CONSEIL D'ORIENTATION DES RETRAITES
Plenary session November 25, 2021 at 10:00
"The choice of long-term economic scenarios"

Brief

Prepared by the General Secretariat of the Council, under the direction of the President of the COR

Summary Projecting the pension system requires making assumptions about the regulatory, demographic and economic developments on which it depends. This COR session is more specifically devoted to the choice of long-term economic assumptions. **For the 2022 annual report, the projections of the French pension system will be broken down according to four productivity targets (i.e. 0.7%, 1%, 1.3%, and 1.6%) with a long-term unemployment rate of 7%**. This dossier looks back on the debates that led to this choice**.**

- **Why are productivity assumptions important?** The shift over the past 30 years from an indexation of entitlements and pensions to wages to an indexation to prices has been a major lever to offset the increase in the share of pension expenditure in GDP linked to population ageing. However, using this lever has the drawback of making the financial situation of the pension system and the relative situation of retirees compared to working people highly dependent on the pace of productivity growth, past and future (see *document 2*). According to the June 2021 COR report, the average pension relative to earned income would vary between 31.6% (1.8% scenario of labour productivity growth) and 36.9% (1.0% scenario) in 2070, while the share of pension expenditure in GDP would represent between 11.3% and 13.0% respectively.

I. The macroeconomic framework: what do economists say?

- **How was the choice of new long-term economic assumptions organized?** First, 82 economists were consulted on the basis of an online questionnaire in order to obtain their opinion on potential long-term changes in labour productivity, the unemployment rate, the value added share and working hours. Of the experts consulted, 23 responded. At the end of this consultation process, the COR organized a colloquium of restitution and consultation where the views of economists were confronted. In the light of this consultation and these debates, the COR members determined the new scenarios which they considered the most relevant to project the long-term evolution of the pension system (see *document 3*)**.**
- **What is the outlook for productivity growth?** The majority of economists have expressed their wish to shift the growth scenarios downwards. The 1% scenario, which roughly corresponds to the average annual productivity growth since the end of the 2008 crisis (*see documents 5 and 9*), would then be an intermediate scenario and no longer an extreme scenario. However, the current economic debate remains very divided between "techno-optimists" and "techno-pessimists" on the future of productivity gains - and in particular on the imminence or otherwise of a positive productivity shock linked to the digital revolution (*see document 4*).
- **What unemployment rate in the future?** A majority of experts recommend keeping a long-term unemployment rate of 7 percent as the central assumption along with the current variants (4.5 percent and 10 percent). The other economists, for their part, advocate a slightly higher unemployment rate as a central assumption (8 per cent, i.e. the current estimated level of structural unemployment rate, or 9 per cent, the average over the last 20 years) (see *document 3*).

- **What are the prospects for sharing productivity gains and changes in working hours?** A very large majority of economists recommends maintaining, for the projections, the current assumption of stability in the sharing of productivity gains and in the working time (see *document 3*). On working time, however, some economists think that it could increase, at least in the short term, with the rise in the share of employees payed on a daily basis or that of the self-employed, two categories where the number of hours worked is greater, and with the spread of teleworking. In the longer term, working time could decline with the development of specifically part-time jobs (such as in personal care professions), an increased preference for leisure time, and finally under the effect of climate change, either as a result of constraint (inability to work during extreme climatic events) or choice (need for energy sobriety) (see *document 6*)

II. Building up macroeconomic scenarios

- **How are the COR's economic scenarios constructed?** Based on the methodology developed by the General Directorate of Treasury, the Council defines its long-term targets for productivity and unemployment and complete scenarios of evolution, both for the potential values of the economy (representing its fundamentals: structural unemployment, etc.) and the actual values. The scenarios distinguish three sub-periods: the short term (generally five years), where all scenarios are identical to the government's forecasts; the medium term (until 2032), where the various variables converge towards their targets; and finally the long term, where unemployment and productivity growth rates evolve according to the targets defined by the COR (see *document 7*).

- **Has the COR always kept the same assumptions?** For unemployment, the assumptions have changed relatively little over the projection exercises. Two assumptions on unemployment rate are kept in all exercises: 4.5% and 7%. Regarding productivity, the COR's projections have each time been based on at least two assumptions, varying between 1% and 2.5% per year, then between 1% and 2% (between 2012 and 2016), and since 2017 between 1% and 1.8% (see d*ocument 8*).

III. Projection exercices abroad

- **What assumptions are used in pension projections abroad?** For productivity, two groups of countries can be fairly clearly distinguished: a group where the productivity expected in the future evolves around 1.0-1.1% (Germany, the Netherlands, Canada and Spain) and another group where targets are higher, equal to or greater than 1.5% (Belgium, Italy, the United Kingdom, the United States and Sweden). France occupies an intermediate position between these two groups. It should be noted that the harmonized financial projections piloted by the European Commission under the AWG foresee a long-term growth rate of 1.5% per year. Regarding unemployment, some countries do not have an explicit assumption on which they communicate. For those countries that do, the central assumption for a long-term unemployment rate is between 5% and 7%. The AWG's average assumption on long-term unemployment rates is 5.8% (see *document 10*).