PUBLIC PENSIONS

Finding a way out

As France recovers from the widespread pension protests, many other European countries have been considering how they can ensure the long-term sustainability of their own pension systems, while avoiding a similar backlash. Sophie Smith **reports**

WRITTEN BY SOPHIE SMITH

Protests have continued across France after President, Emmanuel Macron, signed his pension reforms into law on 14 April, with the French state pension age (SPA) set to increase from 62 to 64.

The reforms navigated their final hurdle after the key aspects of the bill were approved by the Constitutional Council hours before it was signed into law. But the changes, particularly the increase in SPA, have proven deeply unpopular and sparked nationwide protests.

Yet despite the backlash, Macron has repeatedly stressed the need for change, arguing that the reforms are essential to make the nation's pension system more affordable, with the system forecast to run at a deficit in its current state.

This is not an isolated view, as the European Commission previously stressed the need for change in the French pension system, with public pension expenditure estimated at 14.6 per cent of GDP, the third highest in the EU.

Pressure for change is also growing, as Finnish Centre for Pensions (ETK) senior adviser, Antti Mielonen, points out that life-expectancy in France is high, with further improvements expected down the line despite the negative downturn prompted by Covid-19.

And whilst increasing the SPA has not proven popular, Mielonen warns the alternatives, raising contributions or increasing state debt, may not win much more public support.

Now Pensions head of DC pensions, Stefan Lundbergh, agrees, stating that most, if not all, of the levers available to improve financial sustainability are unpleasant for savers, who will either have to pay more, receive less, or retire later.

France is not the only country having difficulties in passing pension reforms, as Mielonen admits that raising retirement age is not something people are cheering about, with particular similarities in Switzerland. ”People may not at all be against the pension reforms suggested by the government, but they are against government’s other political solutions,” he says.

In fact, PensionsEurope CEO, Matti Leppälä, says that financial sustainability more broadly is a common concern across the European pension systems, pointing out that EU member states were asked to reform pension systems to ensure the sustainability of public finances within the framework of the European semester.

Lost in the crowd

The UK also recently made headlines with potential changes to its SPA *[see boxout]*, whilst the Spanish parliament has introduced a number of pension reforms aimed at addressing the rising number of retirees *[see page 9]*.

And whilst the UK and France have focused on SPA changes, the reforms in Spain look to increase workers’ pension contributions.

Spanish union CCOO said the changes will lay the foundations of the public system for at least the next two decades, with general secretary, Unai Sordo, highlighting the reform as a “historic agreement”.

Despite the so-far-positive reception in Spain, Mercer partner, global DB segment leader, Graham Pearce, says that raising company contributions to pension plans increases labour costs, and can act as a deterrent to invest in a country.

Looking at whether this could be option for European pension systems more broadly, Mielonen also points out that rates are high in many countries already. However, he admits that some countries, such as Germany and the Netherlands, have circumvented this by increasing the share of tax-revenues in the financing of pensions.

With all of these factors at play, it can seem like there is no route forward to ensure financial stability for future generations without placing a burden on older savers.

There are some options to help soften the blow though, as Pearce points out that an automatic increase in retirement age, based upon expected life expectancy or healthy

Failed intentions?

NOW PENSIONS HEAD OF DC pensions, Stefan Lundbergh, highlights the Swedish pension system as a best practice example when it comes to generational neutrality, explaining that financial sustainability across generations was an important factor in the system’s design, as well as being separate from the state budget.

“It’s extremely difficult to get politicians to do something like that, even if it’s the right thing to do,” he adds.

Yet despite the intergenerational strengths of the Swedish pension system, the Swedish Pensions Agency (SPA) recently encouraged the government to appoint an inquiry to evaluate the public pension system and make suggestions for improvements, in light of “fundamental flaws” in the existing system.

In particular, the SPA raised concerns that the lifetime income principle determines the size of the pension to a lesser extent than intended.

“We are not in a desirable situation in Sweden today,” SPA head of analysis, Ole Settergren, stated. “The lifetime income principle has been put out of use due to the political interventions of recent years.”

Lundbergh says that the report highlights the importance of maintaining and evolving the pension systems as society evolves, describing the report as an attempt to create a debate in Sweden on how to adapt the pension agreement from 30 years ago to make it more future proof.

However, in a seminar on the research, LSE professor, Nicholas Barr, argued it would be a shame if Sweden gave up a well-functioning system. Given this, he argued that Sweden should look to increase pension contributions and reform basic protection, rather than look to introduce a basic uniform pension that is the same for everyone.

Whether the necessary changes will be made is yet to be seen, however, as Uppsala University professor of political science, Joakim Palme, said that she has “given up hope for the future in terms of the pension debate, because no one seems to be able to make the necessary decisions”.

life expectancy, as seen in Sweden, can make changes in retirement age less unpopular, as any shift is in line with a previously agreed formula.

Braced for change

Indeed, Lundbergh says that not only can this provide an out for politicians, with change occurring on a status-quo basis, it should also encourage small incremental change, rather than a large increase or jump.

And the benefits of such an approach are already being demonstrated, as Leppälä cites recent projections by the European Commission, which revealed that member states utilising automatic adjustment mechanisms would all experience a decline in pension expenditure in the future.

Those countries that have already adopted similar approaches have also provided some lessons learned.

Mielonen, for instance, says that experiences from other countries have shown that linking retirement age 1:1 to life-expectancy seems to be too severe, as this would raise the retirement age too quickly, as well as change the proportion of retirement in relation to working life.

"A better target would be to keep it stable," he says, noting that the Netherlands and Denmark, for instance, slowed down the pace of increases in retirement age from 1:1.

However, Pearce warns that this type of mechanism can also bring unintended consequences, with Portugal recently seeing its pension age fall by three months (to 66 years and four months) as a result of the extraordinary mortality rates seen amid the pandemic.

And given the unequal impact across society, Phoenix Insights director, Catherine Foot, warns that linking the SPA to longevity predictions is not an adequate policy response to the affordability challenge of the system.

"Similarly," she says, "many people fall out of work because of ill

Avoiding the problem

CONCERNS AROUND A potential state pension controversy recently made headlines in the UK, as the government contemplated bringing forward an increase in the state pension age (SPA) against the backdrop of the French protests.

These concerns may be well placed, as research from Penfold found that 67 per cent of Brits disagree with raising the SPA, while nearly a third (28 per cent) of Gen Z and Millennials would protest the SPA being raised.

And with industry experts warning that an increase in SPA could mark 'political suicide', it is perhaps unsurprising that the government later shelved its apparent plans to bring forward the increase.

PensionsEurope CEO, Matti Leppälä, agrees with this decision, pointing out that the UK will already have one of the highest state pension ages in the OECD when it reaches 67 in 2028.

"Healthy life expectancy, and the gaps between years of life in healthy and unhealthy

conditions, need to be taken into account when deciding state pension age to ensure that the single age is set fairly across generations," he says.

But political motivations may also play a factor, as the UK government confirmed that a further review to reconsider the rise to age 68 is expected within two years of the next parliament.

And despite life expectancy increases stalling in recent years in the UK, Phoenix Insights director, Catherine Foot, says that it remains likely we will see an acceleration of the SPA increase at some stage.

"What is critical is that alongside any rise in the state pension age," she adds, "there is a package of measures committed to that seeks to ensure that those who aren't able to remain in work are supported."

Now Pensions head of DC, Stefan Lundbergh, suggests that an automatic link with longevity could also prevent this becoming a political issue again in future.

However, Lundbergh warns that change is needed soon, warning that otherwise, it could be a case of too little, too late.

"WE NEED TO MAKE POLICIES GENERATIONAL NEUTRAL SO WE ALL SHARE THE BURDEN AND BENEFITS TOGETHER, BECAUSE WE CANNOT KEEP PLAYING GENERATIONS AGAINST EACH OTHER"

health and disability years, and in a significant number of cases, decades before reaching SPA. This group face higher risks of poverty in later life with an ever-increasing SPA, so reforms to the system are needed to ensure they are not left behind."

ETK liaison manager, Mika Vidlund, however, says that although some countries have found a universal increase somewhat problematic, solutions are emerging.

"Finland and Denmark have recently established early retirement options for people with long careers either in physically or mentally arduous jobs," he notes, explaining that such measures could also increase the popularity of the reforms.

Lundbergh remains wary of this route though, warning that it can often prove difficult to determine which careers should be deemed worthy of an exclusion.

In practice, WTW senior international benefits consultant, Valentina Rocchi, also notes that more countries have opted to link the benefit level, rather than pension age, to longevity predictions, some more explicitly than others.

Indeed, according to the OECD more than half the OECD countries have elements in their mandatory retirement-income provision linking pension benefits to life expectancy.

Creating a future proof system

However, Rocchi warns that although restoring the balance in these ways seems sensible, it needs to be done thoughtfully, considering affordability and phasing-in to allow savers time to adapt to the changes.

"The risk is that these changes only introduce temporary stability," she continues. "The other problem is that it creates unfair distribution of capital between the young and old – there is no guarantee that the young workers today paying high contributions for the current pensioners will receive equivalent pensions when they retire."

Foot says that affordability is only one part of the picture, arguing that effective state pensions need to be sustainable, but also adequate in value to those receiving them, and fair in terms of both who pays for them and who gets access to them.

Rocchi also says that equity and fairness across generations will face increasing scrutiny: "There needs to be a balance in the state systems to ensure that both workers and retirees 'pay' a fair price for increasing longevity and lower birth rates."

"We need to make policies generational neutral," Lundbergh agrees. "So we all share the pain and burden together, the old and the young, because we cannot play generations against each other".

Alongside intergenerational issues, Vidlund says that a wide consensus is needed to ensure long-term political sustainability of any reform.

However, whilst Lundbergh acknowledges the importance of cross-party support, he says that, at times, politicians need to be bold enough to push change through, even where it might not prove popular, as recently seen in France.

"I would like politicians to stand up and do what's right, because we face a massive challenge in dealing with changing demographics. It's not just pensions, but also how we're going to fund our society," he says.

In fact, Lundbergh says that politicians may be underestimating savers, arguing that a candidate that makes the difficult choices could be seen as a real leader, rather than simply another candle in the wind.

But with further protests scheduled in France for June, and an opposition bill aiming to repeal the recent reforms, tensions over this issue seem set to persist. For the time being, others will have to wait and see if a clearer way out is revealed.