Social Security Abroad

Impact of Recession on Financing of French Program*

Much attention has been given to the effects of the recession on the financing of the social security program in the United States and abroad, where similar economic conditions have arisen This report concentrates on the repercussions in France

Financial problems for the social security systems of many countries have been created by the combination of inflation and recession in the 1970's Benefits, indexed under all the advanced programs, have risen rapidly with increased prices and wages When wages and pensions were affected equally, the social security systems in these countries were able to cope with moderate inflation As the recession intensified, however, mounting unemployment caused a leveling off in payroll tax receipts to a point where receipts fell behind expenditures To compensate for the rising deficits, most countries increased their payroll tax

In France the general recession began in 1974 and led to rapidly rising unemployment The unemployment rate climbed steadily, reaching an estimated 4 7 percent[1] by December 1975—more than double the 2 1-percent average of the previous 15 years The social security system received less revenue than anticipated because the smaller work force meant less in contributions The lower receipts, combined with higher outlays, will result in a significant deficit for 1976—it has been estimated that the revenue gap will reach 9–11 billion francs[2]

To cope with this situation, the French government increased the payroll tax rate beginning January 1976 and proposed legislation to reduce the value-added tax rate[3] on pharmaceutical products from 20 percent to 7 percent These measures, in conjunction with some adjustments in the health care system, are expected to restore the financial balance Planners are now drafting legislation aimed at easing payroll taxes for labor-intensive enterprises

A series of measures was also enacted to meet the income-maintenance needs of the growing number of unemployed, to slow down the increasing number of layoffs, and to create additional employment The new legislation includes a guaranteed benefit of 90 percent of pay for up to 52 weeks to workers laid off as a result of the current economic slowdown, and improved unemployment benefits for workers dismissed at age 60 Unemployment insurance has come to be considered in effect an early retirement plan Dismissed older workers can receive unemployment benefits for up to 5 years—that is, from age 60 to 65—at which point they become old-age pensioners

Although it had been possible to receive a relatively small old-age pension at age 60, most people waited until age 65 Beginning in July 1976—as a first step towards improving old-age pensions and as a method of making room for younger workers—manual workers who have engaged in strenuous labor during a large portion of their work careers will be able to retire at age 60 and receive a pension calculated as it would be if they had waited until age 65 Workers claiming a pension under this law are required to leave their current jobs

To cut the number of layoffs, regulations requiring individual firms to obtain approval for such action from both the Labor Minister and local inspectors were instituted As a further means of stimulating the economy during the recession's peak in mid-1975, Government subsidies were given to employers who hired unemployed workers and offered them on-the-job training

BACKGROUND

France's social security program consists of a general system and several special systems. The

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[1] Seasonally adjusted and adjusted to U S concepts, unemployment rates are calculated as a percent of the civilian labor force plus military personnel Published data for France relate to the population aged 14 and over The adjusted statistics have been adapted, so far as possible, to the population for which compulsory schooling has ended—those aged 16 and over

[2] As of March 31, 1976, $1 U S equaled 4 485 francs

[3] In Europe the value-added tax is paid by business firms The firm pays a tax on the difference between what it pays for materials purchased and the price for which the final product is sold

general system covers approximately three-fourths of the work force—mainly workers in industry and commerce—under three programs old-age and survivors insurance, health insurance (including invalidity), and family allowances The remaining workers are covered by special systems for workers in agriculture, transportation, mining, government service, self-employment, and other fields Each special system determines its own qualifying conditions and pension rates Benefit provisions tend to be more favorable under the special systems than under the general system[4]

An employer payroll tax is the main source of income to the general system The insured contribute at a lower rate In 1975 the joint payroll tax was 32 2 percent (workers 5 5 percent, employers 26 7 percent) of earnings up to 33,000 francs per year An additional contribution of 3 percent (workers 1 percent, employers 2 percent) for sickness and maternity insurance was assessed on total earnings when income exceeded 33,000 francs A designated percentage of the payroll tax contribution is credited to each of the three component funds of the general system Although there has been no general revenue contribution per se, taxes on alcohol and on automobile insurance premiums have been used to subsidize the insurance program The system is financed on a pay-as-you-go basis, with a relatively small contingency fund accumulated during years when income exceeded expenditures In the past, the contingency fund usually would have been able to provide a few months of social security benefits

Each of the three components of the general system independently prepares annual estimates of its income and expenditure It has been the custom when one fund's expenditures exceeded its income, for that fund to receive a transfer or subsidy from a component with a surplus This transfer usually went from the family allowance fund to the health insurance fund and occasionally to the old-age pension fund The latest transfer occurred in January 1974, when the family allowance contribution was lowered by 1 5 percentage points and that part of the contribution was applied instead to the old-age insurance fund Legislative action is required in order to transfer contributions from one component to another within the general system

In many of the special systems, too, income has not kept pace with expenditures because the number of beneficiaries has increased more rapidly than the number of active contributors Beginning in 1974, the general system began transferring a portion of its reserves to those special systems operating with a deficit The general system, in turn, was partially reimbursed from general revenues For the period 1974–76, the general system will have transferred an estimated 6 billion francs into the deficit systems As a result, the contingency fund's capacity to support the pension program has been diminished

DEFICIT GROWTH

Table 1 traces the size of the general system's contingency fund at the end of operating years 1973–76 The annual balances between income and expenditures of the general system for the years 1973–76 also are shown The general social security system, when viewed as a whole, tended to have an annual surplus until the current recession The deficit of one branch could thus be subsidized with transfers from another branch, and all expenses of the general system were covered without dipping into the reserves

After 1972, however, the picture changes By the end of that year the general system had a reserve of about 9 1 billion francs, equivalent to approximately 6¾ months of old-age benefits The following year, despite a surplus of 461 million francs in the general system that increased reserves to 9 6 billion francs, the reserves covered only 6 months' benefits With the onset of the recession in 1974, expenditures exceeded income by 446 million francs At the same time, the general system transferred about 2 9 billion francs from its reserves to special systems with deficits The contingency fund of the general system consequently was reduced to about 6 3 billion francs, or the equivalent of a little more than 3 months of old-age benefits In 1975, although expenditures continued to outstrip income—by 4 6 billion francs—the system nevertheless was still able to finance the deficit from its declining reserves

[4] For more details, see *Social Security Programs Throughout the World, 1975* (Research Report No 48), Social Security Administration, Office of Research and Statistics, 1976, pages 74–75

TABLE 1 —Annual and contingency fund balances of general social security system at end of operating year, 1973–76

[In millions of francs]

Program	1973		1974		1975 [1]		1976 [1]	
	Annual	Contingency fund	Annual	Contingency fund	Annual	Contingency fund	Annual	Contingency fund
Total	+461	+9 592	[1]−3,324	[1]+6 268	−4,569	+1 699	−9 038	−7,339
Health insurance [2]	−2 029	−3,800	−2 645	−6 445	−3 153	−9,598	−5 695	−15 293
Family allowances	+3,440	+12,879	[1]−364	[1]+12 515	−1,424	+11,091	−1 371	+9,720
Old-age and survivors insurance	−950	+513	+2 563	+3 076	+1,663	+4 739	−574	+4 165
Less transfers to special social security system [3]			[1]−2,878		−1 655		−1,398	

[1] Data estimated
[2] Includes health care, sickness invalidity, and work injury benefits
[3] Represents general system's contributions to special social security systems minus amount reimbursed by Government

Source *Liaisons Sociales*, Document No 88/75, Paris, France, Novembe 1975

Estimates for 1976 predict a 10 1 billion franc deficit The calculations assume (1) a 0 4-percent decrease in the actively employed labor force, (2) an average inflation rate of 8 2 percent, and (3) a wage increase of 11 3 percent—for 186 5 billion francs of total expenditures and only 176 4 billion francs in income For the first time, all three of the system's components are expected to have deficits, and the reserves will no longer be able to make up the difference

DEFICIT ORIGIN

The mounting deficit can be attributed primarily to the clash between continuing inflation and the recession The level of all cash benefits continued to rise because benefits are indexed to changes in average wages The cost of noncash benefits, such as health care, also rose Income, derived in bulk from payroll tax contributions, was unable to keep pace with expenditures as contributions declined with rising unemployment The resultant loss of payroll tax is heavier in France than it would be in the United States because the total employer-employee contribution for all programs is about 40 percent in France, compared with about 15 percent in the United States [5]

In France at the beginning of 1975 the source of contributions was

Program	*Employee*	*Employer*
OASI	3 00	7 25
Health and invalidity	3 50	12 45
Work injury	---	[1]3 50
Unemployment insurance	36	1 44
Family allowance	---	9 00

[1] Average rate

In the United States for the same period, a somewhat different situation exists, as the following figures showing the contribution pattern indicate

Program	*Employee*	*Employer*
OASDHI	5 85	5 85
Work injury	---	[1]1 10
Unemployment insurance	---	[1]2 00

[1] Average rate

Before the recent recession, France, along with other Western European countries, had a relatively low unemployment rate for a number of years The seasonally adjusted, average annual unemployment rate was 2 7 percent in 1970 and 2 9 percent in 1973 By December 1975 the monthly unemployment rate had climbed to 4 7 percent, more than double the average rate of 2 1 percent for the past 15 years Shorter workweeks, resulting both from partial layoffs and a trend towards more leisure time for the work force, have helped to minimize unemployment during this recessionary period The number of hours the average earner in manufacturing worked was 41 8 hours per week during 1975, compared with an average of 44 5 hours in 1971

In the past, social planners assumed that there would be steady growth in the number of active contributors and a corresponding growth in the amount of payroll tax receipts Income into the

[5] For a detailed description of the programs financed by these contributions, see Martin B Tracy, "Payroll Taxes Under Social Security Programs Cross-National Survey," *Social Security Bulletin*, December 1975

system thus could keep pace with the anticipated rise in benefit outlay. In 1970–73, for example, coverage in the health insurance system increased by about 1 million.

In contrast to expectations, however, the rising number of unemployed acted to maintain contributors at a steady level during 1974. As a result the annual growth rate of contributions dropped considerably, from 15.8 percent during 1974–75 to 11.6 percent in 1975–76. This increase is comparable with an average annual growth rate for payroll tax receipts of 16.7 percent during 1971–74. Concurrently, the rate of increase of 1975 expenditures (cash and noncash benefits) from those of 1974 was 19.3 percent. In 1976, it is expected to increase by 16.2 percent.

CONTRIBUTING FACTORS

Although the economic strains on the system are presumed to be temporary, long-range factors have also had an unfavorable impact on social security finances. Among the most important of these long-range factors have been changes in demographic patterns and developments occurring within the health insurance and old-age insurance components of the system. The number of those reaching pensionable age has been rising more rapidly than the number in the work force. Health insurance coverage under the general system has been extended to a larger proportion of the population. The use of medical services has increased as a result of scientific advances, greater availability of treatment, and growth in the number of old-age pensioners. Old-age benefit expenditures have grown significantly as both the number of pensioners and the size of pensions increased—the latter after a change in the benefit-computation formula.

During the past decade, many industries covered by special systems—such as agriculture, railroad, and small-scale self-employment—substantially reduced their operations and labor force because of technological changes. Recently, a further decline in these industries has resulted from the recession. A proportion of the workers previously covered by the special systems now are employed in industry covered under the general system. In the past 10 years, the general system has thus absorbed an additional 2.5 million active workers. Concurrently, contributors to the special systems decreased by roughly the same number. The result was an unfavorable change in the proportion of pensioners to contributors. The payroll tax receipts of the special systems consequently were able to finance only a portion of their expenditures, and the transfer of funds from the general system described earlier was necessary.

In recent years the general system has been financing programs that are not directly related to social security, thus adding to the deficit. This broadening of function is exemplified by the health insurance component's participation in the cost of equipping hospitals. The expense of hospital construction and medical instruction has been incorporated into the daily costs of hospitalization covered by the health insurance fund. The general system has absorbed some of the costs of programs that are more in the nature of public assistance, such as the means-tested minimum old-age allowances payable either to persons who do not meet the insurance requirement or to those whose pensions fall below a minimum level. Means-tested housing allowances also have been financed from the family allowance fund.

DEFICIT RESOLUTION

The Government in 1975 concluded that the social security payroll tax rates had to be revised upward beginning in 1976. As a result, the joint contribution rates were increased from 32.2 percent to 32.7 percent of wages below the ceiling and from 3.0 percent to 4.0 percent on total earnings, with employers and employees equally sharing the increase. The taxable income limit was raised from 33,000 francs to 37,920 francs. These changes, it was predicted, should bring an additional 6.9 billion francs into the system.

As a further measure directed towards balancing the components' accounts the Government called for a 13-percent reduction in the value-added tax on pharmaceutical products, enabling the health insurance system to pay a smaller amount for such products. These measures, in conjunction with certain adjustments in the health care system, are expected to decrease expenditures by 3.1 billion francs.

Other suggestions to improve the financial status of the social security program have included proposals to eliminate the wage ceiling for contribution purposes This action would adversely affect private pensions as they are based on earnings above the ceiling Another proposal would use general revenue funds for hospital construction and minimum old-age allowances

To determine the best method of financing benefits, the Labor Minister established the Granger Commission to study the alternatives According to the Commission's findings, the payroll tax continues to be the preferred method Reforms are nevertheless needed Proposed legislation would ease contribution costs of labor-intensive industries

It has been estimated that 14–28 percent of the total amount an employer spends on his workers (including payroll, bonuses, uniforms, transportation, vacations, training, payments-in-kind, and payroll taxes) goes for the social security program Generally, the more labor-intensive the industry, the higher the social security cost because such labor-intensive industries tend to pay lower wages and virtually the entire payroll is under the ceiling Capital-intensive industries have more skilled, technical, and managerial workers with earnings above the ceiling and provide more fringe benefits excluded from the payroll tax base Labor-intensive industries tend to have less favorable unemployment and work-injury experience ratings with consequent higher contributions

The French Minister of Finance has indicated that the optimal social security cost is 23–24 percent Under the suggested legislation, employers whose costs for social security were more than two percentage points above this level would receive a rebate Those whose costs were more than two percentage points below would pay an additional charge A movement of more than two percentage points above or below the national average would trigger the adjustment mechanism