Summary

Despite the context of the health crisis and the progressive ageing of the French population, the evolution of the share of pension expenditure in GDP would remain on a controlled trajectory over the horizon of projection, i.e. 2070. This result prevailed before the health crisis that we have been experiencing since the beginning of 2020. It remains valid after the crisis.

Obviously, this recurring result of the COR reports may seem surprising with respect to the expected demographic ageing which will inevitably impact future pension expenditure, by increasing the number of pensioners relative to the number of contributors. If the ratio of pension expenditure to GDP decreases in 2070 compared to current levels, whatever the assumed economic scenario, it is because unfavourable demographic developments will be counterbalanced by the future decrease in the ratio of average pension on average earnings, assuming unchanged rules in the pension system: the average pension would continue to grow in constant euros, but at a slower pace than earnings, due to an indexation of pensions and pension rights on prices (whereas earnings also benefit from productivity gains).

The fact that pension expenditure is expected to decrease as a percentage of GDP in the long run, and is therefore under control, does not entail any political assessment of its current or future level. Depending on political preferences and the priorities assigned to public finances, it is perfectly legitimate to argue that these levels are too high or too low.

The results of the projections presented in this report are broken down into four scenarios of long-term labour productivity gains (scenarios 1.0%, 1.3%, 1.5% and 1.8%) associated with an unemployment rate of 7% (starting 2032). These scenarios, none of which is preferred, do not constitute a forecast but aim to be sufficiently contrasted and reasonable to inform the debate on the long-term evolution of the pension system. In this respect, the COR has decided to include in its end-of-year agenda a review of these long-term economic assumptions which will underpin the next projection exercises for the French pension system; this is why it has already launched a broad consultation of experts on this issue.

As regards the short and medium term, this new report incorporates the elements known at the time of its preparation: it is based on the economic assumptions made within the 2021-2027 Stability Programme, as well as the final 2018, semi-final 2019 and provisional 2020 accounts published by INSEE at the end of May 2021; likewise, the excess mortality linked to Covid is assessed up to the end of April 2021. Moreover, since 2017, the COR projections have been based on the central demographic assumptions (fertility, life expectancy and migration) of the INSEE projections 2013-2070 carried out in 2016. In view of recent developments in terms of births and mortality - even before the health crisis - the Council decided to adopt another demographic scenario from among those produced by INSEE in 2016, revising the fertility and life expectancy assumptions downwards, but keeping the central migration scenario.

Finally, it is important to emphasise the high degree of uncertainty surrounding this projection exercise. The evolution of the economic context in the coming years will largely depend on the evolution of the epidemic and the health measures taken.

In the very short term, the very sharp contraction in resources associated with the fall in GDP has not been offset by the small reduction in expenditure linked to the excess mortality of pensioners recorded to date. As a result, the deficit of the pension system has increased massively and reached €18 billion in 2020, i.e. 0.8% of GDP (if the one-off payment of €5 billion from the Pension Reserve Fund is taken into account, the deficit is reduced to 0.6% of GDP); this deficit would be reduced to almost 0.4% of GDP in 2021, in connection with the rebound in activity. This sharp deterioration in the deficit would be essentially cyclical.

By 2030, the share of pension expenditure in GDP would be slightly lower than in the November 2020 projections (13.7% versus 13.9% in the 1.3% scenario). Expenditure would grow less dynamically than in November 2020 due to the downward revision of life expectancy and, in the short term, by taking into account the Covid-related excess mortality that has occurred since. By that time, GDP would return to its balanced growth path and the balance of the pension system would be essentially structural.

From 2030 until the early 2060s, the share of pension expenditure in GDP would fall in all scenarios but with a varying amplitude between them. By 2070, the share of pension expenditure would even be lower than in 2019, before the crisis, in all the scenarios, notably in connection with the downward revision of life expectancy gains over the entire projection period. However, it would remain highly dependent on the scenario adopted and would vary between 11.3% of GDP (1.8% scenario) and 13.0% (1.0% scenario). The balances of the pension system would be slightly better than expected in June 2019 and November 2020. They largely depend on the economic scenario and the convention used to project the resources of the system.

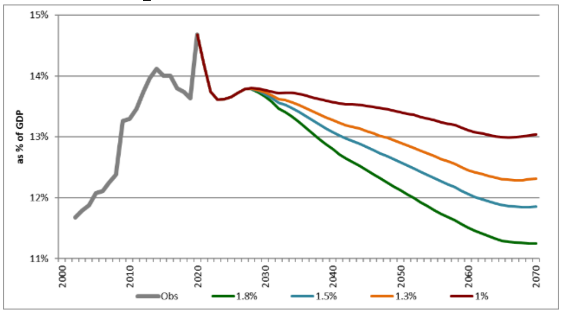
What is the share of national income devoted to pensions?

Pension system expenditure as a proportion of GDP measures the share of national income devoted to paying pensions. This indicator is therefore decisive in assessing the financial sustainability of the pension system insofar as it expresses, in a global and synthetic manner, the level of deductions that must be made from the wealth produced by the active population to ensure a balanced pension system.

The share of pension expenditure in GDP reached a particularly high level in 2020, at 14.7% of national wealth. The impact of the health crisis on expenditure was indeed less important than the contraction of activity, notably because pensions are indexed to prices and therefore insensitive to economic conditions.

The share of expenditure would then decrease from 2021 onwards with the rebound in activity and because of the excess mortality linked to the health crisis. It would return to a level close to that before the crisis from 2022, at around 13.7% until 2030.

Observed and projected pension system expenditure as % of GDP



Sources: reports to CCSS 2002-2020; COR projections– June 2021.

It would decrease from 2030 to 2070 in all scenarios: it would thus vary from 11.3% to 13.0% over the projection horizon. The evolution of the share of pension expenditure in GDP is therefore controlled over the projection period. The great variability from one economic scenario to another reflects the strong dependence of the pension system on growth, which is explained by the revaluation of acquired rights and pensions in line with prices.

The fact that pension expenditure is expected to ultimately decrease as a percentage of GDP (subject to unchanged legislation), and is therefore under control, is an observation that does not imply any political assessment of the current or future level of this expenditure. Depending on political preferences, it is perfectly legitimate to argue that these levels are too high or too low.

Why would the share of pension expenditure fall in GDP in the long run?

The share of pension expenditure would fall in the long run despite the ageing of the French population; the ratio between the number of people aged 20 to 59 and those aged 60 and over would drop from 1.9 in 2020 to 1.3 in 2070. The impact of this demographic ageing on the pension system would be slowed down by the increase in the retirement age, which would rise from 62.2 years in 2019 to just under 64 years around 2040 with unchanged legislation, under the effect of past reforms and the increase in the age of entry into working life. This increase since 2010 has been accompanied by an increase in the employment rate of older people. The ratio between the number of contributors and the number of pensioners would nevertheless decrease, from 1.7 in 2019 to 1.3 in 2070.

However, despite this unfavourable demographic trend, pension expenditure as a percentage of GDP would decrease due to the fall in the average pension relative to earned income: pension would continue to grow in constant euros, but less quickly than income. Thus, the gross pension relative to gross income would vary between 31.6% and 36.5% in 2070, compared to 50.1% today. The stronger the growth, the sharper the decline in this ratio.

How is this expenditure financed?

Levies to finance pensions currently represent almost 31% of working people's income. 75% of the financing of the pension system comes from social contributions. The rest of the resources are made up of earmarked taxes and other resources which come from State subsidies and transfers from third-party organisations, such as the unemployment insurance or the family branch of Social security.

In 2020, the resources of the pension system, in contrast to its expenditure, were hit hard by the sudden drop in activity. They fell by 4% in real terms compared to 2019. The contraction of the private sector wage bill, under the effect of the massive recourse to partial activity and the drop in employment linked to the crisis, as well as the deferrals of payments allowed for the self-employed, explain most of this drop. As a result, the deficit of the pension system has increased and reached 0.8% of GDP in 2020. Taking into account the one-off payment of €5 billion from the Pension Reserve Fund, the deficit is reduced to 0.6% of GDP.

In projection, the resources of the pension system, and *a fortiori* the balance, are largely conventional, given the annual balancing by the State of special schemes (State civil service scheme, SNCF, RATP, mining scheme, seamen's scheme or State workers' scheme). The projections are therefore of little interest for these schemes since, by applying this rule; they are by construction permanently balanced.

This is why the COR projections present the resources and balance of the pension system according to three accounting conventions concerning the civil service scheme and the other special schemes: the EEC convention (constant State effort) where the State's contribution to these schemes as a percentage of GDP is constant in the projection; the TCC convention (constant contribution rate), which consists of freezing the implicit contribution rate of these schemes; and the EPR convention (permanent balance of the schemes) which balances them year after year.

These three conventions, by construction, have no impact on public finances considered as a whole, but lead to different levels of state contribution and subsidy to the pension system, and consequently to a contrasting view of the financial balance of the pension system.

The balance would vary in 2070 between -0.7% of GDP (scenario 1.0%, EPR convention) and +2.1% (scenario 1.8%, EEC convention). It would be the most deteriorated in the EPR convention, whereas the pension system would show surpluses in all scenarios in the EEC convention and in three scenarios in the TCC convention.

Only the ratio of pension expenditure to GDP allows a sound assessment of the financial situation of the pension system; the balance approach gives contrasting results which depend on the convention adopted.

At the end of 2020, the net assets of all pay-as-you-go schemes (reserves built up minus accumulated debts) stood at 89 billion euros, or 3.9% of GDP.

How sensitive are the results to the assumptions made?

Unlike last year's report, the scenarios presented in this report are based on the low life expectancy and birth rate assumptions of the latest INSEE demographic projections: 1.8 children per woman (instead of 1.95) and a moderation of life expectancy gains. Net migration remains unchanged at +70,000 people per year. The revision of fertility has led to an increase in the share of pension expenditure in GDP of around +0.7 points in 2070. Conversely, the slowdown in mortality gains has led to a decrease of around 0.6 percentage points in 2070.

The financial situation also depends on the unemployment rate assumption (4.5% or 10%). In the case of a lower (higher) unemployment rate, the share of expenditure in GDP would be lower (higher) over the whole projection, of the order of 0.2 to 0.3 GDP point. The magnitude of these differences is much smaller than that associated with the different assumptions on labour productivity growth.

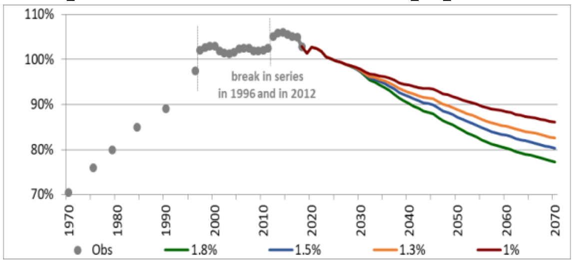
What are the consequences for the standard of living of retirees?

In 2018, the average standard of living of retirees is slightly higher (around 2.9%) than that of the general population. It has been relatively stable since 1996, whereas it had risen sharply since 1970.

This increase has made it possible to reduce the poverty rate of retirees, which has been significantly lower than that of the general population since the 1980s (8.7% compared to 14.8% in 2018).

Depending on the scenario, the relative standard of living of retirees is expected to decline in the long term to between 90% and 95% in 2040 and between 77% and 86% in 2070. It would thus gradually return to its 1980s level.

Average standard of living of retirees compared to that of the entire population



Sources: COR projections– June 2021, INSEE-DGI and INSEE, DESTINIE model.

The stability of the relative average standard of living of retirees over the recent period may not, however, reflect the individual experience of retirees. This average situation is affected by a ‘noria effect’ linked to the renewal of the retired population: the new generations, whose pensions are on average higher, are gradually replacing the older generations with lower pensions.

At the individual level, for present/present retirees, pensions have undergone a different erosion of purchasing power over the last 25 years, depending on the generation, the higher the pension. Thus, studied on a typical case, the purchasing power of a non-executive pensioner from the private sector has decreased by about 3 to 4% depending on the generation, between the year of their retirement and 2020; that of an executive pensioner born in 1932 has recorded a decrease of nearly 14%. These erosions are mainly explained by the indexation mechanisms of pensions and by the increase in social security contributions on pensioners (in particular the CSG since its creation in the early 1990s).

How fair is the pension system between the generations?

Comparisons between generations show contrasting results. Compared to the generations currently retiring (born in the mid-1950s), the younger generations would be penalised by higher contribution rates and a lower average pension relative to average working income. On the other hand, their career duration as a proportion of their total life expectancy would be slightly shorter on average, and in mirror image, their retirement duration relative to the total life expectancy would tend to progress given the gains in life expectancy.

What fairness between women and men with regard to retirement?

Women have lower pension amounts than men and retire later because their careers remain less favourable than men's.

Their unemployment rate is now similar to that of men, but they have lower employment rates (notably due to maternity), work more often part-time and have lower earnings, although the gaps decreased until the early 1990s.

In the future, women are expected to retire slightly earlier than men, in particular because their validated insurance period is expected to match or even exceed that of men. In the private sector, this period would represent on average 105% of that of men for generations born after 1980.

The pension gaps between women and men are significant, even if they narrow over the generations. The ratio between the average amount of direct pensions (excluding the supplement for three children) for women and men has increased steadily over the years, rising from 55% to 63% between 2005 and 2019. When survivor's benefits are taken into account, the gap between women and men narrows: the ratio of women's average total pensions (including supplement for three children and survivor's benefits) to men's would rise from 76% in 2019 to 92% by 2070.

The standard of living gap between women and men in retirement is smaller than the differences in pensions. It mainly results from the fact that more women than men live alone in retirement.

Women currently retired have an expected retirement period about 4 years longer than men, but this gap is expected to narrow for future generations.