Pensions: the Moreau report's poor compromise

By Henri Sterdyniak

Under pressure from the financial markets and Europe's institutions, the government felt obliged to present a new pension reform in 2013. However, reducing the level of pensions should not now be a priority for French economic policy: it is much more urgent to re-establish satisfactory growth, reform the euro zone's macroeconomic strategy, and give a new boost to France's industrial policy as part of an ecological transition. Establishing a committee of senior officials and experts is a common practice that is used these days to depoliticize economic and social choices and distance them from democratic debate. In this respect, the Moreau report, released on 14 June 2013, seems like a bad compromise. Although it does not call into question the public pension system, it weakens it and does not give itself the means to ensure the system's social viability.

Do the social security accounts have to be balanced during a depression?

The deficit in the pension schemes in 2013 was mainly due to the depth of the recession, which has reduced the level of employment by about 5%, causing a loss of about 12 billion euros in funding for the pension schemes. The central objective of Europe's economic policy should be to recover the jobs lost. Unfortunately, the Moreau report proposes continuing the strategy of a race to the bottom that is being implemented in Europe and France: "the pension schemes must contribute to restoring the public accounts and to France's international credibility" (page 82). The report forgets that lower pensions lead to a decline in consumption, and thus in GDP, and to lower tax revenues and social security contributions, especially since all the euro zone countries are doing the same thing.

The report recommends reducing the deficit in the pension system relatively quickly by increasing the taxes paid by retirees. It adopts several well-known proposals uncritically. It would align the rates of pensioners' CSG wealth tax with those of the employed. At one time, unlike employees, pensioners did not pay health insurance contributions. They have been hit by the establishment and then increase in the CSG tax. They already pay an additional contribution of 1% on their supplementary pensions. They are suffering from the retreat of the universal health scheme in favour of top-up health insurance. Increasing their CSG rate from 6.6% to 7.5% – the same as for employees – would bring in 1.8 billion euros. But shouldn't it be necessary in exchange to eliminate the 1% contribution on supplementary pensions and make their top-up health insurance premiums (which are not paid by the companies) deductible?

Pensioners are entitled, like employees, to a 10% allowance for business expenses, but with a much lower ceiling. Even for employees, this allowance is much higher than actual business expenses; it offsets to some extent the possibilities of tax evasion by non-employees. The removal of the allowance would lead to 3.2 billion euros more in tax revenue to the state and a 1.8 billion reduction in certain benefits, linked to the amount of taxable income. Retirees would lose 2% of their purchasing power. But it is hard to see how this 5 billion would make its way into the coffers of the pension programmes.

Taxing pension family benefits (which would yield 0.9 billion) is certainly more justifiable, but again it is unclear how and why the product of this tax would go to the pension funds, especially as family benefits are the responsibility of the CNAF (National family benefits fund).

On the other hand, with regard to increasing contributions the report is very timid in at best proposing an increase of 0.1 percentage point per year for 4 years, *i.e.* ultimately 1.6 billion euros in employee contributions and 1.6 billion in employer contributions.

Most importantly, the report intends to increase the highest pensions (those who pay the full rate of CSG tax) only at the rate of inflation: 1.2 points for 3 years, thereby hitting them with a reduction of 3.6% in their purchasing power. Pensions subject to the reduced rate of CSG would lose only 1.5%. The lowest pensions would be spared. While this disparity in efforts may seem justified, the reliability of the public pension system would be seriously undermined. How can we be sure that this de-indexation will last only three years, that it will not become a more or less permanent management tool, which would especially hit older pensioners whose standard of living is already low? As the pensions received by a retiree are not all currently centralized, it is difficult to have the indexation of pensions vary in accordance with their level. The solution advocated by the report – to take into account the situation of the pensioner vis-à-vis the CSG – is hard to manage; making someone’s pension level depend on their family’s tax situation is just not justifiable. Pensions are a social right, a return on the contributions paid in, and not a tool for adjustments. How can we justify a 3.6% decline in the purchasing power of part of the population while GDP per capita is expected to continue to rise? Should the purchasing power of pensioners be cut when it has not benefited from an increase since 1983, even during periods of wage growth? Respect for the implicit social contract that underpins the pension system means that pensioners should make the same efforts as employees, no more, no less.

Furthermore, in times of economic recession the refrain that *efforts need to be equitably distributed* is dangerous. If everyone makes an effort by accepting less revenue and then reducing their expenditure, the inevitable result will be a drop in overall consumption, which, given spare production capacity, will be accompanied by a decline in investment and thus in GDP.

Guaranteeing a fall in pensions

In the medium term, the report's main concern is to ensure a decline in the relative level of pensions. Indeed, because of the Balladur reform, since 1993 wages recognized in the general pension scheme have been re-valued based on prices, and not on the average wage. The replacement rate (the ratio of the first pension payment to final salary) falls in line with strong increases in the average wage: at one time the pension system's maximum replacement rate was 50%, but this drops to 41.5% if real wages rise by 1.5% per year, but only to 47% if they rise by 0.5% per year. The mechanism introduced will lead to lowering the average level of pensions by 31% if the real wage increases by 1.5% per year, by 12% if it grows by 0.5% per year or by 0% if it stagnates. However, in recent years, wages have been rising by only 0.5% per year. The relative level of pensions might then recover. It is necessary therefore to increase wages to reduce the relative level of pensions.

The committee of experts gathered around Mrs. Moreau have therefore made two alternative proposals:

- – Either the wages used will be re-valued only as: price + (real wages less 1.5%), which means that, regardless of the wage increase, the maximum replacement rate for general pensions would fall to 41.5%. The relative decline in pensions would therefore be definitively consolidated. On the technical side, the increase in wages recorded will become a tool for adjustment, whereas, objectively, it should be used to calculate the average wage over the career; the oldest wages would be sharply devalued. However, the report acknowledges (page

107) that the current level of pensions corresponds to parity in living standards between active employees and pensioners, and that the proposed change would lead eventually to lowering the standard of living for retirees by 13%. Nevertheless, it considers that "this development is acceptable". Is this a judgment that should be made by the experts or by the citizens? Moreover, it neglects that this loss would come on top of the impact of the tax reforms and de-indexation that have also been recommended.

- – Or, every year a committee of experts would propose a reduction in the level of the pensions to be paid based on a *demographic factor* that would ensure the system is balanced. In addition to the fact that this would be another blow to democracy (isn't it up to the citizens to arbitrate between pension levels and contribution rates?) and to social democracy (the social partners would merely be *consulted*), and employees would have no guarantee of the future level of their pension, especially given the memory of the precedent set by the appointment of an expert group for the minimum wage (the *SMIC*), which was fiercely opposed to any increase.

Lengthening the contributions period

The Moreau report calls for further lengthening the period of contribution payments required based on the principles of the 2003 Act (extending the contribution period by two years for every three year increase in life expectancy at age 60). The required contribution period would then be 42 years for the 1962 cohort (2024), 43 years for the 1975 cohort (2037), and 44 years for the 1989 cohort (in 2051). As the average age when vesting begins is currently 22 years, this would lead to an average retirement age of 65 in 2037 and 66 in 2051. This announcement is certainly designed to reassure the European Commission and the financial markets, but it leads above all to worrying the younger generations and reinforcing their fear that they will never be able to retire.

Is it really necessary to announce a decision for the next 25 years without knowing what the situation will be in 2037 or 2051 with respect to the labour market, job needs, social desires or environmental constraints? Eventually, like all the developed countries France cannot escape the need to revise its growth model. Is it really necessary to do everything possible to increase production and private sector employment at a time when ecological constraints should be pushing us to decrease material output? Maintaining the possibility of a period of active retirement in good health is a reasonable use of productivity gains. Reform should not go beyond a retirement age of 62 years and a required contribution period of 42 years. So if the “long career” approach is maintained, people who start work at age 18 can retire at 60, and those who start at age 23 will stay on until 65. But working conditions and career development programmes need to be overhauled so that everyone can actually stay in work until those ages. This also implies that young people seeking their first job receive unemployment benefits, and that the youthful years of precarious employment are validated.

Taking the arduous character of work into account

The convergence of public, supplementary and private pension programmes likewise involves taking into account how arduous jobs are, by distinguishing between professions that are difficult to exercise after a certain age, meaning some kind of mid-term conversion is necessary, and jobs that are too tough, which can reduce life expectancy and thus should be phased out. For those who still have to do such jobs, periods of heavy work should give rise to possible bonus contribution periods and reductions in the age requirements. Common criteria should be applied in all the pension systems. In offering only one year’s bonus for 30 years of hard labor, the Moreau report does not go far enough. This is almost insulting and makes it impossible to open up negotiations on a plan to align the different systems.

What is to be done?

Whereas the COR report declared only a limited deficit (1% of GDP in 2040), the Moreau report proposes inflicting a triple penalty on future pensioners: de-indexation, a lower guaranteed replacement rate and the automatic extension of the contributions period required. This is no way to reassure the young generations or to highlight the advantages of the old-age pension system.

Pension reform is not a priority for the year 2013. In the short term, concern should be focused not on the financial imbalances in the regimes induced by the crisis but mainly on getting out of the depression. A strategy of a race to the bottom economically and socially, which is what de-indexation would lead to, must be avoided.

In the medium term, in order to convince young people that they will indeed enjoy a satisfying retirement, the goal should be to stabilize the pension / retirement ratio at close to its current level. The State and the unions must agree on target levels for the net replacement rate for normal careers: 85% for the minimum wage level; 75% for below the social security ceiling (3000 euros per month); and 50% for one to two times that ceiling.

To guarantee the pay-as-you-go pension system, the government and the unions must state clearly that a gradual increase in contributions will be required to bring the system into equilibrium, if necessary, once a strategy of extending the length of careers has been implemented at the company level that corresponds to the state of the labour market and actual workforce needs.