

The Economics Pioneers

Policy Brief: The French Pension Reform

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Executive Summary

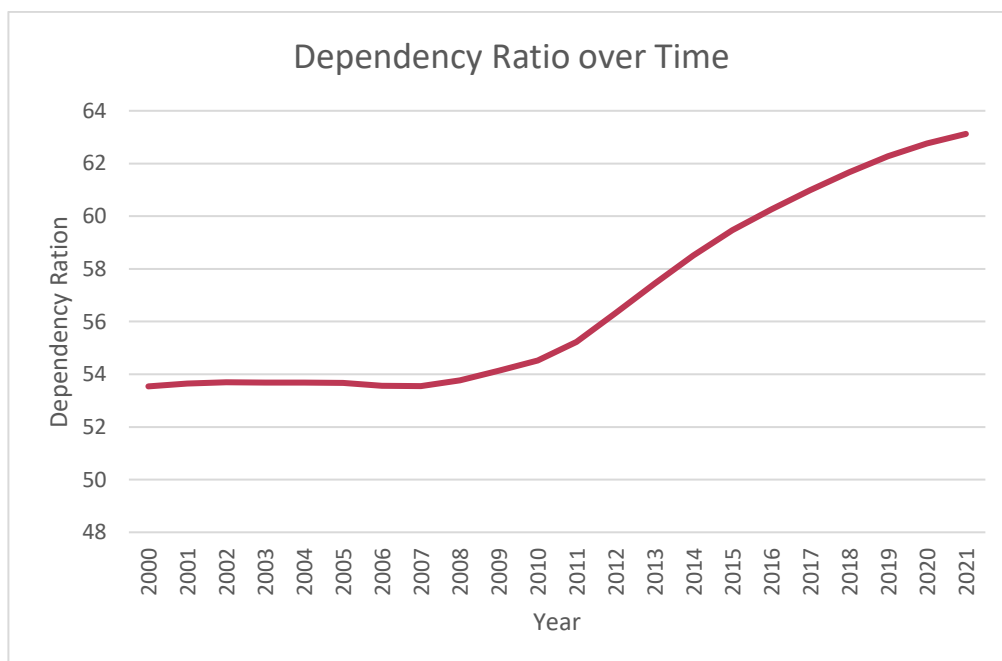
On March 16th, French President Macron proclaimed, “the financial, economic risks are too great” (Conesa 2023). He was referring to a highly controversial pension reform that had just passed through the French Parliament which raised the retirement age from 62 to 64 with a requirement that retiree had worked for at least 43 years (Wilkenfield, 2023). The political maneuvering Macron used allowed the bill to be passed despite much opposition, which found a different place to express their anger: the streets of France. The policy that aimed to be fiscally prudent may have caused political ripples amongst a population supporting a strong welfare state (Busquetes, 2023). Ultimately, as seen in the brief, the policy causes a greater degree of backlash than the economic benefits it provides.

Motivations and Goals of the Policy

The country previously had a pay-as-you-go (PAYGO) system, where pensioners received payments based upon the tax revenue the country earned (Wilkenfield, 2023). Assuming that the demographics allow for the dependent population to be fiscally supported, this policy would work. However, a combination of issues resulted in the policy being unsustainable. Firstly, there was an increase in life expectancy, which resulted in a larger dependent population. Furthermore, this problem was exponentiated, due to rising healthcare costs for individuals of old age – resulting in an increase in necessary expenses. Secondly, there was a decrease in fertility, resulting in future difficulty for the dependent population to be supported. This trend may be visualized in the following time series, mapping the dependency ration over time. The dependency ratio is the ratio between dependents (ages 0-15 or older than 64) to the working age population (15-64) (World Bank, 2023).

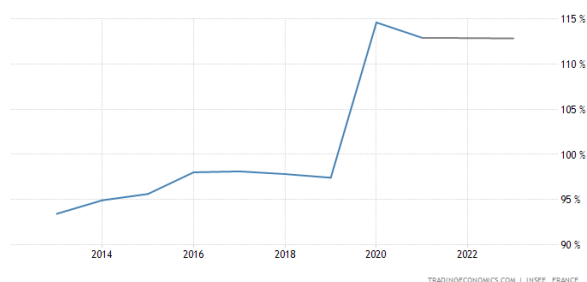
Key Insights

- A pension reform passed through the French parliament raising the retirement age from 62 to 64 years.
- On 14th April of April the Constitutional Court of France will submit its ruling on the reform’s legitimacy.



Two caveats about the data. Firstly, the definition of dependency ratio is extremely lenient on both extremes. Very few teenagers actually work within the French population, and equally, few closer to the age of 65 work. Secondly, what is crucial to notice is the trend, not the value. The positive trend indicates a growing dependent population which will need immense capital to fund their pensions, not to mention healthcare schemes.

The French government thus had three key options. They could raise tax rates to raise the fiscal revenue to reallocate spending. However, this was not only unpopular, but it was also a temporary solution since tax rates could only be raised to a point. After that, the amount of disposable income for individuals would be so low, their spending habits cannot support many businesses. The second option is to take on more debt. This is the policy that the government has been pursuing, evident from their debt accumulation over time. The figure below shows the debt-GDP ratio over time (Trading Economics, 2023).



However, this is equally unsustainable. Firstly, the debt must at some point be repaid, thus this solution simply pushes the problem onto a different generation. But secondly, the interest payments on debt are increasing with the debt itself – thus resulting in an additional cost burden on the government. Unless the growth rate of the economy is larger than the interest payments on debt – this is simply unsustainable.

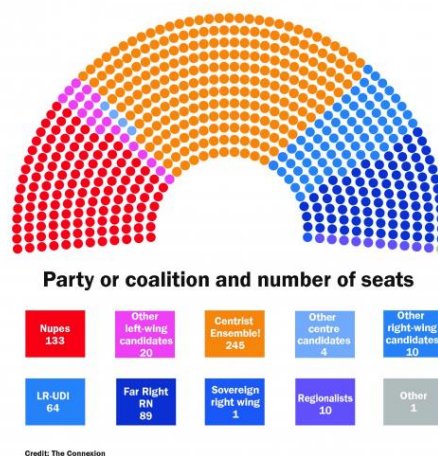
Thus, the third alternative is to raise the pension age. This is seemingly a sensible option – since it decreases the pool of people needing financial support. Simultaneously, it increases the number of people contributing to tax revenue and stimulates the “working age” demographic. This brief will investigate the possible effects of this policy both economically and politically.

Research Overview

The effects of the policy are likely to be closely monitored by the world upcoming. Its political ramifications are highlighted in the news – however the effect on the fiscal state of the economy may be underreported. This research will delve into the trade-offs made by the French government and evaluate the success of the policy.

Political Impacts

Macron pushed through the pension reform without a vote due to a caveat in the constitution. Article 49/3 allows a law to pass unless a no confidence vote for the incumbent government is also passed. Two such votes were proposed within the French parliament, which both failed (AshCenter, 2023). This ensured that the government itself would stay intact and the bill was allowed to pass. However, this may be fickle, since Macron’s unilateralism has created a lot of political backlashes. The majority that Macron holds is slim and rife with opposition (seen in the figure below) which despite having not ousted the incumbent government, still seeks to end the reform. Testament to this is the slim victory for the government in the no confidence vote – which failed by only 9 votes – despite the heavily divided nature of the French parliament (Connexion, 2022).



The opposition still has several channels to strike the bill. Firstly, the reform has been brought before the Constitutional Court of France, which on the 14th of April will submit its ruling on its legitimacy (Paris, 2023). Despite the legal legitimacy of the policy, the court may still rule against it if it encroaches the rights ensured by the French constitution. If it fails, Macron could not only see his flagship fiscal scheme scrapped but could be facing a very strong and angry opposition in the next election in 2027. The political threats may

stem from the NUPES (anti Macron left wing) or RN (far-right), the latter headed by Macron's main opposition Le Pen.

Secondly, and perhaps more strikingly, France is seeing mass mobilization of the general population in major urban areas. Macron's approval ratings have decreased by 7% points since the protests began in early March, and the lack of alternatives for the common person to out their anger is showing. The protest on the 7th of March mobilized more than 1.2 million people according to the ministry of the Interior, with strikes routinely occurring throughout March (Amundi, 2023). The most notable was the waste collection strike, where thousands of trash bags were piled up around the city of Paris due to lack of workers. This could theoretically "bully" the government into repealing the reform.

The French crackdown on the protests has been condemned by various international actors, including the Council of Europe (Coughlan, 2023). Tear gas, unjustified arrests and violence are the norm – despite the French government claiming the violence was proportional. Regardless of the reality, the external perception of the government reaction has been overwhelmingly negative. The impacts could be a spectrum from ousting the government in the 2027 general election just as Sarkozy almost achieved in 2012 when a similar increase in retirement age was passed (increasing the age from 60 to 62) (Horobin and Nussbaum, 2023). However, there is a broader lack of trust within the French political system which may only lead to increasing violence to express discontent.

To understand the importance of this reform to the average person, the French political landscape must be characterized. Historically a strong welfare state, France prides itself on the concept of solidarity, thus the removal of such policies acts against the broader national interests. Additionally, due to a high frequency of reforms passed in the past decade, the French are naturally skeptical of change due to the changing superstructure they must live within. The lack of democratic transparency, where many of the "financial illiterate" are unaware of their rights and liabilities, forces them to blindly trust a paternalistic government. That is difficult with regularity, but also

the optics of change, making democratic reform complicated (GIS, 2023).

Economic Impacts

The tradeoff Macron made was between political instability and economic prosperity. The PAYGO system is significantly indebted, with overall public debt reaching 120% of GDP (Trading Economics, 2023). This is ignoring the rising challenges in high energy prices, political unrest within the country and the Ukrainian war which may all decrease economic growth. On one hand, Macron's policy indicates a step towards sustainable public finances, reducing the welfare base and increasing the working age bracket of individuals. The effect of the reform will be difficult to assess due to the abnormally high unemployment levels, however, should at the very least be able to mitigate the shock in the long run. Some analysts, such as FitchRatings, predict the policy could save 15 billion euros by 2030. Additionally, this is likely to aid the structural budget surplus which may benefit France in future crises (FitchRatings, 2023).

However, 15 billion euros is only 0.6% of GDP and thus may not be enough to solve France's fiscal issues. Firstly, there is direct economic harm from the social instability caused due to the protests (GIS, 2023). France 24 notes that GDP growth per quarter decreases around 0.15% on average during times of protests and social unrest. This is logical, since many essential services are striking, making it difficult for people to work. But furthermore, many people themselves actively strike, removing the productive capacity of industries.

Secondly, the plan has various exceptions, minimizing the effect of the decrease in spending. Government employees with dangerous jobs, such as police and nurses are expected from the reform. These employees represent a large proportion of the government spending (GIS, 2023).

Thirdly, interluding with political affairs, is investor confidence. If the constitutional court scraps the policy, or the protests manage to convince Macron to drop the policy, investor confidence is likely to drop due to spiraling debt. This would increase borrowing costs due to lower confidence in the economy, resulting in a higher interest rate charged to hold French debt.

Conclusion

Macron finds himself in a difficult position. While his policy pushes the correct intentions, decreasing the burden on future generations by stabilizing the fiscal budget, his contemporary population is unhappy. The success or failure of the policy hinges on 3 issues. Firstly, is Macron able to maintain enough support to keep the policy enforced and not succumb to the growing opposition. Secondly, is Macron able to use this policy as a starting point for meaningfully changing the structural budget balance. Thirdly, is Macron able to stay in power in the next election such that the policy is not repealed by a growing left for far right caucus. These are tremulous times that could threaten the very construct of the French democracy. However, it is too early to make qualitative assessments as to the success of this particular policy.

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