

Brief

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

Rationale: Between 1993 and 2023, reforms delayed the retirement age, but also changed the indexation of entitlements and pensions, moving from wages to prices. In recent years, pensions have not always been fully indexed to prices either. These measures have helped to counteract the effects of demographic ageing on the financial balance of the schemes by reducing the relative value of pensions. However, they pose two problems: increased sensitivity of financial projections to demographic and economic assumptions, and a lack of intergenerational equity in the face of economic fluctuations. Simulations based on indexation to wages adjusted by a demographic coefficient are therefore being considered to overcome these disadvantages without jeopardising the financial sustainability of the pension system.

1. The methods used to revalue pensions and pension rights in the French pension system

- ***How have the rules for indexing entitlements and pensions evolved in France?*** Since the late 1980s, basic pensions have been indexed to prices excluding tobacco, whereas they were previously indexed to wages. For several years, revaluation freezes or under-indexation have also been implemented in all schemes (2014, 2018, 2019, 2020 and 2021). The French pension system provides that rights acquired in aligned schemes (including the general scheme) are revalued according to the same rules as for the pensions already paid. However, with repeated de-indexation, a gap between these two revaluations has emerged and from 2018 to 2022, rights have continued to be revalued on the basis of prices excluding tobacco. At Agirc-Arrco, pensions are adjusted in line with prices excluding tobacco, reduced by 0.4 points (without being able to fall in nominal terms) until 2026, after being frozen between 2013 and 2018 (*document no. 2*).
- ***What impact do these measures have on pensioners' purchasing power?*** In theory, indexing pensions to prices aims to preserve pensioners' purchasing power. However, with recent de-indexation, the gross pension of a typical non-executive, with a full career, born in 1939, fell by 5.8% in constant euros between 1999 (the date of his retirement) and 2024. The decrease is 6.8% for a manager, due to the larger share of the Agirc-Arrco pension in their total retirement income, which is less revalued than the general scheme (*document no. 3*).
- ***Can differentiated under-indexation of retirement pensions be considered a sustainable option?*** A sustainable under-indexation of pensions may be deemed necessary to moderate pension spending and maintain intergenerational solidarity in a context of low growth. However, it could be considered too penalising for small pensions. In this regard, targeted measures have already been taken, such as sub-indexation limited to pensions above €2,000 in 2020, or the €40 bonus in 2014. If such measures were to continue, it would nevertheless be preferable to incorporate this differentiation into the initial calculation of pensions *via* progressive settlement rates based on the reference salary (*document no. 4*).
- ***What indexation is used in the countries monitored by the COR?*** In most countries (Germany, Canada, the United States, Japan and Sweden), entitlements are revalued on the basis of wages or GDP, while in Belgium, Spain and France, they are revalued on the basis of inflation. Pensions paid are generally price indexed, except in Germany and the Netherlands, where they are revalued in line with wages. Demographic coefficients may also be included (Germany, Sweden, Italy). Some countries (Canada, Japan) also provide for under-indexation

or freezes to ensure financial sustainability. In practice, derogations are possible in the event of a crisis, as in the United Kingdom in 2022, for example (*document no. 5*).

2. Issues concerning indexation rules: the trade-off between pensioners' standard of living and the financial sustainability of the pension system

- ***What effects does price indexation have on pensioners' standard of living and on the financial balance of the pension system?*** With price indexation, pensioners' relative standard of living falls during periods of strong growth, which improves the pension system's finances. Conversely, in the event of inflation or economic stagnation, their purchasing power is protected, but at the cost of a deterioration in the pension system's balance. Indexation must therefore reconcile two distinct objectives: guaranteeing a satisfactory standard of living for all pensioners and ensuring the financial sustainability of the pension system.
- ***Has it helped to offset the effects of demographic ageing?*** Yes, the switch to price indexation has been a major lever in controlling pension expenditure for 35 years. Without reforms or agreements in supplementary schemes, and with productivity growth of 0.7% per year, expenditure would have been 3.7 percentage points of GDP higher in 2018. The gap would even reach 6.3 points of GDP in 2070, of which 2.6 would be attributable to price indexation. The downside of this control over expenditure is a decline in the relative standard of living of pensioners, which would reach around 90% in 2070, whereas it is broadly equivalent to the current level (*document no. 7*).
- ***Why is the financial situation of the pension system so sensitive to economic and demographic assumptions?*** In a pay-as-you-go system, entitlements and pensions must take into account both the natural return on the pay-as-you-go system (growth in the wage bill at a constant contribution rate) and increased life expectancy in order to guarantee the financial sustainability of the pension system. However, by deviating from these rules and indexing solely to prices, expenditure becomes highly sensitive to economic and demographic assumptions. The gap could thus reach 1.2 percentage points of GDP in 2070 for mortality and 0.8 percentage points between productivity scenarios. This heavy dependence on assumptions makes it difficult to assess the financial health of the pension system (*document no. 6*), as regularly highlighted by the COR and the CSR.

3. How can we envisage a return to wage indexation? Simulation results

- ***What indexation should be used to stabilise expenditure as a share of GDP?*** Simulations show that indexing entitlements to salaries and pensions to salaries adjusted for the contributor/pensioner ratio, combined with a sustainability coefficient from the date of settlement, would stabilise pension expenditure as a percentage of GDP in the long term (*documents 8 to 12*).
- ***What effects would this have on replacement rates and inter- and intra-generational equity?*** These indexation rules would ensure a consistent evolution between pensions at the time of settlement and pensions currently being paid, avoiding inequalities between generations of pensioners caused by price indexation. However, in the event of a low growth, pensions could change less rapidly than prices. Pension inequalities (*documents no. 1 and 9*) would increase further in the event of a strong growth, regardless of the indexation method used. This result would be linked to the fact that the Aspa, which concerns the poorest households, would remain indexed to prices, unlike other pensions.