France's National Retirement System

France like so many other Western European nations is facing a rapid aging of its population. This trend early in the next century will put serious strain on its public finances and the overall economy. One of the key features of the French retirement system is that on top of an earning-related state pension a compulsory complementary pension is provided through two nation-wide elements, ARRCO and AGIRC, for different type of workers and on a pay as you go financing basis. An underlying ethos imbedded in these programs is that of collective solidarity regarding contributions and benefits. Indirectly these concepts have stifled reforms. In response academics and economists share a growing sense that the overall retirement system of France is lurching out of control as a result of growing wage demands and shorter working hours.[1]

Before we examine the structure and complexity of the French pension system it is important to briefly mention its origins and the factors that are likely to shape its ongoing development. By the end of World War II, France's economy had been devastated for a second time by war. Infrastructure, along with financial capital was in short supply. With this as a backdrop, a system of universal protection, regardless of income was created in 1945 to provide France with a comprehensive and compulsory system of health care and retirement provision - Sécurité Sociale. The structure of the retirement system today mirrors this concept of national solidarity and the long tradition of pension design focussing on répartition (pay-as-you-go) principles.

When examining the French pension system one notes the complexity of different pension programs that co-exist in covering different segments of the population. Secondly the rules of these pension funds are often not fixed but can fluctuate over time.[2] In our analysis of the French retirement system we concentrate on the system that affects a majority of the population.

France as nation has a 'rich tapestry' of going against generally accepted economic and social policy. The founder of the Fifth Republic, General Charles de Gaulle in 1962 insisted that a policy of national independence to enhance France's standing in the world should be pursued.[3]France equally seems to resist the fiscal realities that its national retirement system is comparatively generous, compared with other OECD nations. "Unlike the approaches taken by some countries, France did not look at implementing a mandatory funded system. Rather, it looked at introducing a voluntary funded third pillar of retirement income."[4] For example France has a relative value of its social security old age pension that equates to 50 percent of the average of the 25 best years of employment capped to annual social security ceiling. If you add pension provided by ARRCO and AGIRC you get a final salary replacement ratio between 80% and 37% depending on employee category (blue collars, clerks, exempt and management) and career profile. Moreover the higher the final salary and the younger the individual the lower the replacement ratio. Contrasting this level is the United Kingdom and Canada with 25 percent of average wages and the United States with 43 percent of final salary.

While in isolation, the value of these benefits may seem alarming; such a reaction is compounded when evaluating France's poor demographic outlook. Angst over its demographic position is best seen in the movement of dependency ratio data: elderly dependency ratio (population aged 65 and over as a percent of working age population) in 2000 will deteriorate from 23.6 percent to 39.1 percent by 2030. A similar trend is seen in total dependency ratio data (population aged 0-14 and 65 and over as a percent of working age population) will shift from 52.8 percent in 2000 to 67.9 percent by 2030.

The first tier of the French retirement system consists of approximately 120 pension schemes, with the most important being the régime général de la sécurité sociale (general scheme) covering private-sector employees. Essentially the benefits are based on earnings up to the social security ceiling that is reviewed on an annual basis. Under the scheme, a maximum pension of 50 percent of covered revalued earnings over the past 25 years will be provided upon reaching normal retirement age – 65 years. In 2000 the social security ceiling by which the overall benefit is determined was set at a monthly level of 14,700 French Francs ($US2,100 with 7FF to a US$) or annually 176,400 French Francs ($25,200).

For an individual who retires at 65 years their pension is calculated using average annual covered earnings that has been received during their working career. These average earnings are revalued in line with a wage index that is prescribed by the social security administration. Depending on the year of birth for the retiree, the number of years and quarters that are required to calculate the average salary and unreduced early retirement benefit will alter. Employees for example born in 1939 need to have completed at a minimum 156 quarters of insurance payments compared with those born in 1948 who need 160 quarters. Equally the calculation of average salary sees 16 years required for those retirees born in 1939 compared with 25 years for those retirees born in 1948.

A common trend that often occurs in France is that employees seek early retirement. Such an action causes reductions in their first tier pension. For a retiree who was born in 1939 the calculation of this reduction factor can be determined by the lesser of 1.25 percent per quarter multiplied by the minimum required number of quarters or the number of quarters remaining to age 65. These arrangements again seem comparatively generous by OECD standards.

Contributions for this benefit are required from both employers (8.20 percent) and employees (6.55 percent). The maximum annual earnings subject to these contributions is equal to the social security ceiling of 14,700 French Francs ($US2,100).

Overall the minimum retirement pension after 37.5 years of insurance is 42,910 French Francs ($US6,130) for a single person and 76,977 French Francs ($US10,996) for an household. It is worth noting that these benefits are means tested and that unlike other countries, the associated contribution rates, retirement age and formulae for calculating pension benefits changes significantly between schemes and industries.

To 'top up' social security benefits that are mostly generated by the régime général (general scheme), virtually all employees are members of compulsory supplementary programs. While these schemes have separate funds for particular regions, industries or occupations, common benefits and contributions exist. An important distinction that fundamentally underlies these supplementary pension plans is that "..in France certain employees are designated as *cadres*. This roughly translates as 'executives' or 'managerial employees'. *Cadres* account for about 15 percent of the employed population and are covered by different employment terms and conditions."[5]

All private sector workers are required since 1961 to join a scheme that belongs to ARRCO

(Association of Complementary Retirement Systems). The scheme has operated largely for non-executives but since 1973 has required executives to participate. ARRCO’s normal retirement age is 65 for men and women with no actuarial penalty being applied to individuals who retire at or after 60 years. For those employees who work past the normal retirement age, the payment of the pension may be deferred by up to five years.

To calculate the benefit generated by ARRCO, one has to consider the number of “pension points” that the individual has accumulated up to the date of retirement. The value of a “pension point” as at January 1 1999 was 6.5596 French Francs (1 Euro). For non-executives, “pension points” are determined on all earnings up to three times the annual social security ceiling for retirement benefits (529,200 French Francs or $US75,600). In the case of executives, this calculation is based on “Tranche A”

(annual income bracket up to the social security ceiling for retirement benefits – 14,700 French Francs ($US2,100)). For those employees who retire after 20 years of service with a company, the number of credited “pension points” will increase by 5 percent.?

Secondly a valuation has to be made of the “pension point” when the individual retires. Though this method of calculating the final benefit for the retiree seems complex, the methodology tends to be rather straightforward. The number of “pension points” applied to a member during any particular year is equal to the total earnings-related contributions divided by an index referred to as the “reference salary” for that year. The value of the “reference salary” as at January 1 1999 was 71.8534 French Francs ($US10.26). Thus at retirement, the total benefit due to the retiree is calculated by multiplying the accumulated “pension points” by the “pension point” value to determine the overall pension amount.

One further structural design of ARRCO is that if the employee retires on less than 100 “pension points”, he or she will then be entitled to receive a lump payment as an alternative to a pension. The value of this lump sum will be equivalent to seven times the value of the accrued “pension points” at that date.[6] Under ARRCO benefits are vested immediately by law.

Contributions in relation to supplementary schemes like ARRCO can be quite confusing. In its simplest form the employer makes a contribution of 4.5 percent and the employee 3.0 percent with total contributions equaling 7.5 percent. Yet, only 6.0 percent of the total contribution (3.6 percent by the employer and 2.4 percent by the employee) is applied to purchasing “pension points”. The remainder of the contributions are pooled for the general benefit and functioning of the fund and its members.

The second major supplementary plan in France was established by the General Association of Retirement Institutions for *Cadres* (executives) the 14th March 1947 and is known as AGIRC. Although the functioning and broad details of ARRCO and AGIRC are similar, some distinct characteristics do exist. Firstly AGIRC contributions are calculated only on Tranche B (income bracket between the social security ceiling and four times the social security ceiling) and Tranche C (income bracket between four and eight times the social security ceiling) earnings. Secondly an underlying guarantee exists for executives in terms of the fund generating a minimum annual number of “pension points” for utilization in retirement. Additionally less generous “pension point” and “reference salary” values are applied to AGIRC compared with ARRCO.

Finally AGIRC prescribes much steeper contributions by employers and employees. Employers are required to make contributions of 12.50 percent whereas employees only make contributions of 7.50

percent. Like ARRCO, not all of these contributions are applied towards the purchase of "pension points". Total employee and employer contributions that are applied to AGIRC to "purchasing points" are equivalent to 16 percent. An important aspect to note regarding the proportion of contributions between the employer and employee is that it only applies compulsorily to Tranche B earnings. Differing contribution rates may be negotiated by employers and employees relating to Tranche C income.

As identified previously, France has closely embraced the principles of pay-go in reference to pension system design. Clearly both ARRCO and AGIRC operate as pay-go plans, in that their members pay contributions and that the final benefit generated is calculated through the application of a series of variables and fixed values. Importantly contributions and fund arrangements for supplementary plans are compulsory.

An important consideration when evaluating the second pillar of the French retirement system is that it is comparatively small by international standards. This is due in part to little tax incentives existing for employers to establish group insurance contracts that offer retirement benefits or through individually insured pension plans

(the so called "contrats sur salaire"). These plans mainly insured are essentially designed to supplement the first pillar rather than form a separate or distinct layer for employee retirement benefits.

Another voluntary retirement vehicle the PPESV Plan Partenarial d'Epargne Salariale Volontaire is being discussed in Parliament in addition to the PEE Plan d'Epargne d'Entreprise i.e. savings plans created in 1967 and governed by the 26 October 1986 legislation that are fairly close to 401K plans. The assets of a savings plan or provident fund may be administered by the company itself or through a financial institution such as a bank or an insurance company but through dedicated mutual funds to employee savings plans : FCPE.

On the whole though the second pillar remains tiny when compared with the first pillar in reference to contribution volume and the number of plans. While planned reforms are intended to address this imbalance, significant political and economic obstacles exist to pass these much needed reforms.

Endnote

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[1] The Economist, "Retire early, bust the state", *The Economist*, (February 15, 1997), p.47.

[2] Didier Blanchet and Louis-Paul Pelé, "Social Security and Retirement in France", *National Bureau of Economic Research-Working Paper 6214* (October 1997), p.5.

[3] Presidence de la Republique, "The Presidents of the 5th Republic", http://www.elysee.fr/ang/instit/biodg.htm, Paris, France

[4] Laurie W. Letts, “France Moves Toward Funded Third Pillar of Retirement Income”, *IBIS Review*, (May, 1997), p.2.

[5] Tim Reay, “The New Retirement Savings Plan Law”, *Benefits and Compensation International*, (March 1997), p.2.

[6] Watson Wyatt Data Services, *Benefits Report Europe, USA & Canada*, (Brussels, Belgium: Watson Wyatt Worldwide, 1999), p.284.