

## **Poverty Risk and Holding Behavior Among Retirees**

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### **Motivation and Outline:**

We propose to study the risk of poverty among elderly people in European countries and particularly in France using empirical data from a household survey. We put forward the hypothesis that the risk of poverty among elderly people is expected to increase in case of pension cuts, and particularly if households are not able to save. Low-income earners and women are particularly vulnerable during their working life and then during their retirement period.

Proposals to increase private retirement savings have recently attracted considerable attention among policy makers. In the context of pension reforms, additional private saving is being recommended in order to maintain an appropriate standard of living over the life cycle. According to OECD (2005), an increased retirement saving is urgently needed, particularly in countries where benefits from a Pay-As-You-Go (PAYG) pension system are due to decrease. Reforms that have been undertaken in many OECD countries cut benefits and lead to lower pension expenditures. Such major reforms have been introduced in six of the ten OECD countries having the highest public spending on pensions as a percentage of GDP in the 90s: Austria, France, Germany, Italy, Sweden and Finland. We assume that, in the French current context, a complementary retirement income source could avoid a strong increase of the poverty risk among the pensioners. This hypothesis seems obvious, but in most of OECD country private retirement savings is much more developed than in France.

This paper will be structured in four sections. After introducing the subject, we conduct a literature review and show how our paper complements the existing literature on life annuities and individual retirement savings, and poverty during the retirement. Then we expose several facts about poverty and private pension/life annuity holding in France. Third, the econometrics estimates is presented. Finally, we conclude and present policy recommendations for pension systems and social savings in European countries.

### **Methodology and Analysis:**

In the United Kingdom, the pension spending represented 11.9 % of the GDP in 2000 and 10.1 in 2004. In France and in Germany, these expenditures amounted respectively to 12.9 and 13% in 2000 and increased to 13.1 and 13.4% in 2004. To face the significant challenge of increasing public expenditures on pensions, pension reforms encouraging private pension funding are carried out in Germany and France. Pension reforms in the United Kingdom differ from those in most other European countries. Funded pensions have already been largely developed in the United Kingdom. Thus, pension reforms in the UK are more focused on providing adequate

pensions for low income earners, who are more affected by the low replacement rate of the first pillar. In Germany, the 2001 reform brought changes in the first pillar pension levels through the introduction of the sustainability factor and through the development of supplementary pension schemes, especially through the creation of the strong state supported Riester annuity. In 2008, 12 million of Riester annuity had been contracted, for a population of 35 million insured. In France, the situation is quite different as funded pensions are more recent: individual and professional pension plans have been introduced only in 2003. The 2003 Pension Reform (Fillon Law of 2003) increased the required contribution period and attempted to homogenize the private and public sector pension regimes. The reform also strongly pushed for an increase in the importance of the second and third pillars. The introduction of new private savings vehicles encouraged employers to motivate their employees to save for retirement. Important tax benefits were introduced in order to develop the private savings schemes.

We focus on the determinants of annuities and retirement savings among elder individuals under and above the poverty threshold. Besides the new individual and professional pension plans, a long term savings vehicle is particularly developed in France: the life insurance products. We distinguish the well known pure life insurance contracts in case of death from the life annuity contract. This second type is a pure long term savings vehicle, offering at the end of the contract a capital output or an annuity. Over the past decades, we observed that French households are prone to make long-term investment by contracting life annuities, even during the retirement. But very few households receive an annuity from this type of contract: individuals prefer a capital output. Nevertheless, the first motive of life annuity contracting is the retirement planning. By contracting life annuities, the wealthiest individuals benefit from tax exemption, including reduction of taxes on the estate. More surprisingly, our results show that even poor retirees seem to accumulate by contracting life annuities. The retirement savings contracts holding rates amount to 1.9% among poor retirees, and 6.25% among non poor pensioners. The life annuity holding is higher: 26.7% among poor people, and 42.9% among non poor people. These results indicate that the private retirement savings contracts are liquidated during the retirement period, whereas it is not the case of the life annuity contracts. 18.5% of the retirees receive an annuity from a retirement contract, whereas only 4.2% of them receive an annuity from a life annuity contract.

Using representative French households' data, we estimate the effects of different socio-demographic determinants on life annuities and retirement savings contracts holding. Then we estimate a biprobit, to check if the correlation between the annuities holding and the retirement saving contract holding is statistically significant. The both saving contracts are they complementary products, or substitutable assets? What characteristic impact the holding probability among retirees? How could the policy maker influence the holding among vulnerable people?

### **Policy Implications:**

This study has several policy implications. It will help French policy makers to define the adequate institutional framework including social protection system and private retirement planning, in order to improve the coverage and the effectiveness. The identification of the poverty risk among retirees will help policy makers to design programs and reforms minimizing social costs and improving the protection for the most vulnerable.

