COMMENTS ON SESSION 3
PENSION REFORM, REDISTRIBUTION, MACROECONOMIC IMPACT

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First and foremost, let me express my gratitude to Daniele and his colleagues at the Banca d'Italia for their warm welcome and the wonderful organization of this Perugia symposium.

Economists, in my view, forget too easily that the ultimate objective of economic policy is not price stability or the soundness of public finances but poverty reduction. Therefore I am happy to be asked to comment two articles that deal with that issue.

The article by Franco *et al.* uses micro data to illustrate disparities existing across European countries in terms of level of poverty. Its main conclusions are: (1) poverty rates differ significantly among countries and across categories (children, adults and elderly); (2) the highest poverty rates for children and the elderly are found in the group of Anglo Saxon and Southern European countries; and (3) but, whatever the group of countries, it highlights a pro-old bias in the design of public policies which seems to give more assistance to the elderly compared to children.

The article by Dekker *et al.* aims at assessing, thanks to a micro simulation model and on the basis of the Ageing Working Group (AWG) projections, the foreseeable impact on pensioner's income of the recent reforms of PAYG schemes implemented in three countries: Belgium, Germany and Italy. Its main conclusions are not surprising for fiscal experts: (1) a large decline of pension levels and replacement rates must be expected; (2) demographic ageing has a significant impact on the future adequacy of pensions. Indeed, the risk of poverty pertaining to pension benefit recipients strongly increases by 2020 and then tends to decrease a bit; and (3) impact of parametric reforms (Belgium, Germany) and systemic reforms (Italy) on redistribution and poverty go into the same direction but the magnitude differs (it is higher in the case of Italy).

If we attempt to make a synthesis, we can say that both articles have a common feature. They deal with the impact of public policies on the poverty rate. It is true that poverty is also sensitive to factors like demography, economic, social or cultural conditions, and its level and distribution across the age categories are to a large extent dependent on the design of public policies. Thus, the two articles raise important converging questions:

- how can we account for the pro old bias and should it be corrected?
- do the reforms aimed at curbing the rise in pension expenditure endanger the necessary solidarity between generations?

The first issue raised by the two articles is the definition of poverty. The answer is not evident as poverty is a multi-dimensional concept which can be captured with different indicators:

- the easiest way to define poverty is to consider monetary indicators as Franco *et al.* do. In Europe, Eurostat computes for each country a poverty threshold equal to 60 per cent of the median income in the country under review. This indicator is easy to monitor and series are available on a long period. But the measure of poverty is relative as the indicator is based on the living standards of households in each country;
- there are also composite indicators on human development computed by the United Nations or the World Bank and which take into account different parameters like life expectancy, housing conditions, access to medical care, education, drinking water, etc…;

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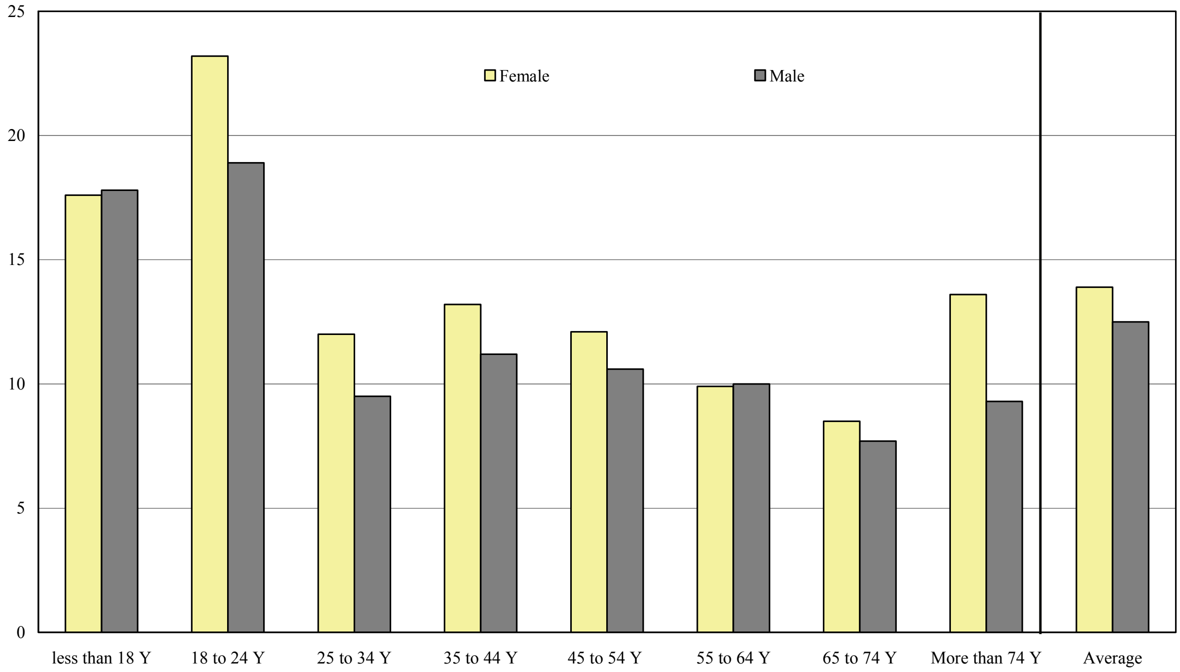
Figure 1

Proportion of Persons below the Poverty Rate (60 per cent of Median Revenue) in France
(percent)



Source: French National Statistical Office.

- then, there exists subjective poverty indicators aimed at capturing the way people assess their own living standards. Indeed, how living conditions are felt can be significantly different from the picture given by statistics taking into account your environment.

Obviously no indicator is able to describe the whole reality. In addition, you must keep in mind that poverty has always some national specificity. First, each society is more or less tolerant towards poverty, which will define the level of public redistribution; Furthermore, redistribution can go through other channels than public intervention. Last when you examine the poverty rate today, you always have to find its main origins in the past, as poverty remains to a large extent an inheritance of history.

To illustrate the impact of public policies, I inserted in my discussion the figure above about the distribution of poverty across the age for France in 2007.

The figure is consistent with the general conclusions of the Franco *et al.* article. Poverty rates are higher for the younger It is a little surprising in the case of France as the country developed a very generous family allowance scheme (which partly explains why France kept a relatively high fertility rate). But family allowances are not means-tested and are therefore insufficiently targeted on families with low revenue. An additional problem is the very high rate recorded for young adults between 18 and 24. In France young adults are especially hit by poverty because of high unemployment for those leaving the education system without any diploma and also because of the existence of a hole in the nest of public benefits. Indeed, young adults are no more eligible to family allowances which stop at the age of 20 and the minimum benefit for adults in state poverty starts at the age of 25. This illustrates how the design of public policies can play a very important role to explain the distribution of poverty in the population.

The article by Franco *et al.* draws a very comprehensive picture of the state of poverty in the European Union 27 countries. Furthermore, it raises very relevant issues on the stance of public policies aimed at reducing poverty and their apparent pro old bias.

My first comment is about the limits inherent to monetary poverty indicators. First, they are relative indicators that give a picture of poverty rates for each country but say nothing about poverty levels. Thus comparisons between countries are made more difficult (better to be poor in Sweden than in Romania). Moreover these indicators are computed on a national basis which let room to huge disparities across regions within a single country (e.g., North and South of Italy). Lastly they are based on the official data and they do not take into account the informal economy, self consumption or the extent of family support, all phenomenon's that can greatly reduce poverty. Conversely, drop outs such as illegal migrant workers are beyond the scope of official indicators.

Moreover, although I do not question the existence of a pro old bias as reflected by the distribution of public expenditure across the age, I wonder whether this bias should be corrected by the fact that young people, even if they get less direct benefits from the public administrations compared with the elderly, do get indirect assistance through the allowances received by their parents. Thus, children poverty could be partly overestimated.

At the end, the article by Franco *et al.* raises a very important question for the European countries. Should social policies be reoriented in favour of the young people? At first thought, I would be tempted to say yes for the two following reasons. First, we need to increase potential growth in Europe. And to reach that objective one instrument is to help active or future active people in order they improve their contribution to the labour force. Then there is the argument of effectiveness: reducing children poverty should contribute to contain the elderly poverty in the future because poverty is frequently received in inheritance.

In addition, I think that understanding the roots of poverty cannot be based only on a picture of poverty rates at a given date. What is also very important is to assess why the persons have been trapped in this situation. It can be done through comparative studies over time and microeconomic analysis aimed at finding if poverty traps are existing or which trajectories fuel the population in poverty state in each country.

The article by Dekkers *et al.* takes a prospective view centred on the impact of recent reforms of pension regimes on the income level of retirees. Indeed this issue is crucial. Taking the example of France, although the same trend was observed in most of European countries, the elderly poverty continually receded as from 1945 thanks to several factors (extension of the coverage of pension systems, more generous pensions, and an increase in the women participation rate). Today, the poverty rate is lower than that of the working population but a reversal risks occurring under the impact of the rise of unemployment which makes it difficult to get full pension benefits and population ageing which threatens the financial balance of pay as you go pension systems.

As a preliminary remark, the AWG cannot be criticized for having disregarded the issue of poverty as its mandate is to assess the foreseeable development of the financial balance of pension regimes and not the adequacy of pension benefits;

I will not comment the results of the MIDAS model but I think we should be cautions with their interpretation.

First, one should keep in mind that the model does not thake into account income other that pensions in the framework of public systems. Capital income is not in the scope of this study nor capitalization funded schemes developed as a replacement to the lesser generosity of PAYG systems.

Also the model is based on Gini coefficients which feature the development over time of pension distribution. This constitutes a relative value analysis which does not necessarily imply a rise in poverty but merely an increase in the risk of poverty. Indeed, you can record at the same time a reduction of poverty if a system of minimum pension is implemented by the government. At last, like any long term projection, adjustments even very small in the parameters related to demography and economic growth may substantially change the results.

A very important question is raised by the paper. Should the objectives of current pension regime reforms be twofold: sustainability and reduction of poverty?

The main problem in my view is the insurance logics inherent to a pension scheme and the need for solidarity is difficult to mix. PAYG schemes or funded schemes as well imply a close link between the financial effort of contributors and the benefits they will be entitled when they retire. Certain specifics risks (spouse survival, disability) may be covered within these schemes through risk pooling. However, for those who have not contributed at all or too little, a specific financing has to be found to guarantee a minimum pension which can be brought only through the State budget.

The article by Dekkers *et al.* gives relevant simulations on the foreseeable development in pension income compared to income received during working life. Within this framework, I would suggest the authors some ways to go further by testing additional variables which could produce a substantial impact on the central scenario:

- an increase in women participation rates;
- changes in migration flows;
- an extension of the number of retirees holding simultaneously an activity.

At last, I wonder whether it is possible to extend the model in order to take into account other factors that can interfere in the elderly poverty rate such as the household capital and the impact of public policies.