little more than 10 per cent comes from earnings and about 30 per cent comes from property. Overall, income from property (as defined in the National Accounts) is equivalent to about 45 per cent of income from pensions. Despite the fact that their pensions are financed almost exclusively on a pay-as-you-go basis, French people save a great deal, and they derive substantial amounts of income in addition to their pensions from their savings after they retire. A large proportion this income from property takes the form of imputed rents. Incomes from financial assets account for a little more than 40 % the total.

Another important feature concerning French retirees is that their standard of living is, on average, equivalent to the standard of living of working age households. This was hardly the case forty years ago. At that time, the poverty rate among old people was 28 %, much more than the average poverty rate.

Figure 2 - Structure of incomes for households aged 55 and over, 2003*



Note * Households are classified by the age of the individual for a person living alone or a lone parent and by the age of the man for a couple.

Source: INSEE, authors' calculations.

4. **Cutbacks in Mandatory Retirement Scheme Replacement Rates**

Since 1983, one of the main objectives of social policy has been to tightly monitor the level of social expenditures. Changes that have been made to the French pension system have followed the same path and have consequently resulted in measures to limit or reduce pension levels. The main steps towards this reduction of pension benefits have been the following ones:

- since 1987, benefits paid to pensioners have been mainly revaluated in line with prices and social contributions levied on pensions have increased;
- during the 1990's, major reforms have been implemented. The "Balladur reform" (1993) has changed the rules for the entitlement and calculation of pensions in the social security basic scheme concerning private sector employees; in the mid-1990's, amendments have been decided on by social partners concerning PAYG supplementary schemes for private employees.
- in January 1997, Parliament adopted a law establishing retirement savings funds ("loi Thomas"). After the political swift that has followed the legislative elections in Spring 1997, this law was never enacted. However, employees' savings schemes have been encouraged in 2001 (PPESV)
- lastly, the 2003 law reduced replacement rates for civil servants, whose schemes had been untouched in the 1993 reforms. The law also created two new types of retirement savings plans: one available to anyone below retirement age (PERP) and one available to private sector employees whose companies have negotiated a collective agreement (PERCO).

The consequence of all these changes is a sharp decrease in the level of pensions. Table 3 shows the expected decline in replacement rates for private sector employees, assuming that current legislation continues to apply and that supplementary schemes continue to follow their current rules. Results are given separately for *cadres* and non *cadres* for hypothetical full time careers beginning at age 25 and ending with retirement at age 65.

Table 3: Replacement rates under current legislation: 2003, 2020, 2050

		2003	2020	2050
Non *cadre*	General Scheme	56%	52%	50%
	Supplementary schemes	28%	24%	14%
	Total	**84%**	**76%**	**64%**
Cadre	General Scheme	27%	24%	23%
	Supplementary schemes	37%	32%	20%
	Total	**64%**	**56%**	**43%**

Source: Conseil d'orientation des retraites 2006, p. 144

Projections point to a drop of almost 10 per cent in the replacement rate for a non *cadre* between 2003 and 2020 (from 84 per cent to 76 per cent) and a 13 per cent drop over the same period for a *cadre* (from 64 per cent to 56 per cent). The reduction between 2003 and 2050 would be 23 per cent for a non *cadre* and 33 per cent for a *cadre*.

These figures show that, in contrast to frequent comments from 'experts' or from international organisations, the reforms undertaken in France are amongst the sharpest in the EU. In other words, the consequences of past political decisions are the main threat for economic security in retirement in France, rather than the volatility of financial markets. This cutback has become the main argument used to encourage individuals to save more for their retirement. As we shall see, the size of this type of savings remains small and there are good reasons to think that they will not develop so `fast in the near future.

5. Funded pensions: current situation and prospects

Changes that have taken place in the pension system have resulted not only in a drop in the expected level of pensions, but also in a loss of confidence in mandatory pension schemes. However, this does not seem to have boosted savings plans. Table 4 shows the number of individual participants for different types of plans in the years 2004, 2005 and 2006. Data on the number of employees covered are difficult to obtain for group company contracts. At the end of 2006, 348 000 private sector employees and 816 000 civil servants had made voluntary contributions to an occupational retirement savings account. These numbers are small compared to the total 5 million civil servants and still smaller compared to the total 18 million private sector employees. The participation rate is much higher (higher than 50 %) for self-employed.

Table 4: Number of participants in non mandatory funded retirement schemes, 2004, 2005, 2006 in thousands

Type of plan	Participants end 2004	Participants end 2005	Participants end 2006
Optional plans for individuals outside a company framework			
Anyone under retirement age (PERP)	1235	1672	1876
Civil servants and local elected officials (PREFON, etc.)	819	818	816
Self-employed ('Madelin' plans)	740	808	940
Self-employed farmers	254	261	264
Other	157	149	226
Private sector employee benefit schemes			
Optional for employee			
Retirement savings plans (PERCO)	38	102	201
Employee contributions to a DC plan (PERE)	ns	1	147
Company group insurance contracts			
Defined benefit ('article 39')	na	est. 2300 to 2500	est. 2700 to 2800
Defined contribution ('article 83')	na	na	na

Source :DREES 2008 and DREES 2007

Table 5 shows detailed data on the contributions collected by non mandatory supplementary schemes. Company retirement schemes that are obligatory for all employees who belong to covered categories collected a total of €4563 million in 2005; €1850 million for defined contribution schemes and €2713 million for defined benefit schemes. For the moment, these relatively old schemes collect much more in contributions than optional individual retirement savings plans (PERPs or PERCOs), but of course the latter could expand. PERPs and PERCOs date only from 2004, when the 2003 law came into force and PERE were authorized only in 2005.

Overall, the total amount of contributions was €9.65 billion in 2006. In comparison, the same year, net flows to life insurance contracts came to €88.2 billion euros and net flows of all financial savings, including life insurance, came to €138.5 billion. These sums dwarf the amounts involved in funded pension plans or retirement savings accounts. One question is whether this will continue to be the case or whether retirement savings plans will come to play a greater role in retirees' income in future.

Table 2.4: Contributions collected by supplementary retirement savings schemes, 2005 & 2006

€ millions

Type of plan	Contributions 2005	Contributions 2006
Optional plans for individuals outside a company framework	3 777	4 129
Anyone under retirement age (PERP)	853	943
Civil servants and local elected officials (PREFON, etc.)	815	794
Self-employed ('Madelin' plans)	1 848	1 922
Self-employed farmers	200	202
Other	61	217
Private sector employee benefit schemes	4 772	5 523
Optional for employee		
Retirement savings plans (PERCO)	209	387
Optional employee contributions to a DC plan (PERE)	ns	46
Company group insurance contracts		
Defined benefit ('article 39')	2 713	2 820
Defined contribution ('article 83')	1 850	2 270
Total	8 549	9 652

Source: DREES, 2008

In the case of France, there exist several obstacles to the development of funded retirement pension schemes.

Firstly, in France, savings already play an important role in providing resources to the older population and life insurance contracts account for a large share of households' financial assets Therefore, the most plausible scenario for development of savings specifically devoted to financing retirement would be a transfer from purchases of life insurance. In order for such a transfer to occur, tax exemptions on retirement savings would have to be enhanced.

Secondly, while public policy appears to favour retirement savings, certain government decisions actually work against the development of retirement savings. New measures adopted by the government following the June 2007 legislative elections do not seem to favour saving specifically for retirement. One of the first measures was designed to favour investment in real estate through tax exemptions on interest on mortgages for people who buy their own homes. Later the same year, in November, the government enacted other measures to encourage people to purchase homes.

Yet another measure introduced by the government in the year 2007 does not favour savings. There has been a good deal of controversy about the purchasing power of French households. In order to boost household consumption, the government decided to allow some employee savings that were previously frozen in special accounts to be withdrawn. The measure came into force at the beginning of 2008. According to professionals in the finance industry, between 5 and 8 billion euros could be withdrawn from these savings plans.

Generally speaking, French workers have experienced poor wage growth for a long time. The national statistical institute recently issued a study showing that the average annual wage has stagnated in real terms over the past thirty years (INSEE 2007). Of course, this is not true for all workers. However, it shows that it might be very difficult for low wage households to save more, be it for retirement or for other purposes.

6. Some concluding remarks

The economic security during retirement goes far beyond some “adequate” levels of pensions. It should entail also access to some basic services and, especially, health care. In this paper, we did not discuss this issue that might become more and more important in the very near future. However, in a market economy, economic security relies heavily on monetary resources provided by pensions.

In some previous works, we have argued that demography might only have been an alibi to move towards pension funds (Concialdi, 2006). After the changes that have taken place in most countries in order to reduce the levels of pensions, it has indeed been argued that households should now save more in order to compensate for the expected decline in replacement rates of public pensions. One can easily stress the contradiction: why should households be able to take a bigger part of their current earnings for saving and not for increasing their social contributions to public pension schemes?

Finally, one might also question the mainstream economic view of pensions as a savings’ device. The French experience shows that it is possible to finance high levels of pensions on current earnings without any damage on savings. Therefore, it could be argued that, ‘paying for pensions,’ to quote the title of Tony Lynes’s seminal study on the French retirement system (Lynes, 1985), remains today a more secure choice for workers than saving for retirement.

Some references

apRoberts, Lucy (1993), 'Complementary retirement pensions: Towards a definition of terms,' *International Social Security Review*, **46** (4), pp. 51-66.

apRoberts, Lucy and Emmanuel Reynaud (1998), *Un panorama de la protection sociale complémentaire*, Report for the MIRE, February., Paris : MIRE

Assemblée Nationale (2003), 'Projet de loi portant réforme des retraites', Exposé des motifs, Presented by François Fillon, Minister of social affairs, labour and solidarity, on behalf of Jean-Pierre Raffarin, Prime Minister, 28 May 2003., Paris : Assemblée National'

Concialdi (2006), 'Demography, the cost of pensions and the move to pension funds', *Review of Political Economy*, 2006, vol.18, issue 3, pp. 301-315.

COR (2007), *Retraites : questions et orientations pour 2008*, Fourth Report of the COR, 10 January 2007, Paris: COR

COR (2006), *Retraites : perspectives 2002 et 2050*, Third Report of the COR, 29 March 2006.

Delahousse, Laure (2006), Les retraites d'entreprise aux Etats-Unis : Peut-on prévoir l'avenir du PERCO à partir du parcours du 401(k) ?, Association française de la gestion financière, www.afg.asso.fr/Etudes et rapports/Epargne retraite, June 2006.

DGTPE (2007), 'Panorama de la fiscalité des produits d'épargne,' Document presented to the COR, 31 January 2007, Paris : COR

DREES (2007), Yannick Croguennec in collaboration with Nathalie Augris, 'L'épargne retraite en 2006,' *Etudes et résultats*, No. 626, February 2007.

DREES (2008), Yannick Croguennec in collaboration with Nathalie Augris, 'L'épargne retraite en 2006,' *Etudes et résultats*, No. 626, February 2008.

INSEE (2007), Romain Aeberhardt, Julien Pouget and Anne Skalitz, 'Le revenu salarial et ses composantes, évolutions et inégalités de 1978 à 2005,' Les salaires en France - édition 2007, Paris: INSEE, pp. 27-49.

Lynes, Tony (1985), *Paying for Pensions: The French Experience*, STICERD Occasional Papers, no. 9, 164 pp.

Marini, Philippe, Senator (2006), Rapport d'information du Sénat, presented on behalf of the French Senate's Commission on finance, budget control and national accounts, report on retirement savings, 21 September 2006.

Moore, Kathryn L. (2001), 'The Best of Times and the Worst of Times: Lessons from the Recent Reforms of the French Retirement System,' *Georgia Journal of International and Comparative Law*, **29** (3), pp. 441-490.

Palier, Bruno (2007), 'Tracking the Evolution of a Single Instrument Can Reveal Profound Changes: The Case of Funded Pensions in France,' *Governance: An International Journal of Policy, Administration and Institutions*, **20** (1), January 2007, pp. 85-107.