

Pension reform: towards an overhaul of family rights

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PENSION REFORM : TOWARDS AN OVERHAUL OF FAMILY RIGHTS?

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Summary
The French pension system includes substantial non-contributive elements that link the right to retirement benefits with the presence of children rather than to contributions paid in. These are called family rights, the main purpose of which is to compensate for career hazards created by having children. However, the current arrangements only partially meet this aim, redistributing in favor of men while doing little for mothers who worked part-time. These family rights could be redesigned, by replacing the bonuses for children and increased benefits periods with a subsidy for each child. This note assesses the impact of such reform – either via a payment proportional to pension benefits or a lump sum payment. The choice between these two options depends chiefly on what role we wish the retirement benefits system to play in compensating women for the career risks they face. Finally, it is important to keep in mind the fact that policies that address directly women's career hazards are ultimately more effective than compensating them later through retirement benefits.



- The main aim of the family rights in the French retirement benefits system is to compensate for career hazards.
- Existing arrangements do not fulfil this aim. The pension bonuses mainly benefit men, while the prolonged insurance period does not compensate women for the loss of earnings suffered.
- Reform of these family rights – by either lump sum or proportional payments – reduce gender inequalities in the pension system and simplify current regulations.
- Public policies designed to reduce *ex ante* career hazards (such as increased child-care places) are likely to be more effective than post-career measures (such as extra retirement benefits).

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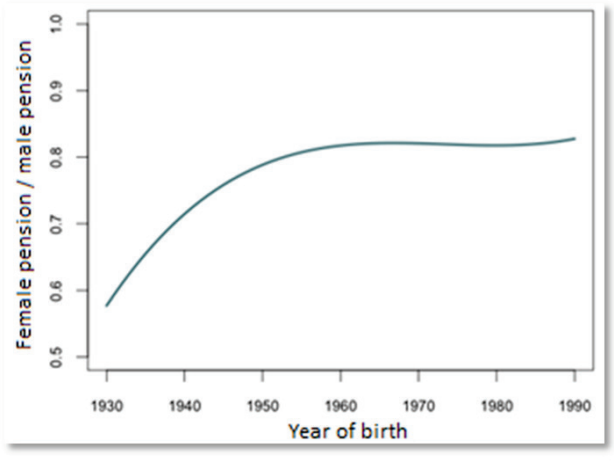
Although the government had announced reform of family pension rights following the recommendations of the Moreau Report, the law finally adopted by the National Assembly contained no changes to this important part of the retirement pension system. Yet, the complexity and inadequacies of these family rights is widely acknowledged. The IPP therefore proposes, in this Policy Brief, to re-examine the issues at stake.

The aims of family retirement rights

Despite some significant improvements in the last few decades, substantial gaps still exist between men's and women's retirement benefits in France. In the French retirement system, the level of the benefits depends chiefly on how many years an employee contributed to the scheme during his or her working life. Despite the continuing rise in women's participation rate, the gender salary gap seems to have stabilised without disappearing, and the incidence of part-time employment continues to be higher among women than men. These factors are in part explained by the impact that having children has on women's career paths and explain why **the average retirement pension for women is barely four-fifths of the average pension for men**, among the generations born after 1960 (see Figure 1).

However, there is in France a bundle of non-contributory measures that take the presence of children into account in retirement benefit calculations. **Currently, there are three such measures**: the bonus payment, the extension of the pension payment period, and the old-age allowance for the at-home parent (see Box 1). They are based on the recognition of the substantial economic impact that children can have on a household, and that it might be desirable to compensate for that. In fact, these measures can be justified on several grounds. However, while historically, the reasons offered were to encourage fertility and to compensate for the savings gap for households with children, these aims seem debatable today.

Figure 1: The ratio of the average female pension to the average male pension at liquidation, by generation.



Source: PENSIPP 0.0

Note: For individuals born in 1960, the average pension for women is equal to 80% of that of the average for men. For those born in 1930, that ratio was 58%.

Box 1: Current family pension rights measures

Pension bonus for children
Most of the basic and complementary schemes pay an increase proportional to the sum of the pension for employees who had at least three children. The rate of the benefit varies depending on the scheme (it is 10% in the general scheme and "aligned" ones, which follow the same rules).

Extension of benefit period (MDA)
In most basic pension schemes, extensions to the payment period are awarded to mothers, or to fathers, for the birth (or adoption) and care of each child. In the general scheme (and aligned schemes), the MDA for children stops at ten years. Since 2010, the MDA for children, hitherto reserved for women, has been divided into two parts: a maternity MDA of one year, awarded to women; and an education MDA, also of one year, which can be shared between the two parents, but by default is assigned to the mother. Retired public servants are entitled to an extension of six months for the birth of a child and periods of interruption to or reduction of work are taken into account for both mothers and fathers, up to three months for each child. Supplementary schemes do not award points of this kind (with the exception of the IRCANTE, the mandatory complementary plan for non-permanent employees of the public sector).

Old-age benefits for stay-at-home parents (AVPF)
Old-age benefits for stay-at-home parents allow parents to count the time when they stayed at home to raise their children as insured periods. The AVPF is awarded under three conditions: recipients must be entitled to family benefits; they must pass a resources means-test; and their work-time must have been reduced. The AVPF treats the periods spent at home like periods of work earning a salary equivalent to the minimum wage. The benefits entailed are registered int eh general scheme; there is no equivalent measure for the complementary schemes.

The rationale that seems the most convincing today in an insurance-based retirement benefits system is **the compensation for career hazards that are linked to having children**. It is well documented that children have a significant impact on professional life, which includes not only interruptions to employment but also increased part-time work, career changes and lower salaries. In reality, however, these penalties involved in having children actually affect mainly women. The non-contributory measures can thus help to compensate mothers *ex post* for their reduced position in the labour market, which explains most of the pension inequalities between men and women.

If family rights have an important role to play, we must also keep in mind that such measures are neither the only means available nor necessarily the most effective for addressing the problem of career hazards. For the younger and future generations, policies that aim to reduce *ex ante* the impact on career paths of having children (that is, measures that favour the conciliation of family and working life, especially an increase in childcare places) would cost less and contribute more to a reduction in pension gender and income inequalities.

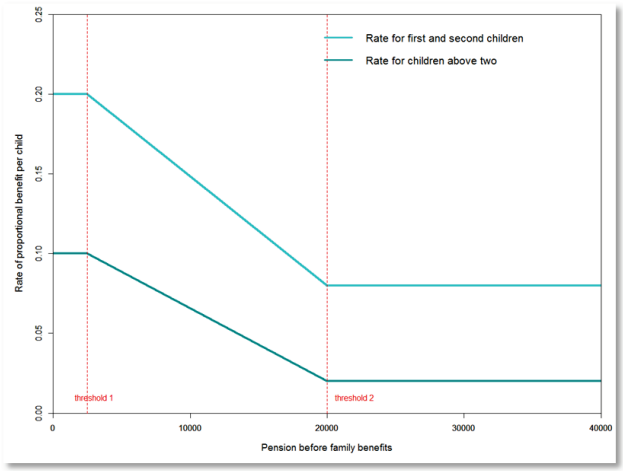
« For the younger and future generations, policies that aim to reduce ex ante the impact on career paths of having children […] would contribute more to a reduction in pension gender and income inequalities »

To decide how to allocate funds between *ex ante* and *ex post* measures to compensate for career hazards, decision makers must also take into account the risk of moral hazards common to all insurance policies: in the case of family rights, overly-generous compensation for career hazards runs the risk of increasing the incidence of affected careers, by reducing the cost to individuals of shifting to part-time work and periods of not working at all. Nevertheless, the *ex post* compensation offered by family rights is undoubtedly the best solution for the oldest generations, which justifies the place these policies occupy in public debate.

The inadequacy of existing measures

Even if the simulations show that generally, family rights reduce the pension gap between men and women, **measures currently in place are not sufficient to compensate effectively for career hazards associated with having children**. Pension bonuses are reserved for mothers and fathers of three children or more, while the consequences for career paths of having children begin with the first child, and more so for women than for men. The increased benefits period has a tendency to "under-compensate" women for whom the arrival of children leads to reduced salaries – notably because of a change to part-time work – and to "over-compensate" women who have had several children. In addition, the increased benefits period measure has a negative impact on job possibilities for women at the end of their careers, because it allows them to arrive at full pension rights more rapidly.
Reform of family rights is therefore desirable, so that these rights can best fulfil their aim of compensating for career hazards, and not depend on the particular ways in which having children affects a career path (interruptions to work activity, reductions in wages or the number of hours worked).

Figure 2 : Schedule for child bonuses proportional to the pension



Source: PENSIPP 0.0

Note: The child bonuses rate is built as such: for first and second children, it goes up to 20% for pension under 2 500€ per year, and goes down linearly to 8% for pension above 20 000€ per year; for children above 2, this rate reaches 10% for pension under 2 500€, and goes down to 2% for pension above 20 000€.

What reform for family rights in retirement?

In line with these objectives, we can envisage different reforms. Two examples are explored in this IPP Note.

The IPP report (2013) proposes a reworking of bonuses and MDAs into one, unified career hazards compensation policy. These two measures would be replaced by a pension bonus for having children, starting with the first child, proportional to the total pension, with a decreasing coefficient related to the level of the pension, that could be varied according to the rank (birth order) of the child. In addition to being a welcome simplification of family rights, this reform would also compensate for career interruptions, as well as for the reduction of income that is associated with having children. Moreover, the proposed measure follows the logic of the existing French pension insurance system. In reality, career hazards lead to a decrease in the pension level linked to having children, through a decrease in either annual salary or periods of contribution. We can hypothesise then, that the pension level of someone with children represents a certain fraction of what it would have been if she or he had not had children. The proportional bonus aims, then, to bring the pension level closer to what potentially it would have been. The advantage of the proportional scale is that would provide compensation that more closely matches the career hazards that might have occurred. The degression in the scale also takes into account the fact that the professional trajectories of lower-skilled women are more affected by the presence of children. However, at this stage, the proposed scale (see figure 2) is only illustrative; ideally, it would be calibrated according to estimations of the quantitative significance of the career hazard by pension level. Using this specific measurement of career hazard, we can expect to reduce the total *ex post* compensations as the hazards are reduced.

« The proportional bonus aims, then, to bring the pension level closer to what potentially it would have been »

Another path to reform is possible, via the introduction of a lump sum per child. This is the proposal made in the Moreau report (2013)[1], which the government has undertaken to study further. Such a strategy has the advantage of simplicity. Nevertheless, theoretically, a lump sum offers uniform compensation, whereas career hazards are not the same for everyone. So, some women who benefit significantly from existing MDA and bonus measures (that is, those on relatively high pensions) would see their pension levels significantly reduced with the introduction of a lump sum system.

« A lump sum offers uniform compensation, whereas career hazards are not the same for everyone »

1. The Moreau reoprt also proposes an overhaul of the AVPF and the « education » MDA into a single policy measure.

Any reform of family rights must respect the rules of the Court of Justice of the European Union (CJEU)[2]. In the two propositions suggested here, the compensation is to be awarded to mothers, when they give birth (and to be shared between the parents in the case of adoption), so long as this is validated by the CJEU.

Who will be affected by the reforms?

With the simulations made using the PENSIPP model (see Box 2), we can estimate the potential effects of the proposed reforms on the total retired population. **The reforms are calibrated in such a way that they do not increase the cost of the existing measures at the time of their introduction** (assuming they are introduced in 2013). For the bonus measure, the schedule (see Figure 2) was designed so as limit the redistributive effects in comparison with the existing system, in order to allow a rapid implementation. For the lump sum, the amount of the increase is initially 720 euros per year (60 euros per month[3]), which then increases with the growth in salary. As they are calibrated here, together the two reforms would allow some savings by 2050, in the order of two billion euros per annum).
Assuming that women were the only beneficiaries of the new measures, the two reforms should enable a significant improvement in the ratio of male-to-female pension payments (of around five percentage points by 2040, see Figure 3).
This effect is explained principally by a decrease in the average pension for men – who would lose the benefit of the existing retirement pension bonus – while the average pension for women would increase only marginally.

2. The CJEU bans any retirement-pension measure that discriminates on the basis of sex.
3. The Moreau Report suggests an indicative amount of 70 to 100 euros per month.
4. The minimum old-age pension – or social allowance for the aged – guaranteeing a level of resources for people aged 65 years or more would have the effect of lessening the negative effect of the bonus for the first decile, but also of reducing the increase in the pension created by the lump sum option. However, women in the first decile whose husbands receive a higher pension would not benefit from this allowance (it being calculated at the household level).

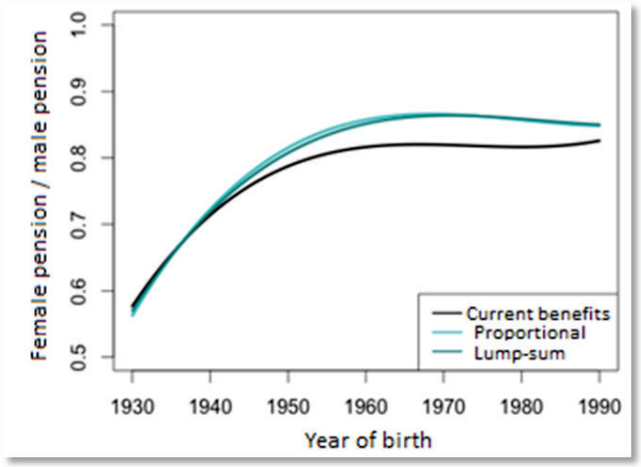
Box 2 : the PENSIPP micro-simulation model

PENSIPP is a micro-simulation model whose main aim is the projection of retirement benefits over the long term. The model is being developed through a scientific partnership between the IPP and the « Redistribution and social policies » division of INSEE, which created the micro-simulation model entitled Destinie that inspired PENSIPP.
The model takes the general structure of the Destinie model and is organised in two parts. The first consists of family and professional biographies (marriages, separations, births and deaths; and periods of employment, unemployment, salaries). Using a representative sample of the French population, individual trajectories are projected up until 2060. The second part models the retirement behaviour of individuals.
From the individual decisions about retirement, the model can calculate the cost of pension payments based on the regulations of the existing system, or on the schema of the reforms whose effects we want to measure.

If the effect of the two reforms is similar when they are aggregated, disaggregating the effects according to the pension level for women reveals some significant differences (see Figure 4).

The two reforms strongly benefit the women who receive the lowest 50 per cent of pension payments. While the lump sum option seems clearly to favour the women on the lowest retirement incomes more than proportional bonus option, it is worth noting that these effects are, in practice, partially erased by the minimum retirement payment policy[4].
The most marked difference between the two proposed reforms concerns the 20 per cent of women who receive the highest pensions. Indeed, the lump sum is the same for all, while the existing measures, in absolute terms, benefit the highest pensions more. In contrast, the bonus proposed here, even if it is regressive, remains proportional: the highest pension payments for women are generally preserved.

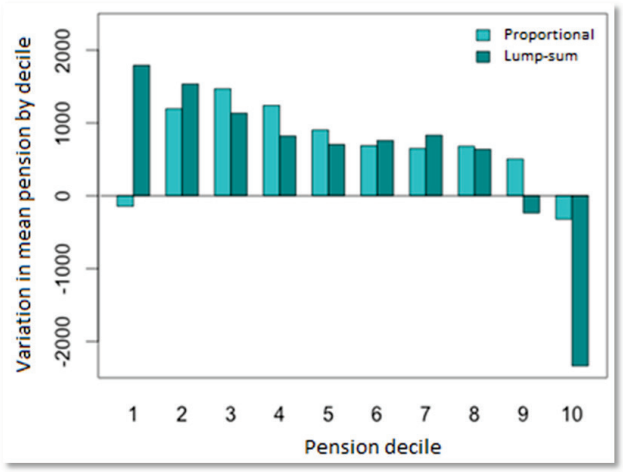
Figure 3 - Ratio average female pension / male pension, by year of birth



Source: PENSIPP 0.0

Note: With the reforms, for individuals born in 1960, the average female pension would reach 85% of the average male one.

Figure 4 - Within the reform, evolution of the average pension by decile



Source: PENSIPP 0.0

Note: The average female pension grows by 1500 € for the women of the first decile, because of the lump-sume effect, and decreases by 1000 € when the proportional calculation is implemented.

The sample is made of women born between 1960 and 1970.

In conclusion…

The two envisaged reforms are two possible ways of rethinking family retirement rights, allowing both a simplification of the existing system and a reduction in gender-based inequalities, particularly for those on the lowest pensions.
Maintaining an insurance component, as is the case with the proportional bonus, is an important aspect of the compensation for career hazards linked to having children.
On the other hand, the lump sum payment has the advantage of simplicity, with the same reduction of inequalities in pension payments between men and women. But this choice implies a reduction in payments for the 20 per cent of women who receive the highest pensions.
A third option for a child bonus would be to combine a partial lump sum with a partial proportional payment, in order to reconcile the two fundamentally different aims (insurance and redistribution).

More generally, **the schemes proposed here have the advantage of enabling savings in the medium term compared with the existing system**. These savings could be used to reduce the deficit in the retirement system, but also could be put towards direct measures that would allow the reduction *ex ante* of the career impact of having children. For the young generations, such measures are likely to be much more effective than adjustments offered through the retirement pension system.

References

This note is based on the analysis of family rights presented in the IPP Report No. 2 : *Réformer le système de retraite : les droits familiaux et conjugaux (2013)*, which can be consulted at www.ipp.eu

See also the Moreau report : « Nos retraites demain: équilibre financier et justice », Rapport de la Commission pour l'avenir des retraites, La Documentation française (juin 2013)