

Financial Institutions and Economic Security



Retirement Security and Pensions: The French Experience

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Plan



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The Predominance of PAYG Financing

ζ The failure of pre-war social insurance schemes

ψ 1910: ROP (*Retraites ouvrières et paysannes*)

- § Funded scheme with contributions from both employers and employees
- § Mandate not effectively enforced
- § The scheme virtually disappeared in the 1920s

ψ 1930: A new social insurance scheme

- § Funded scheme
- § Compulsory for all employees with earnings below a ceiling
- § Occupational plans set up for employees above the ceiling (*cadres*)
- § Drastic depreciation of the assets during WW II
- § Social insurance scheme disbanded in 1941 and funds used to finance a means-tested benefit

ζ 1945 and after

- ψ The creation of Social Security General Scheme (PAYG basis)
- ψ Supplementary occupational pensions set up in the 1940s and 1950s also on a PAYG basis

The Financing of Pensions Today

Funded schemes: less than 2 % of all pension benefits

*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

Some explanations



ζ The failure of previous funded schemes

- ψ A whole generation without pensions?
- ψ "Crediting in" those above pension age is less costly than with a funded scheme

ζ Favourable economic conditions

- ψ Sharp increase in the proportion of cadres
- ψ Low administrative costs
- ψ Possibility to make contributions above the minimum rate (this possibility was phased out in the 1990s)
- ψ Great flexibility (yearly adjustment in contributions and benefits)

Sources fo income of old age people



ζ A very high savings rate

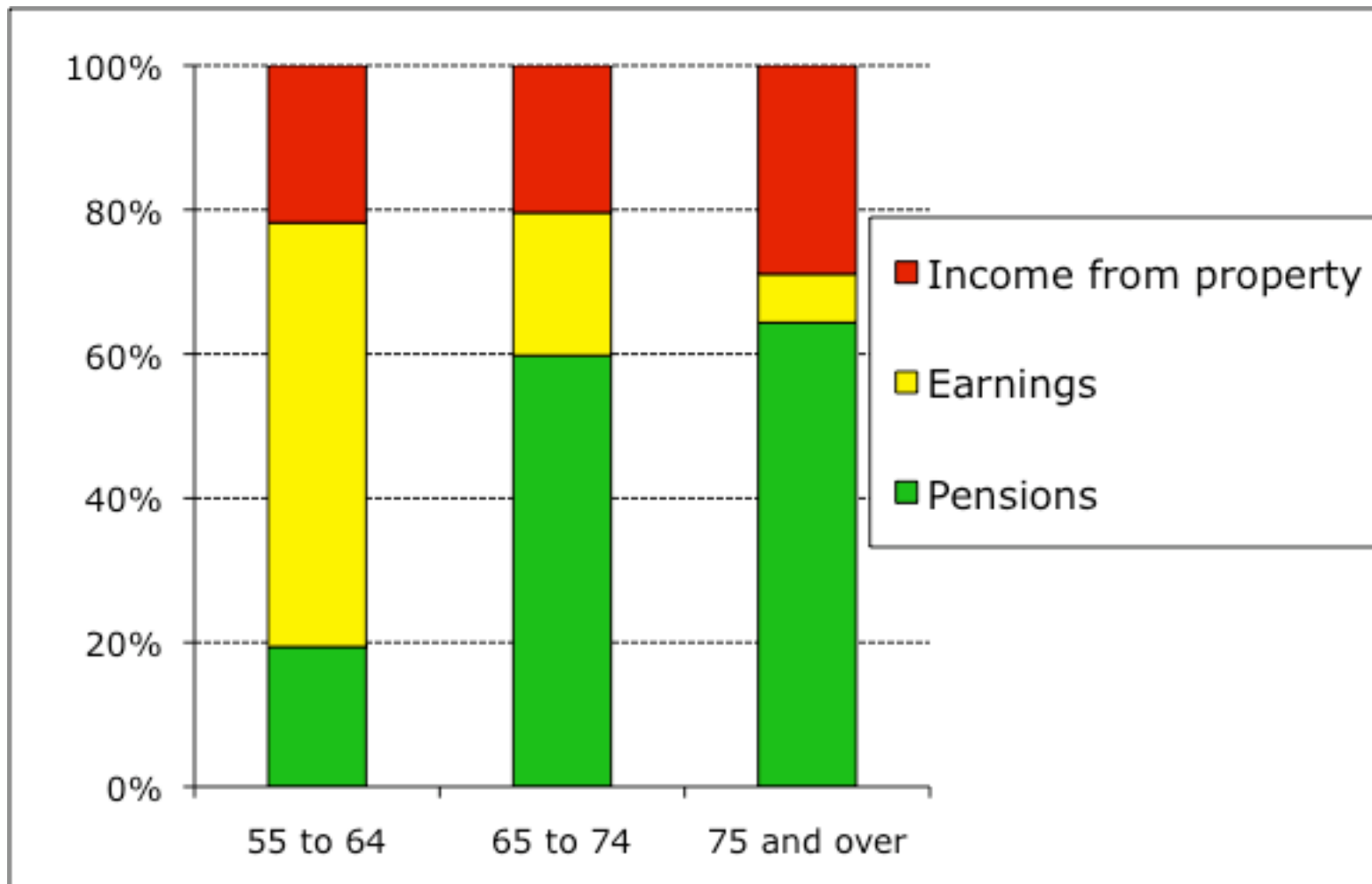
- ψ Savings rate in France = 15,3 % vs 10,9 % in the European Union
- ψ Contrary to the mainstream economic wisdom, no "crowding out" effect
- ψ The share of financial savings: around 40 %

ζ Total income higher than pension incomes

- ψ On average, the standard of living for the retirees and the working age population is the same
- ψ Pensions account for a little more than 60 % of retirees' incomes
- ψ The importance of rents (effective and imputed)

ζ A quite secure mix of incomes

Sources of incomes for households aged 55 and over (year 2003)



Cutbacks in Mandatory Retirement Schemes

- ζ **Since 1983, a tight monitoring of social expenditures**
 - ψ Since 1987, benefits revaluated in line with prices
 - ψ 1993: Changes in social security basic scheme for private sector employees
 - ψ Mid-1990s; amendments decided on by social partners on supplementary pension schemes for private sector employees
 - ψ 2001: law encouraging employees' savings schemes
 - ψ 2003: reduced replacement rates for civil servants.; creation of new types of retirement savings plans; further reductions in supplementary pension schemes for private sector employees

Replacement rates under current legislation (2003, 2020, 2050)

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

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

**Hypothetical full time careers beginning at the age of 25
and ending with retirement at age 65**

Funded pensions: current situation and prospects

- ζ Loss of confidence in mandatory pension schemes
- ζ However, the participation rate in funded schemes is low...
 - ψ Less than 10 % for private sector employees
 - ψ Around 15 % for civil servants
 - ψ Above 50 % for self-employed
- ζ ...and other forms of saving are much more important
(2006 figures)
 - ψ Contributions fo funded schemes: less than 10 billion euros
 - ψ Life insurance contracts: 88.2 billion euros
 - ψ Total net flows of financial savings: 138.5 billion euros

Recent political decisions do not favour funded schemes

- ζ High savings do not go to funded pension schemes
- ζ Fiscal advantages are needed to boost these funded schemes
- ζ But in 2007, the new government:
 - ψ favoured investments in real estate
 - ψ and allowed workers to withdraw savings previously frozen in special accounts
- ζ Moreover, poor wage growth is obviously a limit, especially for low-wage households

Some concluding remarks

- ζ Economic security during retirement goes far beyond “adequate” levels of pensions (the access to health care)
- ζ Whatever type of financing, pensions are always uncertain
- ζ However, the nature of the risk is not the same
 - ψ PAYG schemes: a political risk, but in the long run (changes take gradually place over time)
 - ψ Funded schemes: short-term (and long-term) economic risks that may deeply endanger the economic security of retirees
 - ψ PAYG schemes are more flexible than funded schemes
- ζ Security in retirement: the need to link pensions and wages

Some concluding remarks



ζ Demography, an alibi to move to pension funds?

- ψ The decline in replacement rates now becomes an argument to save more for retirement (OECD)
- ψ More savings, or more social contributions to public schemes?

ζ The French experience shows that one could challenge the mainstream view of pensions as a savings' device

ζ "Paying for pensions" might be better than saving for retirement

Number of participants in non mandatory funded retirement schemes

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

Contributions collected by supplementary retirement savings schemes

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